



## RL Finance Bonds plc

(incorporated with limited liability in England and Wales with registered number 5592117)

**£400,000,000**

### **6.125 per cent. Perpetual Cumulative Step-up Subordinated Guaranteed Notes unconditionally and irrevocably guaranteed on a subordinated basis by**

### **THE ROYAL LONDON MUTUAL INSURANCE SOCIETY LIMITED**

(incorporated with liability limited by guarantee in England and Wales with registered number 99064)

The issue price of the £400,000,000 6.125 per cent. Perpetual Cumulative Step-up Subordinated Guaranteed Notes (the "Notes") of RL Finance Bonds plc (the "Issuer") is 99.676 per cent. of their principal amount. The Notes will bear interest (i) from (and including) 14 December 2005 (the "Issue Date") to (but excluding) 15 December 2015 at the rate of 6.125 per cent. per annum and (ii) from (and including) 15 December 2015 at a rate which is the aggregate of 2.45 per cent. per annum and the offered rate for three-month sterling deposits in respect of the relevant Interest Period as described under "Terms and Conditions of the Notes – Interest". Interest shall be payable on the Notes annually in arrear on 15 December in each year commencing on 15 December 2006 until (and including) 15 December 2015 and thereafter interest shall be payable on the Notes quarterly in arrear on 15 March, 15 June, 15 September and 15 December in each year. Payments on the Notes will be made in sterling without deduction for or on account of taxes imposed or levied by the United Kingdom to the extent described under "Terms and Conditions of the Notes – Taxation".

The Royal London Mutual Insurance Society Limited (the "Guarantor") will unconditionally and irrevocably guarantee on a subordinated basis the due and punctual payment of all amounts at any time becoming due and payable in respect of the Notes, subject to its ability to defer payments of interest. In the event of the bankruptcy, dissolution or winding-up of the Issuer or, as the case may be, the Guarantor, the payment obligations of the Issuer under the Notes and of the Guarantor under the Guarantee shall be subordinated to the claims of all Senior Creditors of the Issuer or, as the case may be, the Guarantor – see "Terms and Conditions of the Notes – Status and Guarantee".

All payments under or arising from the Notes and the Coupons relating to them or to the Guarantee shall be conditional upon the Issuer or the Guarantor, as the case may be, being solvent at the time for payment, and no amount shall be payable under or arising from the Notes and the Coupons relating to them or the Guarantee unless and until such time as the Issuer or the Guarantor, as the case may be, could make such payments and still be solvent thereafter – see "Terms and Conditions of the Notes – Status and Guarantee".

The Issuer (or, as the case may be, the Guarantor) may elect to defer any payment of interest on the Notes which would otherwise be payable on an Interest Payment Date by giving notice of such election to the Noteholders and to the Trustee not less than 14 days prior to the relevant Interest Payment Date. Such deferral of any interest payment on any Interest Payment Date will not constitute a default by the Issuer (or the Guarantor) and will not give the Noteholders or the Trustee any right to accelerate the Notes. Certain restrictions apply following such deferral – see "Terms and Conditions of the Notes – Deferral of Payments".

The Notes have no stated maturity date. The Notes are subject to redemption in whole but not in part at their principal amount or, in certain circumstances, at a make-whole amount, at the option of the Issuer having given at least six months' prior written notice (or such shorter period as the Financial Services Authority (the "FSA") may accept and so long as such notice is required to be given) to, and received no objection from, the FSA and having given not less than 30 nor more than 60 days' notice to the Noteholders, the Trustee and the Principal Paying Agent (i) at any time in the event of certain changes affecting taxation in the United Kingdom or the regulatory treatment relating to the Issuer or the Notes or (ii) on 15 December 2015 or any Reset Date falling thereafter – see "Terms and Conditions of the Notes – Redemption and Purchase".

This Offering Circular has been approved by the FSA which is the United Kingdom competent authority for the purposes of Directive 2003/71/EC (the "Prospectus Directive") and relevant implementation measures in the United Kingdom, as a prospectus issued in compliance with the Prospectus Directive and relevant implementation measures in the United Kingdom for the purpose of giving information with regard to the issue of Notes. Applications have been made to admit the Notes to listing on the Official List of the FSA and to trading on the Gilt-Edged and Fixed Interest Market of the London Stock Exchange plc (the "London Stock Exchange").

The Notes have not been, and will not be, registered under the United States Securities Act of 1933 (the "Securities Act") and are subject to United States tax law requirements. The Notes are being offered outside the United States by the Managers (as defined in "Subscription and Sale") in accordance with Regulation S under the Securities Act ("Regulation S"), and may not be offered, sold or delivered within the United States or to, or for the account or benefit of, U.S. persons except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act.

The Notes are expected to be rated upon issue BBB by Standard & Poor's Rating Services, a division of The McGraw-Hill Companies Inc and Baa1 by Moody's Investors Service Limited. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by any one or all of the rating agencies. A suspension, reduction or withdrawal of the rating assigned to the Notes may adversely affect the market price of the Notes.

The Notes will be in bearer form and issued in the denomination of £50,000 per Note and integral multiples of £1,000 thereabove. The Notes will initially be in the form of a temporary global note (the "Temporary Global Note"), without interest coupons or talons, which will be deposited on or around the Issue Date with a common depository for Euroclear System ("Euroclear") and Clearstream Banking, société anonyme ("Clearstream, Luxembourg"). The Temporary Global Note will be exchangeable, in whole or in part, for interests in a permanent global note (the "Permanent Global Note"), without interest coupons or talons, not earlier than 40 days after the Issue Date upon certification as to non-U.S. beneficial ownership. Interest payments in respect of the Notes cannot be collected without such certification of non-U.S. beneficial ownership. The Permanent Global Note will be exchangeable in certain limited circumstances in whole, but not in part, for Notes in definitive form in respect of all holdings of Notes with a nominal amount which is equal to or greater than £50,000 and with interest coupons and talons attached. See "Summary of Provisions Relating to the Notes in Global Form".

**MERRILL LYNCH INTERNATIONAL**

*Structuring Advisor and Bookrunner*

**UBS INVESTMENT BANK**

**Dresdner Kleinwort Wasserstein**

**Lehman Brothers**

Each of the Issuer and the Guarantor accepts responsibility for the information contained in this Offering Circular. The Issuer and the Guarantor declare that, having taken all reasonable care to ensure that such is the case, the information contained in this Offering Circular is, to the best of their knowledge, in accordance with the facts and contains no omission likely to affect its import.

Each of the Issuer and the Guarantor has confirmed to the Managers named under “*Subscription and Sale*” below (the “**Managers**”) that this Offering Circular contains all information regarding the Issuer, the Guarantor and the Notes which is (in the context of the issue of the Notes) material; such information is true and accurate in all material respects and is not misleading in any material respect; any opinions, predictions or intentions expressed in this Offering Circular on the part of the Issuer or (as the case may be) the Guarantor are honestly held or made and are not misleading in any material respect; this Offering Circular does not omit to state any material fact necessary to make such information, opinions, predictions or intentions (in such context) not misleading in any material respect; and all proper enquiries have been made to ascertain and to verify the foregoing.

Neither the Issuer nor the Guarantor has authorised the making or provision of any representation or information regarding the Issuer, the Guarantor or the Notes other than as contained in this Offering Circular or as approved for such purpose by the Issuer and the Guarantor. Any such representation or information should not be relied upon as having been authorised by the Issuer, the Guarantor or the Managers.

This Offering Circular is not intended to provide the basis of any credit or other evaluation and should not be considered as a recommendation by the Issuer, the Guarantor, the Trustee or the Managers that any recipient of this Offering Circular should purchase any of the Notes. Each investor contemplating purchasing the Notes should make its own independent investigation of the financial condition and affairs of, and its own appraisal of the creditworthiness of, the Issuer and the Guarantor.

Neither the delivery of this Offering Circular nor the offering, sale or delivery of any Note shall in any circumstances constitute a representation or create any implication that there has been no adverse change, or any event reasonably likely to involve any adverse change, in the affairs or condition (financial or otherwise) of the Issuer or the Guarantor since the date of this Offering Circular.

This Offering Circular does not constitute an offer of, or an invitation to subscribe for or purchase, any Notes.

The distribution of this Offering Circular and the offering, sale and delivery of Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular comes are required by the Issuer, the Guarantor and the Managers to inform themselves about and to observe any such restrictions. For a description of certain restrictions on offers, sales and deliveries of Notes and on distribution of this Offering Circular and other offering material relating to the Notes, see “*Subscription and Sale*”.

In particular, the Notes have not been and will not be registered under the Securities Act and are subject to United States tax law requirements. Subject to certain exceptions, Notes may not be offered, sold or delivered within the United States or to U.S. persons.

In this Offering Circular, unless otherwise specified, references to “**pounds sterling**”, “**£**”, “**pence**” or “**p**” are to the lawful currency of the United Kingdom. References to “**billions**” are to thousands of millions.

*Certain figures included in this Offering Circular may have been subject to rounding adjustments; accordingly, figures shown for the same category presented in different tables may vary slightly and figures shown as totals in certain tables may not be an arithmetic aggregation of the figures which precede them.*

In connection with the issue of the Notes, Merrill Lynch International, or any person acting for it, may over allot the Notes (provided that the aggregate principal amount of the Notes allotted does not exceed 105 per cent. of the aggregate principal amount of the Notes), or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that Merrill Lynch International (or persons acting on its behalf) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the terms of the offer of the Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the Notes and 60 days after the date of the allotment of the Notes.

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## KEY FEATURES OF THE NOTES

The following summary refers to certain provisions of the Terms and Conditions of the Notes and the Trust Deed and is qualified by the more detailed information contained elsewhere in this Offering Circular. Terms which are defined in “Terms and Conditions of the Notes” have the same meaning when used in this summary.

<b>Issuer</b>	RL Finance Bonds plc
<b>Guarantor</b>	The Royal London Mutual Insurance Society Limited
<b>Trustee</b>	The Law Debenture Trust Corporation p.l.c.
<b>Issue</b>	£400,000,000 6.125 per cent. Perpetual Cumulative Step-up Subordinated Guaranteed Notes
<b>Guarantee</b>	The payment of principal and interest in respect of the Notes will be unconditionally and irrevocably guaranteed on a subordinated basis by the Guarantor. In the event of a winding-up of the Guarantor, the claims of the Noteholders to payment under the Guarantee will be subordinated as described below.
<b>Status of the Notes and Guarantee</b>	<p>The Notes and Coupons relating to them and the obligations of the Guarantor under the Guarantee constitute direct and unsecured obligations of the Issuer and the Guarantor. The Notes rank <i>pari passu</i> and without any preference among themselves. In the event of the bankruptcy, dissolution or winding-up of the Issuer, the payment obligations of the Issuer under the Notes and Coupons relating to them shall be subordinated in the manner provided in the Trust Deed to the claims of all Senior Creditors of the Issuer and shall rank at least <i>pari passu</i> with all other undated or perpetual obligations of the Issuer that are not expressed by their terms to rank junior to the Notes and in priority to the claims of holders of all classes of share capital of the Issuer.</p> <p>In the event of the bankruptcy, dissolution or winding-up of the Guarantor, the payment obligations of the Guarantor under the Guarantee shall be subordinated in the manner provided in the Trust Deed to the claims of all Senior Creditors of the Guarantor and to the claims of the Issuer under the Intercompany Loan, and shall rank <i>pari passu</i> with the intercompany loan made by Scottish Life Finance PLC and the guarantee granted in respect of the £125,000,000 9 per cent. Undated Subordinated Guaranteed Bonds issued by Scottish Life Finance PLC on 28 November 1996 (the “<b>1996 Subordinated Bonds</b>”) and at least <i>pari passu</i> with all other undated or perpetual obligations of the Guarantor, or any guarantee by the Guarantor of undated and perpetual obligations of any person, that are not expressed by their terms to rank junior to the Guarantee.</p> <p>All payments under or arising from the Notes and the Coupons relating to them or the Guarantee (other than payments made in the event of the bankruptcy, dissolution, or winding-up of the Issuer, or as the case may be, the Guarantor) shall be conditional upon the Issuer or the Guarantor, as the case may be, being solvent at the time of and immediately after any such payment, and no amount shall be payable under or arising from the Notes and Coupons relating to them or the Guarantee unless and until such time as the Issuer or the Guarantor, as the case may be, could make such payment and still be solvent immediately thereafter.</p>

Neither the Issuer nor the Guarantor, as applicable, may redeem or purchase any of the Notes unless the Issuer, or, as the case may be, the Guarantor, is solvent both at the time of and immediately after any such redemption or purchase.

**Interest**

The Notes will bear interest (i) from (and including) 14 December 2005 to (but excluding) 15 December 2015 at a rate of 6.125 per cent. per annum, and (ii) from (and including) 15 December 2015 and from (and including) each Reset Date at the then relevant Reset Rate of Interest. The Reset Rate of Interest for each Interest Period will be that rate which is the aggregate of the offered rate (expressed as a rate per annum) for three-month sterling deposits as at 11.00 a.m. (London time) on the relevant Interest Determination Date, as displayed on the display designated on page “3750” on the Telerate Monitor (or such other page or pages as may replace it for the purpose of displaying such information), and the Margin.

Interest shall be payable on the Notes annually in arrear on 15 December in each year commencing on 15 December 2006 until (and including) 15 December 2015 and thereafter interest shall be payable on the Notes quarterly in arrear on 15 March, 15 June, 15 September and 15 December in each year.

**Optional Deferral of Interest**

The Issuer (or as the case may be, the Guarantor under the Guarantee) may elect to defer any payment of interest on the Notes which would otherwise be payable on an Interest Payment Date by giving notice as described in Condition 5 (*Deferral of Payments*) and such deferral will not constitute a default by the Issuer (or the Guarantor).

Notwithstanding the above, in some circumstances the Issuer shall be obliged to pay interest (see Condition 5(a) (*Deferral of Payments*)).

**Restrictions following Deferral of Interest**

If, on any Interest Payment Date, interest in respect of the Notes shall not have been paid, then from such Interest Payment Date until such time as the full amount of the relevant Arrears of Interest and interest thereon has been received by the Noteholders or the Trustee and no other payment of Arrears of Interest and interest thereon remains unsatisfied, (i) the Issuer shall not declare a dividend or other distribution or payment in respect of any class of its share capital, or pay interest or make a distribution on any other securities or under any guarantee or loan relating thereto ranking junior to or *pari passu* with the Notes or redeem, purchase or acquire any of its ordinary shares or any other securities ranking junior to or *pari passu* with the Notes, and (ii) the Guarantor shall not pay interest or make a distribution on any other securities ranking junior to or *pari passu* with the Guarantee (other than any interest payments or deferred interest payments under any intercompany loan or guarantee in relation to the 1996 Subordinated Bonds) or redeem, purchase or acquire any other securities ranking junior to or *pari passu* with the Guarantee.

**Arrears of Interest**

Any Arrears of Interest will bear interest from (and including) the relevant Interest Payment Date on which interest would have otherwise been payable to (but excluding) the date on which such Arrears of Interest is paid at the relevant rate of interest for that Interest Period. Any Arrears of Interest and any interest thereon may (subject to certain conditions) be paid in whole or in part and will automatically become due and payable upon the occurrence of certain events.

**Redemption at the Option of the Issuer**

The Notes have no maturity date. Subject to the requirement as to solvency, the Notes may be redeemed at the option of the Issuer in whole but not in part on 15 December 2015, or on any Reset Date thereafter, at the Redemption Price together with accrued interest from (and including) the preceding Interest Payment Date (or, if none, the Issue Date) to the Redemption Date and the aggregate amount of any Arrears of Interest and interest thereon.

This optional redemption is subject to the Issuer giving notice to the FSA, the Noteholders, the Trustee and the Principal Paying Agent as described in Condition 6(e) (*Redemption and Purchase – Procedures*).

**Redemption for Tax Reasons**

Subject to the requirement as to solvency, the Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time if the Issuer satisfies the Trustee that a Tax Event has occurred.

If redemption is a result of the occurrence of any of the circumstances described in paragraph (b) or (d) of the definition of Tax Event such redemption will be at the Redemption Price and if redemption is a result of the occurrence of any of the circumstances described in paragraph (a) or (c) of the definition of Tax Event it will be at the Make-Whole Redemption Price and in each case shall be paid together with all accrued interest from (and including) the preceding Interest Payment Date (or, if none, the Issue Date) to the Redemption Date and the aggregate amount of any Arrears of Interest and interest thereon.

This optional redemption is subject to the Issuer giving notice to the FSA, the Noteholders, the Trustee and the Principal Paying Agent as described in Condition 6(e) (*Redemption and Purchase – Procedures*).

**Redemption for Regulatory Reasons**

Subject to the requirement as to solvency, if the Issuer satisfies the Trustee that a Capital Disqualification Event has occurred and is continuing, then the Issuer may redeem the Notes in whole, but not in part, at any time at the Make-Whole Redemption Price together with accrued interest to the Redemption Date and the aggregate amount of any Arrears of Interest and interest thereon.

This optional redemption is subject to the Issuer giving notice to the FSA, the Noteholders, the Trustee and the Principal Paying Agent as described in Condition 6(e) (*Redemption and Purchase – Procedures*).

**Additional Amounts**

All payments in respect of the Notes and the Coupons will be made without withholding taxes of the United Kingdom, unless the withholding is required by law. In such event, the Issuer or the Guarantor will, subject as provided in Condition 8, pay such additional amounts as will be necessary to ensure that the net amount received by Noteholders, after the withholding, will equal the amount which would have been receivable by the Noteholders had no such withholding tax been required.

<b>Form</b>	The Notes will be in bearer form. The Notes will be represented initially by a Temporary Global Note (the “ <b>Temporary Global Note</b> ”) which will be deposited with a common depository for Clearstream, Luxembourg and Euroclear on or about 14 December 2005. The Temporary Global Note will be exchangeable for interests in a Permanent Global Note (the “ <b>Permanent Global Note</b> ”) not earlier than 40 days after the Issue Date upon certification as to non-U.S. beneficial ownership. Save in limited circumstances, Notes in definitive bearer form with coupons and a talon attached on issue will not be issued in exchange for interests in the Permanent Global Note.
<b>Listing</b>	Applications have been made for the Notes to be admitted to the Official List of the FSA and to trading on the Gilt-Edged and Fixed Interest Market of the London Stock Exchange.
<b>Ratings</b>	The Notes are expected to be assigned a rating of BBB by Standard & Poor’s Rating Services, a division of The McGraw-Hill Companies Inc and Baa1 by Moody’s Investors Service Limited.
<b>Governing Law</b>	The Notes and the Trust Deed and all matters arising from or connected with the Notes and the Trust Deed are governed by, and shall be construed in accordance with, English law.
<b>Intercompany Loan</b>	A loan agreement will be entered into on the Issue Date between the Issuer (as lender) and the Guarantor (as borrower) using the proceeds received from the issue of the Notes (the “ <b>Intercompany Loan</b> ”).

## **RISK FACTORS**

*Prospective investors should read the entire Offering Circular. Words and expressions defined in the “Terms and Conditions of the Notes” below or elsewhere in this Offering Circular have the same meanings in this section. Investing in the Notes involves certain risks. Prospective investors should consider, among other things, the following:*

### **Risks Relating To The Issuer And The Guarantor**

A number of factors (risk factors) affect the Group’s operating results, financial condition, business and prospects. In common with other industry participants, the profitability of the Group’s life insurance business depends primarily upon investment performance, administration and acquisition expenses, mortality and morbidity trends and policy surrender rates. Risk factors include economic and market conditions, foreign currency exchange rate fluctuations, regulation, government policy and legislation, competition, product design, selling and marketing practices, credit ratings, operation systems and processes and management.

The risk factors mentioned below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. Further risks which are not presently known to the Directors at the date hereof, or that the Directors currently deem immaterial, may also have an effect on the Group’s business.

### ***Economic Conditions and Financial Markets***

The Group’s businesses are inherently subject to market fluctuations and general economic conditions.

The Group has substantial exposure to fixed interest securities, equity securities and property returns via its constituent life insurance portfolios. While the investment risk is often borne by or shared with, in whole or in part, policyholders, fluctuations in the fixed income and equity markets will directly or indirectly affect the reported financial results and the capital requirements of the Group’s life insurance business where the holding of the investment securities which are exposed to investment risk may cause additional regulatory capital to be required.

Similarly within the asset management business income is primarily defined as an *ad valorem* charge on the value of assets under management. If the value of assets is adversely affected by general movements in the market or by performance within the funds this may lead to reduced operating profit within the business of the Group.

Changes in the level of long-term interest rates may adversely affect the Group’s business, results of operations and/or financial condition. Under relevant UK insurance regulation, actuarial liabilities depend on the level of long-term interest rates and the dividend and earnings yield on equities, amongst other factors. As a result, a change in long-term interest rates would increase the amount of the Group’s insurance liabilities and could thereby reduce its financial strength, depending upon the extent to which the liabilities are matched by assets with similar anticipated cashflows.

The liabilities in respect of certain products, notably annuities, vary as interest rates fluctuate and so life insurance companies often attempt to match such liabilities with assets whose sensitivity to interest rates is the same as, or similar to, that of these liabilities. However to the extent that such asset liability matching is not practicable or fully achieved there may be fluctuations in the difference between assets and liabilities as interest rates change. Sustained interest rate fluctuations could therefore have a material adverse effect on the Group’s business, results of operations and/or financial condition. The Group also has exposure to the equity market. Decline in the equity market may adversely affect investment returns and the value of assets held by it against its liabilities.

Investment portfolios are also susceptible to changes in general economic conditions, including increases in inflation, changes that impact the general creditworthiness of the issuers of debt securities and equity securities and the value and returns from properties held in the portfolios. Default by an issuer of fixed income securities may result in a significant fall in the value of the fixed income securities. The value of fixed income securities may be affected by changes in issuers’ credit ratings.



### ***Actuarial Assumptions***

Although the Group companies which conduct life business monitor their actual experience against the actuarial assumptions they use and apply that outcome to refine their long term assumptions, because of the underlying risks it is not possible to determine precisely the amounts in total which it will ultimately be necessary to pay to meet such life insurance liabilities. Amounts may vary from estimates, particularly when those payments do not occur until well into the future. The life insurance companies evaluate their liabilities at least annually, allowing for changes in the assumptions used to establish their liabilities, as well as for the actual claims experience. Changes in assumptions may also lead to changes in the level of capital required to be maintained.

To the extent that actual claims experience is less favourable than the underlying assumptions, or it is necessary to increase provisions in anticipation of a higher rate of future claims, the amount of additional capital required (and therefore the amount of capital which can be released from the businesses) and the ability of the Group to manage its businesses in an efficient manner may all be materially adversely affected.

The life insurance companies within the Group have made a number of assumptions regarding mortality and morbidity rates, which may or may not prove to be correct. In particular, there is uncertainty as to the rate of future improvements in mortality for holders of annuity policies.

It may be many years before the assumptions are able to be verified to be correct.

If the assumptions underlying the reserving basis were to prove incorrect, the Group may have to increase the amount of its reserves, which could have a material adverse impact on the Group's business, results of operations and/or financial condition. The UK actuarial profession is expected to produce new mortality tables for annuitants and a working paper on projecting future mortality rates by the end of 2005. In common with other insurers and annuity providers, the Group will review its mortality rates and projections in light of this work. The impact of this review cannot be predicted with any certainty.

### ***Insurance risks***

The Group's life insurance business depends to a significant extent on the values of claims paid in the future, relative to the assets accumulated to the date of claim. Typically, over the lifetime of a contract, premiums and investment revenue exceed claims costs in the early years and it is necessary to set aside these amounts to meet future obligations. The amount of such future obligations is assessed by reference to assumptions with regard to the development of interest rates, mortality or (if applicable) morbidity rates, persistency rates (being the extent to which policies remain in force and are not for any reason surrendered or transferred prior to maturity) and future levels of expenses. These assumptions may turn out to be incorrect.

In addition, it is necessary for the Board of Directors of the Guarantor to make decisions, based on advice, which ensure an appropriate build-up of assets and liabilities relative to one another. These decisions include the allocation of investments among equity, fixed income, property, other internal and external unlisted investments and other asset classes, the setting of policyholder bonus rates (some of which are guaranteed) and the setting of surrender terms. Whilst the Board of Directors seeks to ensure that such decisions are consistent with their regulatory obligations, there is a risk that policyholders may argue that their interests have been adversely affected by such decisions.

### ***Actuarial management***

Traditionally, provisions in respect of liabilities for with-profits business written in the UK have been invested in a mix of equities and property as well as fixed interest securities. The value of such assets may reduce and there is a risk that there may be a mismatch between the liabilities and the value of the assets available to meet them. The Group has reduced the exposure in its various with-profits funds to equities and property, but there is a significant remaining exposure. Bonus rates have been reduced to ensure greater alignment between liabilities and the available assets. However, there is not a perfect match between expected revenue streams from the available assets and expected claim payments under policies. If asset and liability values do not move consistently it may be necessary to meet some or all of

the difference from the Group's other capital resources, which could have a material adverse effect on the Group's business, results or operations and/or financial condition.

### ***Product Guarantees and Benefits***

In the 1970s and 1980s, when interest rates were higher than they have been in recent years, life insurance companies (including the Guarantor, Scottish Life Assurance and companies in the United Assurance Group (whose policies have since been transferred to the Guarantor)) sold pension contracts that contained certain guarantees or options, including guaranteed annuity options that allowed the policyholder to elect to take the lump sum payable upon the maturity of the pension and apply the funds to purchase an annuity at a minimum guaranteed rate. During the last decade, interest rates and inflation have fallen and life expectancy has increased more rapidly than originally anticipated. As a result, in many cases the guaranteed rate applicable to these contracts is more favourable than annuity rates currently available in the market.

The Guarantor has existing liabilities relating to guarantees and options contained in policies, which are increased by downward movements in interest rates, increasing life expectancy and the proportion of customers exercising their option. Adverse movements in these factors could lead to a requirement to increase reserves which could potentially require additional capital. In order to address the interest rate risk (but not the risk of increasing life expectancy), the Guarantor has purchased derivatives that provide some protection against an increase in liabilities and the sensitivity of profit to movements in interest rates. The Guarantor will inevitably be exposed to counterparty risk in respect of the financial instruments to which it is party. Steps have been taken to mitigate this risk through the use of margin arrangements.

There has been significant market concern as to the implications of such guarantees and options on reserving and bonus declarations. The Group seeks to manage this issue in accordance with both the terms of the issued policies and the interests of customers, and has obtained external advice supporting the manner in which it operates the long-term funds in this respect.

The most significant factors affecting the cost of these liabilities relative to the provisions made are the number of customers electing to exercise their option to take the more favourable annuity rates and the relative value of the derivatives and the liabilities.

### ***Mis-selling risks***

Until recent years, most life and pensions products written by the Guarantor were distributed through employed (or direct) sales forces. The remuneration of those sales forces, which sold the full range of the Guarantor's life and pension products and provided a face-to-face financial planning and advisory service, was largely based on the value of the business sold. Products which are sold directly have higher potential exposure to mis-selling claims. The Group has received, and may in the future receive, complaints from certain customers that they received misleading advice from advisers as to which products were most appropriate for their circumstances or that the nature of the products sold to them, or the circumstances in which the products were sold to them, were misrepresented. Such customers have sought, and may in the future seek, redress for such advice. Complaints may arise in respect of any aspect of the business where customers feel that they have not been treated reasonably or fairly. The Guarantor reviews product literature, customer services processes and incoming customer complaints and, having assessed the issue, seeks to take appropriate action.

The Financial Ombudsman Service ("FOS") exists to resolve individual or small business policyholder disputes. Decisions are not made public but applicants are allowed normal legal remedies if such decisions are considered unacceptable. From time to time decisions taken by the FOS may, if extended to a particular class or grouping of policyholders, have a material adverse effect on results of operations and/or financial condition of the Group.

While the Group has invested a considerable amount of time and money in reviewing and assessing its historic sales practices, and has in place risk management, legal and compliance procedures to monitor its current sales practices, there can be no assurance that all of the issues associated with current and historic sales practices have been or will be identified, nor that any issue already identified will not be more widespread than presently estimated. The negative publicity associated with any new sales-related

issue and/or any compensation payable in respect of any such issue could have a material adverse effect on the Group's business, results of operations and/or financial condition.

### ***Personal pensions***

Relevant companies in the Group conducted reviews related to the sale of personal pensions in accordance with FSA requirements and this review process is now broadly complete. The Group's activities have been reviewed by the FSA and no outstanding issues of significance remain. The Board of Directors of the Guarantor believes that the bulk of compensation has been paid and it has allocated provisions for assessed residual liability that it believes may arise. If the current provisions established in the audited financial statements of the Group in respect of these additional compensation amounts prove inadequate, the Group may be faced with an unexpected liability, which could have a material adverse effect on the Group's business, results of operations and/or financial condition.

### ***Endowment savings products***

The Guarantor has a portfolio of endowment savings contracts, the majority of which are conventional with-profits products. Some of these were explicitly sold to back mortgages, while others were sold purely for savings purposes. In accordance with FSA guidelines, the Guarantor has contacted all of its mortgage endowment policyholders to make them aware that changing economic conditions could impact the value of their policies at maturity. The Board believes that the Guarantor has adequately provided for current estimates of potential exposures to endowment mis-selling issues. If the current provisions established in the audited financial statements of the Group in respect of these estimates prove inadequate, the Group may be faced with an unexpected liability, which could have a material adverse effect on the Group's business, results of operations and/or financial condition.

### ***Regulatory Compliance and Capital***

The Group's business is subject to regulation by the FSA. The FSA has broad regulatory powers dealing with all aspects of financial services including, among other things, the authority to grant and, in specific circumstances, to vary or cancel permissions, to investigate marketing and sales practices, and to require the maintenance of adequate financial resources. One of the FSA's principal regulatory objectives in the context of the regulation of insurance companies is the protection of policyholders, rather than investors such as Noteholders or general creditors.

The FSA may, from time to time, make enquiries of the companies which it regulates regarding compliance with regulations governing the conduct and operation of business. The Directors believe each of the Group's regulated businesses dedicates sufficient resources to its compliance programme and endeavours to respond to regulatory enquiries in an appropriate way and takes corrective action when warranted. However, all insurance companies face the risk that the FSA could find that they have failed to comply with applicable regulations or have not undertaken corrective action as required.

The FSA has wide powers to supervise and intervene in the affairs of an insurance company. It can, for example, require firms to provide particular information or documents to it, require a "skilled person" report or formally investigate a firm. It has the power to take a range of disciplinary or enforcement actions, including public censure, restitution, fines or sanctions and the award of compensation.

Regulatory proceedings could result in adverse publicity for, or negative perceptions regarding, the Group, as well as diverting management's attention from the day-to-day management of the business. A significant regulatory action against a member of the Group could have a material adverse effect on the business of the Group, its results of operations and/or financial condition.

Firms which are permitted to carry on insurance business in the UK are required to maintain a minimum level of assets (referred to as regulatory capital) in excess of their liabilities ("Pillar I"). The Guarantor satisfies all of the current regulatory requirements in this regard. However, fluctuations in the fixed income and equity markets would, directly or indirectly, affect levels of regulatory capital held by the Guarantor. An inability to meet regulatory capital requirements in the future could lead to intervention by the FSA which could be expected to require the Guarantor to take steps for the security of policyholders with a view to restoring regulatory capital to acceptable levels.

The FSA has introduced a new capital regime under which all insurance firms are required to carry out an Individual Capital Assessment (“ICA”) in relation to the level of regulatory capital which they hold. The ICA assists the FSA in providing Individual Capital Guidance (“ICG”) to firms. The Group has not yet been asked to submit an ICA and such a request is not anticipated prior to 2006. The requirements of the ICG which will, in due course, be issued to the Group cannot be predicted with any certainty.

For further information regarding the regulation of insurance business in the UK by the FSA, please refer to the section of this Offering Circular headed “United Kingdom Regulation of Insurance Business” on page 55 below.

### ***Changes in Legislation or Regulation***

The legislation and regulation affecting members of the Group govern matters with respect to a wide number of areas. The Group will not always be able to predict accurately the impact of future legislation or regulation or changes in the interpretation or operation of existing legislation or regulation on its business, results of operations and/or financial condition. Further changes to financial services legislation or regulation may be enacted and such changes could have a material adverse effect on the Group’s business, results of operations and/or financial condition and may result in increased costs to the Group due to it being required to set up additional compliance controls or due to the direct costs of such compliance. Increased regulation of fund managers in relation to their use of bundled brokerage and soft commission arrangements, or otherwise, may adversely affect the Group’s business through a reduction in the profitability of its asset management operations.

Changes in government policy, legislation or regulatory interpretation applying to companies in the financial services and insurance industries in any of the markets in which the Group operates may adversely affect the Group’s product range, distribution channels, capital requirements and, consequently, reported results and capital requirements. These changes include possible changes in government pension arrangements and policies, the regulation of selling practices and solvency requirements.

The EU Insurance Groups Directive, which was implemented in the UK in 2001, together with the Financial Conglomerates Directive, which was implemented on 1 January 2005, require European financial services groups to demonstrate net aggregate surplus capital in excess of solvency requirements at the Group level. The EU is also currently reviewing future solvency requirements (the Solvency II review). The implementation of these directives will lead to the Group being required to maintain a somewhat higher level of capital than had previously been required.

### ***UK Taxation Law***

UK taxation law includes rules governing business taxes, personal taxes, capital taxes and indirect taxes. The Group will be unable accurately to predict the impact of future changes in tax legislation on its business. From time to time changes in the interpretation of existing tax laws, amendments to existing tax rates, or the introduction of new tax legislation may adversely impact the business, result of operations and/or financial condition of the Group. Further, there is specific legislation that governs the taxation of life insurance companies, changes to which might adversely affect life insurance companies. Whilst such risks may impact on the insurance sector as a whole, the impact on the Group in particular would depend upon the mix of long term business within its portfolio and other relevant circumstances at the time of such change. The Finance Act 2005 contains a number of provisions which impact the taxation of life insurance companies. Regulations made under these provisions have been published in draft by HM Revenue and Customs and are currently the subject of consultation with the insurance sector. The impact of the regulations may vary across the industry according to the specific business structures of individual companies. The impact on the 2005 tax position of the Group will not be clear until the final regulations are laid.

On 29 September 2005 the Government announced certain changes to the taxation of life insurance companies to take effect for periods of account ending on or after that date, to be incorporated in Finance Act 2006. Following discussions with the industry and the Association of British Insurers amendments to these proposals were announced on 3 November 2005. The proposals address the tax effect of the

utilisation of surplus brought forward unallocated where that surplus is derived from mutual business and the tax treatment of investment reserves held in respect of non-profit business. The proposals are not expected to have any effect on the taxation position of the Group.

There are also specific rules governing the taxation of policyholders. The Group will be unable accurately to predict the impact of future changes in tax law on the taxation of life insurance and pension policies in the hands of policyholders. Amendments to existing legislation (particularly if there is the withdrawal of any tax or an increase in tax rates) or the introduction of new rules may impact upon the future long term business and the decisions of policyholders. The impact of such changes upon the Group thereafter might depend on the mix of in-force business at the time of such change and could have a material adverse effect on the Group's business, results of operations and/or financial condition.

### ***Loss of Customer Mandates***

When buying investment products or selecting an investment manager, customers consider, amongst other things, the historical investment performance of the product or the manager. In the event that the Group's asset management business does not provide satisfactory or appropriate investment returns in the future, underperforms its competitors or benchmark performance measures, or does not sell an investment product which a customer requires, existing customers may decide to reduce or liquidate their investment or, alternatively, where relevant, transfer mandates to other investment managers and new customers may not be attracted. As a result, there may be a material adverse effect on the Group's business, results of operations (through a reduction in revenue received by the Group from the products sold) and/or financial condition. In addition, such underperformance may result in the removal of the Group from consultants' shortlists. This would be likely to lead to a loss of business and/or a failure to win new mandates.

### ***Managing Customer Assets***

There are risks associated with the process of managing customer assets. For example, failure to properly define the investment remit applicable to customer assets as a result of unclear agreed guidelines or inaccurate recording of customer communications could lead to investments being made in breach of the mandate. Similarly, failure to manage the investment process or execute the trading activities properly could lead to poor investment decisions and poor asset allocation, the wrong investments being bought or sold and the incorrect monitoring of exposures. Failures of this nature could lead to the loss of customers or a liability for the Group's asset management subsidiary to pay compensation.

### ***Accounting***

Prior to 1 January 2005, the Group prepared its financial statements in accordance with UK GAAP. In this Offering Circular the Group's unaudited financial results for 2004 are shown in accordance with International Financial Reporting Standards ("IFRS"). The Group will prepare its 2005 year end consolidated financial statements in accordance with IFRS as adopted by the European Union. The 2005 financial statements will include the application of IFRS 4 (Insurance Contracts) and IAS 32 and IAS 39 (Financial Instruments), which were not required to be applied to the 2004 unaudited financial information. IFRS is currently being applied in Europe and in other parts of the world simultaneously for the first time. Due to a number of new and revised standards included within the body of standards that comprise IFRS, there is not yet a significant body of established practice on which to draw in forming judgements regarding interpretation and application of IFRS. Changes in rules and in the interpretation of IFRS and the application of IFRS 4, IAS 32 and IAS 39 could have a negative effect on the Group's financial results or net assets.

### ***Staff Pension Scheme***

There are inherent funding risks associated with the Group's participation in its defined benefit pension scheme. Specifically, certain facts could result in the funding position of the scheme being materially reduced and, in some cases, a deficit between the pension scheme's assets and liabilities could arise.

These factors include: (i) poor investment performance of pension fund investments; (ii) greater life expectancy than assumed, which will make pensions payable for longer and therefore more expensive to

provide, whether paid directly from the defined benefit schemes or secured by the purchase of annuities; and (iii) other events occurring which make past service benefits more expensive than predicted in the actuarial assumptions by reference to which funding requirements have been assessed.

The UK government has recently introduced some significant changes to the regulatory framework for retirement benefits, some of which have already been brought into effect. These changes include the establishment of a new pensions regulator with significant additional powers. These powers include the ability to issue a contribution notice to any company connected or associated with the employer which has been involved in any act or deliberate omission intended to reduce the level or recovery of a statutory debt in respect of a defined benefit pension scheme. The regulator also has power to require financial support to be put in place where the employer participating in a scheme is a service company which is insufficiently resourced.

In relation to valuations carried out after 23 September 2005, schemes are also subject to the Statutory Funding Objective (“**SFO**”) which replaces the previous statutory Minimum Funding Requirement (“**MFR**”). The SFO requires employers to agree funding arrangements with the scheme trustees. If agreement cannot be reached, the matter will be referred to the new pensions regulator.

In addition, where an employer ceases to participate in a multi-employer scheme after 2 September 2005, it will be required to fund the scheme to the extent that it would be required to enable the buy out of the benefits under the scheme in respect of which it has participated by the purchase of annuities from an insurance company (this is sometimes known as “exit debt”), unless appropriate financial support is put in place. This obligation to fund benefits to insurance company buy-out levels already applies under section 75 of the Pensions Act 1995 where a pension scheme enters a winding-up process when its sponsoring or participating employers are solvent. Therefore, if the defined benefit section of the Group’s pension scheme is wound up, the cost of buying out the benefits for all scheme members would be considerably more than the value placed on the liabilities (under the SFO or the ongoing funding basis) while the scheme is ongoing. Similarly, if a participating employer stopped participating in the defined benefit section a significant debt could be triggered. If triggered, such liabilities could have a materially detrimental effect on the Group’s resources.

### ***Reputational Damage***

The Group is vulnerable to adverse market perception as it operates in a highly regulated industry where it must display a high level of integrity and have the trust and the confidence of its customers. Any mismanagement, fraud or failure to satisfy fiduciary or regulatory responsibilities, or the negative publicity resulting from such activities or the accusation by a third party of such activities (whether well founded or not) associated with the Group or a relevant investment sector generally (such as mortgage endowments or split capital investment trusts), could have a material adverse effect on the Group’s business, results of operations and/or financial condition.

### ***Reinsurance***

The Group has transferred part of its exposure to certain risks to other insurance companies through reinsurance arrangements. Where the life businesses have obtained reinsurance, they are still liable for those transferred risks if the reinsurer does not meet its obligations. Therefore, the inability or failure of reinsurers to meet their financial obligations could materially affect the Group’s operations, financial results and financial condition. Although the Group conducts periodic reviews of the financial statements of their reinsurers, reinsurers may become financially unsound by the time they are called upon to pay amounts due, which may not occur for many years. In addition, reinsurance may prove inadequate to protect against losses which are ultimately experienced. The Insurers (Reorganisation and Winding Up) Regulations 2004 provide, amongst other things, for priority of claims under direct insurance contracts over certain other claims including reinsurance upon the winding up of an insurance undertaking. This could in certain circumstances affect the collectibility of reinsurance by the Group. In common with other insurers, the Group has taken steps to mitigate this risk by entering into security arrangements with relevant reinsurers.

### ***Operational risks***

Operational risks are present in all of the Group's businesses, including the risk of direct or indirect loss resulting from inadequate or failed internal and external processes, systems and human error or from external events. The Group's business is dependent on processing a large number of complex transactions across numerous diverse products, and is subject to a number of different legal and regulatory regimes. Although the Group has implemented risk controls and loss mitigation actions, it is only possible to be reasonably, but not absolutely certain that such procedures will be effective in controlling each of the operational risks.

Further, because of the long-term nature of much of the Group's business, accurate records have to be maintained for significant periods. The Group's systems and processes are designed to ensure that the operational risks associated with its activities are appropriately controlled, but any weakness in the systems could have a negative impact on its results of operations during the effective period. The Group has not experienced or identified any operational risks in its systems or processes during 2004 or subsequently which have caused, or are expected to cause, a significant negative impact on its results of operations.

### ***Closed Funds***

The Group manages a number of closed with-profits funds, the assets of which will be utilised fully to meet emerging claims on policies within these funds. While the Board of Directors believes that the assets of these funds will be sufficient to meet their liabilities, in the event such assets ultimately prove inadequate there is a risk that this could lead to a call on the Group's general resources and have a material adverse effect on the Group's business, results of operations and/or financial condition.

### **Risks Relating To The Notes**

#### ***There is no active trading market for the Notes.***

The Notes are new securities which may not be widely distributed and for which there is currently no active trading market. If the Notes are traded after their initial issuance, they may trade at a discount to their initial offering price, depending upon prevailing interest rates, the market for similar securities, general economic conditions and the financial condition of the Issuer and the Guarantor. Although applications have been made for the Notes to be admitted to listing on the Official List of the FSA and to trading on the Gilt-Edged and Fixed Interest Market of the London Stock Exchange, there is no assurance that such application will be accepted or that an active trading market will develop. Accordingly, there is no assurance as to the development or liquidity of any trading market for the Notes.

#### ***Payment of interest dependent on payments under the Intercompany Loan and Guarantee.***

The ability of the Issuer to pay interest under the Notes is dependent on the ability of the Guarantor to make payments to the Issuer under the Intercompany Loan and under the Guarantee.

#### ***Neither the Issuer nor the Guarantor is required on a winding-up to pay under the Notes until it first makes other required payments.***

All obligations of the Issuer and the Guarantor under the Notes and the Guarantee will on a winding-up rank junior to all their respective liabilities to Senior Creditors, which include all creditors of the Issuer or the Guarantor (as the case may be) (including, in the case of the Guarantor, all policyholders of the Guarantor) who are (i) unsubordinated creditors of the Issuer or the Guarantor (as the case may be) or (ii) subordinated creditors of the Issuer or the Guarantor (as the case may be) other than those whose claims rank or are expressed to rank *pari passu* with or junior to the claims of the Noteholders. In a winding-up, liquidation or dissolution, the Issuer's or the Guarantor's assets would be available to pay obligations under the Notes only after they have made all payments on such liabilities and claims.

#### ***No limitation on issuing senior or pari passu securities or incurring additional indebtedness.***

There is no restriction on the amount of securities which the Issuer or the Guarantor may issue which rank senior to or *pari passu* with the Notes. The issue of any such securities may reduce the amount

recoverable by Noteholders on a winding-up of the Issuer or the Guarantor and/or may increase the likelihood of a deferral of interest payments under the Notes. In addition, the Notes do not limit the Issuer's or Guarantor's ability or the ability of any entity in the Group to incur additional indebtedness, including indebtedness that ranks senior in priority of payment to the Notes and the Guarantee.

***The Issuer or Guarantor may defer interest payments on the Notes.***

The Issuer (or, as the case may be, the Guarantor under the Guarantee) may defer payment of any interest otherwise due on the Notes, but such deferral will not constitute a default by the Issuer (or the Guarantor) and will not give Noteholders or the Trustee any right to accelerate the Notes.

***The Notes are perpetual securities.***

The Issuer is under no obligation to redeem the Notes at any time and the Noteholders shall have no right to call for their redemption.

***The Issuer may redeem the Notes in certain circumstances.***

The Notes have no stated maturity date but they are redeemable in whole (but not in part): (i) at the option of the Issuer on 15 December 2015 and any Reset Date thereafter at the aggregate principal amount thereof (together with all accrued interest and any Arrears of Interest and interest thereon); (ii) at any time, if the Issuer satisfies the Trustee that a Tax Event has occurred, at either the Redemption Price or the Make-Whole Redemption Price (as further described in the “*Terms and Conditions of the Notes – Redemption and Purchase*”); and (iii) at any time, if the Issuer satisfies the Trustee that a Capital Disqualification Event has occurred, at the Make-Whole Redemption Price (as further described in the “*Terms and Conditions of the Notes – Redemption and Purchase*”), and in each case, subject to the satisfaction of certain other conditions.

The Issuer may choose to redeem the Notes at times when prevailing interest rates may be relatively low. In such circumstances an investor may not be able to reinvest the redemption proceeds in a comparable security at an effective interest rate as high as that of the Notes.

In addition, certain of such Tax Events or regulatory events may occur at any time after the Issue Date and it is therefore possible that the Issuer would be able to redeem at any time after the Issue Date.

***Limited remedies for the enforcement of the Notes.***

In accordance with FSA requirements for subordinated capital, the sole remedy against the Issuer or the Guarantor available to the Trustee or any holder of the Notes for recovery of amounts owing in respect of the Notes will be the institution of proceedings for the winding-up of the Issuer and/or the Guarantor and/or proving in such winding-up.

***Because the Global Notes are held by or on behalf of Euroclear and Clearstream, Luxembourg, investors will have to rely on their procedures for transfer, payment and communication with the Issuer and/or the Guarantor.***

The Notes will be represented by the Global Notes except in certain limited circumstances described in the Permanent Global Note. The Global Notes will be deposited with a common depository for Euroclear and Clearstream, Luxembourg. Except in certain limited circumstances described in the Permanent Global Note, investors will not be entitled to receive definitive Notes. Euroclear and Clearstream, Luxembourg will maintain records of the beneficial interests in the Global Notes. While the Notes are represented by the Global Notes, investors will be able to trade their beneficial interests only through Euroclear and Clearstream, Luxembourg.

The Issuer and the Guarantor will discharge their payment obligations under the Notes by making payments to the common depository for Euroclear and Clearstream, Luxembourg for distribution to their account holders. A holder of a beneficial interest in a Global Note must rely on the procedures of Euroclear and Clearstream, Luxembourg to receive payments under the Notes. The Issuer and the Guarantor have no responsibility or liability for the records relating to, or payments made in respect of, beneficial interests in the Global Notes.



Holders of beneficial interests in the Global Notes will not have a direct right to vote in respect of the Notes. Instead, such holders will be permitted to act only to the extent that they are enabled by Euroclear and Clearstream, Luxembourg to appoint appropriate proxies. Similarly, holders of beneficial interests in the Global Notes will not have a direct right under the Global Notes to take enforcement action against the Issuer or the Guarantor in the event of a default under the Notes but will have to rely upon their rights under the Trust Deed.

#### ***Minimum Denomination***

The Notes have minimum denominations of £50,000 (the “**Minimum Denomination**”) and integral multiples of £1,000 thereabove.

Definitive Notes will only be issued if (a) Euroclear or Clearstream, Luxembourg (or other relevant clearing system) is closed for business for a continuous period of 14 days (other than by reason of legal holidays) or announces an intention permanently to cease business or (b) any of the circumstances described in Condition 9 (*Events of Default*) occurs. If Definitive Notes are issued, such Notes will be issued in respect of all holdings of Notes equal to or greater than £50,000. However, Noteholders should be aware that Definitive Notes that have a denomination that is not an integral multiple of the Minimum Denomination may be illiquid and difficult to trade. Definitive Notes will in no circumstances be issued to any person holding Notes with a nominal amount of less than £50,000 and such Notes will have no rights against the Issuer (including rights to receive principal or interest or to vote) in respect of such Notes.

#### ***Credit Rating***

The Notes have been assigned a rating of “Baa1” by Moody’s Investors Service Limited and “BBB” by Standard & Poor’s Rating Services, a division of The McGraw-Hill Companies Inc. A security rating is not a recommendation to buy, sell or hold securities and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency. Any adverse change in an applicable credit rating could adversely affect the trading price for the Notes.

### **INFORMATION INCORPORATED BY REFERENCE**

The following information shall be deemed to be incorporated in, and to form part of, the Offering Circular:

1. audited annual financial statements of the Guarantor for the financial year ended 31 December 2003, set out on pages 29 to 51 of the 2003 annual report of the Guarantor;
2. auditors' report for the financial year ended 31 December 2004 set out on page 39 of the 2004 annual report of the Guarantor; and
3. auditors' report for the financial year ended 31 December 2003 set out on page 27 of the 2003 annual report of the Guarantor.

Only the pages of the 2004 and 2003 annual reports of the Guarantor specified above are incorporated by reference into this Offering Circular and the remainder of these annual reports is either not relevant to investors or is included in "Description of the Guarantor" beginning on page 40 or "Financial Information of the Guarantor" beginning on page 60 below.

The Issuer will, at its registered office and at the specified offices of the Principal Paying Agent, provide, free of charge, upon the oral or written request therefor, a copy of the Offering Circular (or any document incorporated by reference in the Offering Circular). Written or oral requests for such documents should be directed to the specified office of the Principal Paying Agent.

## TERMS AND CONDITIONS OF THE NOTES

*The following is the text of the Terms and Conditions of the Notes which (subject to completion and amendment) will be endorsed on each Note in definitive form:*

The £400,000,000 6.125 per cent. Perpetual Cumulative Step-up Subordinated Guaranteed Notes (the “**Notes**”) of RL Finance Bonds plc (the “**Issuer**”) are subject to, and have the benefit of, a trust deed dated 14 December 2005 (as amended or supplemented from time to time, the “**Trust Deed**”) between the Issuer, The Royal London Mutual Insurance Society Limited (the “**Guarantor**”) and The Law Debenture Trust Corporation p.l.c. as trustee (the “**Trustee**”, which expression includes all persons for the time being trustee or trustees appointed under the Trust Deed) and are the subject of an agency agreement dated 14 December 2005 (as amended or supplemented from time to time, the “**Agency Agreement**”) between the Issuer, the Guarantor, Citibank, N.A. as principal paying agent (the “**Principal Paying Agent**”, which expression includes any successor principal paying agent appointed from time to time in connection with the Notes), the paying agents named therein (together with the Principal Paying Agent, the “**Paying Agents**”, which expression includes any successor or additional paying agents appointed from time to time in connection with the Notes) and the Trustee. Certain provisions of these Conditions are summaries of the Trust Deed and the Agency Agreement and subject to their detailed provisions. The holders of the Notes (the “**Noteholders**”) and the holders of the related interest coupons (the “**Couponholders**” and the “**Coupons**”, respectively) are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and the Agency Agreement applicable to them. Copies of the Trust Deed and the Agency Agreement are available for inspection by Noteholders during normal business hours at the registered office for the time being of the Trustee, being at the date hereof Fifth Floor, 100 Wood Street, London EC2V 7EX and at the Specified Office (as defined in the Agency Agreement) of each of the Paying Agents, the initial Specified Offices of which are set out below.

### 1. Definitions

As used herein:

“**Additional Amounts**” has the meaning given in Condition 8 (*Taxation*).

“**Arrears of Interest**” has the meaning given in Condition 5(c) (*Deferral of Payments – Arrears of Interest*).

“**Assets**” means the unconsolidated gross assets of the Issuer or the Guarantor, as the case may be, as shown in the latest published audited balance sheet of the Issuer or the Guarantor, as the case may be, but adjusted for subsequent events, all in such manner as the directors of the Issuer or the Guarantor, as the case may be, may determine.

“**Benchmark Gilt**” means in relation to any determination of the Make-Whole Redemption Amount, such United Kingdom government security having a maturity date on or about the next Reset Date as the Principal Paying Agent, with the advice of the Reference Market Makers, may determine to be appropriate.

“**business day**” has the meaning given in Condition 7(f) (*Payments – Payments on business days*).

A “**Capital Disqualification Event**” shall be deemed to occur:

- (a) if the Notes would not be eligible to qualify (save where such non-qualification is only as a result of any applicable limitation on the amount of such capital) as capital resources satisfying the Regulatory Capital Requirements applicable to the Issuer or to all or any part of the Group (which part includes the Issuer and at least one other member of the Group) as a result of any change to the Capital Regulations or the application or official interpretation thereof at any time; or
- (b) if the Notes would no longer be eligible to qualify (save as aforesaid) for inclusion in the Upper Tier Two Capital of the Issuer on a solo basis or of the Group on a consolidated basis; or
- (c) if the Issuer so elects (which election shall comply with the regulatory requirements of the FSA) and if at any time the Issuer has on-lent proceeds from the Notes to the Guarantor

under the Intercompany Loan on terms analogous to the terms of the Notes, and the Intercompany Loan would no longer be eligible to qualify (save as aforesaid) for inclusion in the Upper Tier Two Capital of the Guarantor by reason only of the terms of the Intercompany Loan, to the extent that the terms thereof are analogous to the terms of the Notes,

and, in each case, such ineligibility cannot be avoided by the Issuer or the Guarantor taking reasonable measures available to it.

“**Capital Regulations**” means the rules and regulations of any Relevant Supervisory Authority that require the Issuer, the Guarantor or any of the EEA Regulated Subsidiaries to meet the Regulatory Capital Requirements.

“**Change in Law**” means a change in, or amendment to, or the official announcement of a change in, or amendment to, the laws or regulations of the United Kingdom or any political subdivision or any authority thereof or therein having power to tax (including any treaty to which the United Kingdom is a party), or any change in the application of or official interpretation of those laws or regulations (or the official announcement of any such change), which change or amendment becomes, or would become, effective on or after the 12 December 2005;

“**Coupon Sheet**” has the meaning given in Condition 7(i) (*Payments – Exchange of Talons*).

“**Day Count Fraction**” has the meaning given in Condition 4(a) (*Interest – Interest Period*).

“**Deferral Notice**” has the meaning given in Condition 5(a) (*Deferral of Payments – Optional Deferral of Interest*).

“**EEA Regulated Subsidiary**” means any entity engaged in the insurance business and regulated as such by a member state of the European Economic Area in which the Issuer or the Guarantor, directly or indirectly, holds 20 per cent. or more of the voting rights or capital.

“**European Economic Area**” or “**EEA**” means the countries comprising the European Union together with Norway, Liechtenstein and Iceland.

“**Extraordinary Resolution**” means a resolution passed at a meeting of Noteholders (whether originally convened or resumed following an adjournment) duly convened and held in accordance with the provisions of the Trust Deed by a majority of not less than three quarters of the votes cast.

“**First Reset Date**” means 15 December 2015.

“**FSA**” means the Financial Services Authority (or, if at any time the Financial Services Authority is not the relevant regulator, such other regulator as shall be the relevant regulator of insurance companies operating in the United Kingdom).

“**Gross Redemption Yield**” means, with respect to the Notes, the gross redemption yield on the Notes, as calculated by the Principal Paying Agent on the basis set out by the United Kingdom Debt Management Office in the paper “Formulae for Calculating Gilt Prices from Yields”, page 4, Section One: Price/Yield Formulae “Conventional Gilts; Double dated and Undated Gilts with Assumed (or Actual) Redemption on a Quasi Coupon Date” (published 8 June 1998, as amended or updated from time to time) on a semi-annual compounding basis (converted to an annualised yield and rounded up (if necessary) to four decimal places).

“**Group**” means the Issuer, the Guarantor and their respective Subsidiaries.

“**Guarantee**” means the guarantee of the Notes given by the Guarantor in the Trust Deed.

“**Intercompany Loan**” means the loan agreement which will be entered into on the Issue Date between the Issuer (as lender) and the Guarantor (as Borrower) using the net proceeds received from the issue of the Notes.

“**Interest Amount**” means the amount of interest payable on any Interest Payment Date falling before the First Reset Date for the relevant Interest Period and in respect of an Interest Payment Date falling after the First Reset Date, means the relevant Reset Interest Amount.

“**Interest Determination Date**” in relation to an Interest Period means the first day of the relevant Interest Period.

“**Interest Payment Date**” and “**Interest Payment Dates**” means 15 December in each year commencing on 15 December 2006 until (and including) the First Reset Date and 15 March, 15 June, 15 September and 15 December in each year thereafter.

“**Interest Period**” has the meaning given in Condition 4(a) (*Interest – Interest Period*).

“**Issue Date**” has the meaning given in Condition 4(a) (*Interest – Interest Period*).

“**Liabilities**” means the unconsolidated gross liabilities of the Issuer or the Guarantor, as the case may be, as shown in the latest published audited balance sheet of the Issuer or the Guarantor, as the case may be, but adjusted for contingent liabilities and for subsequent events, all in such manner as the directors of the Issuer or the Guarantor, as the case may be, may determine.

“**Make-Whole Redemption Amount**” means, in respect of each Note (which is intended solely to compensate Noteholders for any reinvestment loss from interest rate risk, and costs of reinvestment as a result of the early redemption of the Notes), the amount equal to the sum of the price, expressed as a percentage (rounded to four decimal places, 0.00005 being rounded upwards) of the principal amount of the Note, at which the Gross Redemption Yield on the Notes on the Reference Date (assuming for this purpose that the principal amount of the Notes was payable on 15 December 2015) is equal to the Gross Redemption Yield (determined by reference to the middle market price) at 3:00 p.m. (London time) on the Reference Date of the Benchmark Gilt plus 0.75 per cent.

“**Make-Whole Redemption Price**” means, in respect of each Note, the greater of the Make-Whole Redemption Amount and the par redemption price.

“**Margin**” means 2.45 per cent.

“**Optional Deferred Interest Payment Date**” has the meaning given in Condition 5(c) (*Deferral of Payments – Arrears of Interest*).

“**par redemption price**” means, in respect of each Note, an amount equal to the sum of its denomination plus the accrued and unpaid interest thereon for the then current Interest Period (including Arrears of Interest and interest thereon) and, if the Redemption Date is on or within five business days following an Interest Payment Date, the interest payable thereon with respect to that Interest Payment Date, to the extent unpaid and any Additional Amounts.

“**PRU**” means the “**Integrated Prudential Sourcebook**” that forms part of the rules of the FSA relating to the regulation of insurers and their groups and any equivalent rules or regulatory provisions from time to time replacing it or the rules therein.

“**Redemption Date**” means any date fixed for redemption pursuant to Condition 6 (*Redemption and Purchase*).

“**Redemption Price**” means the outstanding principal amount of the Notes.

“**Reference Banks**” means four major banks in the sterling interbank market in London as selected by the Principal Paying Agent.

“**Reference Date**” means the third business day prior to the Redemption Date.

“**Reference Market Makers**” means three brokers of gilts and/or gilt-edged market makers selected by the Principal Paying Agent in consultation with the Issuer and the Guarantor.

“**Regulatory Capital Requirements**” means any applicable minimum or notional margin of solvency or minimum capital or capital requirement specified for insurance companies, insurance holding companies or financial groups by any Relevant Supervisory Authority.

“**Relevant Coupons**” has the meaning given in Condition 7(d) (*Payments – Deduction for unmaturing Coupons*).

“**Relevant Date**” has the meaning given in Condition 8 (*Taxation*).

“**Relevant Rules**” means the rules made from time to time by the FSA (including the PRU) or any successor rules or other applicable legislation, rules or regulations (whether having the force of law or otherwise) from time to time relating to the regulation of capital of insurance companies in the United Kingdom.

“**Relevant Supervisory Authority**” means any regulator having jurisdiction over the Issuer, the Guarantor or any of the EEA Regulated Subsidiaries from time to time.

“**Reserved Matter**” has the meaning given in Condition 14(a) (*Meetings of Noteholders; Modification and Waiver; Substitution – Meetings of Noteholders*).

“**Reset Date**” means 15 December 2015 and each Interest Payment Date falling thereafter.

“**Reset Interest Amount**” has the meaning given in Condition 4(c) (*Interest – Calculation of Interest Amount*).

“**Reset Rate of Interest**” has the meaning given in Condition 4(b) (*Interest – Reset Rate of Interest*).

“**Resumption Date**” has the meaning given in Condition 5(c) (*Deferral of Payments – Arrears of Interest*).

“**Senior Creditors**” means all creditors of the Issuer or the Guarantor, as the case may be, (including, in the case of the Guarantor, all policyholders in their capacity as such (for the avoidance of doubt, the claims of policyholders shall include all amounts to which they would be entitled (i) in the event of a winding-up of the Guarantor, under applicable legislation or rules relating to the winding-up of insurance companies to reflect any right to receive or expectation of receiving benefits which policyholders may have and (ii) except in a winding-up of the Guarantor, as a consequence of the Guarantor complying with its obligations to treat its policyholders fairly)) who are (a) unsubordinated creditors of the Issuer or the Guarantor, as the case may be, or (b) subordinated creditors of the Issuer or the Guarantor, as the case may be, other than those whose claims rank or are expressed to rank *pari passu* with or junior to the claims of the Noteholders.

“**Sterling**” is a reference to the lawful currency of the United Kingdom.

“**Subsidiary**” means a subsidiary undertaking within the meaning of section 258 of the Companies Act 1985.

“**Talon**” has the meaning given in Condition 2 (*Form, Denomination and Title*).

“**Tax Event**” means an event where the Issuer and/or the Guarantor determines that:

- (a) in making any interest payment or payments of Arrears of Interest or interest thereon on the Notes or under the Guarantee (as the case may be), it has paid, or will or would on the next Interest Payment Date be required to pay, otherwise than as a result of a Change in Law, Additional Amounts in accordance with Condition 8 (*Taxation*) and such requirement or circumstance cannot be avoided by the Issuer or the Guarantor (as the case may be) taking reasonable measures available to it;
- (b) as a result of a Change in Law any of the events mentioned in (a) above shall occur and such requirement or circumstance cannot be avoided by the Issuer or the Guarantor (as the case may be) taking reasonable measures available to it;
- (c) payments, including payment of Arrears of Interest and interest thereon, on the next Interest Payment Date in respect of any Notes would, otherwise than as a result of a Change in Law, be treated as “distributions” within the meaning of Section 209 of the Income and Corporation Taxes Act 1988 of the United Kingdom (as amended, re-enacted or replaced), or would be treated in such a way under any other provision of that Act or any Finance Act (as amended, re-enacted or replaced) that the Issuer would not obtain full or substantially full relief in respect of those payments for the purposes of United Kingdom corporation tax; or
- (d) as a result of a Change in Law there is a substantial risk that the Issuer will not obtain full or substantially full relief for the purposes of United Kingdom corporation tax for any payment of interest in respect of the Notes including, for the avoidance of doubt, where the Issuer may

be unable to claim or surrender losses as group relief, and such requirement or circumstance cannot be avoided by the Issuer taking reasonable measures available to it.

“**Upper Tier Two Capital**” has the meaning given to it in PRU or which is otherwise treated as upper tier two capital by the FSA.

## 2. Form, Denomination and Title

The Notes are serially numbered and in bearer form and are issued in denominations of £50,000 and integral multiples of £1,000 thereabove with Coupons and talons (each, a “**Talon**”) for further Coupons attached at the time of issue. Title to the Notes, the Coupons and the Talons will pass by delivery. The holder of any Note, Coupon or Talon shall (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust or any other interest therein, any writing thereon or any notice of any previous loss or theft thereof) and no person shall be liable for so treating such holder. No person shall have any right to enforce any term or condition of the Notes or the Trust Deed under the Contracts (Rights of Third Parties) Act 1999.

## 3. Status and Guarantee

- (a) *The Notes:* The Notes and Coupons relating to them and the obligations of the Guarantor under the Guarantee constitute direct and unsecured obligations of the Issuer and the Guarantor. The Notes rank *pari passu* and without any preference among themselves. In the event of the bankruptcy, dissolution or winding-up of the Issuer, the payment obligations of the Issuer under the Notes and Coupons relating to them shall be subordinated in the manner provided in the Trust Deed to the claims of all Senior Creditors of the Issuer and shall rank at least *pari passu* with all other undated or perpetual obligations of the Issuer that are not expressed by their terms to rank junior to the Notes and in priority to the claims of holders of all classes of share capital of the Issuer. No proof for the purposes of obtaining payment under the Notes or Coupons shall be submitted unless and until the claims of all Senior Creditors of the Issuer have been paid (or provided for) in full.
- (b) *The Guarantee:* In the event of the bankruptcy, dissolution or winding-up of the Guarantor, the payment obligations of the Guarantor under the Guarantee shall be subordinated in the manner provided in the Trust Deed to the claims of all Senior Creditors of the Guarantor and to claims of the Issuer under the Intercompany Loan, and shall rank *pari passu* with the intercompany loan made between Scottish Life Finance PLC as lender and the Guarantor as borrower and the guarantee granted in respect of the £125,000,000 9 per cent. Undated Subordinated Guaranteed Bonds issued by Scottish Life Finance PLC on 28 November 1996 (the “**1996 Subordinated Bonds**”) and at least *pari passu* with all other undated or perpetual obligations of the Guarantor, or any guarantee by the Guarantor of undated and perpetual obligations of any person, that are not expressed by their terms to rank junior to the Guarantee.
- (c) *Solvency Condition:* All payments under or arising from the Notes and the Coupons relating to them or the Guarantee (other than payments made in the event of the bankruptcy, dissolution, or winding-up of the Issuer, or as the case may be, the Guarantor) shall be conditional upon the Issuer or the Guarantor, as the case may be, being solvent at the time of and immediately after any such payment, and no amount shall be payable under or arising from the Notes and Coupons relating to them or the Guarantee unless and until such time as the Issuer or the Guarantor, as the case may be, could make such payment and still be solvent immediately thereafter.

The non-payment of any interest on any Interest Payment Date in accordance with Condition 3(c) will not constitute a default by the Issuer (or the Guarantor) and will not give the Noteholders or the Trustee a right to accelerate the Notes.

Neither the Issuer nor the Guarantor, as applicable, may redeem or purchase any of the Notes unless the Issuer, or, as the case may be, the Guarantor, is solvent both at the time of and immediately after any such redemption or purchase.

For the purposes of this Condition 3(c) the Issuer or the Guarantor, as the case may be, shall be solvent if (i) it is able to pay its debts owed to Senior Creditors as they fall due and (ii) its Assets exceed its Liabilities (other than its Liabilities to persons who are not Senior Creditors). A report as

to the solvency of the Issuer or the Guarantor, as the case may be, by two directors of the Issuer or the Guarantor or, if there is a winding-up of the Issuer or Guarantor in England and Wales, the administrator or liquidator of the Issuer or Guarantor (as the case may be) respectively, shall, in the absence of manifest error, be treated and accepted by the Issuer, the Guarantor, the Trustee, the holders of the Notes and Coupons relating to them and all other interested parties as correct and sufficient evidence thereof.

- (d) *Set-off*: Subject to applicable law, none of the Noteholders or Couponholders may exercise or claim any right of set-off in respect of any amount owed to it by the Issuer or the Guarantor, as the case may be, arising under or in connection with the Notes, Coupons or the Guarantee and each Noteholder and Couponholder shall, by virtue of being the holder of any Note or Coupon, be deemed to have waived all such rights of set-off whether prior to or in bankruptcy or in winding-up. Notwithstanding the preceding sentence, if any of the amounts owing to any Noteholder or Couponholder by the Issuer or the Guarantor, as the case may be, under or in connection with the Notes, Coupons or the Guarantee is discharged by set-off, such Noteholder shall immediately pay the amount of such discharge to the Issuer or the Guarantor or, in the event of its winding-up, the administrator or liquidator of the Issuer or the Guarantor respectively and, until such time as payment is made, shall hold an amount equal to such amount in trust for the Issuer or the Guarantor, or the administrator or liquidator of the Issuer or the Guarantor respectively, and accordingly any such discharge shall be deemed not to have taken place.

#### 4. Interest

- (a) *Interest Period*: The Notes bear interest (i) from (and including) 14 December 2005 (the “**Issue Date**”) to (but excluding) 15 December 2015 at the rate of 6.125 per cent. per annum, and (ii) from (and including) 15 December 2015 and from (and including) each Reset Date to (but excluding) the following Reset Date at the then relevant Reset Rate of Interest. Interest shall be payable on the Notes annually in arrear on 15 December in each year commencing on 15 December 2006 until (and including) 15 December 2015 and thereafter interest shall be payable on the Notes quarterly in arrear on 15 March, 15 June, 15 September and 15 December in each year (together, the “**Interest Payment Dates**” and each, an “**Interest Payment Date**”) subject as provided in Conditions 3 (*Status and Guarantee*), 5 (*Deferral of Payments*) and 7 (*Payments*).

If interest is required to be paid in respect of a Note on a date which is not an Interest Payment Date, it shall be calculated by applying 6.125 per cent. per annum or the Reset Rate of Interest, as applicable, to the principal amount of such Note, multiplying the product by the relevant Day Count Fraction and rounding the resulting figure to the nearest penny (half a penny being rounded upwards), where:

“**Day Count Fraction**” means, in respect of any period, the number of days in the relevant period, from (and including) the first day in such period to (but excluding) the last day in such period, divided by the number of days in the Interest Period in which the relevant period falls; and

“**Interest Period**” means each period from (and including) the Issue Date or any Interest Payment Date to (but excluding) the next succeeding Interest Payment Date.

- (b) *Reset Rate of Interest*: The rate of interest applicable to the Notes (the “**Reset Rate of Interest**”) for each Interest Period commencing on or after the First Reset Date will be determined by the Principal Paying Agent on the basis of the following provisions:
- (1) On each Interest Determination Date, the Principal Paying Agent will determine the offered rate (expressed as a rate per annum) for three-month sterling deposits as at 11.00 a.m. (London time) on such Interest Determination Date, as displayed on the display designated on page “3750” on the Telerate Monitor (or such other page or pages as may replace it for the purpose of displaying such information). The Reset Rate of Interest for the Interest Period commencing on the Interest Determination Date shall be such offered rate as determined by the Principal Paying Agent plus the Margin.
  - (2) If such offered rate does not so appear, or if the relevant page is unavailable, the Principal Paying Agent will, on such date, request the principal London office of the Reference Banks



to provide the Principal Paying Agent with its offered quotation to leading banks in the London interbank market for three-month sterling deposits as at 11.00 a.m. (London time) on such Interest Determination Date. If at least two of the Reference Banks provide the Principal Paying Agent with such offered quotations, the Reset Rate of Interest for the Interest Period shall be the rate determined by the Principal Paying Agent to be the arithmetic mean (rounded if necessary to the nearest one hundred thousandth of a percentage point (0.000005 per cent. being rounded upwards)) of such offered quotations plus the Margin.

- (3) If on any Interest Determination Date to which the provisions of sub-paragraph (2) above apply, one only or none of the Reference Banks provides the Principal Paying Agent with such a quotation, the Reset Rate of Interest for the Interest Period shall be the rate which the Principal Paying Agent determines to be the aggregate of the Margin and the arithmetic mean (rounded, if necessary, to the nearest one hundred thousandth of a percentage point (0.000005 per cent. being rounded upwards)) of the sterling lending rates which leading banks in London selected by the Principal Paying Agent are quoting, on such Interest Determination Date, to leading banks in Europe for a period of three months, except that, if the banks so selected by the Principal Paying Agent are not quoting such rates of interest as mentioned above, the Reset Rate of Interest for such Interest Period shall be either (1) the Reset Rate of Interest in effect for the last preceding Interest Period to which one of the preceding sub-paragraphs of this Condition 4(b) shall have applied or (2) if none, 6.125 per cent. per annum.
- (c) *Calculation of Reset Interest Amount:* The Principal Paying Agent will, as soon as practicable after 11.00 a.m. (London time) on each Interest Determination Date, determine the Reset Rate of Interest in respect of the Interest Period commencing on that Interest Determination Date and calculate the amount of interest payable in respect of each Note on the Interest Payment Date for that Interest Period (the “**Reset Interest Amount**”) by applying the Reset Rate of Interest for such Interest Period to the principal amount of the Note, multiplying such sum by the actual number of days in the Interest Period concerned divided by 365 (or, in the case of an Interest Payment Date falling in a leap year, 366) and, if necessary, rounding the resultant figure to the nearest £0.01 (£0.005 being rounded upwards).
- (d) *Publication:* The Principal Paying Agent will cause each Reset Rate of Interest in respect of each Interest Period and each Reset Interest Amount determined by it, together with the relevant Interest Payment Date, to be notified to the Paying Agents, the Trustee and each listing authority, stock exchange and/or quotation system (if any) by which the Notes have then been admitted to listing, trading and/or quotation as soon as practicable after such determination but in any event not later than the fourth business day thereafter. Notice thereof shall also promptly be given to the Noteholders. The Principal Paying Agent will be entitled to recalculate any Reset Interest Amount (on the basis of the foregoing provisions) without notice in the event of an extension or shortening of the relevant Interest Period.
- (e) *Notifications etc:* All notifications, opinions, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of this Condition by the Principal Paying Agent will (in the absence of manifest error) be binding on the Issuer, the Guarantor, the Paying Agents, the Trustee, the Noteholders and the Couponholders and (subject as aforesaid) no liability to any such person will attach to the Principal Paying Agent or (in the circumstances referred to in Condition 4(g) (*Failure of Principal Paying Agent*) below) the Trustee in connection with the exercise or non-exercise by it of its powers, duties and discretions for such purposes.
- (f) *Accrual of Interest:* Subject to Condition 3 (*Status and Guarantee*), each Note will cease to bear interest from the due date for redemption, if any, unless, upon due presentation, payment of principal is improperly withheld or refused, in which case it will continue to bear interest at such rate (both before and after judgment) until whichever is the earlier of (a) the day on which all sums due in respect of such Note up to that day are received by or on behalf of the relevant Noteholder and (b) the day which is seven days after the Principal Paying Agent or the Trustee has notified the Noteholders that it has received all sums due in respect of the Notes up to such seventh day (except to the extent that there is any subsequent default in payment).

- (g) *Failure of Principal Paying Agent:* If the Principal Paying Agent fails at any time to determine a Reset Rate of Interest or to calculate a Reset Interest Amount as aforesaid, the Trustee may determine such Reset Rate of Interest as it in its discretion considers fair and reasonable in the circumstances (having regard as it thinks fit to Condition 4(b) (*Reset Rate of Interest*) above) or (as the case may be) calculate such Interest Amount in accordance with Condition 4(c) (*Calculation of Reset Interest Amount*) above.

## 5. Deferral of Payments

- (a) *Optional Deferral of Interest:* The Issuer (or as the case may be, the Guarantor under the Guarantee) may elect to defer any payment of interest on the Notes which would otherwise be payable on an Interest Payment Date by giving notice (the “**Deferral Notice**”) of such election to the Noteholders which notice shall be given in accordance with Condition 17 (*Notices*) and to the Trustee, in either case not less than 14 days prior to the relevant Interest Payment Date.

The deferral of any interest payment on any Interest Payment Date in accordance with this Condition 5(a) will not constitute a default by the Issuer (or the Guarantor) and will not give the Noteholders or the Trustee any right to accelerate the Notes.

Notwithstanding the above, on any Interest Payment Date with respect to which (i) a Capital Disqualification Event has occurred and is continuing and (ii) the Issuer and the Guarantor are in compliance with their respective Regulatory Capital Requirements, the Issuer shall, subject to the requirement of Condition 3(c) (*Status and Guarantee – Solvency Condition*) as to solvency, be obliged to pay the interest payable on such Interest Payment Date and neither the Issuer (nor the Guarantor) may exercise its discretion pursuant to the first paragraph in this Condition.

- (b) *Restrictions following Deferral of Interest:* If, on any Interest Payment Date, interest in respect of the Notes shall not have been paid, then from such Interest Payment Date until such time as the full amount of the relevant Arrears of Interest and interest thereon has been received by the Noteholders or the Trustee and no other payment of Arrears of Interest and interest thereon remains unsatisfied, (i) the Issuer shall not (a) declare a dividend or other distribution or payment in respect of any class of the Issuer’s share capital, or (b) pay interest or make a distribution on any other securities or under any guarantee or loan relating thereto ranking junior to or *pari passu* with Notes, or (c) redeem, purchase or acquire any of its ordinary shares or any other securities ranking junior to or *pari passu* with the Notes; and (ii) the Guarantor shall not (a) pay interest or make a distribution on any other securities ranking junior to or *pari passu* with the Guarantee other than any interest payments or deferred interest payments under any intercompany loan or guarantee in relation to the 1996 Subordinated Bonds, or (b) redeem, purchase or acquire any other securities ranking junior to or *pari passu* with the Guarantee.
- (c) *Arrears of Interest:* Any interest in respect of the Notes not paid on an Interest Payment Date, together with any other interest in respect thereof not paid on any earlier Interest Payment Date, shall, so long as the same remains unpaid, constitute “**Arrears of Interest**”. Any Arrears of Interest will bear interest from (and including) the relevant Interest Payment Date on which interest would have otherwise been payable to (but excluding) the date on which such Arrears of Interest is paid at the relevant rate of interest for that Interest Period. Any Arrears of Interest and any interest thereon, may (subject to Condition 3(c) (*Status and Guarantee – Solvency Condition*)) be paid in whole or in part at any time upon the expiry of not less than 14 days’ notice to such effect given by the Issuer, or the Guarantor as the case may be, to the Trustee and to the Noteholders in accordance with Condition 17 (*Notices*) as specified in such notice (the “**Optional Deferred Interest Payment Date**”), and in any event will automatically become immediately due and payable (irrespective of any prior written notice to, or absence of objection from, the FSA) but at all times subject to the Issuer or the Guarantor (as the case may be) being solvent (as defined in Condition 3(c) (*Status and Guarantee – Solvency Condition*)) in whole upon the earliest of the following dates (the “**Resumption Date**”):
- (i) the date on which the Issuer declares a dividend or other distribution or payment in respect of any class of its share capital or pays interest or makes a distribution on the Notes or any other securities or guarantee or loan relating thereto ranking junior to or *pari passu* with the Notes;

- (ii) the date on which the Issuer redeems, purchases or acquires any of its ordinary shares or any other securities ranking junior to or *pari passu* with the Notes;
- (iii) the date on which the Guarantor makes a payment under the Guarantee or any other securities ranking junior to or *pari passu* with the Guarantee other than any interest payments or deferred interest payments under any intercompany loan or guarantee in relation to the 1996 Subordinated Bonds;
- (iv) the date on which the Guarantor redeems, purchases or acquires any other securities ranking junior to or *pari passu* with the Guarantee;
- (v) the date on which an order is made or a resolution is passed for the winding-up of the Issuer or the Guarantor, as the case may be, (other than a winding-up which has been approved in writing by the Trustee or by an Extraordinary Resolution of the Noteholders); or
- (vi) the date fixed for any redemption, purchase or repayment of Notes by or on behalf of the Issuer or the Guarantor, as the case may be, pursuant to Condition 6 (*Redemption and Purchase*) or Condition 9 (*Events of Default*).

## **6. Redemption and Purchase**

- (a) *No fixed Redemption Date*: The Notes have no final maturity date and are only redeemable or repayable in accordance with the following provisions of this Condition 6 (*Redemption and Purchase*) and Condition 9 (*Events of Default*).
- (b) *Redemption for tax reasons*: Subject to the requirement of Condition 3(c) (*Status and Guarantee – Solvency Condition*) as to solvency, the Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time if, immediately before giving notice to Noteholders pursuant to Condition 6(e) (*Procedures*), the Issuer satisfies the Trustee in accordance with Condition 6(f) that a Tax Event has occurred; *provided, however, that* no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer or the Guarantor would be obliged to pay such Additional Amounts (in the case of (a) and (b) of the definition of Tax Event) or such amounts (in the case of (c) and (d) of the definition of Tax Event) if a payment in respect of the Notes were then due or (as the case may be) a demand under the Guarantee were then made.
- (c) *Redemption of the Notes for Regulatory Purposes*: If, immediately before giving notice to Noteholders pursuant to Condition 6(e) (*Procedures*), the Issuer satisfies the Trustee in accordance with Condition 6(f) that a Capital Disqualification Event has occurred and is continuing, then subject to the requirement of Condition 3(c) (*Status and Guarantee – Solvency Condition*) as to solvency, the Issuer may redeem the Notes in whole, but not in part, at any time.
- (d) *Redemption at the Option of the Issuer*: Unless the Issuer shall have given notice to redeem the Notes under Condition 6(b) (*Redemption for tax reasons*) or Condition 6(c) (*Redemption of the Notes for Regulatory Purposes*) on or prior to the expiration of the notice referred to below, subject to the requirement of Condition 3(c) (*Status and Guarantee – Solvency Condition*) as to solvency, the Notes may be redeemed at the option of the Issuer, in whole, but not in part, on 15 December 2015 or on any Reset Date thereafter.
- (e) *Procedures*  
Any redemption prior to 15 December 2015:
  - (i) under Condition 6(b) (*Redemption for tax reasons*) as a result of the occurrence of any of the circumstances described in paragraph (b) or (d) of the definition of Tax Event will be at the Redemption Price and any redemption as a result of the occurrence of any of the circumstances described in paragraph (a) or (c) of the definition of Tax Event will be at the Make-Whole Redemption Price;
  - (ii) under Condition 6(c) (*Redemption of the Notes for Regulatory Purposes*) will be at the Make-Whole Redemption Price; and

(iii) under Condition 6(d) (*Redemption at the Option of the Issuer*) will be at the Redemption Price,

and, in each case, shall be paid together with all accrued interest from (and including) the preceding Interest Payment Date (or, if none, the Issue Date) to the Redemption Date and the aggregate amount of any Arrears of Interest and interest thereon and shall be paid on the Redemption Date.

Any redemption on or after 15 December 2015, under Condition 6(b) (*Redemption for tax reasons*) as a result of the occurrence of any of the circumstances described in paragraph (a), (b), (c) or (d) of the definition of Tax Event, Condition 6(c) (*Redemption of the Notes for Regulatory Purposes*) or Condition 6(d) (*Redemption at the Option of the Issuer*) will be at the Redemption Price.

Any redemption under this Condition 6 is subject to the Issuer and the Guarantor, having given at least six months' prior written notice (or such shorter notice period as the FSA may accept and so long as such notice is required to be given) to, and received no objection within that period from, the FSA and having given not less than 30 nor more than 60 days' notice to the Noteholders, the Trustee and the Principal Paying Agent.

- (f) Prior to the giving of any notice of redemption to Noteholders, the Trustee and the Principal Paying Agent following the occurrence of the events in Condition 6(b) (*Redemption for tax reasons*) or 6(c) (*Redemption of the Notes for Regulatory Purposes*), the Issuer shall deliver to the Trustee (a) a certificate signed by two directors of the Issuer or the Guarantor, as the case may be, stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the events giving rise to the right to redemption have occurred, and (b) an opinion (in form and substance satisfactory to the Trustee) of independent legal advisers of recognised standing to the effect that the Issuer is entitled to exercise its right of redemption.

The Trustee shall accept such certificate and opinion as sufficient evidence of the satisfaction of the conditions precedent to any such redemption and they shall be conclusive and binding on the Noteholders and Couponholders.

Any notice of redemption will be irrevocable and will provide details of the Redemption Date.

- (g) *No other redemption:* The Issuer shall not be entitled to redeem the Notes otherwise than as provided in Condition 6(b) (*Redemption for tax reasons*), Condition 6(c) (*Redemption of the Notes for Regulatory Purposes*), Condition 6(d) (*Redemption at the Option of the Issuer*) and Condition 9 (*Events of Default*).
- (h) *Purchases:* Subject to the requirement of Condition 3(c) (*Status and Guarantee – Solvency Condition*) as to solvency, the Issuer, the Guarantor or any of their Subsidiaries may, having given prior written notice to, and received no objection from, the FSA (so long as such notice is required to be given), at any time purchase Notes in the open market or otherwise at any price; *provided that* all unmaturing Coupons and unexchanged Talons relating thereto are attached thereto or surrendered therewith.
- (i) *Cancellation:* All Notes so redeemed or purchased by the Issuer, the Guarantor or any of their respective Subsidiaries and any unmaturing Coupons and unexchanged Talons attached thereto or surrendered therewith shall be cancelled and may not be reissued or resold.

## **7. Payments**

- (a) *Principal:* Payments of principal shall be made only against presentation and (provided that payment is made in full) surrender of Notes at the Specified Office of any Paying Agent outside the United States by Sterling cheque drawn on, or by transfer to a Sterling account maintained by the payee with, a bank in London.
- (b) *Interest:* Payments of interest shall, subject to Condition 7(g) (*Payments other than in respect of matured Coupons*) below, be made only against presentation and (provided that payment is made in full) surrender of the appropriate Coupons at the Specified Office of a Paying Agent outside the United States in the manner described in Condition 7(a) (*Principal*) above.

- (c) *Payments subject to fiscal laws:* All payments in respect of the Notes are subject in all cases to any applicable fiscal or other laws and regulations in the place of payment, but without prejudice to the provisions of Condition 8 (*Taxation*). No commissions or expenses shall be charged to the Noteholders or Couponholders in respect of such payments.
- (d) *Deduction for unmatured Coupons:* If a Note is presented without all unmatured Coupons relating thereto in respect of an Interest Period ending on or before 15 December 2015, then:
  - (i) if the aggregate amount of the missing Coupons is less than or equal to the amount of principal due for payment, a sum equal to the aggregate amount of the missing Coupons will be deducted from the amount of principal due for payment; provided, however, that if the gross amount available for payment is less than the amount of principal due for payment, the sum deducted will be that proportion of the aggregate amount of such missing Coupons which the gross amount actually available for payment bears to the amount of principal due for payment;
  - (ii) if the aggregate amount of the missing Coupons is greater than the amount of principal due for payment:
    - (A) so many of such missing Coupons shall become void (in inverse order of maturity) as will result in the aggregate amount of the remainder of such missing Coupons (the “**Relevant Coupons**”) being equal to the amount of principal due for payment; provided, however, that where this sub-paragraph would otherwise require a fraction of a missing Coupon to become void, such missing Coupon shall become void in its entirety; and
    - (B) a sum equal to the aggregate amount of the Relevant Coupons (or, if less, the amount of principal due for payment) will be deducted from the amount of principal due for payment; provided, however, that if the gross amount available for payment is less than the amount of principal due for payment, the sum deducted will be that proportion of the aggregate amount of the Relevant Coupons (or, as the case may be, the amount of principal due for payment) which the gross amount actually available for payment bears to the amount of principal due for payment.

Each sum of principal so deducted shall be paid in the manner provided in Condition 7(a) (*Principal*) against presentation and (provided that payment is made in full) surrender of the relevant missing Coupons. No payments will be made in respect of void Coupons.

- (e) *Unmatured Coupons void:* On the due date for redemption or repayment pursuant to Condition 6(b) (*Redemption and Purchase – Redemption for tax reasons*), Condition 6(c) (*Redemption and Purchase – Redemption of the Notes for Regulatory Purposes*), Condition 6(d) (*Redemption and Purchase – Redemption at the Option of the Issuer*), or Condition 9 (*Events of Default*), any unmatured Talons relating to such Notes shall become void and no Coupons shall be delivered in respect of such Talons and all unmatured Coupons (if any) (whether or not still attached) shall become void and no payment will be made in respect thereof.
- (f) *Payments on business days:* If the due date for payment of any amount in respect of any Note or Coupon is not a business day in the place of presentation, the holder shall not be entitled to payment in such place of the amount due until the next succeeding business day in such place and shall not be entitled to any further interest or other payment in respect of any such delay. In this paragraph, “**business day**” means, any day other than a Saturday or a Sunday on which commercial banks and foreign exchange currency markets are open for usual business in London.
- (g) *Payments other than in respect of matured Coupons:* Payments of interest other than in respect of matured Coupons shall be made only against presentation of the relevant Notes at the Specified Office of any Paying Agent outside the United States.
- (h) *Partial payments:* If Paying Agent makes a partial payment in respect of any Note or Coupon presented to it for payment, such Paying Agent will endorse thereon a statement indicating the amount and date of such payment.
- (i) *Exchange of Talons:* On or after the maturity date of the final Coupon which is (or was at the time of issue) part of a coupon sheet relating to the Notes (each, a “**Coupon Sheet**”), the Talon forming

part of such Coupon Sheet may be exchanged at the Specified Office of the Principal Paying Agent for a further Coupon Sheet (including a further Talon but excluding any Coupons in respect of which claims have already become void pursuant to Condition 11 (*Prescription*)). Upon the due date for redemption of any Note, any unexchanged Talon relating to such Note (whether or not attached) shall become void and no Coupon will be delivered in respect of such Talon.

## 8. Taxation

All payments of principal and interest in respect of the Notes and the Coupons by or on behalf of the Issuer or the Guarantor shall be made free and clear of, and without withholding or deduction for or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or on behalf of the United Kingdom or any political subdivision thereof or any authority therein or thereof having power to tax, unless the withholding or deduction of such taxes, duties, assessments or governmental charges is required by law. In such event the Issuer or (as the case may be) the Guarantor shall pay such additional amounts as will result in receipt by the Noteholders and the Couponholders after such withholding or deduction of such amounts as would have been received by them had no such withholding or deduction been required (“**Additional Amounts**”), except that no such Additional Amounts shall be payable in respect of any Note or Coupon presented for payment:

- (a) by or on behalf of a holder which is liable to such taxes, duties, assessments or governmental charges in respect of such Note or Coupon by reason of its having some connection with the United Kingdom other than the mere holding of the Note or Coupon; or
- (b) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (c) by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note or Coupon to another Paying Agent in a member state of the European Union; or
- (d) more than 30 days after the Relevant Date, except to the extent that the holder of such Note or Coupon would have been entitled to such Additional Amounts on presenting such Note or Coupon for payment on the last day of such period of 30 days; or
- (e) by, or on behalf of, a holder who could lawfully avoid such withholding or deduction by satisfying any requirement to provide such evidence as is required by statute or making a declaration or any other statement or claim, including, but not limited to, a declaration of non-residence, but fails to do so.

In these Conditions, “**Relevant Date**” means whichever is the later of (1) the date on which the payment in question first becomes due and (2) if the full amount payable has not been received in London by the Principal Paying Agent or the Trustee on or prior to such due date, the date on which (the full amount having been so received) notice to that effect has been given to the Noteholders.

Any reference in these Conditions to principal, interest or Arrears of Interest shall be deemed to include any Additional Amounts in respect of principal, interest or Arrears of Interest (as the case may be) which may be payable under this Condition 8 (*Taxation*) or any undertaking given in addition to or in substitution for this Condition 8 (*Taxation*) pursuant to the Trust Deed.

If the Issuer or the Guarantor becomes resident for tax purposes in any taxing jurisdiction other than the United Kingdom, references in these Conditions to the United Kingdom shall be construed as references to the United Kingdom and/or such other jurisdiction.

## 9. Events of Default

If any of the following events occurs, then the Trustee at its discretion may and, if so requested in writing by holders of at least one quarter of the aggregate principal amount of the outstanding Notes or if

so directed by an Extraordinary Resolution, shall (subject to the Trustee having been indemnified and/or provided with security to its satisfaction) give written notice to the Issuer and the Guarantor declaring the Notes to be immediately due and payable, whereupon they shall become immediately due and payable at their principal amount together with all Arrears of Interest and accrued interest without further action or formality:

- (a) *Non-payment*: subject to the provisions of Condition 5 (*Deferral of Payments*) and Condition 3(c) (*Status and Guarantee – Solvency Condition*), the Issuer and the Guarantor fail to pay any amount of principal in respect of the Notes on the due date for payment thereof or fail to pay any amount of interest in respect of the Notes within 14 days of the due date for payment thereof; or
- (b) *Winding-up, etc.*: an order is made or an effective resolution is passed for the winding-up, liquidation or dissolution of the Issuer or the Guarantor other than a winding-up or dissolution which has been approved in writing by the Trustee or by an Extraordinary Resolution.

#### **10. Proceedings for Winding-up and Enforcement**

- (a) *Proceedings for winding-up*: If the Notes become due and payable pursuant to Condition 9 (*Events of Default*) and are not paid when so due and payable or a redemption notice has been given to Noteholders pursuant to Condition 6(b) (*Redemption and Purchase – Redemption for tax reasons*), Condition 6(c) (*Redemption and Purchase – Redemption of the Notes for Regulatory Purposes*) or Condition 6(d) (*Redemption and Purchase – Redemption at the option of the Issuer*) and the Notes are not redeemed and all amounts due thereon not paid in accordance with such Conditions, (disregarding the requirement of Condition 3(c) (*Status and Guarantee – Solvency Condition*) as to solvency) the Trustee may at its discretion institute proceedings for the winding-up of the Issuer and/or the Guarantor (as the case may be), but may take no further or other action to enforce the obligations of the Issuer and/or the Guarantor for payment of any principal or interest (including Arrears of Interest and any interest thereon if any) in respect of the Notes. No payment in respect of the Notes may be made by the Guarantor pursuant to Condition 9 (*Events of Default*), nor will the Trustee accept the same, otherwise than during or after a winding-up of the Guarantor, unless the Guarantor has given prior written notice to, and received no objection from, the FSA.
- (b) *Enforcement*: Without prejudice to Condition 9 (*Events of Default*) and Condition 10(a) (*Proceedings for winding-up*), the Trustee may at any time, at its discretion and without notice, institute such proceedings as it thinks fit to enforce its rights under the Trust Deed in respect of the Notes and the Guarantee (other than any obligation for the payment of any principal, Arrears of Interest or interest in respect of the Notes or the Guarantee) if the Issuer or the Guarantor (as the case may be) is in default of such terms and fails to remedy such default within 14 days after notice of the same shall have been given to the Issuer or Guarantor (as the case may be) by the Trustee, provided that neither the Issuer nor the Guarantor shall by virtue of the institution of any such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.
- (c) *Entitlement of the Trustee*: The Trustee shall not be bound to take any of the actions referred to in Condition 10(a) (*Proceedings for winding-up*) and Condition 10(b) (*Enforcement*) above unless:
  - (i) it has been so requested in writing by the holders of at least one quarter of the aggregate principal amount of the outstanding Notes or has been so directed by an Extraordinary Resolution; and
  - (ii) it has been indemnified and/or provided with security to its satisfaction.
- (d) *Right of Noteholders*: No Noteholder shall be entitled to proceed directly against the Issuer or the Guarantor or to procure the winding-up of the Issuer or the Guarantor unless the Trustee, having become bound to so proceed or being able to proceed in such winding-up, fails to do so within a reasonable time and such failure is continuing, in which case the Noteholder shall have only such rights against the Issuer or the Guarantor as those which the Trustee is entitled to exercise. Any such proceedings brought by any Noteholder shall be brought in the name of the Trustee, subject to the Noteholder indemnifying the Trustee to its satisfaction.

- (e) *Extent of Noteholders' remedy:* No remedy against the Issuer and/or the Guarantor, other than as referred to in Condition 9 (*Events of Default*) and this Condition 10, shall be available to the Trustee or the Noteholders or Couponholders, whether for the recovery of amounts under or arising from the Notes, the Trust Deed or in respect of any breach by the Issuer and/or the Guarantor of any of its other obligations under or arising from the Notes, Coupons or the Trust Deed.

#### **11. Prescription**

Claims for principal shall become void unless the relevant Notes are presented for payment within ten years of the appropriate Relevant Date. Claims for interest shall become void unless the relevant Coupons are presented for payment within five years of the appropriate Relevant Date.

#### **12. Replacement of Notes, Coupons and Talons**

If any Note, Coupon or Talon is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the Specified Office of the Principal Paying Agent, subject to all applicable laws and stock exchange requirements, upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Issuer may reasonably require. Mutilated or defaced Notes, Coupons or Talons must be surrendered before replacements will be issued.

#### **13. Trustee and Paying Agents**

Under the Trust Deed, the Trustee is entitled to be indemnified and relieved from responsibility in certain circumstances and to be paid its costs and expenses in priority to the claims of the Noteholders. In addition, the Trustee is entitled to enter into business transactions with the Issuer, the Guarantor and any entity relating to the Issuer or the Guarantor without accounting for any profit.

In the exercise of its powers and discretions under these Conditions and the Trust Deed, the Trustee will have regard to the interests of the Noteholders as a class and will not be responsible for any consequence for individual holders of Notes or Coupons as a result of such holders being connected in any way with a particular territory or taxing jurisdiction.

In acting under the Agency Agreement and in connection with the Notes and the Coupons, the Paying Agents act solely as agents of the Issuer, the Guarantor and (to the extent provided therein) the Trustee and does not assume any obligations towards or relationship of agency or trust for or with any of the Noteholders or Couponholders.

The initial Paying Agents and their initial Specified Office are listed below. The Issuer and the Guarantor reserve the right (with the prior approval of the Trustee) at any time to vary or terminate the appointment of any Paying Agent and to appoint a successor principal paying agent and additional or successor paying agents; provided, however, that the Issuer and the Guarantor shall at all times maintain (a) a principal paying agent, (b) a paying agent in London so long as the Notes are admitted to the Official List of the FSA and the United Kingdom Listing Authority rules so require and (c) a paying agent in a member state of the European Union that will not be obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 or any law implementing or complying with, or introduced to conform to, such Directive.

Notice of any change in any of the Paying Agents or in their Specified Offices shall promptly be given to the Noteholders.

#### **14. Meetings of Noteholders; Modification and Waiver; Substitution**

- (a) *Meetings of Noteholders:* The Trust Deed contains provisions for convening meetings of Noteholders to consider matters relating to the Notes, including the modification of any provision of these Conditions or the Trust Deed. Any such modification may be made if sanctioned by an Extraordinary Resolution (as defined in the Trust Deed). Such a meeting may be convened by the Issuer and the Guarantor (acting together) or by the Trustee and shall be convened by the Trustee upon the request in writing of Noteholders holding not less than one-tenth of the aggregate principal amount of the outstanding Notes. The quorum at any meeting convened to vote



on an Extraordinary Resolution will be two or more persons holding or representing more than half of the aggregate principal amount of the outstanding Notes or, at any adjourned meeting, two or more persons being or representing Noteholders whatever the principal amount of the Notes held or represented; provided, however, that certain proposals (including any proposal to change any redemption date or date fixed for payment of interest or Arrears of Interest in respect of the Notes, to reduce the amount of principal, interest or Arrears of Interest payable on any date in respect of the Notes, to alter the method of calculating the amount of any payment in respect of the Notes or the date for any such payment, to change the currency of payments under the Notes, to amend the terms of the Guarantee (other than any amendments in accordance with Condition 15(c)) or to change the quorum requirements relating to meetings or the majority required to pass an Extraordinary Resolution (each, a “**Reserved Matter**”)) may only be sanctioned by an Extraordinary Resolution passed at a meeting of Noteholders at which two or more persons holding or representing not less than two-thirds or, at any adjourned meeting, one-third of the aggregate principal amount of the outstanding Notes form a quorum. Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders and Couponholders, whether present or not.

In addition, a resolution in writing signed by or on behalf of all Noteholders who for the time being are entitled to receive notice of a meeting of Noteholders under the Trust Deed will take effect as if it were an Extraordinary Resolution. Such a resolution in writing may be contained in one document or several documents in the same form, each signed by or on behalf of one or more Noteholders.

- (b) *Modification and waiver:* Except in the circumstances where the provisions of Condition 15(c) (*Transfer of Business – Amendments*) apply where the Trustee, provided the Issuer and the Guarantor have provided to the Trustee a certificate signed by two directors of the Issuer, the Guarantor and/or the transferee (as applicable) certifying, *inter alia*, the necessity or desirability of the changes contemplated by Condition 15(c) (*Transfer of Business – Amendments*), shall accept such changes, in relation to any other matters the Trustee may, without the consent of the Noteholders or Couponholders (i) agree to any modification of these Conditions or the Trust Deed (other than in respect of a Reserved Matter) which is, in the opinion of the Trustee, proper to make if, in the opinion of the Trustee, such modification will not be materially prejudicial to the interests of Noteholders and (ii) to any modification of the Notes or the Trust Deed which is of a formal, minor or technical nature or is to correct a manifest error.

In addition, the Trustee may, without the consent of the Noteholders or Couponholders authorise or waive any proposed breach or breach of the Notes or the Trust Deed (other than a proposed breach or breach relating to the subject of a Reserved Matter) if, in the opinion of the Trustee, the interests of the Noteholders will not be materially prejudiced thereby.

Unless the Trustee agrees otherwise, any such authorisation, waiver or modification shall be notified to the Noteholders in accordance with Condition 17 (*Notices*) as soon as practicable thereafter.

- (c) *Substitution:* The Trust Deed contains provisions under which the Guarantor or any wholly-owned subsidiary (as defined in Section 736 of the Companies Act 1985) of the Guarantor may, without the consent of the Noteholders or Couponholders assume the obligations of the Issuer (or any previous substitute under this Condition) as principal debtor under the Trust Deed and the Notes provided that certain conditions specified in the Trust Deed are fulfilled, including, in the case of a substitution of the Issuer by a company other than the Guarantor, a requirement that the Guarantee is fully effective in relation to the obligations of the new principal debtor under the Trust Deed and the Notes and the Trustee being satisfied that the interests of the Noteholders will not be materially prejudiced thereby, provided that if the Guarantor transfers all or a substantial part (as such term is defined in Condition 15(a) (*Transfer of Business*)) of its business to the Issuer under Condition 15 (*Transfer of Business*), the provisions of Condition 15 (*Transfer of Business*) shall apply instead of this Condition 14(c).

No Noteholder or Couponholder shall, in connection with any substitution, be entitled to claim any indemnification or payment in respect of any tax consequence thereof for such Noteholder or (as the case may be) Couponholder except to the extent provided for in Condition 8 (*Taxation*) (or any undertaking given in addition to or substitution for it pursuant to the provisions of the Trust Deed).

- (d) *Notice to FSA*: No modification to these Conditions or any other provisions of the Trust Deed (other than a modification which is of a formal, minor or technical nature or to correct a manifest error) shall become effective unless the Issuer and/or the Guarantor shall have given at least one month's prior written notice (or such shorter period of notice as the FSA may accept and so long as there is a requirement to give such notice) to, and received no objection within that period from, the FSA.

## 15. Transfer of Business

- (a) *Transfer of business*: If the Guarantor shall transfer all or a substantial part of its long-term business in accordance with Part VII (Control of Business Transfers) of the Financial Services and Markets Act 2000 ("FSMA") to another body corporate, the Guarantor shall procure that there be included in the assets and liabilities to be transferred to such body corporate all the liabilities and obligations of the Guarantor as principal obligor under the Guarantee, without any prior approval thereof being required from the Trustee, Noteholders or Couponholders and references to the Guarantor herein and in the Trust Deed shall be construed accordingly.

As used above, "substantial part" means any part which represents 50 per cent. or more of the amount included in the last audited balance sheet of the Guarantor for long term business provision.

- (b) *Demutualisation*: If the Guarantor shall cease to be a mutual insurer (as referred to in the Relevant Rules), otherwise than by reason of the circumstances described in paragraph (a) above then, it shall continue to be the principal obligor under the Guarantee.
- (c) *Amendments*: Notwithstanding Condition 14(b) (*Meetings of Noteholders; Modification and Waiver; Substitution – Modification and Waiver*) or any other provisions to the contrary, the Trustee shall, without the consent of the Noteholders or Couponholders, accept such changes to the Conditions and the Trust Deed (other than in respect of a Reserved Matter) as the Issuer, the Guarantor and/or transferee (as applicable) shall agree to reflect the changes in Condition 15(a) (*Transfer of business*) or Condition 15(b) (*Demutualisation*) above so as to ensure that the Notes and the Guarantee continue to be eligible:
- (i) to qualify as capital resources satisfying the Regulatory Capital Requirements applicable to the Issuer or to all or any part of the Group; or
  - (ii) to qualify for inclusion in the Upper Tier Two capital of the Issuer at least on a solo basis or (if available) of the Group on a consolidated basis, or (in the case of Condition 15(a)) the transferee or (in the case of Condition 15 (b)) the Guarantor,

including (without limitation) amendments to Condition 3 (*Status and Guarantee*) and Condition 5 (*Deferral of Payments*). If any such changes are to be made to the Conditions and the Trust Deed, the Issuer and/or Guarantor shall provide to the Trustee a certificate signed by two directors of each of the Issuer, the Guarantor and/or transferee (as applicable) (x) certifying the necessity or desirability of such changes, and (y) representing and warranting to the Trustee that such changes will not cause any material prejudice to the Noteholders (as a class) as may be reasonably foreseeable at the time the certificate is delivered.

Such certificate shall be treated and accepted by the Trustee, without need for further evidence, as correct and sufficient evidence of the necessity or desirability of such changes and the Trustee shall have no liability to any Noteholders or Couponholders as a result of accepting such certificate.

## 16. Further Issues

The Issuer may from time to time, without the consent of the Noteholders or Couponholders and in accordance with the Trust Deed, create and issue further notes having the same terms and conditions as the Notes in all respects (or in all respects except for the date from which interest accrues and the amount of the first payment of interest) so as to form a single series with the Notes. The Issuer may from time to time, with the consent of the Trustee, create and issue other series of notes having the benefit of the Trust Deed.

**17. Notices**

Notices to the Noteholders shall be valid if published in a leading English language daily newspaper published in London (which is expected to be the Financial Times) or, if such publication is not practicable, in a leading English language daily newspaper having general circulation in Europe. Any such notice shall be deemed to have been given on the date of first publication. Couponholders shall be deemed for all purposes to have notice of the contents of any notice given to the Noteholders.

**18. Governing Law**

The Notes and the Trust Deed and all matters arising from or connected with the Notes and the Trust Deed are governed by, and shall be construed in accordance with, English law.

*There will appear at the foot of the Conditions endorsed on each Note in definitive form the names and Specified Offices of the Paying Agents as set out at the end of this Offering Circular.*

## SUMMARY OF PROVISIONS RELATING TO THE NOTES IN GLOBAL FORM

The Notes will initially be in the form of the Temporary Global Note which will be deposited on or around the Closing Date with a common depository for Euroclear and Clearstream, Luxembourg. The Temporary Global Note will be exchangeable in whole or in part for interests in the Permanent Global Note not earlier than 40 days after the Closing Date upon certification as to non-U.S. beneficial ownership. No payments will be made under the Temporary Global Note unless exchange for interests in the Permanent Global Note is improperly withheld or refused. In addition, interest payments in respect of the Notes cannot be collected without such certification of non-U.S. beneficial ownership.

The Notes are issued in the denominations of £50,000 per Note (the “**Minimum Denomination**”) and integral multiples of £1,000 thereabove.

The Permanent Global Note will become exchangeable in whole, but not in part, for Notes in definitive form (“**Definitive Notes**”) in respect of all holdings of Notes with a nominal amount which is equal to or greater than £50,000 at the request of the bearer of the Permanent Global Note against presentation and surrender of the Permanent Global Note to the Principal Paying Agent if either of the following events (each, an “**Exchange Event**”) occurs: (a) Euroclear or Clearstream, Luxembourg is closed for business for a continuous period of 14 days (other than by reason of legal holidays) or announces an intention permanently to cease business or (b) any of the circumstances described in Condition 9 (*Events of Default*) occurs.

Under no circumstances will definitive Notes be printed in respect of an amount of Notes which is less than the Minimum Denomination and any Noteholder which on the date on which definitive Notes are issued holds Notes having a nominal amount which cannot be represented by a definitive Note in at least the Minimum Denomination will not be entitled to receive a definitive Note in respect of such Notes or to receive interest or principal in respect of such Notes. The absence of any obligation on the Issuer to print a definitive Note in respect of a holding of Notes which is less than the Minimum Denomination shall not limit any rights of the Noteholder against the Issuer under the Trust Deed and/or any of the other transaction documents in respect of such holding of Notes.

Furthermore, at any meeting of Noteholders while the Notes are represented by a Global Note, any vote cast shall only be valid if it is in respect of at least £50,000 in nominal amount.

Whenever the Permanent Global Note is to be exchanged for Definitive Notes, the Issuer shall procure the prompt delivery (free of charge to the bearer) of such Definitive Notes, duly authenticated and with Coupons and Talons attached, in an aggregate principal amount equal to the principal amount of the Permanent Global Note to the bearer of the Permanent Global Note against the surrender of the Permanent Global Note at the Specified Office of the Principal Paying Agent within 30 days of the occurrence of the relevant Exchange Event.

In addition, the Temporary Global Note and the Permanent Global Note will contain provisions which modify the Terms and Conditions of the Notes as they apply to the Temporary Global Note and the Permanent Global Note. The following is a summary of certain of those provisions:

- (a) *Payments*: All payments in respect of the Temporary Global Note and the Permanent Global Note will be made against presentation and (in the case of payment of principal in full with all interest accrued thereon) surrender of the Temporary Global Note or (as the case may be) the Permanent Global Note at the Specified Office of any Paying Agent and will be effective to satisfy and discharge the corresponding liabilities of the Issuer in respect of the Notes. On each occasion on which a payment of principal or interest is made in respect of the Temporary Global Note or (as the case may be) the Permanent Global Note, the Issuer shall procure that the same is noted in a schedule thereto.
- (b) *Notices*: Notwithstanding Condition 17 (*Notices*), while all the Notes are represented by the Permanent Global Note (or by the Permanent Global Note and/or the Temporary Global Note) and the Permanent Global Note is (or the Permanent Global Note and/or the Temporary Global Note are) deposited with a common depository for Euroclear and Clearstream, Luxembourg, notices to Noteholders may be given by delivery of the relevant notice to Euroclear and Clearstream, Luxembourg and, in any case, such notices shall be deemed to have been given to the

Noteholders in accordance with Condition 17 (*Notices*) on the date of delivery to Euroclear and Clearstream, Luxembourg.

### **USE OF PROCEEDS**

The net proceeds of the issue of the Notes, expected to amount to £396,504,000 after deduction of the combined management and underwriting commission, will be made available on a subordinated basis by the Issuer to the Guarantor by way of the Intercompany Loan, who will, in turn, use the proceeds it receives for general business and commercial activities of the Guarantor and its subsidiaries.

### **YIELD**

The semi-annual yield on each Note shall be 6.077 per cent. This yield is calculated at the Issue Date on the basis of the Issue Price. It is not an indication of future yield.

## DESCRIPTION OF THE ISSUER

### General

RL Finance Bonds plc (the “**Issuer**”) was incorporated in England and Wales on 13 October 2005 under the Companies Act 1985 (as amended) and registered in England and Wales with registered number 5592117. The Issuer is a wholly owned subsidiary of the Guarantor.

The registered office of the Issuer is at 55 Gracechurch Street, London EC3V 0RL and the telephone number is 08708 506070. The authorised share capital of the Issuer is £50,000 divided into 50,000 Ordinary Shares of £1 each. The Issuer had issued 50,000 shares all of which are one quarter paid. The issued shares are held directly or indirectly by the Guarantor, who will control the Issuer.

The Issuer is a special purpose vehicle established for the purpose of issuing securities. Clause 4.2 of the Memorandum of Association of the Issuer describes the principal objects of the Issuer. The Issuer has covenanted to the Trustee in the Trust Deed not to engage in any other activities nor to create, incur or permit to subsist any indebtedness other than in connection with the issue of the Notes.

The ability of the Issuer to pay interest under the Notes will be dependent on the ability of The Royal London Mutual Insurance Society Limited to make payments under the Intercompany Loan.

### Directors

The Directors of the Issuer are as follows:

	<i>Function</i>
Stephen Shone .. .. .	Director
Mike Yardley .. .. .	Director
Paul Langton .. .. .	Director

The business address of the Directors is 55 Gracechurch Street, London EC3V 0RL.

There are no potential conflicts of interest between the duties to the Issuer of each of the Directors and his private interests or other duties.

### Capitalisation

The following table sets out the capitalisation of the Issuer as at 14 October 2005 and has been extracted without material adjustment from the unaudited and unreviewed IFRS special purpose financial information of the Issuer:

	<i>Sterling (£)</i>
Shareholders’ funds:	
Share capital (Authorised 50,000);	
Issued 50,000 Ordinary Shares of £1 each) .. .. .	12,500
<b>Total Capitalisation</b> .. .. .	<b>12,500</b>

As at the date of this Offering Circular the Issuer had no loan capital, borrowing, indebtedness or contingent liabilities.

### Financial Statements

Since the date of incorporation, the Issuer has not commenced operations and no financial statements have been prepared. The Issuer will produce audited financial statements with a financial year ending on 31 December. The Issuer has appointed PricewaterhouseCoopers LLP as its auditors.

## DESCRIPTION OF THE GUARANTOR

### Overview

The Royal London Group (the “**Group**”) consists of the Guarantor and its subsidiaries. The Guarantor, which is a company limited by guarantee and not having share capital, was founded in 1861, initially as a friendly society, and became a mutual life insurance company in 1908. The Guarantor is currently rated A2 (stable outlook) by Moody’s Investor Services for financial strength and has a counterparty credit rating of A- (stable outlook) from Standard & Poor’s.

The Group operates principally in the United Kingdom life insurance and pensions market, with approximately 3 million policy holders and £24.7 billion in funds under management as at 31 December 2004. The Group offers a wide variety of long-term products, including pensions, life assurance and savings and investments, and acts as an intermediary in distributing non-investment insurance products to its customers. The Group provides investment management products and services to third party retail and institutional customers as well. Products are distributed principally under the Royal London, Scottish Life and Bright Grey brands, either directly to customers or through independent financial advisers (“IFAs”).

The Group acquired United Assurance Group plc (“**United Assurance**”) in April 2000 and The Scottish Life Assurance Company (“**Scottish Life Assurance**”) in July 2001. The acquisition of United Assurance increased the Group’s customer base and enabled it to achieve significant cost savings on an on-going basis. The acquisition of Scottish Life Assurance enabled the Group to expand the distribution of its products through access to IFAs, which is now the principal channel for the sale of the Group’s life and pensions products under the Scottish Life brand. All of the long-term business acquired through these acquisitions was subsequently transferred into the Guarantor. These acquisitions have ensured that the Group is now a more broadly based provider of financial services in the United Kingdom.

In March 2003, the Group launched a new protection business under the brand Bright Grey, with the aim of capturing a significant share of the UK protection market.

In mid-2004, the Group decided to close its face-to-face sales force following an in-depth review of its viability. The Group had for some years been working to reposition its retail business model in the light of regulatory changes so as to achieve a profitable position, but reached the conclusion that this could not be achieved in current market conditions. Scottish Life International, its Isle of Man based subsidiary, was also restructured during 2004, in order to align the operating model more closely to the high net worth end of the UK and overseas markets.

The Group’s focus is on the United Kingdom as its core market, but it also pursues a limited strategy of international development, principally through Scottish Life International.

The Group is organised into five business units:

- *Scottish Life which develops new pension products and distributes them through IFAs and other intermediaries;*
- *Bright Grey which develops new protection products and distributes them through IFAs and other intermediaries;*
- *Royal London Asset Management which manages the life and investment funds of the Group in addition to managing funds for external clients;*
- *Scottish Life International which is based in the Isle of Man and specialises in the provision of capital protected investment products and trust solutions; and*
- *Royal London Closed Book which administers the policies previously sold by the sales forces of United Assurance and the Guarantor.*

The registered office of the Guarantor is 55 Gracechurch Street, London EC3V 0RL and the telephone number is 08708 506070. The Guarantor was incorporated as a company limited by guarantee and not having share capital in England and Wales on 31 July 1908 with registered number 99064.



## **Membership of the Guarantor**

The Guarantor is a mutual and therefore has no shareholders and no share capital. The Guarantor has historically funded its activities through retained earnings, and the investment income and capital gains therefrom.

Voting rights in the Guarantor belong equally to its members. The rules determining membership of the Guarantor are set out in its articles of association. These articles have been amended several times, and the membership rules applicable to a given policy may depend on the date such policy was taken out. In general, members include customers with a conventional with-profits contract originally issued by the Guarantor or a contract which has the right from inception to be invested, wholly or partly, in any of the Guarantor's with-profits funds, but not including any customers holding only contracts transferred into the long term funds of the Guarantor from Scottish Life Assurance and companies in the United Assurance Group. A member holding a with-profits product is entitled to participate in the profits generated by the Guarantor. Upon winding up, any surplus is distributable amongst the members. The management of the Guarantor is vested in the Directors who are subject to election by the members at the annual general meeting and, subject to certain exceptions, to re-election at least once every three years thereafter.

## **Strategy**

The Group is committed to becoming a leading producer of financial services products in the United Kingdom. The Group's primary objective is to enhance the appraisal value of the Group by growing profitable businesses that have a secure position in each of their markets. In pursuing this objective, the Group focuses on providing adaptable solutions to its distribution partners that match their needs, and concentrates on protecting the lifestyles of, and providing long term security for, individuals, families and businesses.

In order to achieve these goals, the Group intends to:

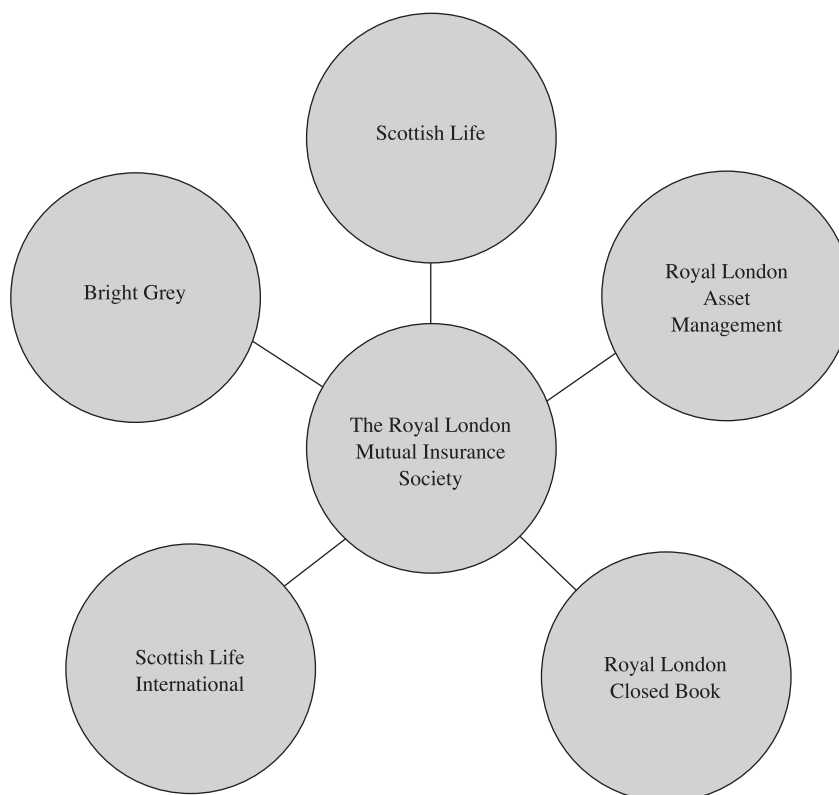
- focus on clearly defined customer segments where the Group can add value;
- build strong relationships and provide active account management with its distribution partners;
- train and develop its staff to provide the highest standards of customer service;
- accelerate product development programmes to provide market leading solutions to its chosen customers;
- provide an investment capability that creates third party demand; and
- invest in technology to deliver rapid development and stable and flexible platforms.

Going forward, the Group intends to build its business by developing further its multi-branded specialist business model to differentiate its propositions to the market and continue to grow market share. Joint ventures, associations and acquisitions will be pursued where they meet the strategic needs of the Group.

As the second largest mutual life assurance company in the UK, the Guarantor's focus is solely on the interests of its members and other customers. The Board of Directors is of the view that mutuality has served its members well and has no plans to change its corporate structure.

## **Organisational Business Units**

The diagram below sets out the business units and reflects how the Group's business is structured and managed. With the exceptions of Royal London Asset Management and Scottish Life International, which are subsidiary companies, the business units are divisions of The Royal London Mutual Insurance Society Limited.



### **Scottish Life**

Scottish Life provides a range of pension products and services through intermediaries, including a wide range of defined contribution arrangements. It is the Group's largest intermediary business and since being acquired by the Group in July 2001 has been a division of the Group specialising in pensions which, on an APE basis, contributed approximately 74 per cent. of the Group's new business in 2004. In addition, *Scottish Life Administration Services* ("SLAS") provides specialist defined contribution pension administration services to life offices and occupational schemes under the brand name, DC Solutions. Separately, Scottish Life also provides administration services to the Closed Book of business acquired from Scottish Life Assurance.

### **Scottish Life International ("SLI")**

SLI was established in 1996 in the Isle of Man and had approximately £630 million in funds under management as at 30 June 2005. SLI re-launched its product offering and restructured its business operations during 2004, developing its service to the high net worth and offshore market. SLI has established a specialist SLI UK sales team and also offers single premium products in South Africa, Germany and Lebanon.

### **Bright Grey**

The Group's protection business, Bright Grey, was launched in March 2003, and provides a variety of protection products, including critical illness, term assurance, income protection and unemployment protection. £18.5 million of APE was written in 2004, in excess of the business plan.

### **Royal London Asset Management ("RLAM")**

RLAM was founded in 1988 and provides fund management services for the Group and third party retail and institutional customers. RLAM was significantly expanded by the integration of United Assurance's and Scottish Life Assurance's asset management operations. As at 30 June 2005, RLAM managed assets of £25.3 billion of which approximately £20.5 billion were assets relating to the Group's life and pensions business with the balance representing third party retail and institutional mandates from just over 200 external clients. RLAM has sought to increase the number of external clients to which it

provides asset management products and services. New investment-only mandates totalled £325 million in 2004.

The table below sets out the division of RLAM's total assets under management as at 30 June 2005 and 31 December 2004 by asset allocation and by product type:

	<b>As at 30 June 2005 (unaudited and unreviewed)</b>	<b>As at 31 December 2004 (unaudited)</b>
	<i>(in millions of pounds)</i>	
<b>Asset Allocation</b>		
Fixed Income .. .. .	10,677	10,115
UK Equities .. .. .	7,437	7,065
Overseas Equities .. .. .	2,226	2,032
Property .. .. .	2,506	2,344
Liquidity .. .. .	2,493	2,229
<b>Total</b> .. .. .	<b>25,339</b>	<b>23,785</b>
<b>Product Type</b>		
Investment Trusts .. .. .	108	108
Unit Trusts .. .. .	1,189	1,046
Institutional Clients .. .. .	682	490
Institutional Clients – Cash .. .. .	1,780	1,652
RL Group Life and Pensions Funds <sup>(1)</sup> .. .. .	21,580	20,489
<b>Total</b> .. .. .	<b>25,339</b>	<b>23,785</b>

Notes:

- (1) Includes Royal London, Scottish Life and staff pension funds.
- (2) In addition to these funds managed by RLAM the Group also has some funds managed by external managers.
- (3) 31 December 2004 numbers are prepared under UK GAAP, and 30 June 2005 numbers are prepared under IFRS.

RLAM aims to maintain its investment performance and build upon its reputation within the industry. It will also continue to expand its product range and funds under management, providing its institutional and retail clients with a wide range of investments.

#### **Royal London Closed Book (“RLCB”)**

RLCB has been established as a separate business unit to deliver a service to its customers that is accurate and reliable, to treat customers fairly by delivering on promises and to add value to the Group through the effective, focused management of the closed book of business.

RLCB managed approximately 5.5 million policies with gross premiums of £0.6 billion in 2004.

## Products

The Group offers a wide range of life and pension products.

The table below shows new business premiums, on an APE basis, for Scottish Life, Bright Grey, SLI and Royal London Closed Book, for the six month period ended 30 June 2005 and the years ended 31 December 2004 and 2003:

	<b>To 30 June 2005 (unaudited and unreviewed)</b>	<b>2004 (unaudited)</b>	<b>2003 (unaudited)</b>
	<i>(in millions of pounds)</i>		
Scottish Life .. .. .	97	160	149
Bright Grey .. .. .	11	18	5
Scottish Life International.. .. .	7	11	13
Royal London Closed Book .. .. .	5	27	34
<b>Total .. .. .</b>	<b>120</b>	<b>216</b>	<b>201</b>

Royal London Closed Book new business was sold by the Group's direct sales force until its closure in 2004 and direct to customers since that time. All other new business was transacted via independent intermediaries.

The Group is able to offer a wide range of pensions services to intermediaries and employee benefit consultants ("EBCs"), including packaged pension products through Scottish Life and tax efficient risk-defined packaged investment products through Scottish Life International. The Group's new protection business, Bright Grey, offers a range of protection products, including critical illness, term assurance, income protection and unemployment protection. In addition, the Group provides investment only services through RLAM.

## Distribution

Scottish Life sells its products exclusively through EBCs, IFAs and whole of market intermediaries. It employs a team of 100 consultants, operating from 10 offices in the United Kingdom, who liaise with intermediaries around the country. In addition it has established specialist teams which focus on liaising with the larger national brokers and EBCs. It has also developed a web-based administration system which allows intermediaries to track the progress of new business, make policy changes and perform other functions which were traditionally completed in meetings or over the telephone.

Bright Grey provides individual life and critical illness protection products via IFAs and other independent distributors throughout the UK. It has no branches and no traditional broker salesforce. Instead, it has a small team of partnership directors who work closely with the product, service and communications teams to create relationships with key IFA firms and other potential distribution partners to help them develop their protection businesses. It has also formed associations with experts who are able to provide customers with support on a range of matters including medical concerns and legal issues.

SLI sells via investment intermediaries in the UK, South Africa, Germany and the Lebanon. It provides a secure extranet facility to enable registered intermediaries to enquire about their SLI client portfolios, to switch funds or receive policy valuations.

## The Investment Portfolio

The Group operates two with-profits funds: the Scottish Life Fund, a closed fund established on 1 July 2001 which includes all the acquired Scottish Life Assurance with-profits business and deposit administration business together with the associated non-profit benefits; and the Royal London Fund which includes all other with-profits business and into which all new with-profits business is written. The Royal London Fund also contains certain non-profit annuity and life business.

The following table sets out the composition of the Royal London Fund and the Scottish Life Fund broken down by business type as at 30 June 2005:

	<b>Royal London Fund (unaudited and unreviewed)</b>	<b>Scottish Life Fund (unaudited and unreviewed)</b>
	<i>(in millions of pounds)</i>	
<b>Business Type</b>		
With-profits .. .. .	9,013	3,493
Non-profit non-linked/deposit administration .. .. .	1,213	1,004
<b>Total</b> .. .. .	<u>10,226</u>	<u>4,497</u>

The Group aims to maximise long-term returns for its with-profits funds while maintaining its financial strength. The following table sets out the distribution of the investments backing the liabilities of these two funds as at 30 June 2005:

	<b>Royal London Fund (unaudited and unreviewed)</b>	<b>Scottish Life Fund (unaudited and unreviewed)</b>
	<i>(in millions of pounds)</i>	
<b>Asset Class</b>		
UK Equities .. .. .	3,337	615
<i>Overseas Equities</i> .. .. .	635	247
North America .. .. .	73	45
Japan .. .. .	130	58
Other Far East .. .. .	179	57
Europe (excluding the United Kingdom) .. .. .	253	83
Other International .. .. .	–	4
UK Bonds .. .. .	4,098	3,138
Overseas Bonds .. .. .	166	17
Index Linked Gilts .. .. .	167	2
Cash .. .. .	253	0
Property-UK .. .. .	1,244	232
Derivatives .. .. .	29	118
Other .. .. .	297	128
<b>Total</b> .. .. .	<u>10,226</u>	<u>4,497</u>

#### Staff Pension Scheme

The Group operates a funded, defined benefit scheme: Royal London Group Pension Scheme (“**RLGPS**”). Previously, the Group operated four principal defined benefit schemes: The Royal London Staff Pension Fund (“**RLSPF**”), United Friendly Group Pension Scheme (“**UFGPS**”), Scottish Life Officers’ Retirement Benefits Scheme (“**SLORBS**”) and RLGPS. On 31 December 2003 the assets and liabilities of RLSPF, UFGPS and SLORBS were transferred into RLGPS which became the sole pension scheme.

The Group has adopted the requirements of Financial Reporting Standard 17 ‘Retirement Benefits’. The position of the scheme is assessed annually by an independent qualified actuary. The latest actuarial valuation of the scheme was carried out as at 31 December 2004 and on the basis required for FRS17 showed a surplus of £43 million.

## **Investment Policy**

The investment strategy pursued by RLAM is to invest a portion of each of the Royal London Fund and Scottish Life Fund in a range of well-researched equity shares both in the United Kingdom and overseas. This type of investment has produced the highest returns over the medium to long-term and is expected to do so in the future. In addition, a significant percentage of the funds under management is required to be invested in high quality fixed income securities which provide fixed returns. The level of fixed income security investments is set with regard to the requirements of the non-participating policies, the guaranteed benefits provided under with-profits policies and the availability of regulatory capital.

With respect to equity investments, RLAM seeks to add value by taking active positions in stocks based on its research and evaluation process to drive portfolio outperformance. RLAM applies selection criteria that it believes will identify companies that are well managed with a sustainable competitive advantage. RLAM operates within agreed asset allocation limits that take account of the composition of the FTSE All-Share Index. An active programme of visits with companies is carried out to keep in contact with company management.

RLAM's fixed income philosophy is centred on value investing and on the belief that corporate bonds will outperform gilts in the long term and that the corporate bond market has inefficiencies that can be exploited through skilled security selection.

RLAM's policy with respect to property is to concentrate upon appropriate property selection with the aim of providing outperformance within the level of risk dictated by the Group. RLAM analyses each individual asset and invests in those that it believes have the best performance prospects over the medium term. In each transaction, RLAM analyses the risk attached to tenants, location and lease lengths to ascertain whether the price being paid adequately reflects the associated risks.

## **Bonus Policy**

The Group seeks to maintain as high a level of investment in equity and property as is consistent with the investment strategy for with-profits business, the levels of guarantees and the requirement to have an appropriate margin in excess of the statutory minimum capital requirement. Any surplus which the Board of Directors resolves to distribute is distributed to with-profits policyholders broadly in proportion to their asset shares. Asset shares are estimates of the value of individual policies and are determined as an accumulation of premiums received and investment return achieved, including capital appreciation and, in some cases, with a contribution from miscellaneous profits, less charges for risk benefits, expenses, tax and guarantees. Asset share investigations are carried out annually (or more frequently if appropriate) in order to assist in making bonus declarations.

Reversionary bonuses across the Group are declared annually in line with trends in the expected future return on longer dated fixed income securities. Such returns have fallen in recent years, consistent with the transition into a low inflation environment and consequently reversionary bonus rates have fallen as well. For business written from 1 January 2001, terminal bonuses are determined such that the total maturity payout approximately equates to the asset share, with an adjustment for smoothing of short term fluctuations which may be positive or negative, so that changes in the levels of total with-profits claim payments reflect medium to long term trends. For business written prior to 2001, asset shares may be enhanced by miscellaneous profits.

In 2004, reversionary bonuses of £79 million and terminal bonuses of £150 million were allocated, compared with £85 million and £202 million, respectively, in 2003.

## **Risk Management**

The Group has established committees and procedures for managing risks, including a Group Risk Committee and a Capital Management Committee as described below together with a description of the operational and financial risks applicable to the Group.

### **Group Risk Committee**

The role of the Group Risk Committee is to ensure that adequate risk management systems are in place, that key risks are being properly managed and that consideration of potential risks forms a part of all decision making throughout the Group.

The Committee includes the Group Chief Executive, the Group Finance Director, the Group Executive Director (who is the executive director responsible for risk, compliance and audit), the Group Legal Director, the With Profits Actuary, the Group Risk and Compliance Director, the Group Actuary and the Head of Internal Audit.

### **Capital Management Committee**

The capital position of the Group is monitored by the Capital Management Committee. This committee meets monthly, is chaired by the Group Finance Director and reports via the Group Chief Executive to the investment committee, a committee of the Board of Directors. The role of the Capital Management Committee is to monitor the Group's capital position and to ensure that it is both maintained within its target range and is sufficient to enable the Group to fulfil its stated core strategic objectives as determined by the Board of Directors from time to time.

### **Regulatory Capital Position**

#### ***Statutory Solvency Position***

Information on the financial position of the Guarantor is contained in the FSA Return (as further described under the "*United Kingdom Regulation of Insurance Business – Regulatory Reporting*"). The FSA is required to monitor the financial position of all UK life assurance companies and requires each to hold sufficient assets to cover its contractual liabilities together with its prescribed capital requirements. The Guarantor manages its ongoing financial position in such a way that it will continue to meet these capital requirements under a wide range of business scenarios and investment conditions.

There is no single measure that properly summarises the financial strength of a life assurance company, nor that allows direct comparisons of financial strength of different life assurance companies. This is because valuations of different companies are not on the same bases and the liabilities are not all of the same kind. Nevertheless, one measure often looked at is the CRR Cover Ratio ("**CRR**" being the Capital Resources Requirement as described in "*United Kingdom Regulation of Insurance Business – Prudential Regime*"). The CRR Cover Ratio represents the ratio of the total capital resources available to meet the CRR. Following the implementation of the PRU (as defined in "*United Kingdom Regulations of Insurance Business – Prudential Regime*") changes in the treatment of the Resilience Capital Requirement ("**RCR**") (as described in "*United Kingdom Regulation of Insurance Business – Prudential Regime*") and the CRR for insurance subsidiaries mean that the CRR is not prepared on a consistent basis in 2004 compared to earlier years.

The following table summarises key figures relating to the solvency of the Guarantor taken from the published FSA Returns with comparative figures from the first half of 2005. This table has not been adjusted to take account of the issue of the Notes.

	<b>30 June 2005 (unaudited and unreviewed)</b>	<b>31 December 2004</b>
	<i>(in millions of pounds)</i>	
<b>Capital Resources</b>		
<b>Total capital resources after deductions (A)</b> .. .. .	2,215*	1,882*
<b>Capital requirements</b>		
Minimum Capital Requirement.. .. .	955	811
With-Profits Insurance Capital Component .. .. .	430	331
<b>Total Capital Requirement (B)</b> .. .. .	1,385	1,142
Excess of available capital over CRR .. .. .	830	740
CRR cover ratio (A/B).. .. .	160%	165%

\*Tier 2 capital £125 million

The increase in capital resources of £333 million over the first six months of 2005 is after a reduction of £162 million in the implicit item for future surpluses (from £237 million to £75 million), resulting in an increase of £495 million before the implicit item. The major factors contributing to this are shown in the table below:

	<b>Open Funds (unaudited and unreviewed)</b>	<b>Closed Funds (unaudited and unreviewed)</b>	<b>Total (unaudited and unreviewed)</b>
	<i>(in millions of pounds)</i>		
<b>Capital resources at 31 December 2004</b> .. .. .	<b>1,168</b>	<b>714</b>	<b>1,882</b>
Changes in valuation interest rates .. .. .	(34)	(112)	(146)
Changes in mortality assumptions .. .. .	0	0	0
Other valuation basis changes .. .. .	0	0	0
Reduction in implicit item.. .. .	(162)	0	(162)
Investment return net of associated liability changes ..	354	286	640
Surplus distributed to with profit policyholders .. .. .	(34)	(33)	(67)
Net Other.. .. .	10	58	68
<b>Capital resources at 30 June 2005</b> .. .. .	<b>1,302</b>	<b>913</b>	<b>2,215</b>

Although the total capital resources have increased by £333 million, the CRR has increased by £243 million, mainly due to the RCR increasing by £136 million and the WPICC increasing by £99 million. As investment markets continue to recover we would expect to remain on the realistic peak under the twin peaks test so that the WPICC will continue to grow. Consequently excess regulatory capital will continue to increase more slowly than surplus reported under the old reporting regime.



### **Realistic balance sheet**

The Guarantor is required to produce a realistic balance sheet, as further described in “*United Kingdom Regulation of Insurance Business – Prudential Regime*”. The table below shows the realistic balance sheet as at 30 June 2005 together with a comparison with the year end position.

	<b>Open Funds (unaudited and unreviewed)</b>	<b>Closed Funds (unaudited and unreviewed)</b>	<b>30 June 2005 Total (unaudited and unreviewed)</b>	<b>31 December 2004 Total (unaudited)</b>
<i>(in millions of pounds)</i>				
<b>Realistic With-Profits balance sheet</b>				
Total statutory realistic with-profits assets	6,160	7,107	13,267	13,003
Value of in force business on realistic basis	882	113	995	925
Current liabilities and subordinated debt	(206)	(216)	(422)	(424)
<b>Total With-profits assets</b> .. .. .	<b>6,836</b>	<b>7,004</b>	<b>13,840</b>	<b>13,504</b>
Realistic Liabilities – with profits benefits				
reserve .. .. .	4,679	6,143	10,822	10,635
– costs of smoothing .. .. .	237	11	248	294
– guarantees .. .. .	487	268	755	734
– options (guaranteed annuities) .. .. .	133	294	427	388
– other .. .. .	101	(89)	12	(9)
<b>Total With-profits liabilities</b> .. .. .	<b>5,637</b>	<b>6,627</b>	<b>12,264</b>	<b>12,042</b>
<b>Working capital*</b>	<b>1,199</b>	<b>377</b>	<b>1,576</b>	<b>1,462</b>
– closed fund transfer commitments ..	–	(377)	(377)	(400)
<b>Excess of Assets over Liabilities</b> .. .. .	<b>1,199</b>	<b>–</b>	<b>1,199</b>	<b>1,062</b>
Risk Capital Margin .. .. .	256	–	256	277

\*before closed fund transfer commitments

The realistic balance sheet methodology can be broadly described as placing a market value on both the assets and with-profits liabilities, including both benefits already guaranteed and future discretionary benefits. Additionally, the value of future profits on all acquired in-force long-term business as well as on non-participating business issued by the Guarantor may be included as an asset. With-profits liabilities comprise the with-profits benefits reserve plus the costs of smoothing plus the value of guarantees and options which have been granted to policyholders. The with-profits benefits reserve for a policy is the asset share as described under “*Description of the Guarantor – Bonus Policy*”. When calculating these liabilities, allowance has been made for actions that management would be expected to undertake on key assumptions, for example future bonus or investment policy in varying market conditions, in line with the Principles and Practices of Financial Management for the Royal London Fund and the Scottish Life Fund.

Under the terms of the Court-approved schemes that led to the transfer of the closed funds, the Guarantor agreed to distribute any excess assets attributable to those businesses solely to those groups of policyholders. This means that for the purpose of the capital statement all excess assets associated with these policies, amounting to £377 million at 30 June 2005, are reported as liabilities because they are not available for distribution to other policyholders or for other business purposes. However those excess assets are available to provide support to the relevant policies under stressed financial conditions before any call on the reported excess capital within the open funds need be made.

### **The Regulatory Regime**

The published solvency positions prior to 31 December 2004 were calculated in accordance with IPRU(INS) (as defined in “*United Kingdom Regulation of Insurance Business – Prudential Regime*”). The published solvency position at 31 December 2004 was calculated in accordance with the PRU, which superseded IPRU(INS) with regard to capital resources with effect from 31 December 2004. The PRU introduced substantial changes to valuation methodology and to the information disclosed within the FSA Returns (these changes are described further in “*United Kingdom Regulation of Insurance Business – Prudential Regime*”). The main impact of these changes on the solvency position of the Guarantor at

31 December 2004 was the introduction of the WPICC, RCM (each as defined and described further in “*United Kingdom Regulation of Insurance Business – Prudential Regime*”) and the consequent move to a gross premium reserve basis for the with-profits business.

### ***Capital Resources and Capital Requirements***

Under the PRU, available capital resources are divided into different categories, or tiers, reflecting the type and quality of the capital. Certain limits are placed on the amount of each type of capital that can be brought into account in different parts of the solvency calculation. At 31 December 2004 these limits did not materially restrict the use of any capital resources within the Guarantor.

### ***Implicit Items***

For reporting at each year end from 2000 onwards, the Guarantor received waivers that allowed it to include an asset on the statutory balance sheet in respect of some future profits expected to emerge over time. This asset is known as an implicit item. The values of this implicit item were £700 million at the end of 2000, £830 million at the end of 2001, £830 million at the end of 2002, £350 million at the end of 2003, £237 million at the end of 2004 and £75 million at 30 June 2005. The granting of implicit item waivers is being phased out by 31 December 2009.

### ***With-Profits Insurance Capital Component***

The excess of the realistic peak over the regulatory peak, for any of an insurer’s with-profits funds, is known as the WPICC, as further described in “*United Kingdom Regulation of Insurance Business – Prudential Regime*”.

### **Market and credit risk**

The major exposure to market and credit risk arises through the investments held by the funds. Equity, property and bond investments are subject to market fluctuations, while bond and cash holdings are at risk of counterparty failure. These classes do tend to overlap, for instance changes to the creditworthiness of bonds would influence their market price.

The Group has delegated operational responsibility for the management of significant credit and market exposures to the RLAM executive team, with strategic direction for the management of these risks set by the Capital Management Committee.

The investment policies and procedures stipulate approved counterparties, permitted investments and exchanges as well as detailing specific counterparty ratings and exposure limits covering money markets, derivatives, foreign exchange, equities and fixed interest securities. In the case of derivatives, the policy also details legal, collateral, margining and valuation requirements to minimise value at risk.

The Group invests primarily in higher-grade bonds. Although some bond holdings are unrated formally, where such bonds are held, RLAM carries out its own internal rating analysis and has assessed the vast majority as being of investment grade (i.e. rated BBB or better) with the benefit of good security.

Other credit and market exposures arise from the use of reinsurance. Business is placed only with higher rated reinsurers. A reinsurance committee is in place which selects and monitors the Group’s exposures and creditworthiness of reinsurers. In December 2004, the Group reinsured a substantial proportion of its immediate annuity business to Prudential Retirement Income Limited (PRIL), with a view to ultimately transferring that risk to PRIL. The reinsurance premium was £1.1 billion.

### **Insurance risk**

Insurance risk can arise in a number of situations, for instance if the reserves are inadequate to pay claims, or the claims experience is worse than anticipated or the pricing is inadequate. During 2004 the Group’s data analysis capabilities have been strengthened to understand past experience and anticipate trends. Assumptions relating to mortality, morbidity, expenses and persistency are taken into account when pricing new products. Clear processes and procedures are in place for underwriting. The Product Pricing Approval Committee approves the pricing of new products and examines the assumptions made, while the specialist businesses within the Group monitor the profitability of products.

**Liquidity risk**

Liquidity risk arises from a firm either not having sufficient funds available to meet its obligations as they fall due, or where such funds can only be secured at excessive costs. The Group undertakes monthly cash flow forecasting to indicate the likely liquidity needs.

**Operational risk**

Line management has primary responsibility for managing operational risks and achieving business objectives. In addition, primary risk identification, assessment and control rests with them. The Risk and Compliance function provides oversight that systems of risk management and internal control are working effectively. Internal Audit provides a third level of defence, testing the effectiveness and adequacy of the risk management processes and ensuring compliance with policies and procedures.

**Group risk**

Group risk is the potential impact of risks arising in one or more parts of the Group to which a company belongs, as well as those resulting from its own activities. The main parts of the business which may cause group risk are subsidiary companies, such as RLAM and Scottish Life International, and the Royal London Group Pension Scheme.

Group risk is managed through a robust corporate governance structure which includes group functions that provide specific cross-business support and direction, and Committees and Approved Persons who are appointed and responsible across all business operations. The Royal London Group Pension Scheme's Trustees, who include company representatives, exercise a similar governance role for the scheme; the pension scheme itself has continued to enjoy a healthy surplus throughout 2004.

**Legal Proceedings**

From time to time, the Guarantor may become involved in legal proceedings relating to claims arising out of its operations in the normal course of business, none of which the Guarantor believes would singly have a material adverse effect on its business.

**Related Party Transactions**

During 2004, The Royal London Unit Trust Managers Limited ("RLUTM") operated as the unit trust managers for the unit trust business marketed by the Group. In addition, the Royal London Group Pension Scheme invested in units of various internal linked funds of the Royal London Pooled Pension Company Limited through the medium of insurance policies issued to RLGPS. For information on transactions between these related parties, please see Note 25 to the Guarantor's audited consolidated financial statements for the financial year ended 31 December 2004.

**Ongoing Issues**

On 1 January 2001 the long term businesses of Refuge Assurance and United Friendly Insurance were transferred to the Guarantor under the provisions of Section 49 and Schedule 2C of the Insurance Companies Act 1982. The Guarantor is corresponding with HM Revenue and Customs as to the correct tax treatment of the transfers in the transferor companies. The Guarantor's advisers have indicated that in their view there is a very low risk that the Revenue would be successful in demonstrating the current treatment is incorrect. If a liability did arise the Guarantor expects that it would not exceed £60 million.

## DIRECTORS OF THE GUARANTOR

The current composition of the Directors is follows:-

Name	Position	Date Initially Appointed
Hubert Reid	Chairman	April 1996
Tim Melville-Ross	Deputy Chairman	June 1999
Mike Yardley	Group Chief Executive	November 1989
Stephen Shone	Group Finance Director	January 1999
Brian Duffin	Executive Director	July 2001
Trevor Bish-Jones	Non-Executive Director	October 2005
Robert Jeens	Non-Executive Director	May 2003
Tom Ross	Non-Executive Director	July 2001
Fields Wicker-Miurin	Non-Executive Director	January 2003

The business address of the Directors is 55 Gracechurch Street, London EC3V 0RL.

*Hubert Reid, Chairman.* Hubert Reid was appointed to the Board as a Non-Executive Director in April 1996 and became Non-Executive Deputy Chairman in January 1997 and Chairman in July 1999. He was managing director and then chairman of the Boddington Group plc (1984 to 1995), and was chairman of Istock PLC and Bryant Group plc. He is chairman of Enterprise Inns plc and Midas Income and Growth Trust PLC, deputy chairman of Majedie Investments PLC and a non-executive director of Michael Page International plc. Hubert has over 33 years' continuous experience as a director of listed companies. Hubert Reid has announced his intention to retire as Chairman and as a director at the end of 2005. The Board intends to invite Tim Melville-Ross, the Deputy Chairman to succeed him.

*Tim Melville-Ross, CBE, Deputy Chairman and Senior Independent Director.* Tim Melville-Ross was appointed to the Board in June 1999. He was chief executive of the Nationwide Building Society from 1985 to 1994 and director-general of the Institute of Directors from 1994 to 1999. He is chairman of Investors in People UK, DTZ Holdings plc, Manganese Bronze Holdings plc and Bank Insinger de Beaufort NV, Chairman of Bovis Homes Group plc and a non-executive director of Equity Trust SARL and Katalyst Ventures Ltd. He is also Chairman of the Council of the University of Essex.

*Mike Yardley, FIA, Group Chief Executive.* Mike Yardley has spent more than 29 years working in the insurance and investment industries in the UK. He took up his current position in April 1998 having spent the previous 5 years as Executive Chairman of Royal London Asset Management. He joined the Guarantor in 1978 after 3 years at Pearl Assurance. In 1988 he was instrumental in forming the new asset management subsidiary of the Group, a manager of third party assets. Mike was appointed to the Board of Directors of the Guarantor in November 1989. He is a Fellow of the Institute of Actuaries, a member of the Life Insurance Committee of the Association of British Insurers and a founder Director of the Association of Mutual Insurers.

*Stephen Shone, BSc (Econ), FCA, Group Finance Director.* Stephen Shone was appointed to the Board in January 1999 when he joined the Guarantor as Group Finance Director. He trained as a chartered accountant with KPMG and has 17 years' experience in the financial management of life companies. On leaving KPMG in 1987 he became finance director of Prolific Group. From 1990 to 1998 he was with Irish Life plc based in Dublin and St Albans, where he held a number of posts, including group chief financial officer from 1996 to 1998.

*Brian Duffin, MA, FFA, Executive Director.* Brian Duffin was appointed to the Board on 1 July 2001 following the acquisition of Scottish Life. He joined Scottish Life in 1976 and has significant experience of investment management and marketing. He qualified as an Actuary in 1979. He was appointed to the Board of Scottish Life in 1996 and became its Group Chief Executive on 1 January 1999.

*Robert Jeens, FCA, Non-Executive Director.* Robert Jeens was appointed to the Board in May 2003. He is chairman of the Audit Committee. He was an audit partner in Touche Ross and Co. (now Deloitte), and in 1992 became finance director of Kleinwort Benson Group plc. From 1996 to 1999 he was group finance director of Woolwich plc. He is currently a non-executive director of TR European Growth Trust PLC and Dialight plc and chairman of a number of private companies.

*Tom Ross, OBE, FFA, Non-Executive Director.* Tom Ross was appointed to the Board as a Non-Executive Director on 1 July 2001 following the acquisition of Scottish Life. He was a partner with Clay & Partners from 1976 to 1993 and, since then, has been principal and actuary with Aon Limited (formerly Alexander Clay). He was appointed to the Board of Scottish Life as a non executive director in 1996, became deputy chairman in 1998 and chairman in 1999. He is chairman of Penta Capital Partners (Holdings) Limited and of the Pension Policy Institute and a director of the Edinburgh UK Tracker Trust plc. He is a past President of the Faculty of Actuaries.

*Fields Wicker-Miurin, Non-Executive Director.* Fields Wicker-Miurin was appointed to the Board in January 2003. She is also a non-executive director of Savills plc, the Carnegie Group AB and the CDC Group. She is co-founder of Leaders' Quest (an international non-profit leadership development organisation). She is on the Executive Board of DTI, chairs its Investment Committee and is a member of the Government's Technology Strategy Board. She is a member of the Nasdaq Technology Advisory Council in New York, and is one of ten experts advising the European Parliament on financial services issues. Previously Fields was chief financial officer and director of strategy at the London Stock Exchange. She brings more than 20 years' experience within financial services.

*Trevor Bish-Jones, Non-Executive Director.* Trevor Bish-Jones was appointed to the Board as a Non-Executive Director on 14 October 2005. He is the Chief Executive of Woolworths Group plc having been appointed to that position in March 2002. Prior to that, he held various senior positions at Dixons Group plc between 1994 and January 2002, latterly as Managing Director of Currys, and was at Boots PLC for 13 years in a number of senior retail, buying and marketing roles.

There are no potential conflicts of interests between the duties to the Guarantor of each of the Directors and his/her private interests or other duties.

## STATEMENT OF INDEBTEDNESS OF THE GUARANTOR

The following table sets out the consolidated indebtedness of the Guarantor as at 31 December 2004 and 30 June 2005. The information as at 31 December 2004 has been extracted without material adjustment from the Guarantor's 2004 restated financial information and the unaudited and unreviewed consolidated financial information for the six months ended 30 June 2005. As the Guarantor is a mutual life assurance company, it does not have any share capital.

	<b>As at 30 June 2005 (unaudited and unreviewed)</b>	<b>As at 31 December 2004 (unaudited)</b>
<i>(in millions of pounds)</i>		
<b>Indebtedness</b>		
Amounts owed to credit institutions		
Less than one year .. .. .	15	43
Between one and two years .. .. .	–	–
More than two years but less than five years .. .. .	27	16
More than five years .. .. .	4	4
Total amount owed to credit institutions .. .. .	46	63
Amounts owed to other creditors		
Loan stock .. .. .	5	6
Other creditors including social security.. .. .	116	85
Subordinated Liabilities.. .. .	125	125
Finance lease commitments .. .. .	20	13
Total amounts owed to other creditors .. .. .	266	229
Total indebtedness .. .. .	312	292

## UNITED KINGDOM REGULATION OF INSURANCE BUSINESS

### *Introduction*

The Guarantor is a United Kingdom authorised insurance company and is subject to the regulation and supervision of the FSA under the FSMA. Apart from FSMA, the Guarantor must also comply with the rules made by the FSA under powers granted by FSMA. An important source of these rules and guidance is the Integrated Prudential Sourcebook (“**PRU**”).

### *Permission to transact business*

Subject to the exemptions provided in the FSMA, no person may carry on insurance business in the United Kingdom unless permitted to do so under the FSMA by the FSA. The FSA, in deciding whether to grant permission, is required to determine whether the applicant satisfies the requirements of the FSMA to be engaged in insurance business, known as threshold conditions, and in particular whether the applicant has and will continue to have adequate resources and that it is and will continue to be a fit and proper person having regard to all the circumstances (including whether the applicant’s affairs are conducted soundly and prudently). A permission to carry on insurance business may include such requirements as the FSA considers appropriate.

In specific circumstances, the FSA may vary or cancel an insurer’s FSMA permission to carry on a particular class or classes of business or insurance business generally. The circumstances in which the FSA can vary or cancel a FSMA permission include a failure to meet the threshold conditions or where such action is desirable in order to protect the interests of consumers or potential consumers.

The Group also carries out other activities, including managing investments belonging to another person and giving investment advice, which require permission from the FSA under the FSMA.

### *Regulatory reporting*

UK insurance companies have to prepare their accounts in accordance with special provisions applicable to them under the Companies Act 1985, and are required to file audited financial statements and related reports. Insurance companies are separately required to deposit with the FSA an annual return comprising audited accounts and other prescribed documents within three months of the end of the relevant financial year, if the deposit is made electronically, and otherwise within two months and fifteen days of the end of the relevant financial year.

### *Principles and Practices of Financial Management*

All UK providers of with-profits life policies, such as the Guarantor, are required by the FSA to document and make available the principles and practices of financial management (“**PPFM**”) that describe how they operate their UK with-profits business. The areas that need to be covered in the PPFM are prescribed by the FSA and must be set out in terms of “principles” (enduring statements of the overarching standards that apply) and “practices” (more detailed statements on the current approach adopted). From 2006, such providers are required to report each year to their UK with-profits policyholders on their compliance with the PPFM in the previous year, and any changes or proposed changes to it.

In addition, the FSA has introduced a requirement to publish Consumer Friendly Principles and Practices of Financial Management (“**CFPPFM**”), which are intended to provide information to with-profits policyholders or potential policyholders in a format that they can more readily understand. The requirement to produce a CFPPFM takes effect on 31 December 2005. The Guarantor expects to publish CFPPFM in December 2005 which recognise the company’s obligations to treat customers fairly.

### *Prudential regime*

Individual companies permitted to carry on insurance business in the United Kingdom are required to maintain a minimum level of assets (referred to as regulatory capital) in excess of their liabilities. Rules in respect of regulatory capital for insurers are provided for in various EU directives and rules derived from these requirements have been in place in the UK for many years. Prior to 31 December 2004, the rules were contained in the FSA’s Interim Prudential Sourcebook for Insurers (“**IPRU(INS)**”).

### *The Integrated Prudential Sourcebook*

With effect from 31 December 2004, PRU has substantially replaced IPRU(INS), although IPRU(INS) continues to govern certain matters such as the requirements for the annual return. The PRU requirements supplement, rather than replace, the EU regime. The FSA cannot allow a UK authorised insurer which is covered by the EU directives to hold less capital than would be required under the directives. The directive-based regulatory capital regime, therefore, continues to set a minimum capital requirement.

The approach of PRU is to identify the various risks to which insurers are subject, such as credit risk, market risk, operational risk and insurance risk. Some of these risks, such as operational risk, are addressed by way of guidance on the systems and controls which insurers should put in place to mitigate the risk. Other risks, in particular insurance risk, have an explicit regulatory capital requirement.

### *Capital Resources Requirement (“CRR”)*

Under PRU, the required regulatory capital for insurers, referred to as the CRR, consists of various different capital components. All insurers are required to hold at least the “minimum capital requirement” (“MCR”), which is calculated differently for life and non-life firms. Many insurers are also required to calculate an “enhanced capital requirement” (ECR) which is intended to provide a more risk responsive measure of insurers’ capital requirements. For long term insurance firms having more than £500 million of with-profits insurance liabilities (such as the Guarantor), CRR is the higher of MCR and ECR.

Further explanations of the MCR and ECR as they affect long term insurers are set out below.

### *Minimum Capital Requirement (MCR)*

MCR is broadly speaking equivalent to the previous required minimum margin under IPRU(INS) and its inclusion in PRU ensures the minimum EU standards are maintained.

MCR is the higher of (i) the base capital requirement and (ii) the sum of the “long term insurance capital requirement” (“LTICR”) and the “resilience capital requirement”.

The base capital requirement is an EU specified minimum capital requirement (expressed as an absolute amount in Euro) which differs for various classes of insurer. Broadly speaking, LTICR is approximately calculated as 4 per cent. of the mathematical reserves of the insurer but the precise formula varies for different classes of business. Mathematical reserves are, in effect, the insurer’s provisions for its life insurance liabilities setting off expected future cash flows from in-force business. The general principle is that mathematical reserves must be set using an actuarial valuation on prudent assumptions which, amongst other things, take into account the insurer’s regulatory duty to treat its customers fairly. The resilience capital requirement is an additional UK requirement which requires capital to be set aside against the potential effects of market risk. Additional capital is required if the effect of stressed market conditions would be that asset values would fall by more than the reduction in mathematical reserves.

### *Enhanced Capital Requirement (“ECR”)*

This is intended to operate as a separate, more risk sensitive measure than the MCR. In overview, the ECR for long term insurers only applies as a prudential requirement if the firm has more than £500 million of with-profits liabilities (such firms, the Guarantor being an example, being known as “realistic basis life firms”). Determination of the ECR for such firms involves the comparison of two separate means of measuring the firm’s financial resources requirements. The FSA has termed this the “twin peaks” approach. The two separate “peaks” are as follows:

- (i) the financial resources requirement comprising the mathematical reserves plus the sum of LTICR and the resilience capital requirement. This is essentially the financial resources of the firm measured on the EU basis, as represented by the mathematical reserves and the MCR. This is known as the “regulatory peak”; and
- (ii) a calculation of the firm’s financial resources requirement calculated by reference to the “realistic” present value of the firm’s expected future contractual liabilities together with projected “fair”



discretionary bonus payments to policyholders. The assessment of what is a “fair” discretionary bonus payment will depend upon what is required to treat the policyholders fairly and this, in turn, is linked to the requirements on with-profits governance and, in particular, the requirement that with-profits insurers have to publish PPFM setting out how the insurer intends to exercise its discretion under with-profits policies. In addition, the FSA requires a margin or buffer to be added to the realistic liabilities calculation to cater for risk. Called the risk capital margin (“**RCM**”), this addresses risk factors, such as market, credit and persistency risks, the effect of which could otherwise render the realistic calculation insufficient. The realistic liabilities and RCM are together known as the “realistic peak”.

If the calculation of the realistic peak, including the RCM, produces a resources requirement in excess of the regulatory peak for any of an insurer’s with-profits funds, then the difference will give rise to a capital requirement known as the “with-profits insurance capital component” (“**WPICC**”) to cover the difference. ECR for a realistic basis life firm is the sum of the LTICR, the resilience capital requirement and the WPICC. If the realistic peak is lower than the regulatory peak, the WPICC will be zero and the ECR and MCR will be the same, meaning that the EU-based MCR approach will be applicable.

For a realistic basis life firm, whether the regulatory peak or the realistic peak produces the higher overall financial resources requirement (reserves plus capital requirement) for any given with-profits fund depends largely on the prevailing market conditions and the degree of prudence in calculation of the mathematical reserves.

#### *Individual Capital Assessment (ICA)*

In addition to the CRR, the FSA requires all insurance firms (whether or not they calculate an ECR) to carry out an Individual Capital Assessment (“**ICA**”). Firms are required to conduct stress and scenario testing to determine the overall adequacy of their financial resources and make a reasonable assessment of their capital needs for their business overall. For firms which do calculate an ECR, this provides a benchmark for the determination of the ICA but the ICA should also take account of any factors which are particular to the firm which are not sufficiently covered by the scope of the ECR.

The ICA assists the FSA to provide Individual Capital Guidance (“**ICG**”) to firms on a confidential basis. ICG is set with reference to the specific business and control risks faced by each individual company and takes account of the company’s ICA and any margins elsewhere in the business. Companies that can demonstrate that they have identified and have assessed their risks and have appropriate controls to mitigate those risks can expect to receive a lower ICG.

ICG is only guidance (and not a formal prudential requirement) although the FSA has indicated that it would expect to be notified of a failure to maintain capital at a level advised in the ICA (or ICG, if applicable) and, on becoming aware of such a failure, the FSA has indicated that they expect to require firms to set out a plan to restore adequate capital.

#### *Treating customers fairly*

One of the regulatory objectives of the FSA, as established by the FSMA, is securing the appropriate degree of protection for consumers. Consequently the fair treatment of customers is a key objective for the FSA and all authorised insurance companies are under a regulatory duty to pay due regard to the interests of their customers and treat them fairly. This duty exists alongside other, more specific, rules contained in the prudential regime and is increasingly being seen by the FSA and authorised insurance companies as governing all aspects of an insurance company’s dealings with its customers. Except in relation to with-profits policyholders, the meaning of the duty has not been further defined beyond the ordinary English meaning of the word “fair” although the FSA has published examples of what in their view constitutes fair treatment in a series of case studies.

New rules and associated guidance on treating with-profits policyholders fairly were introduced by the FSA on 30 June 2005 (or, in some cases, will be introduced on 31 December 2005). The objective behind these provisions is to codify good practice in the industry on how insurance companies determine policy payouts, surrender values, charges to with-profits funds and the terms for new business. When a fund closes to new business the insurance company will be required to notify both the FSA and affected

policyholders promptly, inform policyholders of the options available to them and submit a run-off plan to the FSA.

#### *The Insurance Groups Directive (“IGD”)*

This EU directive introduced new supervisory arrangements (which have been implemented in the UK via PRU) for insurance companies falling within a group, including a supplementary capital calculation to be performed at parent company level. A calculation analogous to the regulatory capital test applied to individual insurers is required which takes into account net assets of the parent and its share of surplus assets of its related insurers, reinsurers and intermediate holding companies.

The IGD currently does not impose any capital requirement on the parent undertaking itself, but merely requires the calculation to be performed by the insurance company and privately reported to the FSA one month after its annual return. Any FSA response must then be directed at the level of the insurance company. The FSA has, however, indicated that the parent company solvency calculation will become a continuous “hard” capital requirement from 31 December 2006 and will be a public reporting requirement from 31 December 2005 (this latter proposal has been the subject of recent consultation by the FSA, the outcome of which is awaited).

The IGD contains further provisions for monitoring intra-group transactions, including at least annual reporting of significant transactions. Insurers must also be required to have appropriate internal control mechanisms to allow the production of data/information relevant to supervision under the IGD.

#### *Supervision and Enforcement*

The FSA has powers to supervise and intervene in the affairs of an insurance company under the FSMA. For example, it can require firms to provide information or documents to it or prepare a “skilled persons” report. It can also formally investigate a firm. It has the power to take a range of disciplinary enforcement actions, including public censure, restitution, fines or sanctions and the award of compensation.

#### *Conduct of Business regulation*

Authorised firms are required to comply with the FSA’s Conduct of Business rules. These rules contain detailed requirements in relation to, among other things, marketing, provision of pre-contractual information and the entry into and terms of customer agreements, provision of advice, dealing and investment management services, customer reporting and the safeguarding of customer assets. Customers are classified as “intermediate” or “private”, with a greater number of rules and protections applying to dealings with private customers. Firms that provide investment advice to private customers are required to ensure the suitability of the products that they recommend.

#### *Compensation Scheme*

The Financial Services Compensation Scheme (“FSCS”) is a safety net for customers of authorised financial services firms. FSCS was created under FSMA and became operational on 1 December 2001 when FSMA came into force. There are transitional arrangements, which allow claims under old schemes in operation prior to 1 December 2001, to be dealt with by the FSCS. FSCS covers business conducted by firms regulated by the FSA in respect of risk situated in the EEA and is funded by levies on authorised firms.

FSCS can pay compensation if an authorised firm is unable, or likely to be unable, to pay claims against it. In general, this is when a firm is insolvent or has gone out of business. FSCS covers deposits, insurance and investments. However, commercial insurance, other than compulsory insurance, is not covered by the FSCS, and reinsurance is also outside its scope. Long-term insurance companies, such as the Guarantor, have been subjected to levies over a number of years. A levy was announced in May 1997 in connection with the pension misselling review on long term (life) insurance companies. Further levies have arisen and may arise in the future.

## **Further regulatory developments**

### ***Solvency II***

The EU is in the process of negotiating a fundamental review (commonly referred to as Solvency II) of the insurance directives. Although expected to involve a risk-based approach along the lines introduced by the FSA through PRU, no firm proposals have yet been adopted and the new regime requirements are not expected to be implemented until 2009 at the earliest.

### ***Pensions simplification***

The Government's proposals for pension tax simplification introduce a new tax regime for pensions which will take effect from 6 April 2006. This will remove the eight existing tax regimes and associated benefit and contribution limits and replace them with a single universal and simplified regime for tax-privileged pensions savings. The Guarantor is in the process of undertaking a substantial development programme to update existing products and introduce new products to support pensions simplification.

### ***Contracting out of the State Earnings Related Pension Scheme ("SERPS")***

In the 1980's it was commonplace for people to contract out of SERPS by way of a rebate into a personal pension contract. Due to the level of rebate during this period it was generally beneficial to contract out. More recently the level of rebates has made the decision to contract out more finely balanced. The industry (in conjunction with the FSA and the Association of British Insurers) is considering how best to approach the issue going forward. In common with other major pension providers, the Guarantor has a considerable number of contracted out policyholders so would be likely to be involved in any action the industry takes.

## **FINANCIAL INFORMATION OF THE GUARANTOR**

The following information is provided:

1. audited consolidated financial statements of the Guarantor for the financial year ended 31 December 2004 prepared on a UK GAAP basis, together with notes, set out on pages 61 to 80;
2. unaudited consolidated balance sheet of the Guarantor as at 31 December 2004 and the unaudited and unreviewed consolidated balance sheet of the Guarantor as at 30 June 2005 prepared in accordance with IFRS, set out on page 87;
3. unaudited consolidated income statement of the Guarantor for the twelve month period ended 31 December 2004 and the unaudited and unreviewed consolidated income statement of the Guarantor for the six month period ended 30 June 2005 prepared in accordance with IFRS, set out on page 88; and
4. recent accounting developments, set out on page 81.

The following financial information has been extracted without material adjustment from the audited consolidated financial statements of the Guarantor as at 31 December 2004 which has been prepared in accordance with generally accepted accounting principles in the United Kingdom.

## Consolidated profit and loss account for the year ended 31 December 2004

<b>TECHNICAL ACCOUNT – LONG-TERM BUSINESS</b>	Notes	<b>2004 £m</b>	2003 £m
<b>Earned premiums, net of reinsurance</b>			
Gross premiums written	2(i)	<b>1,843</b>	2,329
Outward reinsurance premiums	2(ii)	<b>(1,174)</b>	(16)
		<b>669</b>	2,313
<b>Investment income</b>	3(i)	<b>1,041</b>	943
<b>Unrealised gains on investments</b>	3(iii)	<b>1,117</b>	705
<b>Other technical income, net of reinsurance</b>	4(i)	<b>26</b>	25
<b>Total technical income</b>		<b>2,853</b>	3,986
<b>Claims incurred, net of reinsurance</b>			
Claims paid			
– Gross amount		<b>2,532</b>	2,113
– Reinsurers' share		<b>(3)</b>	(2)
		<b>2,529</b>	2,111
Change in the provision for claims			
– Gross amount		<b>10</b>	2
– Reinsurers' share		<b>(3)</b>	(1)
		<b>2,536</b>	2,112
<b>Change in other technical provisions, net of reinsurance</b>			
Long-term business provision, net of reinsurance			
– Gross amount	15	<b>448</b>	(736)
– Reinsurers' share		<b>(1,125)</b>	(4)
		<b>(677)</b>	(740)
Other technical provisions, net of reinsurance			
Technical provisions for linked liabilities			
– Gross amount	15	<b>406</b>	1,425
– Reinsurers' share		<b>(39)</b>	(14)
		<b>367</b>	1,411
<b>Change in other technical provisions, net of reinsurance</b>			
		<b>(310)</b>	671
<b>Net operating expenses</b>	5	<b>314</b>	286
<b>Investment expenses and charges</b>	3(ii)	<b>72</b>	141
<b>Other technical charges, net of reinsurance</b>	4(ii)	<b>59</b>	257
<b>Tax charge attributable to long-term business</b>	7	<b>67</b>	9
<b>Total technical charges</b>		<b>2,738</b>	3,476
<b>Excess of total technical income over total technical charges</b>			
		<b>115</b>	510
Pension scheme gains/(losses) after tax	26(d)	<b>7</b>	(54)
		<b>122</b>	456
<b>Transfer to the fund for future appropriations</b>	15	<b>(122)</b>	(456)
<b>Balance on the technical account – long-term business</b>		<b>–</b>	–

All of the above results relate to continuing operations.

The overall results of the Group are reflected in the technical account – long-term business. As a mutual company, all earnings are retained for the benefit of policyholders and are carried forward within the fund for future appropriations. Accordingly, there is no balance at the foot of the technical account – long-term business. There are no gains and losses other than those included in the profit and loss account.

## Balance sheets as at 31 December 2004

	Notes	Group		Parent company	
		2004 £m	2003 £m	2004 £m	2003 £m
<b>ASSETS</b>					
<b>Intangible assets</b>					
Positive goodwill	9	98	113	98	113
Negative goodwill		(32)	(38)	(32)	(38)
		66	75	66	75
<b>Investments</b>					
Land and buildings	10	1,625	1,513	1,503	1,365
Investments in Group undertakings		–	–	151	177
Other financial investments		12,608	13,099	12,556	13,007
		14,233	14,612	14,210	14,549
<b>Present value of acquired in-force business</b>	11	449	481	449	481
<b>Assets held to cover linked liabilities</b>	12	6,371	5,976	5,353	4,512
<b>Reinsurers' share of technical provisions</b>					
Long-term business		1,136	11	1,136	11
Claims outstanding		12	8	5	2
Technical provision for linked liabilities		59	20	59	20
		1,207	39	1,200	33
<b>Debtors</b>					
Debtors arising out of direct insurance operations					
– due from policyholders		16	15	16	15
Debtors arising out of reinsurance operations		4	4	4	4
Other debtors	13	72	112	92	173
		92	131	112	192
<b>Other assets</b>					
Tangible assets	14	15	17	–	–
Cash at bank and in hand		94	153	43	103
		109	170	43	103
<b>Prepayments and accrued income</b>					
Accrued interest and rent		112	114	110	112
Deferred acquisition costs		201	212	201	212
Deferred taxation	16	16	51	11	46
Other prepayments and accrued income		13	10	2	3
		342	387	324	373
<b>Total assets excluding pension asset</b>		22,869	21,871	21,757	20,318
Pension asset	26(b)	34	35	34	35
<b>Total assets including pension asset</b>		22,903	21,906	21,791	20,353

	Notes	Group		Parent company	
		2004 £m	2003 £m	2004 £m	2003 £m
<b>LIABILITIES</b>					
<b>Subordinated liabilities</b>	18	<b>125</b>	125	<b>125</b>	125
<b>Fund for future appropriations</b>	15	<b>2,462</b>	2,340	<b>2,462</b>	2,340
<b>Technical provisions</b>					
Long-term business provision	15, 21	<b>13,527</b>	13,079	<b>13,523</b>	13,076
Claims outstanding	15	<b>70</b>	59	<b>59</b>	49
		<b>13,597</b>	13,138	<b>13,582</b>	13,125
<b>Technical provisions for linked liabilities</b>	15	<b>6,399</b>	5,993	<b>5,380</b>	4,529
<b>Provisions for other risks and charges</b>	16	<b>14</b>	17	<b>11</b>	10
<b>Creditors</b>					
Creditors arising out of direct insurance operations		<b>86</b>	95	<b>83</b>	90
Creditors arising out of reinsurance operations		<b>29</b>	2	<b>28</b>	1
Amounts owed to credit institutions	17(i)	<b>63</b>	62	<b>14</b>	29
Other creditors including taxation and social security	17(ii)	<b>64</b>	81	<b>81</b>	80
		<b>242</b>	240	<b>206</b>	200
<b>Accruals and deferred income</b>		<b>64</b>	53	<b>25</b>	24
<b>Total liabilities</b>		<b>22,903</b>	21,906	<b>21,791</b>	20,353

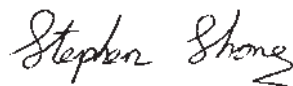
The financial statements on pages 41 to 60 were approved by the Board of Directors and signed on its behalf on 30 March 2005.



**Hubert Reid**  
Chairman



**Mike Yardley**  
Group Chief Executive



**Stephen Shone**  
Group Finance Director

# Notes to the financial statements

for the year ended 31 December 2004

## 1 ACCOUNTING POLICIES

### a. Basis of presentation

The Group financial statements have been prepared in accordance with:

- applicable accounting standards and under the historical cost convention, modified to include the revaluation of investments;
- the Statement of Recommended Practice (SORP) on Accounting for Insurance Business, issued by the Association of British Insurers in November 2003;
- and the provisions of Sections 255 and 255A of, and Schedule 9A to, the Companies Act 1985, except for the treatment of freehold and leasehold investment properties in accordance with Statement of Standard Accounting Practice No. 19. This is set out in note 1h (iii) below.

The balance sheet of the Parent Company has been prepared in accordance with Section 226 of the Companies Act 1985.

All accounting policies have been reviewed for appropriateness in accordance with Financial Reporting Standard 18, 'Accounting Policies'.

### b. Basis of consolidation

The Group financial statements incorporate the assets, liabilities and results of the Parent company and its subsidiaries.

The results of subsidiary undertakings acquired during the period are included in the consolidated results from the date of acquisition. On acquisition of a subsidiary undertaking, all of its assets and liabilities are recorded at their fair values on the date of purchase. Costs incurred directly as a result of acquisitions are included in the cost of acquisition. Interest costs on borrowings used to fund acquisitions are written off as incurred.

### c. Premiums

Premiums, including reinsurance premiums, are accounted for when due for payment except for recurring single premiums and premiums in respect of unit linked business, which are accounted for on a received basis. New business premiums are accounted for when the policy liability is recognised and, in respect of regular premiums, reflect the premiums payable in a full year.

### d. Claims

Death claims are accounted for when notified, surrenders when paid out and maturity and annuity claims when due for payment. For linked policies, claims are accounted for on cancellation of the associated units. Claims payable include related claims handling costs. Reinsurance recoveries are accounted for in the same period as the related claim.

### e. Reinsurance

The Group seeks to reduce its exposure to potential losses by reinsuring certain levels of risk with reinsurance companies. Any asset or liability accounted for represents payments due from or premiums due to reinsurers, and the share of claims recoverable from reinsurers.

### f. Commission

The Group acts as an introducer for certain third party insurers. Commission income and profit commission received on the underwriting results of those insurers is credited to the technical account on an accruals basis and is included in 'other technical income'.

### g. Goodwill

Goodwill, both positive and negative, arising on acquisition of subsidiary undertakings is capitalised in the balance sheet at cost and amortised through the profit and loss account on a straight-line basis, over its useful economic life which has been determined as 10 years.

The carrying value of goodwill arising on acquisitions is reviewed in accordance with Financial Reporting Standard 11, 'Impairment of Fixed Assets and Goodwill'.

The gain or loss on subsequent disposal of a subsidiary undertaking includes any attributable unamortised goodwill.

### h. Investments

#### (i) Investment income and expenses

Investment income comprises interest, rents, dividends receivable and gains on the realisation of investments. Dividends are recorded net of the associated UK tax credits on the date on which the shares are quoted ex dividend. Interest, rents and expenses are accounted for on an accruals basis.

Losses on the realisation of investments are accounted for in 'Investment expenses and charges'.

#### (ii) Realised and unrealised investment gains and losses

Realised gains and losses are calculated as the difference between the net sale proceeds and the original cost. Unrealised gains and losses are calculated as the difference between the current valuation of investments and their valuation at the last balance sheet date or subsequent acquisition. The movement in unrealised gains and losses in the year also includes the reversal of previously recognised gains and losses on investments disposed of in the period.

#### (iii) Investment valuations

All investments, including those classified as assets held to cover linked liabilities, are stated at their current value. Listed securities are valued at mid price, with the exception of holdings in unit trusts which are valued at bid prices. All freehold and leasehold properties, including those occupied by the Group, are regarded as investment properties. These are valued annually, on the basis of open market value, by independent professional valuers who are members of the Royal Institution of Chartered Surveyors.

In accordance with Statement of Standard Accounting Practice No. 19, no depreciation is provided in respect of freehold investment properties and leasehold investment properties. This is a departure from the requirements of the Companies Act 1985 which requires all properties to be depreciated. As depreciation is only one of the factors reflected in the annual valuation, the relevant charge which would otherwise have been shown cannot be separately identified or quantified. This accounting policy is considered necessary for the financial statements to give a true and fair view.

Other investments are valued by the directors on the basis of their estimated open market value. Investments in Group undertakings in the Parent company balance sheet are valued annually by the directors.



### **i. Hedging instruments**

The Group uses hedging instruments, including options and futures contracts.

Purchased options are included at market value under the category of investment to which the underlying value of the contract relates. No adjustment is made to the classification of existing investments to reflect the future settlement of these transactions.

Written options are included at market value and are shown within other creditors. The value included is net of any collateral transferred, where the right of off-set is defined in the underlying contract.

Investment futures contracts are valued at market prices at the year end. All gains and losses on open contracts are treated as unrealised.

### **j. Present value of acquired in-force business (PVIF)**

For long-term business, the PVIF is capitalised and amortised over the remaining lifetime of the related in-force policies. The PVIF is amortised on a systematic basis to reflect the pattern of emergence of profits from these acquired contracts. Amortisation is stated net of any unwind of the discount rate.

The estimated lifetime of these contracts ranges from 10 to 25 years for life business and 20 to 40 years for pensions business.

The carrying value of the asset is assessed annually using current assumptions in order to determine whether any impairment has arisen.

Any amortisation or impairment charge is recorded in the technical account – long-term business, in 'Other technical charges'.

### **k. Tangible assets and depreciation**

Tangible assets are capitalised and depreciated on a straight-line basis over their estimated useful lives which range from three to eight years.

### **l. Deferred acquisition costs**

The costs of acquiring new insurance contracts are deferred to the extent that they are recoverable out of future revenue margins. These costs are disclosed as an asset on the balance sheet.

The rates of amortisation of the deferred acquisition costs asset for each product are consistent with a prudent assessment of the expected pattern of emergence of future revenue margins over the amortisation period for the relevant contracts.

### **m. Fund for future appropriations**

The fund for future appropriations represents all funds whose allocation between specific policyholders has not been determined at the balance sheet date. Any surplus or deficit arising in the technical account – long-term business, is transferred to or from the fund on an annual basis.

### **n. Long-term business provision**

The long-term business provision is calculated initially on a statutory solvency basis to comply with the regulatory reporting requirements laid out in the Integrated Prudential Sourcebook.

This valuation is then adjusted by excluding certain contingency and other reserves required specifically for regulatory purposes and by including provisions for future regular bonuses. Future regular bonuses are only provided for to the extent that they are supported by the valuation assumptions. This adjusted basis is referred to as the modified statutory solvency basis. The principal assumptions used in calculating these provisions are shown in note 21.

Conventional with-profits business is valued on a gross premium method. This calculates the present value of future benefits, which includes both attaching and future regular bonuses, plus the present value of future renewal expenses, less the present value of future premiums payable under the contract. Future regular bonuses are included, to the extent necessary, on a basis consistent with valuation assumptions. There is no allowance within the gross premium method for future terminal bonuses. Future benefits include death, surrender and maturity claims.

For linked business where the benefits are linked to specific pools of assets, the provision is calculated as the number of units allocated to each policy multiplied by a valuation price. Valuation prices are determined using investments valued at the balance sheet date as described in note h. In addition, a cash flow projection, using prudent assumptions, is undertaken for each policy to establish whether or not future inflows are sufficient to cover outflows. If not, an additional provision is included in the long-term business provision.

For accumulating with-profits business, the provision is the greater of:

- a prospective valuation, allowing for future regular bonus additions consistent with valuation interest rates;
- the lower of the bid value of units and surrender value.

### **o. Bonuses**

New regular bonuses declared for the year are provided within the calculation of the long-term business provision. Terminal bonuses paid during the year to policyholders on death, surrender or maturity are included as part of the claims incurred in the technical account.

### **p. Taxation**

Provision is made for taxation at current rates on taxable profits and relievable losses and relief for overseas taxation is taken where appropriate. Deferred taxation is provided on all unrealised gains and other timing differences, between their recognition in the financial statements and their recognition in the tax computations, except that overall assets are only recognised if there is persuasive and reliable evidence that the timing differences will reverse in the foreseeable future. The value of the resultant deferred tax assets and liabilities has been calculated on a discounted basis reflecting the fact that the timing differences are projected to reverse over several years. The discount rates used are the post-tax yields to maturity that could be obtained at the balance sheet date on government bonds with maturity dates similar to those of the deferred tax assets and liabilities.

## Notes to the financial statements for the year ended 31 December 2004

### q. Pension costs

The current scheme is of the funded, defined benefit type. The scheme provides benefits based on final pensionable earnings. The assets of the scheme are held in separate trustee administered funds. The position of the scheme is assessed annually by an independent qualified actuary.

The Group has adopted the requirements of Financial Reporting Standard 17 'Retirement Benefits'.

The aggregate pension scheme asset or liability recognised in the balance sheet is the excess, that is recoverable by the Group, of the value of the assets in the scheme over the present value of the scheme's liabilities. The resulting asset is net of a provision for deferred taxation. Movements in the amount of the pension scheme assets that are recognised, and which are attributable to changes in the membership of the schemes are treated as operating gains and included within net operating expenses. The standard requires certain items to be accounted for through the statement of total recognised gains and losses, which the Group does not prepare as a mutual company. Instead, these items are shown in the technical account. Further details are contained in Note 26.

The pension costs for the scheme are analysed as follows:

- *Current service costs*  
Current service costs are the actuarially calculated present value of the benefits earned by the active employees in each period.
- *Past service costs*  
Past service costs, which comprise costs relating to employee service in prior periods arising in the current period as a result of the introduction of, or improvement to, retirement benefits, are recognised in the profit and loss account on a straight-line basis over the period in which the increase in benefits vest.
- *Settlements or curtailments*  
Settlements or curtailments are recognised in the profit and loss account to the extent that they are not allowed for in the actuarial assumptions. Losses on settlements or curtailments are measured at the date on which the employer becomes demonstrably committed to the transaction. Gains on settlements or curtailments are measured at the date on which all parties whose consent is required are irrevocably committed.
- *Net expected return on pension asset*  
Net expected return on the pension asset comprises the expected return on the pension scheme assets less interest on scheme liabilities.

The actual return less expected return on pension scheme assets and actuarial movements in pension schemes net of tax which arise from any new valuation and from updating the latest actuarial valuation to reflect conditions at the balance sheet date are shown net of tax in the technical account immediately above the transfer to or from the fund for future appropriations.

### r. Foreign currency translation

Assets and liabilities denominated in foreign currencies are expressed in sterling at the exchange rates ruling on the balance sheet date. Revenue transactions and those relating to the acquisition and realisation of investments have been translated into sterling at rates of exchange ruling at the time of the respective transactions. Any exchange differences are dealt with in the technical account under the same heading as the underlying transactions are reported.

### s. Operating leases

Rentals payable under operating leases are charged to the profit and loss account as incurred over the lease term.

## 2 ANALYSIS OF PREMIUMS

It is the opinion of the Board that the Group operates in a single business segment, which is the provision of life assurance, pensions and savings products.

Gross premiums written relate to direct business from continuing operations.

	2004 £m	2003 £m
<b>(i) Gross premiums written</b>		
Regular premiums	767	804
Single premiums	1,076	1,525
	<b>1,843</b>	2,329
Individual premiums:		
With-profits life and annuity contracts	341	420
With-profits individual pension contracts	133	181
Linked life contracts	145	153
Linked individual pension contracts	605	518
DWP rebates	218	230
Non-profit life and annuity contracts	27	16
Non-profit individual pension contracts	140	150
	<b>1,609</b>	1,668
Group premiums:		
With-profits pension contracts	25	21
Linked pension contracts	176	589
Non-profit pension contracts	33	51
	<b>234</b>	661
	<b>1,843</b>	2,329
Premiums written in:		
United Kingdom	1,766	2,232
Isle of Man	77	97
	<b>1,843</b>	2,329

### (ii) Outward reinsurance premiums

On 22 December 2004, The Royal London Mutual Insurance Society Limited entered into an agreement with Prudential Retirement Income Limited to reassure a substantial proportion of the annuities in payment portfolio. The premium payable was £1,134m.

**Notes to the financial statements** for the year ended 31 December 2004

<b>2 ANALYSIS OF PREMIUMS</b> continued	<b>2004</b> £m	2003 £m
<b>(iii) New business premiums</b>		
<i>Insurance regular premiums</i>		
With-profits life contracts	<b>1</b>	3
With-profits individual pension contracts	<b>4</b>	6
With-profits group pension contracts	<b>3</b>	6
Linked life contracts	<b>3</b>	5
Linked individual pension contracts	<b>59</b>	46
Linked group pension contracts	<b>19</b>	17
Non-profit life contracts	<b>19</b>	6
Non-profit individual pension contracts	<b>2</b>	–
Non-profit group pension contracts	<b>1</b>	1
	<b>111</b>	90
<i>Insurance single premiums</i>		
With-profits life and annuity contracts	<b>15</b>	43
With-profits individual pension contracts	<b>24</b>	60
With-profits group pension contracts	<b>7</b>	6
Linked life contracts	<b>94</b>	99
Linked individual pensions contracts	<b>439</b>	373
Linked group pension contracts	<b>110</b>	531
Non-profit individual pension contracts	<b>139</b>	148
Non-profit group pension contracts	<b>30</b>	35
DWP rebates	<b>218</b>	230
	<b>1,076</b>	1,525
<i>Investment regular business</i>		
Unit trust and ISA regular business	<b>1</b>	3
<i>Investment single business</i>		
Unit trust and ISA single business	<b>9</b>	11
Other investment only mandates		
– Investments	<b>207</b>	229
– Cash	<b>118</b>	183
	<b>334</b>	423
<b>Total new business</b>	<b>1,522</b>	2,041
<i>New business written in:</i>		
United Kingdom	<b>1,446</b>	1,944
Isle of Man	<b>76</b>	97
	<b>1,522</b>	2,041

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

- Funds at retirement under pensions contracts which are converted into annuities with the Company are included in both claims incurred and as single premiums within gross premiums;
- Increments under existing group pension schemes are classified as new business premiums;
- DWP premiums are accounted for on a received basis.

All new business regular premiums are included on an annualised basis.

Funds under management in respect of the unit trust business are held in authorised unit trusts and the activities and sales of these unit trusts are not consolidated.

The linked group pension single premiums includes an amount of £4m (2003 £415m) which represents premiums received from the Royal London staff pension schemes.

<b>3 INVESTMENT RETURN SUMMARY</b>	Notes	2004 £m	2003 £m
<b>(i) Investment income</b>			
Income from investments:			
Land and buildings		140	141
Other financial investments		813	781
Gains on the realisation of investments		76	–
		<b>1,029</b>	922
Net expected return on pension scheme assets	26(c)(ii)	12	21
		<b>1,041</b>	943
<b>(ii) Investment expenses and charges</b>			
Interest payable on bank loans and overdrafts		(4)	(2)
Interest payable on other borrowings		(19)	(20)
Investment management expenses		(49)	(50)
Losses on the realisation of investments		–	(69)
		<b>(72)</b>	(141)
<b>(iii) Unrealised gains on investments</b>		<b>1,117</b>	705
<b>Net investment return</b>		<b>2,086</b>	1,507

<b>4 OTHER TECHNICAL INCOME AND CHARGES</b>	Notes	2004 £m	2003 £m
<b>(i) Other technical income</b>			
Amortisation of negative goodwill	9	6	6
General insurance commission		10	14
Other, continuing business		10	5
		<b>26</b>	25
<b>(ii) Other technical charges</b>			
Impairment of acquired PVIF		–	36
Amortisation of acquired PVIF	11	32	33
Amortisation of goodwill	9	15	35
Impairment of goodwill		–	152
Other, continuing business		12	1
		<b>59</b>	257

**Notes to the financial statements** for the year ended 31 December 2004

<b>5 NET OPERATING EXPENSES</b>	Notes	<b>2004 £m</b>	2003 £m
Acquisition costs			
– Expenses		<b>84</b>	85
– Commission		<b>72</b>	51
Change in deferred acquisition costs		<b>11</b>	27
		<b>167</b>	163
Current service pension cost	26(c)(i)	<b>21</b>	22
Profit arising on recognition of previously unrecognised surpluses in the staff pension funds	26(c)(i)	–	(21)
Administrative expenses			
– Expenses		<b>98</b>	104
– Renewal commission		<b>12</b>	12
Exceptional expense – restructuring costs		<b>16</b>	6
<b>Total net operating expenses</b>		<b>314</b>	286

Net operating expenses include:

	Group		Parent company	
	<b>2004 £m</b>	2003 £m	<b>2004 £m</b>	2003 £m
Depreciation of tangible assets	<b>8</b>	7	–	–
Operating lease rentals – land and buildings	<b>4</b>	4	<b>3</b>	–
	<b>£000</b>	£000	<b>£000</b>	£000
Auditors' remuneration (gross of VAT):				
Audit fees	<b>968</b>	837	<b>647</b>	611
Audit of regulatory returns	<b>384</b>	58	<b>354</b>	45
Fees for other non-audit services	<b>319</b>	339	<b>59</b>	106

**6 PARTICULARS OF STAFF**

The average number of persons (including executive directors) employed by the Group during the year was:

	<b>2004 Number</b>	2003 Number
Sales and sales support	<b>1,161</b>	1,481
Administration	<b>2,339</b>	2,314
	<b>3,500</b>	3,795

The aggregate remuneration payable in respect of the above employees was:

	<b>2004 £m</b>	2003 £m
Wages and salaries	<b>110</b>	113
Social security costs	<b>9</b>	10
Other pension costs (see note 26(c)(i))	<b>21</b>	22
	<b>140</b>	145

Wages and salaries includes £14m (2003 £6m) in respect of redundancy costs.

Full details of the directors' emoluments are included in the Board's report on directors' remuneration on pages 36 and 37. The information included therein encompasses that required by the Companies Act 1985.

**7 TAX ATTRIBUTABLE TO LONG-TERM BUSINESS**

Notes

**2004  
£m**2003  
£m

Tax has been provided as follows:

UK corporation tax charge

Current year

Adjustment in respect of prior periods

Foreign tax relieved against UK corporation tax

Deferred tax

16

**30****1****31****1****35****67**

2

4

6

2

1

9

UK corporation tax in the technical account has been calculated at a rate of 20% (2003: 20% – 22%) on the taxable profits of the long-term fund in accordance with the rate applicable to the long-term business of a mutual long-term assurance company and a rate of 30% (2003: 30%) on the taxable profits of subsidiaries of the long-term fund.

**8 PARENT COMPANY PROFIT AND LOSS ACCOUNT**

The Parent company has taken advantage of the exemptions under Section 230 of the Companies Act 1985 not to include a parent company profit and loss account. The Parent company is a mutual society and consequently the result for the year is reported as nil after a transfer to or from the fund for future appropriations.

**9 GOODWILL**

Group and Parent company

**Positive  
goodwill  
£m****Negative  
goodwill  
£m**

Cost:

At 1 January 2004 and 31 December 2004

**354****(56)**

Amortisation:

At 1 January 2004

**241****(18)**

Amortisation for the year

**15****(6)**

At 31 December 2004

**256****(24)****Net book value, 31 December 2004****98****(32)**

Net book value, 31 December 2003

**113****(38)**

**Notes to the financial statements** for the year ended 31 December 2004

	Group		Parent company	
	2004 £m	2003 £m	2004 £m	2003 £m
<b>10 INVESTMENTS</b>				
<b>(i) Land and buildings</b>				
At valuation:				
Freehold	<b>1,288</b>	1,221	<b>1,205</b>	1,104
Long leasehold	<b>337</b>	292	<b>298</b>	261
	<b>1,625</b>	1,513	<b>1,503</b>	1,365
At cost:	<b>1,189</b>	1,279	<b>1,062</b>	1,125
Value of owner occupied properties	<b>43</b>	46	<b>43</b>	46

Land and buildings were valued at 31 December 2004 by a number of independent Chartered Surveyors, principally Jones Lang Lasalle, Atis Real and DTZ.

	Shares £m	Loans £m	Total £m
<b>(ii) Investments in Group undertakings</b>			
<b>Parent company</b>			
At 1 January 2004	<b>114</b>	<b>63</b>	<b>177</b>
Additional share capital	<b>4</b>	–	<b>4</b>
Repayment of loans	–	<b>(37)</b>	<b>(37)</b>
Revaluation	<b>(17)</b>	<b>24</b>	<b>7</b>
<b>At 31 December 2004</b>	<b>101</b>	<b>50</b>	<b>151</b>

	Group		Parent company	
	2004 £m	2003 £m	2004 £m	2003 £m
<b>(iii) Other financial investments</b>				
At current value:				
Shares and other variable-yield securities and units in unit trusts	<b>4,887</b>	4,417	<b>4,867</b>	4,381
Debt securities and other fixed income securities	<b>7,560</b>	8,421	<b>7,543</b>	8,419
Loans secured by policies	<b>34</b>	42	<b>34</b>	42
Deposits with credit institutions	<b>127</b>	219	<b>112</b>	165
	<b>12,608</b>	13,099	<b>12,556</b>	13,007
Listed investments at market value (included in the above):				
Shares and other variable-yield securities and units in unit trusts	<b>4,756</b>	4,366	<b>4,736</b>	4,346
Debts and other fixed income securities	<b>7,530</b>	8,162	<b>7,515</b>	8,144
	<b>12,286</b>	12,528	<b>12,251</b>	12,490

	Group		Parent company	
	2004 £m	2003 £m	2004 £m	2003 £m
At cost:				
Shares and other variable-yield securities and units in unit trusts	<b>3,738</b>	3,544	<b>3,720</b>	3,509
Debt securities and other fixed income securities	<b>7,371</b>	8,474	<b>7,353</b>	8,472
Loans secured by policies	<b>34</b>	42	<b>34</b>	42
Deposits with credit institutions	<b>127</b>	219	<b>112</b>	165
	<b>11,270</b>	12,279	<b>11,219</b>	12,188



**11 PRESENT VALUE OF ACQUIRED IN FORCE BUSINESS**

	Group and Parent company £m
Cost:	
At 1 January 2004 and at 31 December 2004	<b>835</b>
Amortisation:	
At 1 January 2004	<b>354</b>
Amortisation for the year	<b>32</b>
At 31 December 2004	<b>386</b>
<b>Net book value, 31 December 2004</b>	<b>449</b>
Net book value, 31 December 2003	481

	Group		Parent company	
	2004 £m	2003 £m	2004 £m	2003 £m
<b>12 ASSETS HELD TO COVER LINKED LIABILITIES</b>				
At valuation	<b>6,371</b>	5,976	<b>5,353</b>	4,512
At cost	<b>5,978</b>	6,017	<b>4,988</b>	4,466

	Group		Parent company	
	2004 £m	2003 £m	2004 £m	2003 £m
<b>13 DEBTORS</b>				
<b>Other debtors</b>				
Amounts due from Group undertakings	-	-	<b>26</b>	86
Outstanding sales of investments	<b>6</b>	4	<b>5</b>	-
Tax recoverable	-	13	-	12
Dividends receivable	<b>17</b>	37	<b>17</b>	32
Other	<b>49</b>	58	<b>44</b>	43
	<b>72</b>	112	<b>92</b>	173

	Computer, office equipment and motor vehicles £m
<b>14 TANGIBLE ASSETS</b>	
<b>Group</b>	
Cost:	
At 1 January 2004	<b>57</b>
Additions	<b>6</b>
Disposals	<b>(1)</b>
At 31 December 2004	<b>62</b>
Depreciation:	
At 1 January 2004	<b>40</b>
Charge for the year	<b>8</b>
Disposals	<b>(1)</b>
At 31 December 2004	<b>47</b>
<b>Net book value, 31 December 2004</b>	<b>15</b>
Net book value, 31 December 2003	17

**Notes to the financial statements** for the year ended 31 December 2004

<b>15 TECHNICAL PROVISIONS AND FUND FOR FUTURE APPROPRIATIONS</b>	<b>Long-term business provisions £m</b>	<b>Claims outstanding £m</b>	<b>Linked liabilities £m</b>	<b>Fund for future appropriations £m</b>
<b>Group</b>				
At 1 January 2004	<b>13,079</b>	<b>59</b>	<b>5,993</b>	<b>2,340</b>
Change in the year – gross of reinsurance	<b>448</b>	<b>11</b>	<b>406</b>	<b>122</b>
<b>At 31 December 2004</b>	<b>13,527</b>	<b>70</b>	<b>6,399</b>	<b>2,462</b>
<b>Parent company</b>				
At 1 January 2004	<b>13,076</b>	<b>49</b>	<b>4,529</b>	<b>2,340</b>
Change in the year – gross of reinsurance	<b>447</b>	<b>10</b>	<b>851</b>	<b>122</b>
<b>At 31 December 2004</b>	<b>13,523</b>	<b>59</b>	<b>5,380</b>	<b>2,462</b>

The closing balance on the fund for future appropriations of the Group and Parent company includes amounts attributable to the Scottish Life and Refuge Assurance ordinary branch with-profits sub-funds, and are stated after including a pension scheme asset of £34m (2003 £35m).

Claims outstanding includes provisions for long-term and general insurance business of £59m (2003 £49m) and £11m (2003 £10m) respectively.

The method of calculating the long-term business provision of the Parent Company was changed in the year as described in note 21. The effect of the change in the year was to increase the long-term business provision by £22m and reduce the deferred acquisition costs by £44m resulting in a net decrease in the fund for future appropriations of £66m.

<b>16 DEFERRED TAX ASSET AND PROVISIONS FOR OTHER RISKS AND CHARGES</b>	<b>Group</b>		<b>Parent company</b>	
	<b>Deferred tax £m</b>	<b>Provisions £m</b>	<b>Deferred tax £m</b>	<b>Provisions £m</b>
(Asset)/provisions at 1 January 2004	<b>(51)</b>	<b>17</b>	<b>(46)</b>	<b>10</b>
Utilised (including unwind of discount)	<b>–</b>	<b>(4)</b>	<b>–</b>	<b>(2)</b>
Charge for the year	<b>35</b>	<b>1</b>	<b>35</b>	<b>3</b>
<b>(Asset)/provisions at 31 December 2004</b>	<b>(16)</b>	<b>14</b>	<b>(11)</b>	<b>11</b>

Provisions comprise amounts in respect of the long-term incentive plan and surplus sales and administration offices which have been closed and for which the Group retains lease commitments.

	<b>Group</b>		<b>Parent company</b>	
	<b>2004 £m</b>	<b>2003 £m</b>	<b>2004 £m</b>	<b>2003 £m</b>
<b>Deferred tax (asset)/liabilities provided in the financial statements comprises:</b>				
Deferred acquisition costs	<b>(21)</b>	(25)	<b>(21)</b>	(25)
Capital allowances	<b>(4)</b>	(3)	<b>1</b>	1
Unrelieved trading losses	<b>(1)</b>	(2)	<b>–</b>	–
Arising on UAG Schedule 2C agreement	<b>(19)</b>	(20)	<b>(19)</b>	(20)
Revaluation of investments	<b>27</b>	(4)	<b>27</b>	(4)
Capital gains tax on unit trust deemed disposals	<b>3</b>	(1)	<b>3</b>	(1)
Undiscounted deferred tax asset	<b>(15)</b>	(55)	<b>(9)</b>	(49)
Discount:				
Relating to liabilities shown above	<b>(5)</b>	(2)	<b>(5)</b>	(2)
Relating to assets shown above	<b>4</b>	6	<b>3</b>	5
	<b>(1)</b>	4	<b>(2)</b>	3
Discounted deferred tax asset	<b>(16)</b>	(51)	<b>(11)</b>	(46)

The Group has not recognised deferred tax assets amounting to £21m (2003 £23m) arising from surplus trading losses, unrealised capital losses or capital allowances, as there is insufficient evidence that an adequate amount of taxable profits will arise in the future against which to offset these items.

The amount described as 'Arising on UAG Schedule 2C agreement' reflects the present value at the end of the year of future tax savings in the long-term funds of the United Assurance Group following the transfer of the funds to the Company in 2001 under Schedule 2C of the Insurance Companies Act 1982.

	Group		Parent company	
	2004 £m	2003 £m	2004 £m	2003 £m
<b>17 CREDITORS</b>				
<b>(i) Amounts owed to credit institutions</b>	<b>63</b>	62	<b>14</b>	29

Amounts owed to credit institutions fall due for payment as follows:

	Group		Parent company	
	2004 £m	2003 £m	2004 £m	2003 £m
Less than 1 year	<b>43</b>	19	<b>14</b>	18
Between 1 and 2 years	–	17	–	11
More than 2 years but less than 5 years	<b>16</b>	21	–	–
After more than 5 years	<b>4</b>	5	–	–
	<b>63</b>	62	<b>14</b>	29

	Group		Parent company	
	2004 £m	2003 £m	2004 £m	2003 £m
<b>(ii) Other creditors including taxation and social security</b>				
Loan stock	<b>6</b>	7	–	–
Amounts owed to Group undertakings	–	–	<b>41</b>	29
Tax payable	<b>19</b>	–	<b>21</b>	–
Other creditors including social security	<b>39</b>	74	<b>19</b>	51
	<b>64</b>	81	<b>81</b>	80

The loan stock was issued at par and is redeemable at par by the Company at any time. It is unsecured and interest is payable six monthly in arrears at a rate per annum of 0.75% below LIBOR at the start of each interest period. Loan note holders can only redeem the loan stock at the start of each six monthly interest period.

The balances above are all due within one year.

## 18 SUBORDINATED LIABILITIES

On 28 November 1996, Scottish Life Finance plc, now a wholly owned subsidiary of The Royal London Mutual Insurance Society Limited, issued £125m 9% Undated Subordinated Guaranteed Bonds with no specified date of repayment. The Bonds are guaranteed by The Royal London Mutual Insurance Society Limited. The proceeds of the issue were loaned to The Royal London Mutual Insurance Society Limited on the same interest, repayment and subordination terms as those applicable to the bonds. The issuer has the option to redeem all of the Bonds on 28 November 2006.

## 19 STOCK LENDING

At the year end, the Parent company had entered into various contractual arrangements whereby certain of its investments with a value of £2,883m (2003 £2,855m) were on loan to market makers on a temporary basis in return for the payment of interest. Collateral held exceeded the value of the stocks loaned. Income arising from such activities amounted to £2m (2003 £3m).

## 20 COST OF BONUSES

Total surplus arising in the year which has been allocated as regular bonuses, valued on the assumptions set out in note 21 or paid out as interim and terminal bonuses on claims amounted to £229m (2003 £287m).

## Notes to the financial statements for the year ended 31 December 2004

### 21 LONG-TERM BUSINESS PROVISION

The principal assumptions used in determining the long-term business provision for the main classes of business were as follows:

Class of business	2004 Mortality	2003 Mortality	2004 Interest % per annum	2003 Interest % per annum
<b>Ordinary long-term non-linked</b>				
Assurances				
Royal London Mutual	<b>105% AM92 and AF92</b>	AM80 minus two years and AF80 minus two years	<b>3.500</b>	3.750
Ex-United Assurance Group	<b>105% AM92 and AF92</b>	AM80 minus two years	<b>3.500</b>	3.750
Ex-Scottish Life	<b>80% AM92 and AF92</b>	AM80 minus two years	<b>3.400</b>	3.800
Pensions – deferred annuities				
Ex-United Assurance Group (excluding DWP rebates)	<b>80% AM92 and AF92 in deferment 105% PMA92 MC and 105% PFA92 MC in payment</b>	AM80 minus four years in deferment IMA92C27 and IFA92C27 in payment	<b>4.000</b>  <b>3.875 to 4.625</b>	4.000  4.300 to 4.950
Ex-United Assurance Group (DWP rebates)	<b>100% AM92 and AF92 in deferment</b>	AM80 minus four years in deferment	<b>3.000</b>	4.000
Ex-Scottish Life – Individual	<b>80% AM92 and AF92 100% PMA92 MC and 100% PFA92 MC in payment</b>	AM80 minus three years in deferment 95% IMA92C27 and 90% IFA92C27 in payment	<b>4.375</b>  <b>3.875 to 4.625</b>	4.700  4.200 to 4.950
– Group	<b>105% PMA92 MC and 105% PFA92 MC in payment</b>	90% PMA92C27 and 85% PFA92C27 in payment	<b>3.875 to 4.625</b>	4.200 to 4.950
Pensions – pure endowment				
Ex-United Assurance Group	<b>Nil</b>	Nil	<b>4.000</b>	4.000
Pensions – individual in payment				
Royal London Mutual	<b>105% PMA92 MC and 105% PFA92 MC</b>	IMA92C15 and IFA92C15 in payment	<b>4.750</b>	5.125
Ex-United Assurance Group	<b>105% PMA92 MC and 105% PFA92 MC</b>	IMA92C15 and IFA92C15 in payment	<b>4.750</b>	5.125
Ex-Scottish Life	<b>100% PMA92 MC and 100% PFA92 MC</b>	95% IMA92C15 and 90% IFA92C15 in payment	<b>4.750</b>	5.125
Pensions – group in payment				
Ex-Scottish Life	<b>105% PMA92 MC and 105% PFA92 MC</b>	90% PMA92C15 and 85% PFA92C15 in payment	<b>4.750</b>	5.125
<b>Industrial assurance</b>				
Royal London Mutual	<b>80% ELT15 (males)</b>	ELT15 (males) minus four years	<b>3.500</b>	3.750
Ex-United Assurance Group	<b>80% ELT15 (males)</b>	ELT15 (males) minus two years	<b>3.500</b>	3.750

**21 LONG-TERM BUSINESS PROVISION** continued**Renewal expenses**

Class of business	Per policy		Per claim		Premium		Reserve	
	2004 £	2003 £	2004 £	2003 £	2004 %	2003 %	2004 %	2003 %
<b>Ordinary long-term non-linked</b>								
<b>Royal London Mutual</b>								
Royal London Brand Business	11.51	11.05	–	–	5.00	5.00	0.08	0.08
Bright Grey	14.77	14.16	300.00	300.00	1.00	1.00	0.06	0.06
<b>Ex-United Assurance Group</b>								
RA OB business pre 1999	16.63	16.20	–	–	5.00	5.00	0.08	0.08
RA OB business post 1998	15.88	15.50	–	–	2.00	2.00	0.08	0.08
<b>Ex-Scottish Life</b>								
Individual pensions	55.28	53.01	189.86	153.66	0.00	0.00	0.03	0.03
Group pensions	94.73	91.06	–	–	0.00	0.00	0.03	0.03
<b>Industrial assurance</b>								
Royal London Mutual	5.77	5.53	–	–	10.00	10.00	0.08	0.08
Ex-United Assurance Group	7.21	6.97	–	–	17.50	17.50	0.08	0.08

The long-term business provision when calculated on a gross premium valuation method includes explicit allowance for future renewal expenses. The assumed renewal expenses presented in the table above reflect the fees payable under a service agreement with Royal London Management Services Limited. Per policy costs are assumed to inflate annually at 3.75% p.a.

When determining the long-term business provision, an allowance has been made for persistency on with-profits business. Lapse assumptions are set on a prudent basis, taking into account recent experience, on a product by product basis, with rates set for each year in force. For those lines of business where a persistency assumption is assumed, lapse rates typically lie within the range 1.00% – 3.00% per annum.

The gross premium valuation method has been adopted for all lines of business (2003, Royal London and Ex Refuge Assurance ordinary branch conventional with-profits business only). Future annual bonuses are included where supportable on valuation interest rate assumptions. Based on recent investigations, the provision included no allowance for future annual bonuses on conventional with-profits business, with future annual bonus rates provided for at current rates on unitised with-profits business.

When calculating the long-term business provision, judgement is required, particularly in the choice of assumptions for future experience where uncertainty exists. The material assumptions are interest rates and mortality. The assumptions used are described in the tables above and the following paragraphs provide additional detail on these two elements.

Assumed interest rates on Assurance and Deferred Pensions are set by reference to market yields at the balance sheet date on investments held within the Long-Term Fund. During 2004, equity earnings yields rose, equity dividend yields remained broadly unchanged and yields on fixed income securities fell. Valuation interest rates have been reduced by 0.25% to 3.50% on life business, maintained at 4.00% p.a for deferred pensions business and reduced by up to 0.375% for annuities in payment and in deferment. The changes in valuation interest rates reflect the allocation of assets to the various lines of business and margins consistent with the statutory solvency basis of valuation. Reductions in interest rates increase the long-term business provision.

Mortality bases are reviewed periodically to ensure that assumptions remain appropriate, taking into account recent company and industry experience for each class of business. In the case of term assurances, including those that offer critical illness benefits, a worsening in mortality experience leads to increased claim levels and hence an increase in the long-term business provision. For annuity contracts the risk is that policyholders live longer than expected. Term assurance and part of the annuity book are subject to reinsurance, which mitigates these risks. Following a review in 2004, mortality assumptions have been strengthened for pensions business, increasing provisions by around 0.5%, with the change for life business being broadly neutral. In particular, annuitant mortality rates have been strengthened to the '92 Series' with future improvements on the Medium Cohort basis. Under this approach, mortality rates depend on both age and calendar year and are applied on a policy by policy basis.

The provision for Guaranteed Annuity Options (GAOs) in respect of acquired Scottish Life Business has been calculated as £527m (2003 £311m). This has been calculated as the additional cost of converting projected fund values to annuities on guaranteed rates, for those policyholders electing to do so, over annuities purchased on the anticipated interest and mortality assumptions described in the table above. In performing this calculation, it has been assumed that 80% of projected values will be converted on GAO terms, reflecting policyholders' ability to take tax free lump sums.

The provision for Guaranteed Annuity Options (GAOs) in respect of acquired United Assurance Group and pre October 1986 Royal London pensions business has been calculated as £170m (2003 £137m). The vast majority of this provision relates to deferred annuity contracts where the guaranteed annuity is valued directly in the base policy provision. The GAO element of the provision is estimated by determining the excess of the cost of providing the GAO over annuity rates consistent with the valuation basis. The GAO provision for the remaining lines of business are calculated as for the acquired SL business described above. In performing these calculations, it has been assumed that 80% (2003 100%) of projected values will be converted on GAO terms, reflecting policyholders' ability to take tax free lump sums.

The long-term business provision includes £57m (2003 £61m) in respect of guarantees, redress payments and expenses outstanding under the Pensions Review.

**Notes to the financial statements** for the year ended 31 December 2004**22 COMMITMENTS****(i) Investment expenditure**

Investment expenditure contracted for but not provided for at the balance sheet date amounted to £8m (2003 £23m).

**(ii) Investments in private equity funds**

The Company has a portfolio of investments in private equity funds. The structure of these funds is such that the Company makes a commitment which is drawn down over the investment period. The total amount committed, net of drawdown, at the balance sheet date is £35m (2003 £56m).

	Group		Parent company	
	2004 £m	2003 £m	2004 £m	2003 £m
<b>(iii) Lease commitments in respect of land and buildings</b>				
Annual commitments which expire:				
Up to one year	1	1	1	1
In the second to fifth years	3	3	3	2
In more than five years	2	2	2	1
	<b>6</b>	<b>6</b>	<b>6</b>	<b>4</b>

**23 PRINCIPAL SUBSIDIARY UNDERTAKINGS**

The following represents the principal subsidiary undertakings of the Group as at 31 December 2004. All undertakings shown are wholly owned, and have been included in the Group financial statements.

	Country of incorporation or registration	Nature of business
Royal London Asset Management Limited	England	Investment management
The Royal London Unit Trust Managers Limited	England	Unit Trust management
Royal London Savings Limited	England	ISA management
Royal London Management Services Limited	England	Administration services
Scottish Life International Insurance Company	Isle of Man	Life Assurance
Royal London Pooled Pensions Company Limited	Scotland	Pension Fund management
Scottish Life Finance plc	Scotland	Finance company

**Significant holdings in other companies**

As at 31 December 2004, Royal London owned 100% of the annuity shares in the Royal London UK Equity and Income Trust plc. The aggregate share capital and reserves as at 31 August 2004 were £34m and the profit for the year was £6m.

As at 31 December 2004, Royal London owned 12.35% of London Scottish Bank plc and 12.25% of Britannic plc. In addition, Royal London held investments in a number of companies which exceeded 10% but less than 20% of the equity share capital of these companies. Details of these investments have not been provided as they are not material. All of these holdings have been included in investments in the financial statements.

**24 CONTINGENT LIABILITY****Regulatory reviews**

During the year, the Group continued to address issues from past inappropriate selling practices. Provision for liabilities continues to be made and is regularly reviewed. However, it is not possible to predict with any certainty the extent and the timing of the financial impact of these liabilities. Nevertheless, the directors consider that they have made prudent provision for such liabilities and, as and when circumstances calling for such provision arise, that the Group has adequate reserves to meet all reasonably foreseeable eventualities.

**25 RELATED PARTY TRANSACTIONS****(i) Subsidiary undertakings' transactions with unit trust funds**

The Royal London Unit Trust Managers Limited operates as the unit trust manager for the unit trust business marketed by the Group. The transactions during the year were as follows:

	2004 £m	2003 £m
Management fees earned during the year	41	34
Amounts outstanding at the year end	4	3

The total value of the units held by the Parent company at 31 December 2004 was £4,194m (2003 £3,821m).

**(ii) Subsidiary undertaking's transactions with the Company's staff pension scheme**

The Royal London Group Pension Scheme (RLGPS) invests in units in various internal linked funds of the Royal London Pooled Pension Company Limited (RLPPC), through the medium of insurance policies issued to RLGPS.

During the year RLGPS invested £4m (2003 £415m), by way of single premium investment, in RLPPC insurance policies. In addition RLGPS disinvested £459m (2003 £33m) from RLPPC.

The total market value of the units held by RLGPS in RLPPC as at 31 December 2004 was £375m (2003 £786m).

## 26 PENSION SCHEME

### a. Summary

The Group operates a funded, defined benefit scheme: Royal London Group Pension Scheme (RLGPS). Previously, the Group operated four principal defined benefit schemes: The Royal London Staff Pension Fund (RLSPF), United Friendly Group Pension Scheme (UFGPS), Scottish Life Officers' Retirement Benefits Scheme (SLORBS) and RLGPS. On 31 December 2003 the assets and liabilities of RLSPF, UFGPS and SLORBS were transferred into RLGPS which became the sole pension scheme.

Throughout this note, the figures for prior years have been restated to show the aggregate position for all four schemes in 2003 and 2002 instead of scheme by scheme.

Details of the latest valuation of the principal scheme are given below using the projected unit method.

Last full actuarial valuation date	31 December 2001
Scheme actuary	Keith Lewis (Watson Wyatt)
Market value of assets at 31 December 2004	£1,550m
Level of funding	103%

The major assumptions used by the scheme actuaries, which were consistently applied across the schemes, were:

	2004 %	2003 %	2002 %
Inflation assumption	2.7	2.6	2.3
Rate of increase in salaries (including promotional increase)	4.5	4.7	5.1
Rate of increase in pensions in payment	2.7	2.6	2.3
Discount rate	5.4	5.5	5.8

No contributions were made by the Group during 2004 (2003 £nil).

### b. Analysis of net pension scheme assets and liabilities

The fair value of assets in the scheme and the expected rate of return and net pension scheme assets/(liabilities) were:

#### As at 31 December 2004

	Expected longer-term rate of return %	2004 £m	Expected longer-term rate of return %	2003 £m	Expected longer-term rate of return %	2002 £m
Fixed interest bonds	4.6	127	4.8	104	4.5	104
Index-linked bonds	4.4	316	4.6	299	4.5	142
Corporate bonds	5.4	259	5.5	251	5.8	140
Equities	7.1	749	7.3	725	8.6	892
Property	6.6	95	6.8	69	6.5	68
Cash	4.8	4	4.8	16	4.0	28
Total market value of assets		1,550		1,464		1,374
Present value of scheme liabilities		(1,507)		(1,421)		(1,189)
Surplus in the scheme		43		43		185
Restriction on recoverability of surplus		-		-		(94)
Recognised surplus		43		43		91
Related deferred tax		(9)		(8)		(18)
Net pension scheme asset		34		35		73
Analysed as follows:						
Pension asset		34		35		111
Pension liability		-		-		(38)
		34		35		73

The scheme also held AVC investments totalling £3m (2003 £3m; 2002 £2m) under money purchase arrangements.

**Notes to the financial statements** for the year ended 31 December 2004**26 PENSION SCHEME** continued**c. Analysis of movements in consolidated profit and loss account**

	2004 £m	2003 £m
<b>(i) Analysis of the amount charged to net operating expenses</b>		
Current service cost	(21)	(22)
Profit arising on recognition of previously unrecognised surpluses	–	21
	<b>(21)</b>	<b>(1)</b>

	2004 £m	2003 £m
<b>(ii) Analysis of the net expected return on pension scheme assets</b>		
Expected return on pension scheme assets	89	99
Less: restriction due to unrecognised surpluses	–	(11)
	<b>89</b>	<b>88</b>
Less: interest on pension scheme liabilities	(77)	(67)
Net expected return on pension scheme assets	<b>12</b>	<b>21</b>

The expected return on pension scheme assets is calculated using the investment return assumptions applied to the market value of pension scheme assets as stated in the tables above for the preceding year end. In 2003 the expected return was restricted as a result of the existence of unrecognised surpluses in SLORBS and UFGPS.

**d. Analysis of pension scheme gains and losses after tax**

	2004 £m	2003 £m
Actual return less expected return on pension scheme assets	53	59
Experience gains and losses arising on the scheme liabilities	10	2
Changes in assumptions underlying the present value of the scheme liabilities	(54)	(156)
Absorbed within unrecognised surpluses brought forward	–	27
Actuarial gains/(losses) before tax	9	(68)
Deferred tax on actuarial gains/(losses)	(2)	14
Pension scheme gains/(losses) after tax	<b>7</b>	<b>(54)</b>

**e. Movement in surplus during the year before tax**

	Notes	2004 £m	2003 £m
<b>Considered as recoverable surplus in schemes at beginning of the year</b>			
		<b>43</b>	91
Movement in year:			
Total operating charge	26(c)(i)	<b>(21)</b>	(1)
Net expected return on pension scheme asset	26(c)(ii)	<b>12</b>	21
Actuarial gains/(losses)	26(d)	<b>9</b>	(68)
<b>Considered as recoverable surplus in schemes at end of year</b>			
		<b>43</b>	43

**f. History of experience gains and losses (Group)**

	Notes	2004 £m	%	2003 £m	%	2002 £m	%	2001 £m	%
Difference between the expected and actual return on scheme assets as a percentage of closing scheme assets	26(d)	<b>53</b>	<b>3.5</b>	59	4.0	(375)	(27.4)	(415)	(26.0)
Experience gains and losses on scheme liabilities	26(d)	<b>10</b>	<b>0.6</b>	2	0.2	48	4.0	51	4.2
Total amount recognised as part of actuarial gains and losses as a percentage of scheme liabilities	26(d)	<b>9</b>	<b>0.6</b>	(68)	(4.8)	(253)	(21.3)	(100)	(8.3)

The calculation of the differences between the expected and actual return on scheme assets as a percentage of closing scheme assets has been adjusted to take account of the fact that the acquisition of Scottish Life took place during 2001.



## **Recent Accounting Developments**

### *International Financial Reporting Standards*

From 2005, all European Union listed groups are required to prepare their consolidated financial statements using International Financial Reporting Standards (“**IFRS**”) issued by the International Accounting Standards Board (“**IASB**”). Although not listed, the Group has chosen to adopt IFRS in 2005. Therefore, in addition to the audited consolidated financial statements under UK GAAP for the two years ended 31 December 2004, the Directors of the Group have prepared financial information for the Group for the year ended 31 December 2004 (the “**2004 restated financial information**”) on the basis expected to be applicable, insofar as this is currently known, to comparative information prepared for inclusion in the first financial statements of the Group prepared in accordance with IFRS. The 2004 restated financial information has not been audited by the auditors, PricewaterhouseCoopers LLP, (“**PwC**”).

The 2004 restated financial information and the Group’s unaudited and unreviewed IFRS interim consolidated financial information have been prepared using the accounting policies which the Group expects to apply in its first annual financial statements under IFRS. These accounting policies are in accordance with IFRS and International Financial Reporting Interpretations Committee (“**IFRIC**”) interpretations adopted for use in the European Union to be effective for 2005 year ends.

The European Commission has endorsed all relevant IFRS including the amendment to IAS 39, The Fair Value Option, published by the IASB in June 2005. Although this amendment is not mandatory until 2006, the Group has decided to adopt it early and reflect its impact within the 2004 restated financial information and the IFRS interim consolidated financial information. The Group’s full year financial statements at 31 December 2005 will be prepared in accordance with these endorsed IFRS and the information set out below reflects the accounting policies expected to apply at the year end.

IFRS and the related interpretative guidance remain subject to possible amendment by the IASB or other external bodies and therefore the financial information presented is subject to change prior to publication of the Group’s first full IFRS financial statements early in 2006.

### *FRS 27 Life Assurance*

In December 2004, the UK’s Accounting Standards Board (“**ASB**”) issued Financial Reporting Standard 27, Life Assurance (FRS 27). The Group has adopted FRS 27 in its 2004 restated financial information. FRS 27 requires insurance companies to measure their liabilities on with-profits business as the realistic basis liabilities as set out by the UK’s Financial Services Authority (FSA) for the purposes of regulatory reporting (as described under “*Regulatory Capital Position*” and “*United Kingdom Regulation of Insurance Business – Regulatory Reporting*”). Within FRS 27, the ASB acknowledged the difficulty in applying the requirements retrospectively and it is the Group’s view that it would be impractical to do so in accordance with IAS 8. Therefore, only the balance sheet at 31 December 2004 has been restated for the impact of FRS 27. No adjustments for FRS 27 have been made to the income statement for the year ended 31 December 2004.

In certain with-profits long-term insurance and investment business, the nature of the policy benefits is such that the division between free assets and policyholder liabilities is uncertain. Amounts whose allocation to policyholders has not been determined by the end of the financial year are held within liabilities as an unallocated divisible surplus. The Unallocated Divisible Surplus (“**UDS**”) was previously known under UK GAAP as the Fund for Future Appropriations. FRS 27 requires the use of ‘realistic’ bases to measure liabilities calculated by reference to the present value of the firm’s expected future contractual liabilities together with projected ‘fair’ discretionary bonus payments to policyholders from unallocated surplus. FRS 27 does not therefore change the underlying economics of the business, but does result in changes in balance sheet presentation between the UDS and the long-term business provisions for insurance and participating investment contract liabilities, to allow for the amounts by which such discretionary payments were not previously recognised under UK GAAP.

For with-profits life funds falling within the scope of the FSA realistic capital regime, and hence FRS 27, an amount may be recognised for the present value of future profits on non-participating business written in a with-profits fund where the determination of the realistic value of liabilities in that with-profits fund takes account, directly or indirectly, of this value. This amount is recognised as a reduction in the liability rather than as an asset on the balance sheet.

***Application of IFRS and FRS 27 to the Group Balance Sheet as at 31 December 2004***

The information in the table below has been extracted without material adjustment from the Group's unaudited 2004 restated financial information. It has been prepared in accordance with IFRS issued by the IASB and adopted by the European Commission ("EC") to be effective for 2005 year ends. Due to the continuing work of the IASB and possible amendments to interpretive guidance, the Group's accounting policies and consequently the information presented may change prior to the publication of the 31 December 2005 financial statements in early 2006.

In addition, IFRS 4 permits the Group to maintain its existing accounting policies in relation to insurance contracts but allows a change in accounting policy where that change makes the financial statements more relevant and no less reliable, or more reliable and no less relevant. The Group is of the view that an accounting policy change reflecting the adoption of FRS 27 would make its financial statements more relevant and no less reliable and has therefore adopted FRS 27 when preparing its 2004 restated financial information.

	<b>31 December 2004 (Unaudited)</b>
	<i>(in millions of pounds)</i>
<b>ASSETS</b>	
Property, plant and equipment .. .. .	180
Investment property .. .. .	1,950
Goodwill, intangibles and other assets .. .. .	1,862
Financial investments .. .. .	18,181
Loans and receivables, including insurance receivables .. .. .	145
Cash and cash equivalents.. .. .	836
<b>Total assets</b> .. .. .	<b>23,154</b>
<b>LIABILITIES</b>	
Participating insurance contract liabilities .. .. .	10,426
Participating investment contract liabilities .. .. .	2,063
Unallocated divisible surplus.. .. .	1,246
Non-participating value of in-force business .. .. .	(272)
<b>Participating contract liabilities</b> .. .. .	<b>13,463</b>
Non-participating insurance contract liabilities .. .. .	3,639
Non-participating investment contract liabilities .. .. .	4,833
<b>Non-participating contract liabilities</b> .. .. .	<b>8,472</b>
Other financial liabilities .. .. .	200
Provisions and other liabilities .. .. .	719
Creditors .. .. .	300
<b>Total liabilities</b> .. .. .	<b>23,154</b>

**Major adjustments which impact on the unallocated divisible surplus at 31 December 2004**

***Deferred acquisition costs on insurance and participating investment contracts***

As noted above, the Group has adopted FRS 27 within its restated 2004 financial information. FRS27 does not permit acquisition costs on participating business to be deferred. For non-participating insurance business written in the with profits fund, FRS 27 permits the recognition of the present value of future profits in the determination of the realistic value of liabilities meaning that the deferred acquisition costs on this business need to be adjusted for consistency. Consequently the balance of insurance and participating investment contract deferred acquisition costs as at 31 December 2004 is written off. The

impact is to reduce the unallocated divisible surplus at 31 December 2004 by £77 million. There is no impact on the transfer to the unallocated divisible surplus for the year to 31 December 2004.

### ***Product classification***

Under UK GAAP all contracts written by an insurance company are accounted for in the same way regardless of whether there has been a transfer of significant insurance risk. Under IFRS 4, 'Insurance Contracts' all contracts must be classified for accounting purposes as either insurance, investment or investment with discretionary participation features (participating investment contracts).

For the Group this classification is further complicated by hybrid investment contracts. Hybrid contracts are those where the policyholder can invest in and switch between both unit linked and unitised with-profits investment mediums at the same time.

These hybrid investment contracts are accounted for as two contracts – a financial liability and a contract for the provision of investment management services. The service contract is accounted for under IAS 18, 'Revenue'. This is described further below.

The unitised with-profits portion of the financial liability is valued under IFRS 4 as a participating investment contract. The unit linked portion of the liability is valued as a non-participating investment contract under IAS 39. Both of these valuation bases are explained further below.

### ***Participating contracts***

Under IFRS 4, participating (more commonly known as 'with-profits') contracts, whether insurance or investment, are valued using accounting principles consistent with those adopted under existing accounting practices. This includes the unitised with-profits portion of the financial liability of hybrid investment contracts. Changes from the practices previously applied are permitted where this can be justified as an improvement. The Group has applied FRS 27 as such an improvement.

As set out above, FRS 27 requires the liabilities for participating contracts to be valued using a 'realistic' basis. This has resulted in an increase in the liability for participating insurance contracts of £1,325 million and for participating investment contracts of £125 million as at 31 December 2004. A corresponding amount has been deducted from the unallocated divisible surplus. There is no impact on the transfer to unallocated divisible surplus as a result of this change.

Under the FSA realistic basis, a with-profits life fund includes within assets the value of future profits expected to arise from non-participating business (i.e. policies that do not have a with-profits feature) written in the with-profits fund. This asset is sometimes referred to as 'value of in-force business'. This value is also taken into account in determining the returns earned by the fund and hence the value of future bonuses included in the realistic value of liabilities, although there is not necessarily a direct link between the value of in-force business and the additional amount included in liabilities.

Under FRS 27 the value of in-force business is not shown as an asset but as an adjustment to the measurement of the liabilities and the UDS. This value is presented as a deduction from a sub-total of participating contract liabilities and the UDS. The amount of the deduction as at 31 December 2004 is £272 million. This value is in addition to the value of acquired in-force business included within goodwill, intangibles and other assets.

### ***Non-participating investment contracts***

All of the Group's non-participating investment contracts are unit linked. This includes the unit linked portion of the financial liability of hybrid investment contracts. Under UK GAAP the liability for unit linked contracts is calculated as the market value of the underlying fund of assets plus a prudential regulatory reserve.

As set out above, the Group has adopted the amendment to IAS 39, 'Financial instruments: Recognition and measurement', published by the IASB in June 2005. This permits the liabilities to be valued at the fair value of the underlying assets and for movements in those liabilities to be taken through the income statement. Consequently, under IFRS the liability for unit linked investment contracts is calculated by reference to the fair value of the underlying assets but excludes the prudential regulatory

reserves. The impact of this is to increase the unallocated divisible surplus by £110 million at 31 December 2004.

The transfer to the unallocated divisible surplus in the income statement is reduced in the year to 31 December 2004 by £7 million as a result of the above changes.

#### ***Accounting for revenue and expenses relating to investment contracts***

Revenue and expenses for non-participating investment contracts and hybrid investment contracts (both participating and non-participating portions) are accounted for in accordance with IAS 18, 'Revenue'. This standard requires income to be recognised as the related services are provided over the life of the contract. Consequently, a deferred income liability of £49 million is required at 31 December 2004, in respect of up front fees received. No such liability is recognised under UK GAAP as the fees are recognised when received.

IAS 18 requires acquisition costs to be deferred and recognised over the same period as the related revenue. The costs that can be deferred are restricted to directly attributable incremental costs only. This is a narrower definition than under UK GAAP.

In addition IFRS requires an explicit provision of £22 million to be made for future renewal commission payable on business written as at the balance sheet date. A corresponding amount is included in deferred acquisition costs, to the extent that these commissions are recoverable from future margins.

The net impact of these changes to the deferred acquisition costs asset results in an increase in the asset recognised at 31 December 2004 of £13 million.

#### **Major adjustments which do not impact on the unallocated divisible surplus at 31 December 2004**

The following adjustments arise from the different accounting treatments and presentational requirements of IFRS as compared to UK GAAP. None of these have a net impact on the unallocated divisible surplus in the balance sheet or to the transfer to the unallocated divisible surplus in the income statement.

#### ***Deposit accounting for investment contracts***

Under UK GAAP all premiums and claims are recorded in the income statement as income and expense respectively.

Under IFRS, premiums receivable under investment contracts are no longer shown as premiums in the income statement but as additions to the investment contract liability in the balance sheet. Similarly, claims payments are not included as claims in the income statement but as deductions from the balance sheet liability. The premiums and claims deducted in this way from the income statement for the year to 31 December 2004 were £986 million and £1,054 million respectively.

In addition fees and charges deducted from investment contracts are shown as an explicit income item in the income statement. An amount of £83 million has been recognised in this way for the year to 31 December 2004.

A corresponding adjustment for all these entries is made to the movement in investment contract liabilities line in the income statement (equivalent to the UK GAAP line 'change in other technical provisions'). The adjustment for the year to 31 December 2004 is £151 million.

#### ***Technical provisions***

The UK GAAP line, 'change in other technical provisions' incorporates movements in insurance contracts, investment contracts and the reinsurers' share of those contract liabilities. Under IFRS these three elements are shown as separate lines in the income statement.

Technical provisions in the UK GAAP balance sheet are reclassified under IFRS as either insurance or investment contract liabilities.

### ***Assets held to cover linked liabilities***

Assets held to cover linked liabilities of £6,371 million at 31 December 2004 are no longer shown in a single line but have been reclassified to the relevant individual asset and liability categories in the balance sheet.

### ***Consolidation of unit trusts and other investment funds***

The IFRS definition of when an entity is considered to be under the control of another is wider than under UK GAAP. Consequently certain unit trusts and other investment vehicles which would not have been consolidated under UK GAAP are consolidated into the Group under IFRS.

Consolidation of unit trusts and other investment funds has resulted in an increase in total assets and total liabilities of £285 million and an increase in revenue of £95 million, expenses of £91 million and the taxation charge of £4 million, with no net impact.

### ***Accounting for pension scheme obligations***

The pension asset/liability recognised on the Group balance sheet under IAS 19 is calculated as the difference between the present value of the defined benefit obligation and the fair value of the scheme assets. Scheme assets that are non-transferable financial instruments issued by the Group are not permitted to be included within the scheme assets for the purposes of this calculation. Instead an equivalent deduction is made from the corresponding liability to the scheme.

Consequently, scheme assets of £375 million which consist of pooled pension contracts issued by a subsidiary of the Group, are presented as a deduction from the Group's investment contract liabilities and not as a deduction from the defined benefit pension obligation.

### ***Investment property***

Properties under construction and operational properties occupied by Group entities of £161 million at 31 December 2004, which were treated as investment assets under UK GAAP are shown as property, plant and equipment under IFRS.

### ***Financial Information for the six months ended 30 June 2005***

The tables below have been prepared from the Guarantor's unaudited and unreviewed consolidated financial information for the six months ended 30 June 2005. All information in these tables has been prepared in accordance with IFRS as per the previous section.

**CONSOLIDATED BALANCE SHEET as at 30 June 2005**

	<b>30 June 2005</b>	<b>31 December</b>
	<b>(Unaudited</b>	<b>2004</b>
	<b>and</b>	<b>(Unaudited)</b>
	<b>unreviewed)</b>	<b>(Unaudited)</b>
	<i>(in millions of pounds)</i>	
<b>ASSETS</b>		
Property, plant and equipment .. .. .	138	180
Investment property .. .. .	2,110	1,950
Goodwill, intangibles and other assets .. .. .	1,908	1,862
Financial investments .. .. .	18,963	18,181
Loans and receivables, including insurance receivables .. .. .	207	145
Cash and cash equivalents.. .. .	1,009	836
<b>Total assets</b> .. .. .	<b>24,335</b>	<b>23,154</b>
<b>LIABILITIES</b>		
Participating insurance contract liabilities .. .. .	10,644	10,426
Participating investment contract liabilities .. .. .	2,050	2,063
Unallocated divisible surplus.. .. .	1,418	1,246
Non-participating value of in-force business .. .. .	(313)	(272)
<b>Participating contract liabilities</b> .. .. .	<b>13,799</b>	<b>13,463</b>
Non-participating insurance contract liabilities .. .. .	3,886	3,639
Non-participating investment contract liabilities .. .. .	5,360	4,833
<b>Non-participating contract liabilities</b> .. .. .	<b>9,246</b>	<b>8,472</b>
Other financial liabilities .. .. .	190	200
Provisions and other liabilities .. .. .	771	719
Creditors .. .. .	329	300
<b>Total liabilities</b> .. .. .	<b>24,335</b>	<b>23,154</b>

## CONSOLIDATED INCOME STATEMENT

	Six months ended 30 June 2005 (Unaudited and unreviewed)	Twelve months ended 31 December 2004 (Unaudited)
<i>(in millions of pounds)</i>		
<b>Revenues</b>		
Gross earned premiums .. .. .	385	857
Amounts paid to reinsurers .. .. .	(2)	(1,140)
Net earned premiums .. .. .	383	(283)
Fee and commission income from fund management and investment contracts .. .. .	59	98
Investment income .. .. .	1,432	2,220
Reinsurance recoveries .. .. .	39	2
Reinsurance ceded .. .. .	38	1,127
Other income .. .. .	5	7
	1,956	3,171
<b>Expenses</b>		
<b>Customer benefits and claims</b> .. .. .		
Claims paid (gross) .. .. .	(698)	(1,478)
Movement in insurance contract liabilities.. .. .	(425)	(557)
Movement in investment contract liabilities .. .. .	(385)	(462)
	(1,508)	(2,497)
<b>Operating expenses</b>		
Administration expenses .. .. .	(134)	(288)
Investment management expenses.. .. .	(38)	(89)
Finance costs .. .. .	(10)	(24)
Other expenses.. .. .	(43)	(63)
	(225)	(464)
Income tax charge.. .. .	(51)	(75)
<b>Total expenses</b> .. .. .	(1,784)	(3,036)
	172	135
Transfer to the unallocated divisible surplus .. .. .	(172)	(135)
<b>Profit for the period</b> .. .. .	-	-

As a mutual company, all earnings are retained for the benefit of policyholders and are carried forward within the unallocated divisible surplus. Accordingly, the profit for the period shown in the income statement is £nil. There are no gains and losses other than those included in the income statement.



## TAXATION

*The following is a general description of certain United Kingdom tax considerations relating to the Notes. It does not purport to be a complete analysis of all tax considerations relating to the Notes whether in the United Kingdom or elsewhere. Prospective purchasers of Notes should consult their own tax advisers as to the consequences under the tax laws of the country of which they are resident for tax purposes and the tax laws of the United Kingdom of acquiring, holding and disposing of Notes and receiving payments of interest, principal and/or other amounts under the Notes. This summary is based upon the law as in effect on the date of this Offering Circular and is subject to any change in law that may take effect after such date.*

### **United Kingdom Taxation**

The following is a summary of the United Kingdom withholding taxation treatment at the date hereof in relation to payments of principal and interest in respect of the Notes. The comments do not deal with other United Kingdom tax aspects of acquiring, holding or disposing of Notes. The comments relate only to the position of persons who are absolute beneficial owners of the Notes. Prospective Noteholders should be aware that the particular terms of issue of any further notes may affect the tax treatment of that and other series of notes. The following is a general guide and should be treated with appropriate caution. **Noteholders who are in any doubt as to their tax position should consult their professional advisers.**

Noteholders who may be liable to taxation in jurisdictions other than the United Kingdom in respect of their acquisition, holding or disposal of the Notes are particularly advised to consult their professional advisers as to whether they are so liable (and if so under the laws of which jurisdictions), since the following comments relate only to certain United Kingdom taxation aspects of payments in respect of the Notes. In particular, Noteholders should be aware that they may be liable to taxation under the laws of other jurisdictions in relation to payments in respect of the Notes even if such payments may be made without withholding or deduction for or on account of taxation under the laws of the United Kingdom.

#### *UK Withholding Tax on UK Source Interest*

The Notes which carry a right to interest will constitute “quoted Eurobonds” provided they are and continue to be listed on a recognised stock exchange. On the basis of Her Majesty’s Revenue and Customs’ published interpretation of the relevant legislation, securities which are to be listed on a stock exchange in a country which is a member state of the European Union or which is part of the European Economic Area will satisfy this requirement if they are listed by a competent authority in that country and are admitted to trading on a recognised stock exchange in that country; securities which are to be listed on a stock exchange in any other country will satisfy this requirement if they are admitted to trading on a recognised stock exchange in that country. The London Stock Exchange is a recognised stock exchange for these purposes. Whilst the Notes are and continue to be quoted Eurobonds, payments of interest on the Notes may be made without withholding or deduction for or on account of United Kingdom income tax.

In all cases falling outside the exemption described above, interest on the Notes may fall to be paid under deduction of United Kingdom income tax at the lower rate (currently 20 per cent.) subject to such relief as may be available under the provisions of any applicable double taxation treaty or to any other exemption which may apply.

#### *Payments by Guarantor*

If the Guarantor makes any payments in respect of interest on the Notes (or other amounts due under the Notes other than the repayment of amounts subscribed for the Notes) such payments may be subject to United Kingdom withholding tax at the basic rate (currently 22 per cent.) subject to such relief as may be available under the provisions of any applicable double taxation treaty or to any other exemption which may apply. Such payments by the Guarantor may not be eligible for the quoted Eurobond exemption described above.

#### *Provision of Information*

Noteholders should note that where any interest on Notes is paid to them (or to any person acting on their behalf) by the Issuer or any person in the United Kingdom acting on behalf of the Issuer (a

“paying agent”), or is received by any person in the United Kingdom acting on behalf of the relevant Noteholder (other than solely by clearing or arranging the clearing of a cheque) (a “collecting agent”), then the Issuer, the paying agent or the collecting agent (as the case may be) may, in certain cases, be required to supply to Her Majesty’s Revenue and Customs details of the payment and certain details relating to the Noteholder (including the Noteholder’s name and address). These provisions will apply whether or not the interest has been paid subject to withholding or deduction for or on account of United Kingdom income tax and whether or not the Noteholder is resident in the United Kingdom for United Kingdom taxation purposes. Where the Noteholder is not so resident, the details provided to Her Majesty’s Revenue and Customs may, in certain cases, be passed by Her Majesty’s Revenue and Customs to the tax authorities of the jurisdiction in which the Noteholder is resident for taxation purposes.

For the above purposes, “interest” should be taken, for practical purposes, as including payments made by the Guarantor in respect of interest on Notes.

With effect from 6 April 2006 the provisions referred to above may also apply, in certain circumstances, to payments made on redemption of any Notes where the amount payable on redemption is greater than the issue price of the Notes.

#### *Other Rules Relating to United Kingdom Withholding Tax*

Where Notes are issued at an issue price of less than 100 per cent. of their principal amount, any discount element on any such Notes will not generally be subject to any United Kingdom withholding tax pursuant to the provisions mentioned above, but may be subject to reporting requirements as outlined above.

Where Notes are to be, or may fall to be, redeemed at a premium, as opposed to being issued at a discount, then any such element of premium may constitute a payment of interest. Payments of interest are subject to United Kingdom withholding tax and reporting requirements as outlined above.

Where interest has been paid under deduction of United Kingdom income tax, Noteholders who are not resident in the United Kingdom may be able to recover all or part of the tax deducted if there is an appropriate provision in any applicable double taxation treaty.

The references to “interest” above mean “interest” as understood in United Kingdom tax law. The statements above do not take any account of any different definitions of “interest” or “principal” which may prevail under any other law or which may be created by the terms and conditions of the Notes or any related documentation.

The above description of the United Kingdom withholding tax position assumes that there will be no substitution of the Issuer and does not consider the tax consequences of any such substitution.

#### **EU Savings Directive**

Under EU Council Directive 2003/48/EC on the taxation of savings income, each Member State is required from 1 July 2005, to provide to the tax authorities of another Member State details of payments of interest or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident in that other Member State; however, for a transitional period, Austria, Belgium and Luxembourg may instead apply a withholding system in relation to such payments, deducting tax at rates rising over time to 35 per cent. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating to such payments.

Also with effect from 1 July 2005, a number of non-EU countries including Switzerland, and certain dependent or associated territories of certain Member States, have agreed to adopt similar measures (either provision of information or transitional withholding) in relation to payments made by a person within its jurisdiction to, or collected by such a person for, an individual resident in a Member State. In addition, the Member States have entered into reciprocal provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident in one of those territories.

## SUBSCRIPTION AND SALE

Merrill Lynch International and UBS Limited (together, the “**Joint Lead Managers**”) and Dresdner Bank AG London Branch and Lehman Brothers International (Europe) (together with the Joint Lead Managers, the “**Managers**”) have, in a subscription agreement dated 12 December 2005 (the “**Subscription Agreement**”) and made between the Issuer, the Guarantor and the Managers upon the terms and subject to the conditions contained therein, jointly and severally agreed to subscribe for the Notes at their issue price of 99.676 per cent. of their principal amount less a combined management and underwriting commission of 0.55 per cent. of their principal amount. The Issuer (failing which, the Guarantor) has also agreed to reimburse the Joint Lead Managers for certain of their expenses incurred in connection with the management of the issue of the Notes. The Managers are entitled in certain circumstances to be released and discharged from their obligations under the Subscription Agreement prior to the closing of the issue of the Notes.

The total expenses related to the admission of the Notes to trading on the London Stock Exchange were approximately £6,825.

### **United States of America**

The Notes have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from the registration requirements of the Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S.

The Notes are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. tax regulations. Terms used in this paragraph have the meanings given to them by the United States Internal Revenue Code of 1986 and regulations thereunder.

Each Manager has agreed that, except as permitted by the Subscription Agreement, it will not offer, sell or deliver the Notes, (a) as part of their distribution at any time or (b) otherwise, until 40 days after the later of the commencement of the offering and the issue date of the Notes, within the United States or to, or for the account or benefit of, U.S. persons, and that it will have sent to each dealer to which it sells Notes during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, U.S. persons.

In addition, until 40 days after commencement of the offering, an offer or sale of Notes within the United States by a dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act.

### **United Kingdom**

Each Manager has further represented, warranted and undertaken that:

- (a) *General compliance*: it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Notes in, from or otherwise involving the United Kingdom; and
- (b) *Financial promotion*: it has only communicated or caused to be communicated, and will only communicate or cause to be communicated, any invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of any Notes in circumstances in which section 21(1) of the FSMA does not, or, in the case of the Guarantor would not, if it was not an authorised person, apply to the Issuer or the Guarantor.

### **European Economic Area**

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a “**Relevant Member State**”), each Manager has represented, warranted and agreed that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the “**Relevant Implementation Date**”) it has not made and will not make

an offer of Notes to the public in that Relevant Member State, except that it may with effect from and including the Relevant Implementation Date, make an offer of Notes to the public in that Relevant Member State:

- (a) in (or in Germany, where the offer starts within) the period beginning on the date of publication of a prospectus in relation to those Notes which has been approved by the competent authority in that Relevant Member State or where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive and ending on the date which is 12 months after the date of such publication;
- (b) at any time to legal entities which are authorised or regulated to operate in the financial markets or, if not so authorised or regulated, whose corporate purpose is solely to invest in securities;
- (c) at any time to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than EUR 43,000,000 and (3) an annual turnover of more than EUR 50,000,000, all as shown in its last annual or consolidated accounts; or
- (d) at any time in any other circumstances which do not require the publication by the Issuer of a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this provision, the expression “offer of Notes to the public” in relation to any Notes in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Notes to be offered so as to enable an investor to decide to purchase or subscribe to the Notes, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State.

### **General**

With the exception of the approval by the FSA of this Offering Circular as a prospectus issued in compliance with the Prospectus Directive and relevant implementing measures in the United Kingdom, no action has been or will be taken in any jurisdiction by the Issuer, the Guarantor or any Manager that would, or is intended to, permit a public offering of the Notes, or possession or distribution of this Offering Circular or any other offering material relating to the Notes, in any country or jurisdiction where action for that purpose is required. Persons into whose hands this Offering Circular comes are required by the Issuer, the Guarantor and the Managers to comply with all applicable laws and regulations in each country or jurisdiction in which they purchase, offer, sell or deliver Notes or have in their possession, distribute or publish this Offering Circular or any other offering material relating to the Notes, in all cases at their own expense.

## GENERAL INFORMATION

1. The creation and issue of the Notes has been authorised by a resolution of the Board of Directors of the Issuer dated 9 December 2005. The giving of the Guarantee of the Notes has been authorised by the resolutions of the Board of Directors dated 27 September 2005 and 2 November 2005 and sub-committees of the Board of Directors of the Guarantor dated 8 November 2005, 7 December 2005 and 9 December 2005.
2. Neither the Issuer nor the Guarantor and its subsidiaries taken as a whole is or has been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened, of which the Issuer or the Guarantor is aware) during the 12 months before the date of this Offering Circular, which may have, or have had in the recent past, significant effects on the financial position or profitability of the Issuer or of the Guarantor and its subsidiaries taken as a whole.
3. There has been no material adverse change in the prospects of the Issuer or of the Guarantor and its subsidiaries taken as a whole since the date of the Issuer's incorporation or 31 December 2004, respectively, nor has there been any significant change in the financial or trading position of the Issuer or the Guarantor and its subsidiaries taken as a whole, which has occurred since the date of the Issuer's incorporation or 30 June 2005, respectively.
4. The consolidated financial statements of the Guarantor have been audited without qualification for the three financial years immediately preceding the date of this Offering Circular by PricewaterhouseCoopers LLP, Registered Auditors and Chartered Accountants, a member of the Institute of Chartered Accountants in England and Wales.
5. The financial information contained in this document does not constitute statutory accounts within the meaning of Section 240 of the Companies Act 1985 (the "Act"). Statutory accounts of the Guarantor relating to the years ended 31 December 2002, 2003 and 2004 have been delivered to the Registrar of Companies in England and Wales. PricewaterhouseCoopers LLP, Registered Auditors and Chartered Accountants, made a report under Section 235 of the Act in respect of the statutory accounts of the Guarantor in respect of such years. Such reports were not qualified within the meaning of Section 262 of the Act and did not contain a statement under Section 237(2) or Section 237(3) of the Act.
6. Copies of the following documents may be inspected during normal business hours at the offices of Herbert Smith LLP, Exchange House, Primrose Street, London EC2A 2HS during the period of 12 months from the date of this Offering Circular:
  - (a) the Memorandum and Articles of Association of the Issuer;
  - (b) the Memorandum and Articles of Association of the Guarantor;
  - (c) the Subscription Agreement;
  - (d) drafts (subject to modification) of the Paying Agency Agreement and the Trust Deed;
  - (e) the audited consolidated financial statements of the Guarantor for the years ended 31 December 2003 and 31 December 2004; and
  - (f) the unaudited and unreviewed consolidated financial statements of the Guarantor for the six month period ended 30 June 2005.
7. The Notes and any Coupons and Talons appertaining thereto will bear a legend to the following effect: "Any United States person who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in Sections 165(j) and 1287(a) of the Internal Revenue Code." The sections referred to in such legend provide that a United States person who holds a Note, Coupon or Talon will generally not be allowed to deduct any loss realised on the sale, exchange or redemption of such Note, Coupon or Talon and any gain (which might otherwise be characterised as capital gain) recognised on such sale, exchange or redemption will be treated as ordinary income.
8. The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The ISIN is XS0236968946 and the common code is 023696894.

9. The listing of the Notes on the London Stock Exchange will be expressed in Sterling as a percentage of their principal amount (exclusive of accrued interest). Transactions will normally be effected for settlement in Sterling for delivery on the third business day in London after the date of the transaction. It is expected that the Notes will be admitted to the Official List of the FSA on 15 December 2005, subject only to the issue of the Temporary Global Note. However, prior to official listing dealings in the Notes will be permitted by the London Stock Exchange in accordance with its rules.

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