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STANDARD LIFE

**Standard Life plc  
Annual Report and Accounts 2006**

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# The Group at a glance

Standard Life has long been one of the UK's largest financial services providers. With over 10,000 employees, we manage assets of £156 billion and have 7 million customers across three continents. We are acutely aware of the world we live and work in.

Our aim is to create value by being a leading and dynamic business which grows assets through offering a holistic approach to our customers' money, wealth and wellbeing.

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## UK life and pensions

Page 25

**£372m**

EEV pro forma operating profit before tax, an increase of 37%

One of the UK's largest providers of long term financial solutions from retirement planning to Wrap

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## Asia Pacific life and pensions

Page 28

**£206m**

PVNBP sales, an increase of 172%\*

Attractive growth opportunities in India and China

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## Canada life and pensions

Page 27

**£163m**

EEV pro forma operating profit before tax, an increase of 24%

The most significant of our operations outside the UK offers a wide range of savings, retirement and insurance products.

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## Investment management

Page 29

**£132bn**

total funds under management including £39bn of third party funds, an increase of 11% and 32% respectively

Offers a range of asset management products and investment vehicles to retail and institutional investors

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## Europe life and pensions

Page 28

**£10m**

new business contribution, an increase of 25%

Offers a range of life and pensions products in Germany, Austria and Ireland

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## Banking

Page 30

**£38m**

IFRS pro forma underlying profit before tax, an increase of 58%

Offers a range of innovative, flexible mortgage solutions and retail savings products to meet the wider financial needs of our customers

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## Some financial terms

APE	annual premium equivalent
EEV	– European Embedded Value
GAAP	– generally accepted accounting principles
IFRS	– International Financial Reporting Standards
NBC	– new business contribution
PVNBP	– present value of new business premiums
ROEV	– return on embedded value

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## Healthcare and general insurance

Page 31

**£16m**

IFRS pro forma underlying profit before tax, an increase of 129%

Offers a range of private medical insurance solutions and is the fourth largest provider in the UK.

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\*Percentage change is based on sales in the underlying joint ventures

## Group financial highlights

It has been a challenging but successful year. On 10 July 2006, Standard Life demutualised after members of The Standard Life Assurance Company voted decisively in favour of this important step forward. Having worked hard to prepare strong foundations for our successful future as a plc, we are pleased with our financial results for 2006. These show excellent improvements in profitability across the Group. Our progress since flotation reaffirms our confidence in our future business prospects and we look forward to sharing that success with our shareholders over the coming years.

We are recommending the payment of our first dividend of 5.4p a share on 31 May 2007, covering the period from flotation to 31 December 2006.

<sup>1</sup> See section 3 of the business review on page 32.

<sup>2</sup> See basis of preparation notes on pages 36 and 206.

<sup>3</sup> Earnings per share (EPS) is based on operating profit after tax including notional interest on IPO proceeds where appropriate and on 2,102m shares for basic EPS and 2,173m shares for diluted EPS. For consistency 2005 has been restated based on 2,102m shares for basic EPS and 2,173m shares for diluted EPS.

<sup>4</sup> ROEV is based on operating profit after tax including notional interest on IPO proceeds where appropriate.

<sup>5</sup> See section 5 of the business review on page 43.

<sup>6</sup> Before demutualisation on 10 July 2006, the parent company of the Group was a mutual company operated for the benefit of its with profits policyholders with all surpluses attributable to policyholders through bonuses declared or through transfers to the unallocated divisible surplus. See basis of preparation on page 91.

<sup>7</sup> Total assets managed by the Group including third party assets not held on the balance sheet.

	2006	2005
Worldwide new business sales PVNBP <sup>1</sup>	<b>£14,263m</b>	<b>£9,675m</b>
Worldwide new business sales APE <sup>1</sup>	<b>£1,734m</b>	<b>£1,249m</b>
Group EEV pro forma operating profit before tax <sup>2</sup>	<b>£614m</b>	<b>£395m</b>
Group EEV pro forma profit after tax <sup>2</sup>	<b>£748m</b>	<b>£535m</b>
EEV earnings per share (basic) <sup>3</sup>	<b>21.4p</b>	<b>14.3p</b>
EEV earnings per share (diluted) <sup>3</sup>	<b>20.7p</b>	<b>13.9p</b>
Return on embedded value <sup>4</sup>	<b>8.9%</b>	<b>7.4%</b>
Group IFRS pro forma underlying profit before tax <sup>5</sup>	<b>£540m</b>	<b>£145m</b>
Group IFRS profit after tax attributable to equity holders <sup>6</sup>	<b>£283m</b>	<b>n/a</b>
Group assets under management <sup>7</sup>	<b>£156bn</b>	<b>£138bn</b>

[image removed]

## A message from your Chairman

Sir Brian Stewart

2006 was a challenging but successful year for us. Standard Life plc floated on the London Stock Exchange on 10 July, welcoming over 1.5 million new shareholders who have chosen to play an important part in the future of one of the UK's largest and most successful financial services groups.

**99%**

Percentage of our shareholders who are also customers of Standard Life

**95%**

Percentage of our shareholders who are individual investors.

### A new chapter

In May 2006, members of The Standard Life Assurance Company voted overwhelmingly in favour of demutualisation and flotation. The proposal was approved by the Court of Session in Scotland and the shares of Standard Life plc were listed on the London Stock Exchange on 10 July 2006.

Standard Life's financial results for 2006 show excellent improvements in profitability across the Group. Our successful strategy of concentrating on higher margin products which require lower capital investment has delivered continued improvement in new business profitability and volumes. Worldwide new business sales were over 47% higher than last year on a present value of new business premiums (PVNBP) basis, with a particularly strong performance following flotation.

### In tune with our customers and our environment

Across the Group, we have been making the most of a vital competitive advantage – our ability to understand and meet customers' needs. This kind of thinking has always been a huge part of the culture of Standard Life, and we believe it continues to set us apart as a plc. We remain focused on developing solutions that fit in with people's lives as they change, offering them financial flexibility and control.

Our aim is to provide genuine value for our shareholders over the long term, sustainable growth for Standard Life and a better financial future for our

customers. We want to bring about a fundamental change in the way people think about financial services, building their confidence and trust by offering them products that work for them – throughout their lives.

As well as reflecting our customers' needs, our thinking is also in tune with the wider environment. The financial services industry has seen dramatic changes over the past few years – including exciting product developments like SIPP's (Self Invested Personal Pensions) and the Wrap platform, where Standard Life is leading the field and winning awards. There have also been many regulatory changes designed to protect customers' interests and help them save for the future.

Although these developments offer more choice and flexibility than ever before, they can leave people uncertain about how to take their financial planning forward. Our aim is to make the most of this opportunity by building our customers' trust in a simple, clear way – helping them to understand the potential of new financial products, and providing the information they need to make the right choices.

Treating customers fairly remains very much part of our ethos. Our approach is consistent with the Treating Customers Fairly (TCF) principle of the Financial Services Authority (FSA). The FSA expects all firms to be in the implementing stage of TCF by the end of March – and they have already confirmed that we are in this stage. We have developed plans and processes, allocated TCF resources and responsibilities and created capability among our employees.

### Strategic focus

Our aim is to provide genuine value for our shareholders over the long term, sustainable growth for Standard Life and a better financial future for our customers. We want to bring about a fundamental change in the way people think about financial services, building their confidence and trust by offering them products that work for them throughout their lives.

### Business performance

Standard Life's financial results for 2006 show excellent improvements in profitability across the Group. Our successful strategy of concentrating on higher margin products which require lower capital investment has delivered continued improvement in new business profitability and volumes.

### Looking ahead

We look forward to another year of progress, as our award winning service, exceptional investment performance and broad ranging offer help us to build the loyalty of existing and new customers around the world and add real value for our business and shareholders.

**5.4p**

Recommended dividend payment per share

**20.7p**

EEV earnings per share (diluted)

### Creating value for shareholders

We are recommending the payment of our first dividend of 5.4p a share on 31 May 2007, covering the period from flotation to 31 December 2006. This payment reflects our business performance since 10 July and our confidence in the future progress of the Group. The payment is around half of the total dividend that we would have expected to pay if Standard Life plc had been listed throughout the year.

After this, we expect to pay an interim dividend every November and a final dividend every May – and our intention is to pay a progressive dividend which will take into account the long-term earnings and cash flow potential of the Group.

We are also arranging for our shareholders to have the opportunity to reinvest their dividend payments in Standard Life plc shares and participate further in our long term potential. The dividend reinvestment plan allows shareholders, who are eligible, to use their cash dividends to buy more shares in the Company through a special dealing arrangement – as an alternative to receiving a cash dividend.

### A strong, dedicated team

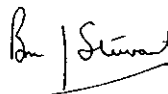
A Group that is making such dramatic progress places great demands on all its people, and I would like to thank our employees across the world for the commitment and energy they have shown over the past year. Their impressive achievements have been directed by a first class management team, led by Sandy Crombie as Group Chief Executive. Our success, both before and after flotation, is a direct result of the strong and thriving business that they and our employees have built – and we continue to strengthen our team. In November, we were delighted to welcome our new Finance Director, David Nish, who has worked with major UK listed companies and brings a broad range of skills to complement our Board's expertise.

Since the year end, we have announced that John Hylands is to step down as a Director at the end of March and Alison Mitchell will retire from the Board at the conclusion of the 2007 Annual General Meeting. I would like to extend the Board's appreciation for their considerable contribution to the Group, especially during the demutualisation and flotation process. I am delighted that Crawford Gillies and Margaret McDonagh have joined the Board, adding their experience to a well balanced team.

### Corporate responsibility

Standard Life has long been committed to maintaining high standards of corporate governance and, in a plc environment, we are continuing this approach with a focus on our shareholders. We are already communicating electronically with over 400,000 of our 1.5 million shareholders as a cost saving, environmentally responsible step. With 7 million customers and over 10,000 employees worldwide, Standard Life is a major business – and we believe that brings major responsibilities. We have always considered that fair and ethical thinking about our stakeholders, people, communities, environment and economic impact is essential in running a successful and sustainable company. Although last year saw a significant change in the legal structure of the Group, this has not, and will not, affect how we approach those responsibilities. Our commitment to corporate responsibility is becoming an integral part of every aspect of Standard Life and we have introduced performance measures and processes that will help us to quantify and communicate our achievements in each area more accurately. You can read more about our work on pages 51 to 53.

On a personal note, this will be my last statement to you as Chairman of Standard Life, as I will be retiring from the Board at the conclusion of the 2007 Annual General Meeting. During my time on the Board, I have witnessed a real corporate success story – culminating in our well received stock market flotation. As I prepare to hand over the Chairmanship to Gerry Grimstone, our Deputy Chairman, I would like to pay tribute to everyone throughout the Group who has worked to create a business that excels in helping so many people to realise their financial goals throughout their lives. We look forward to another year of progress as our award winning service, superior investment performance and broad ranging offer help us to build the loyalty of existing and new customers around the world and add real value for our business and shareholders. Finally, I would like to thank you for your support as a Standard Life plc shareholder. We are delighted to have rewarded your confidence in our potential and I look forward to following this Group's continuing success story.



Sir Brian Stewart  
Group Chairman

[image removed]

## Talking about achievements with your Group Chief Executive

Sandy Crombie

Standard Life is an international Group working to add long term value for shareholders by meeting people's lifetime financial needs in a flexible, innovative way. Our aim is to work with our customers – institutional and individual – and to protect their assets through the breadth of our offer. We offer helpful choices about the important financial decisions – owning a home, planning for a rewarding retirement, protecting health, saving for the future and investments.

To do this, we talk to people to understand what they want, provide financial products that can adapt to life's changes, help our customers to pick solutions that suit them, and make sure they get great personal service from the first moment they talk to us. Customers' needs will continue to be at the very forefront of our thinking – and our 2006 results show that looking after our customers is good for our business and for our shareholders too.

### Financial highlights

We have achieved a strong improvement in our financial performance in 2006. Our strategy of concentrating on higher margin and less capital intensive products has delivered strong growth in new business volumes and profitability. I am confident that, by continuing to focus on such products and continuing to invest in producing award winning service and superior investment performance, we can capitalise on the market opportunities now open to us.

The Group pro forma European Embedded Value (EEV) operating profit before tax rose substantially from £395m in 2005 to £614m in 2006 and our return on embedded value (ROEV) has improved from 7.4% in 2005 to 8.9% in 2006. This was driven by significantly higher sales volumes, increased life and pensions new business contribution and greater profits from our asset management, banking and healthcare businesses. These factors more than offset the impact of the strengthening of lapse assumptions.

On an IFRS basis, pro forma underlying profit before tax increased by 272% to £540m. This increase was driven by higher fee and commission income resulting from increased funds under management, greater profitability in new business and the prior year figure including £189m in reserve strengthening in the UK life and pensions business. For the period commencing 10 July 2006, i.e. following demutualisation the Group is able to report an IFRS profit after tax attributable to equity holders of £283m. Sales for the Group also increased with worldwide new business sales on a present value of new business premiums (PVNBP) basis up 47% to £14,263m from £9,675m in 2005. Annual premium equivalent (APE) increased by 39% to £1,734m from £1,249m. We are on track to achieve our return on embedded value target for 2007 of 9.10%, and increasing thereafter.

UK life and pensions intensified its focus on profitable areas of the market offering favourable margin opportunities and succeeded in increasing EEV pro forma operating profit before tax by £100m, or 37%, from £272m. This was mainly driven by increased new business contribution (NBC), which resulted from increased new business sales volumes, improvements in profit margins and a greater focus on a more profitable product mix. IFRS pro forma underlying profit before tax increased from £16m to £230m for the full year, primarily due to the reserve strengthening in 2005, mentioned above. Total APE sales increased by 54% to £1,442m from £939m (PVNBP sales increased

## Performing for shareholders

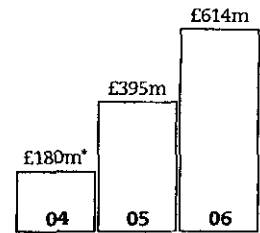
We are recommending the payment of our first dividend of 5.4p a share on 31 May 2007, covering the period from flotation to 31 December 2006. This payment reflects our business performance since 10 July 2006 and our confidence in the future progress of the Group.

**5.4p** Recommended dividend payment per share

## Improving profitability

Our strategy of focusing on products that add value for our business, shareholders and customers has seen strong results.

Rise in EEV pro forma operating profit



\*13.5 months

**+1.5m**

Shareholders around the world

**+7m**

Customers around the world

**99%**

of our shareholders are also Standard Life customers, which gives us a unique business perspective.

by 69% to £11,400m from £6,763m), driven mainly by our market leadership in SIPP, superior investment performance and the heightened activity in the pensions market as a result of A Day. Although life and pensions product lapses continued at levels in excess of long term trends, net fund flows remained strongly positive and amounted to £3.2bn during the year.

The Canadian operations concentrated on building sustainable and profitable new business during 2006. This had a positive impact on NBC, with all product lines generating positive NBC by the year end. Profitability increased after certain individual insurance products were repriced, with EEV pro forma operating profit before tax up £32m to £163m. However, in a price-sensitive market, the repricing did have the effect of reducing new business. Overall APE sales of life and pension products decreased by 10% to £166m (2005 £184m). On a PVNBP basis sales decreased by 5% from £1,882m to £1,791m. Focus on higher profit margin products and cost control, higher fee income from the management of funds and increased investment returns contributed towards an IFRS pro forma underlying profit, which rose by 95% to £168m (2005 £86m).

Our European operations produced an EEV pro forma operating profit before tax of £45m (2005 £53m), following increased costs in respect of new product developments, negative lapse experiences in relation to the Irish business and lower than expected return in Germany as a result of lower present value of in force business (PVIF). IFRS pro forma underlying profit increased by 48% to £108m (2005 £73m), primarily due to a reserving strain adjustment of £55m in the prior year offset by a reduction in margins earned on exceptionally high sales experienced in 2004 and early 2005. German new business sales for the year decreased by 23% to £51m on an APE basis compared to the previous year, which had benefited from changes to German tax legislation. Irish new business sales were 35% higher on an APE basis at £46m (2005 £34m). We maintained our focus on profitable products and launched the Synergy range of new products based on the UK SIPP platform. Sales in the European business are set to keep building in 2007, driven by new product launches, wider distribution and market growth.

In Asia, growth continues to be strong, with total APE sales of the Asian life insurance businesses up 61%<sup>1</sup> in constant currency terms. The Indian joint venture, HDFC Standard Life Insurance Company Limited, contributed APE of £25m, and the Chinese joint venture, Heng An Standard Life Insurance Company Limited, contributed APE of £4m. We anticipate further sales growth in 2007 as our joint venture operations continue to expand.

Standard Life Investments' continued investment out performance drove further mandate wins to record levels. Together with improving equity markets, this saw third party funds under management increase by 32% to £38.5bn (2005 £29.1bn). Total funds under management increased to £132.1bn by the end of 2006 (2005 £118.8bn). IFRS pro forma underlying profit before tax was up by 50% to £66m (2005 £44m) with net investment management revenues increasing 27% from £179m to £227m as a result of higher fee and commission income due to the growth of funds under management and favourable market conditions in the period, which boosted the underlying funds under management.

At Standard Life Bank the focus remained on profitability. An aggressive market, and a significant number of mortgages reaching the end of their incentive period during the year, led to gross lending decreasing by 3% from £3.1bn to £3.0bn and mortgages under management decreasing by 2% to £10.4bn. Despite this, Standard Life Bank succeeded in increasing IFRS pro forma underlying profit before tax by 58% to £38m (2005 £24m). Attracting financially astute customers and establishing a long term relationship with them has resulted in a high quality mortgage portfolio, with only 0.17% of total mortgages three or more months in arrears at the end of 2006, compared with the industry average of 0.95%.

Standard Life Healthcare has an ongoing strategy of writing profitable business. Even in a competitive environment, this focus succeeded in increasing IFRS pro forma underlying profit before tax by £8m to £12m, before taking into account significant one-off costs relating to the purchase of the private medical insurance business of FirstAssist. The emphasis on profitability resulted in stable sales during 2006 of £20m APE (2005 £20m). This was compensated for by an increase in individual business sales, which grew by 27% to £7m (2005 £6m), partly due to the successful launch of the EspritHealth product.

<sup>1</sup> The percentage change figures quoted are based on the new business of the underlying joint ventures to avoid distortion due to changes in the Group's shareholdings.

### **A market view**

With new technology and products, tighter regulations and increasing globalisation, the financial services market is changing more rapidly than ever. To thrive in this environment, successful companies must anticipate developments intelligently and adapt swiftly.

Having more than 1.5 million shareholders and 7 million customers in over 140 countries gives us a great advantage in keeping in touch with this fast-changing world – and we work hard to make the most of it. As a newly listed plc, we are also working hard to build the effective relationships with financial analysts, market commentators and regulators that will help us to keep meeting the expectations of our shareholders.

### **Performing for shareholders**

To increase further the efficiency of our UK businesses and enhance their growth prospects, we will focus on driving synergy benefits from UK life and pensions, Standard Life Healthcare and Standard Life Bank through the establishment of a UK Retail Division, headed by Trevor Matthews.

We aim to reduce underlying costs by a further £100m per annum by 2009. This is in addition to the existing 2007 targets to reduce UK life and pensions' expenses by £30m and to reduce corporate costs to £58m per annum, the 2005 level.

To service our existing levels of business, we can achieve a reduction in the underlying headcount requirement by around 1,000 by 2009 – but we expect growth and natural turnover to keep involuntary job losses to a minimum.

Our drive for continuous improvement in efficiency and productivity will help enhance our commitment to grow and to invest further.

We aim to keep rewarding the loyalty of our shareholders by adding financial value for them, and the next stage of this is our planned bonus share distribution this summer to eligible shareholders. With 99% of our investors also holding at least one Standard Life product, we understand that our relationship with them is about much more than shareholder returns. In fact, performing for our shareholders also means staying true to the philosophy that has always made our business successful – looking after our customers.

### **Working for customers**

People need effective, flexible, rewarding financial products from companies that they can trust – which is why Standard Life is totally committed to doing things this way. We aim to build lifetime relationships with our customers by focusing on developing solutions that fit people's lives.

### **Engaging with our team**

2006 was a time of significant change for all our employees, as they played a part in our move from mutual company status to a listed plc. The support from our staff throughout the restructuring has been invaluable – from helping us develop new strategic goals and implement market leading operational processes, to welcoming our new shareholders, and much more. I would like to thank every one of our people for their hard work and commitment during this demanding time.

### **Corporate responsibility in practice**

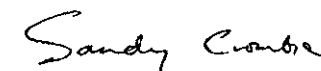
Standard Life has long understood the importance of doing business responsibly, and last year we stepped up our commitment in every area. We also introduced new systems to measure the results, including a database that tracks environmental data from our property investment portfolio. Across the Group, Standard Life raised £2.2m for charities and staff spent more than 11,000 hours helping out with good causes. In the UK, we succeeded in reducing CO2 emissions by 6% and cutting waste by 8% – at the same time as we increased our business. We cut our consumption and increased our use of environmentally friendly paper for all printed communications, and began to tap into the environmental benefits of keeping in touch with our stakeholders online. Now we are set to build on our achievements and will be focusing on managing our environmental footprint as well as continuing our long-standing work within our local communities.

Standard Life plc has recently become a member of the FTSE4Good Index, which is used to identify companies that meet globally recognised corporate responsibility standards. The inclusion of the Company in the Index is excellent recognition of our long standing commitment to running the business to high ethical, legal and professional standards.

### **An award winning approach**

Many people have asked me whether Standard Life's new status as a plc will have an impact on our approach to business. The answer is an emphatic 'no'. In fact, moving into a new and exciting time for our business has only served to renew our focus on delivering excellent service, great products and innovative thinking. This year we won a number of awards including the 5 star life and pensions provider and investment provider awards – for the 11th consecutive year.

Our progress since flotation reaffirms my confidence in our future business prospects and we look forward to sharing the rewards of that success with our shareholders over the coming years.



**Sandy Crombie**  
Group Chief Executive

# Business review

## Business review contents

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## 1 Group information

### 1.1 Introduction

2006 was a historic year for the Standard Life Group with highlights that included the successful demutualisation, strong new business sales and improved new business profitability. The demutualisation and our achievements in repositioning our business model will allow us to keep providing our customers with flexible and responsive service, whilst we continue to build a successful business that will generate value for our shareholders.

The shares of Standard Life plc were listed on the London Stock Exchange (LSE) on 10 July 2006 and on 18 September 2006 the Company was admitted to the FTSE 100 – an index of the largest 100 companies on the LSE. Our move towards listing as a plc was a key objective of the 2004 strategic review, which identified the need to reposition our business model and create a more flexible capital structure that would support profitable growth.

The 2006 results reflect the success of the strategic initiatives that have been implemented over the past two years. The initiatives, which focused on customer service, profitability, capital management and distribution channels, have now created a solid foundation for our future growth. We are committed to achieving our key 2007 targets.

#### Our key targets for 2007

- Increasing the return on embedded value to between 9% and 10%
- To increase further the efficiency of our UK businesses and enhance their growth prospects, we will focus on driving synergy benefits from UK life and pensions, Standard Life Healthcare and Standard Life Bank through the establishment of a UK Retail Division, headed by Trevor Matthews. We aim to reduce underlying costs by a further £100m per annum by 2009.
- Achieving cost reductions of £30m in the UK life and pensions business compared with 2005 levels.
- Maintaining Group corporate centre costs at 2005 levels – offsetting the increase in additional costs that resulted from the move to being a listed company.

#### Basis of preparation

The business review has been prepared in accordance with section 234 ZZB of the Companies Act 1985, which reflects the European Union Accounts Modernisation Directive. To enhance the information provided to our shareholders, we have considered the best practice principles of the Reporting Statement – Operating and Financial Review (OFR) as provided by the Accounting Standards Board (ASB) – although this is not mandatory.

The Group's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). However, the Board believes that non GAAP measures, which have been used in the business review, in conjunction with other measures that are computed in accordance with IFRS, provide useful information to both management and investors and enhance understanding of the Group's performance.

The most significant non GAAP measures in the business review include European Embedded Value (EEV) information and IFRS pro forma underlying profit. See section 4.1 and section 5.1 for the basis of preparation for EEV and IFRS pro forma underlying profit respectively.

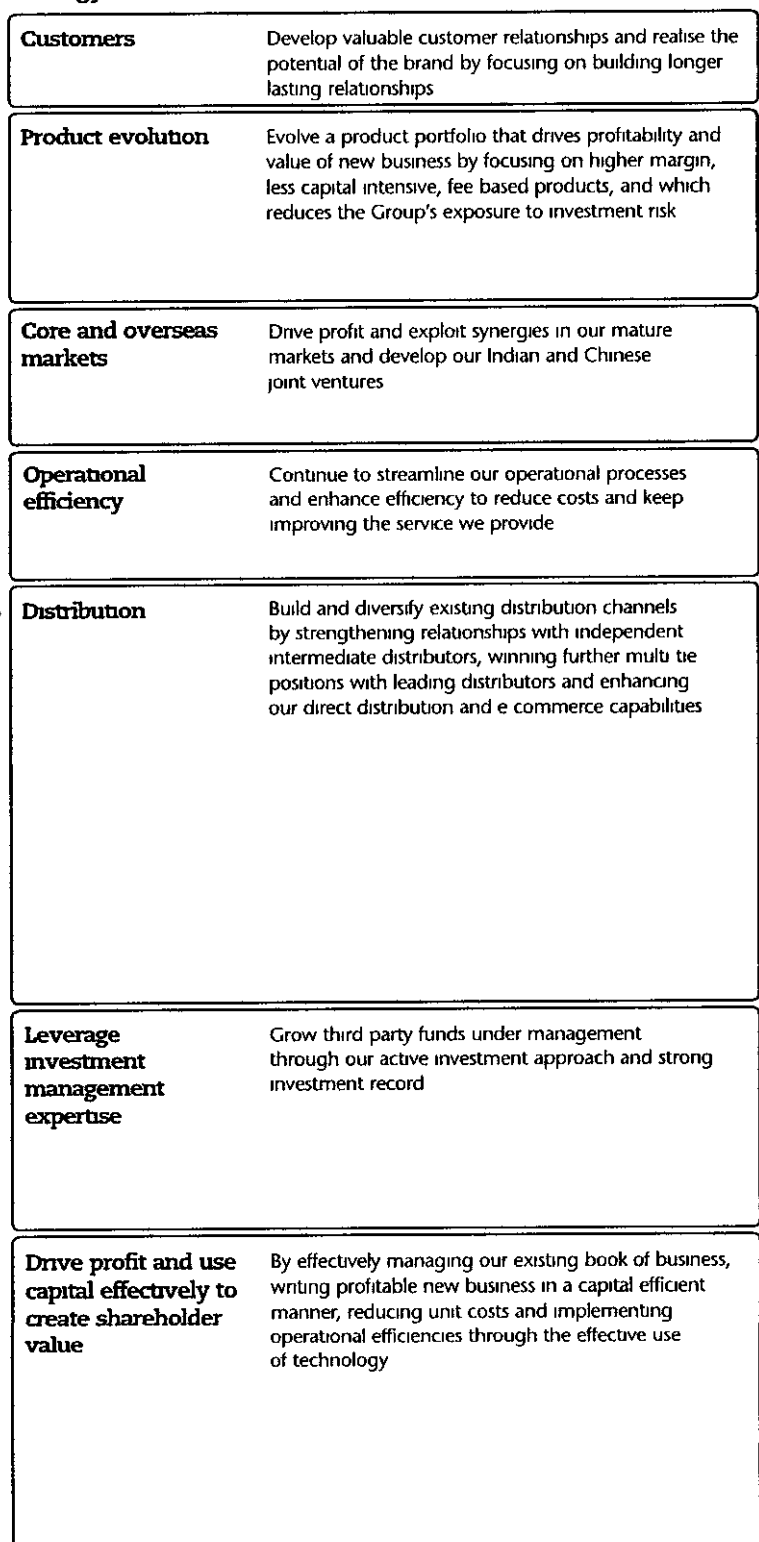
All non GAAP measures should be read in conjunction with the Group's IFRS statutory income statement, balance sheet and cash flow statement that are presented in the Group's financial statements on pages 84 to 201.

## 1.2 Objective and strategy

The successful listing of the Company's shares on the LSE during 2006 created a stronger and more flexible capital base. Operationally, the Group implemented the strategy below, which focused the businesses on customer service, profitability, capital management and distribution channels. The success of the strategy to date has been reflected in our results, as highlighted in the strategy assessment table in section 1.2.1. The Group continues its work on repositioning the business to drive value for our shareholders and help our customers achieve their financial goals.



## Strategy



## 1 2.1 Strategy assessment

Strategy	KPI <sup>1</sup>	Progress against KPI																												
<b>Customers</b>	<ul style="list-style-type: none"> <li>Customer service awards</li> </ul>	Five star life and pensions provider and investment provider at the Financial Adviser Service Awards for the 11th consecutive year																												
<b>Product evolution</b>	<ul style="list-style-type: none"> <li>New business strain</li> <li>Present value of new business premium (PVNBP) margin</li> <li>New business contribution (NBC)</li> </ul>	<p> <b>New business strain</b>            04: £332m, 05: £335m, 06: £335m  <small>see section 1.4 13.5 months</small> </p> <p> <b>Group PVNBP margin %</b>            04: 12%, 05: 0.4%, 06: 1.4%  <small>see section 4.2.2 13.5 months</small> </p> <p> <b>Group NBC £m</b>            04: £132m, 05: £33m, 06: £205m  <small>see section 4.2.2 13.5 months</small> </p>																												
<b>Core and overseas markets</b>	<ul style="list-style-type: none"> <li>Worldwide PVNBP</li> <li>Worldwide annual premium equivalent (APE)</li> </ul>	<p><b>PVNBP up 47% to £14,263m</b> (2005 £9,675m) – see section 3</p> <p><b>APE up 39% to £1,734m</b> (2005 £1,249m) – see section 3</p>																												
<b>Operational efficiency</b>	<ul style="list-style-type: none"> <li>EEV expense variance</li> <li>EEV expense assumptions</li> </ul>	<p>Positive expense variance of £7m (2005 £31m)</p> <p>Positive expense assumption change of £88m (2005 £339m)</p>																												
<b>Distribution</b>	<ul style="list-style-type: none"> <li>Distribution mix by APE</li> </ul>	<p><b>UK distribution by Channel</b></p> <table border="1"> <thead> <tr> <th>Channel</th> <th>04</th> <th>05</th> <th>06</th> </tr> </thead> <tbody> <tr> <td>Banks/New Channels</td> <td>£38m</td> <td>£63m</td> <td>£118m</td> </tr> <tr> <td>Direct</td> <td>£71m</td> <td>£55m</td> <td>£192m</td> </tr> <tr> <td>Consultant Actuaries</td> <td>£49m</td> <td>£78m</td> <td>£178m</td> </tr> <tr> <td>IFA Locals</td> <td>£392m</td> <td>£307m</td> <td>£348m</td> </tr> <tr> <td>IFA Nationals</td> <td>£105m</td> <td>£125m</td> <td>£177m</td> </tr> <tr> <td>IFA Network</td> <td>£308m</td> <td>£311m</td> <td>£429m</td> </tr> </tbody> </table>	Channel	04	05	06	Banks/New Channels	£38m	£63m	£118m	Direct	£71m	£55m	£192m	Consultant Actuaries	£49m	£78m	£178m	IFA Locals	£392m	£307m	£348m	IFA Nationals	£105m	£125m	£177m	IFA Network	£308m	£311m	£429m
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<b>Leverage investment management expertise</b>	<ul style="list-style-type: none"> <li>Funds under management</li> <li>Industry awards</li> </ul>	<p><b>Standard Life Investments FUM</b> ‘UK Equity Manager of the Year’<sup>2</sup></p> <p><input type="checkbox"/> SLI internal FUM    <input type="checkbox"/> 3rd party FUM</p> <table border="1"> <thead> <tr> <th>Year</th> <th>SLI internal FUM</th> <th>3rd party FUM</th> </tr> </thead> <tbody> <tr> <td>06</td> <td>£93.6bn</td> <td>£38.5bn</td> </tr> <tr> <td>05</td> <td>£89.7bn</td> <td>£29.1bn</td> </tr> <tr> <td>04</td> <td>£77.4bn</td> <td>£18.3bn</td> </tr> </tbody> </table>	Year	SLI internal FUM	3rd party FUM	06	£93.6bn	£38.5bn	05	£89.7bn	£29.1bn	04	£77.4bn	£18.3bn																
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<b>Drive profit and use capital effectively to create shareholder value</b>	<ul style="list-style-type: none"> <li>Return on embedded value (ROEV)</li> <li>EEV pro forma operating profit before tax and IFRS pro forma underlying profit before tax<sup>3</sup></li> <li>Group EEV</li> </ul>	<p><b>ROEV</b></p> <table border="1"> <thead> <tr> <th>Year</th> <th>ROEV</th> </tr> </thead> <tbody> <tr> <td>06</td> <td>8.9%</td> </tr> <tr> <td>05</td> <td>7.4%</td> </tr> <tr> <td>04</td> <td>3%</td> </tr> </tbody> </table> <p><b>EEV pro forma operating profit before tax of £614m</b> (2005 £395m) – see section 1.4</p> <p><b>IFRS pro forma underlying profit before tax of £540m</b> (2005 £145m) – see section 5</p> <p><b>Group EEV of £5,608m</b> (2005 £3,744m) – see section 1.4</p>	Year	ROEV	06	8.9%	05	7.4%	04	3%																				
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<sup>1</sup> The Board also uses certain key performance indicators (KPIs) in relation to employee and environmental matters. These are discussed in the Corporate Citizenship report, which is on our website at [www.standardlife.com](http://www.standardlife.com). A glossary of the technical terms is provided on page 244.

<sup>2</sup> At the Financial News ‘Awards for Excellence in Institutional Asset Management Europe 2006’.

<sup>3</sup> EEV pro forma operating profit before tax and IFRS pro forma underlying profit before tax should be read in conjunction with the basis of preparation information in sections 4 and 5 respectively.

### 1.3 Overview

#### Overview of results

In 2006 EEV operating profit before tax increased by 55% to £614m delivering a return on embedded value of 8.9% (2005 7.4%). Increased life and pensions new business contribution, improved experience variances and greater profits from our asset management, banking and healthcare businesses more than offset the impact of increased lapse assumptions. On an IFRS basis, pro forma underlying profit before tax increased by 272% to £540m. This increase was driven by higher fee and commission income resulting from increased funds under management, greater profitability in new business and the prior year including £189m in reserve strengthening in the UK life and pensions business. Worldwide insurance sales were up by 47% to £14,263m, on a PVNBP basis, reflecting strong new business performance in UK life and pensions. This substantial improvement in trading performance gives rise to diluted EEV operating earnings per share 49% higher at 20.7p. Diluted underlying earnings per share on an IFRS basis increased by 276% to 21.8p.

UK life and pensions benefited from a substantial increase in new business contribution of 519% to £167m (2005 £27m). This reflects margin improvement in every product group and the significant growth in PVNBP new business volumes of 69% to £11,400m (2005 £6,763m) driven by the success of SIPP, Capital Investment Bonds and TIP, and the impact of A-day on customer activity. EEV operating profit before tax increased by 37% to £372m despite changes in long term assumptions and provisions for lapses of £207m. Although UK life and pensions product lapses continued at levels in excess of long term trends, net fund flows remained strongly positive and amounted to £3.2bn during 2006. We anticipate the continuation of strong underlying sales momentum in 2007, underpinned by our market leading service and innovative product offerings coupled with our impressive track record in investment performance.

In our Canadian life and pensions business the focus on margin over volume and the repricing of certain Universal Life products resulted in a turnaround in new business contribution from a loss of £2m in 2005 to a profit of £28m in 2006, which helped EEV operating profit before tax increase 24% to £163m. While we expect market conditions to remain challenging this year, our continued efforts on cost control and the product initiatives undertaken in the second half of 2006 will support steady profitable growth in 2007.

The EEV operating profit before tax from European businesses decreased 15% to £45m reflecting the further investment in product development in Germany and Ireland. Following successful product launches in both countries, we expect to build on the sales momentum we achieved in the second half of 2006.

The Asian life and pensions EEV operating loss increased to £8m (2005 £2m loss) due to the continued expansion of the operations in India and China. These businesses are expected to achieve improved sales in 2007, driven by new product launches, wider distribution and market growth.

Standard Life Investments' third party funds under management increased by 32% to £38.5bn at the end of 2006, reflecting continued investment outperformance, which has driven record levels of both institutional and retail third party mandate wins. Standard Life Investments' operating profit before tax increased 50% to £66m on an IFRS basis as a result of the higher funds under management leading to a significant improvement in the EBIT margin to 27.0% (2005 22.3%). The pipeline of new business remains strong and this, along with Standard Life Investments' impressive performance track record and the successful introduction of additional products in both the retail and institutional markets, provides a powerful platform to deliver continued growth in 2007.

Standard Life Bank increased underlying profit before tax by 58% to £38m on an IFRS basis as a result of improved interest margin and cost control in a year when gross mortgage lending was similar to the prior year. In 2007 we expect Standard Life Bank to benefit from continued reduction in its cost income ratio and increasing SIPP and Wrap balances. Credit quality remains extremely high, the arrears rate of 0.17% at the year end continues to be well below the industry average of 0.95%.

Through a disciplined approach to business Standard Life Healthcare more than doubled 2005 IFRS underlying profit before tax. Standard Life Healthcare's new policy administration system coupled with the launch of a new product proposition is expected to increase sales and reduce operating costs in 2007. The integration of FirstAssist continues to plan with the full benefits being realised in 2008 and thereafter.

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EEV increased to £5,608m, equivalent to 258p per share (diluted), driven by the strong operating performance for the year and positive investment return variances. EEV cash generation increased to a £262m inflow (2005 £17m outflow) due to a reduction in new business strain, improved contribution from in force life business and greater non life profits.

We are recommending the payment of our first dividend of 5.4p a share on 31 May 2007, as indicated at flotation. This dividend represents around half of the total dividend that we would have expected to pay if Standard Life plc had been listed throughout the year. Our intention is to pay a progressive dividend which will take account of the long term earnings and cash flow potential of the Group.

### **Delivering continuous improvement**

On 22 March 2007, we announced further initiatives to increase the efficiency of our UK businesses and enhance their growth prospects. These initiatives focus on driving synergy benefits from UK Life and Pensions, Standard Life Healthcare, Standard Life Bank and shared services for Standard Life Investments. In due course we will look at achieving additional savings in our Canadian, German and Irish businesses.

At the time of the flotation in July 2006 we announced a target to reduce UK Life and Pensions' expenses by £30m by the end of 2007, £15m has been achieved to date. This commitment is being achieved at the same time as delivering strong sales growth. We also committed to reduce corporate costs in 2007 to £58m per annum, the 2005 level, despite the incremental costs of being a listed company. This target is also expected to be achieved. The initiatives announced today are in addition to those targets.

We aim to reduce underlying costs by a further £100m per annum by 2009. It is expected that the phasing of savings will be achieved as follows: in the second half of 2007 £15m, in 2008 a further £70m, and in 2009 an additional £15m. Through efficiency and productivity we can achieve a reduction in the underlying headcount requirement to service our existing levels of business by around 1,000 by 2009. We expect growth and natural turnover to keep involuntary job losses to a minimum. The one-off costs of implementing these savings are expected to be no greater than the annual savings achieved by 2009.

We are establishing a UK Retail Division, headed by Trevor Matthews, currently Chief Executive of Standard Life Assurance Limited. He will be responsible for the continued development of UK Life and Pensions, Standard Life Bank and Standard Life Healthcare and for driving synergies in both costs and revenues by streamlining common functions and enhancing our capability to grow. Duplication of activities which are currently taking place across multiple business units, divisions and product lines will be targeted.

Other key initiatives include the expansion of the use of shared service activities, rationalisation of group central functions, re-engineering of key processes and the implementation of smarter sourcing of services.

The cost savings are expected to be achieved roughly equally between covered and non-covered businesses. Within the covered business, we expect at least £20m would be capitalised into the EEV in long term maintenance unit cost savings by end 2009 after allowing for approximately 10% of the savings attributable to the with profits policyholders.

These additional actions will strengthen further our customer focus and improve the efficiency of our operations. This will enhance our ability in the medium term to increase new business margins, drive higher profitability and augment future embedded value.

### **General industry matters and outlook**

We continue to drive our business forward and have exciting product and market opportunities both in the UK and overseas. Customers' needs will remain at the forefront of our thinking. Growth will continue to be driven by our strategy of concentrating on higher margin and less capital intensive products delivered with best in class customer service levels and through leading edge platforms and efficient systems.

Our results are affected by general industry factors such as economic and market conditions, changes in demographics, government legislation and regulatory changes and competition. The outlook for 2007 is encouraging and we believe we are well placed to manage and take advantage of the opportunities that the changing market conditions present.

### **Economic and market conditions**

Like our peers, a significant portion of the Group's life and pension and investment management income is based on a percentage of the value of funds under management. This income stream is affected by changes to equity and bond markets. Our outlook for these markets in 2007 remains positive, however, shocks to the economy can increase volatility, which may affect our income streams.

### **Changing demographics**

Changes in the demographics of the population in which the Group operates present both opportunities and risks. Demographic studies suggest that, over the next decade, there will be continued growth in the number of individuals entering the age group that we believe are most likely to buy life assurance and pension products. The Group has taken steps to benefit from this by providing innovative market leading propositions, such as our award winning Self Investment Pension Plan (SIPP).

However, demographic studies also indicate that mortality rates continue to improve. Like other life assurance and pension providers, the Group is affected by this, because future expected mortality rates have a direct impact on our annuity pricing and reserves. The Group has an established risk management framework – see section 1.8, which monitors our overall exposure to such changes. In addition, actuarial assumptions are reviewed on a regular basis to ensure they remain appropriate.

### **Government and regulatory changes**

Government policy on pensions, tax and regulatory regime impacts the Group's operating environment in the territories where we do business.

A recent change in government legislation in the UK has resulted in a more flexible pensions regime. This has not only increased industry churn, but has also brought new money into the industry. The Group has been a net beneficiary of this change.

In late 2006, the UK government unveiled proposals for a National Pensions and Savings Scheme (NPSS), due to be introduced in 2012. The purpose of the scheme is to encourage individuals to save and take greater responsibility for their retirement. This emphasis offers the Group opportunities to develop new products that will help customers achieve their long term financial goals.

### **Competition**

The markets for financial services in the UK, Canada and the Group's other geographic markets are highly competitive. Our competitors include other insurance companies, mutual fund companies, investment management firms, commercial banks, other financial institutions and niche providers. Some competitors offer similar products, which places pressure on product pricing and margins, and can have an impact on distribution channels. This can ultimately affect the Group's ability to achieve its objective.

The Group's overall strategy, detailed in section 1.2, provides the basis for how we will achieve our objective. The business units adopt the Group's strategy and tailor it for the market conditions in which they operate. The link between the Group and individual business unit strategies is what ultimately allows us to compete successfully and achieve our objective. Over the past two years, our strategic initiatives, which focused on customer service, profitability, capital management and distribution channels, have allowed our business to compete successfully. We believe we are well placed to continue this trend.

## 1 4 EEV – Group

### Summary EEV pro forma income statement

	Pro forma period 1 January 2006 to 10 July 2006 <sup>1</sup> (H1)	Audited period 10 July 2006 to 31 December 2006 (H2)	Pro forma Full Year (FY) 2006	Pro forma FY 2005
	£m	£m	£m	£m
Operating profit before tax <sup>2</sup>	268	346	614	395
Non operating income	26	382	408	375
<b>Profit before tax</b>	<b>294</b>	<b>728</b>	<b>1,022</b>	<b>770</b>
Attributed tax	(61)	(213)	(274)	(235)
<b>Profit after tax</b>	<b>233</b>	<b>515</b>	<b>748</b>	<b>535</b>
<b>Key statistics</b>				
NBC	£100m	£105m	£205m	£33m
PVNB <sup>3</sup> margin <sup>3</sup>	1 6%	1 3%	1 4%	0 4%
Basic EEV EPS <sup>4</sup>	9 6p	11 8p	21 4p	14 3p
Diluted EEV EPS <sup>4</sup>	9 3p	11 4p	20 7p	13 9p
ROEV <sup>5</sup>	8 2%	9 8%	8 9%	7 4%

The above results should be read in conjunction with the basis of preparation information in section 4 1

#### Operating profit before tax

The Group EEV operating profit before tax increased by 55% to £614m (2005 £395m)

New business contribution increased by 521% to £205m (2005 £33m), consistent with the Group's focus on improving product margins – see section 4 2 2 and the strong growth in sales – see section 3

Expected return increased by £64m and positive experience variances increased by £62m – see section 4 2 2

Assumption changes were £58m negative in 2006 (2005 £37m positive) Within this was a cost in respect of increased lapse assumptions of £260m in 2006, including £100m announced at 30 June 2006 (2005 £103m) – see section 4 2 2

Non life losses reduced to £2m (2005 loss £59m), reflecting higher profits from the main subsidiary companies, along with the transfer of the cost of carry of the subordinated debt to covered business – see section 4 2 2

#### Non-operating income

Non operating income increased by 9% to £408m (2005 £375m) This reflects the favourable impact of market changes and other movements, offset by lower economic assumption changes, reflecting current market conditions – see section 4 2 3

#### New business margin

The increase to 1 4% (2005 0 4%) is largely due to UK performance, where margins have increased from 0 4% to 1 5% In addition, new business margins in Canada rose from 0 1% to 1 6% – see section 4 2 2 The H2 margin was impacted by the doubling of sales of UK institutional pensions business which generates relatively low margins

#### EEV EPS

This is based on operating profit after tax with an adjustment for notional interest on Initial Public Offering (IPO) proceeds and shows an increasing trend from full year 2005 EPS for all periods was calculated using 2,102m shares for basic EPS and 2,173m shares for diluted EPS, to allow comparison

<sup>1</sup> Including adjustments to arrive at 10 July 2006 opening position

<sup>2</sup> Operating profit after tax for 2006 is £429m (2005 £270m)

<sup>3</sup> New business contribution as a percentage of PVNB<sup>3</sup>

<sup>4</sup> Earnings per share (EPS) is based on operating profit after tax including notional interest on IPO proceeds where appropriate and on 2,102m shares for basic EPS and 2,173m shares for diluted EPS For consistency 2005 has been restated based on 2,102m shares for basic EPS and 2,173m shares for diluted EPS (notional interest £21m H1, £nil H2, £31m FY 2005)

<sup>5</sup> Return on embedded value (ROEV) is based on operating profit after tax including notional interest on IPO proceeds where appropriate (notional interest £21m H1, £nil H2, £31m FY 2005) divided by the opening embedded value including the IPO proceeds.

### EEV balance sheet

	Audited 2006 £m	Pro forma 2005 £m
<b>Covered business</b>		
Free surplus	720	163
Required capital	562	549
<b>Net worth</b>	<b>1,282</b>	<b>712</b>
Present value of in force	3,480	3,153
Cost of required capital	(263)	(264)
<b>Total embedded value of covered business</b>	<b>4,499</b>	<b>3,601</b>
<b>Non covered business</b>		
Investment management	149	105
Banking	355	284
Healthcare and general insurance	119	73
Group corporate centre	553	
Other non-covered business	73	128
<b>Total net assets of non covered business</b>	<b>1,249</b>	<b>590</b>
<b>Other</b>		
Pension scheme deficit	(140)	(228)
Mark to market of subordinated debt		(219)
<b>Total Group embedded value</b>	<b>5,608</b>	<b>3,744</b>

#### Free surplus

The 2006 closing free surplus is the sum of the actual free surplus attributed to shareholders in respect of life and pensions on demutualisation, the IPO proceeds that were injected into the life and pensions business and the free surplus generated since demutualisation. The 2005 free surplus position reflected the expected free surplus on demutualisation, excluding the IPO proceeds.

#### Required capital and cost of required capital

Required capital has increased by £13m and the cost of holding this capital remained in line with the previous year. The total required capital still largely relates to Canada (£526m), where all required capital is met by the shareholder. Required capital in the UK and Europe only relates to business written outside the Heritage With Profits Fund (HWPF). Required capital for relevant pre-demutualisation in force business continues to be met by the HWPF.

#### Present value of in force

The present value of in force (PVIF) increased by 10% to £3,480m (2005 £3,153m). The increase was largely attributable to new business contribution and the expected return on existing business, partially offset by transfers of emerging profits to free surplus.

#### Non covered business

The net assets of the non-covered business are shown on an IFRS basis. The increase in the net asset positions of £659m is largely driven by the IPO proceeds of £567m held centrally. The balance is derived from pre-demutualisation capital transfers from the HWPF, as dictated by the Scheme of Demutualisation, and the results of the 2006 operations.

#### Other

The pension scheme deficit in 2005 related to both covered and non covered business. For 2006 the portion of this deficit relating to schemes in Ireland, Germany and Canada, exclusively covering life and pensions staff has been reallocated to covered business. The remaining deficit shown within 'Other' relates to the whole of the UK pension scheme as this covers employees of all the UK operations, not only life and pensions staff.

The UK mark to market of the subordinated debt is no longer disclosed separately and has been reallocated to UK covered business as part of the demutualisation adjustments

#### EEV cash generation

The Group's IFRS cash flow statement, included in the Group's financial statements on page 90, combines cash flows relating to both policyholders and shareholders. The analysis of free surplus arising within EEV is the preferred method used by the Group to monitor the shareholder cash flow generation of the life and pensions business.

The ability of the life and pensions operations to finance the writing of new business out of cash flows from existing business is a key consideration in capital management. Any new business strain that cannot be funded by net cash received from in force business would have to be met from existing excess working capital in the business or from additional capital sources. There has been a significant improvement in underlying cash flow generation in 2006, to £179m from £9m in 2005, as illustrated in the table below.

	Pro forma 2006			Pro forma 2005		
	Free surplus	Required capital	Net worth	Free surplus	Required capital	Net worth
	£m	£m	£m	£m	£m	£m
New business strain	(335)	32	(303)	(332)	26	(306)
Expected cash flows from existing business	451	(15)	436	339	12	351
<b>Operating cash flows from new business and expected return</b>	<b>116</b>	<b>17</b>	<b>133</b>	<b>7</b>	<b>38</b>	<b>45</b>
Cash flows from variances, development costs and assumption changes	63	48	111	2	(25)	(23)
<b>Total cash movements*</b>	<b>179</b>	<b>65</b>	<b>244</b>	<b>9</b>	<b>13</b>	<b>22</b>

\* Cash movements are shown net of tax for covered business including the current profits and losses of SLI on its management of funds relating to the life and pensions business. Net (expense)/income directly recognised in the EEV balance sheet, including exchange differences and capital movements are not included as these are not trading related cash flows. Separate cash flows are shown for free surplus (which shows the free cash flow after setting up required capital) and net worth (where required capital and free surplus are combined). In general, cash flows are on the free surplus basis, whilst movements in net worth are referred to as capital generation.

#### New business strain

New business strain is virtually unchanged at £335m in 2006 (2005: £332m) despite a significant increase in new business premiums – see section 3. This reflects our strategy of focusing on more capital efficient products. It also reflects a change in the commission payment structure on certain new products.

#### Expected cash flows from existing business

Expected cash flows from existing business increased by £112m to £451m, reflecting the increase in the opening PVIF.

In addition to the positive cash flows generated by the life and pensions covered business, the Group has indicative net cash inflows (on an after tax IFRS basis) from non covered entities of £18m (2005: outflows of £39m).

**1.5 IFRS – Group**  
**IFRS condensed income statement**

	Period 1 January 2006 to 10 July 2006 £m	Period 10 July 2006 to 31 December 2006 £m	FY 2006 £m	FY 2005 £m
<b>Revenue</b>				
Net earned premium	1,927	2,036	3,963	3,516
Net investment return	2,868	7,911	10,779	14,377
Fee and commission income	251	270	521	360
Other income	28	58	86	54
<b>Total net revenue</b>	<b>5,074</b>	<b>10,275</b>	<b>15,349</b>	<b>18,307</b>
<b>Expenses</b>				
Net insurance benefits and claims	2,251	4,346	6,597	4,136
Net change in policyholder liabilities	1,385	4,253	5,638	11,354
Administrative expenses	1,239	952	2,191	2,150
Change in liability for third party interest in consolidated funds	33	83	116	43
Finance costs	59	55	114	109
<b>Total expenses</b>	<b>4,967</b>	<b>9,689</b>	<b>14,656</b>	<b>17,792</b>
Share of profits from associates and joint ventures	63	54	117	99
<b>Profit before tax</b>	<b>170</b>	<b>640</b>	<b>810</b>	<b>614</b>
Total tax expense	118	297	415	531
<b>Profit for the period</b>	<b>52</b>	<b>343</b>	<b>395</b>	<b>83</b>
<b>Attributable to</b>				
Equity holders of Standard Life plc		283	283	
Minority interest	52	60	112	83

As a result of the different operating models of the Group pre and post demutualisation comparisons of the performance of the business over the periods shown in the IFRS condensed income statement above cannot be derived from the profit figures. IFRS pro forma underlying profit before tax (non GAAP measure) figures have been provided in section 5 and, read in conjunction with the IFRS statutory income statement, may provide a more meaningful analysis of our results.

**Total net revenue**

Total net revenue decreased by 16%, primarily due to a decrease in investment return, which is consistent with the performance of equity and debt markets in 2006.

Net earned premiums increased by 13% to £3,963m (2005 £3,516m) largely due to annuity sales. As detailed in section 3, most of the Group's new business is in respect of non participating investment contracts, the premiums on which are excluded from the income statement under IFRS accounting rules.

Fee and commission income increased by 45% as fees from investment contracts reflected robust new business sales of investment products and the strong growth in third party funds under management.

**Total expenses**

Total expenses were down by 18% primarily due to the reduced change in policyholder liabilities. This was partly offset by an increase in claims paid.

Net insurance benefit and claims increased by £2,461m, up 60% on 2005. The increase is primarily due to lapses post 10 July 2006 in relation to demutualisation and A Day.

Net change in policyholder liabilities of £5,638m (2005 £11,354) was lower than 2005 due to the increase in claims paid and investment return volatility.

Administration expenses increased by £41m, up 2% on 2005 because of demutualisation expenses and strong sales growth in the first half of the year. Following demutualisation, a greater portion of new business expenses can be capitalised.

## IFRS balance sheet

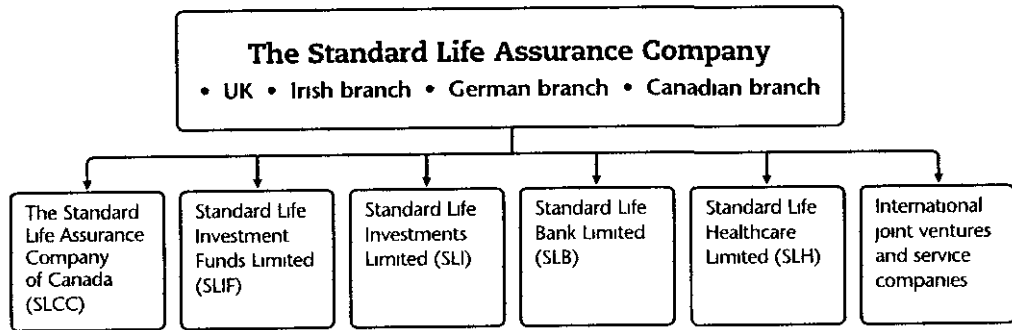
	2006	2005
	£m	£m
<b>Assets</b>		
Intangible assets and deferred acquisition costs	505	334
Investments in associates and joint ventures	3,237	2,608
Investment property	11,338	9,907
Loans and receivables	12,021	12,496
Investment securities	97,224	87,431
Other assets	4,304	3,033
Cash and cash equivalents	3,962	4,451
<b>Total assets</b>	<b>132,591</b>	<b>120,260</b>
<b>Equity</b>		
Share capital and share premium reserve	1,009	
Retained earnings	298	
Other reserves	1,571	
<b>Capital and reserves attributable to equity holders of Standard Life plc</b>	<b>2,878</b>	
Minority interest	307	340
<b>Total equity</b>	<b>3,185</b>	
<b>Liabilities</b>		
Non participating contract liabilities	71,133	62,087
Participating contract liabilities	39,996	41,008
Third party interest in consolidated funds	961	358
Borrowings	6,506	6,233
Subordinated liabilities	1,834	1,878
Other liabilities	3,905	3,222
Customer accounts related to banking activities and deposits by banks	5,071	5,134
<b>Total liabilities</b>	<b>129,406</b>	<b>119,920</b>
<b>Total equity and liabilities</b>	<b>132,591</b>	<b>120,260</b>

The 2006 balance sheet reflects the change in the ownership structure following demutualisation. The Group raised £1.3bn from IPO proceeds, net of transaction costs. Of this, £737m was transferred to Standard Life Assurance Limited (SLAL) to support its operations. The remaining portion is to be used for corporate purposes. Note 1 and Notes 23 to 26 of the Group's financial statements provide details of the demutualisation and the equity sections of the balance sheet.

The increase in assets and liabilities was primarily attributable to strong new business flows and positive investment returns. The UK life and pensions insured business had net inflows of £2.3bn (2005: £2.0bn) driven by strong growth in SIPP, Capital Investment Bond (CIB) and Trustee Investment Plan (TIP) products. Together with strong property and equity markets, these contributed to the £9.0bn increase in non-participating investment contract liabilities and related assets.

Other liabilities include £220m (2005: £386m) relating to the Group's pension obligations. The decrease was the result of additional contributions of £60m and the inclusion of £110m of assets that were previously classed as 'non-transferable' financial instruments – see note 34 in the financial statements. The Group is currently implementing a number of steps to manage its pension liability, including additional contributions of £10m every six months.

**1.6 Group structure**  
**Pre demutualisation structure**



**Demutualisation**

On 10 July 2006, The Standard Life Assurance Company demutualised and the shares of a new holding company for the Standard Life Group, Standard Life plc were listed on the London Stock Exchange

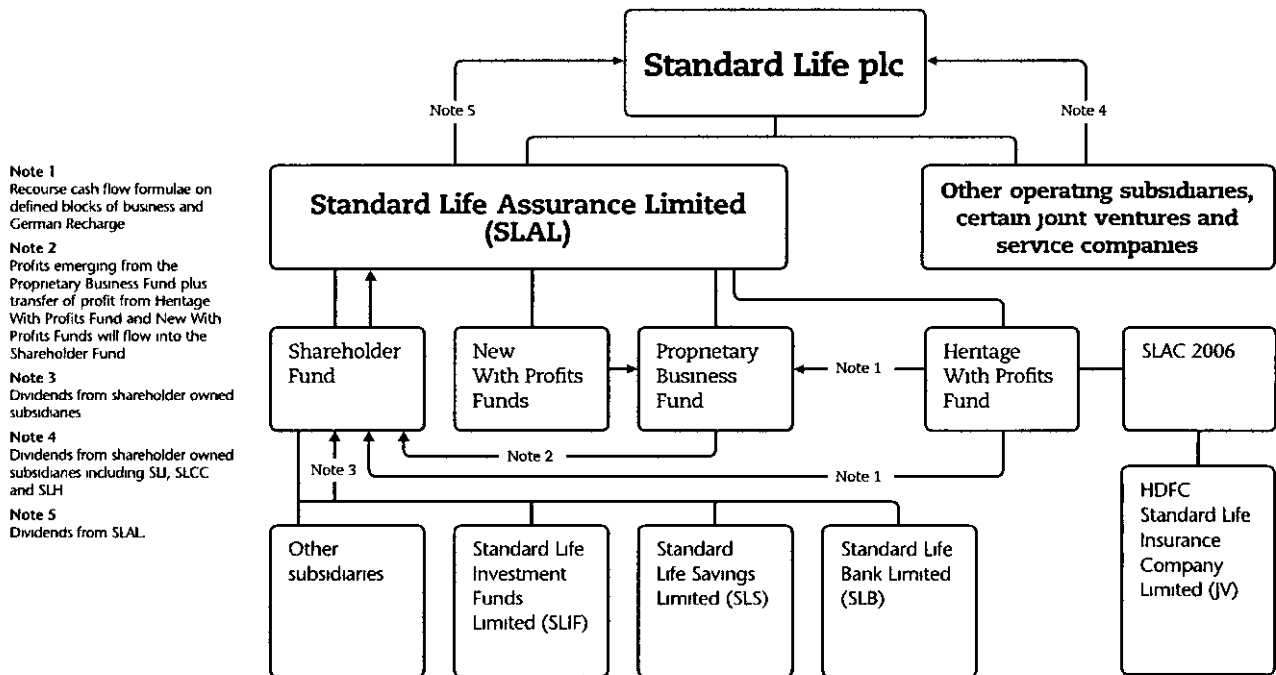
Following demutualisation, all of SLAC's existing UK business and business written in the Irish and German branches was transferred to Standard Life Assurance Limited (SLAL) – an authorised insurance company which is a wholly-owned subsidiary of the Company

On demutualisation, SLAC changed its name to The Standard Life Assurance Company 2006 (SLAC 2006) and became a subsidiary of SLAL. SLAC 2006 is now almost exclusively involved in managing a small block of Canadian business. SLAC 2006 is not expected to write any new business

The Scheme of Demutualisation (the Scheme) determined the rights of the policyholders and shareholders to the assets, liabilities and future cash flows on the in force business transferred from SLAC and business written after demutualisation. The Scheme requires SLAL to establish and maintain the Heritage With Profits Fund, New With Profits Funds, Proprietary Business Fund and the Shareholder Fund

## Post demutualisation structure

The arrows in the diagram below show the cash flow movements from the various long term insurance funds and operating companies post demutualisation



## New structure and emergence of profits

### Heritage With Profits Fund

The Heritage With Profits Fund (HWPF) contains all existing business – both with profits and non participating – written before demutualisation in the UK, Insh or German branches, with the exception of the classes of business which the Scheme allocated to the Proprietary Business Fund. This fund also contains increments to existing business allocated to the Heritage With Profits Fund.

### New With Profits Funds

There are four New With Profits Funds. One fund accommodates the investment element of unithised with profits business of the German branch written after demutualisation. This has guaranteed minimum unit price growth rates. The other three funds accommodate the investment element of all unithised with profits business written by the UK and European life and pensions businesses in the Proprietary Business Fund after demutualisation. This business has no guarantees.

### Proprietary Business Fund

The Proprietary Business Fund contains, certain existing non participating business including pension contribution insurance policies, income protection plan policies, a number of SIPP policies written before demutualisation and most new insurance business written after demutualisation in the UK, Ireland and Germany.

### Shareholder Fund

The Shareholder Fund contains some of the IPO proceeds, assets and liabilities associated with the subordinated debt and holdings in certain significant operating subsidiaries – Standard Life Investment Funds Limited (SLIF), Standard Life Bank Limited (SLB) and Standard Life International Limited (SLIL).

#### Other operating subsidiaries and joint ventures

The other operating subsidiaries of the Group are owned by SL plc and include The Standard Life Assurance Company of Canada (SLCC), Standard Life Investments Limited (SLI) and Standard Life Healthcare Limited (SLH). The Group's interest in the Chinese joint venture Heng An Standard Life Insurance Company Limited is owned by the Shareholder Fund of SLAL. The Group's interest in the Indian joint venture HDFC Standard Life Insurance Company Limited is held by SLAC 2006.

#### Emergence of profit

The Scheme allows for certain cash flows arising in the HWPF on specified blocks of UK and Irish business to be transferred out of the fund and accrue to the ultimate benefit of shareholders. This is called the recourse cash flow (RCF). To protect policyholders, the Scheme sets out limits on these transfers, and in some situations, the Shareholder Fund may be required to make a transfer to the HWPF. The Scheme also allows for certain expenses to be charged by the Proprietary Business Fund to the HWPF in respect of the German branch.

As presented in the post demutualisation structure diagram, profit is derived from

- The RCF from the HWPF, which affects the UK and Ireland – see sections 5.2.1 and 5.2.3 respectively
- The German branch recharge, which affects Germany's shareholder profit – see section 5.2.3
- Results from life and pension business written outside the HWPF – see section 5.2
- Results from other operating subsidiaries – see section 5.2

#### 1.7 Capital management and financing

Effective capital management is an integral part of the Group's operations. It focuses on managing the financial strength of the organisation, as well as establishing the best way to allocate capital resources to drive profitability.

The objective of the Group's capital management programme is to help the Group drive profit and use capital effectively to create shareholder value.

#### The capital management policy was created with two goals in mind.

		Key metric
1 To maintain confidence in the business	→	Regulatory Solvency
2 To create shareholder value	→	European Embedded Value

#### Capital management policy

Our capital management policy applies throughout the Group. This policy provides a pragmatic framework for the effective and consistent management of capital and value.

The two goals are closely related and the Group manages its capital on both bases. This principle is embedded in the Group's policy framework.

The scope of the capital management policy is wide-ranging and consists of five key elements – see page 23. These elements have been integrated into many of the Group's key processes.

The capital management policy forms one pillar of the Group's overall management framework. Most notably, it operates alongside, and complements, the strategic investment policy and the Group risk policy. By integrating policies in this way, the Group is working towards a capital management framework that robustly links the processes of capital allocation, value creation and risk management.

**Five key elements of the capital management framework**

- 1 Establishing Group wide performance targets
- 2 Monitoring current capital amounts
- 3 Forecasting and planning required capital amounts
- 4 Establishing target capital levels
- 5 Managing capital structure and capital raising activities

**Responsibilities and ownership**

The basic principle of this policy is that matters related to management of the Group’s capital are reserved for the Group Board

As a pragmatic policy, it also recognises the role of our senior executives and provides a framework for day to-day management of the business. The Group Chief Executive (GCE) has substantial responsibilities under the policy – many of which are delegated to two key management committees the Group Executive Committee and the Group Asset and Liability Committee (GALCO)

The Group Finance Director has responsibility for reporting to and advising both the GCE and the Group Board on capital matters. As head of the Group Finance function, he also has significant responsibilities for managing the key elements of the policy. In practice, many of these responsibilities are delegated to the Group Chief Actuary, the Managing Director of Corporate Finance and the Group Treasurer

These structures are mirrored in the Group companies. Although the capital management policy gives individual businesses substantial autonomy to manage their own capital, the Group has put controls in place to ensure that this is done effectively, in line with the key elements of the policy framework

**Responsibility of the Group Chief Executive**

Key responsibility	Supporting Management Committee
Group strategy, capital structure performance assessment	Group Executive Committee
Monitoring and oversight, policy enforcement	GALCO

**Maintaining confidence – the Group’s capital position**

The Financial Groups Directive defines the Group as a financial conglomerate. Capital resources and requirements are consolidated within the Group on this basis with the dual aims of maintaining confidence in the business through regulatory strength, and creating shareholder value

**Regulatory strength**

At the end of 2006, the ratio of the Group’s capital to its regulatory capital requirements stood at approximately 175%

**Residual Estate**

The primary role of the residual estate, as set out in paragraph 4.1 of schedule 1 of the Scheme, is to ensure a prudent amount is retained in the HWPF in respect of any amounts which may be charged to the HWPF in accordance with the Scheme. To the extent that the SLAL Board is satisfied that the residual estate exceeds that required to meet its primary role, the excess residual estate shall be distributed over time in as fair and equitable manner as is practicable as an enhancement to final bonus payable on the remaining HWPF with profits policies. As reported by SLAC’s with profits actuary in its members’ circular issued in April 2006, it was estimated that, as at 31 December 2005, after allowing for estimates of the effects of the various transactions and asset and liability movements associated with demutualisation, the residual estate would have been expected to be in excess of £0.5bn. As at 31 December 2006, the residual estate increased to approximately £1.3bn

## 1.8 Risk management

The Group considers risk management to be a core competency. The Group's risk management strategy focuses on identifying potential events that may affect investors' returns, and managing the impact of those events within identified parameters.

The principal risks facing the Group are:

- **Market risk** – in particular the risks arising from volatility in equity, bond and property markets
- **Insurance risk** – in particular the risks arising from increasing lapse rates, faster than expected annuitant mortality improvements and deteriorating expense experience
- **Credit risk** – in particular the risks arising from increasing default rates in the corporate bond and mortgage markets
- **Operational risk** – in particular the risks arising from compliance failures, liability modelling and pricing errors, inadequate planning processes and loss of operations due to failure of business continuity arrangements
- **Strategic risk** – in particular the risks arising from failure to retain a leading position in our core markets, or to maximise value from the customer base, or to compete on cost and service, or to achieve our target market shares

The Board Charter states that the Board's responsibility is 'to establish and maintain a framework of internal controls that enables the financial and operational risks of the Group to be assessed and managed'. Matters Reserved for the Board include 'the approval of the Group risk management policy, and the Group's financial risk policies and the Group operational risk policy, and review of their implementation'.

The risk management framework has established three lines of defence for managing risks:

- Day to day risk management is delegated from the Board to the Group Chief Executive and, through a system of delegated authorities, to business managers
- Risk oversight is provided by two risk management Committees. These Committees are supported by the specialist risk management and compliance functions across the Group
- Independent verification of the adequacy and effectiveness of the internal risk and control management systems is provided by the Group Audit Committee, which is supported by the internal audit function

As part of the risk management framework, the Group establishes its risk profile by identifying, assessing, controlling and monitoring the risks it faces. The risk profile is assessed regularly – at least quarterly – and reviewed by the relevant executives and the Group risk management committees.

The Group Chief Executive has established two Group risk management Committees. The GALCO is responsible for ensuring the financial risks inherent in the Group's activities are identified and managed in accordance with the appetite and limits approved by the Board. The Group Operational Risk Committee (GORC) has responsibility for ensuring that the operational risks inherent in the Group's activities are identified and managed in accordance with the appetite approved by the Board.

The Group's risk management policy and exposure to financial risks are described in more detail in the corporate governance report on page 62 and in note 39 of the Group's financial statements.

## 2 Business unit overview

### 2.1 UK life and pensions

#### Key performance indicators

	2006	2005
See section 3 PVNBP	£11,400m	£6,763m
APE sales	£1,442m	£939m
See section 4 NBC	£167m	£27m
PVNBP margin	1.5%	0.4%
EEV pro forma operating profit before tax	£372m	£272m
See section 5 IFRS pro forma underlying profit before tax	£230m	£16m

<sup>1</sup> These assets are managed by Standard Life Investments (SLI) on behalf of UK life and pensions and are included within SLI's total funds under management reported in section 2.5

Standard Life is one of the largest life and pensions providers in the UK with a 8.7% market share and total assets under management of £82bn<sup>1</sup>. We offer a broad range of products and have particular strengths in the accumulation for retirement market.

Our vision is to become the UK's leading provider of retirement, wealth management and life insurance products and services by offering solutions designed to help protect and enhance the quality of life of our customers, their families and their organisations.

Last year our business continued its significant transformation programme, which began following our 2004 strategic review. This review identified the need for our business to improve profitability in a capital efficient way, whilst maintaining our outstanding levels of customer service.

#### Customer service

Meeting our customers' needs is at the core of our business. This is supported by our customer service strategy, which is to retain and grow our existing business and attract new customers by being the market leader for high quality, low cost service.

2006 was an exceptional year for the financial services industry. For Standard Life, the combination of Pensions Simplification (A Day) and our demutualisation increased customer contact by 10% compared to 2005. We continued to be recognised for high quality customer service and won the 5 Star Service Award at the Financial Adviser Service Awards for the 11th year running.

Our strong culture of continuous improvement and our use of innovative technology have enabled us to deliver award winning service whilst reducing our cost base. In 2006 we successfully implemented cutting edge natural language voice-recognition technology. Our industry leading Group Pensions e-commerce offering was also awarded a coveted eee+ rating from the Financial Technology Research Centre (FTRC).

This focus on improvement and creating capacity has also enabled us to support the rapid growth of our SIPP product and Wrap offering.

A Day, and continued negative press about with profits have increased levels of customer churn in the pensions market. Despite these challenges, we were able to write record levels of new business during 2006, with the balance of premiums and claims resulting in £3.2bn of positive net fund inflows during the year.

### Product innovation

Our market leading, innovative product portfolio played a major part in the record levels of new business we achieved during 2006 and will continue to be of fundamental importance. In developing new products, our focus is on meeting our customers' needs as they change at different stages in their lives, improving the profitability of our business and managing our capital efficiently.

The success of this strategy is illustrated by our SIPP offering. In December 2004 we became the first major UK life insurer to offer a SIPP administered in house. Take-up of our market leading offer remains significant.

SIPP sales for 2006 amounted to £395m APE – a 150% increase over the previous year. Against this backdrop, SIPP funds under management (FUM) more than tripled to £4.3bn (2005: £1.3bn) whilst customer numbers increased from 9,000 to over 25,000. During the year we made significant investments in our SIPP servicing capability, increasing SIPP Customer Centre (SCC) staffing levels to 290 by the end of 2006 – from 50 people at the launch. Our commitment was recognised with a number of SIPP customer service awards, including:

- |   |  |
|---|--|
| • Financial Adviser Life & Pensions Awards      | – SIPP Provider of the Year – 2005<br>– SIPP and/or SSAS Provider of the Year – 2006 |
| • Moneyfacts Investment, Life & Pensions Awards | – Best SIPP Provider – 2006<br>Service beyond the call of duty – 2006                |
| • Defaqto                                       | 5* product rating – 2005 and 2006  |

A number of our competitors launched SIPP products during 2006 and we expect others to join the market in 2007. Our continuing innovation, enhancements of our SIPP offering and service enabled us to maintain our market leader status against this backdrop during 2006 and we are in a strong position to continue our success into 2007 and beyond.

### Distribution

Our distribution strategy focuses on building on our strong independent financial adviser (IFA) relationships, whilst making the most of the opportunities presented by depolarisation to diversify and develop additional sales channels.

We continued to improve our service-based propositions to IFAs with new platform based technology that enables them to enhance their own customer service. We also acquired strategic stakes in IFA distribution and service companies such as Tenet and Simplybiz.

We also continued to build on our success in winning exclusive distribution agreements, such as SIPP product tie ups with Barclays, UBS, HSBC and Fidelity.

At the same time we expanded our direct sales capabilities, via face to face contact with private and corporate clients, as well as telephone and internet based sales to the mass market. Technology and the growth of the internet are set to be key factors in shaping UK intermediary distribution and improving customer access. We see these areas as high priority for investment, underpinning our future distribution strategy.

### Wrap

We believe Wrap has the potential to transform the way business is conducted between providers and intermediaries in the UK. Our aim is to become a major player in this platform space and we began a controlled roll out of our own Wrap platform to a core group of IFAs in May 2006. Although it is a relatively new proposition, our Wrap platform has already received positive feedback from the IFA community and industry commentators.

In early 2007 we had over £200m funds under management and administration, with over 100 IFA firms using their own configured version of the platform. And in 2006 we were the first Wrap provider to be awarded the coveted 'eee' rating by the FTRC.

## 2.2 Canada life and pensions

### Key performance indicators

	2006	2005
See section 3 PVNBP	£1,791m	£1,882m
APE sales	£166m	£184m
See section 4 NBC	£28m	(£2m)
PVNBP margin	1.6%	(0.1%)
EEV pro forma operating profit before tax	£163m	£131m
See section 5 IFRS pro forma underlying profit before tax	£168m	£86m

The Standard Life Group is the fourth largest provider of life assurance and pension products in Canada. There are now 25 sales offices around Canada, offering a full range of group savings and retirement, individual savings and retirement and group insurance products.

Canada is the largest of the non UK operations, and currently accounts for 74% of non UK life and pensions EEV.

The Canadian market has experienced rapid consolidation over the past 15 years and is now dominated by three large players who control around 60% of the market. Standard Life is the largest of the three second tier players which control around 16%. We are recognised as a market leader in pensions, where we rank in the top three.

2006 was a successful transitional year for the Canadian operations, with an emphasis on higher margin products, cost management and delivering quality customer service.

#### Customer service

Around the world, the Standard Life brand is a recognised market leader in customer service – and Canada is no exception. The Canadian life and pensions operations have achieved a client retention ratio of 95.5% to 95.7% (based on internal methodology) for the past three years and this forms the basis of our growth strategy.

In 2006, we upgraded our systems and implemented a new group insurance administration system designed to improve our customers' experience. These initiatives will continue through 2007 alongside plans to refine and target our distribution strategy. Our aim is to strengthen existing relationships, while exploring new channels.

#### Product profitability and innovation

Our focus on higher margin products involved repositioning our individual insurance product range, in particular some Universal Life options were re-priced to improve profitability.

We made significant efforts to improve the overall product offer and technological platforms to attract new clients. Our group savings and retirement line was updated to improve administrative processes and introduce innovative new features. A major individual wealth management system conversion was successfully completed in the year, enabling us to launch a new suite of retirement products. This was followed by enhancements to our suite of individual segregated funds.

To improve profitability, product innovation will remain a focus. Canada is experiencing similar changes in demographics to many western countries, with declining population growth and an ageing population. The result will be a greater emphasis on private sector solutions to cover health costs and individual retirement provisions. This creates an opportunity to provide products that meet our customers' long term savings requirements and also drive our future profitability.

### Cost management

We have maintained a more aggressive approach to cost management which was undertaken in 2005. This involved tighter management of costs and a company wide efficiency and synergy programme. The number of full time equivalent employees decreased to 1,944 in 2006 from 2,308 in 2003, with many of the cost savings coming from streamlining internal processes and upgrading systems. We have also succeeded in maintaining our excellent standards of customer service.

### 2.3 Europe life and pensions

#### Key performance indicators:

	2006	2005
See section 3 PVNBP	£866m	£920m
APE sales	£97m	£100m
See section 4 NBC	£10m	£8m
PVNBP margin	1.2%	0.9%
EEV operating profit before tax	£45m	£53m
See section 5 IFRS pro forma underlying profit before tax	£108m	£73m

#### Standard Life Germany

Standard Life Germany operates in both Germany and Austria. We have had a presence in Germany since 1996 and in Austria since 1999.

We continue to evolve our product offer to match the significant changes that have taken place in the German market during recent years. Our success in doing this was demonstrated by the successful launch of our new unit linked offering, Maxxellence, in October.

#### Standard Life Ireland

Standard Life Ireland was established in 1834. We provide Irish investors with a comprehensive range of investment and pension solutions.

During 2006 we continued to innovate and improve our product range, largely driven by the feedback from our customers. We enhanced our Synergy proposition by launching a number of self investment options based on the UK SIPP platform, helping to align our product range more closely with the current market in Ireland. These developments have been well received by customers – as demonstrated by our 35% increase in new business volumes.

The recent launch of our Global Real Estate Investment Trust (REIT) Fund, coupled with further planned enhancements to our Synergy product range, is expected to drive sales momentum into 2007, enabling us to grow our share of this market.

In addition, in 2006 we launched Standard Life International Limited (SLIL), a Dublin based life insurance company, to focus initially on offshore bond products for the UK market.

### 2.4 Asia Pacific life and pensions

#### Key performance indicators

	2006	2005
See section 3 PVNBP	£206m	£101m
APE sales	£29m	£24m

Standard Life has a presence in the Asia Pacific life and pensions market place through a joint venture in India, HDFC Standard Life Insurance Company Limited (HDFC SL), which was established in 2000 and one in China, Heng An Standard Life Insurance Company Limited (Heng An SL), which was established in 2003.

HDFC SL continued to develop rapidly last year and we expect further growth in 2007 as the business continues with its expansion plans, increasing its agency force and geographic footprint

Heng An SL is making good progress with its expansion plans. Individual business performed particularly well in the last quarter of the year reflecting the core business strategy. Our branch expansion programme continues at pace. In October Heng An SL opened its sixth sales office in Jiangsu province, the largest insurance market in mainland China. In 2007 we expect Heng An SL to set up new branches in two provinces, Liaoning and Sichuan and in six new cities, with a current aim to continue such rapid expansion over coming years.

## 2.5 Investment management

### Key performance indicators

	2006	2005
See section 3 Third party FUM	£38.5bn	£29.1bn
Total FUM	£132.1bn	£118.8bn
See section 5 IFRS pro forma underlying profit before tax	£66m	£44m
EBIT margin	27.0%	22.3%

Launched in November 1998, Standard Life Investments (SLI) is a leading global investment company. Our focus is on delivering consistently high investment results for our clients by working as an integrated global team, using an investment style that focuses on change, and on processes that are both robust and repeatable.

SLI's global investment network is enhanced by our presence on the ground in key markets giving us a clear understanding of worldwide investment issues. We have operations in Edinburgh, London, Montreal, Boston, Hong Kong and Dublin, and representative offices in Beijing and Seoul. Our global platform provides us with the local insight to give our clients exceptional investment performance.

SLI has established itself as a leading global investment management company by

- Delivering superior investment returns and demonstrating the ability to continue to do so
- Winning additional substantial funds under management through the quality of our investment returns, products and client service
- Bringing significant value to the Standard Life Group through building a large and successful investment business

### Superior investment performance

Our Focus on Change investment philosophy seeks to identify and understand the most important factors that drive the market price of an investment and the dynamics behind these drivers. It is not inherently growth or value biased or necessarily momentum driven. This means that we have an opportunity to outperform throughout the cycle.

This superior performance was recognised with a number of awards during 2006. These included 'UK Equity Manager of the Year' at the Financial News Awards for Excellence in Institutional Asset Management - Europe 2006, 'What Investment' Unit Trust Manager of the Year Award for our UK Smaller Companies Fund and 'Property Manager of the Year 2006' at the Professional Pensions Awards. We also won the Investment Provider 5 Star Award at the Financial Adviser Service Awards for the 11th year running.

### Quality people

Along with the rest of the Group the quality of our people is critical to our success. We work exceptionally hard to recruit and retain the most talented people for our teams and are dedicated to providing them with first class training and rewarding exceptional performance.

### Superior growth

During 2006 SLI achieved record levels of sales, funds under management and third party funds under management. This has been driven by unprecedented levels of mutual fund sales, strong growth in the UK institutional market and strong demand for UK equity, fixed income and property products.

Continued investment outperformance drove new mandate wins and together with improving equity markets, this saw SLI's total funds under management increase to £132.1bn at the end of the year (2005 £118.8bn). Third party funds under management increased by 32% to £38.5bn (2005 £29.1bn).

This means that since 15 November 1998, third party funds under management have now grown by 626%, from £5.3bn to £38.5bn.

## 2.6 Banking

### Key performance indicators.

	2006	2005
See section 3 Mortgages under management	£10.4bn	£10.6bn
Saving and deposits	£4.2bn	£4.1bn
See section 5 IFRS pro forma underlying profit before tax	£38m	£24m
Interest margin	74bps	63bps

Launched in 1998, Standard Life Bank (SLB) offers mortgage and retail savings products in the UK via intermediaries and also direct to customers through telephone and internet based platforms.

Standard Life is one of the few UK life assurance and pension providers to have a mortgage and retail savings business in its portfolio. This extends the Group's product offering, and enables Standard Life to position and market itself as a broad range financial services provider, and take advantage of new opportunities in markets to which it previously had no direct access.

### Profitable growth

SLB's strategy is to actively pursue sustained profitable growth by capitalising on Standard Life's franchise and brand and by exploiting synergies with other businesses within the Group. Flexible product design and sophisticated mortgage underwriting support our aim of attracting financially astute customers from carefully selected demographic categories and establishing long term relationships with them. This strategy has resulted in a high quality mortgage portfolio with only 0.17% of total mortgages three or more months in arrears at the end of 2006, compared with the industry average of 0.95%.

With our focus on profitability, SLB mortgage balances under management fell marginally to £10.4bn (2005 £10.6bn). Our market share was also slightly down to 0.9% (2005 1.1%) of gross mortgage lending at 31 December 2006.

SLB's retail savings balance at the end of 2006 was up to £4.2bn (2005 £4.1bn).

### A positive outlook

SLB expects the economic environment to remain positive in 2007, providing support for the UK mortgage market. Based on existing market conditions and the management strategies we have in place, we consider that SLB's current levels of performance will continue to improve in 2007 and beyond.

## 2.7 Healthcare and general insurance

### Key performance indicators

	2006	2005
See section 3 New business APE sales	£20m	£20m
See section 5 IFRS pro forma underlying profit before tax	£16m	£7m

Standard Life Healthcare (SLH) was established in 1988 as Prime Health Limited. Prime Health became part of the Standard Life Group in 1994 and continued trading under this name until 2000, when the business formally became Standard Life Healthcare.

SLH completed its purchase of FirstAssist's private medical insurance business on 1 April 2006, which resulted in the relocation of the head office from Guildford to Bournemouth.

This made us the fourth largest private medical insurer in the UK, with an estimated 8.6% market share, based on an in force premium income of £280m at 31 December 2006, and lives insured of 601,000.

Approximately 80% of the lives are insured through company schemes, and in 2007 we plan to improve our product propositions to corporate customers, especially to small and medium sized companies (SME business).

Other general insurance operations contributed £4m (2005: £3m).

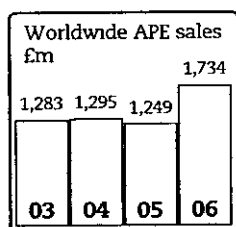
### 3 New business

#### 3.1 Long term insurance

	PVNBP			APE		
	2006 £m	2005 £m	Change %	2006 £m	2005 £m	Change %
<b>UK</b>						
Retail pensions <sup>1</sup>	6,709	4,383	53%	970	698	39%
Institutional pensions	2,310	912	153%	231	91	153%
Life	1,901	1,131	68%	191	114	68%
Annuities	438	295	48%	44	30	48%
Protection	42	42	0%	6	6	0%
<b>UK life and pensions</b>	<b>11,400</b>	<b>6,763</b>	<b>69%</b>	<b>1,442</b>	<b>939</b>	<b>54%</b>
<b>Canada</b>						
Group savings and retirement	1,188	1,033	15%	98	89	10%
Individual insurance, savings and retirement	460	565	(19%)	49	71	(31%)
Group insurance	143	284	(50%)	19	24	(21%)
<b>Canada life and pensions</b>	<b>1,791</b>	<b>1,882</b>	<b>(5%)</b>	<b>166</b>	<b>184</b>	<b>(10%)</b>
Europe life and pensions	866	920	(6%)	97	100	(3%)
Asia Pacific life and pensions <sup>2</sup>	206	101	172%	29	24	55%
Discontinued operations		9	N/A		2	N/A
<b>Total worldwide insurance</b>	<b>14,263</b>	<b>9,675</b>	<b>47%</b>	<b>1,734</b>	<b>1,249</b>	<b>39%</b>

<sup>1</sup> The 2005 figures have been restated to reflect the inclusion of the non-insured element of SIPP which has been included in the 2006 figures. The impact was PVNBP 2006 £1 218m (2005 £308m) APE 2006 £129m (2005 £31m). The relevant mutual fund element of the non-insured SIPP new business is also included within the gross and net inflows for investment management new business - see section 3.2

<sup>2</sup> The percentage change is based on new business of the underlying joint ventures to avoid distortion due to changes in the Group's shareholding



\* 2006 and 2005 sales include the non-insured element of SIPP see table in section 3.1

\*\* 2004 figure is the 12 month calendar figure, actual 2004 was a 13.5 month period and totalled £1 443m

#### 3.1.1 Overview

Our strategy of focusing on product innovation – see section 1.2 – has driven 2006 new business sales. We experienced strong sales performance with worldwide PVNBP up 47% and APE up 39%.

The effectiveness of our strategy of developing a product portfolio that meets our customers' needs and adds value to our business is evident – with worldwide NBC of £205m, up 521% on 2005, at a PVNBP margin of 1.4% (2005 0.4%). See section 4 for a more detailed discussion about NBC and PVNBP margin.

The UK had a particularly strong year, driven by single premium business and external factors such as A Day. Canadian sales were down compared to 2005, as it focused on profitability. Europe experienced a decrease in sales compared to 2005 because of changes in tax legislation in Germany, which inflated sales in 2004 and the early part of 2005. This more than offset the positive increase in Ireland's APE sales, which were up 35%. Our Asian operations continued to experience strong growth with PVNBP increasing by 172% and APE up by 55%.

We anticipate that with our continued focus on strengthening our distribution network, evolving our product offering and building strong customer relationships should provide a recipe for future growth.

#### 3.1.2 UK life and pensions

- PVNBP sales increased by 69% to £11,400m
- APE sales increased by 54% to £1,442m

Strong growth in new business volumes was driven mainly by our market leadership in SIPP, superior investment performance and the heightened activity in the pensions market as a result of A Day. We continued our focus on profitable areas of the market that offer favourable margin opportunities. As a result, single premium business increased by 89% compared to 2005 and represented 65% of UK life and pensions APE sales. Although life and pension product lapses continued at levels in excess of long term assumptions, net fund flows remained strongly positive and amounted to £3.2bn during the year.

#### **Retail Pensions (APE £970m up 39%)**

APE sales of SIPP and Drawdown – which now include non insured SIPP<sup>1</sup> – increased by 150% to £395m (2005 £158m) At the end of 2006, total SIPP assets under management amounted to £4.3bn (2005 £1.3bn) This represented an average case size of £169,000 (2005 £147,000), highlighting the attractiveness of this product to high net worth individuals A number of our competitors launched SIPP products during the year Our first mover advantage, coupled with a superior product and service offering have, however, enabled us to remain a leader in this market

Group pensions remains the largest single product by APE sales volume in our UK life and pensions business Sales increased by 8% to £437m for 2006 (2005 £403m) The increase in sales is largely due to higher levels of increments from existing schemes, as well as the successful launch of the Group Flexible Retirement Plan and Group SIPP in January 2006

Sales of individual pensions fell by 7% to £126m (2005 £135m) as many customers opted for our innovative SIPP offering Another contributory factor was our decision to close our Executive Pension Plan (EPP) and Individual Buy-out Plan (IBOP) to new business following A Day

#### **Institutional Pensions<sup>2</sup> (APE £231m up 153%)**

Institutional TIP sales increased by 153% to £231m (2005 £91m) This was principally a result of strong investment performance, but also included a bulk TIP mandate from Citigroup – announced in the fourth quarter – which generated £84m of APE

Excluding this bulk TIP transaction, total underlying UK life and pension sales were £1,358m, an increase of 45% compared to the previous year

#### **Life (APE £191m up 68%)**

Strong investment performance, coupled with the availability of an additional 57 external fund links, helped drive investment bond sales and delivered sales growth of 66% to £185m (2005 £112m)

#### **Annuities (APE £44m up 48%)**

The increase in annuities sales volumes was largely driven by business from customers who had postponed their retirement until after A Day and demutualisation Over 93% of annuity sales during 2006 came from customers with maturing Standard Life pensions

#### **Protection (APE £6m)**

Protection sales volumes have been flat during 2006 We were disappointed by the reversal of the Government's position in respect of pension term assurance (PTA)

We anticipate further strong growth in UK life and pensions as we continue to enhance our product offering and build on our commitment to our customers

### **3.1.3 Canada life and pensions**

- PVNBP sales decreased by 5% to £1,791m
- APE sales decreased by 10% to £166m

The Canadian operations focused on building sustainable and profitable new business during 2006 and this had a positive impact on NBC with all product lines generating positive new business contribution by the year end – see section 4 Certain individual insurance products were repriced as part of the focus on profitability and this had an effect on new business volumes Overall APE sales of life and pension products decreased by 10% (15% in constant currency) to £166m (2005 £184m) amidst increasing pricing pressures across all product lines

#### **Group savings and retirement (APE £98m up 10%)**

We maintained our position as a leader in group savings and retirement, where we witnessed a 10% increase in sales (3% in constant currency) to £98m, with two large cases in each half year offsetting a weak market Retention rates also remained strong in challenging conditions

<sup>1</sup> Total SIPP sales included £129m APE in respect of non-insured SIPP (2005 £31m) Prior year comparatives have been restated accordingly

<sup>2</sup> Trustee Investment Plan (TIP) is designed to meet the needs of trustees of exempt approved occupational pension schemes This product is sold by Standard Life Investments.

#### Individual insurance, savings and retirement (APE £49m down 31%)

APE sales declined by 31% (35% in constant currency). This is largely explained by the repricing of our main Universal Life product in late 2005 and the repositioning of our overall individual insurance offering. Our segregated funds grew 29% in constant currency during 2006.

#### Group Insurance (APE £19m down 21%)

Sales were 21% lower (25% in constant currency) at £19m (2005 £24m), affected by our commitment to protecting margins in an aggressive price driven market.

We anticipate that market conditions will remain challenging in 2007. Our key focus will be to grow profitability and this aim will be supported by the product and business developments we have undertaken in the second half of 2006.

### 3.1.4 Europe life and pensions

#### Total Europe

- PVNBP sales decreased by 6% to £866m
- APE sales decreased by 3% to £97m

#### Germany

- PVNBP sales decreased by 21% to £536m
- APE sales decreased by 23% to £51m

The decrease in German life and pensions sales was mainly due to changes in domestic tax legislation, which resulted in exceptional new business in the first quarter of 2005. Sales growth improved in the second half of 2006, primarily driven by the success of the employee benefit and smoothed managed fund business. The launch of the new unit linked product in October was also well received. As the improved product range is sold through a wider group of independent intermediaries, sales in Germany are expected to grow in 2007.

#### Ireland

- PVNBP sales increased by 36% to £330m
- APE sales increased by 35% to £46m

Standard Life Ireland sales on an APE basis were 35% higher than in 2005, following the continued success of the Synergy suite of products launched in 2005 and the introduction of new products based on the UK SIPP platform in 2006. Sales momentum is set to keep building in 2007, driven by new product launches, enhancements to existing products and market growth.

### 3.1.5 Asia Pacific life and pensions<sup>1</sup>

- PVNBP sales increased by 172% to £206m
- APE sales increased by 55% to £29m

Growth in Asia continues to accelerate, with total APE sales of the Asian life insurance businesses up 55% (61% in constant currency). The Indian joint venture, HDFC SL, and the China joint venture, Heng An SL, contributed APE of £25m and £4m respectively. We anticipate further sales growth in 2007 as our joint venture operations continue to expand.

### 3.2 Investment management

- Third party FUM increased by 32% to £38.5bn
- Third party gross inflows £9.0bn (2005 £7.3bn)
- Total FUM increased by 11% to £132.1bn
- Third party net inflows £6.4bn (2005 £5.5bn)

Continued investment outperformance drove further mandate wins to record levels and together with improving equity markets, resulted in Standard Life Investment's (SLI) third party funds under management increasing by 32% to £38.5bn (2005 £29.1bn) and total funds under management increasing to £132.1bn at the end of 2006 (2005 £118.8bn). Total property funds under management exceeded £13bn, assisted by the Select Property Fund, which was the fastest growing mutual fund in the UK in 2006.

<sup>1</sup> The percentage change figures quoted are based on the new business of the underlying joint ventures to avoid distortion due to changes in the Group's shareholdings.

Third party gross inflows rose to £9.0bn and net inflows increased to £6.4bn – equating to 22% of third party funds under management at the start of the year – including record levels of UK institutional business. This reached £3.3bn, up 24% on 2005.

SLI experienced its strongest ever year for UK mutual fund sales since it was launched in 1998, with gross inflows up to £1.7bn (2005: £0.6bn). Net sales of £1.3bn were up 339% on 2005.

Investment performance was strong, with 87% of pooled pension funds outperforming their respective peer groups over the year. The range of OEICs and unit trusts enjoyed another very good year with over 70% of the 23 actively managed funds producing above average returns and 52% of them delivering upper quartile performance. Eight out of the 23 OEIC funds obtained a top ten ranking.

The pipeline of new business remains strong. SLI's impressive performance track record and the successful launch of new products including the Dynamic Distribution Fund, UK Property Development Fund and the Global Absolute Return Strategies Fund gives us the platform to deliver continued growth in 2007.

### 3.3 Banking

- Mortgages under management decreased by 2% to £10.4bn
- Gross lending of £3.0bn down 3% (2005: £3.1bn)
- Savings balances increased by 1% to £4.2bn

Gross lending in 2006 was similar to 2005 (£3.0bn for 2006 compared to £3.1bn for 2005), however SLB's market share of gross lending for 2006 is expected to be 0.9%, lower than 2005 (1.1%) due to the growth in the size of the market. Mortgages under management at SLB were £10.4bn for 2006 (2005: £10.6bn), due to higher levels of mortgage attrition, primarily as a result of the increased numbers of customers coming to the end of tie-in periods driven by high volumes of business written in 2004.

Savings balances grew by £34m primarily driven by growth in SIPP cash deposits which increased to £246m (2005: £82m).

We expect to see growth in gross lending improve in the first quarter of 2007, assisted by a strong pipeline of new business. Sales in the remainder of the year are expected to benefit from enhanced offerings.

### 3.4 Healthcare and general insurance

- New business sales APE of £20m (2005: £20m)

Standard Life Healthcare's (SLH) ongoing strategy of writing profitable business in a competitive market resulted in stable sales during 2006. In particular, overall levels of new small and medium size enterprise (SME) business were lower as we concentrated on profitable segments of that market. This was compensated for by an increase in individual business sales, which grew by 27% to £7m (2005: £6m), partly due to the successful launch of the EspritHealth product, aimed at meeting the specific needs of the over 55s age group.

The first phase of a new policy administration system for SME business was developed on the Group IT platform and will be implemented in the second quarter of 2007. The remaining product lines, including the business acquired from FirstAssist in April 2006, are expected to move fully on to the new system during the rest of 2007 and 2008. This new platform, coupled with the launch of a new product proposition, is expected to increase sales, improve efficiencies and reduce operating costs in 2007 with the full benefits being realised in 2008 and beyond.

## **4 EEV pro forma income statement**

### **4.1 Basis of preparation**

#### **(a) Derivation of full year 2006 results**

The H1 2006 column contains the results that were published in the Half Year Report 2006, plus those transactions that affected the shareholder results in the period before demutualisation on 10 July 2006, plus any adjustments considered appropriate to arrive at the opening shareholder position on 10 July 2006. Note that the FY 2005 EEV results were calculated assuming that the demutualisation took place on 31 December 2005, but the H1 2006 results assumed that demutualisation took place on 30 June 2006. As a result, previously reported EEV results for 2005 were not directly comparable with the H1 2006 EEV results. To take account of this, a number of adjustments were made to the H1 2006 opening balances.

The H2 column represents all shareholder transactions from the date of demutualisation on 10 July 2006 to 31 December 2006. These figures are reported in more detail in the EEV supplementary financial statements.

The addition of these columns provides a pro forma full year 2006 result.

Where figures are described as pro forma, this means that they have been prepared for periods before demutualisation occurred, indicating the profits that would have occurred if the post-demutualisation structure had applied.

#### **(b) Methodology**

The EEV results have been prepared in accordance with the EEV Principles and Guidance issued in May 2004 and October 2005 by the CFO Forum of European Insurance Companies.

EEV methodology has been applied to 'covered' business, which mainly comprises the Group's life and pensions business. Non-covered business is generally reported on an IFRS basis.

#### **(c) Income statement preparation and tax**

The opening and closing EEV numbers, and therefore the profit arising in the period, for the covered business are determined on an after tax basis. The tax assumptions used are based upon the best estimate of the actual tax expected to arise. Profit before tax is derived by grossing up profit after tax at the standard rate of corporation tax appropriate to each territory. Whilst for some territories this rate does not equate to the actual effective rate of tax used in the calculation of after tax profits, it provides a consistent grossing up basis upon which to compare results from one year to another and is in line with the Group's expectation of the rate of tax applicable to the business sold after demutualisation.

#### **(d) Other**

A full description of the basis of preparation and EEV methodology can be found in the EEV supplementary financial statements.

## 4 2 EEV pro forma income statement

The following provides a detailed analysis of the Summary EEV pro forma income statement disclosed in section 1 4

	Pro forma period from 1 January 2006 to 10 July 2006 (H1)	Notes 1 January 2006 to 10 July 2006	Audited period from 10 July 2006 to 31 December 2006 (H2)	Pro forma FY 2006	Pro forma FY 2005
	£m		£m	£m	£m
* Includes movements in TVOG A number of adjustments were required to arrive at the post demutualisation 10 July 2006 opening position and to ensure consistency of presentation between the periods shown. An explanation of the adjustments made is given in Notes (a) to (j)					
Contribution from new business	100	(a)	105	205	33
Contribution from in force business					
Expected return on existing business	194	(b)	198	392	328
Experience variances	60	(c)	62	122	60
Operating assumption changes	(38)		(20)	(58)	37
Development costs	(12)		(13)	(25)	(17)
Expected return on free surplus	(17)	(d)	(3)	(20)	13
<b>Life and pensions operating profit</b>	<b>287</b>		<b>329</b>	<b>616</b>	<b>454</b>
<b>Non life and pensions operating profits / (losses)</b>	<b>(19)</b>	<b>(e)</b>	<b>17</b>	<b>(2)</b>	<b>(59)</b>
<b>Operating profit before tax</b>	<b>268</b>		<b>346</b>	<b>614</b>	<b>395</b>
<b>Other non operating items</b>					
Investment return and tax variances	23	(f)	229	252	187*
Effect of economic assumption changes	(109)	(g)	140	31	232
Mark to market of subordinated debt	107	(h)		107	(63)
Movement in pension scheme deficit		(i)			19
Impairment of intangibles	(9)		(4)	(13)	
Restructuring expenses	(5)		(12)	(17)	
Volatility arising on different asset and liability valuation bases	19		29	48	
<b>Profit before tax</b>	<b>294</b>		<b>728</b>	<b>1,022</b>	<b>770</b>
Attributed tax	(61)	(j)	(213)	(274)	(235)
<b>Profit after tax</b>	<b>233</b>		<b>515</b>	<b>748</b>	<b>535</b>
<b>4 2 1 Total EEV profit</b>					
Total profit before tax increased by 33% to £1,022m (2005 £770m) The main contributor to this increase was operating profit before tax, which increased by £219m (55%) to £614m Non operating profit before tax increased by £33m (9%) to £408m The latter reflects investment gains in time value of options and guarantees (TVOG) and higher positive mark to market adjustments in respect of the subordinated debt in H1, offset by smaller changes in economic assumptions					

The attributed tax rate in 2006 was 27% compared to 31% in 2005 This reflects the different mix in profits arising from different territories and business with different tax rates

Profit after tax increased by 40% to £748m (2005 £535m) This rise is largely driven by the increase in total profit before tax and the reduction in the attributed tax rate as explained above

#### 4.2.2 EEV Operating profit

Operating profit before tax increased to £614m (2005 £395m). Life and pensions operations contributed £162m of the increase, the main driver being new business contribution, which increased by £172m to £205m. In addition, increases in expected return and positive experience variances also contributed to the rise in operating profit. These increases were partly offset by the impact of assumption changes, including increases in lapse assumption costs of £157m, reduced return on free surplus and increased development expenses. The non life companies also made a sizeable contribution of £57m to the increase in operating profit. This was largely driven by improvements in IFRS underlying profits of the main non life subsidiaries – SLI, SLB and SLH – along with the transfer of the cost of carry of the subordinated debt to covered business in 2006.

A segmental analysis of EEV operating profit before tax is contained in section 4.3.

New business contribution is a key component of operating profit. An analysis of new business contribution and its profitability by territory is given below.

#### New business contribution

	Pro forma PVNBP margin <sup>1</sup>		Pro forma NBC	
	2006 %	2005 %	2006 £m	2005 £m
UK life and pensions	1.5	0.4	167	27
Canada life and pensions	1.6	(0.1)	28	(2)
Europe life and pensions	1.2	0.9	10	8
Asia Pacific life and pensions				
<b>Total worldwide insurance</b>	<b>1.4</b>	<b>0.4</b>	<b>205</b>	<b>33</b>

<sup>1</sup> PVNBP margin is calculated by dividing NBC by PVNBP which is provided in section 3.

New business contribution was £205m, £172m higher than 2005. This increase is the result of significantly higher sales volumes in the UK and Ireland and improvements in margins and product mix in almost all territories. Section 3 covers new business results in more detail.

#### Expected return on in force business

Expected return on in force business is £392m which is £64m higher than 2005. This increase is attributable to the increase in the opening embedded value at 1 January 2006 compared to 1 January 2005, which offsets the impact of lower risk discount rates over the same period.

#### Experience variances

Experience variances were £122m, compared to £60m in 2005. The UK produced £90m of variances in 2006 (2005 £48m), whilst the HWPF TVOG showed £41m of variances, which includes £28m arising from the net impact of management actions taken to hedge guarantees and increase the equity backing ratios in the HWPF. The balance reflects various items, including mortality effects in respect of the annuity books. These were partially offset by £16m of negative experience variances in Canadian life and pensions.

#### Operating assumption changes

Operating assumption changes were £58m negative compared to £37m positive in 2005. This fall in contribution was largely driven by reduced maintenance expense assumption changes and increased lapse assumptions. These were partially offset by mortality changes.

In 2006 there were £88m of positive changes in relation to maintenance expenses, reflecting continuing efficiencies achieved in the business. In addition there were £65m of favourable mortality effects, reflecting the movement to new industry tables and internal experience. There were also £49m of other changes which are principally attributable to the UK and Canadian life and pensions operations.

Offsetting these positives were short term lapse provisions and assumption changes of £260m, mainly comprising £49m from Canada and £207m from UK, which includes the £100m increase in provisions for short term lapse activity that was announced in 30 June 2006 results.

**Development costs**

Development costs totalled £25m (2005 £17m). The increase arose mainly in Germany and Ireland, reflecting new major product developments and other one-off project costs.

**Expected return on free surplus**

This fell from a positive £13m in 2005 to a negative £20m in 2006. This decrease was due in part to the transfer of £19m for the 2006 full year cost of carry of the subordinated debt from non-covered to covered business.

**Non life operating profit/(loss)**

Non life operating losses have decreased to £2m (2005 loss £59m). The main drivers of the improvement are higher operating profits from SLB, SLI and SLH, coupled with the transfer of the subordinated debt and its related cost of carry to covered business, and the recognition of non insured SIPP on an EEV basis rather than an IFRS basis.

**Operating profit after tax**

Operating profit after tax increased by 59% to £429m (2005 £270m). This increase includes a change in the attributed tax rate to 30% (2005 32%), which reflects the change in the mix of profits arising from different territories and businesses with different tax rates.

**4.2.3 Non operating profit**

Non operating items contributed £408m before tax in 2006 (2005 £375m), an increase of 9%. The life and pensions businesses produced a profit in 2006 of £283m, including long term investment variances of £252m (2005 £187m) plus £31m (2005 £232m) in relation to changes made to economic assumptions to reflect current market conditions. Within the £31m of assumption changes were positive adjustments of £92m from investment, tax and other, offset by losses of £36m and £25m from changes in risk discount rates and inflation respectively.

Outside life and pensions, the other main component was a gain of £107m arising in the period ended 10 July 2006 from the mark to market adjustment of the UK subordinated debt before demutualisation. This was a result of higher bond yields narrowing the gap between the market value of the debt and its IFRS value. From 10 July 2006 the market value movement on these liabilities is included within the UK life and pensions results in line with the treatment of the assets, and flows through investment return variances.

In 2006 the pension scheme deficits that could be attributed to staff working in life and pensions operations were transferred to covered business. The main UK scheme remains the only scheme that is shown in non-covered business as it covers staff in all UK operations – not just life and pensions. The movement in relation to the UK scheme is included in other non covered business losses, and actuarial gains and losses are disclosed in the SORIE.

The remaining items relate to positive economic hedge gains in SLB of £48m, partially offset by an impairment charge of £13m and a restructuring expense provision of £17m in relation to SLH.

Non operating profit after tax for 2006 increased by 20% to £319m (2005 £265m).

#### 4.3 Segmental analysis of EEV pro forma operating profit

	Pro forma period from 1 January 2006 to 10 July 2006 £m	Audited period from 10 July 2006 to 31 December 2006 £m	Pro forma FY 2006 £m	Pro forma FY 2005 £m
<b>Life and pensions</b>				
UK	158	214	372	272
Canada	83	80	163	131
Europe	34	11	45	53
Other	(1)	(7)	(8)	(2)
HWPf TVOG	13	31	44	
<b>Life and pensions operating profit</b>	<b>287</b>	<b>329</b>	<b>616</b>	<b>454</b>
Investment management	15	23	38	24
Banking	17	21	38	15
Healthcare and general insurance	3	13	16	7
Group corporate centre costs	(42)	(47)	(89)	(58)
Other	(12)	7	(5)	(47)
<b>Operating profit before tax</b>	<b>268</b>	<b>346</b>	<b>614</b>	<b>395</b>

Pre-tax operating profit increased by 55% to £614m (2005 £395m). The main life and pensions businesses account for £162m of this increase, with UK operating profit increasing by £100m, management of the HWPf TVOG exposure contributing £44m (2005 £nil) and Canada improving its operating profit by £32m. The non life entities showed an increase of £57m, as a result of moving the cost of carry of the subordinated debt to covered business for 2006, which in 2005 totalled £28m, together with significant increases in the IFRS underlying profits of the main operating subsidiaries – SLI, SLB and SLH, compared to 2005.

An analysis of life and pensions operating profit by territory is given below

	UK £m	Canada £m	Europe £m	Other £m	HWPf TVOG £m	Total £m
<b>1 January 2006 to 31 December 2006</b>						
Contribution from new business	167	28	10			205
Contribution from in force business						
Expected return on existing business	268	93	31			392
Experience variances	90	(16)	7		41	122
Operating assumption changes	(128)	61	6		3	(58)
Development costs	(15)		(10)			(25)
Expected return on free surplus	(10)	(3)	1	(8)		(20)
<b>Operating profit before tax</b>	<b>372</b>	<b>163</b>	<b>45</b>	<b>(8)</b>	<b>44</b>	<b>616</b>
<b>1 January 2005 to 31 December 2005</b>						
Contribution from new business	27	(2)	8			33
Contribution from in force business						
Expected return on existing business	225	70	33			328
Experience variances	48	2	10			60
Operating assumption changes	(22)	58	1			37
Development costs	(17)					(17)
Expected return on free surplus	11	3	1	(2)		13
<b>Operating profit before tax</b>	<b>272</b>	<b>131</b>	<b>53</b>	<b>(2)</b>		<b>454</b>

### 4.3.1 UK life and pensions

UK operating profit before tax (excluding HWPF TVOG) increased by 37% to £372m (2005 £272m). This is mostly attributable to increased new business contribution of £167m (2005 £27m). The higher expected return on existing business of £268m (2005 £225m) reflects the higher opening embedded value. The £42m increase in positive experience variances to £90m (2005 £48m) was offset by a £106m increase in negative assumption changes to £128m (2005 negative £22m) and a negative return on free surplus of £10m (2005 positive £11m). This latter item is largely due to the inclusion of £19m cost of carry within the UK life and pensions business, since the subordinated debt is now shown within UK covered business, whereas previously it was included at Group level. Development costs totalled £15m for 2006 (2005 £17m).

	Pro forma PVNBP margin		Pro forma NBC	
	2006	2005	2006	2005
	%	%	£m	£m
<b>UK new business</b>				
Retail pensions*	1.5	0.2	98	8
Institutional pensions	0.1	0.3	2	3
Life	1.6	0.8	31	9
Annuities	11.5	7.5	50	22
Protection	(33.6)	(35.7)	(14)	(15)
<b>UK life and pensions</b>	<b>1.5</b>	<b>0.4</b>	<b>167</b>	<b>27</b>

The 2005 PVNBP figures have been restated to reflect the inclusion of the non-insured element of SIPP which has been included in the 2006 figures (PVNBP 2006 £1,218m (2005 £308m)).

UK NBC increased from £27m in 2005 to £167m in 2006, with a strengthening of new business margins on a PVNBP basis from 0.4% to 1.5%. This was due to increased volumes of new business – see section 3 – improvements in underlying product margins, changes in the product mix towards more profitable lines and lower acquisition costs. The largest improvement in profitability was seen in pensions, driven by increased volumes of the SIPP offering.

Experience variances were £90m in 2006 compared with £48m in 2005. The 2006 figure includes mortality profits, mainly arising from annuities, the extension of retirement ages from 50 to 55 as a result of A Day, as well as enhancements to data and model points as reported at the half year.

Operating losses due to assumption changes in the UK increased to £128m (2005 £22m). These comprise increases in short term lapse provisions on 30 June 2006 – £79m in relation to A Day and £21m in relation to demutualisation, plus £107m due to further changes in long term lapse assumptions made at the year end. This is made up of £59m in respect of pensions, based on recent experience and the expectation that A Day will be a trigger for increased consolidation activity in the years leading to retirement. The balance of £48m arises on life with profits business, a reflection of continued high levels of outflows.

These negative movements are partially offset by positive changes of £26m in relation to mortality – largely attributable to annuities, £26m in relation to expense assumption changes and £27m of other (mainly updated valuation assumptions reported at the half year). The losses in 2005 included significant negative assumption changes in relation to annuity reserves and lapse assumptions in relation to with profits bonds, partially offset by large positive movements for expense savings and increased charges on Capital Investment Bonds.

#### 4.3.2 Canada life and pensions

Canada operating profit before tax increased by 24% to £163m (2005 £131m). This increase comprises an improvement in new business contribution to a profit of £28m (2005 loss £2m), an increase in expected return on in force business to £93m (2005 £70m) and positive assumption changes of £61m (2005 £58m). These positive movements are partially offset by negative experience variances of £16m (2005 positive £2m) and a negative return on free surplus of £3m (2005 positive £3m).

NBC in Canada of £28m is £30m higher than 2005. This improvement is largely due to the repricing of some products, a shift to sales of higher margin products and the impact of expense reductions from management actions taken during 2006. It was achieved despite sales of life and pensions products decreasing by 10% (15% in constant currency) to £166m APE (2005 £184m). NBC in 2005 was adversely affected by certain individual life insurance products which generated a loss of £36m, these have now been repriced. There were £5m residual losses related to these products in H1 2006 and no losses for H2 2006.

Canada operating assumption gains of £61m comprised £50m of maintenance and investment expense cost reductions, £37m of gains from changes in mortality and morbidity assumptions (mainly relating to individual and group insurance products) and other gains of £23m. These other gains include the release of annuity provisions offset by modelling changes for group insurance. These gains were partially offset by negative lapse assumption changes of £49m which mainly arose from group savings and retirement products.

#### 4.3.3 Europe life and pensions

The 2006 operating profit before tax for Europe of £45m is £8m lower than 2005. This is largely due to an increase in development costs to £10m (2005 £nil) in respect of new product developments. Negative lapse experience on Irish life with profits business and lower expected return on existing business in Germany were partially offset by a £2m increase in NBC and positive expense assumption changes in Ireland.

The increase in the new business margin from 0.9% to 1.2% arises from an improvement in the profitability of Irish new business, which was assisted by the launch of the Synergy proposition.

#### 4.3.4 Other – covered business

Asia Pacific operating losses were higher due to continued expansion in India and China.

#### 4.3.5 HWPF TVOG

There was no impact on operating profit in respect of TVOG in 2005. The £44m arising in 2006 includes £28m, being the net impact of management actions taken to hedge guarantees, offset by increases in the equity backing ratios for with profits business in the HWPF. A total of £13m arises due to model improvements bringing in the effects of the dynamic guarantee deduction framework, the operation of which was finalised as part of the Scheme of Demutualisation. In addition, the TVOG benefited by £3m from the increases in lapse assumptions.

#### 4.3.6 Non-covered operating profit items

Operating profit before tax in respect of the Investment management, Banking, Healthcare and general insurance businesses is consistent with the IFRS pro forma underlying profit before tax except that Investment management profits exclude profits from managing the life and pensions business, which are included in the life and pensions operating profit. Section 5 provides an analysis of IFRS underlying profit for these entities.

#### Group corporate centre costs

Group corporate centre costs increased by 53% to £89m (2005 £58m) – see section 5.2.7.

#### Other

'Other' no longer includes the cost of carry of the subordinated debt in 2006, as this has been moved to covered business. This totalled £28m in 2005. Other non covered business losses were £5m (2005 loss £19m). 2006 losses largely comprise Mutual Fund and Wrap expenses due to new business strain, partially offset by income on assets held in the Group's holding company, Standard Life plc.

## 5 IFRS pro forma underlying profit

IFRS pro forma underlying profit before tax increased by 272% to £540m in 2006 (2005 £145m). The increase reflected higher fee and commission income arising from the increase in funds under management (FUM), and the result of business wide focus on profitability and cost management. The increase also reflected the impact of assumption changes, in particular the inclusion in 2005 of £189m reserve strengthening in relation to the UK life and pensions business. A further breakdown and discussion of the results are provided in section 5.2 and should be read in conjunction with the Group financial statements on pages 86 to 201 and the basis of preparation information in sections 5.1 and 5.3.

### 5.1 Introduction

The following section provides analysis of the IFRS underlying profit attributable to equity holders for the period from 10 July 2006 to 31 December 2006. It also includes pro forma results for the full year 2006 and comparative results for 2005.

#### Pro forma results

Before demutualisation on 10 July 2006, the parent company of the Group was a mutual organisation operated for the benefit of its with profits policyholders. The statutory accounts recorded neither a profit nor a loss on the operations of its long term business because, under the mutual structure, all surpluses from the business accrued to the benefit of with profits policyholders through bonuses declared or through transfers to the unallocated divisible surplus.

To give shareholders a guide to the Group's performance for the period after demutualisation – from 10 July to 31 December – together with illustrative performance for FY2006 compared to FY2005, the pre demutualisation IFRS mutual figures were adjusted to derive a pro forma profit figure. In order to provide illustrative financial information for FY2006, full year pro forma results have been prepared by adding the pro forma results for the period from 1 January 2006 to 10 July 2006 to the actual results for the period from 10 July 2006 to 31 December 2006.

It should be noted that this information is unaudited and is prepared for illustrative purposes only and, because of its nature, addresses a hypothetical situation. It does not represent the Group's actual financial position or results. The methodology used to derive the pro forma profit figure is consistent with that used in the Company's Prospectus issued in June 2006 and is derived by first calculating a Historical Financial Information (HFI) result and then adjusting for certain items. The basis of preparation of the HFI and pro forma results is discussed in more detail – see section 5.3.

#### Underlying profit

Underlying profit is a 'normalised' profit measure that the Group uses to provide a more meaningful analysis of the underlying business performance. Underlying profit is calculated by adjusting profit for the period for items such as volatility arising from different IFRS measurement bases for assets and liabilities, impairment of intangibles and certain restructuring expenses. See the accounting policy (hh) on page 106 of the Group's financial statements for more details.

#### Period 10 July 2006 to 31 December 2006

The figures included within the underlying profit result for the period from 10 July 2006 to 31 December 2006 have been prepared in accordance with the accounting policies described in the financial statements. A reconciliation of the Group's profit for the period to the underlying profit for the period from 10 July 2006 to 31 December 2006 is given on page 87.

In comparing the actual results for the period after demutualisation to that of the pro forma results for the periods before demutualisation, it is important to consider that the pro forma results include certain assumptions and estimations which may differ from the actual results arising in the post demutualisation environment. The main areas of difference relate to the fund structure in which new business is written after demutualisation, the treatment of immediate annuities in the UK and Ireland and the method used to calculate profit on German business. These are described in more detail in the basis of preparation – see section 5.3.

## 5.2 Segmental analysis of IFRS pro forma underlying profit

	Pro forma period from 1 January to 10 July 2006 <sup>1</sup>	Period from 10 July 2006 to 31 December 2006	Pro forma FY 2006	Pro forma FY 2005
	£m	£m	£m	£m
<b>Underlying profit before tax attributable to equity holders of Standard Life plc</b>				
<b>Life and pensions</b>				
UK	120	110	230	16
Canada	68	100	168	86
Europe	57	51	108	73
Other	(2)	(7)	(9)	—
<b>Total life and pensions</b>	<b>243</b>	<b>254</b>	<b>497</b>	<b>175</b>
Investment management	29	37	66	44
Banking	17	21	38	24
Healthcare and general insurance	3	13	16	7
Group Corporate Centre costs	(42)	(47)	(89)	(58)
Other		12	12	(47)
<b>Underlying profit before tax attributable to equity holders of Standard Life plc and adjusted items</b>	<b>250</b>	<b>290</b>	<b>540</b>	<b>145</b>
Profit attributable to minority interest	52	60	112	83
<b>Underlying profit before tax attributable to equity holders and adjusted items</b>	<b>302</b>	<b>350</b>	<b>652</b>	<b>228</b>
<b>Adjustments for the following items<sup>2</sup></b>				
Volatility arising on different asset and liability valuation bases	(43)	68	25	59
Impairment of intangibles	(9)	(5)	(14)	
Restructuring expenses	(5)	(12)	(17)	
<b>Profit before tax attributable to equity holders</b>	<b>245</b>	<b>401</b>	<b>646</b>	<b>287</b>
<b>Tax attributable to</b>				
Underlying profit	27	39	66	18
Non operating items	(18)	19	1	21
<b>Total tax</b>	<b>9</b>	<b>58</b>	<b>67</b>	<b>39</b>
<b>Profit for the period</b>	<b>236</b>	<b>343</b>	<b>579</b>	<b>248</b>
<b>Basic earnings per share (EPS)<sup>3</sup></b>	<b>10.6p</b>	<b>11.9p</b>	<b>22.5p</b>	<b>6.0p</b>
<b>Diluted EPS<sup>4</sup></b>	<b>10.3p</b>	<b>11.5p</b>	<b>21.8p</b>	<b>5.8p</b>

<sup>1</sup> The figures which were reported in the Half Year Report 2006 have been adjusted to reflect the trading period from 1 July to 10 July 2006 and to reclassify items which were previously classed as non-covered in 'Other' to UK life and pensions. This treatment is consistent with the Pro forma reconciliation of Group underlying profit to profit for the period on page 87

<sup>2</sup> Refer to accounting policy (hh) in the Group's financial statements which details the nature of the adjustments

<sup>3</sup> Basic EPS is based on 2,102m shares and underlying pro forma profit after tax attributable to equity holders of Standard Life plc of £474m (2005: £127m) see note 10 in the Group's financial statements

<sup>4</sup> Diluted EPS is based on 2,173m shares

### **5.2.1 UK life and pensions**

UK life and pensions IFRS pro forma underlying profit before tax has increased to £230m for 2006 (2005 £16m)

The 2005 figure is after £189m of annuity reserve strengthening due to changes in expected future rates of mortality improvement and annuity enhancements post A Day. There was no similar effect in 2006. Excluding this adjustment the 2005 figure would have been £205m.

The IFRS underlying profit from life and pensions is determined mainly by the Recourse Cash Flow (RCF), i.e. the amount that can be transferred from the HWPF to the shareholder fund based on regulatory cash flows determined by the rules of the Scheme, and to a lesser extent by the strain of writing new business, adjusted for Deferred Acquisition Costs (DAC) and Deferred Income Reserve (DIR).

IFRS underlying profit before tax of £110m for the period 10 July to 31 December 2006, includes £23m relating to a one off reserve release in respect of deferred annuities.

IFRS pro forma underlying profit before tax of £120m for the period 1 January to 10 July 2006 was boosted by a sizeable release of SIPP sterling reserves of £30m which flows through the RCF. This was due to a sharp fall in unit costs, resulting from the significant increase in the size of the SIPP book of business over this period.

The 2006 result includes the cost of carry of subordinated debt of £19m and losses in relation to non-covered business of £25m. In 2005 these items were not included in the UK life and pensions result, but were disclosed as part of 'Other' – see section 5.2.7.

The IFRS pro forma underlying profit excludes the impact of volatility which arises as a result of subordinated liabilities being measured at amortised cost, whilst the assets are measured at fair value.

### **5.2.2 Canada life and pensions**

Canada life and pensions IFRS pro forma underlying profit before tax increased by 95% to £168m (2005 £86m)

The increase in pro forma underlying profit before tax was driven by higher fee income from the continued growth in mutual funds and segregated funds under management, continued cost control and also from the strategic focus on higher margin products. The period benefited from strong returns in a buoyant property market, coupled with positive returns in the equity markets.

IFRS underlying profit before tax of £100m for the period 10 July to 31 December 2006 reflected the increase in investment and fee income as equity markets rallied in the second half of 2006. Investment return also benefited from the decrease in interest rates in the second half of the year. In addition, the repositioning of the individual life products and the subsequent fall-off in sales led to a decrease in commission and other acquisition expenses.

Pro forma underlying profit before tax of £68m for the period 1 January to 10 July 2006 was lower than the second half results. This was due largely to lower investment returns.

Pro forma underlying profit excludes the impact of volatility arising in Canada on non-linked investment contracts. The volatility arises because policyholder liabilities, associated with a portfolio of assets measured at fair value, are measured at amortised cost.

### 5.2.3 Europe life and pensions

IFRS pro forma underlying profit before tax generated by the European life and pensions branches was £108m (2005 £73m). This represents an increase of 48%. The German branch contributed £105m (2005 £80m) whilst the Ireland branch achieved an overall profit of £3m (2005 loss £7m).

The 2005 figure is after £55m of reserving strain for Germany. Excluding this adjustment the 2005 figure would have been £128m. The decrease in 2006 compared to the adjusted 2005 amount is due to margins earned in 2005 on the exceptional sales experienced in 2004 and the first quarter of 2005 (due to changes in the German tax legislation) coming to an end.

IFRS underlying profit before tax of £51m for the period 10 July to 31 December 2006 compares to £57m for the pre-demutualisation period.

### 5.2.4 Investment management

IFRS pro forma underlying profit before tax increased by 50% to £66m (2005 £44m). The increase was driven by fee and commission income due to the growth of funds under management (FUM).

<sup>1</sup> Total investment management revenue includes fee and commission income and other income.

<sup>2</sup> EBIT margin is calculated by dividing EBIT by net investment management revenue plus net investment return excluding interest received of £3m (2005 £nil). EBIT is derived by taking IFRS profit before tax attributable to equity holders and adding back interest expense of £1m (2005 £1m) and deducting interest received of £5m (2005 £5m).

<sup>3</sup> Sum of net investment management revenue and net investment return excluding interest received of £5m (2005 £5m) / average monthly funds under management.

<sup>4</sup> Net expenses / average monthly funds under management.

	2006	2005
Investment management revenue <sup>1</sup>	£242m	£189m
Less fee and commission expenses	(£15m)	(£10m)
Net investment management revenue	£227m	£179m
EBIT <sup>2</sup>	£62m	£40m
EBIT Margin <sup>2</sup>	27.0%	22.3%
Revenues/average monthly FUM <sup>3</sup>	18.3bps	17.0bps
Expenses/average monthly FUM <sup>4</sup>	(13.7)bps	(13.4)bps

Net investment management revenue increased by 27% to £227m in 2006 (2005 £179m). The increase was primarily due to strong inflows into third party funds during 2006, together with the favourable market conditions in the period, which boosted the value of underlying FUM.

Expenses during the period increased to support the business growth and performance experienced during 2006.

## 5 2 5 Banking

Excluding the volatility in respect of non qualifying economic hedges, IFRS pro forma underlying profit before tax increased by 58% to £38m (2005 £24m)

	2006	2005
Net interest income <sup>1</sup>	£88m	£73m
Non interest income	£10m	£11m
Expenses	(£60m)	(£60m)
IFRS pro forma underlying profit before tax	£38m	£24m
Cost to income ratio <sup>2</sup>	61%	71%
Interest margin <sup>3</sup>	74bps	63bps

<sup>1</sup> Net interest income measures the difference between total interest income earned and the cost of funding

<sup>2</sup> Cost to income ratio is the measure SLB uses to determine the success of its cost savings initiatives and is calculated on an underlying basis as the ratio of total costs to total income for the year expressed as a percentage

<sup>3</sup> Interest margin measures the amount of interest margin being generated by SLB's assets and is calculated as a % of average total interest bearing assets during the year and quoted in basis points (bps) 1/100ths of 1 percent.

The increase in IFRS pro forma underlying profit before tax occurred despite mortgages under management decreasing due to a focus on improving margins and controlling costs. Staff numbers reduced to 725 during 2006 (2005 795). This was reflected in improvements to the cost income ratio, net interest income and interest margin.

## 5 2 6 Healthcare and general insurance

IFRS pro forma underlying profit before tax within SLH increased by £8m to £12m. This is before taking into account significant one-off costs of £21m relating to the purchase of FirstAssist's private medical portfolio and the subsequent restructuring – including the relocation of the head office to Bournemouth.

The one off costs include an impairment charge of £7.8m on the goodwill purchased as part of the FirstAssist deal.

IFRS pro forma underlying profit increased, mainly because claims experience was better than expected, including a surplus on the run off of the previous year's outstanding claims reserves of £4m. The improved claims experience is linked to medical claims inflation in 2006 being below expectations, and to pricing and underwriting actions to improve profitability.

Other general insurance operations contributed £4m (2005 £3m).

## 5 2 7 Group corporate centre costs and other

Group corporate centre (GCC) costs increased by 53% to £89m (2005 £58m). This was due to the significant additional costs associated with the transition to a public listed company. One of the key targets of the Group is to reduce GCC costs in 2007 – see section 1.1.

'Other' increased to £12m (2005 loss of £47m) due to the 2005 figure including non covered business as detailed in section 4.3.6. In 2006 this was included within the life and pension underlying profit figure. In addition the period from 10 July to 31 December 2006 includes income of £18m in relation to assets held by the Group's holding company, Standard Life plc.

### 5.3 Derivation of pro forma underlying profit and additional basis of preparation information

Detailed below is a reconciliation of the IFRS mutual results to pro forma profit. A reconciliation of the IFRS underlying profit is provided in the Group financial statements, refer to page 87

	Pro forma period from 1 January to 10 July 2006	Pro forma FY 2005
	£m	£m
Total net revenue	5,074	18,307
Total operating expenses	(4,967)	(17,792)
Share of profits from associates and joint ventures	63	99
<b>Profit before tax</b>	<b>170</b>	<b>614</b>
Tax expenses	(118)	(531)
<b>Profit for the period</b>	<b>52</b>	<b>83</b>
<b>Adjustments to derive HFI profit</b>		
(Profit)/loss attributable to minority interest	(52)	(83)
HFI adjustment to unallocated divisible surplus	83	30
HFI adjustment to tax	2	39
<b>HFI profit before tax attributable to equity holders and after minority interest</b>	<b>85</b>	<b>69</b>
<b>Adjustments to derive Pro forma profit</b>		
Deferred acquisition costs	94	157
Assumed interest on proceeds of share issue	18	33
New business reserving strain	(4)	(55)
<b>Pro forma profit before tax attributable to equity holders and after minority interest</b>	<b>193</b>	<b>204</b>
<b>Adjustments to derive underlying profit*</b>		
Volatility arising on different asset and liability valuation bases	43	(59)
Impairment of intangibles	9	
Restructuring expenses	5	
<b>Underlying profit before tax attributable to equity holders and after minority interest</b>	<b>250</b>	<b>145</b>

\* Adjusted items are consistent with those detailed in accounting policy (hh) on page 106 of the Group's financial statements

The estimated shareholder tax on underlying profit is assumed to be £27m for the period 1 January to 10 July 2006 (FY 2005 £18m)

#### Basis of preparation Pro forma period 1 January 2006 to 10 July 2006 and FY 2005

The pro forma results for the period from 1 January 2006 to 10 July 2006 and FY 2005 have been prepared on a consistent basis. Due to the nature of the adjustments made to the IFRS mutual figures, pro forma profit figures are not directly comparable and may differ from the actual results had demutualisation occurred at the beginning of those periods.

To provide shareholders with some level of comparison of the performance of the Group, the IFRS mutual results have been restated as if the parent company of the Group had been a proprietary company during the above periods. This restatement process was first carried out for the Standard Life plc Prospectus issued in June 2006 which provided financial information on a Historical Financial Information (HFI) basis and on the pro forma basis.

The HFI results have been prepared in order to show the results which would have been attributable to shareholders and policyholders had SLAC been a company owned by shareholders under the terms of the Scheme during the two accounting periods. The pro forma results comprise the income statement as set out in the HFI results basis, adjusted to reflect the profit that would have arisen had the Scheme and anticipated post demutualisation capital and debt structure been in place at the start of each period.

After demutualisation, the recourse cash flow (RCF) formulae are used to determine the amount attributable to shareholders in respect of in force business. The results of new business written (with the exception of increments written in the Heritage With Profits Fund) will be directly attributable to shareholders. Therefore the RCF formulae will not apply to that new business. This distinction means that acquisition costs and certain reserving strains are treated differently in the HFI in comparison to the way that those costs are actually treated post demutualisation. These differences are adjusted in the pro forma profit calculation – see section 5.3.2.

### **5.3.1 HFI basis of preparation**

The terms of the Scheme have been reflected in the preparation and presentation of the HFI results. Further details about the terms of the Scheme are discussed in the Company's Prospectus. The HFI results have been derived using the SLAC Group accounting records and in accordance with the accounting policies set out in the Prospectus. The principal adjustments made to the underlying Standard Life Group accounting records are summarised below.

#### **Profit/(loss) attributable to shareholders**

The income statement in the HFI results has been prepared to show those proportions of the transfers made to the unallocated divisible surplus which would have been attributable to shareholders and with profits policyholders had the Group been owned by shareholders under the terms of the Scheme during the two accounting periods.

The profit/(loss) attributable to shareholders comprises five components:

- (a) The transfer of assets between shareholders and policyholders that would have arisen under the Scheme in respect of the UK and Irish unitised with profits and non participating business (the RCF)
- (b) The recharge in respect of business written in the German branch
- (c) The profits attributable to the operating subsidiaries which, under the Scheme, transfer to SLAL's Shareholder Fund or the Proprietary Business Fund, through the RCF
- (d) In relation to subordinated debt and Subordinated Members' Accounts (SMAs), the amount by which the return on the assets backing the subordinated debt exceeds the coupon paid (cost of carry)
- (e) In relation to annuities, the amount attributable to shareholders represents the profit or loss resulting from the difference between actual mortality experience and the mortality reserving assumptions used to determine the reinsurance premium received by SLIF from the Heritage With Profits Fund

In order to calculate the shareholder profit/loss that would have arisen in the two accounting periods in relation to (a), (b) and (e) above long term insurance premiums, claims and commissions, associated reinsurance and operating costs and actuarial reserves have been derived from the accounting and actuarial records of the Group and have been allocated to each business unit and product category by reference to the nature of the individual products giving rise to the transactions. The RCF is then calculated for each product category by reference to formulae defined in the Scheme.

It should be noted that in relation to immediate annuities post demutualisation, the profit that is attributable to shareholders results from the difference between actual mortality experience and the mortality reserving assumptions used to determine the reinsurance premium paid to SLIF by the HWPF. For the purposes of the pro forma results prior to demutualisation, the result of the annuity business was allocated between policyholders and shareholders according to a basis that was similar to that used for other conventional non insurance business, with allowances made for the different actual and assumed administration expenses and the movements in mathematical reserves held in respect of future administration expenses.

In addition, the post demutualisation results for Germany arise from a recharge of expenses to the HWPF, whereas the pro forma results were calculated based on a method which allocated the results between shareholders and policyholders on a basis that is consistent with business written in the UK and Ireland.

#### **Taxation**

As the parent company of the Group was a mutual company pre demutualisation, the Group's life and pensions business was not subject to shareholder tax. The tax attributable to that business is therefore regarded as policyholder tax, and no calculations have been made either to re-analyse that tax between shareholder and policyholder tax, or to compute any additional tax charge or credit (current or deferred taxation) which might arise in the shareholder environment. The tax charge attributable to shareholders in the HFI results solely reflects the tax in the operating subsidiaries that are held outside the Heritage With Profits Fund.

#### **5.3.2 Basis of preparation – Pro forma results**

The pro forma results are calculated by adjusting the HFI results for the following items:

(a) **Deferral of acquisition costs**

In the HFI, a component of shareholder profit is represented by the transfer of assets to the Shareholder Fund and the Proprietary Business Fund. This transfer was calculated in accordance with the formula defined in the Scheme by reference to certain cash flows from the unitised business and non-participating business. These cash flows are based on the amounts reported in the regulatory return and therefore exclude any deferral of acquisition costs.

The adjustment shown in the pro forma income statement reflects the deferral of that element of acquisition costs, which would have been attributable to shareholders had the new business been written in the Proprietary Business Fund.

(b) **Assumed interest on proceeds of share issue**

An element of the IPO proceeds is used to support the capital adequacy of the Group. An amount of £750m of the proceeds was assumed to be used within the Group for capital adequacy purposes (after the payment of £50m to the UK Standard Life Staff Pension Scheme). The pro forma income statement includes additional investment income to reflect a return achieved on gilts during the period. The return on the remaining estimated IPO proceeds of £500m is not shown in the pro forma income statement and has been estimated to be £11m before tax based on the rate of return on gilts (4.40%). Post demutualisation, investment return on the full £1.3bn IPO proceeds is recognised.

(c) **New business reserving strain**

The reserving strain arising from new unitised with profits business (excluding increments) has changed post-demutualisation. This business is written in the Proprietary Business Fund (and the with profits element is transferred to a new with profits fund), and therefore is attributable to shareholders.

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# Corporate responsibility

As a listed plc Standard Life remains committed to running the business to high ethical, legal, and professional standards

We view corporate responsibility as an integral part of managing our day to day business – as important as excellent customer service and profitable growth. For example, since our first Trees for Life initiative in 2004, we have bought one seedling for each of the first 150,000 e mail addresses we received to help restore the Caledonian Forest to its former glory – and this is just one part of a sound business practice of our drive to reduce paper based communications

Overall, we focus on five key areas where our business has had most impact. These are understanding and engaging on the issues that matter most to our external stakeholders, creating the environment that allows our people to realise their full potential, being active and responsible investors, reducing our environmental impacts, and playing an active role in supporting our local communities

## Engaging with our stakeholders

The success of the vote on demutualisation and flotation in May 2006 depended on our members' support. Their support was crucial in two areas: we needed a Special General Meeting (SGM) vote that would demonstrate to the Court of Session that members were in favour of the proposals, and a demand for shares that would maximise the value of each member's demutualisation entitlement

To help us achieve this, we aimed to ensure that all communications about the proposals encouraged members and policyholders to take part in the SGM and the flotation process

We worked hard to engage our members and understand their concerns and views about the proposed demutualisation. An important initiative was the Members' Roadshows, where a team from the Board and areas across the business went out 'on the road' to meet with and talk through their questions. We also sent all 2.4m qualifying members of SLAC a regular issue of *Members' Update*, and carried out research to gauge their views and help make sure our communications were meeting their needs

Our research has shown that our customers want regular communication rather than just annual statements, so last year we launched the new *Standard Life* magazine to provide a thought provoking read on today's key financial issues. The first issue went out to 500,000 customers at the end of November. Our communications continued to evolve with the first issue of *Shareholder News* in December 2006

We also continued our programme of research with a range of key stakeholders, including personal finance journalists, business and finance journalists, industry leaders, MPs and MSPs. Each study is carried out yearly, and covers a broad range of topics including familiarity, favourability, advocacy and image ratings. The studies also look at areas like our company strategy, how we deal with our customers and the quality of our management

Thanks to better communications with our stakeholders about the new direction our business is taking, the results of these studies improved last year – we achieved better scores in key areas, such as relationship management, favourability and image ratings

### **Focusing on life at work**

Our people made a significant contribution to our successful stock market listing. For our part, we made sure that we supported their efforts and needs throughout all the changes. We have always believed that engaging our people is key to our business success.

During the year we established a Staff Pensions Working Group to discuss prospective changes to the Staff Pension Scheme.

We maintained our focus on keeping Standard Life a healthy and safe place to work, and developed our strategy to support the wellbeing of all our employees. A Group-wide Health and Safety Committee was set up in March, and in December we conducted a UK wide audit to measure our levels of stress against HSE management standards. We also launched Vielifit – an online health promotion tool that gives our employees a simple way to look after their personal wellbeing. This has been well received and has resulted in healthy eating and fitness initiatives throughout the Group.

### **Shareholder responsibility**

We take our responsibility as shareholders seriously, using our influence to encourage high standards on environmental, social and governance (ESG) issues at the companies we invest in. This supports our goal of delivering excellent investment returns for our clients, because we believe that well managed companies that tackle ESG issues responsibly tend to perform better in the long term. Through our corporate governance team, we use our vote at every company meeting in the UK and Ireland where we have a shareholding. The team monitors how many company meetings we vote at, as well as the number of meetings held with company management to discuss governance and Socially Responsible Investment (SRI) issues. In 2006, the team took part in meetings with over 200 companies – the records are published on the Standard Life Investments website.

To demonstrate our ongoing commitment to being an active and responsible investor, Standard Life has also signed up to the UN Principles for Responsible Investment. Launched in April 2006 by UN Secretary General Kofi Annan, these principles provide a framework that helps investors to build ESG issues into their investment activities, and improve long term returns.

### **Reducing our environmental impact**

The environment, particularly climate change is becoming increasingly important for many people, as research shows serious long term effects if action is not taken in the short term. Standard Life has long recognised its responsibilities to the environment, and this has become an increasingly important issue in recent years. Our focus is on reducing our environmental impact by using less, recycling more, and disposing of waste sensitively.

We are committed to controlling our consumption of energy and raw materials – two of the primary contributors to CO<sub>2</sub> emissions both from direct use and transportation. We aim to keep reducing the amount of energy used in our office buildings, and last year we succeeded in cutting the level in the UK for each full time employee by around 5%. This builds on our success in reducing our total energy consumption by approximately 40% over the last eight years.

Because of demutualisation, we needed to send customers more printed information last year. We worked hard with the FSA and other organisations to minimise the increase to just 53 tonnes – and limited the overall total to 756 tonnes.

The other main resource our business uses is paper. So a key aim over 2006 was to cut our consumption and increase our use of recycled paper and paper sourced from Forest Stewardship Council accredited wood. In February we moved to printing the majority of the Group's product literature on Era Silk – the first recycled coated paper that is made from genuine UK waste and performs like a normal graphic paper.

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We also succeeded in cutting the amount of waste sent to landfill in the UK by 8%, from 549 to 504 tonnes, and we sent less paper for recycling. It was down from 846 to 628 tonnes, thanks to initiatives to reduce internal paper consumption – such as duplex printing and copying, and reducing paper weight from 90gms to 80gms.

### **In the community**

Our Corporate Community Investment (CCI) strategy is to be alive to the community and is implemented through the four strands of our framework: Working Life, Financial Life, Healthy Life and Strengthen Life.

Last year, we repositioned the framework to make sure that it is fully integrated into the business, our values and the needs of the community. We also focused on embedding it more firmly by securing sponsorship from the Group Executive Committee and by developing effective partnerships in the business and the wider community. These partnerships gave us valuable external feedback, which helped us to review our activities and supporting material.

We continued to invest in education, and our work supported 8,064 people during 2006. A key area was reviewing, revamping, and relaunching Step up in Life – our employability skills programme for schools. We also worked on two key projects to support our financial education strategy. The first was Money Week – a teacher resource for primary schools across Scotland, developed in partnership with Learning Teaching Scotland and launched successfully in November.

The second project – On the Money – uses storytelling to help develop the financial skills of primary school children and improve their attitudes and behaviour in relation to money. This project is being developed in partnership with the Scottish Book Trust and Learning Teaching Scotland, and will be launched in the summer of 2007.

Our people continued to give their own time to raise money for the Standard Life Charity Fund, and we remained committed to matching all donations. As well as this we also contributed the excess funds received by individuals who bought shares at flotation, where the amount left over was less than the value of a share – this totalled £197,211. Each year, a number of causes are selected to benefit. In 2006, the Association for International Cancer Research (AICR), and WellChild, received £343,825 and £185,136 respectively, while Rainbow Family Trust received £7,542, CHASE received £11,300 and £2,561 was given to both Wessex Children's Hospice and Julia's House.

Donations by Standard Life Canada benefited 96 Canadian charities including a single donation of £48,661 to United Way of Montreal and £158,566 raised for the Foundation for Research into Children's Diseases.

You can read more about our work in our Corporate Responsibility report which you can find at [www.standardlife.com/corporate\\_responsibility](http://www.standardlife.com/corporate_responsibility)

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## Board of Directors

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### **Sir Brian Stewart CBE**

**Chairman, age 61**

Appointed Director and Chairman of Standard Life plc in March 2006. He was previously appointed Director of The Standard Life Assurance Company in April 1993, and Chairman in July 2003.

He is also Chairman of Scottish & Newcastle plc.

### **Gerry Grimstone**

**Deputy Chairman, age 57**

Appointed Director and Deputy Chairman of Standard Life plc in March 2006. He was previously appointed Director of The Standard Life Assurance Company in July 2003 and Deputy Chairman in March 2006. He is a non-executive Director of Dairy Crest Group plc and the non-executive Chairman of Candover Investments plc and F&C Global Smaller Companies plc.

As has been announced, it is intended that Gerry Grimstone will succeed Sir Brian Stewart as Chairman of the Company at the end of the AGM.

### **Kent Atkinson**

**Non executive Director, age 61**

Appointed Director of Standard Life plc in March 2006, and previously appointed Director of The Standard Life Assurance Company in January 2005. He is Chairman of the Audit Committee. He is also currently Senior Independent Director and Chairman of the Audit Committee of Coca Cola HBC S.A. and telent plc, Non Executive Chairman of Link Plus Corporation and a non-executive director of Gemalto N.V.

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### **Trevor Matthews**

**Executive Director, age 54**

Appointed Director of Standard Life plc in March 2006 and previously appointed Director of The Standard Life Assurance Company in July 2004. He joined the Standard Life Group in July 2004 and is currently Chief Executive of Standard Life Assurance. He previously held the role of President and Chief Executive Officer of Manulife in Japan and before that was the Executive Vice President of Manulife's Canadian operations.

### **Alison Mitchell**

**Non executive Director, age 54**

Appointed Director of Standard Life plc in March 2006 and previously appointed Director of The Standard Life Assurance Company in December 2000. She is a well known UK personal finance journalist, having presented BBC Radio 4's 'Moneybox' programme for many years and been a financial presenter of BBC TV's 'Breakfast Time' and ITV's Budget programmes. She has written several popular financial books.

### **David Nish**

**Executive Director, age 46**

Appointed Director and Group Finance Director of Standard Life plc in November 2006. Previously a partner with Price Waterhouse and Group Finance Director at Scottish Power plc, he is also a non-executive Director of Northern Foods plc and Royal Scottish National Orchestra Limited.

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### **Lord Blackwell**

**Non-executive Director, age 54**

Appointed Director of Standard Life plc in March 2006 and previously appointed Director of The Standard Life Assurance Company in June 2003. He is Chairman of Standard Life Assurance. He is also Chairman of Interserve plc, Senior Independent Director of Slough Estates plc and a Board Member of the Office of Fair Trading, special adviser to KPMG's Corporate Finance Practice, Chairman of the Centre for Policy Studies and an active member of the House of Lords.

### **Sandy Crombie**

**Group Chief Executive, age 57**

Appointed Director and Group Chief Executive of Standard Life plc in March 2006. He was previously appointed Director of The Standard Life Assurance Company in January 2000, and Group Chief Executive in January 2004. He joined Standard Life in 1966 and was Chief Executive of Standard Life Investments from its launch in 1998 until his appointment as Group Chief Executive in 2004.

### **John Hylands**

**Executive Director, age 55**

Appointed Director of Standard Life plc in March 2006 and previously elected Director of The Standard Life Assurance Company in April 2002. He joined the Standard Life Group in 1979 and was Group Finance Director between December 2001 and June 2005. Previously he was General Manager (Marketing) between 1994 and 2001. He led the demutualisation programme.

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### **Jocelyn Proteau**

**Non-executive Director, age 59**

Appointed Director of Standard Life plc in March 2006 and previously appointed Director of The Standard Life Assurance Company in August 2003. He is Chairman of The Standard Life Assurance Company of Canada and has worked for much of his career in the Canadian financial services industry. He holds a number of non-executive positions and is Chairman of Technologies 20/20 Inc and BTB Real Estate Investment Trust.

### **Keith Skeoch**

**Executive Director, age 50**

Appointed Director of Standard Life plc in May 2006 and previously appointed Director of The Standard Life Assurance Company in March 2006. He is Chief Executive of Standard Life Investments. He joined Standard Life Investments in 1999 after nearly 20 years' investment experience at James Capel & Co Limited, in a number of roles including Chief Economist and Managing Director International Equities.

### **Hugh Stevenson**

**Non-executive Director, age 64**

Appointed Director of Standard Life plc in March 2006 and previously appointed Director of The Standard Life Assurance Company in June 1999. He is the Company's Senior Independent Director and Chairman of Standard Life Investments. He is also Chairman of Equitas Limited and The Merchants Trust plc, and is a non-executive director of the Financial Services Authority. From 1992 to 1998, he was Chairman of Mercury Asset Management Group plc.

As at 31 December 2006

# Board Committees

The Board of Standard Life plc has four committees Audit, Remuneration, Nomination and Governance, and Investment

The boxes below show the membership of each Board Committee You can find out more about how these committees operate – including the duties of the members – on page 63 to 67

**Audit Committee**  
 Kent Atkinson (Chairman)  
 Lord Blackwell  
 Crawford Gillies  
 Gerry Grimstone  
 Baroness McDonagh  
 Jocelyn Proteau

**Remuneration Committee**  
 Gerry Grimstone (Chairman)  
 Lord Blackwell  
 Crawford Gillies  
 Baroness McDonagh  
 Hugh Stevenson

**Nomination and Governance Committee**  
 Sir Brian Stewart (Chairman)  
 Sandy Crombie  
 Gerry Grimstone  
 Lord Blackwell  
 Jocelyn Proteau  
 Hugh Stevenson

**Investment Committee**  
 Hugh Stevenson (Chairman)  
 Kent Atkinson  
 Crawford Gillies  
 Gerry Grimstone  
 Alison Mitchell

## Subsidiary company boards

As well as sitting on the Board Committees, many of the Directors, including non executives, sit on subsidiary company boards We believe that this is key to them gaining a true understanding of the everyday work of our business and adds value to decision making

**Standard Life Assurance**  
 Lord Blackwell (Chairman)  
 Kent Atkinson  
 Sandy Crombie  
 Trevor Matthews

**Standard Life Bank**  
 Sir Brian Stewart (Chairman)  
 Sandy Crombie  
 John Hylands  
 Alison Mitchell

**Standard Life Healthcare**  
 Sandy Crombie (Chairman)  
 John Hylands

**Standard Life Investments**  
 Hugh Stevenson (Chairman)  
 Sandy Crombie  
 Keith Skeoch

**The Standard Life Assurance Company of Canada**  
 Jocelyn Proteau (Chairman)  
 Sandy Crombie

We have only listed the Standard Life plc Directors who sit on these boards, not the full list of members

As at 22 March 2007

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# Directors' report

Standard Life plc acquired the business of The Standard Life Assurance Company (SLAC) and its subsidiaries after members of SLAC voted in favour of demutualisation and flotation at a Special General Meeting on 31 May 2006. Standard Life plc concluded its Initial Public Offering and its shares were listed on the London Stock Exchange on 10 July 2006 (the 'listing date').

## Reporting for the year to 31 December 2006

The activities of the Company and its principal subsidiary undertakings are summarised in sections 1 and 2 of the business review. Reviews of the operating and financial performance of the Group for the year to 31 December 2006, of any important events after the year end and of likely future developments, are given in the Group Chief Executive's statement and the business review, and together with the Chairman's statement and the corporate responsibility report form part of this report.

The corporate governance report is submitted by the Board, and the Directors' Remuneration Report of the Remuneration Committee is submitted on behalf of the Board.

Before the listing date, the holding company of the Group was SLAC – a mutual company operated for the benefit of its with profits policyholders. All surpluses generated were attributable to with profits policyholders, either through bonuses declared, or through transfers to the unallocated divisible surplus.

After the listing date, the Group was able to report International Financial Reporting Standards (IFRS) profit for the first time as a listed company. The 2006 IFRS consolidated income statement on page 86 shows the results separately for the periods before and after the listing date, to distinguish between the results of SLAC and the Company respectively before and after the listing date.

To assist users and give shareholders a basis for future comparison, the results for the year ended 31 December 2005 and for the period from 1 January 2006 to 10 July 2006 have also been prepared on a pro forma basis. This represents the IFRS mutual results for these periods, adjusted to calculate a profit figure for the Group, as if its holding company had been a listed public company at the beginning of the relevant period. Because of the nature of the adjustments required to the IFRS mutual figures, pro forma profit figures are not directly comparable and may differ from the actual results if the holding company of the Group had been a listed public company at the beginning of the relevant period. The pro forma results for the period 1 January 2006 to 10 July 2006 are presented for comparison in the segmental analysis of IFRS pro forma underlying profit in section 5.2 of the business review.

The results of the Group on a European Embedded Value (EEV) basis are presented in section 4.2 of the business review.

A more detailed description of the basis of preparation for IFRS pro forma underlying profit and the preparation on a EEV basis is set out in sections 5.1 and 4.1 respectively of the business review. There is information about the Group's use of financial instruments and related financial risk management matters in note 39 to the Group financial statements.

A statement of Directors' responsibilities for the preparation of the financial statements for the year to 31 December 2006 follows this report and a cautionary comment concerning forward looking statements is made below.

At the date of approving this report, so far as each Director is aware, there is no relevant audit information, being information needed by the auditors in connection with the preparation of their report, of which the auditors are unaware. Having made enquiries of fellow Directors and the Company's auditors, all the Directors have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the auditors are also aware of that information.

The Chairman's statement, Group Chief Executive's statement, business review and other sections of this Annual Report and Accounts may contain 'forward looking statements' about certain of the Group's current plans, goals and expectations relating to future financial conditions, performance, results, strategy and objectives. Statements containing the words 'believes', 'intends', 'expects', 'plans', 'seeks' and 'anticipates' and other words of similar meaning are forward looking. All forward looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the Group's control.

As a result, the Group's actual future financial condition, performance and results may differ materially from the plans, goals and expectations set out in the forward looking statements. The Company will not undertake any obligation to update any of the forward looking statements in this Annual Report and Accounts

### Dividend

The Board recommends the payment of a final dividend for 2006 of 5 p per ordinary share, payable on 31 May 2007 to shareholders on the register of members on 30 March 2007. This represents the total ordinary dividend for the year and will amount to an estimated £114m. A local currency payment service will be available to shareholders residing in certain countries outside the UK. Commencing with the final dividend for 2006, the Company will offer a dividend reinvestment plan that gives shareholders the option to choose to receive ordinary shares instead of cash dividend payments. There are more details of these shareholder services in the shareholder information section at the end of this Annual Report and Accounts

### Share capital

Full details of increases in the Company's issued ordinary share capital during the period between the listing date and the year end are shown in note 23 to the Group financial statements. Details of ordinary shares under option are shown in note 42 to the Group financial statements

As at 31 December 2006, there were 2,106.1 million issued ordinary shares held by 128,820 registered members, with the Standard Life Share Account (the Company sponsored nominee member) holding 1,088.1 million shares on behalf of 1,393,306 participants. These shareholdings are analysed by category of shareholder and size of shareholding at the end of the Annual Report and Accounts

As at 20 March 2007, the Company had been notified of the following interests of 3% or more in its issued ordinary share capital

Computershare Trustees Limited	83,696,266 shares (3.97%)
Legal & General Group plc	74,555,119 shares (3.53%)

The holding of Computershare Trustees Limited is in respect of the Unclaimed Assets Trust – a trust established by the Company and its share registrar to hold the demutualisation entitlements of those eligible members who have not yet confirmed their details in accordance with the Scheme of Demutualisation

The Company did not make any market purchases of ordinary shares during the period from the listing date up to the date of this report under its limited authority to make market purchases of up to 10% of the Company's issued ordinary share capital

Eligible shareholders who hold Demutualisation Shares, Employee Shares or Ordinary Shares issued to them under the Preferential Offer, all as defined in the Initial Public Offering Prospectus dated 15 June 2006, will be eligible to receive one additional ordinary share (a 'bonus share') for every 20 ordinary shares that they have held continuously up to 10 July 2007, the first anniversary of the Company's listing date

### Annual General Meeting

The Company's Annual General Meeting will be held at 11.00am on Tuesday 29 May 2007. After considering separate resolutions relating to the Company's Annual Report and Accounts, the Directors' remuneration report, a final dividend, the re-appointment of the auditors (and the setting of their fees) and the individual election or re-election of certain Directors of the Company, shareholders will be asked to consider proposals to

- grant the Directors power to allot the Company's ordinary shares and to disapply, to a limited extent, shareholders' pre-emption rights in respect of new ordinary shares issued for cash
- grant the Directors limited authority to make market purchases of the Company's ordinary shares
- grant the Directors limited authority to make certain payments which might inadvertently breach the provisions of the Political Parties, Elections and Referendums Act 2000

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Information about the meeting venue and full details of the resolutions to be proposed, together with explanatory notes, are set out in the *AGM guide*

### **Directors and their interests**

All the current Directors, with the exception of David Nish, Crawford Gillies and Baroness McDonagh, were appointed Directors of the Company on 30 March 2006 (25 May 2006 in the case of Keith Skeoch) and were re-elected as Directors at an Annual General Meeting of the Company on 7 July 2006, before the Company became the holding company of the Group DW Director 1 Limited, which was a Director on 1 January 2006, resigned on 30 March 2006 David Nish, Crawford Gillies and Baroness McDonagh were appointed Directors on 1 November 2006, 1 January 2007 and 1 March 2007 respectively and will retire and offer themselves for election at the 2007 Annual General Meeting All the other current Directors will retire and offer themselves for re-election at the 2007 Annual General Meeting, apart from John Hylands who will step down as a Director on 31 March 2007, and Sir Brian Stewart and Alison Mitchell who will retire at the conclusion of the meeting and not offer themselves for re-election David Newlands resigned as a Director of SLAC on 6 March 2006 and Alison Reed resigned as a Director of the Company on 27 October 2006 As explained in the Directors' corporate governance report, Gerry Grmstone will succeed Sir Brian Stewart as Chairman of the Company at the conclusion of the 2007 Annual General Meeting

The interests of the Directors in the Company's ordinary shares, the employee share plan and the share-based executive long term incentive plans, are set out in the Directors' Remuneration Report, together with details of the executive Directors' service contracts and non-executive Directors' appointment letters

During the period from the listing date to the year end, no Director had any interest in the Company's listed debt securities or in any shares, debentures or loan stocks of the Company's subsidiaries, or any material interest in any contract with the Company or a subsidiary undertaking, being a contract of significance in relation to the Company's business, other than the benefit of a third-party indemnity provided by the Company (in accordance with company law and the Company's articles of association) and service contracts between each executive Director and subsidiary undertakings Copies of these documents are available for inspection at the Company's registered office during normal business hours and will be available for inspection at the Company's 2007 Annual General Meeting

The Company maintains Directors' and Officers' liability insurance on behalf of its Directors and its officers

### **Employment policies**

Worldwide, the Group employed 10,256 people at 31 December 2006 2,476 were employed outside the UK The Group's policy on rewarding its employees is set out in the Directors' Remuneration Report

Employees are informed about significant business issues and the Group's performance using e-mail, the Company's intranet and in house publications, as well as DVDs and briefing meetings When appropriate, the Group also consults with employee and trade union representatives

The Group takes the issue of equality and diversity seriously By using the talent and skills available in all communities in the countries where it operates, the Group is able to create strong foundations for the lasting success of its business This is achieved by using appropriate recruitment and selection techniques, ensuring equal employment opportunities and equal access to development opportunities

The Group is also committed to providing a work environment free from harassment and discrimination and remains committed to treating people with disabilities fairly in relation to job applications, training, promotion and career development The Group makes every effort to find appropriate alternative jobs for those who are unable to continue in their existing job because of disability

Employees have the opportunity to participate in the Company's employee share plan which enables eligible individuals to buy ordinary shares in the Company each month directly from their earnings – up to an aggregate market value of £125, or an equivalent sum in the relevant currency These are called 'partnership shares'

For each partnership share bought under the plan, the Company matches the purchase by allocating the relevant individual one ordinary share up to a maximum aggregate value of £25 a month, or an equivalent sum in the relevant currency. These are called 'matching shares'. At 31 December 2006, the plan had been in existence for three months. 56% of eligible Group employees were participating, making an average monthly purchase of £41.21 and holding, on average, an interest in 62 ordinary shares.

In addition, ordinary shares or rights to ordinary shares up to an aggregate market value of £3,000 may be allotted annually to each eligible employee. These are called 'free shares'. A total of 10,563 eligible employees accepted an individual award of 185 free shares on the listing date. The free shares awarded then totalled 1,954,155.

The health and safety of all employees is a priority and is reviewed at regular intervals. Each business within the Group has an appointed health and safety representative, whose role is to bring to the attention of senior management any areas of concern that should be addressed within the health and safety programme.

### **Creditor payment policy**

It is the Group's policy to agree payment terms at the start of business with each supplier and to pay all creditors promptly and in accordance with contractual and other legal obligations. In respect of Group activities, the amounts due to trade creditors at 31 December 2006 represented 13 days' purchases, based on the average daily amount invoiced by suppliers during the year.

### **Charitable and political donations**

Payments for charitable purposes made by the Company during the year totalled £183,624. Full details of charitable donations made by the Group and its employees and shareholders are given in the corporate responsibility report. The Company did not make any donations to any registered party or other EU political organisation, or incur any EU political expenditure.

### **Auditors**

Resolutions to re-appoint PricewaterhouseCoopers LLP as auditors to the Company and to authorise the Directors to determine their remuneration will be proposed at the 2007 Annual General Meeting on 29 May 2007.

On behalf of the Board



**M J Wood**  
Group Company Secretary and General Counsel  
22 March 2007

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## Statement of Directors' responsibilities for preparing the financial statements

The following statement, which should be read in conjunction with the statement of auditors' responsibilities included in the independent auditors' report, is made to help shareholders distinguish the respective responsibilities of the Directors and the auditors in relation to the financial statements for 2006

The Directors are required by company law to prepare financial statements for each financial year, giving a true and fair view of the state of affairs of the Company and of the Group at the end of the financial year, and of the profit or loss of the Company and the Group for the financial year. The financial statements of the Group must be prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board, as adopted for use in the European Union. The Directors have elected to prepare the Company's financial statements on the same basis.

The Directors consider that, in preparing the financial statements on a going concern basis, the Company has used appropriate accounting policies, that these have been consistently applied and supported by reasonable and prudent judgements and estimates, and that all applicable accounting standards have been followed.

The Directors have responsibility for ensuring the maintenance of proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the Company and the Group and to enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 1985 and, as regards the Group financial statements, article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Company and the Group and for taking reasonable steps for preventing and detecting fraud and other irregularities.

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# Corporate governance

The Board is committed to maintaining high standards of corporate governance in managing the Group's affairs and in its accountability to shareholders

This section of the *Annual Report and Accounts* has been prepared in respect of the Code of Best Practice in the Combined Code on Corporate Governance (the Code) issued by the Financial Reporting Council in July 2003. It explains how the Group's corporate governance framework ensures that the Company applies all the principles of good governance set out in the Code to its organisational structure, its processes to appoint and remunerate Directors, its contact with shareholders and its financial reporting, internal control and assurance procedures. The Company has also considered its corporate governance framework in the light of the revised Code, issued in June 2006 to apply to accounting periods beginning after 1 November 2006, and has adopted the revised Code on a voluntary basis from that date.

The Board considers that throughout the year to 31 December 2006, the Company, for the period after the listing date, and The Standard Life Assurance Company, for the period before the listing date, complied with all relevant provisions of Section 1 of the Code, apart from Sir Brian Stewart's chairmanship of another FTSE 100 company. He was appointed as a Director and Chairman of the Company on 30 March 2006, having been Chairman of The Standard Life Assurance Company for the previous three years and a Director of that company since 1993. Because of the long term nature of much of the Group's business, and the need for continuity and strong leadership following the listing of the Company's ordinary shares on the London Stock Exchange, the Board considers that Sir Brian's breadth of knowledge, relevant experience and continuing Chairmanship have been important to the balance of the Board. The Board has considered his other commitments and is satisfied that these do not interfere with the performance of his duties as Chairman of the Company.

## The Board

The Board's role is to organise and direct the affairs of the Company and the Group to maximise value for the benefit of shareholders as a whole, in accordance with the Company's constitution and all relevant laws, regulations and corporate governance standards. The Group Chief Executive, assisted by the executive Directors and senior management, is responsible for the day to-day management of the Group. The Chairman leads the Board, which is responsible for determining the Group strategy, reviewing operating and financial performance, and ensuring adequate resourcing and an effective system of control. The roles and responsibilities of the Board, collectively and for individual Directors, are set out in a Board Charter, which is reviewed by the Nomination and Governance Committee in the light of developments in regulatory guidance. A section of the Board Charter identifies matters that are specifically reserved for decision by the Board. These include approving objectives, strategies and business plans, capital structure, dividend policy, financial reporting and internal controls, external communications, terms of reference of Board Committees, appointments to the Board and Committees, and key Group policies.

The Board and its Committees meet regularly, operating to an agreed timetable of scheduled meetings. The Board has also established a formal procedure for conducting unscheduled meetings when, exceptionally, decisions on matters specifically reserved for the Board are required to be taken urgently.

It is the Company's policy that, apart from the Chairman, at least half the Board should normally be made up of independent non executive Directors. This balance ensures that no individual Director or small group of Directors dominates the decision making process. At 22 March 2007 the Board currently comprises the Chairman, eight independent non executive Directors and five executive Directors. Each non executive Director serves for a fixed term not longer than three years. This term may then be renewed by mutual agreement and re-election at the appropriate Annual General Meeting. As long as the Board is satisfied with a Director's performance, independence and ongoing commitment, there is no specified limit to the number of terms a Director may serve. All Directors must be elected by shareholders at the Annual General Meeting following their appointment by the Board and offer themselves for re-election at least once every three years. Non executive Directors who have served on the Board for more than six years will be proposed for re-election following a rigorous evaluation of individual performance by the Chairman at a one to one meeting. Those with nine years or more continuous service must offer themselves for re election each year.

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Advised by the Nomination and Governance Committee, the Board's policy is to appoint and retain non executive Directors who can bring the widest possible perspective to the affairs of the Group and its decision making framework, regularly reviewing and refreshing the skills and experience it requires through a programme of rotational retirement and a broad recruitment search

All Directors have access to the advice and services of the Group Company Secretary, whose appointment and removal is a matter for the Board. He is responsible for advising the Board, through the Chairman, on all governance matters

### **The Directors**

David Nish, Crawford Gillies and Baroness McDonagh, who have all been appointed as Directors since the listing date, must retire and offer themselves for election at the 2007 Annual General Meeting. John Hylands will step down from the Board on 31 March 2007. As the 2007 Annual General Meeting is the Company's first since the listing date, the Board has decided that it would be appropriate for all the Directors to retire and offer themselves for election or re-election – except Sir Brian Stewart and Alison Mitchell, who will retire at the conclusion of the meeting

Sir Brian Stewart will be succeeded as Chairman of the Board by Gerry Grimstone, who became Deputy Chairman of SLAC in March 2006 and has served as Deputy Chairman of the Company since his appointment as a Director. Hugh Stevenson was the Senior Independent Director of SLAC, and has served as the Company's Senior Independent Director since the listing date. In this capacity, he is available to discuss any concerns with shareholders that they have been unable to resolve through the normal channels of Chairman, Group Chief Executive or Group Finance Director, or if these channels are inappropriate. The Senior Independent Director is also responsible for leading the Board's discussion on the Chairman's performance and the process supporting the Nomination and Governance Committee's recommendation of a candidate for appointment as Chairman by the Board.

The Board conducts an annual review of the independence of non-executive Directors in which all issues relevant to their independence are considered. This involves reviewing their external appointments and considering their individual circumstances against independence criteria, including those contained in the Code. Having considered the matter carefully, the Board is of the opinion that all the current non-executive Directors are independent in character and judgement and that there are no relationships or circumstances which are likely to affect this.

The Board's policy is to allow Directors to seek, at the Company's expense, appropriate professional advice outside the Company when they consider this necessary to carry out their responsibilities.

### **Board effectiveness**

The effectiveness of the Board is key to the Group's success. As a result, the Board has, through the Nomination and Governance Committee, developed a formal annual review process to assess how well the Board, its Committees and Directors are performing and how their respective performances might be improved. The process involves using confidential questionnaires and conducting individual interviews with all Board members to gather information. A report on the output is considered in detail by the Nomination and Governance Committee before being formally reviewed by the Board.

Following the review in late 2006, the Board concluded that it had performed effectively overall, and agreed actions in respect of certain processes identified for improvement. These included, for example, spending more time on the development and execution of Group strategy and strengthening communications between the Board and the principal operating subsidiaries through regular presentations. The Chairman also held one to one meetings with the Directors to assess their individual performances and contributions against performance objectives set out in the Board Charter. No review meetings were held with David Nish, Crawford Gillies and Baroness McDonagh, who were appointed in November 2006, January 2007 and March 2007 respectively. The confidential questionnaires used in the process also supported the Board's review of the Chairman's performance. The non-executive Directors, led by Hugh Stevenson and without the Chairman being present, met once during the period to consider the Chairman's performance and concluded that he had performed effectively during the period. In addition, the Chairman and the non executive Directors met without the executive Directors present to discuss the performance of the executive Directors and senior management succession planning.

## Professional development

The Chairman, supported by the Group Company Secretary, is responsible for arranging for all new Directors to receive a comprehensive and structured induction, tailored to their individual requirements. This includes discussions with key members of senior management, visits to operating businesses within the Group, and meetings with the external auditors and the supervisory team from the Financial Services Authority. The aim of this programme is to give new Directors an understanding of the Group's organisational structure and business activities, the key drivers of business performance, the role of the Company's Board and its Committees, and the Company's corporate governance policies and procedures. When a non executive Director is appointed to one of the Board's Committees, additional relevant induction training is arranged.

On appointment, the Directors undertake to broaden their understanding of the Group's business and are invited to identify any additional matters relating to the Group's activities, or to relevant developments in the external business environment, where they would benefit from additional training.

## Meetings attendance

The Company requires Directors to attend all meetings of the Board and the Committees on which they serve, and to devote sufficient time to the Company to perform their duties. It may sometimes be necessary to call or rearrange meetings at short notice and it is recognised that it may be difficult for all Directors to attend in these circumstances. The attendance of the Directors<sup>†</sup> at the Board and Committee meetings held in 2006 is shown in this table.

	*SLAC Board	Company Board	Audit Committee*	Remuneration Committee*	Nomination and Governance Committee*	Investment Committee*	Demutualisation Committee*
<b>Number of meetings</b>	12	10	9	6	8	7	8
<b>Chairman</b>							
Sir Brian Stewart	12	9			7		7
<b>Executive Directors</b>							
Sandy Crombie	12	10			8		8
John Hylands	12	10					8
Trevor Matthews	12	9					
David Nish (i)		2					
Alison Reed (ii)	12	7					6
Keith Skeoch (iii)	9	9					
<b>Non executive Directors</b>							
Kent Atkinson	8	7	7				6
Norman Blackwell	10	8	9	6	1		6
Gerry Grimstone	12	10	7	6	6	6	7
Alison Mitchell	12	8				7	
David Newlands (iv)	2		1		1		2
Jocelyn Proteau	7	7	7		8		
Hugh Stevenson	12	10		6	8	7	

(i) David Nish was appointed to the Board on 1 November 2006

(ii) Alison Reed resigned from the Company on 27 October 2006

(iii) Keith Skeoch was appointed to the Board of SLAC on 6 March 2006 and the Company on 25 May 2006

(iv) David Newlands resigned from the Board of SLAC on 6 March 2006

\* Membership and Attendance records apply to the SLAC Board Committees and the Company Board Committees

# Meetings up to 10 July 2006

† D W Director 1 Limited was a Director in the period up to 30 March 2006 and attended no Board or Committee meetings

Notes  
Crawford Gillies and Baroness McDonagh were appointed to the Board on 1 January 2007 and 1 March 2007 respectively

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## **Board Committees**

The Board of SLAC established a number of committees to deal with specific aspects of the Group's affairs. These stood down at the listing date and the Board established a number of Committees to oversee, consider and make recommendations to the Board on important issues of policy and oversight. At each Board meeting, the Committee chairmen provide oral reports of the key issues considered at earlier Committee meetings, and minutes are circulated to the Board. The Committees operate within specific terms of reference approved by the Board. These terms are published on the Company's website and are available from the Group Company Secretary on request. Board Committees are authorised to engage the services of external advisers at the Company's expense, whenever they consider this necessary.

The Board has also established a Corporate Responsibility Committee to provide guidance and direction in respect of the Group's corporate responsibility programme and to monitor progress. In connection with this, the Board has adopted a Code of Business Conduct which sets out the behaviour expected of all employees in their dealings with shareholders, customers, fellow employees, suppliers and other stakeholders. There are more details about the activities of the Committee in the corporate responsibility report and there is a copy of the Company's Code of Business Conduct in the corporate responsibility section of the Company's website at [www.standardlife.com](http://www.standardlife.com).

During the run up to the Initial Public Offering in July 2006, the board of SLAC established a demutualisation and flotation Committee to oversee the demutualisation of SLAC and associated matters. That Committee met for the last time in July 2006.

## **Audit Committee**

The Committee members are Kent Atkinson, who was appointed Committee Chairman on 6 March 2006, Lord Blackwell, Gerry Grimstone, (appointed on 14 March 2006), Jocelyn Proteau, Crawford Gillies (appointed 1 March 2007) and Baroness McDonagh (appointed on 13 March 2007) – all of whom are considered by the Board to be independent non-executive Directors, with at least one member having recent and relevant financial experience. The Committee met nine times in the year. Kent Atkinson was unable to attend the April and July meetings, Jocelyn Proteau was unable to attend the meetings in January and July, and David Newlands resigned at 6 March 2006. Gerry Grimstone attended all meetings following his appointment to the Committee. The remit of the Committee is to consider any matter relating to the financial affairs of the Group, its internal and external audit arrangements and its internal control and compliance arrangements, and to make appropriate recommendations to the Board. A copy of the Committee's terms of reference is available from the Group's website at [www.standardlife.com](http://www.standardlife.com). The Committee is required to meet at least four times a year and, at least once a year, it meets with the external and internal auditors without management being present. Committee meetings are also attended by the Group Chief Executive, the Group Finance Director and other members of senior management, as appropriate.

The Committee reviews the intended publication of financial statements of the Group and any formal statements relating to the financial performance of the Group and Group companies. This includes consideration of significant accounting policies, estimates and judgements applied, any changes made to these during the year, and the views of the external auditors. It considers the effectiveness of the Group's internal audit function, monitors the external auditors' independence and objectivity, within the context of regulatory requirements and professional standards, and assesses the effectiveness of the external audit process.

As part of its review of the effectiveness of the external auditors, the Committee assesses the qualifications, expertise and resources of the external auditors and considers the scope and planning of the external audit of the Group, reviewing the findings with the external auditors. The Committee also has responsibility for making a recommendation to the Board on the appointment, reappointment or removal of the external auditors and approves their terms of engagement and remuneration for audit services.

In considering the effectiveness of the internal audit function, the Committee reviews the scope and planning of the internal audit programme for the Group and ensures that the internal audit function is adequately resourced. During 2006, an external review of the effectiveness of the internal audit function was carried out and the recommendations of this have been built into the current internal audit plan. The Committee also considers the effectiveness of existing processes and initiatives to manage key Group risks, receiving regular update reports from the Group Operational Risk Committee.

The Committee also reviews the arrangements for employees of the Group to raise concerns, in confidence, about possible impropriety in financial reporting and other matters. Any concerns are independently investigated and the Committee ensures that appropriate follow up action is taken. A policy on non audit services provided by the external auditors is monitored by the Committee. The aim of this is to support and safeguard the objectivity and independence of the external auditors, by ensuring that the audit services provided are not impaired by the provision of certain non audit services. The policy prohibits the auditors from performing certain types of non audit services and ensures that where non audit fees are significant, they are subject to the Committee's approval. The involvement of the auditors in performing non-audit work related mainly to the financial statements in the prospectus that supported the Company's Initial Public Offering.

The remit and effectiveness of the Committee is reviewed annually. In undertaking its duties, the Committee is authorised by the Board to obtain any information it requires from any Director or employee of the Group, and to seek, at the expense of the Group, appropriate professional advice inside and outside the Group, whenever it considers this necessary.

### **Remuneration Committee**

The Committee members, who were present at all six meetings of the Committee held during the year, are Gerry Grimstone (Committee Chairman), Hugh Stevenson and Lord Blackwell – all of whom are considered to be independent non executive Directors. Crawford Gillies and Baroness McDonagh were appointed to the Committee on 13 March 2007. Details of the Committee's main functions and its current remuneration policies for the Company Directors and senior executives are given in the Remuneration Directors' Report.

### **Nomination and Governance Committee**

The Committee members are Sir Brian Stewart (Committee Chairman), Lord Blackwell (appointed on 31 October 2006), Sandy Crombie, Gerry Grimstone (appointed on 25 April 2006), Jocelyn Proteau and Hugh Stevenson – a majority of whom are considered to be independent non executive Directors. The Committee met eight times in the year. All members were present at these meetings apart from Sir Brian Stewart who was unable to attend the October meeting and David Newlands who resigned on 6 March 2006. Lord Blackwell and Gerry Grimstone attended all meetings following their appointment to the Committee. The Committee's role is to keep under review the Group's executive and non-executive leadership needs, with a view to ensuring the Group's continued ability to compete effectively in the marketplace. It meets when required to make recommendations to the Board on new directorship appointments and also carries out other activities related to the composition and effectiveness of the Board. Members of the Committee are not present when their own performance or re appointment is being considered.

When considering new appointments, the Committee evaluates the balance of skills, knowledge and experience of the Board, and then prepares a description of the role, including the capabilities needed. Once a role description has been agreed, the Committee interviews suitable candidates and makes appropriate recommendations to the Board. For Board appointments, the process includes using external search consultants.

The Committee also approves succession planning processes, which take into account the skills and expertise required by the Board and senior management to allow the Group to operate effectively. Each year, the Committee reviews the input required from non executive Directors and checks that they have sufficient time to meet their commitment to the Group. The formal letter of appointment received by non executive Directors is available from the Group Company Secretary.

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The Committee also reviews the Group's corporate governance arrangements, with regard to relevant generally accepted corporate governance standards. In particular, it reviews in detail the Group's compliance with Section 1 of the Code, and makes appropriate recommendations on governance arrangements to the Board. A copy of the Committee's terms of reference is available from the Group's website at [www.standardlife.com](http://www.standardlife.com)

### **Investment Committee**

The Committee members are Hugh Stevenson (Committee Chairman), Kent Atkinson (appointed on 31 January 2006), Gerry Grimstone, Alison Mitchell and Crawford Gillies (appointed on 1 March 2007). These members were present at all seven meetings of the Committee held during the year, apart from Kent Atkinson who was unable to attend the April meeting, and Gerry Grimstone who was unable to attend the January meeting and Crawford Gillies, who was appointed after the year end.

The Committee meets regularly to review and report to the Board on matters relevant to the management of the Group's investments. The Chief Executive Officer and other executives (as appropriate) of Standard Life Investments Limited attend Committee meetings to update members on the investment activities of that company's board and on other relevant matters. A copy of the Committee's terms of reference is available from the Group's website at [www.standardlife.com](http://www.standardlife.com)

### **Communications with investors**

As a mutual organisation, The Standard Life Assurance Company (SLAC) put considerable emphasis on communicating with its members and engaged with them on a wide range of issues. For example, all members received a regular magazine, *Members' Update*, which provided current information about the Group and answered frequently asked questions in the run up to the demutualisation of SLAC and the Company's Initial Public Offering. This philosophy has been carried forward into the Company's communications with its shareholders.

Shareholders received an issue of *'Shareholder News'* in December 2006 giving details of the Company's operating and share price performance in the six months following the listing date.

In addition, all material information reported via the London Stock Exchange's regulatory news service is simultaneously published on the Company's website, allowing all shareholders full access to the Company's announcements.

The Group has an ongoing programme of meetings between the executive Directors and institutional investors, fund managers and analysts. A wide range of relevant issues are discussed at these meetings, including business strategy, financial performance, operational activities and corporate governance – but excluding price-sensitive inside information.

The Chairman's statement, Group Chief Executive's statement and business review contained in this *Annual Report and Accounts* together aim to provide a balanced overall assessment of the Group's activities, performance and prospects. This information will be supported by a presentation at the 2007 Annual General Meeting – an event that provides a valuable opportunity for the Board to communicate with investors. Shareholders will be invited to ask questions during the meeting and will have an opportunity to meet the Directors after the formal part of the meeting. Details of proxy voting by shareholders, including votes withheld, will be published on the Company's website at [www.standardlife.com](http://www.standardlife.com)

### **Institutional investor**

Standard Life Investments Limited (SLI), the Group's principal asset management company, recognises the importance of good governance. As a major investor, it monitors the governance of those companies in which it invests and holds regular meetings with their senior management representatives. The board of SLI maintains detailed policy guidelines on corporate governance and voting, which support its approach to engaging and voting at company general meetings. The policy guidelines, which also cover social, environmental and ethical issues, are applied pragmatically, after careful consideration of all relevant information. SLI makes voting reports available to clients and publishes summary information on its website.

### **Going concern**

After making enquiries, the Directors have a reasonable expectation that the Company and the Group as a whole have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

### **Internal control and risk management**

#### **Internal risk and control framework**

The Group has an internal risk and control framework (IRCF). This provides the basis for ensuring that risks inherent in the design and execution of strategy and the operations of each of the Group's businesses are adequately assessed, monitored, controlled and communicated in line with the overall expectations of the Group's stakeholders.

Overall responsibility for approving, establishing and maintaining the IRCF rests with the Board. The effectiveness of the framework and its implementation are kept under ongoing review by the Group Audit Committee, in accordance with authority delegated to it by the Board.

The Group Chief Executive and the Group's senior management are responsible for the implementation of the respective elements of the IRCF and for ensuring that it is operating effectively across the Group.

The key elements of the Group's IRCF include:

- defined terms of reference for the Board, each of its Committees and senior executive Committees at Group and principal subsidiary level,
- clear organisational governance structures with documented delegation of authority,
- a Group policy framework, which sets the minimum standards for risk and control against key financial, operational and governance-related activities across the Group's operations,
- a quarterly control self assessment process, where management assess whether the controls for which they are responsible have operated as defined, and that the population of controls defined for self assessment is complete, and
- obtaining external and internal information to give management a basis on which to assess performance in relation to the Group's objectives.

#### **Risk identification, assessment and management**

The Group's IRCF is designed to help identify, evaluate, monitor and manage risks that could prevent the Group from achieving its objectives.

A Group-wide risk assessment process is in place, using a standardised approach to the evaluation of risks across the Group. Each quarter, principal subsidiary risk functions facilitate the identification, assessment and reporting of risks through their risk committees. At the Group level, relevant information about the risks within the principal subsidiaries is reviewed regularly by the Group's two risk management committees, Group Asset and Liability Committee (GALCO) and the Group Operational Risk Committee (GORC).

Risks are categorised as market, credit, liquidity, insurance or operational. Group policies have been established for each of these categories. The policies define the Group's interpretation of these risks and set out the requirements for reporting to the two Group risk committees and the Board. They also contain limits and structures that have been approved by the Board to ensure that appropriate controls are in place and maintained over the risk exposures. Regular reports summarising the Group's overall exposure are submitted to the Board. The reporting systems are replicated at each principal subsidiary in the Group, to allow the key risks to be filtered to the Board.

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### **Risk oversight**

The GALCO and the GORC have formal terms of reference and meet regularly throughout the year. Their role is to support the implementation and monitoring of the Group risk policies and to report to the Group Chief Executive and the Board on the effectiveness of their implementation. The GALCO is chaired by the Group Finance Director and its members include senior finance representatives of the principal subsidiaries. The GORC is chaired by the Group Chief Executive and its members include the chief executives of the principal subsidiaries.

### **Structure and organisation of the risk management function**

The Group has an established risk management function to support the Board in meeting its risk management responsibilities. This function is responsible for establishing the overall risk management framework and associated minimum standards, and for overseeing how the principal subsidiaries comply with these. Each principal subsidiary operates a risk function which is responsible for overseeing risk management processes within the relevant business.

### **Internal control framework**

The Directors have overall responsibility for the Group's system of internal control and for the ongoing review of its effectiveness. The system was in place throughout the year and up to the date of the approval of the *Annual Report and Accounts*. It is designed to manage, rather than eliminate, the risk of failure to meet business objectives and can only provide reasonable, not absolute, assurance against material misstatement or loss.

In accordance with the Code, and the further guidance in the Turnbull Report, the Board has reviewed the effectiveness of the system of internal control. The review incorporated an evaluation of the Group's IRCF and an assessment of any significant internal control issues raised during the year in the reports provided by Group Internal Audit, Group Compliance and Group Risk Management. The review covered significant internal controls, including financial, operational and compliance risk controls. Where any significant control weaknesses were identified during the course of the year, necessary corrective action plans were put in place and monitored through to completion, as required by the principal subsidiary and Group Risk Committees.

The effectiveness of internal controls is reviewed regularly by the Group's internal audit and compliance functions, which report their findings to the Audit Committee and the Board. As noted above, a specific annual review is also undertaken by the Directors.

### **Internal audit**

The Group internal audit function advises management on the extent to which the systems of risk management and control are adequate and effective to manage business risks. It provides objective assurance on risk and control to senior management and the Group Audit Committee.

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# Directors' Remuneration Report

## Foreword

This is the Directors' Remuneration Report for the 12 month period to 31 December 2006. It shows remuneration paid to Directors over that period and, except as stated, reflects remuneration paid by The Standard Life Assurance Company and its subsidiaries prior to demutualisation on 10 July 2006 and by the Company and its subsidiaries after that date. The Company's remuneration policy is that remuneration should reward outstanding performance but not pay out when performance is poor. As a listed company, we have more flexibility than previously because shares can now make up part of our remuneration package. We will seek to encourage share ownership by our employees as we believe this helps them to understand the interests of our shareholders and the changes that Standard Life has been going through. These four initiatives have promoted employee share ownership over the past year:

1. At the time of flotation we had a separate employee offer which enabled employees to buy shares in Standard Life plc on the same terms as members of The Standard Life Assurance Company.
2. Consistent with the fixed awards to members, at the time of flotation we awarded 185 shares to eligible employees. The executive Directors waived their right to receive these shares. 10,563 employees in the UK, Ireland, Canada, Germany and Austria were awarded shares.
3. After flotation, we launched a share purchase scheme where employees can buy shares directly from their earnings. Take up has been excellent. At 31 December 2006, 62% of eligible employees in the UK were making a monthly average contribution of £45.15. A similar tax approved plan was launched in Ireland and has seen a 54% take up. In Canada, Germany and Austria the plan could not be structured on a tax favourable basis, but, nevertheless, more than 900 employees in these countries are buying shares each month.
4. We have introduced a Group wide annual profit sharing scheme under which employees can receive additional shares if Group profit targets are outperformed. In respect of the 2006 results we have decided to award 100 shares to each eligible employee.

## Remuneration Committee

The members of the Remuneration Committee – who are all independent non executive Directors – are Gerry Grimstone (Chairman), Hugh Stevenson, Lord Blackwell, Crawford Gillies and Baroness McDonagh.

The Remuneration Committee considers and makes recommendations to the Board on the remuneration policy and rewards for the Chairman, the executive Directors and senior executives. A copy of the Remuneration Committee's terms of reference is available from our website at [www.standardlife.com](http://www.standardlife.com) or on request from the Group Company Secretary.

During the year the Remuneration Committee has continued to take advice from New Bridge Street Consultants LLP, whom it appointed in 2004. Other than assisting in the Remuneration Committee's work, New Bridge Street Consultants LLP do not provide any other services to Standard Life. The Remuneration Committee receives information on comparative pay data from Towers Perrin. Where appropriate – and never in respect of their own remuneration – it also receives advice from the Group Chief Executive, Group Operations Director, Group HR Director and the Compensation and Benefits Manager. This is mainly about the implementation of remuneration policy.

## Remuneration policy

Standard Life believes that our people are a key factor in contributing to the overall success of our organisation. The Company is committed to providing total remuneration packages which enable it to attract, reward and retain high quality staff. Remuneration packages are based on market rates and on an individual's contribution to Standard Life's performance. We also take into account the Company's pay policy across all members of staff and our strong commitment to good corporate governance standards.

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Standard Life aims to provide remuneration packages which reward superior performance in a way that is consistent with the long term interests of the policyholders and shareholders. For example, this is achieved by ensuring that potential rewards under long term incentive arrangements are greater than those available under short term incentive plans. This has also been reflected by the Remuneration Committee setting more demanding performance targets year on year.

Remuneration packages for the Group's executive Directors consist of base salary, participation in the Company wide flexible benefits scheme, pension provision, short term annual bonus and participation in a share-based long term incentive plan. Details of each element of the package are as follows:

### **Base salary**

Every March the Remuneration Committee reviews independent data about the level of salaries paid to senior executives carrying out similar roles within the financial services industry – and more broadly where appropriate. It also considers the prevailing circumstances of the Company and base salary levels throughout the organisation. The contribution and level of experience of each executive Director are taken into account to determine base salary. Finally this is then reviewed by the Remuneration Committee in the context of the total package.

### **Benefits**

During 2006, Standard Life introduced a flexible benefit scheme for all UK based staff. Executive Directors participate on the same terms with no special arrangements being made.

### **Pension arrangements**

In the UK, Standard Life's final salary pension scheme was closed to new entrants, including any new Directors, from 16 November 2004. This means that Alison Reed did not, and David Nish does not, participate in the final salary pension scheme.

As a consequence of the Government's A-Day changes to pensions arrangements and their taxation, in common with other companies, an alternative arrangement was put in place for those employees – including executive Directors – whose pension pot was likely to be affected by the new regime. The alternative was designed on a cost neutral basis for Standard Life. It provides, as an alternative to participation in the final salary pension scheme – which is available to all eligible executive Directors – the option to receive an employer contribution into the money purchase Group Personal Pension Plan of 27.5% of salary or a cash payment of 25% of salary in lieu of pension provision. This cash payment does not count for bonus and equity incentives purposes. Participation in the pension plans requires a 5% of salary employee contribution. If a Director chooses not to make this contribution then benefits are reduced.

Sandy Crombie, John Hylands and Keith Skeoch have elected to forego any future service accrual in the final salary pension scheme and from 6 April 2006 have elected to receive the cash payment outlined above. Trevor Matthews continues to accrue benefits in the final salary pension scheme. David Nish initially received the cash supplement outlined above and from March 2007 has elected to join the Group Personal Pension Plan.

Under the Standard Life pension scheme the normal retirement age in the UK is 60 years. In response to the recently introduced age discrimination legislation our employees can continue to work beyond this and accrue further pension entitlement up to their eventual retirement date.

The accrual rate of the final salary pension scheme is 1/60th provided that the employee agrees to sacrifice a proportion of salary – 3.5% from 16 November 2005 and 5% from 16 November 2006. It is 1/80th of pensionable pay if no sacrifice is made. Post retirement increases in pensions are discretionary and in November 2006 an indexation of 3% was applied to pensions in payment except where statutory requirements dictated otherwise.

For executive Directors with service before 1982 – only Sandy Crombie and John Hylands – past commitments were made that annual pension increases should be made in line with salary inflation up to the age of 65 – and for John Hylands that he would be able to accrue by age 60 the level of pensionable service that would have applied at age 65. As John Hylands opted out of the defined benefit pension scheme from 6 April 2006, the Committee has indicated that he will receive compensation on a cost neutral basis at his retirement date for any loss of accrued service. The Committee also asked Sandy Crombie and John Hylands to forego the special increase provision for service after 5 April 2006. As compensation for this, the Group injected a payment of £35,600 for Sandy Crombie and £38,100 for John Hylands in March 2006 into their respective Retirement Account Plans. These are individual money purchase arrangements attached to the main staff defined benefit pension scheme. The payments were calculated by the Scheme Actuary and were based on the present value of the difference between the special pension increase rate and the normal increase rate for service after April 2006.

For death during pensionable service in the UK scheme, a lump sum of up to 4 x salary is payable, together with a spouse's pension of up to 1/3rd of the member's pensionable salary. For death in retirement, a spouse's pension of up to 2/3rds of the member's pension is payable. Children's allowances are payable, usually up to the age of 18, and there is protection in the event of disablement.

As a result of the A Day pension reforms, the Company has retained a notional earnings cap in the pension scheme rules. This is based on the previous earnings cap indexed in April each year, in line with movements in national average earnings.

In February 2006, as part of the preparations for demutualisation, the Board resolved to implement changes to pensions arrangements to achieve a lower IAS 19 Pension Scheme Deficit than would have arisen if pension benefits reflected the total expected salary increases. The deficit included in the 2005 financial statements took this into account. Subsequently an agreement was made with the Trustees to reduce the resulting deficit – approximately £200m – by paying a £50m contribution by 30 September 2006, with further additional contributions of £10m to be made every six months from December 2006, until the deficit is eliminated.

A working party sought independent advice from Mercer Human Resource Consulting and has developed proposals to contain future deficits. Its recommended solution, involving a Revalued Career Average Salary benefit structure, has been provisionally accepted by the Board and consultation with the Staff Associations on implementation is now under way.

### **Annual bonus**

Following flotation, the Remuneration Committee reviewed the performance related annual bonus scheme to ensure that it remains fit for purpose. The conclusions of this review were:

- profit would be retained as the sole financial measure,
- for executive Directors, the balance of having 80% of bonus depending on financial measures and 20% depending on personal measures remains appropriate,
- for the Chief Executive of UK life and pensions, half of his financial targets should relate to Group profit and half should relate to UK life and pensions' performance. Other executive Directors only have Group financial targets – except Keith Skeoch who is discussed below,
- bonus deferral was not considered appropriate, and
- bonus levels remain appropriate.

This means that the Group Chief Executive participates in an annual bonus scheme that is designed to deliver a bonus of 50% of salary for achieving target performance and he has a maximum bonus potential of 100% of salary. For the other executive Directors, the maximum bonus potential is 90% of salary and achieving target performance would deliver a payment of 45% of base salary, except Keith Skeoch, whose bonus arrangements are described on page 75. From 2007, a proportion of Keith Skeoch's annual bonus will be determined by reference to the Group's results – the maximum bonus potential for this element of his remuneration package is 45% of salary and achieving target performance would deliver a payment of 22.5% of base salary. He will also continue to participate in the bonus arrangements of Standard Life Investments and his personal performance bonus cap will reduce from 150% to 105% of salary.

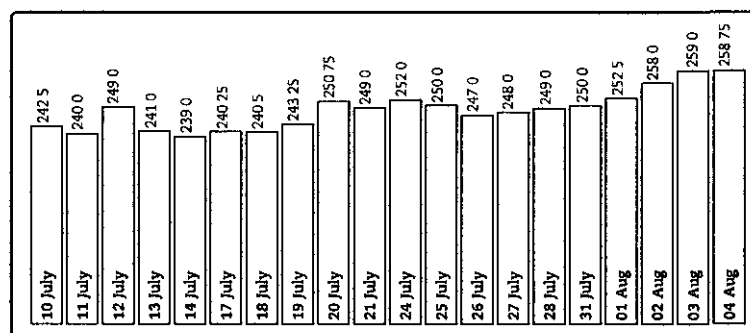
The financial bonus metric is profit and this is measured by comparing the year's actual profitability with budgeted profitability. For example, European Embedded Value (EEV) profits before tax will be used for life and pensions businesses, and operating profits before interest and tax will be used for Standard Life Investments, Standard Life Bank and Standard Life Healthcare. The Group's profitability will be the sum of these businesses' EEV and operating profits. Since each business unit will also be expected to operate within clear capital plans, the Remuneration Committee will have appropriate discretion to reduce payments on an exceptional basis if capital usage is significantly greater than planned. All payments under the annual bonus scheme will be taken into account when calculating the profits earned by the Group and/or the relevant business. Annual bonus payments do not qualify for pension purposes.

### Long term incentive plans

During 2004 and as described in SLAC's 2005 remuneration report, the Remuneration Committee undertook a full review of long term incentive provision at Standard Life. As a result of this, it introduced a new long term incentive plan (LTIP). The Remuneration Committee reviewed the LTIP before flotation and concluded that it remained a suitable plan for Standard Life in a quoted environment. Because of this, no new executive share plans were introduced at the time of flotation.

The 2005 and 2006 LTIP awards were granted pre-flotation, so they were cash based awards. To promote alignment with shareholders, it was a term of these awards that they would convert into equivalent awards over shares after flotation using the average Standard Life plc share price over the 20 dealing days following flotation. This averaging was deliberately done so as to avoid any allegation that the Directors planned to benefit from a lower flotation share price. The following graph shows Standard Life's share price performance over these 20 dealing days and the rising share price meant that awards were converted at an average share price of 247.975 pence rather than the flotation price of 230 pence. Consequently, the Directors received converted LTIP awards over fewer shares than would have been the case had the conversion been done immediately on flotation.

#### Standard Life plc share price over the 20 dealing days following flotation on 10 July 2006



In 2007 and future years, LTIP awards will be granted over shares.

Before 2004, Standard Life operated other cash based long term incentive plans that did not convert into shares following flotation. These are described in more detail in the later section headed Directors' interests in the Group's cash based long term incentive plans.

### Grant levels

Grant levels in 2007 will be the same as in 2006. Although the LTIP provides for a maximum annual grant of 200% of salary, the Group Chief Executive will be awarded a 2007 LTIP award over shares worth 175% of salary. The other executive Directors will receive a grant over shares worth 100% of salary, except Keith Skeoch who will receive 80%.

### Performance conditions

The Remuneration Committee's policy – which has been applied to the 2005 and 2006 grants – is that LTIP awards will only vest to the extent that a return on capital performance condition has been met. Return on capital is defined as the sum of the operating profits of Standard Life Bank, Standard Life Healthcare and Standard Life Investments and the EEV profits of the United Kingdom, Canadian and international life and pensions businesses divided by a Group capital figure. To date the Group's capital figure has been defined as the Group's opening EEV for the financial year being reviewed.

The target is set on a sliding scale basis and performance will be measured over a three year period. In light of the Company's transition to reporting EEV profits, the 2005 awards will be based on the return on capital for the financial year ending 31 December 2007, compared with the target. For the 2006 awards, the return on capital over the two financial years ending 31 December 2007 and 31 December 2008 will be compared with the target.

The policy on setting the performance conditions is as follows:

- The Remuneration Committee will set a threshold, target and stretch return on capital for each award.
- At threshold performance, 30% of an award will vest, the target return on capital will result in 50% vesting, and full vesting will only be achieved for stretch performance. Between these three calibration points straight line pro rating of vesting will apply.
- If the performance condition is not met at the first and only review at the end of the performance period, then the awards lapse.
- The targets are set as a combined return of capital ensuring performance over the whole period is measured. The awards are not sub-divided across performance in the separate years making up the performance period.
- The targets will generally become more demanding each year reflecting the improvement in the Group's return of capital.
- When defining the stretch performance, the Remuneration Committee will take into account the levels of return on capital being made by the Company's competitors on comparable business.
- Retrospective disclosure of the targets will be made and, in addition, disclosure of the return on capital target for the forthcoming year will also be disclosed. The 2007 return on capital targets are

Performance level	Level of vesting	2007 return on capital applicable to both the 2005 and 2006 awards
Threshold	30%	9.0%
Target	50%	9.5%
Stretch	100%	10.5%

The return on capital performance condition is underpinned by the Remuneration Committee having a power to adjust the resulting vesting level in light of actual versus expected cash generation over the performance period. This will ensure that management is encouraged to write an appropriate balance of short, mid and long term profitable business.

This performance target has been chosen by the Remuneration Committee because it is an appropriate measure of the financial performance of the Group as a whole, it is aligned to the corporate goals of the Group and has universal application across all participants. The returns on capital are calculated using audited results thus ensuring that there is third party verification.

## Standard Life Investments

Standard Life Investments' remuneration policy is consistent with the practices of competing fund managers and is overseen by the Standard Life Investments' Remuneration Committee, which then reports to the Group Remuneration Committee in respect of its overall remuneration policy and specifically with regard to the remuneration for Keith Skeoch and other senior executives at Standard Life Investments. These three cash based incentive arrangements are used within Standard Life Investments.

### Personal bonus plan

This is a discretionary annual cash bonus plan that rewards personal performance and team investment performance. Keith Skeoch's personal performance bonus is capped at 150% of salary (105% from 2007) and will be assessed by Standard Life Investments' Remuneration Committee.

### Company bonus plan

This annual cash bonus plan rewards participants by referring to Standard Life Investments' investment performance over the year. Under this plan, and in line with the practice of other major investment management companies, Keith Skeoch's bonus is uncapped and will be determined by the Remuneration Committee of Standard Life Investments each year.

### Standard Life Investments Executive Performance plan

The purpose of this incentive arrangement is to give selected executives of Standard Life Investments the opportunity to share in the longer term success of Standard Life Investments by rewarding them for contributing to the future growth in its value. Since the introduction of an arm's length fee agreement between Standard Life Investments and SLAL, this incentive plan has been built around the actual profit growth of Standard Life Investments over a three year performance period, compared with the expected profit growth over this period. It is a cash arrangement that does not operate over Standard Life shares. Instead, participants share in a cash bonus pool of up to 15% of Standard Life Investments' profits of the third year in the performance period. This is adjusted by a market value capital factor, which is based upon the change in the price earnings ratio of the FTSE General Financials sector over the performance period. The profit performance condition is underpinned by an investment performance target. At the end of the three-year performance period, the bonus pool is calculated with regard to the extent that the performance conditions have been met and by applying the market value factor. Individual allocations are then calculated by referring to the points held by each participant, compared with the total number of points that remain in allocation. Participants who leave during the three year performance period generally lose their points. Any cash payments are then paid at the first practical payroll date following determination.

## Share ownership guidelines

During 2006, the Remuneration Committee adopted share ownership guidelines. The executive Directors are expected to build up a holding of shares worth 100% of base salary and other Group executive members are expected to build up a holding worth 50% of base salary. This is to be achieved by retaining any shares they or their family members acquire, plus at least half of the shares acquired under the LTIP on an after tax basis, until the target has been met.

As at 31 December 2006 executive directors' share ownership against this target was as follows:

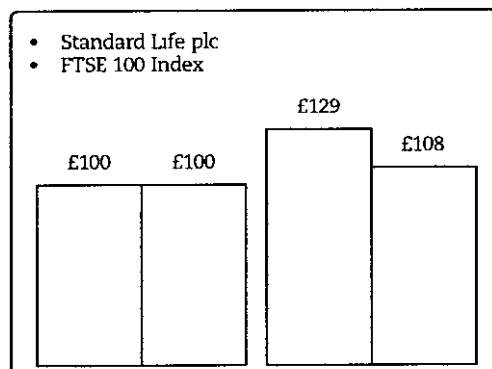
	Share ownership as a percentage of salary	Guideline already met?
<b>Director</b>		
Sandy Crombie	111%	Yes
John Hylands	43%	No <sup>1</sup>
Trevor Matthews	228%	Yes
David Nish		No <sup>2</sup>
Keith Skeoch	215%	Yes

<sup>1</sup> John Hylands will step down as a Director of the Company with effect from 31 March 2007.

<sup>2</sup> David Nish was appointed as a Director of the Company on 1 November 2006.

### Total shareholder return performance graph

The following chart shows the value on 31 December 2006 of £100 invested in Standard Life and across the FTSE 100 as a whole on 10 July 2006 (the first day of trading for Standard Life plc shares). The FTSE 100 has been chosen as the comparator index because Standard Life is a member of this FTSE grouping



### Policy on service contracts

All executive Directors have service contracts that provide for a 12 month notice period from the Company and six months if given from the Director. Dates of the service contracts are

Sandy Crombie	31 March 2006
John Hylands	15 December 2006
Trevor Matthews	9 April 2006
David Nish	1 November 2006
Keith Skeoch	3 April 2006

Except for John Hylands, no Directors have contracts that contain any provisions for compensation payments on termination. The contracts do contain 'payment in lieu of notice' clauses that allow Standard Life to terminate a contract without giving due notice by making a payment equal to the salary, pension contributions and the value of other contractual benefits due to the relevant executive, in lieu of any unexpired notice period. This payment may be made in instalments and the Remuneration Committee's policy is to invoke this payment by instalments for unexpired notice periods in excess of six months. Such payments would then stop if the executive found alternative employment of an equal or better remuneration.

John Hylands' service agreement does contain a clause stating that he will receive a termination payment equating to one year's 'package', which equates to annual bonus, long term incentive plan awards, pension and other benefits. This was considered appropriate and necessary by the Remuneration Committee to ensure that John remained with Standard Life during the flotation process and Standard Life's transition to a major listed plc.

The dates of the letters of appointment of the Chairman and the non-executive Directors as at 31 December 2006 were

\* Gerry Grimstone entered into a letter of appointment with the Company on 28 February 2007 relating to his proposed appointment as Chairman. This letter provides for six months notice on either side

Sir Brian Stewart	27 April 1993
Kent Atkinson	26 January 2005
Lord Blackwell	24 June 2003
Gerry Grimstone*	22 July 2003
Alison Mitchell	16 December 2000
Jocelyn Proteau	26 August 2003
Hugh Stevenson	16 June 1999

The letters of appointment do not contain any provisions for compensation payments to be made to the Chairman and non executive Directors on termination

### **Chairman and non executive Directors' remuneration**

Fees for the Chairman and other non executive Directors will be determined annually by the Board, based on market information supplied by Towers Perrin and New Bridge Street Consultants, and in accordance with the restrictions contained in the Company's articles of association

The Chairman and non executive Directors are not eligible to participate in annual bonus plans, long term incentive plans or pension schemes. Their fees are set by the Board after taking advice from the Group Chief Executive and take into account the time commitment and responsibility of their roles and the fees paid by other comparable organisations within the financial services sector

### **Recruitment of David Nish**

David Nish was appointed Group Finance Director on 1 November 2006. He will retire as a Director and stand for election at the 2007 Annual General Meeting

He was recruited on the following terms

- His base salary is £475,000 per annum, which will be reviewed by no later than March 2008 and annually thereafter
- He will participate in the annual bonus scheme and the long term incentive plan in line with the Remuneration Committee's stated policy
- Shortly after his recruitment, he was granted a recruitment LTIP award on terms equivalent to the 2006 LTIP awards described above. For technical reasons, this grant was made as a one off recruitment award as permitted by the Listing Rules rather than under the terms of the LTIP. This means that this award will potentially vest on the same date as the 2006 LTIP awards granted to other executive Directors. The level of grant was pro rated to reflect the fact that he was not an employee during the first ten months of the 2006 financial year
- No other special recruitment arrangements were made

### **Policy on external appointments**

Subject to the Board's approval, executive Directors are able to accept a limited number of external appointments to the boards of other organisations. Any fees may be retained by the individual. During 2006, David Nish received fees of £41,000 as a non executive director of Northern Foods plc. He is also a non executive Director of the Royal Scottish National Orchestra and receives no fees for this work. Sandy Crombie is a member of the board of the Association of British Insurers and receives no fee for this work.

**Directors' remuneration for 2006****1. Directors' emoluments, excluding LTIP and pension information (audited)**

Aggregate emoluments in respect of the 12 month period ended 31 December 2006 paid by The Standard Life Assurance Company before 10 July 2006 and by the Company from that date are shown below

	Note	Base Salary / Fees £000	Taxable Benefits £000	Annual Bonus £000	Total 2006 £000	Total 2005 £000
<b>Executive Directors</b>						
Sandy Crombie	1	706	164	693	1,563	1,362
John Hylands	2	344	85	300	729	649
Trevor Matthews	3	505	33	748	1,286	1,285
David Nish	4	78	27	70	175	
Keith Skeoch	5	329	84	1,063	1,476	
<b>Non executive Directors</b>						
Sir Brian Stewart		150			150	150
Kent Atkinson	6	59			59	48
Lord Blackwell	7	60			60	54
Gerry Grimstone	8	78			78	60
Alison Mitchell		50	1		51	50
Jocelyn Proteau	9	55			55	70
Hugh Stevenson	10	80			80	80
<b>Former executive Directors</b>						
Alison Reed	11	379	113		492	527
<b>Former Non executive Directors</b>						
David Newlands	12	17			17	80
Sir Nicholas Monck	13					15
<b>Total</b>		<b>2,890</b>	<b>507</b>	<b>2,874</b>	<b>6,271</b>	<b>4,430</b>

- <sup>1</sup> Sandy Crombie elected to sacrifice £5,078 from his salary in return for an equivalent employer contribution into the defined benefit pension scheme. From 6 April he elected to forego any future service accrual in the final salary pension scheme and receives a non benefit bearing cash supplement of 25% of base salary in lieu of pension provision. His taxable benefits in the above table relate to this supplement, car allowance, private health scheme, service award, the reimbursement of professional fees and use of accommodation.
- <sup>2</sup> John Hylands elected to sacrifice £2,457 from his salary in return for an equivalent employer contribution into the defined benefit pension scheme. From 6 April he elected to forego any future service accrual in the final salary pension scheme and receives a non benefit bearing cash supplement of 25% of base salary in lieu of pension provision. His taxable benefits in the above table relate to this supplement, car allowance, private health scheme and use of accommodation.
- <sup>3</sup> Trevor Matthews elected to sacrifice £18,435 from his salary in return for an equivalent employer contribution into the defined benefit pension scheme. In order to provide compensation for loss of share options and other long term equity benefits, the Board agreed a non pensionable personal bonus arrangement for 2004, 2005 and 2006. For 2006, the Board has approved a personal bonus payment of £321,938 related to his recruitment arrangements and this is included under annual bonus. In 2005, this was £363,375 and is included in the total for 2005. Full details of the special recruitment arrangements required when hiring Trevor Matthews in 2004 were fully disclosed in the 2004 Annual Report and Accounts of SLAC. His taxable benefits in the above table relate to car allowance, private health scheme, use of accommodation, life assurance premium and the reimbursement of professional fees.
- <sup>4</sup> David Nish was appointed as a Director on 1 November 2006. Base salary, taxable benefits and annual bonus in the above table relate to the period since appointment to the year-end. Taxable benefits relate to car allowance, private healthcare and a non benefit bearing pension cash supplement. He has also incurred relocation expenses of £4,870 to date.
- <sup>5</sup> Keith Skeoch was appointed as a Director on 6 March 2006. Base salary, taxable benefits and annual bonus in the above table relate to the full 12 month period ended 31 December 2006. He elected to sacrifice £1,797 from his salary in return for an equivalent employer contribution into the defined benefit pension scheme. From 6 April he elected to forego any future service accrual in the final salary pension scheme and receives a non benefit bearing cash supplement of 25% of base salary in lieu of pension provision. His taxable benefits in the above table relate to this supplement, car allowance, private health scheme, life assurance premium, the reimbursement of professional fees and use of accommodation. The Remuneration Committee of Standard Life Investments approved personal and Company bonus payments of £437,500 and £625,000 respectively.
- <sup>6</sup> Kent Atkinson was appointed as a director of The Standard Life Assurance Company on 26 January 2005. His total fee includes a fee as Chairman of the Audit Committee (£9,000).
- <sup>7</sup> Lord Blackwell's total fee includes a fee as Chairman of Standard Life Assurance Limited (£10,000).
- <sup>8</sup> Gerry Grimstone's total fee includes fees as Deputy Chairman (£18,000) and Chairman of the Remuneration Committee (£10,000).
- <sup>9</sup> Jocelyn Proteau's total fee includes a fee as Chairman, Standard Life Canada (£5,000).
- <sup>10</sup> Hugh Stevenson's total fee includes a fee as Chairman of Standard Life Investments (£10,000) and as Senior Independent Director (£20,000).
- <sup>11</sup> Alison Reed was appointed as a director of The Standard Life Assurance Company on 13 June 2005 and resigned as a Director on 27 October 2006. Base salary, taxable benefits and annual bonus in the total for 2005 relate to the period from appointment to the year end. Her employment and directorship ceased with effect from 27 October 2006 and base salary and taxable benefits for 2006 relate to the period from 1 January to her termination date. No payments in respect of the termination of her employment were made. Taxable benefits relate to car allowance, private healthcare and a non benefit bearing pension cash supplement, from which she elected to sacrifice £5,500 and in return the Group made an equivalent employer contribution into a money purchase pension scheme.
- <sup>12</sup> David Newlands resigned as a director of The Standard Life Assurance Company on 6 March 2006.
- <sup>13</sup> Sir Nicholas Monck retired as a director of The Standard Life Assurance Company on 22 March 2005.

**2 Directors' pension information (audited)**

	Accrued (reported) entitlement at 31/12/2005	Accrued unfunded entitlement at 31/12/2005	Accrued (restated) entitlement at 31/12/2005 <sup>1</sup>	Additional pension earned during the year	Additional pension earned in excess of inflation	Transfer value of additional pension in excess of inflation	Accrued entitlement at 31/12/2006
	£000	£000	£000	£000	£000	£000	£000
Sandy Crombie <sup>2</sup>	429		429	17	4	81	446
John Hylands <sup>3</sup>	166		166	9	5	78	175
Trevor Matthews <sup>4</sup>	5	7	12	9	9	150	21
Keith Skeoch <sup>5</sup>	11	16	27	11	9	136	38
Sir Brian Stewart <sup>6</sup>	5		5				5

	Age at 31/12/2006	Years of pensionable service at 31/12/06	Transfer value of pension (reported) at 31/12/2005	Transfer value of unfunded pension at 31/12/2005	Transfer value of pension (restated) at 31/12/2005	Increase in transfer value	Transfer value of pension at 31/12/2006
			£000	£000	£000	£000	£000
Sandy Crombie <sup>2</sup>	57	37	8,302		8,302	8	8,310
John Hylands <sup>3</sup>	55	30	2,505		2,505	493	2,998
Trevor Matthews <sup>4</sup>	54	2	83	103	186	175	361
Keith Skeoch <sup>5</sup>	50	7	126	173	299	250	549
Sir Brian Stewart <sup>6</sup>	61	9	89		89	4	93

<sup>1</sup> Following the A Day changes to pension arrangements and their taxation the Company elected to merge funded and unfunded benefits during 2006. The restated figures at 31 December 2005 reflect the position as if pension provision had previously been provided on a wholly funded basis enabling comparison with the values quoted at 31 December 2006. The previously declared value of the unfunded benefits at 31 December 2005 for Trevor Matthews (£147,000) and Keith Skeoch (£334,000) declared in the Prospectus, had been based on provisional IAS 19 assumptions. For provision of benefits on an approved basis the valuations quoted are based on the scheme valuation assumptions applicable to all scheme members.

<sup>2</sup> The increase in transfer value (£8,000) includes an employer contribution of £5,078 resulting from Sandy Crombie's decision to sacrifice this element of his salary. In return for agreeing to forego the past commitment whereby pension increases up to the age of 65 would be made in line with salary inflation a payment of £35,600 was made into his Retirement Account Plan on 31 March 2006 and this had a value of £39,078 at 31 December 2006. From 6 April 2006, he has elected to forego any future service accrual in the final salary pension scheme and he receives a non-benefit bearing cash supplement of 25% of base salary from that date.

<sup>3</sup> The increase in transfer value (£493,000) includes an employer contribution of £2,457 resulting from John Hylands' decision to sacrifice this element of his salary. His Retirement Account Plan was valued at £354,986 at 31 December 2006 and included an employer contribution of £300,299 (in April 2006) resulting from his decision to sacrifice the full element of his 2005 bonus payment (which was declared in the 2005 Annual Report and Accounts of SLAC) and £38,100 (in March 2006) in return for agreeing to forego the past commitment whereby pension increases up to the age of 65 would be made in line with salary inflation. From 6 April 2006, he has elected to forego any future service accrual in the final salary pension scheme and he receives a non-benefit bearing cash supplement of 25% of base salary from that date.

<sup>4</sup> Trevor Matthews' total contractual pension entitlement is 1/60th of uncapped salary for each year of service. The increase in transfer value (£175,000) includes an employer contribution of £18,435 resulting from his decision to sacrifice this element of his salary.

<sup>5</sup> The increase in transfer value (£250,000) includes an employer contribution of £1,797 resulting from Keith Skeoch's decision to sacrifice this element of his salary. From 6 April 2006, he has elected to forego any future service accrual in the final salary pension scheme and he receives a non-benefit bearing cash supplement of 25% of base salary from that date.

<sup>6</sup> Sir Brian Stewart was a member of a scheme which provided pensions based on final fees payable in respect of services as a Director of the Group. The Group wound up this scheme on 16 November 2001 and since that date he has not been entitled to earn additional pension benefits from the Group.

### 3 Directors' interests in share based long term incentive plans (audited)

Details of the rights to shares (structured as nil cost share options) that have been granted to Directors under the plans are set out below. More detailed information on the awards, their conversion to awards over shares following flotation and the performance conditions relating to these conditional awards have already been described on pages 73 to 75.

	Maximum value of LTIPs awarded in 2005 that could vest in 2008 <sup>1</sup>	Maximum value of LTIPs awarded in 2006 that could vest in 2009 <sup>2</sup>	Conversion share price <sup>3</sup>	Maximum number of shares that could vest in 2008 <sup>4</sup>	Maximum number of shares that could vest in 2009 <sup>5</sup>	Number of shares lapsed in 2006
	£000	£000				
Sandy Crombie	1,138	1,225	£2.47975	458,715	494,001	
John Hylands	331	340	£2.47975	133,561	137,302	
Trevor Matthews	475	500	£2.47975	191,551	201,633	
Keith Skeoch	200	200	£2.47975	80,653	80,653	
<b>Former Executive Director</b>						
Alison Reed	383	450	£2.47975	154,456	181,469	335,925

<sup>1</sup> This column shows the maximum cash value of the 2005 awards which cover the performance period from 1 January 2005 to 31 December 2007, with vesting thereafter.

<sup>2</sup> This column shows the maximum cash value of the 2006 awards which cover the performance period from 1 January 2006 to 31 December 2008 with vesting thereafter.

<sup>3</sup> This column shows the average share price for the 20 dealing day period immediately following flotation.

<sup>4</sup> This column shows the maximum value of the 2005 awards converted into a maximum number of shares based on the conversion share price.

<sup>5</sup> This column shows the maximum value of the 2006 awards converted into a maximum number of shares based on the conversion share price.

Shortly after his recruitment, David Nish was granted a recruitment LTIP award which entitles him to acquire a maximum of 118,729 ordinary shares in the Company on terms equivalent to the 2006 LTIP awards described above. For technical reasons, this grant was made as a one-off recruitment award as permitted by the Listing Rules rather than under the terms of the LTIP. This means that this award will potentially vest on the same date as the 2006 LTIP awards granted to other executive Directors. However, the level of grant was pro-rated to reflect the fact that he was not an employee during the first ten months of the 2006 financial year.

#### 4 Directors' interests in the Group's cash based long term incentive plans (audited)

In 2003, an award was granted under an earlier LTIP. The three-year performance period commenced on 16 November 2003. Under the rules of the former plan, the Board is required to assess the Group's success in creating value for its participating with profits policyholders over this period. In making this assessment, the Board takes into account the profitability of the Group's operations, investment in the Group's with profits funds and any other matters it may consider relevant. Comparative information is used where available. As the basis of its review, the Board assesses each business unit's performance and considers the relative weighting each business unit has on overall Group performance. In making its assessment, the Board has determined that an 80% level of vesting is applicable and payment of awards will be made in April 2007.

	Maximum unvested LTIPs outstanding at 01/01/2006 <sup>1</sup>	Amounts paid in period <sup>2</sup>	LTIPs that have lapsed <sup>3</sup>	Maximum unvested LTIPs outstanding at 31/12/2006 <sup>4</sup>	Amounts payable after year end in respect of 2003 LTIP award <sup>5</sup>
	£000	£000	£000	£000	£000
Sandy Crombie	594		114	480	670
John Hylands	272		54	218	303
Trevor Matthews <sup>6</sup>					
David Nish <sup>7</sup>					
Keith Skeoch <sup>8</sup>					

#### Former Executive Director

Alison Reed<sup>9</sup>

- <sup>1</sup> This column shows the aggregate maximum value of cash awards outstanding at 31 December 2005. This comprises the 2003 cash awards.
- <sup>2</sup> This column represents the cash amount paid to participants in the period to 31 December 2006.
- <sup>3</sup> This column shows the cash awards which have lapsed during the period due to the performance conditions not being met.
- <sup>4</sup> This column represents the cash amount relating to the 2003 award which will be paid in April 2007.
- <sup>5</sup> This column represents the payments to be made in April 2007 to the extent that the 2003 LTIP award vested. In accordance with the plan rules, an indexation factor of 39.6% has been applied to reflect the notional investment of each bonus payment in the Group's main with profits fund from the beginning of the relevant performance period (16 November 2003) to the actual date of payment (2 April 2007).
- <sup>6</sup> Trevor Matthews did not receive an award in 2003.
- <sup>7</sup> David Nish did not receive an award in 2003.
- <sup>8</sup> Keith Skeoch did not receive an award under the Group's LTIP in 2003. He participates in the Executive Performance plan of Standard Life Investments. The annual awards from this plan are not subject to a formal limit. During 2006, Keith Skeoch received a payment of £507,000 in relation to the 2002 award. The Remuneration Committee of Standard Life Investments has approved a payment of £776,490 in respect of his 2003 award.
- <sup>9</sup> Alison Reed did not receive an award in 2003.

## 5 Directors' interests in shares

	Total number of shares owned at 01/01/2006	Shares acquired by the Director during the period	Total number of shares owned at 31/12/2006	Total number of shares held on appointment	Shares acquired by the Director during the period 31/12/2006 to 20/03/2007
<b>Executive Directors</b>					
Sandy Crombie		265,600	265,600		
John Hylands		51,312	51,312		
Trevor Matthews		389,274	389,274		32
David Nish					
Keith Skeoch		254,543	254,543		101
<b>Non Executive Directors</b>					
Sir Brian Stewart		16,593	16,593		
Kent Atkinson		3,478	3,478		
Lord Blackwell		5,403	5,403		
Gerry Grimstone		62,295	62,295		
Alison Mitchell		23,644	23,644		
Jocelyn Proteau		1,848	1,848		
Hugh Stevenson		22,783	22,783		
Crawford Gillies <sup>1</sup>				21,862	
Baroness McDonagh <sup>2</sup>					

<sup>1</sup> Crawford Gillies was appointed as a Director on 1 January 2007

<sup>2</sup> Baroness McDonagh was appointed as a Director on 1 March 2007

This table shows the total number of shares acquired by the Director and their connected persons during the year, or held on their appointment if this took place after 31 December 2006. This will include shares awarded at flotation in their capacity as a member, shares purchased at flotation through the preferential share offer and shares acquired after flotation, including any partnership and matching shares acquired through the Company's share purchase scheme. In their capacity as employees, Sandy Crombie, John Hylands, Trevor Matthews and Keith Skeoch waived their right to the award of 185 free shares at flotation.

### Related party transactions

All transactions between Directors and the Group are on commercial terms which are equivalent to those available to all employees. During the year to 31 December 2006 the Directors contributed £1m (2005 £6m) to products sold by the Group.



Approved on behalf of the Board of Directors  
**Gerry Grimstone**  
 Chairman, Remuneration Committee  
 Edinburgh 22 March 2007

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## Independent auditors' report to the members of Standard Life plc

We have audited the consolidated financial statements of Standard Life plc for the year ended 31 December 2006 which comprise the Consolidated income statement, the Consolidated balance sheet, the Consolidated statement of recognised income and expense, the Consolidated cash flow statement, the Accounting policies and the related notes. These consolidated financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of Standard Life plc for the year ended 31 December 2006 and on the information in the Directors' Remuneration Report that is described as having been audited.

### Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and the consolidated financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the consolidated financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the consolidated financial statements give a true and fair view and whether the consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' report is consistent with the consolidated financial statements. The information given in the Directors' report includes that specific information that is cross referred from the Directors' report to the business review.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding director's remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the Combined Code (2003) specified for our review by the Listing Rules of the Financial Services Authority and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the *Annual Report and Accounts* and consider whether it is consistent with the audited consolidated financial statements. The other information comprises the Chairman's statement, the Group Chief Executive's statement, the business review, the Directors' report, the unaudited sections of the Directors' Remuneration Report and the other information as listed on the contents page. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the consolidated financial statements. Our responsibilities do not extend to any other information.

### Basis of audit opinion

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

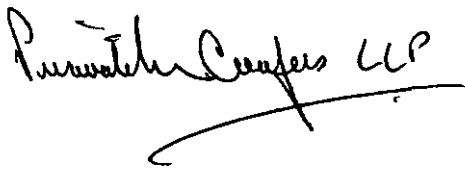
We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the consolidated financial statements are free from material misstatement, whether caused by fraud or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

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## Opinion

In our opinion

- the consolidated financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2006 and of its profit and cash flows for the year then ended,
- the consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation, and
- the information given in the Directors' report is consistent with the consolidated financial statements



PricewaterhouseCoopers LLP  
Chartered Accountants and Registered Auditors  
Edinburgh  
22 March 2007

- (a) The maintenance and integrity of the Standard Life website is the responsibility of the Directors, the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website
- (b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

## Consolidated income statement

For the year ended 31 December 2006

	Notes	Period 1 January 2006 to 10 July 2006 £m	Period 10 July 2006 to 31 December 2006 £m	2006 £m	2005 £m
<b>Revenue</b>					
Gross earned premium		1,980	2,076	4,056	3,609
Premium ceded to reinsurers		(53)	(40)	(93)	(93)
Net earned premium		1,927	2,036	3,963	3,516
Net investment return	3	2,868	7,911	10,779	14,377
Fee and commission income	4	251	270	521	360
Other income		28	58	86	54
<b>Total net revenue</b>	2	5,074	10,275	15,349	18,307
<b>Expenses</b>					
Claims and benefits paid		2,285	4,381	6,666	4,195
Claim recoveries from reinsurers		(34)	(35)	(69)	(59)
Net insurance benefits and claims		2,251	4,346	6,597	4,136
Change in reinsurance assets	29	(28)	12	(16)	(112)
Change in insurance and participating liabilities	29	(452)	571	119	5,167
Change in investment contract liabilities		1,654	3,775	5,429	5,886
Change in deduction from liabilities due to present value of future results		(180)		(180)	(488)
Change in unallocated divisible surplus	30	391	(105)	286	901
Administrative expenses					
Restructuring and demutualisation expenses	8	117	(17)	100	84
Other administrative expenses	5	1,122	969	2,091	2,066
		1,239	952	2,191	2,150
Change in liability for third party interest in consolidated funds	27	33	83	116	43
Finance costs		59	55	114	109
<b>Total expenses</b>		4,967	9,689	14,656	17,792
Share of profits from associates and joint ventures	14	63	54	117	99
<b>Profit before tax</b>		170	640	810	614
Tax expense attributable to policyholders' returns	9	118	239	357	531
<b>Profit before tax attributable to equity holders</b>		52	401	453	83
Total tax expense		118	297	415	531
Less Tax expense attributable to policyholders' returns		(118)	(239)	(357)	(531)
Tax expense attributable to equity holders' profits	9		58	58	
<b>Profit for the period</b>		52	343	395	83
<b>Attributable to</b>					
Equity holders of Standard Life plc			283	283	
Minority interest	27	52	60	112	83
		52	343	395	83
<b>Earnings per share</b>					
Basic (pence per share)	10		13.5	13.5	
Diluted (pence per share)	10		13.0	13.0	

Prior to the demutualisation of The Standard Life Assurance Company on 10 July 2006, the parent company of the Group was a mutual insurer and the results of the Group were attributable to participating policyholders. The format of the consolidated income statement has been revised from that reported for the year ended 31 December 2005, to align the presentation more closely with that of an equity holder owned company. Certain items presented on lines differ to those reported in the consolidated income statement for the year ended 31 December 2005. The presentation of the consolidated income statement is explained in the Group accounting policies basis of preparation and in Note 1(b).

The parent company of the Group did not issue shares or have equity holders prior to the demutualisation of The Standard Life Assurance Company and therefore there are no amounts attributable to equity holders or earnings per share for the period from 1 January to 10 July 2006 or for the year ended 31 December 2005.

The notes on pages 107 to 201 are an integral part of these consolidated financial statements.

## Pro forma reconciliation of Group underlying profit to profit for the period

For the period from 10 July 2006 to 31 December 2006

	Period 10 July 2006 to 31 December 2006 £m
<b>Underlying profit before tax attributable to equity holders of Standard Life plc</b>	
Life and pensions	
UK	110
Canada	100
Europe	51
Other	(7)
Total life and pensions	254
Investment management	37
Banking	21
Healthcare and general insurance	13
Other	(35)
<b>Underlying profit before tax attributable to equity holders of Standard Life plc and adjusted items</b>	<b>290</b>
Profit attributable to minority interest	60
<b>Underlying profit before tax attributable to equity holders and adjusted items</b>	<b>350</b>
Adjusted for the following items	
Volatility arising on different asset and liability valuation bases	68
Impairment of intangibles	(5)
Restructuring expenses	(12)
<b>Profit before tax attributable to equity holders</b>	<b>401</b>
Tax attributable to	
Underlying profit	(39)
Adjusted items	(19)
<b>Total tax</b>	<b>(58)</b>
<b>Profit for the period</b>	<b>343</b>

Prior to the demutualisation of The Standard Life Assurance Company on 10 July 2006, the results of the Group were attributable to participating policyholders and the parent company of the Group did not have equity holders. Therefore, the pro forma reconciliation of Group underlying profit to profit for the period is only presented for the period from 10 July to 31 December 2006.

Underlying profit is calculated by adjusting the profit for the period for volatility that arises from different IFRS measurement bases for liabilities and backing assets, volatility arising from derivatives that are part of economic hedges but do not qualify as hedge relationships under IFRS, restructuring costs, impairment of intangibles and profit or loss arising on the disposal of a subsidiary, joint venture or associate. The Directors believe that, by eliminating this volatility from the equity holder profits, they are presenting a more meaningful indication of the underlying business performance of the Group.

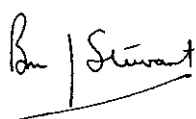
# Consolidated balance sheet

As at 31 December 2006

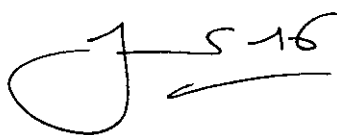
	Notes	2006 £m	2005 £m
<b>Assets</b>			
Intangible assets	12	60	44
Deferred acquisition costs	13	445	290
Investments in associates and joint ventures	14	3,237	2,608
Investment property	15	11,338	9,907
Property, plant and equipment	16	1,067	590
Deferred tax assets	17	17	75
Reinsurance assets	29	740	779
Loans and receivables	18	12,021	12,496
Derivative financial assets	19	333	247
Investment securities	20	97,224	87,431
Other assets	21	2,147	1,342
Cash and cash equivalents	22	3,962	4,451
<b>Total assets</b>		<b>132,591</b>	<b>120,260</b>
<b>Equity</b>			
Share capital	23	210	
Share premium reserve	24	799	
Retained earnings	25	298	
Other reserves	26	1,571	
Capital and reserves attributable to equity holders of Standard Life plc		2,878	
Minority interest	27	307	340
<b>Total equity</b>		<b>3,185</b>	
<b>Liabilities</b>			
Non participating contract liabilities	29	71,133	62,087
Participating contract liabilities	29	39,996	41,008
Third party interest in consolidated funds	27	961	358
Borrowings	32	6,506	6,233
Subordinated liabilities	33	1,834	1,878
Pension and other post retirement benefit provisions	34	220	386
Deferred income	35	257	238
Deferred tax liabilities	17	615	559
Current tax liabilities	17	268	240
Customer accounts related to banking activities and deposits by banks	36	5,071	5,134
Derivative financial liabilities	19	432	241
Other liabilities	37	2,113	1,558
<b>Total liabilities</b>		<b>129,406</b>	<b>119,920</b>
<b>Total equity and liabilities</b>		<b>132,591</b>	<b>120,260</b>

Prior to the demutualisation of The Standard Life Assurance Company on 10 July 2006, the parent company of the Group did not issue shares or report retained earnings and reserves were recognised as part of the unallocated divisible surplus. Therefore there are no comparative balances for consolidated equity

Approved on behalf of the Board of Directors on 22 March 2007 by the following Directors



Sir Brian Stewart, Chairman



David Nish, Group Finance Director

The notes on pages 107 to 201 are an integral part of these consolidated financial statements

## Consolidated statement of recognised income and expense

For the year ended 31 December 2006

	Notes	Period 1 January 2006 to 10 July 2006 £m	Period 10 July 2006 to 31 December 2006 £m	2006 £m	2005 £m
Fair value gains/(losses) on cash flow hedges		14	5	19	(4)
Actuarial (losses)/gains on defined benefit pension schemes	34	(10)	(2)	(12)	22
Revaluation of land and buildings	16	44	22	66	11
Exchange differences on translating foreign operations		(101)	(113)	(214)	218
Equity movements transferred to the unallocated divisible surplus	26		1	1	
Retained earnings arising on demutualisation	25		17	17	
Aggregate policyholder tax effect of items not recognised in income statement	9	4		4	
Aggregate equity holder tax effect of items not recognised in income statement	9		(8)	(8)	
Other		4		4	1
<b>Net (expense)/income not recognised in income statement</b>		<b>(45)</b>	<b>(78)</b>	<b>(123)</b>	<b>248</b>
<b>Profit for the period</b>		<b>52</b>	<b>343</b>	<b>395</b>	<b>83</b>
<b>Total recognised income for the period</b>		<b>7</b>	<b>265</b>	<b>272</b>	<b>331</b>
<b>Transfer from/(to) unallocated divisible surplus</b>		<b>45</b>		<b>45</b>	<b>(248)</b>
		<b>52</b>	<b>265</b>	<b>317</b>	<b>83</b>
<b>Attributable to</b>					
Equity holders of Standard Life plc			205	205	
Minority interest		52	60	112	83
		<b>52</b>	<b>265</b>	<b>317</b>	<b>83</b>

The consolidated statement of recognised income and expense presentation has been revised as described in the Group accounting policies basis of preparation and Note 1(b). For the period from 1 January to 10 July 2006 and for the year ended 31 December 2005, the net (expense)/income not recognised in the income statement is transferred to the unallocated divisible surplus (Note 30). For those reporting periods, the 'Total recognised income for the period' represents the sum of the net (expense)/income not recognised in the consolidated income statement and the increase in net assets attributable to minority interest.

Prior to the demutualisation of The Standard Life Assurance Company, the parent company of the Group did not have equity holders and therefore there are no amounts attributable to equity holders for the period from 1 January to 10 July 2006 or for the year ended 31 December 2005.

Subsequent to the listing of the shares of Standard Life plc on the London Stock Exchange on 10 July 2006, there have been significant movements in equity, which are summarised below.

	Notes	Period 10 July 2006 to 31 December 2006 £m
<b>Equity at 10 July</b>		
Minority interest	27	
Recognised prior to 10 July 2006		260
Change in the period from 10 July to 31 December 2006		(13)
		247
Total recognised income for the period		265
Issue of share capital for cash, net of transaction costs	23, 24	1,363
Issue of share capital other than in cash	23, 24	146
Difference between fair value and book value of the Group at demutualisation	26	(2,065)
Merger relief on issue of demutualisation shares	26	3,214
Reserves credit for employee share-based payment schemes	26	15
<b>Equity at 31 December</b>		<b>3,185</b>

The notes on pages 107 to 201 are an integral part of these consolidated financial statements.

## Consolidated cash flow statement

For the year ended 31 December 2006

	Notes	2006 £m	2005 £m
<b>Cash flows from operating activities</b>			
Profit before tax		810	614
Gain on disposal of property, plant and equipment		(3)	(10)
Depreciation of property, plant and equipment	5	15	17
Amortisation of intangible assets	5	6	7
Amortisation of deferred acquisition costs	5	83	72
Impairment losses on property, plant and equipment	5		9
Impairment losses on intangible assets	5	14	
Reversal of impairment on property and equipment	5	(11)	(8)
Change in present value of future results on non participating contracts		(180)	(488)
Interest cost on other borrowings		(1)	(4)
Adjustment for finance costs on bank activities		(72)	136
Finance costs		114	109
Net foreign exchange (gains)/losses on investment activities	3	(17)	6
Share of profits from associates and joint ventures	14	(117)	(99)
Net (increase)/decrease in operating assets and liabilities	38	(2,355)	395
Adjustment for non-cash movements in investment income		(10)	(39)
Taxation paid		(304)	(285)
Change in unallocated divisible surplus		286	901
<b>Net cash flows from operating activities</b>		<b>(1,742)</b>	<b>1,333</b>
<b>Cash flows from investing activities</b>			
Purchase of property, plant and equipment	16	(281)	(84)
Proceeds from sale of property, plant and equipment		6	21
Proceeds from disposal of a subsidiary, net of cash disposed			179
Acquisition of investment in associates and joint ventures		(9)	(26)
Purchase of intangible assets	12	(36)	(24)
<b>Net cash flows from investing activities</b>		<b>(320)</b>	<b>66</b>
<b>Cash flows from financing activities</b>			
Proceeds from subordinated liabilities, net of transaction costs			263
Proceeds from other borrowings		119	11
Repayment of other borrowings		(131)	(2)
Proceeds from issue of ordinary share capital, net of transaction costs	23, 24	1,363	
Consideration paid to eligible members in non permitted countries		(59)	
Capital contributions from minority interest		329	18
Distributions paid to minority interest		(14)	(7)
Interest paid		(134)	(107)
<b>Net cash flows from financing activities</b>		<b>1,473</b>	<b>176</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(589)</b>	<b>1,575</b>
Cash and cash equivalents at the beginning of the year	22	4,346	2,696
Effects of exchange rate changes on cash and cash equivalents		(37)	75
<b>Cash and cash equivalents at the end of the year</b>	22	<b>3,720</b>	<b>4,346</b>
<b>Supplemental disclosures on cash flow from operating activities</b>			
Interest received		3,054	2,910
Dividends received		1,452	1,110
Rental income received on investment properties		634	618

The consolidated income statement presentation has been revised as described in the Group accounting policies basis of preparation and Note 1(b). In accordance with these revisions, the 'Change in unallocated divisible surplus' has been moved from the line presented in the consolidated cash flow statement for the year ended 31 December 2005 to be included in the reconciliation of 'Profit before tax' to 'Net cash flows from operating activities'

The notes on pages 107 to 201 are an integral part of these consolidated financial statements

## Accounting Policies

### (a) Basis of preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations issued by the International Accounting Standards Board (IASB) as endorsed by the European Union (EU) and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and liabilities (including derivative instruments) at fair value through profit and loss (FVTPL), property and investment property. The principal accounting policies set out below have been consistently applied to all financial reporting periods presented in these consolidated financial statements, unless otherwise stated

### (i) Presentation of the primary statements

On 10 July 2006, The Standard Life Assurance Company (SLAC) demutualised and the shares of a new holding company for the Standard Life Group, Standard Life plc, were listed on the London Stock Exchange. As a result, the Group operated under two different operating models in the periods that are presented in the consolidated financial statements. For the year ended 31 December 2005 and the period from 1 January to 10 July 2006, the parent company of the Group was a mutual insurer and for the period from 10 July to 31 December 2006, the Group was equity holder owned

To reflect the different operating models in place over the reporting periods, the 2006 consolidated income statement has been split to show the period from 1 January to 10 July 2006 and the period from 10 July to 31 December 2006 in two separate columns with a third column which combines these periods to show the total for the year ended 31 December 2006

The consolidated income statement included in the financial statements for the year ended 31 December 2005 was appropriate when the parent company of the Group was a mutual and the presentation reflected that the Group did not report profit. Prior to the demutualisation of SLAC, the balance on the consolidated income statement was transferred to the unallocated divisible surplus. Subsequent to the demutualisation of SLAC, the format has been revised to align the presentation more closely with that of an equity holder owned company. Within the revised format of the consolidated income statement, certain items are now presented on different lines

- The amounts included in 'Transfer to the unallocated divisible surplus' for the year ended 31 December 2005 and for the period from 1 January to 10 July 2006 are reported in 'Change in unallocated divisible surplus' within expenses,
- The amounts included in 'Result before tax' for the year ended 31 December 2005 and for the period 1 January to 10 July 2006 are reported in 'Profit before tax'. Given that the 'Transfer to unallocated divisible surplus' is reported within expenses, the amounts reported as 'Profit before tax' for those periods are the tax expense and the increase in net assets attributable to minority interest, and
- 'Increase in net assets attributable to minority interest' was included below the 'Result before tax' for the year ended 31 December 2005 and for the period 1 January to 10 July 2006. In the revised income statement presentation, the amounts included in this line are reported in 'Profit before tax attributable to equity holders' which appears above the 'Profit for the period'

For the period from 10 July to 31 December 2006, the amount reported within 'Profit before tax' includes equity holder profit in respect of this period in addition to tax expense and the increase in net assets attributable to minority interest

The pro forma reconciliation of underlying profit to profit before tax is presented directly after the consolidated income statement to facilitate consideration of this measure in conjunction with the equity holder profit. As explained in (hh), certain items are adjusted against equity holder profit, and in doing so the Directors believe they are presenting a more meaningful indication of the underlying business performance of the Group. The reconciliation is only relevant for the period from 10 July to 31 December 2006 when the Group reported a profit and, therefore, reconciliations for the year ended 31 December 2005 and for the period 1 January to 10 July 2006 are not presented

The consolidated statement of recognised income and expense has been revised in line with the consolidated income statement and in 2006 has similarly been split between the period from 1 January to 10 July 2006 and the period from 10 July to 31 December 2006 with a third column which combines these periods to show the year from 1 January to 31 December 2006. As a result of the revision, for the period from 1 January to 10 July 2006 and the year ended 31 December 2005, the 'Total recognised income for the period' represents an amalgamation of the 'Net (expense)/income not recognised in the income statement' and the increase in net assets attributable to minority interest

**(a) Basis of preparation**

**(i) Presentation of the primary statements** *continued*

The consolidated cash flow statement has been revised in line with the consolidated income statement, showing 'Profit before tax' and adjusting for the transfers to/from unallocated divisible surplus for the period from 1 January to 10 July 2006 and the year ended 31 December 2005 through the 'Change in unallocated divisible surplus' in the reconciliation to 'Net cash flows from operating activities'

Other than the inclusion of equity, presented as at 31 December 2006 only, there have been no revisions to the presentation of the consolidated balance sheet and therefore comparative balances for the year ended 31 December 2005 are as originally reported

**(ii) Amendments to published standards that have been adopted by the Group**

The amendments to IAS 27 *The Effects of Foreign Exchange Rates Net Investment in a Foreign Operation* and the amendments in respect of Financial Guarantee Contracts, to IAS 39 *Financial Instruments Recognition and Measurement* and IFRS 4 *Insurance Contracts* have been adopted by the Group from 1 January 2006

**(iii) Standards, interpretations and amendments to published standards that are not yet effective and have not been early adopted by the Group**

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the Group's accounting periods beginning on or after 1 January 2007 or later periods. The Group has not early adopted the standards, amendments and interpretations described below

IFRS 7 *Financial Instruments Disclosures* and a complementary amendment to IAS 1 *Presentation of Financial Statements* and complementary revised guidance on implementing IFRS 4 *Insurance Contracts* (all effective from 1 January 2007)  
IFRS 7 introduces new disclosures to the information on financial instruments and the revision to IFRS 4 reflects the changes made by IFRS 7 and affects the disclosure section of the amended IFRS 4. The amendment to IAS 1 introduces disclosures on the level of management of capital resources. This will be applied by the Group for annual periods beginning 1 January 2007. The Standard has no financial impact but will change the disclosures surrounding the Group's Financial Instruments and Insurance Contracts

IFRS 8 *Operating Segments* (effective from 1 January 2009)

IFRS 8 will replace IAS 14, *Segment reporting* and proposes that the 'management approach' is adopted for reporting the financial performance of operating segments. Management is currently considering whether the Group will early adopt the requirements for 2007. The standard has no financial impact but is expected to have a significant impact on the Group's segmental disclosures

IFRIC 8 *Scope of IFRS 2* (effective for annual periods beginning on or after 1 May 2006)

The interpretation requires consideration of transactions involving the issuance of equity instruments – where the identifiable consideration received is less than the fair value of the equity instruments issued – to establish whether they fall within the scope of IFRS 2. The Group will apply IFRIC 8 from 1 January 2007, but it is not expected to have a significant impact on the Group's financial statements

IFRIC 9 *Reassessment of embedded derivatives* (effective for annual periods beginning on or after 1 June 2006)

The interpretation requires an assessment of whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the Group first becomes a party to the contract. Subsequent reassessment is prohibited, unless there is a change in the contract's terms, in which case it is required. The Group will apply IFRIC 9 from 1 January 2007, but it is not expected to have a significant impact on the Group's financial statements

IFRIC 10 *Interim Financial Reporting and Impairment* (effective for annual periods beginning on or after 1 November 2006)

The interpretation prohibits the impairment losses recognised in an interim period on goodwill and investments in equity instruments and in financial assets carried at cost to be reversed at a subsequent balance sheet date. The Group will apply IFRIC 10 from 1 January 2007 but it is not expected to have any impact on the Group's financial statements

IFRIC 11 *IFRS 2 – Group and treasury share transactions* (effective for annual periods beginning on or after 1 March 2007)

The interpretation provides guidance on accounting for share-based transactions involving treasury shares or involving group entities and considers accounting for such transactions as equity settled and as cash settled share-based payment transactions. The Group will apply IFRIC 11 from 1 January 2008, but it is not expected to have a significant impact on the Group's financial statements

#### **(iv) Interpretations to existing standards that are not yet effective and not relevant for the Group's operations**

IFRIC 7 *Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies* (effective for annual periods beginning on or after 1 March 2006)

The interpretation is not deemed relevant to the Group's operations since none of the Group's entities operate in hyperinflationary economies

IFRIC 12 *Service concession arrangements* (effective for annual periods beginning on or after 1 January 2008)

The interpretation applies to contractual arrangements whereby a private sector operator participates in the development, financing, operation and maintenance of infrastructure for public sector services and as such is not relevant to the Group's operations

#### **(v) Judgement in applying accounting policies**

The preparation of financial statements, in conformity with generally accepted accounting principles (GAAP), requires management to exercise judgements in applying the accounting policies that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses arising during the period. The areas where those judgements have the most significant effect on the amounts recognised in the financial statements are as follows

- Group reconstructions – refer to (c),
- Classification of insurance and investment contracts – refer to (f),
- Insurance contract liabilities – refer to (u), (v), (w), (x) and Note 28,
- Pension and other post retirement provisions – refer to (aa) and Note 34

#### **(b) Basis of consolidation**

The Group financial statements consolidate the income statements and balance sheets of the Company and its subsidiary undertakings. Associate and joint venture undertakings are accounted for using the equity method from the date that significant influence or joint control, respectively, commences until the date this ceases

##### **(i) Subsidiaries**

Subsidiaries are all entities, including special purpose entities, over which the Group has the power to govern the financial and operating policies. Such power, generally but not exclusively, accompanies a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group, until the date that control ceases

The Group uses the purchase method of accounting for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition

Intra group transactions, balances and unrealised gains on intra group transactions are eliminated. Unrealised losses are also eliminated unless the transactions provide evidence of an impairment of the asset transferred. Subsidiaries' accounting policies have been changed where necessary to ensure consistency with the policies adopted by the Group

Where the Group owns more than 50% of an investment vehicle, such as Open Ended Investment Companies, Unit Trusts and Limited Partnerships, and it is consolidated, the interests of parties other than the Group in such vehicles are classified as liabilities. These are recorded in the consolidated balance sheet line Third party interest in consolidated funds and any movements are recognised in the consolidated income statement. The interests of parties other than the Group in all other types of entities are recorded as minority interest in equity

##### **(ii) Associates and joint ventures**

Associates are entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights

Where the Group has a significant holding in an investment vehicle that meets the definition of an associate or joint venture and that investment in associate backs policyholder liabilities including the unallocated divisible surplus, that investment is accounted for at fair value through profit and loss in accordance with IAS 39

Joint ventures are entities whereby the Group and other parties undertake an economic activity, which is subject to joint control arising from contractual agreement

**(b) Basis of consolidation**

**(ii) Associates and joint ventures** *continued*

All other associates and joint ventures are equity accounted for and in this case, the Group's investment in associates and joint ventures includes goodwill, net of any impairment loss, identified on acquisition

Investments in associates and joint ventures that are equity accounted for are initially recognised at cost and adjusted thereafter for the post acquisition change in the Group's share of net assets of the associate. The Group's share of post acquisition results of its associates is recognised in the income statement. The Group's share of any post acquisition movements in reserves, where the associate recognised a gain or loss directly in equity, is recognised in unallocated divisible surplus prior to the demutualisation of SLAC and reserves post the demutualisation of SLAC. The cumulative post acquisition movements are adjusted against the carrying amount of the investment.

Where the Group's share of losses in an associate equals or exceeds its interest in an associate, including any other unsecured receivables, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations in connection with or made payments on behalf of an associate.

Unrealised gains on transactions between the Group and its associates and joint ventures are eliminated to the extent of the Group's interest in the associates and joint ventures. Unrealised losses are also eliminated unless the transactions provide evidence of an impairment of the asset transferred. The accounting policies of associates and joint ventures have been changed where necessary to ensure consistency with the policies adopted by the Group.

**(c) Group reconstructions**

The Group uses merger accounting principles to account for group reconstructions which are not business combinations within the scope of IFRS 3 *Business Combinations*. Under the principles of merger accounting, assets and liabilities transferred to a new entity are recorded in the new entity at the carrying value they were measured at by the transferor. No goodwill is recognised as a result of such transactions. These principles were applied in the demutualisation of SLAC as described in Note 1 to the financial statements.

Where the group reconstruction involves a change in the operation of with profits funds which changes the measurement of participating contract liabilities and the present value of future profits on non participating contracts with corresponding changes to the unallocated divisible surplus, these changes are not recognised in the change in participating contract liabilities, the change in the present value of future profits on non participating contracts and the change in unallocated divisible surplus in the income statement. The liabilities are initially recognised at their revised valuation basis in the balance sheet.

**(d) Foreign currency translation**

The consolidated financial statements are presented in millions pounds Sterling, which is the Group's presentation currency.

The balance sheets of Group entities that have a different functional currency than the Group's presentation currency are translated into the presentation currency at the year end exchange rate and their income statements and cash flows are translated at average exchange rates for the year. Prior to the demutualisation of SLAC, all resulting exchange differences were recognised in the unallocated divisible surplus and post the demutualisation of SLAC, all exchange differences arising are recognised in the foreign exchange reserve in equity. Where the unallocated divisible surplus changes as a result of such exchange differences which are attributable to participating policyholders, this change in the unallocated divisible surplus is not recognised in the income statement but is recognised in equity (refer also to (h), (v)).

Foreign currency transactions are translated at the exchange rate prevailing at the date of the transaction. Gains and losses arising from such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Translation differences on non monetary items, such as equities held at FVTPL, are reported as part of the fair value gain or loss in the income statement. Translation differences on financial assets and liabilities held at amortised cost are included in foreign exchange gains or losses in the income statement.

**(e) Segment reporting**

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. Segments have been separately identified after consideration of the

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various regulatory reporting regimes, the nature of the products sold, distribution channels, customer segments and management's view of the relative risks and rewards associated with each segment

A geographical segment is engaged in providing products or services within a particular economic environment that is subject to risks and returns that are different from those of segments operating in other economic environments

**(f) Classification of insurance and investment contracts**

The measurement basis of assets and liabilities arising from life and pensions business contracts is dependent upon the classification of those contracts as either insurance or investment contracts. A contract is classified as insurance only if it transfers significant insurance risk. Insurance risk is significant if an insured event could cause an insurer to pay significant additional benefits to those payable if no insured event occurred, in any scenario, excluding scenarios that lack commercial substance. A contract that is classified as an insurance contract remains an insurance contract until all rights and obligations are extinguished or expire. Contracts can be reclassified as insurance contracts after inception if insurance risk becomes significant. Life and pensions business contracts that are not considered to be insurance contracts are classified as investment contracts.

The Group has written life and pensions business contracts which contain discretionary participating features (e.g. with profits business). These contracts provide a contractual right to receive additional benefits as a supplement to guaranteed benefits. These additional benefits are based on the performance of with profits funds and their amount and timing is at the discretion of the Group. These contracts are referred to as participating contracts.

Generally, life and pensions business product classes are sufficiently homogeneous to permit a single classification at the level of the product class. However, in some cases, a product class may contain individual contracts that fall across multiple classifications (hybrid contracts). For certain significant hybrid contracts the product class is separated into the insurance element, a non-participating investment element and a participating investment element so that each element is accounted for separately.

Healthcare and general insurance business contracts are classified as insurance contracts only if they transfer significant insurance risk.

**(g) Revenue recognition**

**(i) Deposit accounting for non participating investment contracts**

Contributions received on non participating investment contracts are treated as policyholder deposits and not reported as revenue in the income statement.

Deposit accounting is also applied to reinsurance contracts that do not qualify as insurance contracts under policy (f) above.

The fee income associated with non participating investment contracts is dealt with under policy (g)(iv) below.

**(ii) Premiums**

Premiums received on life and pensions business insurance contracts and participating investment contracts are recognised as revenue when due for payment, except for unit linked premiums which are accounted for when the corresponding liabilities are recognised. For single premium business, this is the date from which the policy is effective. For regular premium contracts, receivables are taken at the date when payments are due.

Premiums receivable on healthcare and general insurance business insurance contracts are recognised as revenue as they are earned over the period of the policy having regard to the incidence of risk.

**(iii) Net investment income**

Gains and losses resulting from changes in both market value and foreign exchange on investments classified as FVTPL are recognised in the income statement in the period in which they occur.

Changes in the fair value of derivative financial instruments that are not hedging instruments are recognised immediately in the income statement.

For loans and receivables measured at amortised cost, interest income recognised in the income statement is calculated using the effective interest rate (EIR) method.

Dividend income is recognised when the right to receive payment is established.

Rental income is recognised in the income statement on a straight line basis over the term of the lease.

**(g) Revenue recognition** *continued*

**(iv) Fee and commissions**

All fees related to unit linked non participating investment contracts are deemed to be associated with the provision of investment management services. Fees related to the provision of investment management services and administration services are recognised as the services are provided. Front end fees, which are charged on the inception of service contracts, are deferred as a liability and recognised over the life of the contract. Ongoing fees that are charged periodically, either directly or by making a deduction from invested funds, are recognised as received, which corresponds to when the services are provided.

Commissions received or receivable are recognised as revenue on the commencement or renewal date of the related policies. However, when it is probable the Group will be required to render further services during the life of the policy, the commission is deferred as a liability and is recognised as the services are provided.

Trail or renewal commissions, where the Group does not have an unconditional legal right to avoid payment, is deferred at inception of the contract and an offsetting liability for contingent commission is established.

**(h) Expense recognition**

**(i) Deposit accounting for non participating investment contracts**

Withdrawals paid out to policyholders on non participating investment contracts are treated as a reduction to policyholder deposits and not recognised as expenses in the income statement.

Deposit accounting is also applied to reinsurance contracts that do not qualify as insurance contracts under policy (f) above.

**(ii) Claims and benefits paid**

Claims paid on life and pensions business insurance contracts and participating investment contracts and healthcare and general insurance business insurance contracts are recognised as expenses in the income statement.

Maturity claims and annuities are accounted for when due for payment. Surrenders are accounted for when paid or, if earlier, on the date when the policy ceases to be included within the calculation of the insurance liability. Death claims and all other claims are accounted for when notified. Healthcare and general insurance claims are accounted for when there is sufficient evidence of their existence and a reasonable assessment can be made of the monetary amount involved.

Claims payable include the direct costs of settlement. Reinsurance recoveries are accounted for in the same period as the related claim.

**(iii) Change in insurance and participating investment contract liabilities**

The change in insurance and participating investment contract liabilities comprising the full movement in the corresponding liabilities during the period, excluding the impact of foreign exchange adjustments, is recognised in the income statement. The liabilities transferred on the demutualisation of SLAC to Standard Life Assurance Limited (SLAL) were recognised at their revised valuation basis in the balance sheet and any change was not recognised in the income statement.

**(iv) Change in investment contract liabilities**

Benefits paid in respect of non participating investment contracts are recognised in the income statement as changes in investment contract liabilities.

**(v) Change in unallocated divisible surplus (UDS)**

The change in UDS recognised in the income statement comprises the movement in the UDS during the period. However, where movements in assets and liabilities which are attributable to participating policyholders are taken directly to equity, the change in UDS arising from these movements is not recognised in the income statement as it is also recognised in equity.

**(i) Impairment of non financial assets**

The carrying amounts of non financial assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, at least at each balance sheet date. An impairment loss is recognised in the income statement for the amount by which the asset's carrying amount exceeds its recoverable amount.

The recoverable amount of an asset is the greater of its net selling price (fair value less costs to sell) and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit, or group of units, to which the asset belongs.

#### **(j) Goodwill and intangible assets**

##### **(i) Goodwill**

Goodwill represents the excess of the cost of a business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities at the acquisition date.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated, from the acquisition date, to each of the Group's cash generating units that are expected to benefit from the business combination. The carrying amount of goodwill for each cash generating unit is reviewed when changes in circumstances or events indicate that there may be uncertainty over its carrying value, and at least annually.

Goodwill is carried at cost less any accumulated impairment losses and is included in intangible assets.

##### **(ii) Intangible assets**

Intangible assets, including internally developed software and software purchased from third parties, are recognised in the balance sheet if it is probable that the relevant future economic benefits attributable to the asset will flow to the Group and its cost can be measured reliably and are either identified as separable (i.e. capable of being separated from the entity and sold, transferred, rented, or exchanged) or they arise from contractual or other legal rights, regardless of whether those rights are transferable or separable.

Intangible assets are carried at cost less accumulated amortisation and any accumulated impairment losses. Amortisation is charged to the income statement on a straight line basis over the estimated useful life of the intangible asset. Impairment losses are calculated and recorded on an individual basis in a manner consistent with policy (i).

#### **(k) Deferred acquisition costs**

##### **(i) UK, Ireland and Germany – participating insurance and participating investment contracts**

Acquisition costs incurred in issuing participating insurance or participating investment contracts are not deferred where such costs are borne by a with profits fund that is subject to the FSA's realistic capital regime. For other participating investment contracts incremental costs directly attributable to the issue of the contracts are deferred. For other participating insurance contracts, acquisition costs which include both incremental acquisition costs and other indirect costs of acquiring and processing new business, are deferred.

Deferred acquisition costs are amortised in proportion to projected margins over the period the relevant contracts are expected to remain in force. After initial recognition deferred acquisition costs are reviewed by category of business and written off to the extent that they are no longer considered to be recoverable.

##### **(ii) Canada – insurance and participating investment contracts**

Implicit allowance is made for deferred acquisition costs in the Canadian Asset Liability Valuation Model (CALM) therefore no explicit deferred acquisition costs have been recognised separately for business written by the Canadian subsidiaries.

##### **(iii) UK, Ireland, Germany and Canada – non participating investment contracts**

Incremental costs directly attributable to securing rights to receive fees for asset management services sold with unit linked investment contracts are deferred. Where such costs are borne by a with profits fund that is subject to the FSA's realistic capital regime deferral is limited to the level of any related deferred income.

Deferred acquisition costs are amortised over the life of the contracts as the related revenue is recognised. After initial recognition deferred acquisition costs are reviewed by category of business and are written off to the extent that they are no longer considered to be recoverable.

**(k) Deferred acquisition costs** *continued*

**(iv) UK, Ireland and Germany – non participating insurance contracts**

Acquisition costs incurred in issuing non participating insurance contracts are not deferred where such costs are borne by a with profits fund that is subject to the FSA's realistic capital regime. For other non participating insurance contracts acquisition costs, which include both incremental acquisition costs and other indirect costs of acquiring and processing new business, are deferred.

Deferred acquisition costs are amortised in proportion to projected margins over the period the relevant contracts are expected to remain in force. After initial recognition deferred acquisition costs are reviewed by category of business and are written off to the extent that they are no longer considered to be recoverable.

**(l) Investment property**

Property held for long term rental yields or investment gain that is not occupied by the Group is classified as investment property.

Investment property is initially recognised at cost including any directly attributable transaction costs. Subsequently investment property is measured at fair value. Fair value is determined without any deduction for transaction costs that may be incurred on sale or other disposal, unless the property is under development with a view to resale and is based on valuations at least annually, by external independent qualified valuers. Gains or losses arising from changes in fair value are recognised in the income statement. Investment property is not depreciated.

Property located on land that is held under an operating lease is classified as investment property as long as it is held for long term rental yields and is not occupied by the companies in the Group. The initial cost of the property is the lower of the fair value of the property and the present value of the minimum lease payments.

Rental income from investment property is recognised in the income statement on a straight line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income and are also spread over the term of the lease.

**(m) Property, plant and equipment**

Land and buildings consists of property occupied by the Group and property that is being constructed or developed for future use as investment property. Land and buildings are recognised initially at cost and subsequently at fair value, based on valuations, at least annually, by external independent qualified valuers less subsequent depreciation on buildings. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset.

Prior to the demutualisation of SLAC, increases in the fair value of land and buildings were recognised in the unallocated divisible surplus and following the demutualisation of SLAC, all fair value increases are recognised in the revaluation reserve in equity. Where the unallocated divisible surplus changes as a result of fair value increases which are attributable to participating policyholders, this change in the unallocated divisible surplus is not recognised in the income statement but through equity. Decreases in the fair value of land and buildings that offset previous increases in the same asset were recognised in the unallocated divisible surplus prior to the demutualisation of SLAC and are recognised in the revaluation reserve in equity post the demutualisation of SLAC. All other decreases are charged to the income statement for the period.

Owner occupied properties are depreciated on a straight line basis over their estimated useful lives, generally between thirty and fifty years. The depreciable amount of an asset is determined by the difference between the fair value and the residual value. The residual value is the amount that would be received on disposal if the asset was already at the age and condition expected at the end of its useful life. Properties under development are not depreciated.

Equipment is stated at historical cost less depreciation. Depreciation on equipment is charged to the income statement on a straight line basis over their estimated useful lives of between two and fifteen years. The residual values and useful lives of the assets are reviewed at each balance sheet date and adjusted if appropriate.

**(n) Income tax**

The current tax expense is based on the taxable profits for the year, after adjustments in respect of prior years. Amounts are charged or credited to the income statement or equity as appropriate.

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Deferred tax is provided using the balance sheet liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities.

Temporary differences arising from investments in subsidiaries and associates give rise to deferred tax only to the extent that it is probable that the temporary difference will reverse in the foreseeable future or the timing of the reversal of that difference cannot be controlled. Deferred tax is provided on unremitted earnings of subsidiaries to the extent that the temporary difference created is expected to reverse in the foreseeable future.

Deferred tax is recognised in the income statement except when it relates to items recognised directly in the statement of recognised income and expense in which case it is credited or charged directly to equity through the statement of recognised income and expense.

The income tax expense is determined using rates enacted or substantively enacted at the balance sheet date.

From the date of demutualisation, the Group has attributed an element of total income tax expense to equity holder profit. In addition to being subject to tax on equity holder profits, however, the Group's long term businesses in the UK and Ireland are subject to tax on policyholders' investment returns on certain products. Policyholder tax is accounted for as an income tax and is included within the total income tax expense. Total income tax expense is analysed between equity holder tax and policyholder tax in the consolidated income statement. Equity holder tax is current and deferred tax on that part of profits subject to or expected to be subject to tax at equity holder tax rates. Policyholder tax represents current and deferred tax payable or expected to be payable at policyholder tax rates.

#### **(o) Reinsurance assets**

Reinsurance assets primarily include balances due for ceded insurance liabilities. Amounts recoverable from reinsurers are estimated in a manner consistent with the assumptions used for ascertaining the underlying policy benefits, subject to the terms of the contract. Reinsurance assets that do not qualify as insurance contracts, under the classification requirements described in policy (f), are classified as financial assets and measured at FVTPL.

Amounts due from reinsurers in respect of claims incurred are separately recognised in 'Other assets' and are accounted for on a basis consistent with loans and receivables (refer to policy (p)).

If a reinsurance asset is considered to be impaired, the carrying amount is reduced to the recoverable amount and the impairment loss is recognised in the income statement. The recoverable amount is determined as the carrying amount less any impairment losses. Impairment losses are determined using the process adopted for assessing the impairment of financial assets held at amortised cost on an individual basis (refer to policy (p)).

#### **(p) Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than those that the Group intends to sell in the short term or that it has designated as FVTPL. Financial assets classified as loans and receivables include deposits with credit institutions, loans secured by mortgages and loans secured on policies.

Loans and receivables are initially measured at fair value less directly attributable transaction costs. Subsequently, they are measured at amortised cost, using the EIR method, less any impairment losses. Revenue from financial assets classified as loans and receivables is recognised in the income statement on an EIR basis.

Impairment on individual loans is determined, at each reporting date, by an evaluation of the exposure on a case by case basis. The impairment loss is calculated as the difference between the present value of future cash flows, discounted at the loan's original effective rate, and the loan's current carrying value. Any impairment loss identified is recognised in the income statement. Subsequent recoveries are credited to the income statement.

If there is no evidence of impairment on an individual basis, a collective impairment review is undertaken whereby the assets are grouped together, on the basis of similar credit risk characteristics, in order to calculate a collective impairment loss.

### **(q) Investment securities and derivatives**

Management determines the classification of investment securities and derivatives at initial recognition. The Group has designated its investment securities as either fair value through the profit and loss or held to maturity. All derivatives are held at fair value and where derivatives are not designated as part of a hedging relationship, changes in fair value are recorded in the income statement. Where derivatives are designated within hedging relationships, the treatment of the fair value changes depends on the nature of the hedging relationship as described below.

#### **(i) Designation as fair value through profit and loss (FVTPL)**

Financial assets and liabilities are designated at FVTPL where the asset or liability is part of a group of assets that are evaluated and managed on a fair value basis. The Group holds portfolios of equities and debt securities that are all managed and monitored, through quarterly investment reports, on a fair value basis so as to maximise returns either for with profits policyholders or equity holders.

The Group uses derivative financial instruments including forwards, swaps, futures, and options for the purposes of matching contractual liabilities, reducing investment risks and for efficient portfolio management activities. In accordance with its treasury policy, the Group does not hold or issue derivative financial instruments for speculative trading purposes. The Group designates certain derivatives as part of fair value and cash flow hedge relationships under IAS 39 *Financial Instruments: Recognition and Measurement*. The impact of hedge accounting on the measurement of financial assets and liabilities is detailed in policy (q)(iii).

The Group recognises these assets at fair value on the trade date of the transaction. In the case of derivatives where no initial premium is paid or received the initial measurement value is nil. Directly attributable transaction costs are not included in the initial measurement value but are recognised in the income statement.

Fair values are based upon the current quoted bid price where an active market exists. Where a quoted price in an active market cannot be obtained an appropriate market consistent valuation technique (for example discounted cash flows and recent market transactions) is used to determine fair value. If a price/technique is not available to provide a reliable fair value the investment is carried at cost less a provision for impairment.

#### **(ii) Designation as held to maturity**

The Group classifies certain government bonds, held for regulatory purposes, as held to maturity financial assets. Held to maturity financial assets are recognised as assets on the trade date and initially measured at fair value plus any directly attributable transaction costs incurred on recognition. At each subsequent reporting date, the Group measures the held to maturity investments at amortised cost, using the EIR method, less any impairment losses identified. Revenue from held to maturity assets is recognised in the income statement on an EIR basis.

#### **(iii) Hedge accounting**

A hedge relationship will qualify for hedge accounting by the Group if, and only if, the following conditions are met:

- Completion of formal hedging documentation at inception of the hedge which details the hedging instrument, hedged item, risk management objective, strategy, effectiveness testing methodology and hedge relationship,
- Hedge relationship is expected to be highly effective at inception in achieving offsetting changes in fair value or cash flow attributable to the hedged risk, and
- Effectiveness of the hedge can be reliably measured and the hedge is assessed for effectiveness regularly during the reporting period for which the hedge was designated to demonstrate that it is highly effective.

The Group discontinues hedge accounting in the following circumstances:

- It is evident from the effectiveness tests that the hedge is not, or ceased to be, highly effective,
- Hedging instrument expires, or is sold, terminated or exercised, or
- Hedged item matures or is sold or repaid.

#### **Fair value hedge relationships**

A fair value hedge is a hedge of the changes in fair value of a recognised asset or liability or an identified portion of such an asset or liability that is attributable to a particular risk and could impact the income statement. A fair value hedge is therefore used to hedge the exposure to variability in the fair value of financial assets and liabilities such as fixed rate debt instruments. The change in the fair

value of the underlying assets or liabilities relating to the hedged risk is recognised in the income statement offsetting the change in the fair value of the hedging derivative. The change in the fair value of the hedged item in relation to the hedged risk is shown as an adjustment against the carrying value of the hedged item in the balance sheet.

If the fair value hedge ceases to meet the relevant hedging criteria, hedge accounting is discontinued and the adjustment to the carrying value of the hedged item is amortised over the remaining period to maturity and recognised in the income statement.

#### **Cash flow hedge relationships**

A cash flow hedge is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction and could affect the profit or loss. A cash flow hedge is therefore used to hedge exposure to variability in cash flows such as those on variable rate assets and liabilities. Where a derivative is designated and qualifies as a cash flow hedge, the effective part of any gain or loss resulting from the change in fair value of the derivative is recognised directly in the cash flow reserve in equity. Any ineffectiveness is recognised immediately in the income statement. Amounts that have been recognised directly in the cash flow reserve are recognised in the income statement in the same period or periods during which the hedged item affects the profit or loss.

If a cash flow hedge no longer meets the relevant hedging criteria, hedge accounting is discontinued and no further changes in the fair value of the derivative are recognised in the cash flow reserve. Amounts that have already been recognised directly in the cash flow reserve are recognised in the income statement in the same period or periods during which the hedged item affects the profit or loss. Where the forecast transaction is no longer expected to occur or the asset or liability is derecognised, the associated accumulated amounts in the cash flow reserve are recognised immediately in the income statement.

#### **(iv) Embedded derivatives**

Options, guarantees and other derivatives embedded in a host contract are separated and recognised as a derivative unless they are either considered closely related to the host contract, meet the definition of an insurance contract or if the host contract itself is measured at fair value with changes in fair value recognised in income.

#### **(r) Financial guarantee contracts**

The Group recognises and measures financial guarantee contracts in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. The Group initially recognises and measures a financial guarantee contract at its fair value. At each subsequent reporting date, the Group measures the financial guarantee contract at the higher of the initial fair value recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue* and the best estimate of the expenditure required to meet the obligations under the contract at the reporting date.

#### **(s) Cash and cash equivalents**

Cash and cash equivalents include cash in hand, deposits held at call with banks and any highly liquid investments with less than three months to maturity from the date of acquisition. For the purposes of the cash flow statement cash and cash equivalents also include bank overdrafts, which are included in borrowings on the balance sheet.

#### **(t) Equity**

##### **(i) Share capital and treasury shares**

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Shares are classified as equity instruments when there is no contractual obligation to deliver cash or other assets to another entity on terms that may be unfavourable. The difference between the proceeds received on issue of the shares and the nominal value of the shares issued is recorded in the share premium account. Incremental costs directly attributable to the issue of new equity instruments are shown in share premium account as a deduction from the proceeds, net of tax. Incremental costs directly attributable to the issue of equity instruments in a business combination are included in the cost of acquisition.

If the Company or its subsidiaries purchase any equity instruments of the Company, the consideration paid is treated as a deduction from total equity. Where such shares are sold, if the proceeds are equal to or less than the purchase price paid, the proceeds are treated as a realised profit. If the proceeds exceed the purchase price, the excess over the purchase price is transferred to the share premium account.

##### **(ii) Merger reserve**

If the Company issues shares at a premium and the conditions for merger relief under s131 of the UK Companies Act 1985 are met, a sum equal to the difference between the issue value and nominal value is transferred to a 'merger reserve'.

#### **(u) Insurance and investment contract liabilities**

For insurance contracts and participating investment contracts IFRS 4 *Insurance Contracts* permits the continued application of previously applied GAAP, except where a change is deemed to make the financial statements more relevant to the economic decision making needs of users and no less reliable, or more reliable, and no less relevant to those needs. The Group therefore adopts UK GAAP, including the requirements of FRS 27 *Life Assurance* in relation to its UK regulated with profits funds, for the measurement of its insurance and participating investment contract liabilities. As permitted under UK GAAP, the Group adopts local regulatory valuation methods, adjusted for consistency with asset measurement policies, for the measurement of liabilities under insurance contracts and participating investment contracts issued by overseas subsidiaries.

Further details on these policies and the policies for the measurement of non participating investment contracts are given in (v), (w) and (x) below.

#### **(v) Participating contract liabilities**

Participating contract liabilities are analysed into the following components:

- Participating insurance contract liabilities
- Participating investment contract liabilities
- Unallocated divisible surplus
- Present value of future profits on non participating contracts, which is treated as a deduction from the gross participating contract liabilities

The policy for measuring each component is noted below.

#### **(i) Participating insurance and investment contract liabilities**

Participating contract liabilities arising under contracts held in with profits funds falling within the scope of the FSA's realistic capital regime are measured on a FSA realistic basis. Under this approach the value of participating insurance and participating investment contract liabilities in each with profits fund is calculated as:

- With profits benefits reserves (WPBR) for the fund as determined under the FSA realistic basis, plus
- Future policy related liabilities (FPRL) for the fund as determined under the FSA realistic basis, less
- Any amounts due to equity holders included in FPRL, less
- The portion of future profits on non participating contracts included in FPRL not due to equity holders, where this portion can be separately identified (see policy (v)(iii) below)

The WPBR is primarily based on the retrospective calculation of accumulated assets shares. The largest component of the FPRL is a market consistent stochastic valuation of the cost of options and guarantees.

Prior to the demutualisation of SLAC, all Group business was held within one with profits fund. On a FSA realistic basis, the portion of future profits on non participating contracts included in the FPRL could not be separately identified and hence the present value of future profits on non participating contracts was presented as a separate item deducted from liabilities comprising participating contract liabilities and the unallocated divisible surplus.

After the demutualisation of SLAC the Group's principal with profits fund is the Heritage With Profits Fund (HWPF) operated by SLAL. Under the Scheme of Demutualisation (the Scheme) the residual estate of the HWPF exists to meet amounts which may be charged to the HWPF under the Scheme. However, to the extent that the Board of Standard Life Assurance Limited is satisfied that there is an excess residual estate, it shall be distributed over time as an enhancement to final bonuses payable on the remaining policies invested in the HWPF. This planned enhancement to the benefits under with profits contracts held in the HWPF is included in the FPRL under the FSA realistic basis resulting in a realistic surplus of nil. Applying the policy noted above this planned enhancement is therefore included within the measurement of participating contract liabilities.

The Scheme provides that certain defined cash flows (recourse cash flows) arising in the HWPF on specified blocks of UK and Irish business, both participating and non participating, may be transferred out of that fund when they emerge, being transferred to the Shareholder Fund or Proprietary Business Fund of SLAL, and thus accrue to the ultimate benefit of equity holders of the Company. Under the Scheme such transfers are subject to constraints to protect policyholders and if the recourse cash flows emerging in a period result in a negative amount, the fund attributable to equity holders will make a transfer to the HWPF of at least the negative amount.

Under the FSA realistic basis the discounted value of expected future cash flows on participating contracts not reflected in the WPBR is included in the FPRL (as a reduction in FPRL where future cash flows are expected to be positive) The discounted value of expected future cash flows on non participating contracts not reflected in the measure on non participating liabilities is recognised as a separate asset (where future cash flows are expected to be positive) The Scheme requirement to transfer future recourse cash flows out of the HWPF is recognised as an addition to FPRL The discounted value of expected future cash flows on non participating contracts can be apportioned between those included in the recourse cash flows and those retained in the HWPF for the benefit of policyholders

Applying the policy noted above

- The value of participating insurance and participating investment contract liabilities is reduced by future expected (net positive) cash flows arising on participating contracts
- Future expected (net positive) cash flows on non participating contracts are not recognised as an asset of the HWPF However future expected (net positive) cash flows on non participating contracts that are not recourse cash flows under the Scheme are not included in the value of participating insurance and participating investment contract liabilities

As the recourse cash flows emerge they are recognised as an addition to shareholder funds if positive or as a deduction from shareholder funds if negative

In accordance with Group policy for overseas subsidiaries, the method used to determine participating contract liabilities for the Canadian business is based on Canadian accounting and regulatory valuation principles In accordance with Canadian accounting principles, for most participating business the value of participating policy liabilities is set equal to the value of the assets set aside in a separate fund for this business, unless this is insufficient to cover guaranteed benefits, in which case a higher liability is recognised Generally, Canadian GAAP measures assets at cost or amortised cost, however, as the Group's policy is to measure investment securities at FVTPL an adjustment is made to the Canadian GAAP liability to reflect the impact of the measurement change in the backing assets

#### **(u) Unallocated divisible surplus (UDS)**

The UDS represents the difference between assets and all other recognised liabilities in the Group's with profits funds It is recognised as a liability

As a result of the policies for measuring the HWPF's assets and all its other recognised liabilities, the UDS of the HWPF comprises the value of future recourse cash flows in participating contracts (but not the value of future recourse cash flows on non participating contracts) and the effect of any measurement differences between the realistic balance sheet value and IFRS accounting policy value of all assets and all liabilities other than participating contract liabilities recognised in the HWPF

#### **(m) Present value of future profits (PVFP) on non participating contracts held in a with profits fund**

For with profits funds falling within the scope of the FSA's realistic capital regime an amount is recognised for the present value of future profits on non participating contracts where the determination of the realistic value of liabilities for with profits contracts in that with profits fund takes account directly or indirectly, of this value The amount is recognised as a deduction from liabilities Where this amount can be apportioned between an amount recognised in the realistic value of with profits contract liabilities and an amount recognised in the unallocated divisible surplus, the apportioned amounts are deducted in the measurement of participating contract liabilities and unallocated divisible surplus respectively Otherwise it is recognised as a separate amount deducted from liabilities comprising participating contract liabilities and the unallocated divisible surplus

#### **(w) Non participating contract liabilities**

##### **(i) Non participating insurance contracts (life and pension business)**

The insurance contract liabilities for conventional business are calculated using the gross premium method In general terms, a gross premium valuation basis is one in which the premiums brought into account are the full amounts receivable under the contract The method includes explicit estimates of premiums, expected claims, costs of maintaining contracts and future renewal expenses Cash flows are discounted at the valuation rate of interest determined in accordance with FSA requirements The relaxations to reserving requirements for non participating insurance contracts set out in the FSA's Policy Statement PS 06/14 have not been adopted

The liability for annuity contracts is calculated by discounting the expected future annuity payments together with an appropriate estimate of future expenses at an assumed rate of interest derived from yields on the underlying assets

**(w) Non participating contract liabilities**

**(i) Non participating insurance contracts (life and pension business) continued**

In accordance with Group policy for overseas subsidiaries, the method used to determine the insurance contract liabilities for the Canadian business is based on Canadian accounting and regulatory valuation principles (CALM). The Canadian regulations set the value of policy liabilities equal to the value of a set of supporting assets just sufficient with reinvestment and disinvestments to meet all policy liabilities when due. Generally, Canadian GAAP measures assets at cost or amortised cost, however, as the Group's policy is to measure investment securities at FVTPL an adjustment is made to the CALM liabilities to reflect the impact of the measurement change in the backing assets.

**(ii) Non participating insurance contracts (healthcare and general insurance business)**

All healthcare and general insurance business insurance contracts are short term contracts, generally of a duration no longer than a year. Claims outstanding comprise provisions representing the estimated ultimate cost of settling, including claims notified but not settled by the balance sheet date and claims incurred as a result of events up to the balance sheet date not reported as at that date.

A provision is made at the balance sheet date for the total expected cost of settlement of all claims incurred in respect of events up to that date, together with related claims handling expenses, less any amounts already paid. Unearned premiums represent that proportion of premiums received on in force contracts that relate to unexpired risks at the reporting date and are recognised as a liability.

**(iii) Non participating investment contracts (life and pensions business)**

Unit linked non participating investment contract liabilities are designated as FVTPL as they are implicitly managed on a fair value basis as their value is directly linked to the market value of the underlying portfolio of assets. The fair value of a unit linked liability is equal to the value of the (funded) units allocated to the contracts. The unit value is based on the bid value of the fund assets at the reporting date before expenses of selling or buying the underlying assets.

Liabilities for non linked investment contracts are measured at amortised cost. Amortised cost is calculated as the fair value of contributions received at the date of initial recognition, less the effect of payments such as transaction costs, plus or minus the cumulative amortisation, using the EIR method, of any difference between that initial amount and the maturity value, and less any write-down for surrender payments. At each reporting date, the amortised cost liability is determined as the value of future best estimate cash flows discounted at the EIR.

**(x) Liability Adequacy Test**

The Group applies a Liability Adequacy Test at each reporting date to ensure that the insurance liabilities are adequate in the light of the estimated future cash flows. This test is performed by comparing the carrying value of the liability and the discounted projections of future cash flows (including premiums, claims, expenses, investment return and other items), using best estimate assumptions.

If a deficiency is found in the liability (i.e. the carrying value amount of its insurance liabilities is less than the future expected cash flows) that deficiency is provided for in full. The deficiency is recognised in the income statement.

**(y) Borrowings**

Borrowings include bank overdrafts and certificates of deposit, commercial paper, medium terms notes and mortgage backed securities issued by Standard Life Bank. Borrowings are recognised initially at fair value, less attributable transaction costs. Subsequent to initial recognition, borrowings are carried at amortised cost with any difference between the carrying value and redemption value being recognised in the income statement over the period of the borrowings on an EIR basis.

**(z) Subordinated liabilities**

Subordinated liabilities are initially recognised at the value of proceeds received net of issue expenses. The total finance costs are charged to the income statement over the relevant term of the instrument using the EIR. The carrying amount of the debt is increased by the finance cost in respect of the reporting period and reduced by payments made in respect of the debt in the period.

**(aa) Pension costs and other post retirement benefits**

The Group operates a number of defined benefit and defined contribution plans, the assets of which are held in separate trustee administered funds. The pension plans are funded by payments from employees and by the relevant Group companies, determined by periodic actuarial calculations.

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For defined benefit plans, the liability recognised in the balance sheet is the present value of the defined benefit obligation less the fair value of plan assets, together with adjustments for past service costs. Plan assets exclude any insurance contracts or non-transferable financial instruments issued by the Group. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method whereby estimated future cash outflows are discounted using interest rates of high quality corporate bonds denominated in the currency in which the benefits will be paid of similar term as the pension liability.

Actuarial gains and losses are recognised in the statement of recognised income and expense in the period in which they occur.

For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised in staff expenses when they are due.

**(bb) Deferred income**

Front end fees on service contracts, including investment management service contracts are deferred as a liability and amortised to the income statement over the period services are provided.

**(cc) Provisions and contingent liabilities**

Provisions for restructuring costs and legal claims are recognised when the Group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount has been reliably estimated. Provisions are not recognised for future operating losses. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole.

Contingent liabilities are disclosed if the future obligation is probable and the amount cannot be reasonably estimated.

**(dd) Dividend distribution**

Final dividends on share capital classified as equity instruments are recognised in equity when they have been approved by equity holders. Interim dividends on these shares are recognised in equity in the period in which they are paid.

**(ee) Leases**

Leases, where a significant portion of the risks and rewards of ownership are retained by the lessor, are classified as operating leases. Where the Group is the lessee, payments made under operating leases, net of any incentives received from the lessor, are charged to the income statement on a straight line basis over the period of the lease.

Where the Group is the lessor, lease income from operating leases is recognised in the income statement on a straight line basis over the lease term. Initial direct costs incurred in arranging an operating lease are added to the carrying amount of the leased asset and recognised as an expense over the lease term on the same basis as the lease income.

The Group has not entered into any material finance lease arrangements as either the lessor or lessee.

**(ff) Employee share based payments**

The Group operates share incentive plans for all employees, share-based long term incentive plans for senior employees and awards annual performance shares when the Group's profit exceeds target to all employees. Further details of the schemes are set out in Note 42. These schemes are treated as equity settled share-based payment schemes under IFRS 2 *Share based Payment*.

For equity settled share-based payment employee transactions, the services received as compensation are measured at their fair value. This fair value is measured by reference to the fair value of the equity instruments granted. The fair value of those equity instruments is measured at the grant date, which is the date that the Group and the employees have a shared understanding of the terms and conditions of the award. If that award is subject to an approval process then the grant date is the date when that approval is obtained.

If the equity instruments granted vest immediately, the employees become unconditionally entitled to those equity instruments. Therefore, the Group immediately recognises the charge in respect of the services received in full in the income statement with a corresponding credit to the equity compensation reserve in equity.

**(ff) Employee share based payments** *continued*

If the equity instruments do not vest until the employee has fulfilled specified vesting conditions, the Group presumes that the services to be rendered by the employee as consideration for those equity instruments will be received in the future, during the period of those vesting conditions ('vesting period'). Therefore, the Group recognises the charge in respect of those services as they are rendered during the vesting period with a corresponding credit to the equity compensation reserve in equity.

At the time the equity instruments vest, the amount recognised in the equity compensation reserve in respect of those equity instruments is transferred to retained earnings.

**(gg) Derecognition and offset of financial assets and liabilities**

A financial asset (or a part of a group of similar financial assets) is derecognised where

- The rights to receive cash flows from the asset have expired,
- The Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement, or
- The Group has transferred its rights to receive cash flows from the asset and has either transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Financial asset and liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

**(hh) Underlying profit**

Underlying profit is calculated by adjusting the profit for the period for volatility that arises from different IFRS measurement bases for liabilities and backing assets, volatility arising from derivatives that are part of economic hedges but do not qualify as hedge relationships under IFRS, restructuring costs, impairment of intangibles and profit or loss arising on the disposal of a subsidiary, joint venture or associate. The Directors believe that, by eliminating this volatility from equity holder profit, they are presenting a more meaningful indication of the underlying business performance of the Group.

**(ii) Earnings per share**

Basic earnings per share is calculated by dividing profit attributable to ordinary equity holders by the weighted average number of ordinary shares in issue during the year less the weighted average number of shares owned by the Company and employee trusts that have not vested unconditionally in employees.

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares in issue during the year to assume the conversion of all dilutive potential ordinary shares, such as share options granted to employees.

Diluted earnings per share can also be calculated by adjusting the profit or loss for the effects of changes in income, expenses, tax and dividends that would have occurred had the dilutive potential ordinary shares been converted into ordinary shares.

Alternative earnings per share is calculated on underlying profit before non-operating items and tax. Refer to policy (hh) above for details of the adjusted items.

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## Notes to the Group financial statements

### 1. The Demutualisation of The Standard Life Assurance Company and the Company's Initial Public Offering

#### (a) Impact of demutualisation transaction and Initial Public Offering

On 10 July 2006 SLAC demutualised and the shares of a new holding company for the Standard Life Group, Standard Life plc (the Company), were listed on the London Stock Exchange

The demutualisation of SLAC was governed by its Scheme of Demutualisation (the Scheme) Under the Scheme substantially all of the assets and liabilities of SLAC were transferred to Standard Life Assurance Limited (SLAL), which is a wholly owned direct subsidiary of the Company SLAL established six long term insurance funds, the Heritage With Profits Fund (HWPF), the Proprietary Business Fund, UK Smoothed Managed With Profits Fund, Irish Smoothed Managed With Profits Fund, German Smoothed Managed With Profits Fund and German With Profits Fund The assets and liabilities transferred were allocated to the HWPF unless, under the Scheme, they were specifically allocated to SLAL's Shareholder Fund or Proprietary Business Fund The details of the Scheme were set out in the proposal for the demutualisation of SLAC issued to members in April 2006 and in the prospectus issued in June 2006 in relation to the offer of shares in the Company In summary

- (a) SLAC's liabilities under existing UK business, Irish branch business and German branch business were transferred to SLAL's HWPF with the exception of liabilities under Pension Contribution Insurance policies, Income Protection Plan policies and certain Self Invested Personal Pension policies which were transferred to the Proprietary Business Fund along with appropriate backing assets
- (b) SLAC's investment in certain operating subsidiaries (including Standard Life Bank Limited, The Standard Life Assurance Company of Canada, Standard Life Healthcare Limited and Standard Life Investments Limited) were transferred to SLAL's Shareholder Fund or Proprietary Business Fund
- (c) SLAC's liabilities as at 10 July 2006 in respect of its staff pension schemes for employees in the UK and Ireland were transferred to the Proprietary Business Fund
- (d) All remaining assets and liabilities were transferred to the HWPF

Immediately prior to the demutualisation of SLAC, it repaid its liabilities to its subsidiaries that had issued subordinated guaranteed bonds and Mutual Assurance Capital Securities (the instruments) and lent it the funds received The repayment proceeds were transferred to the Company in return for its assumption of the obligations under the instruments At the time of the demutualisation transaction the Company entered into a loan arrangement with SLAL under which it lent the proceeds it had received for assuming the obligations under the instruments The instruments were re listed on the London Stock Exchange with the Company as the new issuer

Also, immediately prior to its demutualisation SLAC transferred its Canadian branch business (excluding the Stacking Policy and Structured Settlement businesses) to The Standard Life Assurance Company of Canada, a Canadian registered subsidiary of SLAC, in return for additional shares in The Standard Life Assurance Company of Canada The Stacking Policy business was transferred to the Proprietary Business Fund of SLAL and the Structured Settlement business remained in SLAC

The Scheme provides that certain recourse cash flows arising in the HWPF on specified blocks of UK and Irish business may be transferred out of that fund and thus accrue to the ultimate benefit of equity holders of the Company (referred to as 'recourse cash flows') Under the Scheme such transfers are subject to constraints to protect policyholders If the recourse cash flows result in a negative amount, then the Shareholder Fund will make a transfer to the HWPF of at least the negative amount The residual estate of the HWPF exists primarily to meet amounts which may be charged to the HWPF under the Scheme However, to the extent that the Board of SLAL is satisfied that there is an excess residual estate, it shall be distributed over time as an enhancement to final bonuses payable on the remaining policies invested in the HWPF The Scheme also provides for additional expenses to be charged by the Proprietary Business Fund to the HWPF in respect of the German branch business

In consideration for the transfer of the assets and liabilities from SLAC, SLAL issued shares to the Company As compensation for the loss of their membership rights, eligible members of SLAC received shares in the Company

## 1. The Demutualisation of The Standard Life Assurance Company and the Company's Initial Public Offering

### (a) Impact of demutualisation transaction and Initial Public Offering continued

On 10 July 2006, the shares of the Company were listed on the London Stock Exchange and as a result of its Initial Public Offering issued 556,944,945 shares raising £1,224m before transaction costs. Subsequently, as described in Note 23, the exercise of an over allotment provision resulted in the issue of 83,541,742 shares raising further capital of £192m before transaction costs. The transaction costs directly attributable to the issue of the shares are £53m therefore the total capital raised net of transaction costs is £1,363m.

Immediately after demutualisation certain subsidiaries that had been transferred to SLAL's Shareholder Fund were distributed, as a dividend in specie, to the Company.

On 21 July 2006, the Court of Session in Scotland confirmed a reduction of £500m in the Company's share premium account and the cancellation of SLAL's entire share premium account. These capital reductions were undertaken to create distributable reserves of £500m in the Company and to remove a possible restriction upon declaring and paying dividends to the Company out of future surplus cash flows derived from the long term business of SLAL.

The demutualisation transaction is a group reconstruction which is not a business combination within the scope of IFRS 3 *Business Combinations*. Therefore merger accounting principles have been applied to the transaction in the consolidated financial statements of the Group resulting in assets and liabilities being transferred to new Group entities at their carrying value prior to the transfer.

The impact of the demutualisation and IPO transactions on the consolidated balance sheet is shown below.

	Before Demutualisation 10 July 2006	Transfer of assets outside Heritage With Profits Fund and issue of shares to eligible members Note 1	Impact of Scheme on measurement of participating contract liabilities and non par PVFP Note 2	Apportionment of non par PVFP Note 3	IPO proceeds	Other	After Demutualisation 10 July 2006
	£m	£m	£m	£m	£m	£m	£m
<b>Total assets</b>	124,942		17		1,224	60	126,243
Equity		(1,300)	(17)		(1,224)	23	(2,518)
Participating contract liabilities	(37,887)		(1,013)	224			(38,676)
Unallocated divisible surplus	(5,173)	1,359	1,014	1,490			(1,310)
Non participating contract PVFP	1,708		6	(1,714)			
Other liabilities and minority interest	(83,590)	(59)	(7)			(83)	(83,739)
<b>Total equity and liabilities</b>	(124,942)		(17)		(1,224)	(60)	(126,243)

**Note 1** It is the Group's policy that liabilities under participating contracts, including unallocated divisible surplus (UDS), are measured at a value equal to the value of the assets held in the related with profits fund. Therefore the value of the net assets, and thus equity, recognised by the Group following the demutualisation transaction equalled the value at which the net assets not transferred to the HWPF were carried at in the Group prior to the demutualisation transaction.

**Note 2** The future operation of the HWPF is determined by the Scheme. Applying the FSA realistic measurement basis to the HWPF led to some differences in the measurement of participating contract liabilities (such as the inclusion in participating contract liabilities of planned enhancements to with profits contracts) and in the measurement of the present value of future profits (PVFP) arising from non participating contracts (such as the elimination of PVFP on contracts not transferred to the HWPF or the increase in PVFP as a result of Group corporate expenses not being charged to the HWPF).

**Note 3** Non participating contract PVFP can be apportioned between the component related to contracts whose future cash flows under the Scheme will be transferred out of the HWPF to equity holders and the component related to contracts whose future cash flows remain in the HWPF thus contributing to the planned enhancement component of participating liabilities. These components are offset in the measurement of the UDS and participating contracts respectively.

The impact of the transaction on the financial position of the Group is reflected throughout the consolidated financial statements for the year ended 31 December 2006. To assist users this note summarises the key information on the transaction that is provided in notes to the consolidated financial statements.

- As described in the Group accounting policies basis of preparation, the consolidated income statement has been split to show the period from 1 January to 10 July 2006 and the period from 10 July to 31 December 2006 in two separate columns, with a third column which combines these periods to show the result for the year ended 31 December 2006. Further detail is provided in Note 1(b).
- There is no requirement to provide a consolidated balance sheet as at 10 July 2006. Except for equity line items, all balance sheet line items are directly comparable with the comparative period irrespective of the change in legal structure of the Group.
- Notes 23 to 26 set out how the transaction is reflected in the various categories of equity held by the Group.
- The Scheme governs the calculation of amounts attributable to equity holders transferred from business written prior to demutualisation. Note 2(i) segmental income statement provides further detail on the source of profit for life and pensions business for the period since 10 July 2006.
- The valuation of insurance liabilities written in the UK is derived from regulatory requirements. The transfer of business from SLAC to SLAL on demutualisation gave rise to a change in the realistic valuation of liabilities. Note 29 analyses the movement in insurance contract liabilities, non-participating investment contract liabilities, participating investment contract liabilities and reinsurance assets between the periods 1 January to 10 July 2006, demutualisation on 10 July 2006, and 10 July (post-demutualisation) to 31 December 2006.
- Other notes detail the impact of specific aspects of the transaction as applicable, for example Note 33 sets out the changes to subordinated liabilities arising from requirements set out in the Scheme.

#### **(b) Presentation of the consolidated income statement**

As described in the Group accounting policies basis of preparation, the revised format of the consolidated income statement has resulted in certain items being presented on lines different to that reported for the year ended 31 December 2005. The following items, reported in the consolidated income statement for the year ended 31 December 2005, have been presented within the consolidated income statement on different lines as follows:

- The amount reported as 'Transfer to the unallocated divisible surplus' for the year ended 31 December 2005 is reported in 'Change in unallocated divisible surplus' within expenses, resulting in an increase to the amount reported as 'Total expenses' of £901m.
- The amount reported as 'Profit before tax' represents the sum of 'Tax expense' (of £531m) and 'Increase in net assets attributable to minority interest' (of £83m) that were reported in the consolidated income statement for the year ended 31 December 2005, and
- 'Increase in net assets attributable to minority interest' was included below the 'Result before tax' in the mutual accounting model. In the revised income statement presentation, the amounts included in this line for the year ended 31 December 2005 are reported in 'profit before tax attributable to equity holders' which appears above the 'profit for the period'.

The following table combines the presentation of the 2005 year-end consolidated income statement with the revised format presented. It shows summary financial information for the year ended 31 December 2005 in the format presented in the consolidated income statement reported for the year-end 31 December 2005 and the reallocations of balances made between line items to derive the comparative consolidated income statement for the purposes of the 2006 consolidated financial statements. The table illustrates the differences in presentation by shading those areas which are not relevant to the accounting model being applied, for the purposes of this note, to each of the periods presented.

## 1. The Demutualisation of The Standard Life Assurance Company and the Company's Initial Public Offering

### (b) Presentation of the consolidated income statement *continued*

	2005 as reported in financial statements for the year ended 31 December 2005	Presentation changes	Transfer to unallocated divisible surplus	Increase in net assets attributable to minority interest	Income arising from associates and joint ventures	2005 comparatives reported
	£m	£m	£m	£m	£m	£m
Total net revenue	18,406	(18,307)			(99)	
Total expenses (including finance costs)	16,891	(16,891)				
<b>Result before tax</b>	1,515	(1,416)			(99)	
Tax expense	531	(531)				
Transfer to unallocated divisible surplus	901		(901)			
Increase in net assets attributable to minority interest	83			(83)		
<b>Balance on income statement</b>						
Total net revenue		18,307				18,307
Total expenses		16,891	901			17,792
Share of profits from associates and joint ventures					99	99
<b>Profit before tax</b>		1,416	(901)		99	614
Tax expense attributable to policyholders' returns		531				531
<b>Profit before tax attributable to equity holders</b>				83		83
Total tax expense		531				531
Less tax expense attributable to policyholders' returns		(531)				(531)
Tax expense attributable to equity holders' profits						
<b>Profit for the year</b>						83

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## **2. Segmental analysis**

### **Primary reporting format – business segments**

The Group is managed and organised into five (2005 four) reportable business segments

#### **Life and pensions**

Life and pensions offers a broad range of pension, protection, savings and investment products to individual and corporate customers. Within these product classes are executive and group pension products, pooled pension funds and income protection products.

#### **Healthcare and general insurance**

Healthcare and general insurance primarily provides insurance cover to customers for medical expenses, accident and sickness.

#### **Investment management**

Investment management provides a range of investment products for individuals and institutional customers through a number of different investment vehicles such as mutual funds, limited partnerships and investment trusts. Asset classes offered via these vehicles include equities, bonds, cash and property. Segregated investment mandates are also provided to large investors. Additionally, Investment management services are provided to other business segments.

#### **Banking**

Banking offers a range of retail mortgage and deposit products via on line and telephone operations.

#### **Other**

Other comprises the Group corporate centre and shared service centre in 2006. Prior to 10 July 2006, these costs were borne by the life and pensions segment.

**2. Segmental analysis** *continued***(i) Segmental income statement**

12 months to 31 December 2006	Life and pensions £m	Healthcare and general insurance £m	Investment management £m	Banking £m	Other £m	Elimination £m	Total £m
<b>Revenue from external customers</b>							
Net earned premium	3,714	249					3,963
Net investment return	10,065	1	8	693	12		10,779
Other segment income	462	2	120	11	12		607
<b>Total revenue from external customers</b>	<b>14,241</b>	<b>252</b>	<b>128</b>	<b>704</b>	<b>24</b>		<b>15,349</b>
Inter segment revenue	11		122	1	610	(744)	
<b>Total segment revenue</b>	<b>14,252</b>	<b>252</b>	<b>250</b>	<b>705</b>	<b>634</b>	<b>(744)</b>	<b>15,349</b>
<b>Expenses</b>							
Segment expenses	13,515	258	207	629	675	(742)	14,542
Finance costs	98			18		(2)	114
<b>Total segment expenses</b>	<b>13,613</b>	<b>258</b>	<b>207</b>	<b>647</b>	<b>675</b>	<b>(744)</b>	<b>14,656</b>
Share of profits from associates and joint ventures	104	7	4		2		117
<b>Segment result for the year</b>	<b>743</b>	<b>1</b>	<b>47</b>	<b>58</b>	<b>(39)</b>		<b>810</b>
Tax expense attributable to policyholders' returns							357
Tax expense attributable to equity holders' profits							58
<b>Profit for the year</b>							<b>395</b>
<b>Other items included in the income statement are</b>							
Impairment losses recognised	2	8		6			16
Impairment losses reversed	(11)						(11)
Amortisation of intangible assets	6						6
Amortisation of deferred acquisition costs	50	31	2				83
Depreciation of property, plant and equipment	3				12		15

The consolidated income statement presentation has been revised as described in the Group accounting policies basis of preparation and Note 1(b). An impact of the revisions is that the amounts included in 'Transfer to unallocated divisible surplus' for the period from 1 January to 10 July 2006 and for the year ended 31 December 2005 are reported in 'Change in unallocated divisible surplus' within 'Total expenses' and are therefore included in 'Segment expenses'. For the period from 1 January to 10 July 2006 and for the year ended 31 December 2005, 'Increase in net assets attributable to minority interest' was included below the 'Result before tax' and in the revised income statement presentation, these are reported in 'Profit before tax attributable to equity holders' which appears above the 'Profit for the year'.

There are legal restrictions surrounding the holding of shares by occupational pension scheme trustees. Therefore, on demutualisation of The Standard Life Assurance Company, the shares to which the occupational pension scheme members were entitled were sold as part of the Institutional Offer. The cash raised on the sale of the shares was subsequently remitted to the Group and used to enhance benefits under the policies. £224m is included in the net earned premium in respect of the proceeds raised from the sale of these shares.

Note 1 describes the establishment of the Heritage With Profits Fund (HWPF) as part of the demutualisation transaction on 10 July 2006. The Scheme provides that certain recourse cash flows arising in the HWPF on specified blocks of UK and Irish business may be transferred out of that fund and thus accrue to the ultimate benefit of equity holders in the Company. Under the Scheme such transfers are subject to constraints to protect policyholders. If the recourse cash flows result in a negative amount, then the Shareholder Fund will make a transfer to the HWPF of at least the negative amount. The Scheme also provides for additional expenses to be charged by the Proprietary Business Fund to the HWPF in respect of German branch business.

As explained in accounting policy (v) the expected future value of the recourse cash flows on UK and Irish unitised with profits contracts is recognised as a reduction in the measurement of participating contract liabilities or in the unallocated divisible surplus. As these recourse cash flows arise they are no longer included in the measurement of participating contract liabilities or the unallocated divisible surplus and thus contribute to equity holder profit.

As explained in accounting policy (v) the expected future value of the recourse cash flows on UK and Irish non participating contracts is not recognised either in the measurement of non participating liabilities or in the unallocated divisible surplus. For regulatory reporting purposes the realistic valuation includes an adjustment to reflect the expected future value of cash flows due to equity holders. This adjustment is excluded from the IFRS valuation. As these recourse cash flows arise they contribute to equity holder profit.

As explained in accounting policy (v) the expected future value of the additional expenses to be charged on German unitised with profits contracts is recognised as a liability within the unallocated divisible surplus. As these additional expenses are charged they are no longer included in the measurement of the unallocated divisible surplus and thus contribute to equity holder profit.

In the period from 10 July to 31 December 2006 the recourse cash flows resulted in a positive amount, the transfer of which out of the HWPF was not subject to any constraint.

From 10 July 2006 new UK business is written in the Proprietary Business Fund and equity holder profits are recognised on an earned basis. Any with profits element is transferred to the appropriate with profits fund.

The life and pensions segment result comprises the following:

	2006
	£m
Recourse cash flows arising on UK and Irish unitised with profits contracts	116
Recourse cash flows arising on UK and Irish non participating contracts	42
Additional expenses charged on German unitised with profits contracts	51
Transfer out of HWPF	209
Profits arising from life and pension business held outside the HWPF	362
Profit before tax in the period 10 July to 31 December 2006	571
Result attributable to period 1 January to 10 July 2006	172
<b>Life and pension segment result for the year</b>	<b>743</b>

Profits arising from life and pensions business held outside the HWPF are shown before deduction of tax attributable to policyholders' returns. Further details of the results of the life and pensions segment for the period from 10 July to 31 December 2006 are shown in the pro forma reconciliation of Group underlying profit to profit for the period, providing an analysis of underlying profit before tax attributable to equity holders.

**2. Segmental analysis****(i) Segmental income statement continued**

12 months to 31 December 2005	Life and pensions £m	Healthcare and general insurance £m	Investment management £m	Banking £m	Elimination £m	Total £m
<b>Revenue from external customers</b>						
Net earned premium	3,308	208				3,516
Net investment return	13,761	1	5	610		14,377
Other segment income	318	1	87	8		414
<b>Total revenue from external customers</b>	<b>17,387</b>	<b>210</b>	<b>92</b>	<b>618</b>		<b>18,307</b>
Inter segment revenue	33		102	2	(137)	
<b>Total segment revenue</b>	<b>17,420</b>	<b>210</b>	<b>194</b>	<b>620</b>	<b>(137)</b>	<b>18,307</b>
<b>Expenses</b>						
Segment expenses	16,814	214	181	603	(129)	17,683
Finance costs	100		1	16	(8)	109
<b>Total segment expenses</b>	<b>16,914</b>	<b>214</b>	<b>182</b>	<b>619</b>	<b>(137)</b>	<b>17,792</b>
Share of profits from associates and joint ventures	92	5	2			99
<b>Segment result for the year</b>	<b>598</b>	<b>1</b>	<b>14</b>	<b>1</b>		<b>614</b>
Tax expense attributable to policyholders' returns						531
<b>Profit for the year</b>						<b>83</b>
<b>Other items included in the income statement are</b>						
Impairment losses recognised	9			1		10
Impairment losses reversed	(8)					(8)
Amortisation of intangible assets	3			4		7
Amortisation of deferred acquisition costs	44	27	1			72
Depreciation of property, plant and equipment	17					17

(ii) Segmental balance sheet

At 31 December 2006	Life and pensions £m	Healthcare and general insurance £m	Investment management £m	Banking £m	Other £m	Elimination £m	Total £m
<b>Assets</b>							
Segment assets	116,490	179	457	12,116	454	(403)	129,293
Investments in associates and joint ventures	2,765	170	38		264		3,237
<b>Total segment assets</b>	<b>119,255</b>	<b>349</b>	<b>495</b>	<b>12,116</b>	<b>718</b>	<b>(403)</b>	<b>132,530</b>
Unallocated assets							61
<b>Total assets</b>							<b>132,591</b>
<b>Liabilities</b>							
Segment liabilities	116,449	197	348	11,745	187	(402)	128,524
<b>Total segment liabilities</b>	<b>116,449</b>	<b>197</b>	<b>348</b>	<b>11,745</b>	<b>187</b>	<b>(402)</b>	<b>128,524</b>
Unallocated liabilities							882
<b>Total liabilities</b>							<b>129,406</b>
Share capital and reserves							2,878
Minority interest							307
<b>Total equity and minority interest</b>							<b>3,185</b>
<b>Total equity and liabilities</b>							<b>132,591</b>
<b>Capital expenditure incurred during the year on</b>							
Intangible assets	9	25		2			36
Deferred acquisition costs	210	34	2				246
Property, plant and equipment	274	1			10	(4)	281

**2. Segmental analysis****(u) Segmental balance sheet** *continued*

At 31 December 2005	Life and pensions £m	Healthcare and general insurance £m	Investment management £m	Banking £m	Elimination £m	Total £m
<b>Assets</b>						
Segment assets	105,490	111	188	11,812	(116)	117,485
Investments in associates and joint ventures	2,470	117	21			2,608
<b>Total segment assets</b>	<b>107,960</b>	<b>228</b>	<b>209</b>	<b>11,812</b>	<b>(116)</b>	<b>120,093</b>
Unallocated assets						167
<b>Total assets</b>						<b>120,260</b>
<b>Liabilities</b>						
Segment liabilities	106,894	234	216	11,820	(122)	119,042
<b>Total segment liabilities</b>	<b>106,894</b>	<b>234</b>	<b>216</b>	<b>11,820</b>	<b>(122)</b>	<b>119,042</b>
Unallocated liabilities						878
<b>Total liabilities</b>						<b>119,920</b>
Minority interest						340
<b>Total liabilities and minority interest</b>						<b>120,260</b>
<b>Capital expenditure incurred during the year on</b>						
Intangible assets	20			4		24
Deferred acquisition costs	42	27	1			70
Property, plant and equipment	84					84

**(b) Secondary reporting format – geographical segments**

The geographical segments are the United Kingdom, Canada and International operations, which includes all other geographical regions

Revenues are allocated based on the country in which the contracts are issued, or products are sold. Total assets and capital expenditure are allocated based on where the contracts or products to which they relate are issued or sold

	Segment revenue from external customers £m	Segment assets £m	Capital expenditure on intangible assets, deferred acquisition costs and property, plant and equipment £m
<b>At 31 December 2006</b>			
United Kingdom	11,988	113,794	500
Canada	2,361	13,271	19
International	1,000	5,341	44
Unallocated items		185	
<b>Total</b>	<b>15,349</b>	<b>132,591</b>	<b>563</b>
<b>At 31 December 2005</b>			
United Kingdom	14,211	100,362	160
Canada	2,192	14,261	9
International	1,904	5,470	2
Unallocated items		167	7
<b>Total</b>	<b>18,307</b>	<b>120,260</b>	<b>178</b>

**3. Net investment return**

	2006	2005
	£m	£m
<b>(a) Financial instruments other than those at fair value through profit or loss</b>		
Cash and cash equivalents	203	126
Loans and receivables	703	710
Held to-maturity debt securities	2	9
Derivative financial instruments	26	2
Other	1	1
	<b>935</b>	<b>848</b>
<b>Impairment</b>		
Impairment losses recognised		(1)
	<b>935</b>	<b>847</b>
<b>(b) Net foreign exchange transaction gains/(losses)</b>	<b>17</b>	<b>(6)</b>
<b>(c) Gains/(losses) on financial assets at fair value through profit or loss</b>		
Equity securities and interests in pooled investment funds	7,515	8,865
Debt securities	736	3,240
Derivative financial instruments	(353)	(354)
Other		7
	<b>7,898</b>	<b>11,758</b>
<b>(d) Investment property</b>		
Rental income	638	587
Net fair value gains	1,313	1,166
Derivative financial instruments	(22)	25
	<b>1,929</b>	<b>1,778</b>
<b>Net investment return</b>	<b>10,779</b>	<b>14,377</b>

Included within interest income is £2m (2005 £1m) in respect of interest income accrued on impaired financial assets

Included in gains/(losses) on financial assets at fair value through profit or loss are dividends on equity securities for £1,437m (2005 £1,121m) and interest income on debt securities of £2,231m (2005 £2,021m)

#### 4. Fee and commission income

	2006	2005
	£m	£m
Fee income on investment contracts at fair value	366	248
Fee income from third party funds under management	121	88
Reinsurance commission income	2	2
Other fee and commission income	32	22
<b>Total fee and commission income</b>	<b>521</b>	<b>360</b>

#### 5. Other administrative expenses

	2006	2005
	£m	£m
Commission expenses	493	410
Interest expense on customer accounts related to banking activities and deposits by banks	206	205
Interest expense on debt securities issued and mortgage backed floating notes	334	324
Staff costs and other employee related costs	6	545
Operating lease rentals	3	2
Other corporate expenses	8	29
Other interest expense	18	17
Auditors' remuneration	7	17
Other administrative expenses	553	490
Impairment losses on loans and receivables	18	2
Depreciation of property, plant and equipment	16	17
Impairment losses on property, plant and equipment	16	9
Reversal of impairment on property, plant and equipment	16	(8)
Amortisation of intangible assets	12	7
Impairment losses on intangible assets	12	14
	<b>2,254</b>	<b>2,064</b>
Acquisition costs deferred during the year	13	(70)
Amortisation of deferred acquisition costs	13	72
<b>Total other administrative expenses</b>	<b>2,091</b>	<b>2,066</b>

**6. Staff costs and other employee related costs**

	Notes	2006 £m	2005 £m
<b>The aggregate remuneration payable in respect of employees was</b>			
Wages and salaries		479	440
Social security costs		47	39
Other pension costs	34		
Defined benefit schemes		54	63
Defined contribution schemes		6	3
Employee share-based payments	42	13	
<b>Total staff costs and other employee related costs</b>		<b>599</b>	<b>545</b>

	2006	2005
<b>The average number of staff employed by the Group during the year was</b>		
United Kingdom	8,040	8,324
Canada	2,150	2,352
International	670	644
<b>Total average number of staff employed</b>	<b>10,860</b>	<b>11,320</b>
Life and pensions	8,464	9,166
Healthcare and general insurance	966	671
Banking	725	795
Investment management	705	688
<b>Total average number of staff employed</b>	<b>10,860</b>	<b>11,320</b>

The information required to be disclosed under the Companies Act 1985 in respect of Directors' remuneration is provided in the Directors' Remuneration Report on pages 70 to 83

**7. Auditors' remuneration**

	2006 £m	2005 £m
Fees payable to the Group auditor for the audit of the Group financial statements	0.5	0.9
Fees payable to the Group's auditor for other services		
The audit of the Company's subsidiaries pursuant to legislation	6.6	2.8
Other services pursuant to legislation	4.4	4.3
Tax services		
Advisory services	1.4	2.2
Other services	1.4	6.9
<b>Total auditors' remuneration</b>	<b>14.3</b>	<b>17.1</b>

Fees in respect of non audit services and other services pursuant to legislation performed in the UK were £7.2m (2005 £13.4m), including £6.6m (2005 £12.7m) in respect of preparation for the demutualisation and the initial public offering

During the year, the Group incurred audit fees in respect of the UK staff pension scheme of £24,000 (2005 £10,000)

## 8. Restructuring and demutualisation expenses

Included within administrative expenses are restructuring and demutualisation expenses of £100m (2005 £84m), £80m (2005 £68m) of the expenses were incurred in association with work undertaken preparing for the demutualisation and flotation in 2006 and £13m (2005 £nil) relate to restructuring costs incurred by Standard Life Healthcare following its acquisition of the private medical insurance business of FirstAssist (see Note 44). The remaining costs were incurred as part of the implementation of the 2004 Strategic Review and relate mainly to redundancy costs and lease expiry costs.

Prior to demutualisation, SLAC incurred costs associated with the Initial Public Offering of the Company's shares. Under the Scheme these costs were transferred to the Heritage With Profits Fund (HWPF). At the time of the listing of its shares on the London Stock Exchange, costs amounting to £31m were recharged to the Company by the HWPF. Expenses directly related to the listing of the Company's shares have been charged to share premium resulting in a reduction to the overall cost of demutualisation shown in the income statement. In total, £53m of expenses incurred in 2006 that were attributable to the listing of the Company's shares on the London Stock Exchange have been set off against the share premium account (Note 24).

## 9. Tax expense

The income tax expense is attributed as follows

	Period 1 January 2006 to 10 July 2006	Period 10 July 2006 to 31 December 2006	2006	2005
	£m	£m	£m	£m
Income tax expense attributable to policyholders' returns	118	239	357	531
Income tax expense attributable to equity holders' profits		58	58	
	118	297	415	531

### (a) Current year tax expense

	Period 1 January 2006 to 10 July 2006	Period 10 July 2006 to 31 December 2006	2006	2005
	£m	£m	£m	£m
<b>Current tax</b>				
United Kingdom	90	129	219	373
Double tax relief		(5)	(5)	
Canada and international	31	22	53	54
Adjustment to tax expense in respect of prior years	(14)	1	(13)	(1)
<b>Total current tax</b>	107	147	254	426
<b>Deferred tax</b>				
Deferred tax expenses arising from the current period	11	150	161	105
<b>Total deferred tax</b>	11	150	161	105
<b>Total income tax expense</b>	118	297	415	531

Attributable to equity holders' profits

58

58

No unrecognised tax losses of previous years were used to reduce current and deferred tax expenses in the period (2005 £18m and £84m respectively).

Deferred tax has not been provided on retained earnings of overseas subsidiaries totalling £105m.

**9 Tax expense continued****(b) (i) Tax expensed to equity**

	Period 1 January 2006 to 10 July 2006	Period 10 July 2006 to 31 December 2006	2006	2005
	£m	£m	£m	£m
Deferred tax		8	8	
Aggregate tax effect of items debited directly to equity		8	8	

**(b) (ii) Tax expense taken to unallocated divisible surplus**

	Period 1 January 2006 to 10 July 2006	Period 10 July 2006 to 31 December 2006	2006	2005
	£m	£m	£m	£m
Deferred tax relating to employee benefits and cash flow hedges	(4)		(4)	
Aggregate tax effect of items credited to the unallocated divisible surplus	(4)		(4)	

Refer to narrative in Note 30 which describes why amounts will no longer be taken to unallocated divisible surplus

**(c) Reconciliation of tax expense**

	Period 1 January 2006 to 10 July 2006	Period 10 July 2006 to 31 December 2006	2006	2005
	£m	£m	£m	£m
Profit before tax	170	640	810	614
Change in unallocated divisible surplus	391		391	901
	561	640	1,201	1,515
Tax at 30%	168	192	360	455
Policyholder tax (net of tax at UK standard rate)		167	167	
Differences in tax base for life assurance business	47		47	270
Permanent differences	(82)	(15)	(97)	(72)
Temporary timing differences		3	3	
Non taxable transfer to equity holders		(51)	(51)	
Different tax rates	13	6	19	(13)
Adjustment to current tax expense in respect of prior years	(14)	1	(13)	(1)
Recognition of previously unrecognised tax loss/(tax credit)	(8)		(8)	(102)
Deferred tax not recognised	(11)		(11)	(6)
Other	5	(6)	(1)	
<b>Total tax expense for the year</b>	<b>118</b>	<b>297</b>	<b>415</b>	<b>531</b>

The consolidated income statement presentation has been revised as described in the Group accounting policies basis of preparation and Note 1(b). In accordance with these revisions, the profit before tax has been adjusted for the change in unallocated divisible surplus for the period from 1 January to 10 July 2006 and for the year ended 31 December 2005.

## 10. Earnings per share

### (a) Basic earnings per share

Basic earnings per share is calculated by dividing profit attributable to ordinary equity holders of the Company by the weighted average number of ordinary shares outstanding during the year. The weighted average number of ordinary shares outstanding during the year is the weighted average number of shares in issue less the weighted average number of shares owned by employee share trusts that have not vested unconditionally in employees.

	Period 10 July 2006 to 31 December 2006
Profit attributable to equity holders of Standard Life plc (£m)	283
Weighted average number of ordinary shares in issue (millions)	2,102
<b>Basic earnings per share (pence per share)</b>	<b>13.5</b>

### (b) Diluted earnings per share

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. The Group has two categories of dilutive potential ordinary shares – bonus shares committed to at the time of the demutualisation of SLAC and flotation of the Company and share awards and share options.

As part of the offer on the flotation of the Company, holders of demutualisation shares, employee shares or shares acquired in the preferential offer who hold such shares for a continuous period of one year, will be eligible to receive, at the end of that one year period, one bonus share for every twenty shares retained. The expected number of bonus shares to be issued is based on the number of shares that, at 31 December 2006, still meet the continuous holding requirement.

For share options, a calculation is made to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated is compared with the number of shares that would have been issued assuming the exercise of the share options. Further details on the share awards and share options are set out in Note 42.

	Period 10 July 2006 to 31 December 2006
Profit attributable to equity holders of Standard Life plc (£m)	283
Weighted average number of ordinary shares for diluted earnings per share (millions)	2,173
<b>Diluted earnings per share (pence per share)</b>	<b>13.0</b>

The dilutive effect of the bonus shares included in the weighted average number of ordinary shares above was 69m.

The dilutive effect of share awards and options included in the weighted average number of ordinary shares above was 2m. The effect of these dilutive potential ordinary shares did not impact the profit attributable to equity holders of the Company.

### (c) Alternative earnings per share

Earnings per share is also calculated based on the underlying profit before tax and certain non operating items as well as on the profit attributable to equity holders of the Company. The Directors believe that earnings per share based on underlying profit provides a better indication of operating performance.

**(c) Alternative earnings per share** *continued*

	Period 10 July 2006 to 31 December 2006	Period 10 July 2006 to 31 December 2006
	£m	Per share p
<b>Underlying profit before tax attributable to equity holders</b>	<b>350</b>	<b>16.7</b>
Volatility arising on different asset and liability valuation bases	68	3.2
Impairment of intangibles	(5)	(0.2)
Restructuring expenses	(12)	(0.6)
<b>Profit before tax attributable to equity holders</b>	<b>401</b>	<b>19.1</b>
Tax attributable to		
Underlying profit	(39)	(1.8)
Adjusted items	(19)	(0.9)
Profit attributable to minority interest	(60)	(2.9)
<b>Profit attributable to equity holders of Standard Life plc</b>	<b>283</b>	<b>13.5</b>

**11. Dividends**

Subsequent to 31 December 2006, the Directors have proposed a dividend for the period from 10 July 2006 to 31 December 2006 of 5.4p per share, an estimated £114m in total. The dividend will be paid on 31 May 2007, subject to approval at the Annual General Meeting on 29 May 2007. This dividend will be recorded as an appropriation of retained earnings in the financial statements for the year ended 31 December 2007.

**12. Intangible assets**

	Notes	Software development costs £m	Goodwill £m	Total £m
<b>Gross amount</b>				
At 1 January 2005		51		51
Additions – internal development		24		24
At 31 December 2005		75		75
Additions – internal development		12		12
Additions – acquisitions	44		24	24
Impairment	5	(30)	(8)	(38)
<b>At 31 December 2006</b>		<b>57</b>	<b>16</b>	<b>73</b>
<b>Accumulated amortisation</b>				
At 1 January 2005		(24)		(24)
Amortisation charge for the year	5	(7)		(7)
At 31 December 2005		(31)		(31)
Amortisation charge for the year	5	(6)		(6)
Impairment charge	5	24		24
<b>At 31 December 2006</b>		<b>(13)</b>		<b>(13)</b>
<b>Carrying amount</b>				
At 31 December 2005		44		44
At 31 December 2006		44	16	60

### 13. Deferred acquisition costs

	Notes	2006 £m	2005 £m
<b>At 1 January</b>			
Cost		692	636
Accumulated amortisation and impairment		(402)	(367)
<b>Opening net book amount</b>		<b>290</b>	<b>269</b>
Exchange differences		(8)	6
Costs deferred	5	246	70
Amortisation charge	5	(83)	(72)
Other			17
<b>Closing net book amount</b>		<b>445</b>	<b>290</b>
<b>At 31 December</b>			
Cost		930	692
Accumulated amortisation and impairment		(485)	(402)
<b>Closing net book amount</b>		<b>445</b>	<b>290</b>

The amount of deferred acquisition costs expected to be recovered after more than twelve months is £365m (2005 £244m) Included in deferred acquisition costs above are costs deferred on investment contracts (known as deferred origination costs) amounting to £389m (2005 £278m)

Insurance and investment contracts sold by The Standard Life Assurance Company prior to demutualisation were written in its with profits fund Acquisition costs for participating contracts were not deferred explicitly as they were taken into account in the measurement of the liabilities for these contracts Acquisition costs for non participating insurance contracts were not deferred explicitly as they were taken into account in the measurement of the present value of future profits for non participating contracts For the same reason acquisition costs on non participating investment contracts were not deferred explicitly except to the extent of any deferred income recognised on these contracts

Following demutualisation the Group's new insurance and investment contracts are written in proprietary business funds Acquisition costs are explicitly deferred on these contracts in line with accounting policy (k) since they are not taken into account in the measurement of the contract liabilities and the present value of future profits on non participating contracts is not separately recognised

**14. Investments in associates and joint ventures**

	2006	2005
	£m	£m
<b>At 1 January</b>	<b>2,608</b>	<b>1,891</b>
Share of profits from associates and joint ventures	117	99
Net increase in investment vehicle holdings	616	648
Additions on assuming significant influence/joint control	9	48
Cessation of significant influence/joint control or disposal of interest held	(9)	
Exchange differences	(20)	
Dividends received	(90)	(90)
Other	6	12
<b>At 31 December</b>	<b>3,237</b>	<b>2,608</b>

Share of profits from associates and joint ventures includes £108m (2005 £90m) arising from associates accounted for at fair value through profit and loss in accordance with IAS 39 *Financial Instruments Recognition and Measurement*

Net increase in investment vehicle holdings relates to the purchase and sale of units in Standard Life Investments (Global Liquidity Funds) plc. The majority of additions and disposals relate to the purchase and sale of non principal associates and joint ventures

**(a) Investments in associates**

The following are particulars of the Group's share of significant associates, all of which are held at fair value

Name of associates	Country of incorporation or registration	% interest held	Year end	Nature of business	Assets	Liabilities	Revenues	Profit / (Loss)
					£m	£m	£m	£m
<b>At 31 December 2006</b>								
Standard Life Investments (Global Liquidity Funds) plc	Ireland	36.0	15 Nov	OEIC	3,137	72	105	103
<b>At 31 December 2005</b>								
Standard Life Investments (Global Liquidity Funds) plc	Ireland	44.0	15 Nov	OEIC	2,475	59	92	90

The Group also owns certain investments where its holding exceeds 20% of the equity instruments of the investees without having significant influence over their financial and operating policies. Certain investments held by mutual funds, unit trusts and unit linked insurance funds are therefore not treated as associates and are recorded in Investment Securities. Their operations are not significant in relation to the financial statements of the Group.

## (b) Investments in joint ventures

The following are particulars of the Group's significant joint ventures, all of which are unlisted

Name of joint ventures	Country of incorporation or registration	% interest held	Current assets £m	Long term assets £m	Current liabilities £m	Long term liabilities £m	Income £m	Expenses £m
<b>At 31 December 2006</b>								
Castan Waterfront Development Inc	Canada	50.0		16	1			11
First Real Properties	Canada	49.0	9	52	7	13	10	3
HDFC Asset Management Company Limited	India	49.9	9	18	5	1	5	3
HDFC Standard Life Insurance Company Limited	India	17.4	7	82	5	77	64	66
Heng An Standard Life Insurance Company Limited	China	50.0	20	51	1	31	20	24
<b>At 31 December 2005</b>								
Castan Waterfront Development Inc	Canada	50.0		31	1		2	4
First Real Properties	Canada	49.0	5	48	7	14	15	5
HDFC Asset Management Company Limited*	India	49.9	3	20	3		6	4
HDFC Standard Life Insurance Company Limited*	India	14.8	2	37	2	31		2
Heng An Standard Life Insurance Company Limited	China	50.0		65	1	18	9	10

\* In 2005 the Group also had a 9.4% interest in Housing Development Finances Corporation Limited (HDFC Limited). HDFC Limited owned 79.4% and 50.1% of HDFC Standard Life Insurance Company Limited and HDFC Asset Management Company Limited respectively. This gave the Group an effective interest in these entities of 22.2% and 54.6% respectively. The Group did not exercise significant influence over these joint ventures in 2005.

## 15. Investment property

	Notes	2006 £m	2005 £m
<b>At 1 January</b>			
Additions – acquisitions		525	416
Additions – subsequent expenditure		206	147
Transfers (to)/from property, plant and equipment	16	(33)	209
Net fair value gain/(loss)		1,289	953
Disposals		(446)	(622)
Foreign exchange adjustment		(105)	54
Other		(5)	(29)
<b>At 31 December</b>		<b>11,338</b>	<b>9,907</b>
The fair value of investment property can be analysed as			
Freehold		8,896	7,857
Long leasehold		2,363	1,976
Short leasehold		79	74
		<b>11,338</b>	<b>9,907</b>

The rental income arising from investment properties during the year amounted to £638m (2005: £587m), which is included in net investment return. Direct operating expenses (included in other administrative expenses in Note 5) arising in respect of such properties during the year amounted to £129m (2005: £125m).

**16. Property, plant and equipment**

	Notes	Land and buildings £m	Equipment £m	Total £m
<b>Cost or valuation</b>				
At 1 January 2005		667	190	857
Additions		75	9	84
Disposals		(11)	(7)	(18)
Transfers (to)/from investment property	15	(209)		(209)
Revaluations		11		11
Disposal of a subsidiary			(2)	(2)
Impairment losses (recognised)/reversed*	5	(1)		(1)
Foreign exchange adjustment		2	6	8
Revaluation of property held by linked funds		33		33
<b>At 31 December 2005</b>		<b>567</b>	<b>196</b>	<b>763</b>
Additions		268	13	281
Disposals		(3)	(33)	(36)
Transfers from/(to) investment property	15	33		33
Revaluations	26, 30	66		66
Impairment losses (recognised)/reversed*	5	11		11
Foreign exchange adjustment		(2)	(4)	(6)
Revaluation of property held by linked funds		107		107
<b>At 31 December 2006</b>		<b>1,047</b>	<b>172</b>	<b>1,219</b>
<b>Accumulated depreciation</b>				
At 1 January 2005			(158)	(158)
Depreciation charge for the year	5		(17)	(17)
Disposals			7	7
Disposal of a subsidiary			1	1
Foreign exchange adjustment			(6)	(6)
<b>At 31 December 2005</b>			<b>(173)</b>	<b>(173)</b>
Depreciation charge for the year	5		(15)	(15)
Disposals			33	33
Foreign exchange adjustment			3	3
<b>At 31 December 2006</b>			<b>(152)</b>	<b>(152)</b>
<b>Carrying amount</b>				
At 31 December 2005		567	23	590
At 31 December 2006		1,047	20	1,067

\* Impairment losses (recognised)/reversed in the income statement were £11m (2005 £(1)m) (refer to Note 5). The reversal of impairment of £11m in 2006 arose due to changes in the lease agreements of a number of properties. In 2005 the impairment losses arose due to reductions in the market value of a number of properties below original deemed cost, offset by the reversal of such reductions on properties in previous years.

Land and buildings consists of property occupied by the Group and property that is being constructed or developed for future use as investment property. The value of property that is being constructed or developed for future use as investment property at 31 December 2006 was £711m (2005 £286m).

If land and buildings were measured using the cost model, the carrying amounts would be £820m (2005 £487m). Where the expected residual value of owner occupied property is in line with the current fair value, no depreciation is charged. Equipment primarily consists of computer equipment.

## 17 Tax assets and liabilities

	Notes	2006 £m	2005 £m
Current tax recoverable	21	45	12
Deferred tax assets		17	75
<b>Total tax assets</b>		<b>62</b>	<b>87</b>
Current tax liabilities		268	240
Deferred tax liabilities		615	559
<b>Total tax liabilities</b>		<b>883</b>	<b>799</b>

There are no current tax assets and liabilities recoverable or payable in more than one year (2005 nil and nil). All deferred tax assets and liabilities are recoverable or payable after more than one year.

### (a) Recognised deferred tax

	2006 £m	2005 £m
<b>Deferred tax assets comprise</b>		
Actuarial liabilities	184	281
Losses carried forward	18	98
Depreciable assets	34	22
Deferred income	11	
Employee benefits	47	38
Insurance related items	101	93
Subordinated debt valuation differences	7	
Other	4	23
<b>Gross deferred tax assets</b>	<b>406</b>	<b>555</b>
Less: offset against deferred tax liabilities	(389)	(480)
<b>Net deferred tax assets</b>	<b>17</b>	<b>75</b>
<b>Deferred tax liabilities comprise</b>		
Insurance related items	14	
Unrealised gains on investment securities	837	896
Deferred acquisition costs	86	32
Deferred gains on realisation	57	90
Subordinated debt valuation differences	5	
Temporary timing differences	3	
Other	2	21
<b>Gross deferred tax liabilities</b>	<b>1,004</b>	<b>1,039</b>
Less: offset against deferred tax assets	(389)	(480)
<b>Net deferred tax liabilities</b>	<b>615</b>	<b>559</b>
<b>Movements in deferred tax assets/(liabilities) comprise</b>		
At 1 January	(484)	(385)
Disposal of subsidiaries	21	
Change in tax basis arising on demutualisation	31	
Amounts (charged)/credited to net profit	(161)	(105)
Amounts (charged)/credited directly to equity	(8)	
Amounts (charged)/credited to unallocated divisible surplus	4	
Exchange differences	(1)	6
<b>At 31 December</b>	<b>(598)</b>	<b>(484)</b>

## 17. Tax assets and liabilities

### (a) Recognised deferred tax continued

A deferred tax asset of £18m (2005 £98m) has been recognised in respect of the amount of losses of Standard Life Healthcare Limited and Canadian subsidiaries. Deferred tax assets are recognised in respect of tax losses carried forward to the extent that it is probable that the losses will be capable of being offset against taxable profits in future periods. The value attributed to them takes into account the certainty or otherwise of their recoverability. Their recoverability is measured against anticipated taxable profits. The losses in Canada will expire between 2007 and 2015. The remaining losses have no expiry date.

### (b) Unrecognised deferred tax

Due to uncertainty regarding recoverability, deferred tax has not been recognised in respect of the following assets/(liabilities)

- Cumulative losses carried forward of £29m (2005 £188m) of the Canadian business
- Intangible asset of the German branch of Standard Life Assurance Limited of £166m (2005 £nil)
- Other unrecognised temporary differences of £15m (2005 £nil) of the Canadian business

## 18. Loans and receivables

The loans and receivables relating to the Group at year-end were as follows

	2006	2005
	£m	£m
<b>Loans and receivables comprise</b>		
Loans secured by mortgages	11,877	12,301
Loans secured on policies	109	129
Other	37	67
<b>Gross loans and receivables</b>	<b>12,023</b>	<b>12,497</b>
Less: Allowance for impairment losses	(2)	(1)
<b>Net loans and receivables</b>	<b>12,021</b>	<b>12,496</b>

Loans and receivables with variable interest rates and fixed interest rates are £6,221m and £5,782m respectively (2005 £7,637m and £4,852m)

Included in loans secured by mortgages are mortgages subject to securitisations of £5,525m (2005 £4,968m)

Impairment losses of £2m (2005 £1m) have been recorded in Other administrative expenses in Note 5

Loans and receivables that are expected to be recovered after more than 12 months are £10,939m (2005 £11,617m)

## 19. Derivative financial instruments

The Group's insurance business uses derivative financial instruments in order to match contractual liabilities, to reduce the risk from potential movements in foreign exchange rates, equity indices, property indices and interest rates, or to achieve efficient portfolio management

The Group's banking business uses derivative financial instruments in order to match or reduce the risk from potential movements in foreign exchange rates, equity indices and interest rates inherent in the banking book or to reduce credit risk

The Group designates certain derivative financial instruments as cash flow hedges and fair value hedges to mitigate risk, as detailed below. Derivative financial instruments that are not designated part of a hedge relationship are held for trading.

	2006			2005		
	Contract amount	Fair value assets	Fair value liabilities	Contract amount	Fair value assets	Fair value liabilities
	£m	£m	£m	£m	£m	£m
Cash flow hedges	2,472	16	14	1,368	10	5
Fair value hedges	2,349		155	4,357	24	98
Held for trading	24,570	317	263	19,401	213	138
<b>Total derivative financial instruments</b>	<b>29,391</b>	<b>333</b>	<b>432</b>	<b>25,126</b>	<b>247</b>	<b>241</b>

Derivative assets of £249m (2005: £201m) are expected to be recovered after more than 12 months. Derivative liabilities of £362m (2005: £145m) are expected to be settled after more than 12 months.

### (a) Cash flow hedges

The Group designates as cash flow hedges those currency forwards and currency swaps used to reduce the exposure to variability in cash flows arising from the foreign exchange risk associated with foreign currency borrowings. The Group also designates as cash flow hedges those interest rate swaps used to reduce the exposure to variability in cash flows arising from the interest rate risk associated with floating rate borrowings.

	2006			2005		
	Contract amount	Fair value assets	Fair value liabilities	Contract amount	Fair value assets	Fair value liabilities
	£m	£m	£m	£m	£m	£m
<b>Foreign exchange derivatives</b>						
Forwards	1,071	1	14	918	10	1
<b>Interest rate derivatives</b>						
Interest rate swaps	1,401	15		450		4
<b>Total cash flow hedges</b>	<b>2,472</b>	<b>16</b>	<b>14</b>	<b>1,368</b>	<b>10</b>	<b>5</b>

**19. Derivative financial instruments** *continued***(b) Fair value hedges**

The Group designates as fair value hedges those interest rate swaps used to hedge changes in the fair value of the Group's fixed rate mortgage book arising from interest rate risk and those currency swaps used to hedge changes in the fair value of foreign currency borrowings arising from exchange rate risk

	2006			2005		
	Contract amount	Fair value assets	Fair value liabilities	Contract amount	Fair value assets	Fair value liabilities
	£m	£m	£m	£m	£m	£m
<b>Foreign exchange derivatives</b>						
Cross currency swaps	2,084		144	2,079	21	83
<b>Interest rate derivatives</b>						
Interest rate swaps	265		11	2,278	3	15
<b>Total fair value hedges</b>	<b>2,349</b>		<b>155</b>	<b>4,357</b>	<b>24</b>	<b>98</b>

**(c) Held for trading**

Derivative financial instruments classified as held for trading include those that the Group holds as economic hedges of financial instruments that are measured at fair value. Held for trading derivative financial instruments are also held by the Group to match contractual liabilities that are measured at fair value or to achieve efficient portfolio management in respect of instruments measured at fair value

	2006			2005		
	Contract amount	Fair value assets	Fair value liabilities	Contract amount	Fair value assets	Fair value liabilities
	£m	£m	£m	£m	£m	£m
<b>Equity derivatives</b>						
Equity swaps	4	1		4		
Futures	951		9	2,796	5	35
Options	2,324	122		1,800	54	4
<b>Interest rate derivatives</b>						
Interest rate swaps	16,117	92	185	7,982	41	28
Forward rate agreements				60		
Futures	887	1	16	1,202	8	3
Options	352	14		541	35	
<b>Foreign exchange derivatives</b>						
Cross currency swaps	512	35		533	54	1
Forwards	3,027	52	8	4,025	16	53
Futures				28		
Options	2			247		
<b>Other derivatives</b>						
Property index swaps	394		45	126		12
Property index forwards				49		2
Credit default swaps				8		
<b>Total derivative financial instruments held for trading</b>	<b>24,570</b>	<b>317</b>	<b>263</b>	<b>19,401</b>	<b>213</b>	<b>138</b>

## 20. Investment securities

	2006	2005
	£m	£m
Equity securities and interests in pooled investment funds		
Listed	49,168	42,747
Unlisted	1,016	854
<b>Equity securities and interests in pooled investment funds</b>	<b>50,184</b>	<b>43,601</b>
Debt securities		
At fair value through profit and loss		
Listed	40,865	37,366
Unlisted	6,124	6,386
	46,989	43,752
Held to-maturity debt securities		
Listed	51	78
<b>Debt securities</b>	<b>47,040</b>	<b>43,830</b>
<b>Total investment securities</b>	<b>97,224</b>	<b>87,431</b>

Held to maturity debt securities include UK treasury bills, eligible bills and gilts held by Standard Life Bank for regulatory purposes which are measured at amortised cost

Of the total unlisted bonds of £6,124m (2005 £6,386m), £5,617m (2005 £5,905m), relates to Canadian bonds, which are categorised as unlisted because there is no regulated stock exchange for bonds in Canada, however these securities are actively traded

The amount of debt securities expected to be recovered after more than 12 months is £41,300m (2005 £41,918m) Due to the nature of equity securities and interests in pooled investment funds, there is no fixed term associated with these securities

## 21 Other assets

	2006	2005
	£m	£m
Amounts receivable on direct insurance business	139	108
Amounts receivable on reinsurance contracts	1	4
Outstanding sales of investment securities	484	111
Current tax recoverable	45	12
Prepayments	17	24
Accrued income	762	710
Cancellations of units awaiting settlement	227	35
Other	472	338
<b>Total other assets</b>	<b>2,147</b>	<b>1,342</b>

The carrying amounts disclosed above reasonably approximate the fair values as at the year-end

The amount of other assets expected to be recovered after more than 12 months is £32m (2005 £12m)

## 22. Cash and cash equivalents

	2006	2005
	£m	£m
Cash at bank and in hand	368	320
Balance with central bank	190	7
Money at call and short notice	874	742
Demand and term deposits with original maturity of less than 3 months	1,456	1,808
Debt investments with original maturity of less than 3 months	1,074	1,574
<b>Total cash and cash equivalents</b>	<b>3,962</b>	<b>4,451</b>

	Notes	2006	2005
		£m	£m
Cash and cash equivalents		3,962	4,451
Bank overdrafts	32	(242)	(105)
<b>Total cash and cash equivalents for cash flow</b>		<b>3,720</b>	<b>4,346</b>

Balances with central banks include mandatory reserve deposits of £7m (2005 £7m), which are not available for use in the Group's day to-day operations

Cash at bank and in hand, balances with the central bank and mandatory reserve deposits are non interest bearing. Money at call and short notice and deposits are subject to variable interest rate

## 23. Share capital

### (a) Authorised share capital

At 31 December 2005 the authorised share capital of the Company was 1,000 £1 ordinary shares

On 10 May 2006 the Company amended its authorised share capital into 10,000 ordinary shares of £0.10 each and 50,000 £1 redeemable preference shares. A further amendment was made to the authorised share capital on 30 May 2006. This revised the authorised ordinary share capital to 3,000,000,000 ordinary shares of £0.10 each and 50,000 £1 redeemable preference shares.

The authorised share capital of the Company at 31 December 2006 was

	Number	£m
Ordinary shares of £0.10 each	3,000,000,000	300
Redeemable preference shares of £1 each	50,000	

### (b) Issued share capital

At 31 December 2005 the Company had allotted and issued share capital of 2 £1 ordinary shares

On 10 May 2006, each of the 2 issued ordinary shares were subdivided into 10 £0.10 ordinary shares. An additional 10 ordinary shares of £0.10 each were issued on the same date at par for cash. During the year, a further 2,106,070,439 £0.10 ordinary shares were allotted and issued by the Company as follows:

	Number	£m
<b>At 10 May 2006</b>	<b>30</b>	
Demutualisation shares	1,463,516,990	146
Shares issued for cash on Initial Public Offering	556,944,945	56
Shares issued in respect of the over allotment provision	83,541,742	8
Shares issued in respect of employee share compensation plans	2,066,762	
<b>Total allotted and fully paid ordinary shares of £0.10 each</b>	<b>2,106,070,469</b>	<b>210</b>

As detailed in Note 1, on 10 July 2006 The Standard Life Assurance Company demutualised 1,463,516,990 demutualisation shares were issued by the Company to eligible members of The Standard Life Assurance Company to compensate them for the loss of their membership rights. A further 556,944,945 shares were issued on 10 July 2006, raising £1,224m of new capital before transaction costs. An over allotment provision was granted to Merrill Lynch International to subscribe for additional ordinary shares at the original offer price. It was exercised on 19 July 2006 with a further 83,541,742 shares issued on that date, raising £192m before transaction costs.

All ordinary shares in issue in the Company rank *pari passu* and carry the same voting rights and rights to receive dividends and other distributions declared or paid by the Company.

On 10 May 2006 the Company issued 50,000 £1 redeemable preference shares at par for cash to meet the share capital requirements of a public limited company. The preference shares were redeemable on 31 August 2007, but the Company had the option to redeem the shares prior to this date at its own discretion. The Company exercised this right on 13 July 2006. The preference shareholders were entitled to a dividend of 1% on the nominal value of the shares. However, the preference shareholders waived their right to this dividend.

## 24. Share premium reserve

The premium arising on the shares issued during the year was

	Notes	2006 £m
<b>At 1 January</b>		
Shares issued for cash on Initial Public Offering		1,168
Shares issued in respect of the over allotment provision		184
Share premium reduction	26	(500)
Transaction costs directly attributable to the issue of shares		(53)
<b>At 31 December</b>		<b>799</b>

In 2005, the Company had not issued any ordinary shares at a premium and, therefore, there was no share premium reserve.

## 25 Retained earnings

	Notes	2006 £m
<b>At 1 January</b>		
Profit for the period attributable to equity holders		283
Retained earnings arising at demutualisation	1	17
Transfer from equity compensation reserve for vested employee share based payments	26	4
Actuarial gains/(losses) on defined benefit pension schemes	34	(2)
Aggregated tax items recognised in equity	9	(4)
<b>At 31 December</b>		<b>298</b>

Prior to demutualisation, the parent company of the Group was a mutual insurer and the balance on the income statement was transferred to the unallocated divisible surplus, which was attributable to participating policyholders. Therefore, during the year ended 31 December 2005 and in the period from 1 January to 10 July 2006 the Group did not recognise any retained profits.

**26. Reconciliation of movements in other reserves**

	Notes	Revaluation of land and buildings £m	Cash flow hedges £m	Foreign currency translation £m	Merger reserve £m	Equity compensation reserve £m	Special reserve £m	Reserve arising on Group reconstruction £m	Total £m
<b>At 1 January 2006</b>									
Transfer to shareholders' funds at demutualisation		71	10	26					107
Fair value gains on cash flow hedges			5						5
Revaluation of land and buildings	16	22							22
Exchange differences on translating foreign operations				(113)					(113)
Merger relief on issue of demutualisation shares					3,214				3,214
Release of merger relief on demutualisation shares					(1,872)				(1,872)
Merger relief on ordinary shares acquired in operating subsidiaries following dividend in specie					1,872				1,872
Share premium reduction	24						500		500
Reserves credit for employee share based payment schemes						15			15
Transfer to retained earnings for vested employee share-based payments	25					(4)			(4)
Difference between the fair value and book value of the Group at demutualisation								(2,065)	(2,065)
With profits funds associated UDS movement not recognised in income statement prior to demutualisation	30	(71)	(10)	(26)					(107)
With profits funds associated UDS movement recognised in equity	30	(22)		23					1
Aggregate deferred tax items recognised in equity	9		(4)						(4)
<b>At 31 December 2006</b>			1	(90)	3,214	11	500	(2,065)	1,571
<b>Balance at 31 December 2006 comprises</b>									
Total reserve before with profits fund adjustment		93	11	(87)	3,214	11	500	(2,065)	1,677
Total with profits fund adjustment		(93)	(10)	(3)					(106)
<b>At 31 December 2006</b>			1	(90)	3,214	11	500	(2,065)	1,571

The 'with profits adjustment' represents the cumulative amounts transferred to the unallocated divisible surplus as they represent movements attributable to participating policyholders, which would otherwise have been included in other reserves

In 2005, reserves were recognised as part of the unallocated divisible surplus as the parent Company of the Group was a mutual insurer. Refer to Note 30 for further information

**Merger Reserve** On demutualisation of The Standard Life Assurance Company, the demutualisation shares issued by the Company qualified for merger relief under section 131 of the UK Companies Act 1985. Merger relief permits, where shares are issued at a premium, the difference arising between the issue value and nominal value of the shares issued to be transferred to a reserve other than the share premium account. The difference between the issue value and nominal value of the demutualisation shares was transferred to the merger reserve following the dividend in specie discussed in Note 1. £1,872m of merger reserves attached to the demutualisation shares was replaced with merger relief on the ordinary shares of the operating subsidiaries acquired by the Company.

**Reserve arising on Group reconstruction** On demutualisation of The Standard Life Assurance Company, the value of the demutualisation shares issued was equal to the fair value of the assets and liabilities of the Group. As detailed in Note 1, merger accounting principles have been applied to the demutualisation transaction and, therefore, all assets and liabilities were transferred at their book value at the time of demutualisation in the consolidated financial statements. The reserve arising on Group reconstruction represents the difference between the fair value and book value of the assets and liabilities of the Group at the time of demutualisation of The Standard Life Assurance Company on 10 July 2006.

**Special reserve** As detailed in Note 1, on 21 July 2006 the Court of Session confirmed a £500m reduction in the share premium account of the Company. Following the reduction, a Special Reserve was created for the same amount. The Special Reserve forms part of the Company's distributable profits for the purpose of section 263 of the Companies Act 1985.

## 27. Minority interest and third party interest in consolidated funds

The movement in minority interest during the year was

	2006	2005
	£m	£m
At 1 January	340	250
Transfer to third party interest in consolidated funds	(117)	
Exchange differences on translating foreign operations	(3)	(2)
Increase in net assets attributable to minority interest	112	83
Net contributions	(11)	(8)
Distributions	(13)	(4)
Other	(1)	21
<b>At 31 December</b>	<b>307</b>	<b>340</b>

In 2005, minority interest was recognised as part of total liabilities as the parent company of the Group was a mutual entity.

The movement in third party interest in consolidated funds during the year was

	2006	2005
	£m	£m
At 1 January	358	77
Transfer from minority interest	117	
Exchange differences on translating foreign operations	(14)	9
Change in liability for third party interest in consolidated funds	116	43
Net contributions	339	232
Distributions	(16)	(3)
Transfer from borrowings	60	
Other	1	
<b>At 31 December</b>	<b>961</b>	<b>358</b>

## **28. Insurance contract liabilities, investment contract liabilities and reinsurance assets – terms, methods and assumptions**

Insurance and investment contract liabilities include unitised, non unitised, conventional and annuity business. Unitised contracts are those where the contractual benefits are determined with reference to units allocated to the contract, non unitised contracts consist primarily of bonds where the benefits are linked to chosen indices although no units are allocated, annuity contracts are those where regular payments are made depending on the survival of life or lives or for a certain period of time and all other contracts are classed as conventional business.

Prior to the demutualisation of The Standard Life Assurance Company, all European life and pensions business was held in the With Profits Fund of SLAC. During the period, significant changes were made to the structure of the Group as described in Note 1. This has led to the European business now being held within a number of funds. The terms, methods and assumptions applicable to the business have not changed as a result of these changes to the structure of the Group unless indicated otherwise.

The following sections give details of these main classes of business for each European long term business fund – Heritage With Profits Fund (HWPF), Proprietary Business Fund (PBF), the UK Smoothed Managed With Profits Fund (UK SMWPF), the Irish Smoothed Managed With Profits Fund (ISMWPF), the German Smoothed Managed With Profits Fund (GS MWPF), the German With Profits Fund (GWPF), together with the business of The Standard Life Assurance Company of Canada.

### **(a) (i) UK Insurance and investment contract liabilities – terms**

This section describes the terms of business held within this fund, including the investment element of those participating contracts written in the PBF for which the HWPF is the appropriate participating fund (e.g. With Profits Bonds and participating pension contracts with a 0% investment guarantee). It also gives details of significant options and guarantees that have the potential to increase the benefits paid to policyholders. Under some options and guarantees the benefits paid depend on the behaviour of financial variables such as interest rates and equity returns. The significant options and guarantees that are not valued at fair value are disclosed below.

#### **Unitised pensions business**

This class of business comprises single or regular premium contracts under which a percentage of the premium is used to allocate units in one or more internal linked funds, or on a participating basis. Most of this business is classified as investment contracts although there are some contracts that are classified as insurance, for example those with guaranteed minimum pensions. The major unitised pension products include Individual and Group Personal Pension business, Executive Pensions and Stakeholder.

Provision for additional death benefits may be provided by cancellation of units or through supplementary term assurance contracts.

Costs are recovered out of policies invested in internal linked funds by use of a fund management charge. Under Stakeholder contracts, this fund management charge has a maximum limit.

The significant options and guarantees under these contracts are the following:

- participating contracts where, subject to specified conditions, it is guaranteed either that the unit price will rise at an annual rate of at least 4% a year or that the unit price will not fall, and, that there will be no unit price adjustment (UPA) at specified retirement dates or death,
- certain participating Trustee Investment Plan contracts where, subject to specified conditions and limits, it is guaranteed that there will be no UPA when units are encashed.

#### **Conventional pensions business**

Conventional pensions business comprises contracts where a minimum level of benefit is set at the outset and applies at the date(s) specified in the policy, for example pure endowment contracts. Regular bonuses may be added to this initial minimum over the term of the policy and in addition, a final bonus may be paid. These contracts are classified as insurance contracts.

Guaranteed annuity options providing for payment of a minimum annuity, in lieu of a cash sum, are available under pure endowment contracts. Under some of these contracts the guarantee applies only at the maturity date.

Under other contracts, the option also applies for a specified period preceding the maturity date, in which case the sum assured and bonuses are reduced by specified factors and different guaranteed annuity rates apply.

### **Unitised life business**

Unitised life business comprises single or regular premium endowment and whole life contracts under which a percentage of the premium is used to allocate units in one or more internal linked funds or on a participating basis. Some of this business is classified as insurance contracts, for example Homeplan and With Profits Bonds. Others are classified as investment contracts, for example Capital Investment Bonds.

The significant options and guarantees under these contracts are the following:

- participating contracts where, subject to specified conditions, it is guaranteed on death and maturity either that the unit price will rise at an annual rate of at least 3% a year or that the unit price will not fall, and, that there will be no unit price adjustment (UPA) at maturity,
- for participating bonds it is guaranteed that no UPA will apply on regular withdrawals up to certain specified limits.

The death benefit under regular premium contracts is the greater of the bid value of units allocated and sum assured under the contract. Some contracts also contain critical illness cover providing for payment of a critical illness sum assured on diagnosis of certain defined serious illnesses. Under single premium contracts, the death benefit normally equals 101% or 100% of the bid value of units depending on the type of contract and when it is taken out.

Under contracts effected in connection with house purchase the death benefit is guaranteed. Under other contracts, at any time after the first ten years, the Group may review the status of the contract and, if it deems it necessary, the sum assured may be reduced, within the limits permitted.

Under some contracts effected in connection with house purchase, provided the original contract is still in force the following options can normally be exercised at any time before the 55th birthday of the life assured:

- future insurability option under which a new contract can be effected on then current premium rates, in connection with a further loan, up to the level of life and basic critical illness cover available on the original contract, without any further evidence of health,
- term extension option on then current premium rates under which the term of the contract may be extended by a whole number of years if the lender agrees to extend the term of the loan.

### **Non unitised life business**

The non unitised business largely comprises single premium policies where the maturity value is linked to increases in the FTSE 100 Index subject to minimum maturity values established when the policies commenced. These bonds are classified as investment contracts.

### **Conventional life business**

Conventional business consists of single or regular premium endowment, whole life and term assurance contracts where guaranteed benefits are payable on death and under some products on permanent and total disability or on diagnosis of a specified critical illness. These contracts are classified as insurance contracts. Under participating contracts, regular bonuses may be added to the guaranteed sum assured over the term of the policy and in addition, a final bonus may be paid on death and maturity. Certain endowment assurances have minimum surrender value provisions and minimum paid up values.

### **Annuities**

This class of business consists of single premium contracts that provide guaranteed annuity payments and are classified as insurance contracts. The payments depend on the survival of a life or lives with or without a guaranteed period and may reduce on a specified death or increase each year at a predefined rate or in line with the increase in the UK Retail Price Index (RPI). Further details are provided below of those contracts which provide a guaranteed rate of increase and which are valued on the regulatory basis.

For those annuities in payment which increase at a predefined rate the total liability at 31 December 2006 is £3,177m and this represents about 25% of the total UK annuity business held within this fund. These are valued on the regulatory basis with allowance for the predefined rate of increase.

There is a subset of annuities where the RPI linked annuity payment cannot fall or is guaranteed to increase at a minimum rate, the majority of such annuities are those whose payment cannot fall.

The total liability at 31 December 2006 for RPI linked annuities (including any guaranteed minimum rate of escalation) is £1,883m and this represents about 15% of the total UK annuity business held within this fund. These are valued on the regulatory basis with allowance for a positive rate of RPI escalation.

## **28. Insurance contract liabilities, investment contract liabilities and reinsurance assets – terms, methods and assumptions**

### **(a) (i) UK insurance and investment contract liabilities – terms**

#### *Annuities continued*

As shown in the Sensitivity Analysis for the HWPF, (refer to Note 31) there is no impact on shareholder equity due to market movements for the sensitivity shown. As explained in the limitations this is because although shareholders are potentially exposed to the full cost if the assets of the fund are insufficient to meet policyholder obligations, the assumption change given is not severe enough for such an event to occur.

For some participating deferred annuity policies, at maturity the annuity income can be converted to cash on guaranteed minimum terms.

The Participating Pension annuity is an annuity contract under which changes to the level of annuity are based on a declared rate of return but reductions in the level of the annuity are limited.

### **(a) (ii) UK insurance and investment contract liabilities – methods**

#### **Calculation of liabilities**

The FSA's realistic reporting regime seeks to place a realistic and market consistent value on both assets and liabilities for participating insurance and investment contracts. In particular, the liabilities reflect discretionary benefits such as future bonuses as well as both the intrinsic value and the time value of options and guarantees and allow for possible future management actions.

The realistic liabilities are based on the aggregate value of individual policy asset shares that reflect the actual premium, expense and charge history of each policy. For example, the investment return credited to the asset shares is consistent with the return achieved on the assets backing participating business, any mortality deductions are based on published mortality tables, for those asset shares on an expense basis the allowance attributed to the asset share is as far as practical the appropriate share of the actual expenses, for those on a charges basis the allowance is consistent with the charges for an equivalent unit linked policy. The calculation of asset shares is described in more detail in the Principle and Practices of Financial Management (PPFM) for the HWPF.

Other components of the realistic liability reflect policy related liabilities such as policy guarantees, options and future bonuses, which are calculated using a stochastic model that simulates future investment returns, asset mix and bonus strategies. The liabilities recorded in the balance sheet are also reduced by an offset in respect of the present value of future profits on non participating insurance and investment contracts written in the HWPF.

The liabilities for non participating conventional insurance contracts are calculated using the gross premium method. The method brings into account full premiums receivable under the contracts, estimated renewal and maintenance costs and contractually guaranteed benefits.

The liabilities for annuity contracts are calculated by discounting the expected future annuity payments together with an appropriate estimate of future expenses at an assumed rate of interest derived from the yields on the underlying assets.

For contracts with guaranteed insurability options, the calculated liabilities reflect an assumption that the options are foregone by those experiencing the select mortality of newly underwritten lives. For Lifetime Protection Series term assurance business, the liabilities include an allowance for whichever options the policyholder has exercised.

For unutilised non participating insurance contracts and investment contracts the liability is based on the value of the underlying assets supporting the contracts. For non utilised non participating investment contracts, the liability is measured at amortised cost using the effective interest rate method. The effective interest rate is that which equates the value of the expected future cash flows over the life of the contract to the original investment value. The estimation of cash flows incorporates all contractual terms relating to the instrument.

#### **Participating contracts allocations**

Regular bonuses are declared at the discretion of the Group in accordance with the PPFM of the HWPF and are set at levels, which aim to achieve a gradual build up in guaranteed participating policy benefits whilst not unduly constraining investment freedom and the prospects for final bonuses. In setting these rates, the financial position (both current and projected) of the HWPF is taken into account. Were it necessary, regular bonus rates would be set to zero. Regular bonus rates are set for each relevant class of participating policy and/or internal fund and reflect its characteristics, including any guaranteed rates.

For some contracts, final bonuses may also be paid. These bonuses are not guaranteed and can be withdrawn at any time.

### Participating contracts payouts

The Group's aim is that, subject to meeting all contractual obligations and maintaining adequate financial strength, payouts on a participating policy (including any final bonus applying) should fairly reflect the experience of the HWPF applicable to such a policy, after any adjustments for smoothing, and any distribution of the residual estate deemed appropriate by the Board

When setting payout levels, the Group seeks to ensure fair treatment between those participating policyholders who choose to withdraw and those who remain

Asset shares are used as a tool to determine fair treatment. The calculation of asset shares varies between products, for example calculations can be on the basis of representative policies or on an individual policy basis. The calculation of asset shares is described in more detail in the Group's PPFM for the HWPF

The methodology and parameters used in payout calculations may, of necessity, involve some measure of approximation. The Group reviews regularly the methodology and parameters used, and sets parameters on bases appropriate for the participating class and/or internal fund concerned

In normal circumstances the Group seeks to offer some smoothing of investment returns to participating policyholders at the time of claims due to maturity for life policies or for pension policies where the Group has no right to reduce benefits as defined in the relevant contractual terms and conditions. The Group may, at its discretion, also provide some smoothing of investment returns for death claims and some types of withdrawal at the time of payment. The Group aims to operate smoothing of investment returns in such a way as to be neutral for participating policyholders as a whole over time. The Group monitors the anticipated cost of smoothing on a regular basis and, in some circumstances, it may be appropriate to reflect the costs in asset shares and/or adjust the approach to smoothing

When calculating asset shares, the Group may at its discretion make fair deductions to reflect its assessment of the cost of guarantees. In April 2004 the Group announced that it would take an allowance for the assessed costs of guarantees when determining final bonuses payable on claims, calculating policy switch values and calculating surrender and transfer values. These allowances vary between types of policies, reflecting the nature of the guarantees provided. These allowances are kept under review. A deduction is also taken from participating asset shares, determined on an expense basis, of 0.5% pa as a contribution to the capital of the HWPF

### Mortgage endowment policies

In accordance with The Standard Life Assurance Company Scheme of Demutualisation (Schedule 4) eligible policies covered by the Mortgage Endowment Promise may receive top up amounts as defined in the scheme

### (a) (iii) UK insurance and investment contract liabilities – assumptions

Most guarantees on participating contracts and future bonuses are valued prospectively using a stochastic model, which generates future investment returns. Within the projections, allowance is made for future bonus reflecting projected investment conditions and the Group's HWPF PPFM. For guarantees on participating contracts not valued using the stochastic model, the liability is calculated by applying the ratio of guarantee costs to the asset share for the product most similar in nature with appropriate adjustments

The economic assumptions for the calculation of the present value of future profits on non participating insurance and investment contracts are shown in the table below

	2006		2005	
Risk Discount Rate	5.23%	5.52%	6.72%	7.07%
Investment returns				
Equities		4.93%		4.22%
Property		4.93%		4.22%
Fixed Interest Gilts	4.93%	4.97%	4.19%	4.22%
Fixed Interest Corporate	4.93%	5.42%	4.22%	4.87%
Expense Inflation		3.97%		3.83%

The table above shows the changes in the basis between 2006 and 2005. The 2006 risk discount rate is calculated on a market consistent basis and is set equal to the risk free rate plus a margin to allow for the non market risks inherent in the cash flows being discounted

## 28. Insurance contract liabilities, investment contract liabilities and reinsurance assets – terms, methods and assumptions

### (a) (iii) UK insurance and investment contract liabilities – assumptions *continued*

The investment returns for 2006 are the risk free rate of return that are used to value the non participating business on a market consistent basis

The non economic assumptions include expenses, mortality and withdrawals

The expense and mortality assumptions are best estimate assumptions determined from the Group's recent analyses. They are consistent with the assumptions for non participating insurance contracts with the explicit margins for prudence removed

A withdrawal investigation is carried out each year and assumptions are set with reference to recent levels taking into account any trends evident. However, in general the results for participating business are not particularly sensitive to the overall level of withdrawals. For non participating business, appropriate allowances are made for withdrawals only where this would lead to an increase in the insurance and investment contract liabilities

For non participating insurance contracts, the assumptions used to determine the liabilities are updated at each reporting date to reflect recent experience. Material judgement is required in calculating these liabilities and, in particular, in the choice of assumptions about which there is uncertainty over future experience. These assumptions are determined as appropriate estimates at the date of valuation. The basis is considered prudent in each aspect. In particular, options and guarantees have been provided for on prudent bases and no credit is taken for possible beneficial effects on liabilities of voluntary withdrawals

The principal assumptions for the main UK non participating insurance contracts are as follows

#### Valuation interest rates

The valuation interest rates used are determined in accordance with the FSA Integrated Prudential Sourcebook. The process used to determine the valuation interest rates used in the calculation of the liabilities comprises three stages: determining the current yield on the assets held after allowing for risk and tax, hypothecating the assets to various types of policy and determining the discount rates from the hypothecated assets

For equity assets, the current earnings and dividends are considered and, if necessary, a deduction is made to reflect sustainability. Similarly, a deduction to the yields on property assets is made where necessary, to allow for the possibility of rental defaults. For corporate bonds, a deduction is made for the risk of default. The yield for each category of asset is taken as the average adjusted yield weighted by the market value of each asset in that category. The valuation interest rates used are

Non participating	2006	2005
<b>1. Assurances</b>		
Life	3.40%	3.00%
Other	4.35%	3.75%
<b>2. Annuities</b>		
Individual/Group		
life	4.50%	4.00%
pension	5.15%	4.50%
linked to RPI	1.70%	1.30%

#### Mortality rates

The future mortality assumptions are based on historical experience with an allowance for future mortality improvement in annuities. The Group's own mortality experience is regularly assessed and analysed, and the larger industry wide investigations are also taken into account

Mortality tables used	2006
<b>1. Assurances</b>	90% AM00
<b>2. Annuities</b>	90% AM00
Individual and group in deferment	Males 92.6% RMC00M05 / Females 110.2% PPFV00M05
Individual after vesting	Males 110.9% RMV00M05 / Females 111.1% WA00M05
Group after vesting	

A significant assumption is the rate at which future mortality is expected to improve for annuitants. The mortality improvement factors assumed for the males are in line with the projection basis underlying the above tables published by the Continuous Mortality Investigation (CMI) with a minimum improvement of 1.5% per annum. The improvement factors assumed for females also reflect the projection basis underlying the above tables published by the CMI but to a lesser extent and with a different minimum improvement.

#### **Expenses**

The assumptions for future policy expense levels are determined from the Group's recent expense analyses. No allowance has been made for potential expense improvement, and the costs of projects to improve expense efficiency have been ignored. The assumed future expense levels incorporate an annual inflation rate allowance of 3.97% for UK business derived from the expected Retail Price Index (RPI) implied by current investment yields and an additional allowance for earnings inflation.

For non-participating immediate and deferred annuity contracts, an expense loading is made in respect of renewal expenses, an explicit allowance is made for termination expenses and an implicit allowance is made for fund management expenses, by reducing the valuation rate used.

For conventional non-participating insurance contracts, an explicit allowance for renewal and termination expenses is included in the liabilities. An allowance for investment expenses is reflected in the valuation rate of interest.

In calculating the liabilities for unitised life contracts, the administration expenses are assumed to be identical to the expense charges made against each policy. Similar assumptions are made, where applicable, in respect of mortality, morbidity and the risk benefit charges made to meet such costs.

#### **(a) (iv) Canadian business – terms, methods and assumptions**

As detailed in Note 1, following the demutualisation of The Standard Life Assurance Company (SLAC) the structured settlement business written in Canada remained in SLAC.

SLAC is an asset of the HWPF and is exclusively involved in the following operations, which are all based in Canada:

- Managing the block of third party structured settlement assignment policies issued between 1 January 2005 and 10 July 2006. The structured settlement assignment policies were contracts issued in respect of clients, primarily property and casualty insurers, who had obligations to claimants under court settlements and who intended to transfer these obligations to third parties. In each such case SLAC purchased an annuity benefit from The Standard Life Assurance Company of Canada (SLCC) to exactly match the liability it had accepted under the assignment. For this block of policies, SLAC holds a liability and an equal offsetting asset which are both set to the value of the actuarial liability established by the Canadian subsidiary for the annuity benefit.
- Managing the portfolio of structured settlement annuity contracts, which had been issued by SLAC as part of its regular operations until 31 December 2004 at which point this portfolio was totally indemnity reinsured with the Canadian subsidiary. SLAC has no net liability in respect of this portfolio of business.

#### **(a) (v) European business – terms, methods and assumptions**

##### **Republic of Ireland**

The contracts issued in the Republic of Ireland have features similar to those in the UK. The contracts issued are mainly participating business. The options and guarantees are also similar to those in the UK, including guaranteed sums assured on some conventional life business, no unit price adjustments (UPA) at maturity or on regular withdrawals on some unitised participating contracts and guaranteed annuity options on some pension business.

The liabilities are calculated using a methodology and basis consistent with the UK approach but using assumptions appropriate to the market. The value of options and guarantees on the Irish business are measured using a methodology consistent with the UK. However, the basis used is calibrated for the Irish market.

##### **Germany**

The contracts investing in the HWPF mainly consist of unitised participating endowment assurances and deferred annuities, under which a percentage of each premium is applied to purchase units in the Fund. Certain unit prices in the HWPF are guaranteed not to decrease. The death benefit under endowment assurances is the greater of the sum assured on death or 105% of the current surrender value. The death benefit under deferred annuities is the greater of the sum assured on death, 100% of the current surrender value and, for regular premium paying contracts and certain single premium contracts, a refund of premiums.

## **28. Insurance contract liabilities, investment contract liabilities and reinsurance assets – terms, methods and assumptions**

### **(a) (v) European business – terms, methods and assumptions** *continued*

Provided all premiums have been received to date, the maturity value, and for certain contracts the surrender benefits, are subject to guaranteed minimum amounts (except for the investment linked contract). For some participating unitised policies it is guaranteed that there will be no UPA on claims on or after the surrender option date. Some of these policies guarantee that the premium required for a given level of benefit will not exceed a specified amount. Deferred annuities have a guaranteed annuity at the Selected Benefit Date and the annuity start date. In addition certain contracts are subject to guaranteed annuity amounts.

The liabilities are calculated using a methodology basis consistent with the UK approach but using assumptions appropriate to the German market. The value of options and guarantees on the German business are measured using a methodology consistent with the UK. However, the basis used is calibrated for the German market.

### **(b) Proprietary Business Fund (PBF)**

Post demutualisation, both non participating and participating business has been written in this fund, with most business being reinsured to Standard Life Investment Funds Limited, with the exception of protection business. For participating contracts also written in this fund, the participating investment element is transferred to the appropriate with profits fund. Therefore the contract liabilities held in the fund are non participating.

### **(b) (i) UK insurance and investment contract liabilities – terms**

This section describes the terms of UK business held in this fund. It also gives details on significant guarantees on annuity business that have the potential to increase the benefits paid to policyholders.

#### **Unitised pensions business**

This class of business comprises single or regular premium contracts under which a percentage of the premium is used to allocate units in one or more internal linked funds. The major unitised pension products include Individual and Group Personal Pension business, Executive Pensions, Stakeholder and Self Invested Personal Pensions (SIPP), which are classified as investment contracts.

Provision for additional death benefits may be provided by cancellation of units or through supplementary term assurance contracts.

The costs of policies invested in internal linked funds are recovered by use of a fund management charge. Under Stakeholder contracts, this fund management charge has a maximum limit.

#### **Unitised life business**

Unitised life business mainly comprises single premium whole life contracts under which a percentage of the premium is used to allocate units in one or more internal linked funds. This business comprises principally Capital Investment Bonds, which are classified as investment contracts.

The death benefit normally equals 101% or 100.1% of the bid value of units depending on the type of contract and when it is taken out.

#### **Conventional life business – protection**

Conventional business consists of term assurance contracts where guaranteed benefits are payable on death and under some products on permanent and total disability or on diagnosis of a specified critical illness. These contracts are classified as insurance contracts.

#### **Annuities**

This class of business consists of single premium contracts that provide guaranteed annuity payments and are classified as insurance contracts. The payments depend on the survival of a life or lives with or without a guaranteed period and may reduce on a specified death or increase each year at a predefined rate or in line with the increase in the UK Retail Price Index (RPI).

For those annuities in payment which increase at a predefined rate the total liability at 31 December 2006 is £14m and this represents about 5% of the total UK annuity business held in this fund. These are valued on the regulatory basis with allowance for the predefined rate of increase.

If the market moves in line with the adverse Scenario II as shown in the Sensitivity Analysis, Note 31, (i.e., market value of equities 15%, change in property values 12.5%, change in yields on 15 year gilt fixed interest bonds of 17.5%) then the impact on shareholder equity from those annuities with a predefined rate of increase is not significant

There is a subset of annuities where the RPI linked annuity payment cannot fall or is guaranteed to increase at a minimum rate, the majority of such annuities are those whose payment cannot fall

The total liability at 31 December 2006 for RPI linked annuities (including any guaranteed minimum rate of escalation) is £14m and this represents about 5% of the total UK annuity business held within this fund. These are valued on the regulatory basis with allowance for a positive rate of RPI escalation

The RPI annuities are backed by index linked securities and so if the market moves in line with the adverse Scenario II as shown in the Sensitivity Analysis, then the impact on shareholder equity from these annuities is not significant

#### **(b) (i) UK insurance and investment contract liabilities – methods**

##### **Calculation of liabilities**

For unitised investment contracts the liability is based on the value of the underlying assets supporting the contracts

The liabilities for conventional life insurance contracts are calculated using the gross premium method. The method brings into account full premiums receivable under the contracts, estimated renewal and maintenance costs and contractually guaranteed benefits, and includes an allowance for any options the policyholder has exercised

The liabilities for annuity contracts are calculated by discounting the expected future annuity payments together with an appropriate estimate of future expenses at an assumed rate of interest derived from the yields on the underlying assets

#### **(b) (ii) UK insurance and investment contract liabilities – assumptions**

The principal assumptions for the main UK non participating insurance contracts are as follows

##### **Valuation interest rates**

The valuation interest rates used are determined in accordance with the FSA Integrated Prudential Sourcebook

The process used to determine the valuation interest rates used in the calculation of the liabilities comprises three stages: determining the current yield on the assets held after allowing for risk and tax, hypothecating the assets to various types of policy and determining the discount rates from the hypothecated assets

For equity assets, the current earnings and dividends are considered and, if necessary, a deduction is made to reflect sustainability. Similarly, a deduction to the yields on property assets is made where necessary, to allow for the possibility of rental defaults. For corporate bonds, a deduction is made for the risk of default. The yield for each category of asset is taken as the average adjusted yield weighted by the market value of each asset in that category

The valuation interest rates used are

Non participating	2006
<b>1 Assurances</b>	
Life	3.50%
Other	4.00%
<b>2 Annuities</b>	
Individual/Group	
Life	4.10%
Pension	4.10%
Linked to RPI	1.05%

## 28. Insurance contract liabilities, investment contract liabilities and reinsurance assets – terms, methods and assumptions

### (b) (iii) UK insurance and investment contract liabilities – assumptions continued

#### Mortality rates

The future mortality assumptions are based on historical experience with an allowance for future mortality improvement in annuities. The Group's own mortality experience is regularly assessed and analysed, and the larger industry wide investigations are also taken into account.

Mortality tables used	2006
<b>1. Assurances</b>	90% AMC00
<b>2. Annuities</b>	
Individual and group in deferment	90% AMC00
Individual after vesting	Males 92.6% RMC00M05 / Females 110.2% PPFV00M05
Group after vesting	Males 110.9% RMV00M05 / Females 111.1% WA00M05

A significant assumption is the rate at which future mortality is expected to improve for annuitants. The mortality improvement factors assumed for the males are in line with the projection basis underlying the above tables published by the CMI with a minimum improvement of 1.5% per annum. The improvement factors assumed for females also reflect the projection basis underlying the above tables published by the CMI but to a lesser extent and with a different minimum improvement.

#### Expenses

The assumptions for future policy expense levels are determined from the Group's recent expense analyses. No allowance has been made for potential expense improvement, and the costs of projects to improve expense efficiency have been ignored. The assumed future expense levels incorporate an annual inflation rate allowance of 3.97% for UK business derived from the expected Retail Price Index (RPI) implied by current investment yields and an additional allowance for earnings inflation.

For non-participating immediate and deferred annuity contracts, an expense loading is made in respect of renewal expenses, an explicit allowance is made for termination expenses and an implicit allowance is made for fund management expenses, by reducing the valuation rate used.

For conventional non-participating insurance contracts, an explicit allowance for renewal and termination expenses is included in the liabilities. An allowance for investment expenses is reflected in the valuation rate of interest.

In calculating the liabilities for unitised life contracts, the administration expenses are assumed to be identical to the expense charges made against each policy. Similar assumptions are made, where applicable, in respect of mortality, morbidity and the risk benefit charges made to meet such costs.

### (b) (iv) Canadian business – terms, methods and assumptions

The only Canadian business written by the Proprietary Business Fund is in respect of stacking policies and structured settlement assignment policies as detailed below.

- managing the portfolio of stacking business – a second position insurance on accumulation contracts and vested annuities, which had been issued by SLAC in conjunction with, and subsequently indemnity reinsured with SLCC, up to the time of demutualisation,
- the issuing of new stacking business, in conjunction with, and indemnity reinsured with SLCC,
- the issuing of structured settlement annuities to SLCC, in the case of third party structured settlement assignment policies issued by SLCC. These annuities are indemnity reinsured with SLCC.

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**(b) (v) European business – terms, methods and assumptions**

**Republic of Ireland**

The contracts issued in the Republic of Ireland have features similar to those in the UK. The contracts issued are mainly non-participating business. The options and guarantees are similar to those in the UK.

The liabilities are calculated using a methodology and basis consistent with the UK approach but using assumptions appropriate to the Irish market. The value of options and guarantees on the Irish business are measured using a methodology consistent with the UK. However, the basis is calibrated to the Irish market.

**Germany**

The German contracts issued in this class mainly consist of unisex participating deferred annuities, which are written in the Proprietary Business Fund with the participating element being transferred to the German With Profits Fund or German Smoothed Managed With Profits Fund. Certain unit prices in the German With Profits Fund are guaranteed not to decrease. The Unit Linked deferred annuity is also in this class. Under this contract a percentage of the premium is used to allocate units in one or more internal linked funds. The death benefit under all the deferred annuities is the greater of the sum assured on death, 100% of the current surrender value and, for regular premium paying contracts and certain single premium contracts, a refund of premiums.

Provided all premiums have been received to date, the maturity value for certain contracts are subject to guaranteed minimum amounts. In addition certain contracts are subject to guaranteed annuity amounts.

The liabilities are calculated using a methodology basis consistent with the UK approach but using assumptions appropriate to the market. The value of options and guarantees on the German business are measured using a methodology consistent with the UK. However, the basis used is calibrated for the German market.

**(c) Other With Profits funds**

**(c) (i) UK Smoothed Managed With Profits Fund (UK SMWPF) – terms and methods and assumptions**

This fund holds the investment element of UK Stakeholder pension contracts and so the business is classified as investment contracts. The terms of this business and the method used to calculate the liability in respect of this business are described below.

The Group's aim is that, subject to meeting all contractual obligations and maintaining adequate financial strength, payouts on a participating policy (including any final bonus applying) should fairly reflect the experience of the UK Smoothed Managed With Profits Fund applicable to such a policy, after any adjustments for smoothing.

When setting payout levels, the Group seeks to ensure fair treatment between those participating policyholders who choose to withdraw and those who remain.

Asset shares are used as a tool to determine fair treatment. The calculation of asset shares is described in more detail in the Principles and Practices of Financial Management for the UK Smoothed Managed With Profits Fund.

The methodology and parameters used in payout calculations may, of necessity, involve some measure of approximation. The Group reviews regularly the methodology and parameters used and sets parameters on bases appropriate for the participating class and/or internal fund concerned.

In normal circumstances the Group seeks to offer some smoothing of investment returns on all claims. The Group may, at its discretion, cease smoothing of payouts or differentiate the smoothing approach for different types of claim, if it is appropriate to do in the interest of policyholders or to protect the fund. The Group aims to operate smoothing of investment returns in such a way as to be neutral for policyholders as a whole over time.

The liability is based on the value of the underlying assets supporting the contracts.

## **28. Insurance contract liabilities, investment contract liabilities and reinsurance assets – terms, methods and assumptions** *continued*

### **(c) (i) Irish Smoothed Managed With Profits Fund (ISMWPF) – terms, methods and assumptions**

This fund will hold the with profits investment element for any post demutualisation contracts where a smoothed managed with profits investment option is introduced. The contracts issued in the Republic of Ireland will have features similar to those in the UK and liabilities will be calculated using a methodology and basis consistent with the UK. Considerations in respect of payouts on a participating policy will also be in line with the UK. There are no policyholder liabilities in this fund at present.

### **(c) (ii) German Smoothed Managed With Profits Fund (GSMWPF) – terms, methods and assumptions**

The German smoothed managed product is a deferred annuity. A percentage of each premium is applied to allocate units in the German Smoothed Managed With Profits Fund. Investors in the German Smoothed Managed With Profits Fund do not participate in the profits of Standard Life Group. The death benefit is the greater of the sum assured on death, 100% of the current surrender value and a refund of premiums. Neither surrender nor maturity benefits are guaranteed.

### **(c) (iv) German With Profits Fund (GWPF) – terms, methods and assumptions**

The German contracts in this class consist of unisex participating deferred annuities, which are written in the Proprietary Business Fund with the participating element being transferred to the German With Profits Fund. Certain unit prices in the German With Profits Fund are guaranteed not to decrease. The death benefit under all the deferred annuities is the greater of the sum assured on death, 100% of the current surrender value and, for regular premium paying contracts and certain single premium contracts, a refund of premiums.

Provided all premiums have been received to date, the maturity value for the contracts is subject to guaranteed minimum amounts. In addition contracts are subject to guaranteed annuity amounts.

The liabilities are calculated using a methodology basis consistent with the UK approach but using assumptions appropriate to the market.

The value of options and guarantees on the German business are measured using a methodology consistent with the UK. However, the basis used is calibrated for the German market.

## **(d) The Standard Life Assurance Company of Canada (SLCC)**

### **(d) (i) Business written in Canada**

#### **Annuities**

These contracts are similar to those issued in the UK and provide a guaranteed annuity payment based on the survival of a life or for a specified period. The majority of the portfolio are life contingent annuities and are classified as life insurance. However there are some term certain annuities classified as investment contracts. Most of the annuity portfolio is written on a non participating basis. The benefits may increase each year at a pre defined rate or in line with increases in the Canadian Consumer Price Index (CPI) and will not decrease in periods of deflation.

For those annuities which increase at a predefined rate the total liability at 31 December 2006 is £379m and these represent about 12% of the total Canadian annuity business. The liability for annuities linked to CPI index is approximately £234m. This represents about 7.5% of the total Canadian annuity business.

The annuity liabilities, including these guarantees, are valued using the Canadian Asset Liability Method (CALM). The liability is set as the maximum reserve required under a number of projected economic scenarios including changes in the interest rate environment and inflation rates. For CPI linked annuities, a 1% increase in the CPI would increase liabilities by £24m. However, inflation risk on these annuities is mitigated by investments in assets linked to inflation.

#### **Universal Life insurance**

The main Universal Life product written by the Canadian business is named Perspecta and is a non participating life insurance product. Perspecta is a whole life assurance contract, under which premiums may be invested on both an index linked and non linked basis. Premiums invested on a non linked basis are placed on deposit at rates of interest guaranteed for periods from 1 day to 20 years. The rate offered is determined with reference to the financial conditions at the time of premium payment. The contract provides life cover, and in addition, on death the value of the index linked funds is guaranteed never to be less than 75% of premiums deposited into those funds, adjusted for expense charges and any withdrawals. The liability for these policies is £562m at 31 December 2006.

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Perspecta contracts issued up to November 2003 provided the following interest rate guarantees

- 0% for the Daily Interest Fund

For each term investment fund (TIF), the greater of 90% of the Government of Canada Bond rate for the same term, less 1.75%, and

- 0% for the 1 year TIF
- 1% for the 3 year TIF
- 2% for the 5 year TIF
- 3% for the 10, 15 and 20-year TIF

Furthermore, it was guaranteed that at least one TIF at a minimum guaranteed interest rate of 3% would be offered as long as the policy is in force

Perspecta contracts issued after November 2003 provide lower interest rate guarantees for terms of at least three years, there is no guarantee that a term with a 3% minimum guaranteed rate will be offered and the TIF investment option can be withdrawn

In addition, on all Perspecta policies the value of the investment account may increase on guaranteed terms at specified policy anniversaries. The level of increase depends upon various conditions, including when the contract was effected

Perspecta policyholders have the option to switch into TIFs some or all of their investments in the other investment options and can increase their premiums up to statutory limits. The guarantees that then apply are those set when the contract was effected

These options and guarantees are valued using a stochastic model that has been approved by the Appointed Actuary in Canada

A reduction of 1% in the yields curve would increase the value of the guarantee by £3m. At 31 December 2006, the liability for all the TIFs (i.e. pre and post November 2003) is £35m

#### **Accumulation contracts**

This category comprises savings products that are classified as non-participating investment contracts. The major individual product is Ideal Solution for Savings and the major group product is SLX. Deposits can be invested on a non-linked basis at guaranteed interest rate for a given period. New market conditions apply if the plan renews after maturity

Also included in this category are unit-linked products sold on an individual or group basis. The individual product is non-participating and offers a death benefit guarantee of the greater of the fund value and 100% of the net deposits

Provided that the monies have been invested for a minimum of ten years, the maturity benefit is the greater of the fund value and 75% of deposits at the annuity commencement date less any cash values previously paid out. Otherwise the maturity benefit is the fund value. The cost of the guarantee has been calculated in accordance with local regulations and results in no provision being required

The group version of this product differs in that it does not offer a guarantee upon death or maturity

#### **Registered Retirement Income Fund (RRIF) and Life Income Fund (LIF) products**

RRIF and LIF products are non-participating investment account contracts into which single premiums are invested on a linked or non-linked basis. Non-linked premiums are placed on deposit at rates of interest guaranteed for a selected term. The rate offered depends on financial conditions at the time of deposit. Proceeds at the end of a guarantee period may be reinvested at the then current rates. Regular withdrawals are made from the account to provide an income during retirement. The policyholder may vary the amounts withdrawn subject to the regulatory minimum. The unit-linked version offers guarantees on death and maturity similar to the individual product described above

## 28. Insurance contract liabilities, investment contract liabilities and reinsurance assets – terms, methods and assumptions

### (d) (i) Business written in Canada *continued*

#### Conventional life business

Conventional business consists of participating or non participating single or regular premium endowment, whole life and term assurance contracts where the guaranteed benefit is payable on death. Participating whole life and endowment assurance contracts contain scales of minimum guaranteed surrender values and paid up policy amounts. Participating whole of life contracts issued prior to 1985 include a guaranteed annuity rate option where the lump sum death benefit can be converted into an annuity on guaranteed terms or retained by SLCC whereupon the value accumulates at an annual interest rate of at least 2.5%. For some participating whole life policies it is guaranteed that the interest on policy loans will not exceed 6%. There are some participating policies where it is guaranteed that the annual interest rate credited will be at least 4%.

### (d) (ii) Canadian business – methods

The participating insurance contracts are set aside in a distinct fund from the other non participating liabilities, with an undertaking on how the earnings of the fund will be distributed and how the participating liabilities will be valued in future. The liability in respect of participating contracts is set equal to the value of the fund, being the best estimate of the amount that will be distributed. This value is of the order of double the value of the liabilities in respect of guaranteed benefits, calculated in accordance with methods prescribed by Canadian regulations. The liabilities in respect of non participating business are determined in accordance with methods prescribed by Canadian regulations, adjusted where appropriate to comply with UK accounting principles.

Under Canadian regulations, liabilities are determined according to the Canadian Asset Liability Method (CALM). SLCC's assets and liabilities are projected under a number of different economic scenarios. These scenarios include the current yield curve as at the valuation date and a number of various rising and falling interest rate environments. Under each scenario the assets required to support the liabilities are the value of assets which will achieve zero surplus at the end of the projection period. The liability is set equal to greatest value of the required assets.

### (d) (iii) Canadian business – assumptions

The Canadian economic environment at 31 December 2006 is used to determine the expected interest rates for the current valuation. The expected experience scenario of risk free rates is derived from the yield curve of Canadian federal bonds at that date, as summarised below.

Yield curve by duration	2006	2005
6 months	4.20%	3.65%
1 year	4.20%	3.91%
2 years	4.07%	3.81%
3 years	4.05%	3.84%
5 years	4.04%	3.89%
7 years	4.08%	3.92%
10 years	4.15%	3.94%
20 years	4.29%	4.07%
30 years	4.29%	4.02%

The following table shows the other key investment returns used in the asset and liability projections under CALM.

Investment returns	2006	2005
Equities	6.94%	7.00%
Property	7.02%	6.91%

These investment returns are net of investment expenses and are prudent assumptions as they include risk margins determined in line with Canadian standards of practice. A further drop in the asset values of 30% for equities and 25% for property is applied, consistent with Canadian standards of practice, to allow for adverse deviations in projecting cash flows arising from capital gains on non fixed income assets.

Mortality assumptions have a significant impact on the liabilities and are shown below

Mortality tables used	2006	2005
<b>1 Assurances</b>		
Perspecta Universal Life and Term Life	65%-120% of base table (where base table is 65% 77% of CIA 86-92)	65% 120% of base table (where base table is 71% 83% of CIA 86 92)
Participating and non participating Life, closed to new business	65% 78% of CIA 86 92	69% 83% of CIA 86 92
<b>2 Annuities</b>		
Individual – after vesting	68% 106% of IAM83M / IAM83F with projection scale AA (projected from 2003)	86% 88% of IAM83M / IAM83F with projection scale AA (projected from 2006)
Group after vesting	89% 125% of GAM83M / GAM83F with projection scale AA (projected from 2003)	75% 124% of GAM83M / GAM83F with projection scale AA (projected from 2006)

Mortality assumptions are derived from studies performed during 2004 and 2005 using a blend of industry and SLCC's experience. The rates are expressed as a percentage per the tables shown. For assurance business the percentages vary depending on the underwriting classification and the duration of the contracts. For annuity business the percentages vary depending on whether the contract is in payout or in deferment, and on the gender of the annuitant.

Margins for adverse deviation are added and vary depending on the nature of the products and the strength of the underwriting criteria. These margins are consistent with Canadian actuarial standards of practice for use in local regulatory reporting.

#### (e) Healthcare business – terms, methods and assumptions

The contracts issued by Standard Life Healthcare mainly consist of individual and corporate private medical insurance products that include a range of benefit options. All contracts are written on annual premium income basis. A provision for unearned premiums is calculated on a daily basis as the most accurate method for calculating the proportion of premium accounted for in periods up to the accounting date that is attributable to subsequent periods.

Claims incurred comprise claims paid in the year and changes in the provision for outstanding claims, whether reported or not, together with any adjustment to claims from previous years.

Outstanding claims comprise provisions for the claims incurred up to, but not paid at, the balance sheet date, whether reported or not.

Commission payable is deferred on the same basis as unearned premiums.

#### (f) Reinsurance – terms, methods and assumptions

The Group limits its exposure to loss within insurance operations through participation in reinsurance arrangements within the Group and externally. The majority of the business ceded externally is placed on a quota share basis with retention limits varying by product line and territory. Amounts recoverable from reinsurers are estimated in a manner consistent with the methods and assumptions used for ascertaining the underlying policy benefits and are presented in the balance sheet as reinsurance assets.

Even though the Group may have reinsurance arrangements, it is not relieved of its direct obligations to its policyholders and thus a credit exposure exists with respect to reinsurance ceded, to the extent that any reinsurer is unable to meet its obligations assumed under such reinsurance agreements.

The Group is not dependent on a single reinsurer nor are the operations of the Group substantially dependent upon any reinsurance contract.

## 29. Insurance contract liabilities, non participating investment contract liabilities, participating investment contract liabilities and reinsurance assets

	Notes	2006 £m	2005 £m
<b>Non participating contract liabilities</b>			
Non participating insurance contracts	29(a)	20,202	21,158
Non-participating investment contracts	29(c)	50,931	40,929
		<b>71,133</b>	<b>62,087</b>
<b>Participating contract liabilities</b>			
Participating insurance contracts	29(a)	20,225	19,633
Participating investment contracts	29(a)	18,563	18,076
Present value of future profits on non participating contracts	29(b)		(1,528)
Unallocated divisible surplus	30	1,208	4,827
		<b>39,996</b>	<b>41,008</b>

Non participating insurance contracts include £152m (2005 £118m) relating to Standard Life Healthcare Limited and £3m (2005 £3m) relating to general insurance, conventional term assurances (Lifetime Protection Series or LPS), life contingent annuities, Perspecta Universal Life in Canada, and a small amount of linked Homeplan business

Note 1 describes the establishment of the Heritage With Profits Fund (HWPF) as part of the demutualisation transaction on 10 July 2006. Under the Scheme of Demutualisation (the Scheme) certain non participating contracts were transferred to the HWPF. The present value of future profits (PVFP) on these non-participating contracts can be apportioned between the component related to contracts whose future cash flows under the Scheme are expected to be transferred out of the HWPF to equity holders and the component related to contracts whose future cash flows will remain in the HWPF to be applied either to meet amounts that may be charged to the HWPF under the Scheme or distributed over time as enhancements to final bonuses payable on the remaining policies invested in the fund.

These components are deducted in arriving at the amount of participating contract liabilities and unallocated divisible surplus as follows:

	2006 £m
Participating contract liabilities before apportionment	38,950
Non participating PVFP deducted	(162)
	<b>38,788</b>
Participating insurance contracts	20,225
Participating investment contracts	18,563
<b>Participating contract liabilities after apportionment</b>	<b>38,788</b>
Unallocated divisible surplus before apportionment	2,968
Non participating PVFP deducted	(1,760)
<b>Unallocated divisible surplus after apportionment</b>	<b>1,208</b>

**(a) Insurance contract liabilities, participating investment contract liabilities and reinsurance assets**

The movement in insurance contract liabilities, participating investment contract liabilities and reinsurance assets during 2006 was as follows

	Participating insurance contract liabilities	Non participating insurance contract liabilities	Participating investment contract liabilities	Total insurance and participating contracts	Reinsurers' share of liabilities (reinsurance asset)	Net 2006
	£m	£m	£m	£m	£m	£m
<b>At 1 January 2006</b>	19,633	21,158	18,076	58,867	(779)	58,088
Expected change	(105)	(119)	(303)	(527)	(16)	(543)
Methodology/modelling changes	237	9	89	335		335
Effect of changes in						
Economic assumptions	(245)	(691)	(238)	(1,174)	18	(1,156)
Non economic assumptions	(22)		11	(11)		(11)
Effect of						
Economic experience	(89)	(95)	(33)	(217)	(6)	(223)
Non economic experience	230	(178)	595	647	(10)	637
New business	1	450	44	495	(14)	481
<b>Total change in contract liabilities</b>	<b>7</b>	<b>(624)</b>	<b>165</b>	<b>(452)</b>	<b>(28)</b>	<b>(480)</b>
Foreign exchange adjustment		(135)	6	(129)	11	(118)
Change in Unearned Premium Reserve*		68		68		68
<b>At 10 July 2006 – before demutualisation</b>	<b>19,640</b>	<b>20,467</b>	<b>18,247</b>	<b>58,354</b>	<b>(796)</b>	<b>57,558</b>
Demutualisation (Note 1)	450	4	339	793		793
<b>At 10 July 2006 after demutualisation</b>	<b>20,090</b>	<b>20,471</b>	<b>18,586</b>	<b>59,147</b>	<b>(796)</b>	<b>58,351</b>
Expected change	(197)	(129)	(423)	(749)	26	(723)
Benefit enhancements			224	224		224
Methodology/modelling changes	(57)	99	(9)	33		33
Effect of changes in						
Economic assumptions	33	(100)	40	(27)	(4)	(31)
Non economic assumptions	71	(50)	46	67		67
Effect of						
Economic experience	979	323	650	1,952	(17)	1,935
Non economic experience	(609)	(300)	(573)	(1,482)	10	(1,472)
New business	24	475	54	553	(3)	550
<b>Total change in contract liabilities</b>	<b>244</b>	<b>318</b>	<b>9</b>	<b>571</b>	<b>12</b>	<b>583</b>
Foreign exchange adjustment	(109)	(556)	(32)	(697)	44	(653)
Change in Unearned Premium Reserve		(31)		(31)		(31)
<b>At 31 December 2006</b>	<b>20,225</b>	<b>20,202</b>	<b>18,563</b>	<b>58,990</b>	<b>(740)</b>	<b>58,250</b>

\* Change in Unearned Premium Reserve includes the liabilities acquired in relation to the private medical business of FirstAssist (see Note 44)

The table above has been split to show the movements for the period from 1 January 2006 to demutualisation on 10 July 2006 and the period from demutualisation on 10 July 2006 to 31 December 2006. The demutualisation impact is disclosed in Note 1.

## 29. Insurance contract liabilities, non participating investment contract liabilities, participating investment contract liabilities and reinsurance assets

### (a) Insurance contract liabilities, participating investment contract liabilities and reinsurance assets *continued*

Included in the movement in actuarial liabilities in the period 1 January to 10 July 2006 is an amount of £307m arising from periodic adjustments to asset shares to bring the credited investment return in line with the actual returns generated, and from a change in the allocation of fixed income returns to adjust allocations previously determined

The impact of economic assumptions in the period 1 January to 10 July 2006 primarily reflects changes in fixed interest yields leading to lower valuation rates on non participating business

The primary role of the residual estate, as set out in paragraph 4.1 of schedule 1 of the Scheme, is to ensure a prudent amount is retained in the HWPF in respect of any amounts which may be charged to the HWPF in accordance with the Scheme. To the extent that the SLAL Board is satisfied that the residual estate exceeds that required to meet its primary role, the excess residual estate shall be distributed over time in as fair and equitable manner as is practicable as an enhancement to final bonus payable on the remaining HWPF with profits policies. Therefore it is necessary to recognise the residual estate of the HWPF as part of the participating liabilities. The movement tables above therefore include the movements in this residual estate post demutualisation

Non economic experience changes in the period 1 January to 10 July 2006 primarily represent lower than expected claims (including deaths, surrenders, maturities and lapses) whereas experience changes in the period from 10 July to 31 December 2006 reflect higher than expected claims

Economic experience changes in the period from 10 July to 31 December 2006 reflect higher than anticipated investment returns during that period

The movement in insurance contract liabilities, participating investment contracts and reinsurance assets during 2005 was as follows

	Participating insurance contract liabilities	Non participating insurance contract liabilities	Participating investment contract liabilities	Total insurance and participating contracts	Reinsurers share of liabilities (reinsurance asset)	Net 2005
	£m	£m	£m	£m	£m	£m
<b>At 1 January 2005</b>	18,264	18,854	15,929	53,047	(617)	52,430
Expected change	(430)	(275)	(161)	(866)	(62)	(928)
Methodology/modelling changes	202	(46)	(71)	85	22	107
Effect of changes in						
Economic assumptions	336	679	336	1,351	(12)	1,339
Non economic assumptions	(95)	186	(66)	25	(46)	(21)
Effect of						
Economic experience	1,131	342	931	2,404	(28)	2,376
Non economic experience	205	(62)	1,062	1,205	29	1,234
New business	30	781	152	963	(15)	948
<b>Total change in contract liabilities</b>	1,379	1,605	2,183	5,167	(112)	5,055
Foreign exchange adjustment	(10)	699	(36)	653	(50)	603
<b>At 31 December 2005</b>	19,633	21,158	18,076	58,867	(779)	58,088

Economic assumptions reflect changes in fixed income yields, leading to lower valuation rates on non participating business, and other market movements. Experience changes in 2005 primarily represent higher than expected investment returns, increasing the participating liabilities

Non-economic assumptions cover mortality, persistency and expenses. Experience changes in 2005 primarily represent lower than expected claims (including deaths, surrenders, maturities and lapses)

Changes in methodology and models include refinement of the realistic liability models, including enhanced modelling of the cost of guarantees for Germany

**(b) Present value of future profits on non participating contracts**

The change in the present value of future profits on non participating contracts was as follows

	2006
	£m
<b>At 1 January 2006</b>	<b>1,528</b>
Expected change, including unwind of discount	(43)
Methodology/modelling changes	77
Effect of changes in economic and non-economic assumptions	(15)
Effect of economic and non-economic experience	(4)
New business	165
<b>At 10 July 2006 – before demutualisation</b>	<b>1,708</b>
Demutualisation (Note 1)	(1,708)
<b>At 10 July 2006 – after demutualisation</b>	
	2005
	£m
<b>At 1 January 2005</b>	<b>1,041</b>
Expected change, including unwind of discount	(25)
Methodology/modelling changes	303
Effect of changes in economic and non-economic assumptions	(122)
Effect of economic and non-economic experience	88
New business	244
Foreign exchange adjustment	(1)
<b>At 31 December 2005</b>	<b>1,528</b>

## 29 Insurance contract liabilities, non participating investment contract liabilities, participating investment contract liabilities and reinsurance assets *continued*

### (c) Non participating investment contract liabilities

The change in non participating investment contract liabilities was as follows

	2006
	£m
<b>At 1 January 2006</b>	<b>40,929</b>
Contributions	4,960
Initial charges and reduced allocations	(5)
Account balances paid on surrender and other terminations in the year	(2,355)
Investment return credited and related benefits	1,693
Foreign exchange adjustment	(187)
Other	3
Recurring management charges	(126)
<b>At 10 July 2006</b>	<b>44,912</b>
Contributions	6,057
Initial charges and enhanced allocations	16
Account balances paid on surrender and other terminations in the year	(3,024)
Investment return credited and related benefits	3,851
Foreign exchange adjustment	(817)
Other	87
Recurring management charges	(151)
<b>At 31 December 2006</b>	<b>50,931</b>
	2005
	£m
<b>At 1 January 2005</b>	<b>30,597</b>
Contributions	6,952
Initial charges and reduced allocations	(7)
Account balances paid on surrender and other terminations in the year	(3,407)
Investment return credited and related benefits	5,996
Foreign exchange adjustment	913
Other	71
Recurring management charges	(186)
<b>At 31 December 2005</b>	<b>40,929</b>

Refer to Note 39 Risk Management policies for an indication of the term to contractual maturity/repnicing date for insurance and investment contract liabilities. Reinsurance contracts are generally structured to match liabilities on a class of business basis. The reinsurance assets are therefore broadly expected to be realised in line with the settlement of liabilities (as per the terms of the particular treaty) within a reinsured class of business.

### 30. Movement in components of unallocated divisible surplus (UDS)

	Notes	Revaluation of land and buildings £m	Cash flow hedges £m	Foreign currency translation of foreign operations £m	Remaining components £m	UDS before income statement recognition £m	Total income/ (expense) recognised in the income statement £m	UDS £m
<b>At 1 January 2006</b>		27	(4)	104	4,700	4,827		4,827
Fair value gains on cash flow hedges			14			14		14
Actuarial losses on defined benefit pension schemes	34				(10)	(10)		(10)
Revaluation of land and buildings	16	44				44		44
Exchange differences on translating foreign operations				(78)		(78)		(78)
Aggregate tax effect of items not recognised in the income statement	9				4	4		4
Other					4	4		4
<b>Income/(expense) not recognised in the income statement during the period</b>		44	14	(78)	(2)	(22)		(22)
Transfer to unallocated divisible surplus							391	391
Foreign exchange adjustment					(23)	(23)		(23)
<b>At 10 July 2006</b>		71	10	26	4,675	4,782	391	5,173
<b>Impact of demutualisation on UDS</b>								
<b>UDS at 10 July 2006 – before demutualisation</b>		71	10	26	5,066			5,173
Revaluation of land and buildings	26	(71)						(71)
Cash flow hedges	26		(10)					(10)
Foreign currency translation	26			(26)				(26)
Cumulative UDS movements not recognised in the income statement	26				107			107
Net assets transferred out of the with profits fund	1				(1,359)			(1,359)
Other adjustments to UDS	1				(2,504)			(2,504)
<b>UDS at 10 July 2006 – after demutualisation</b>					1,310			1,310
<b>At 10 July 2006</b>								1,310
Change in unallocated divisible surplus								
Recognised in the income statement								(105)
Not recognised in the income statement	26							(1)
								(106)
Foreign exchange adjustment								4
<b>At 31 December 2006</b>								1,208

**30. Movement in components of unallocated divisible surplus (UDS) continued**

The shaded boxes represent those line items that are not applicable to a particular period given the demutualisation of The Standard Life Assurance Company on 10 July 2006

Prior to demutualisation all the Group's assets and liabilities were ultimately held for the benefit of The Standard Life Assurance Company's with profits fund. The UDS, being a component of participating contract liabilities, represented the difference between the Group's recognised assets and all other recognised liabilities and minority interest.

Where items of income and expense were required not to be recognised in the income statement the transfer to/from the UDS was correspondingly affected. The movement in UDS in the period therefore comprised both the transfer to/from the UDS recognised in the income statement and the impact of items of income or expense not included in the income statement. The accumulated amount of these items of income or expense was recorded as a separate component of UDS.

On demutualisation, as explained in Note 1, certain assets and liabilities were transferred out of the with profits fund with a corresponding reduction in the UDS. The Scheme of Demutualisation of The Standard Life Assurance Company affected the measurement of the participating contract liabilities resulting in a further adjustment to the UDS. The accumulated amount of income and expenses not reflected in the income statement and the associated accumulated movement in UDS not recognised in the income statement were transferred to equity holders reserves.

	Notes	Revaluation of land and buildings £m	Cash flow hedges £m	Foreign currency translation of foreign operations £m	Remaining components £m	UDS before income statement recognition £m	Total income/ (expense) recognised in the income statement £m	Total UDS £m
<b>At 1 January 2005</b>		16		(89)	3,751	3,678		3,678
Fair value losses on cash flow hedges			(4)			(4)		(4)
Actuarial gains on defined benefit pension schemes	34				22	22		22
Revaluation of land and buildings	16	11				11		11
Exchange differences on translating foreign operations				193		193		193
Other					1	1		1
<b>Income/(expense) not recognised in the income statement during the period</b>		11	(4)	193	23	223		223
Transfer to unallocated divisible surplus							901	901
Foreign exchange adjustment					25	25		25
<b>At 31 December 2005</b>		27	(4)	104	3,799	3,926	901	4,827

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## **31. Sensitivity of shareholder equity and profits to changes in assumptions**

### **(a) 2006 sensitivity analysis**

Shareholder equity and the value of corresponding assets and liabilities and shareholder profits depend on a number of key assumptions and any variation in these assumptions could significantly change the shareholder equity. Whether and how much of an impact each change has depends on the methodology and key assumptions used in calculating the liability. This note shows the sensitivity of shareholder equity and profits to the assumptions underlying the calculation of the liabilities in Note 28 together with the assets assumed to be backing those liabilities.

For participating business (both insurance and investment), the liability calculated on a realistic basis consists primarily of the inherent value in the policy (for example, the asset share) and the assets supporting it, which are not impacted by changes to non-economic assumptions such as mortality, lapses and expenses. However, other components of the realistic liability, such as policy guarantees, options and future bonuses, are impacted by changes in these assumptions.

For non-participating insurance contract liabilities four key assumptions in the calculation are mortality, interest rates, expenses and lapse/withdrawal rates.

Non-participating investment contracts are relatively insensitive to changes in non-economic assumptions.

#### **Mortality**

For non-participating business the main insurance risk results from changes in mortality. The risk depends on the assumptions made and the type of contract involved. The mortality rates are based on published mortality tables, adjusted to reflect actual and expected future experience. If mortality rates were assumed to be lower this would lead to an increase in the insurance contract liability for annuities and a decrease in that for assurances.

#### **Valuation interest rates**

For non-participating business the valuation interest rates used to discount liabilities are determined in accordance with the FSA Integrated Prudential Sourcebook. The valuation interest rates are determined with reference to market rates and so changes in the market rates will impact the value of both assets and liabilities.

#### **Expenses**

For non-participating business the current level of expenses adjusted for inflation is taken as the appropriate expense base. An increase in the level of expenses would result in fewer assets being available to meet obligations.

#### **Withdrawal and lapse rates**

For non-participating business, although lapses and withdrawals prior to the original contract end date do not currently impact on the timing of cash flows and the value placed on non-participating liabilities is mostly independent of these considerations. This is because the values represent the greater of the prospective reserve or the surrender value (withdrawal value).

For participating policies (both insurance and investment contracts) the realistic value includes an explicit assumption for lapses and withdrawals. Each of our Principles and Practices of Financial Management (PPFM) state that when setting payouts the Group will seek to ensure fair treatment between those participating policyholders who choose to withdraw and those who remain, so changes in volumes of withdrawals do not necessarily impact available capital, equity and profit.

### 31 Sensitivity of shareholder equity and profits to changes in assumptions

#### (a) 2006 sensitivity analysis continued

##### Heritage With Profits Fund

For the Heritage With Profits Fund (HWPF) business the recourse cash flow transfer arising to shareholders is dependent upon the fund as a whole and hence the fund has been treated as a whole for the purposes of these sensitivities

Sensitivity analysis	Heritage With Profits Fund	2006 Change in assumption	2006 Impact on pre tax profit net of reinsurance	2006 Impact on pre tax shareholder equity net of reinsurance
		%	£m	£m
Market movement (see note below)		Scenario I		
		Scenario II		
Expense assumptions		+ 10%	(35)	(35)
		10%	32	32
Morbidity/mortality assumptions	Assurances	+ 5%	(11)	(11)
	Assurances	5%	11	11
Morbidity/mortality assumptions	Annuities	+ 5%	17	17
	Annuities	5%	(17)	(17)
Withdrawal and lapse rate assumptions		+ 10%		
		10%		

##### Non Heritage With Profits Fund business

The table below demonstrates the effect of changes in key assumptions, including market movement, on the shareholder equity and profit whilst other assumptions remain unchanged. Only first order effects are shown.

When the same sensitivities are applied to the non HWPF participating business there is no significant impact on net liabilities after reinsurance, shareholder equity or profits for either investment or insurance contracts. For the participating liabilities the risk to shareholders is that the assets of the fund are insufficient to meet the obligations to policyholders. The assumption changes seen above are not severe enough for such an event to occur.

The market movement scenarios affect the value of both assets and liabilities, whereas the other movements only impact the liabilities. The change in the liabilities allowing for Scenario I is £(194)m and under Scenario II is £197m.

Sensitivity analysis – Insurance Contracts		2006 Change in assumption	2006 Impact on pre tax profit net of reinsurance	2006 Impact on pre tax shareholder equity net of reinsurance
		%	£m	£m
Non participating insurance contracts				
Market movement (see note below)		Scenario I	28	28
		Scenario II	(19)	(19)
Expense assumptions		+ 10%	(12)	(12)
		10%	12	12
Morbidity/mortality assumptions	Assurances	+ 5%	(11)	(11)
	Assurances	5%	11	11
Morbidity/mortality assumptions	Annuities	+ 5%	220	220
	Annuities	5%	(233)	(233)
Withdrawal and lapse rate assumptions		+ 10%	10	10
		10%	(9)	(9)

Sensitivity analysis – Investment Contracts	2006	2006	2006
	Change in assumption	Impact on pre tax profit net of reinsurance	Impact on pre tax shareholder equity net of reinsurance
	%	£m	£m
Non participating investment contracts			
Market movement (see note below)	Scenario I	(71)	(71)
	Scenario II	71	71
Expense assumptions	+ 10%	(1)	(1)
	10%	1	1
Morbidity/mortality assumptions	+ 5%		
	5%		
Withdrawal and lapse rate assumptions	+ 10%		
	10%		

#### Market movement note

Since net equity is impacted by economic conditions, two scenarios are considered reflecting the movement in the underlying asset values in the analysis. Scenario I allows for the combined impact of three components – a change in market value of equities of +15.0%, a change in property values of +12.5% and a change in yields on 15 year gilt fixed interest bonds of +17.5% and scenario II allows for the negative combination of these changes. These changes do not impact the various valuation interest rates to the same extent but can be broadly translated to a +/- 0.5% change in valuation interest rates where applicable. It has also been assumed that the valuation interest rates have moved to reflect the movements in asset values.

This movement is similar in nature to the risk capital margin calculation required by the FSA. This calculation allows for certain management actions and for consistency, allowance for these actions is also included in this analysis.

When assessing the impact of the burn through cost on the recourse cash flow the following main management actions have been assumed:

- Regular bonuses are modelled dynamically, where the decision algorithm allows for the projected affordability of the bonuses in the portfolio and takes into account policyholders' reasonable expectations with respect to movements in the regular bonus rates over time.
- Investment mixes are dynamically controlled within the model. Fixed interest assets are assumed to be held broadly reflecting the nature of the underlying liabilities. Exposure to equities and property is gradually reduced as adverse scenarios unfold.
- The size of the deduction for guarantees taken from asset shares currently varies depending on the business being valued. However under stressed conditions it is assumed that an additional uniform deduction would be applied to all relevant contracts subject to certain limitations to reflect the loss arising under such conditions.

### **31. Sensitivity of shareholder equity and profits to changes in assumptions**

#### **(a) 2006 sensitivity analysis** *continued*

##### **Limitations**

The above tables demonstrate the effect of a change in a key assumption while other assumptions remain unchanged. In reality, such an occurrence is remote, due to correlations between the assumptions and other factors.

It should be noted that these sensitivities are non-linear and larger or smaller impacts should not be derived from these results. Also, it should be noted that the sensitivity analysis represents a snap shot of the impact that the changes in assumptions can have.

The sensitivity for annuitant mortality has been performed on an instantaneous change in mortality assumption at all ages, rather than considering gradual changes in mortality improvement rates.

The sensitivity analysis does not take into account the fact that the assets and liabilities are actively managed and may vary at the time that any actual market movement occurs. Other limitations in the above analysis include the use of hypothetical market movements to demonstrate potential risk.

For the with profits funds and in particular the HWPF the risk to shareholders is that the assets of the fund are insufficient to meet the obligations to policyholders. For the HWPF whilst shareholders are only entitled to the recourse cash flows in respect of this business they can be potentially exposed to the full cost if the assets of the fund are insufficient to meet policyholder obligations. The assumption changes given above are not severe enough for such an event to occur.

#### **(b) 2005 sensitivity analysis**

As described in Note 1, prior to the demutualisation of The Standard Life Assurance Company, the parent company of the Group was a mutual insurer entity and therefore did not hold shareholders' equity or report profit. The following represents the sensitivity disclosures provided within the consolidated financial statements of the parent company of the Group for the year ended 31 December 2005 where the impact of assumption changes on the unallocated divisible surplus was shown.

The unallocated divisible surplus and the value of corresponding assets and liabilities depended on a number of key assumptions and any variation in these assumptions could significantly change the unallocated divisible surplus – this is illustrated in the tables in this section.

The subordinated debt and the subordinated members' accounts are valued in these statements on an amortised cost basis and so are independent of assumptions. The value of these will vary with exchange rates.

Changes in assumptions which impact insurance and investment contract liabilities could impact the unallocated divisible surplus. Whether and how much of an impact each change has depends on the methodology and key assumptions of the liability.

As noted above in the 2006 sensitivity analysis, for participating business, the liability calculated on a realistic basis consists primarily of the inherent value in the policy (for example, the asset share), and the assets supporting it, which are not impacted by changes to non-economic assumptions such as mortality, lapses and expenses. However, other components of the realistic liability, such as policy guarantees, options and future bonuses, are impacted by changes in these assumptions.

Four of the key assumptions in the calculation of non-participating insurance contract liabilities being mortality, interest rates, expenses and lapse/withdrawal rates are described in the 2006 sensitivity analysis.

The table below demonstrates the effect of changes in key assumptions, including market movement, on the unallocated divisible surplus whilst other assumptions remain unchanged. Only first order effects are shown.

The market movement scenarios affect the value of both assets and liabilities, whereas the other movements only impact the liabilities. The change in the liabilities allowing for Scenario I is £305m and under Scenario II is £(156)m.

Sensitivity analysis – Insurance Contracts	2005	2005
	Change in assumption	Impact on unallocated divisible surplus
	%	£m
Net insurance contracts		
Market movement (see note below)	Scenario I	343
	Scenario II	(283)
Expense assumptions	+ 10%	(91)
	10%	83
Morbidity/mortality assumptions	+ 10%	483
	10%	(508)
Withdrawal and lapse rate assumptions	+ 10%	15
	10%	(23)

Sensitivity analysis – Investment Contracts	2005	2005
	Change in assumption	Impact on unallocated divisible surplus
	%	£m
Participating investment contracts		
Market movement (see note below)	Scenario I	205
	Scenario II	(291)
Expense assumptions	+ 10%	(45)
	10%	45
Morbidity/mortality assumptions	+ 10%	
	10%	
Withdrawal and lapse rate assumptions	+ 10%	(4)
	10%	5

Non participating investment contracts		
Market movement (see note below)	Scenario I	(10)
	Scenario II	11
Expense assumptions	+ 10%	
	10%	
Morbidity/mortality assumptions	+ 10%	
	10%	
Withdrawal and lapse rate assumptions	+ 10%	
	10%	

### 31. Sensitivity of shareholder equity and profits to changes in assumptions

#### (b) 2005 sensitivity analysis continued

##### Market movement note

Since unallocated divisible surplus is impacted by economic conditions, two scenarios are considered reflecting the movement in the underlying asset values in the analysis. Scenario I allows for the combined impact of three components – a change in market value of equities of +1.5%, a change in property values of +12.5% and a change in yields on 15 year gilt fixed interest bonds of +17.5% and Scenario II allows for the negative combination of these changes. These changes do not impact the various valuation interest rates to the same extent but can be broadly translated to a +/- 0.75% change in valuation interest rates where applicable. It has also been assumed that the valuation interest rates have moved in line with the movements in asset values.

This movement is similar in nature to the risk capital margin calculation required by the FSA. This calculation allows for certain management actions and for consistency, allowance for these actions, is also included in this analysis.

In calculating the above figures the following main management actions have been assumed for participating business:

- Regular bonuses are modelled dynamically, where the decision algorithm allows for the projected affordability of the bonuses in the portfolio and takes into account policyholders' reasonable expectations with respect to movements in the regular bonus rates over time.
- Investment mixes are dynamically controlled within the model. Fixed interest assets are assumed to be held broadly reflecting the nature of the underlying liabilities. Exposure to equities and property is gradually reduced as adverse scenarios unfold.
- Additional payments from the capital set aside under the Mortgage Endowment Promise may cease under certain adverse conditions, with payment only being resumed once the capital growth condition under the Promise had been met.
- The size of the deduction for guarantees taken from asset shares currently varies depending on the business being valued. However, under stressed conditions it is assumed that an additional uniform deduction would be applied to all relevant contracts subject to certain limitations to reflect the loss arising under such conditions.

It should be noted that these sensitivities are non linear and larger or smaller impacts should not be derived from these results. Also, it should be noted that the sensitivity analysis represents a snap shot of the impact that the changes in assumptions can have.

The sensitivity analysis does not take into account the fact that the assets and liabilities are actively managed and may vary at the time that any actual market movement occurs. Other limitations in the above analysis include the use of hypothetical market movements to demonstrate potential risk.

## 32. Borrowings

	Notes	2006 £m	2005 £m
Certificates of deposit, commercial paper and medium term notes	32(a)	1,812	1,963
Securitisations – mortgage backed floating notes	32(b)	4,383	4,025
Bank overdrafts	22	242	105
Other		69	140
<b>Total borrowings</b>		<b>6,506</b>	<b>6,233</b>

### (a) Certificates of deposit, commercial paper and medium term notes

The Group has issued certificates of deposit through its subsidiary Standard Life Bank Limited (SLB). The Group has also issued commercial paper and medium term notes through Standard Life Funding B V, a wholly owned subsidiary of SLB. SLB has guaranteed the liabilities of its subsidiary in relation to the issuance of this debt. The guarantee is in respect of notes issued and is for a maximum of US\$2bn and €4bn in relation to the US commercial paper and Euro commercial paper programmes respectively, and €4bn in respect of the medium term note programme. This guarantee is considered a financial guarantee contract under the revised IAS 39 *Financial Instruments: Recognition and Measurement* effective from 1 January 2006 and is initially recognised at fair value. The fair value at 31 December 2006 is £nil (2005: £nil).

	Average interest rates 2006 %	Average interest rates 2005 %	Carrying amount 2006 £m	Carrying amount 2005 £m
<b>Due within 1 year</b>				
Standard Life Bank certificates of deposit – GBP	5.04%	4.45%	734	789
Standard Life Bank certificates of deposit – USD	5.31%		52	
Standard Life Bank certificates of deposit – EUR	2.89%		10	
Standard Life Funding B V commercial paper – GBP	5.20%	4.60%	20	196
Standard Life Funding B V commercial paper – USD	5.45%	4.43%	354	440
Standard Life Funding B V commercial paper – EUR	3.65%	2.45%	540	341
Standard Life Funding B V commercial paper – JPY		0.09%		20
Standard Life Funding B V medium term notes – GBP	5.39%	5.60%	3	15
Standard Life Funding B V medium term notes – USD		4.58%		58
			<b>1,713</b>	<b>1,859</b>
<b>Due between 1 and 5 years</b>				
Standard Life Bank certificates of deposit – GBP	4.97%	4.54%	6	5
Standard Life Funding B V medium term notes – GBP	5.43%	4.80%	12	12
			<b>18</b>	<b>17</b>
<b>Due after 5 years</b>				
Standard Life Funding B V medium term notes – EUR	3.89%	2.70%	81	83
Standard Life Funding B V medium term notes – GBP		4.63%		4
			<b>81</b>	<b>87</b>
<b>Total certificates of deposit, commercial paper and medium term loan notes</b>			<b>1,812</b>	<b>1,963</b>

The carrying amounts disclosed above reasonably approximate the fair values as at the year end.

**32. Borrowings continued****(b) Securitisations – mortgage backed floating notes**

Loans are issued by the Group, which are subject to securitisations (Note 18). Under this arrangement, the beneficial interest in these mortgages is transferred to special purpose entities. The issue of mortgage backed floating rate notes by the special purpose entities funded the purchase of the mortgages. The Company and its subsidiaries are not obliged to support any losses suffered by the note holders and do not intend to provide such support. The notes were issued on the basis that note holders are only entitled to obtain payment, of both principal and interest, to the extent that the available resources of the respective special purpose entities, including funds due from customers in respect of the securitised mortgages, are sufficient and that note holders have no recourse to the Company or its subsidiaries. This has been clearly stated in the legal agreements with note holders.

The mortgage backed floating rate notes at year end are as follows

	Average interest rates 2006 %	Average interest rates 2005 %	Carrying amount 2006 £m	Carrying amount 2005 £m
Lothian Mortgages No 1 plc – USD Maturity 2017	5.78%	4.62%	129	215
Lothian Mortgages No 1 plc – GBP Maturity 2035	5.68%	5.09%	570	570
Lothian Mortgages No 2 plc – GBP – Maturity 2038	5.50%	4.93%	202	202
Lothian Mortgages No 2 plc – USD – Maturity 2038	5.73%	4.56%	155	333
Lothian Mortgages No 2 plc – EUR – Maturity 2038	3.95%	2.62%	510	522
Lothian Mortgages No 3 plc – USD – Maturity 2019	5.65%	4.49%	142	295
Lothian Mortgages No 3 plc – GBP – Maturity 2039	5.52%	4.95%	786	786
Lothian Mortgages No 4 plc – USD Maturity 2006		4.41%		57
Lothian Mortgages No 4 plc – EUR Maturity 2040	3.66%	2.33%	381	476
Lothian Mortgages No 4 plc – GBP – Maturity 2040	5.40%	4.81%	570	569
Lothian Mortgages Master Issuer plc – USD Maturity 2028	5.52%		213	
Lothian Mortgages Master Issuer plc – USD – Maturity 2050	5.60%		26	
Lothian Mortgages Master Issuer plc – EUR – Maturity 2050	3.70%		319	
Lothian Mortgages Master Issuer plc – GBP – Maturity 2050	5.42%		380	
<b>Total mortgage backed floating rate notes</b>			<b>4,383</b>	<b>4,025</b>

### 33. Subordinated liabilities

	2006	2005
	£m	£m
Subordinated guaranteed bonds		
6.75% £500,000,000 Fixed rate perpetual	502	505
6.375% €750,000,000 Fixed/floating rate 12 July 2022	514	527
Subordinated guaranteed notes		
6.14% £265,000,000 Fixed rate perpetual	253	267
Mutual Assurance Capital Securities		
6.546% £300,000,000 Fixed rate perpetual	314	319
5.314% €360,000,000 Fixed/floating rate perpetual	251	260
<b>Total subordinated liabilities</b>	<b>1,834</b>	<b>1,878</b>

Subordinated liabilities are considered current if the contractual repricing or maturity dates are within one year

As detailed in Note 1, on 10 July 2006 the Company was substituted as the new issuer of the subordinated guaranteed bonds and Mutual Assurance Capital Securities and the instruments were re-listed on the London Stock Exchange

The classification of amounts due under the subordinated loan arrangements is determined by the interaction of these arrangements with the internal subordinated loan note issued by Standard Life Assurance Limited (SLAL) to the Company, as set out below

#### Subordinated guaranteed bonds

The subordinated guaranteed bonds were issued on 12 July 2002. The payment of principal and interest in respect of the bonds has been irrevocably and unconditionally guaranteed by SLAL. The claims of the bondholders to payment under the guarantee will rank below the claims of all senior creditors of SLAL including policyholders. This guarantee is considered a financial guarantee contract under IAS 39 *Financial Instruments: Recognition and measurement* effective from 1 January 2006, and is initially recognised at fair value. The fair value at 31 December 2006 is £nil (2005: £nil).

The sterling denominated bonds are perpetual securities and as such have no fixed redemption date. However, the bonds are redeemable at par at the option of the Company on 12 July 2027 and on every fifth anniversary thereafter. If the sterling bonds are not redeemed on 12 July 2027, the interest rate payable will be reset to 2.85% over the gross redemption yield on the appropriate five-year benchmark gilt on the reset date. The Company can elect to defer the payment of interest on the sterling bonds. Interest will accrue on any interest deferred at the then current rate of interest on the bonds. Any interest deferred becomes immediately due and payable on the date of any declaration or payment of dividends, interest or other payment in respect of any pari passu ranking securities or securities that rank junior to the sterling bonds, or the date any of the securities are purchased by the Company, SLAL or a subsidiary of the Company, the date fixed for any payment under a guarantee that ranks junior to the sterling bonds, the date of any redemption or purchase of sterling bonds, or the commencement of winding up of the Company or SLAL. There was no such right to defer payment under the terms of the bonds in the prior year.

The maturity date for the Euro denominated bonds is 12 July 2022 and all outstanding obligations under the instruments become immediately due and payable on this date. There are specific conditions surrounding the solvency of SLAL, which allow the repayment of the outstanding obligations to be deferred to the second anniversary of the maturity date. The Company does have the option to redeem at par the bonds on 12 July 2012 and on any interest payment date thereafter until maturity. From 12 July 2012 the Euro bonds will bear interest quarterly in arrears at a floating rate determined by the three-month Euro deposit rate.

### **33. Subordinated liabilities *continued***

#### **Subordinated guaranteed notes**

On 29 June 2005, Standard Life Funding B V (SLFBV), a wholly owned subsidiary of Standard Life Bank Limited (SLB), issued £265m of undated subordinated notes (the subordinated notes) In the terms of a Subordinated Deed of Guarantee, SLB guarantees the payment of all sums payable by SLFBV under the subordinated notes The rights and claims of all subordinated note holders are subordinated to the claims of all senior creditors of both SLFBV and SLB

The subordinated notes are perpetual securities and as such have no fixed redemption date However, the notes are redeemable at par at the option of the issuer on 29 June 2015 but if they are not redeemed on 29 June 2015, then interest rate payable will be reset to 2.80% over the gross redemption yield on the appropriate benchmark gilt on the reset date

During the year, there have been no changes to the terms and conditions of the subordinated guaranteed notes

#### **Mutual Assurance Capital Securities**

The Mutual Assurance Capital Securities (MACS) were issued on 4 November 2004 The payment of principal and interest in respect of the MACS is irrevocably and unconditionally guaranteed by SLAL The claims of the holders of the MACS to payment under the guarantee will rank below the claims of all senior creditors of SLAL including policyholders

The MACS are perpetual securities and as such have no fixed redemption date

The sterling denominated MACS started accruing interest from 4 November 2004 and bear interest at a rate of 6.546% per annum payable annually in arrears on 6 January each year, commencing on 6 January 2006 From and including 6 January 2020 and every fifth anniversary thereafter, these MACS will bear interest annually in arrears based on the aggregate of a margin plus the gross redemption yield of specific gilts

The euro denominated MACS started accruing interest from 4 November 2004 and bear interest at a rate of 5.314% per annum payable annually in arrears on 6 January, commencing on 6 January 2006 From and including 6 January 2015, these MACS will bear interest quarterly in arrears, commencing 6 April 2015, at a floating rate of interest to be calculated quarterly based on the aggregate of a margin plus the rate for three month Euro deposits

The payment of interest can be deferred at the option of the Company on an interest payment date and deferral is mandatory on any interest payment date on which the Company does not satisfy certain specified solvency conditions SLAL has corresponding mandatory deferral rights in relation to payments under the guarantee Any interest deferred becomes immediately due and payable on the date the payment of interest is resumed by the Company or SLAL, the date fixed for the redemption or purchase of MACS by the Company, the commencement of winding up of the Company or the date of any declaration or payment of dividends, interest or other payment in respect of securities that rank junior to MACS or the date any of these junior securities are purchased by the Company, SLAL or a subsidiary of the Company

The obligation to pay any deferred interest must be satisfied with cash raised from the issue of ordinary shares or the sale of treasury shares

During the year, there have been no changes to the key terms and conditions of the MACS

#### **Internal subordinated loan note**

SLAL issued a subordinated loan note to the Company on 10 July 2006 The loan note at all times ranks senior to ordinary share capital and junior to Innovative Tier 1 capital of SLAL There is no fixed redemption date for the note, but interest payments cannot be deferred and must be paid on the date they become due and payable The note is ranked junior to the subordinated guaranteed bonds and MACS, therefore any interest deferred on the sterling guaranteed bonds or MACS becomes immediately due and payable on the date of interest payment in respect of the note This removes the discretionary nature of the interest payments on the sterling guaranteed bonds and MACS

### 34. Pension and other post retirement benefit provisions

The Group operates defined benefit and defined contribution schemes for staff employed by the Group

#### Defined contribution plans

In the UK, with effect from 16 November 2004, new employees are eligible to join a defined contribution scheme. The assets of the scheme are held separately from those of the Group in an independently administered fund. In Canada employees have the option to have their current year of service credited on a defined contribution basis, the contributions under this option are equivalent to the amount that the Group would have otherwise determined using the projected unit credit valuation method under the defined benefit scheme.

£6m (2005 £3m) is included as an expense in the income statement in respect of defined contribution pension plans. The Group expects to contribute £5m to its defined contribution plans in 2007.

#### Defined benefit plans

The Group operates defined benefit schemes for its employees in Europe and Canada. The plans operating in Europe are in the UK, Ireland and Germany with the scheme in the UK having the largest number of members. With effect from 16 November 2004, the UK scheme was closed to new entrants. The Group has agreed to make deficit reduction contributions to the UK scheme in addition to the normal contributions assessed from time to time in respect of ongoing benefit accrual. The Group made a contribution of £60m in the year to 31 December 2006 and has committed to make further contributions of twice yearly instalments of £10m.

Updates to the valuations on which the pension liability of £220m (2005 £386m) was based were at 31 December 2006 for all schemes. The European schemes accounted for £174m (2005 £217m) of the total pension liability and £46m (2005 £169m) related to the Canadian scheme. The Group expects to contribute £64m to its defined benefit pension plans in 2007 inclusive of deficit reduction payments of £20m.

In Canada, certain scheme plans provide employees with post retirement medical benefits. A 1% point change in assumed medical cost trend rates would have the following effects:

	One percentage point increase 2006 £m	One percentage point increase 2005 £m	One percentage point decrease 2006 £m	One percentage point decrease 2005 £m
Effect on the aggregate of the service cost and interest cost	1			
Effect on defined benefit obligation	3	3	(2)	(2)

#### (a) Analysis of amounts recognised in the income statement

The amounts recognised in the income statement for defined contribution and defined benefit schemes are as follows:

	Notes	2006 £m	2005 £m
Current service cost		(59)	(61)
Interest cost on benefit obligation		(71)	(68)
Expected return on plan assets		71	63
Past service cost		(1)	
<b>Expense recognised in the income statement</b>	<b>6</b>	<b>(60)</b>	<b>(66)</b>

**34. Pension and other post retirement benefit provisions** *continued***(b) Actuarial gains and losses recognised in the statement of recognised income and expense**

The actuarial (losses)/gains recognised in the statement of recognised income and expense is as follows

	2006 £m	2005 £m
Actual return less expected return on plan assets	(31)	137
Experience gains and losses arising on schemes' liabilities	(18)	15
Changes in assumptions underlying schemes' liabilities	37	(130)
<b>Actuarial (losses)/gains in the Statement of Recognised Income and Expenses</b>	<b>(12)</b>	<b>22</b>

The cumulative amount of actuarial (losses)/gains recognised in the statement of recognised income and expense since 16 November 2003, the date of adoption of IFRS, is £(32)m (2005 £(20)m)

The actuarial (losses)/gains for the year ended 31 December 2005 of £22m and for the period 1 January to 10 July 2006 of £(10)m were recognised directly in the unallocated divisible surplus (see Note 30) when the parent company of the Group was a mutual insurer. The actuarial losses for the period 10 July to 31 December 2006 of £(2)m were recognised directly in retained earnings (see Note 25)

**(c) Analysis of amounts recognised in the balance sheet**

The present value of the defined benefit obligation less the fair value of gross scheme assets is as follows

	2006 Europe £m	2006 Canada £m	2006 Total £m	2005 Europe £m	2005 Canada £m	2005 Total £m
Present value of funded obligation	(1,332)	(115)	(1,447)	(1,265)	(126)	(1,391)
Present value of unfunded obligations	(3)	(41)	(44)	(3)	(43)	(46)
Fair value of plan assets	1,161	110	1,271	1,051		1,051
<b>Net liability on the balance sheet</b>	<b>(174)</b>	<b>(46)</b>	<b>(220)</b>	<b>(217)</b>	<b>(169)</b>	<b>(386)</b>

The definition of plan assets excludes non transferable financial instruments issued by the reporting entity. Investments that do not meet the definition of plan assets are not deducted from the defined benefit pension scheme obligation. Certain non transferable financial instruments were amended to enable transferability in 2005 in relation to the European schemes and in 2006 in relation to the Canadian scheme.

The present value of the defined benefit obligation including all assets backing the scheme is as follows

	2006 £m	2005 £m
Defined benefit pension deficit recognised on the balance sheet	(220)	(386)
Investment by pension scheme in non transferable financial instruments		111
<b>Net liability on the balance sheet including all assets backing the scheme</b>	<b>(220)</b>	<b>(275)</b>

**(d) Defined benefit obligation**

The movement in the present value of defined benefit obligation is as follows

	2006	2005
	£m	£m
At 1 January	1,437	1,207
Foreign exchange differences	(22)	18
Current service cost	53	58
Interest cost	71	68
Actuarial (gains)/losses	(19)	115
Past service cost	1	
Benefits paid	(30)	(29)
At 31 December	1,491	1,437

The defined benefit obligation is funded as follows

	2006	2005
	£m	£m
Wholly unfunded	44	46
Wholly funded	1,447	1,391
At 31 December	1,491	1,437

**(e) Plan assets**

The changes in the fair value of plan assets are as follows

	2006	2005
	£m	£m
At 1 January	1,051	735
Recognition of plan assets	110	96
Expected return on plan assets	71	63
Actuarial (losses)/gains	(31)	137
Contributions by employer	107	46
Exchange difference on foreign plans	(13)	
Benefits paid	(24)	(26)
At 31 December	1,271	1,051

The difference between the Group benefits paid disclosed in 'Table d' and 'Table e' is due to the exclusion of Canadian assets in 'Table e'

In 2005, the Group entered into futures contracts in order to increase exposure to bonds and reduce exposure to equities

**34. Pension and other post retirement benefit provisions****(e) Plan assets** *continued*

The distribution of the fair value of the plan assets at year end is as follows

	2006 £m	2005 £m
Equities	874	871
Bonds – government	225	94
Bonds – corporate	15	5
Property	53	41
Other	104	40
<b>Total</b>	<b>1,271</b>	<b>1,051</b>

The expected return on plan assets is based on market expectations at the beginning of the period for returns over the entire life of the related benefits obligations. The actual return on plan assets during 2006 was £40m (2005 £200m)

**(f) Principal assumptions**

The principal assumptions used in determining pension benefit obligation for the Group's plans are as follows

	2006 %		2005 %	
Rate of increase in salaries	3.05	4.55	2.85	4.00
Rate of increase in pensions	2.25	3.05	2.25	2.85
Discount rate	4.60	5.25	4.80	5.25
Inflation assumption	2.25	3.05	2.25	2.85
Rate of return on plan assets	7.15		6.45	

Mortality tables used for the UK defined benefit pension obligations

Post retirement – males	PMA92	PMA92
Post retirement – females	PFA92	PFA92
Pre retirement – males	AM92 5 years	AM92 5 years
Pre retirement – females	AF92 5 years	AF92 5 years

The change in the assumption rate for the increase in salaries reflects management action regarding future salary increases which impact the UK scheme

The long term rate of return expected on plan assets is as follows

	2006 Europe %	2006 Canada %	2006 Total %	2005 Europe %	2005 Canada %	2005 Total %
Equities	7.98	8.50	8.02	7.98	8.50	7.98
Bonds – government	4.53	5.75	4.63	3.99	5.75	3.99
Bonds – corporate	5.15	5.75	5.58	4.80	5.75	4.80
Property	7.87	5.75	7.70	7.83	5.75	7.83
Other	5.00	5.75	5.04	4.50	5.75	4.50

### (g) History of experience gains and losses

The following disclosure of experience gains and losses will be built up over time to give a five year history

	2006	2005	2004
	£m	£m	£m
Present value of the defined benefit obligation	1,491	1,437	1,207
Fair value of the plan assets	1,271	1,051	735
Deficit in the plan	(220)	(386)	(472)
Experience adjustments on plan liabilities	19	(115)	(65)
Experience adjustments on plan assets	(31)	137	23

### 35 Deferred income

	2006	2005
	£m	£m
At 1 January	238	234
Additions during the year	54	39
Released to the income statement as fee income	(35)	(35)
At 31 December	257	238

The amount of deferred income expected to be settled after more than 12 months is £217m (2005 £202m)

### 36. Customer accounts related to banking activities and deposits by banks

	2006	2005
	£m	£m
Current/demand accounts	2,344	2,217
Term deposits	1,854	2,040
Deposits by banks	873	877
<b>Total customer accounts related to banking activities and deposits by banks</b>	<b>5,071</b>	<b>5,134</b>

Current/demand accounts are subject to variable interest rates and term deposits are subject to fixed interest rates

The carrying amounts disclosed above reasonably approximate the fair values as at the year end

The amount of term deposits expected to be settled after more than 12 months is £59m (2005 £62m) All other amounts are expected to be settled within 12 months

**37 Other liabilities**

	2006	2005
	£m	£m
Contingent commissions	29	28
Amounts payable on direct insurance business	397	452
Deposits received from reinsurers	46	54
Amounts payable on reinsurance contracts	12	12
Outstanding purchases of investment securities	490	204
Accruals	282	276
Provisions	25	16
Creations of units awaiting settlement	184	29
Other	648	487
<b>Total other liabilities</b>	<b>2,113</b>	<b>1,558</b>

Provisions comprise obligations in respect of compensation, litigation, staff entitlements and reorganisations. Additional provisions made during the year were £13m (2005 £11m). The amount of other liabilities expected to be settled after more than 12 months is £119m (2005 £171m).

**38. Net (increase)/decrease in operating assets and liabilities**

	2006	2005
	£m	£m
<b>(Increase)/decrease in operating assets</b>		
Investment property	(1,540)	(919)
Investment securities	(11,497)	(12,857)
Derivative net assets	10	21
Reinsurance assets	(536)	(558)
Investment in associates*	5	(50)
Other debtors	(736)	(79)
Prepayments and accrued income	14	
Deferred acquisition costs	(245)	(87)
Loans and receivables	275	(108)
	<b>(14,250)</b>	<b>(14,637)</b>
<b>Increase/(decrease) in operating liabilities</b>		
Customer accounts related to banking activities	17	(26)
Other liabilities	465	156
Pension and other post retirement benefit provisions	(23)	(28)
Deferred income	19	6
Insurance contract liabilities	(120)	2,947
Investment contract liabilities	11,101	11,634
Certificate of deposits, commercial paper and medium term notes and securitisations	327	287
Current, demand and term deposits and deposits by banks	(7)	13
Change in liability for third party interest in consolidated funds	116	43
	<b>11,895</b>	<b>15,032</b>
<b>Net (increase)/decrease in operating assets and liabilities</b>	<b>(2,355)</b>	<b>395</b>

\* Investment in Standard Life Investments (Global Liquidity Funds) plc and certain unit trusts have been classified as operating activities due to the nature of the underlying transactions.

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## 39. Risk management policies

### (a) Overview

A significant part of the Group's business involves the acceptance and management of risk. As a provider of financial services, the Group considers risk management a core competency, which is an integrated part of the system of internal controls and key when considering strategic, business and capital planning. The Risk Management Framework provides a structured approach to identify, assess, control and monitor financial and non financial risk and is an integral part of the Group's Internal Risk and Control Framework. The framework has established three lines of defence for managing risks.

- Day to-day risk management is delegated from the Board to the Group Chief Executive and, through a system of delegated authorities, to business managers.
- Risk oversight is provided by established risk management committees. These management committees are supported by the specialist risk management and compliance functions across the Group.
- Independent verification of the adequacy and effectiveness of the internal risk and control management systems is provided by the Group Audit Committee, which is supported by the internal audit function.

The Group's risk management strategy is to identify potential events that may affect stakeholders' returns and manage the impact of these events within identified parameters (Risk Appetite) to provide reasonable assurance regarding the achievement of the Group's business goals and objectives.

As part of the Risk Management Framework, the Group establishes its risk profile by identifying, assessing, controlling and monitoring the risks faced by it.

- Risk identification requires the major sources of risk to be identified.
- Risk assessment requires an assessment of the exposure to each major source of risk. The assessment includes qualitative and quantitative factors and is subject to appropriate stress and scenario testing.
- Risk control requires a response to the risk exposure. Management selects the risk responses, which may include avoiding, accepting, reducing or transferring the risk exposure.
- Risk monitoring requires that the current exposure to identified risks is monitored and reported as required.

The risk profile is assessed regularly, at least quarterly, and reviewed by the relevant executives and the Group Risk Committees. As part of the development of their business plan, each Group company ensures that relevant stress testing is carried out, at least annually, to help identify the exposure to risks.

Risks are classified into the following categories: insurance risk, credit risk, liquidity risk, market risk, operational risk, strategic risk and group risk.

The Board Charter states the Board's responsibility is 'to establish and maintain a framework of internal controls that enables the financial and operational risks of the Group to be assessed and managed' and the Matters Reserved for the Board include 'the approval of the Group Risk Management Policy, and the Group's Financial Risk Policies and the Group Operational Risk Policy, and review of their implementation'.

### 39. Risk management policies

#### (a) Overview *continued*

The Group Chief Executive has established two Group Risk Management Committees,

- Group Asset and Liability Committee (GALCO) – GALCO's duties include ensuring that the financial risks (market, credit, liquidity and insurance) inherent in the Group's activities are identified and managed in accordance with the appetite and limits approved by the Board
- Group Operational Risk Committee (GORC) – the GORC's duties include ensuring that the operational risks inherent in the Group's activities are identified and managed in accordance with the appetite approved by the Board

The Group Chief Executive has allocated the control function of 'Risk Assessment' to the Chief Risk Officer and Group Chief Actuary. This is 'the responsibility for reporting to the Board in relation to setting and controlling risk exposure'. The Chief Risk Officer and Group Chief Actuary are supported by the Group Risk Management function and report directly to the Group Finance Director.

Group Risk Management has primary responsibility for supporting the Board, the GALCO, and the GORC in meeting their risk management responsibilities. In addition, it liaises with the Group companies and Group company risk functions, in relation to their risk management tools, analysis and management information.

Each Group company has its own risk function. These functions do not report directly to Group Risk Management except for reporting breaches to Group Risk Policies, which are reported directly to the Chief Risk Officer and Group Chief Actuary. Instead, they report functionally to Group Risk Management with representatives of Group Risk Management attending the meetings of the individual Group company's risk committees (as appropriate) and ensuring that the requirements of the Group Risk Policies are met in the individual Group company's risk policies.

#### (b) Insurance risk

Insurance risk arises from the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities. It is the risk of adverse deviations from the cash flows assumed when pricing or reserving for insurance contracts.

The Group sets the acceptable level of insurance risk through the Group Insurance Risk Policy.

Insurance risk is managed by assessing certain characteristics based on experience and statistical data and by making certain assumptions on the risks associated with the policy during the period it is in force.

In analysing insurance risk, the Group's insurance companies take, among others, the following factors into account as applicable:

- Insurance liabilities are assessed in accordance with the Group's obligation to treat customers fairly
- In respect of the adequacy of premium rates, the experience of significant factors such as expenses, persistency, mortality, morbidity or claims are reviewed periodically
- A regular review of experience with respect to the factors above is carried out over the life of a policy
- Reinsurance and risk transfer are used as key methods for managing the risk exposure
- New business is written in accordance with the approved pricing assumptions. Underwriting criteria are defined and aligned to the approved pricing assumptions and to the identification of aggregations of risk. New products are reviewed annually to confirm, or otherwise, that pricing assumptions remain appropriate.

The Group's insurance risk arises through its exposure to mortality, morbidity and experience factors such as withdrawals/lapses/Paid Up Policies (PUPs) (i.e. persistency) and expenses.

### **(b) (i) Mortality**

The risk of loss arising due to payouts from policyholder deaths experience being greater than expectations, or for annuities, risk of loss due to annuitants living longer than expected (known as longevity risk)

#### **Assurances**

When pricing policies, an assumption is made as to the likelihood of death and this assumption is reviewed annually. Mortality assumptions are also reviewed annually as part of the annual valuation process. To the extent that actual mortality experience is worse than that anticipated in pricing (and subsequently in the insurance liability valuation) profits will reduce. Reinsurance arrangements with other insurance companies can be used to manage the risk exposure.

#### **Annuities**

Life annuities are contracts that, in return for a lump sum, pay a regular amount (usually monthly or annually and sometimes increasing at a fixed or index linked rate), until the death of the policyholder (or the death of a second life in the case of joint life annuities). As a result, if annuitants live longer than expected on average, profits will reduce. In many cases the annuity is guaranteed payable for a fixed term (usually five years) and is often written on joint lives. These features tend to reduce the volatility of results to random fluctuations in experience but not the impact of a general increase in longevity. Deferred annuities are contracts whereby there is a promise to pay a life annuity starting from a specified date in the future. These policies are subject to a similar risk from the impact of longevity, the only difference being that the risk of adverse impact is greater given that the annuity is payable further into the future.

The sensitivity to changes in mortality assumptions for assurance and annuity policies can be seen in Note 31.

### **(b) (ii) Persistency**

The risk of loss arising from experience of actual policyholder withdrawal/lapse/PUP behaviour being different from expectations. Persistency experience varies over time as well as from one type of contract to another. Factors which influence persistency rates include changes in investment performance of the assets underlying the contract, regulatory changes that make alternative products more attractive, customer (including adviser) perceptions of the insurance industry in general and the Group in particular, service standards, product structure (surrender terms/commission reclaims) and the general economic environment.

The sensitivity to changes in withdrawal and lapse rate assumptions can be seen in Note 31.

### **(b) (iii) Expenses**

The risk of loss due to expense experience being worse than expectations. Although under IFRS 4 expense risk is not a component of insurance risk, it is an important financial risk in the context of insurance and investment contracts.

The sensitivity to changes in expense assumptions can be seen in Note 31.

### 39. Risk management policies

#### (b) (iii) Expenses continued

The Group's concentration of insurance risk, measured by insurance liabilities, before and after reinsurance by territory in relation to the type of insurance contract is as follows

	Life and pensions 2006 £m	Healthcare and general insurance 2006 £m	Total 2006 £m	Life and pensions 2005 £m	Healthcare and general insurance 2005 £m	Total 2005 £m
<b>United Kingdom</b>						
Gross liabilities	31,815	184	31,999	32,115	153	32,268
Net liabilities	31,514	166	31,680	31,811	131	31,942
<b>Canada</b>						
Gross liabilities	5,609		5,609	5,987		5,987
Net liabilities	5,213		5,213	5,560		5,560
<b>International</b>						
Gross liabilities	2,758	61	2,819	2,473	63	2,536
Net liabilities	2,756	38	2,794	2,471	39	2,510
<b>Total gross liabilities</b>	<b>40,182</b>	<b>245</b>	<b>40,427</b>	<b>40,575</b>	<b>216</b>	<b>40,791</b>
<b>Total net liabilities</b>	<b>39,483</b>	<b>204</b>	<b>39,687</b>	<b>39,842</b>	<b>170</b>	<b>40,012</b>

Where an embedded derivative is an insurance contract in its own right or is closely related to the host insurance contract then separation is not required and the whole contract is treated as an insurance contract. At the year end all embedded derivatives were either insurance contracts in their own right or were closely related to the host insurance contract and did not require separation.

#### (c) Credit risk

Credit risk is the risk of exposure to loss if a counterparty fails to perform its financial obligations, including failure to perform those obligations in a timely manner.

The Credit Risk Policy sets limits for specific types of financial instrument and liability.

#### Cash and cash equivalents

Maximum exposure limits are set with reference to credit ratings issued by Standard & Poor's and Moody's.

#### Derivative financial assets

Maximum exposure limits, net of collateral, are set with reference to long term credit ratings issued by Standard & Poor's and Moody's. The forms of collateral that may be accepted are also specified and minimum transfer amounts in respect of margin deposits are also set by reference to the counterparty's rating.

#### Debt securities

Maximum limits are set on the proportions of the total portfolio of debt securities, which may be placed with counterparties rated below certain agreed credit ratings levels.

#### Loans and receivables

Portfolio limits are set by the individual Group companies. These limits specify the proportion of the value of the total portfolio of mortgage loans and mortgage bonds that are represented by single or group of related counterparties, geographic area, employment status or economic sector, risk rating and loan to value percentage.

#### Reinsurance assets

The Group's policy is to place reinsurance only with highly rated counterparties. The credit ratings are assessed on an ongoing basis. Furthermore, the policy restricts the Group from assuming concentrations of risk with few individual reinsurers by specifying certain limits on ceding and the minimum conditions for acceptance and retention of reinsurers.

### Other financial instruments and liabilities

Appropriate limits are set for other financial instruments and liabilities which the Group may be exposed to from time to time, e.g. commission terms paid to intermediaries

### Credit ratings

The following table provides information regarding the credit risk exposure of the Group at 31 December 2006 and 2005, by classifying the following financial assets, excluding those backing unit linked business, according to credit ratings of the counterparties. AAA is the highest possible rating. Rated financial assets that fall outside the range of AAA to BBB are classified as below BBB.

31 December 2006	Credit rating AAA £m	Credit rating AA £m	Credit rating A £m	Credit rating BBB £m	Credit rating Below BBB £m	Not rated £m	Total £m
Reinsurance assets	190	311	106		9	124	740
Debt securities	23,150	3,108	5,636	1,246	658	1,672	35,470
Derivative financial assets		325					325
Cash and cash equivalents	758	2,458	147			13	3,376
Off balance sheet financial assets*						2,218	2,218

31 December 2005	Credit rating AAA £m	Credit rating AA £m	Credit rating A £m	Credit rating BBB £m	Credit rating Below BBB £m	Not rated £m	Total £m
Reinsurance assets	210	265	180		11	113	779
Debt securities	25,277	3,604	5,426	1,334	124	1,536	37,301
Derivative financial assets		223	23				246
Cash and cash equivalents	697	2,666	300	1			3,664
Off balance sheet financial assets*						2,299	2,299

#### \* Mortgage lending commitments

For reinsurance assets, in the above tables, where a rating does not exist for a counterparty's subsidiary company then the rating of that subsidiary's parent company has been used.

Credit risk is primarily concentrated in the United Kingdom within the Government and Financial Services Industry sectors. Counterparty risk is monitored in accordance with the Group Credit Risk Policy.

Included in the Investments in associates and joint ventures (Note 14) is the Group's investment in Standard Life Investments (Global Liquidity Funds) plc, which is accounted for at fair value through the profit and loss in accordance with IAS 39 *Financial Instruments - Recognition and Measurement*. This fund is rated as AAA.

Assets amounting to £12,163m (2005 £7,317m) backing unit linked business have been excluded from these tables as the credit risk on such financial assets is borne by the policyholders.

### **39. Risk management policies *continued***

#### **(d) Liquidity or funding risk**

Liquidity risk is the risk that the Group or individual Group companies, although solvent, do not have sufficient financial resources available to meet their obligations as they fall due, or can secure them only at excessive cost

The Group sets the acceptable level of liquidity risk through the Group Liquidity Risk Policy

The methods used to manage liquidity risk include

- Limits on the volume of financial assets held which are both not quoted and not regularly traded on a recognised exchange
- Committed third party funding facilities
- Establishing contingency funding plans to ensure adequate liquid financial resources are in place to meet obligations as they fall due in the event of reasonably foreseeable abnormal circumstances

Liquidity risk is managed by the central Group Treasury function. Group Treasury is also responsible for the production and management of the contingency funding plan if required

#### **(e) Market risk**

Market risk is the risk that as a result of market movements there is exposure to fluctuations in the value of assets, the amount of liabilities or the income from their assets. General market risks include movements in interest rates, equity values, exchange rates and real estate income. Specific market risk refers to the risk that arises from fluctuations in the value or income from a specific asset

The Group sets the acceptable level of market risk through the Group Market Risk Policy

The primary market risks facing the Group are equity risk and interest rate risk because most of its assets are either equity type investments and subject to equity price risk, or fixed interest securities, mortgages or cash deposits, the values of which are subject to interest rate risk

The Group ensures that its risks remain within the approved market risk appetite and the specific controls used will include, where appropriate

- **Lists of permitted securities** these are described by asset type, quality or actual security
- **Benchmarks** defined in terms of the permitted deviations
- **Market value limits under approved stress scenarios** limits on the value change under approved stress scenarios

The amount of risk borne by the Group's equity holders depends on the extent to which its customers share the investment risk through the structure of the Group's products. Market risks are managed through the design of products, asset/liability management and limitations on the exposure to certain amounts and types of security

#### **Use of derivatives**

Derivative instruments are utilised only to match contractual liabilities or for efficient portfolio management by either reducing risk or reducing cost. The derivative instruments the Group uses include options, futures contracts and contracts for differences, or any contract or asset having the effect of such a derivative. All transactions must be in derivatives that are listed on a regulated market or are with an approved counterparty. In employing derivatives, the relevant Group company will always have sufficient cash equivalents or underlying assets to cover any potential obligation or exercise right. Further information on derivative financial instruments can be found in Note 19

#### **Asset Liability Matching**

The Group manages its assets and liabilities locally, in accordance with local regulatory requirements and reflecting the different types of liabilities that the Group has in each Group company. As a result of the diversity of the products offered by the Group and the different regulatory environments in which it operates, the Group employs different methods of asset and liability management, on both an in force and new business basis, across its companies

### **UK and European Life Assurance and Pensions**

The key factors in asset liability management for the Group's UK and European Life Assurance and Pensions businesses are the need to ensure that regulatory capital requirements are met and that the assets supporting participating business are invested in a manner consistent with the reasonable expectations of policyholders and what is set out in the relevant Principles and Practices of Financial Management (PPFM)

The statutory financial position, including exposure to changes in market conditions, is monitored at least weekly. If appropriate, changes to investment policy would be recommended to the Board to protect the financial position.

Each quarter, a full analysis is carried out to quantify the market risk that the UK and European Life Assurance and Pensions business is exposed to. Where necessary, changes to the current investment policy are recommended to the Group Board, following appropriate review by both the Standard Life Assurance Limited ALCO and the GALCO.

### **Canadian Life Assurance and Pensions**

Standard Life Canada's asset and liability matching policy (CALM Policy) establishes the extent to which it is willing to assume interest rate risk. This requires a close matching of assets and liabilities by nature and duration except for longer term liabilities where appropriate assets are unavailable.

The CALM Policy also prescribes limits on interest rate risk exposure and this exposure is measured and monitored on a regular basis. The primary approach used is duration, key rate duration and convexity analysis combined with scenarios testing analysis, which measures the sensitivity of assets and liabilities to interest rate changes across the entire yield curve.

### **Banking**

Standard Life Bank uses deterministic modelling and stress testing to examine exposure to interest rate movements. Interest rate risk is measured for all (on and off balance sheet) instruments using an asset and liability risk management system.

### **(e) (i) Currency risk**

The Group's investments are generally held in the same currency as its liabilities in its operational geographical locations. However, where the Group believes it to be appropriate to hold non-domestic assets to support domestic liabilities on the grounds that geographical diversification helps reduce the risk profile of the portfolio, it will do so. In these cases, appropriate hedges are employed to minimise currency exposure.

The following table summarises the Group's exposure to foreign currency exchange rate risks at year end by categorising assets and liabilities by major currencies. Other includes a wide range of other currencies due to the Group's investment strategy. These are stated after excluding exposures related to unit linked business.

**39. Risk management policies****(e) (i) Currency risk continued**

	2006 GBP £m	2006 Euro £m	2006 CAD £m	2006 Other £m	2006 Total £m
Loans and receivables	10,506	1	1,465		11,972
Investment securities					
Debt securities	28,012	2,518	4,520	214	35,264
Equity securities and interests in pooled investment funds	10,627	2,848	342	4,124	17,941
Other financial assets	4,390	296	226	183	5,095
Non financial assets	8,728	125	1,154	10	10,017
<b>Total assets excluding unit linked assets</b>	<b>62,263</b>	<b>5,788</b>	<b>7,707</b>	<b>4,531</b>	<b>80,289</b>
Unit linked assets					52,302
<b>Total assets</b>					<b>132,591</b>
Subordinated liabilities	1,574	260			1,834
Non participating contract liabilities					
Non participating insurance contracts	13,098	387	4,093	14	17,592
Non participating investment contracts	195	55	1,957	2	2,209
Participating contract liabilities					
Participating insurance contracts	17,357	2,427	441		20,225
Participating investment contracts	17,342	1,215	5		18,562
Other financial liabilities	10,283	1,877	262	1,171	13,593
Net assets attributable to unit holders	862		77	22	961
Non financial liabilities	807	65	48		920
<b>Total liabilities excluding unit linked liabilities and unallocated divisible surplus</b>	<b>61,518</b>	<b>6,286</b>	<b>6,883</b>	<b>1,209</b>	<b>75,896</b>
Unit linked liabilities					52,302
Unallocated divisible surplus					1,208
<b>Total liabilities</b>					<b>129,406</b>
<b>Total assets less liabilities</b>					<b>3,185</b>
Capital and reserves attributable to the equity holders of Standard Life plc					2,878
Minority interest					307
<b>Total equity</b>					<b>3,185</b>

	2005 GBP £m	2005 Euro £m	2005 CAD £m	2005 Other £m	2005 Total £m
Loans and receivables	10,734	1	1,638	2	12,375
Investment securities					
Debt securities	29,401	2,435	4,924	541	37,301
Equity securities and interests in pooled investment funds	11,847	2,835	433	5,025	20,140
Other financial assets	4,135	305	406	146	4,992
Non financial assets	909	1,364	551	1,081	3,905
<b>Total assets excluding unit linked assets</b>	<b>57,026</b>	<b>6,940</b>	<b>7,952</b>	<b>6,795</b>	<b>78,713</b>
Unit linked assets					41,547
<b>Total assets</b>					<b>120,260</b>
<b>Minority Interest</b>					<b>340</b>
Subordinated liabilities	1,091	787			1,878
Non participating contract liabilities					
Non participating insurance contracts	13,772	410	4,464	26	18,672
Non participating investment contracts	244	5	2,175	2	2,426
Participating contract liabilities					
Participating insurance contracts	17,056	2,101	476		19,633
Participating investment contracts	16,812	1,258	6		18,076
Present value of future profits on non participating contracts	(1,505)	(23)			(1,528)
Other financial liabilities	9,186	1,782	291	1,476	12,735
Net assets attributable to unit holders	279		79		358
Non financial liabilities	1,008	113	173	2	1,296
<b>Total liabilities excluding unit linked liabilities and unallocated divisible surplus</b>	<b>57,943</b>	<b>6,433</b>	<b>7,664</b>	<b>1,506</b>	<b>73,546</b>
Unit linked liabilities					41,547
Unallocated divisible surplus					4,827
<b>Total liabilities and minority interest</b>					<b>120,260</b>
<b>Total assets less liabilities and minority interest</b>					

Financial assets and liabilities exclude items falling outside the disclosure requirements of the relevant IFRS standard. Items such as investments in associates and reinsurance assets are included in non financial assets.

The unallocated divisible surplus by nature is not attributed to currency categories.

**39 Risk management policies continued****(e) (ii) Interest rate risk**

Interest rate risk refers to the potential variability in the Group's financial condition as a result of changes in interest rates

Assets backing the fixed term insurance and investment liabilities may include those without fixed terms like equities and property, included in N/A, as well as fixed term assets

Liabilities without fixed terms such as most annuity business may be backed by assets with fixed terms

The following table sets out the time to contractual maturity or repricing date, whichever is the earliest, for the Group's assets and liabilities exposed to interest rate risk

	2006 Term to maturity/ repricing	2006 Term to maturity/ repricing	2006 Term to maturity/ repricing	2006 Term to maturity/ repricing	2006 Term to maturity/ repricing	2006 Term to maturity/ repricing	2006 No fixed term	2006 N/A	2006 Total
	Within 1 year	1-5 years	5-10 years	10-15 years	15-20 years	>20 years			
	£m	£m	£m	£m	£m	£m	£m	£m	£m
<b>Assets</b>									
<b>Financial assets</b>									
Fair value interest rate risk	5,078	12,094	6,984	5,504	2,044	8,410	1,435	3	41,552
Cash flow interest rate risk	2,102	846	5,844		202	127	110		9,231
Non interest bearing financial instruments								19,489	19,489
<b>Non financial assets</b>									
								10,017	10,017
<b>Total assets excluding unit linked assets</b>	<b>7,180</b>	<b>12,940</b>	<b>12,828</b>	<b>5,504</b>	<b>2,246</b>	<b>8,537</b>	<b>1,545</b>	<b>29,509</b>	<b>80,289</b>
Unit linked assets									52,302
<b>Total assets</b>									<b>132,591</b>
<b>Liabilities</b>									
<b>Insurance and investment contract liabilities</b>									
<b>Fair value interest rate risk</b>									
Insurance contracts	1,352	5,704	6,609	1,874	1,001	493	20,784		37,817
Investment contracts	2,173	4,677	4,431	3,471	2,670	3,199	105	45	20,771
Unallocated divisible surplus								1,208	1,208
<b>Other financial liabilities</b>									
Fair value interest rate risk	890	72	996	295		492			2,745
Cash flow interest rate risk	6,436	120	4,441					23	11,020
Net assets attributable to unit holders								961	961
Non interest bearing financial instruments								1,662	1,662
<b>Non financial liabilities</b>									
								920	920
<b>Total liabilities excluding unit linked liabilities</b>	<b>10,851</b>	<b>10,573</b>	<b>16,477</b>	<b>5,640</b>	<b>3,671</b>	<b>4,184</b>	<b>20,889</b>	<b>4,819</b>	<b>77,104</b>
Unit linked liabilities									52,302
<b>Total liabilities</b>									<b>129,406</b>
<b>Total assets less liabilities</b>									<b>3,185</b>
Capital and reserves attributable to the equity holders of Standard Life plc									2,878
Minority interest									307
<b>Total equity</b>									<b>3,185</b>

	2005 Term to maturity/ repricing Within 1 year £m	2005 Term to maturity/ repricing 1-5 years £m	2005 Term to maturity/ repricing 5-10 years £m	2005 Term to maturity/ repricing 10-15 years £m	2005 Term to maturity/ repricing 15-20 years £m	2005 Term to maturity/ repricing >20 years £m	2005 No fixed term £m	2005 N/A £m	2005 Total £m
<b>Assets</b>									
<b>Financial assets</b>									
Fair value interest rate risk	3,831	13,423	10,554	4,476	2,915	6,677	1,117		42,993
Cash flow interest rate risk	9,407	52	15		349	566	124		10,513
Non interest bearing financial instruments								21,302	21,302
Non financial assets								3,905	3,905
<b>Total assets excluding unit linked assets</b>	<b>13,238</b>	<b>13,475</b>	<b>10,569</b>	<b>4,476</b>	<b>3,264</b>	<b>7,243</b>	<b>1,241</b>	<b>25,207</b>	<b>78,713</b>
Unit linked assets									41,547
<b>Total assets</b>									<b>120,260</b>
<b>Minority Interest</b>									
									340
<b>Liabilities</b>									
<b>Insurance and investment contract liabilities</b>									
<b>Fair value interest rate risk</b>									
Insurance contracts	1,323	4,885	6,543	2,353	712	1,071	21,392	26	38,305
Investment contracts	1,626	4,949	3,774	3,017	2,813	4,247	76		20,502
Present value of future results on non participating contracts								(1,528)	(1,528)
Unallocated divisible surplus								4,827	4,827
<b>Other financial liabilities</b>									
Fair value interest rate risk	11	88	347		3		4	9	462
Cash flow interest rate risk	11,229	73	758	300		489		66	12,915
Net assets attributable to unit holders								358	358
Non interest bearing financial instruments								1,236	1,236
Non financial liabilities								1,296	1,296
<b>Total liabilities excluding unit linked liabilities</b>	<b>14,189</b>	<b>9,995</b>	<b>11,422</b>	<b>5,670</b>	<b>3,528</b>	<b>5,807</b>	<b>21,472</b>	<b>6,290</b>	<b>78,373</b>
Unit linked liabilities									41,547
<b>Total liabilities and minority interest</b>									<b>120,260</b>
<b>Total assets less liabilities and minority interest</b>									

Included in non financial assets is the Group's investment in Standard Life Investments (Global Liquidity Funds) plc, which is accounted for at fair value through the profit and loss in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. This investment, disclosed in Note 14, will expose the Group to both fair value and cash flow interest risk as the underlying investments within the fund are a mixture of fixed and floating rate cash investments.

### 39. Risk management policies

#### (e) (u) Interest rate risk continued

Financial assets subject to interest rate risk include debt securities, loans and receivables and derivative financial instruments. Non interest bearing financial instruments includes equity securities. Insurance and investment contract liabilities exposed to interest rate risk comprise with and without participating non unit linked liabilities. Other financial liabilities subject to interest rate risk include bank customer accounts, derivative financial instruments, subordinated liabilities and borrowings.

Financial instruments classified as exposed to fair value interest rate risk are those with a fixed rate of interest. Financial instruments classified as exposed to cash flow interest rate risk are those with a floating interest rate, which is reset as market rates change. For those contracts where part of the liability is exposed to fair value interest rate risk then the whole contract is considered to be exposed to fair value interest rate risk.

The Group is also exposed to interest rate risk as a result of off balance sheet credit commitments as detailed in Note 41. Under such arrangements, the Group is contractually obliged to extend financing facilities to such counterparties at agreed terms and conditions. Such commitments are subject to counterparties continuing to satisfy certain conditions and are normally renewed on an annual basis.

The Group's range for weighted average effective interest rates is shown for selected assets and liabilities valued at amortised cost. These weighted averages represent the weighted average interest rates across all currencies in which the Group's business is conducted. The applicable rates are as follows:

	2006	2005
	%	%
<b>Assets</b>		
Mortgage loans	5.83%	6.04%
Loans secured on policies	6.24%	5.91%
Loans secured by mortgages subject to securitisation	5.30%	5.76%
Held to maturity debt securities	4.30%	7.33%
Cash and cash equivalents	4.33%	4.44%
	2006	2005
	%	%
<b>Liabilities</b>		
Customer accounts related to banking activities	4.34%	4.11%
Borrowings	4.93%	4.18%
Subordinated liabilities	6.48%	6.51%
Investment contracts at amortised cost		
Annuities	7.68%	7.77%
Term deposits	3.83%	3.94%
Guaranteed bonds	3.95%	3.78%

#### Unit linked contracts

For unit linked contracts, the unit prices (i.e. obligation to the policyholders) are based on fair values of investments and other assets within the portfolio. Therefore, there is no interest rate risk for these contracts. However, the Group's exposure to such contracts is the risk of volatility in asset management fees due to the impact of interest rate and market price movements on the fair value of assets held in the linked funds, on which asset management fees are based.

Within this category of contracts there are insurance contracts with guaranteed minimum death benefits that expose the Group to the risk of a reduction in the value of underlying investments as a result of changes in interest rates.

All such contracts have embedded surrender options and unit linked features. These derivatives vary in response to the change in financial variables (such as market interest rates). The Group is therefore required to separate and fair value these derivatives when the instrument is not designated to be measured at fair value through income and the embedded derivatives are not closely related to the host contract. At year end, all embedded derivatives within these liabilities were closely related to the host contract and did not require separation.

#### **(f) Operational risk**

Operational risk is the risk of loss, or adverse consequences for the Group's business, resulting from inadequate or failed internal processes, people or systems, or from external events

The Group sets an acceptable level of operational risk through the Group Operational Risk Policy (the Group ORP). The Group ORP requires that each Group company takes into consideration the guidance given in the relevant local legislation and regulations when defining and implementing its Operational Risk Policy. The main features of the Group ORP are set out below

The types of operational risk that the Group is exposed to are identified using the following operational risk categories: fraud or irregularities, regulatory or legal, customer treatment, business interruption, supplier failure, planning, process execution, and people. Activities undertaken to ensure the practical operation of controls over financial risks (i.e. market, credit, liquidity and insurance risk) are treated as an operational risk

Operational risk exposures are controlled using a combination of one or all of the following: modifying operations such that there is no exposure to the risk, accepting exposure to the risk and choosing not to control the risk, or accepting exposure to the risk and controlling the exposure by risk transfer or risk treatment. The level of control and nature of the controls implemented are based on, amongst other things:

- the potential cause and impact of the risk,
- the likelihood of the risk being realised in the absence of any controls,
- the ease with which the risk could be insured against,
- the cost of implementing controls to reduce the likelihood of the risk being realised, and
- the operational risk appetite

The Control Self Assessment (CSA) process is a key element used in monitoring the effectiveness of the Operational Risk controls. The CSA is intended to provide assurance as to the adequacy of the existing control activities implemented to manage risks associated with business processes. Assessments are performed by business managers and monitored by the individual Group company's Risk Function. Group Risk Management is responsible for monitoring the completion of the process and reviewing and challenging the results. Independent monitoring is provided by Group Internal Audit. Results of the process are reported through the GORC to the Board as part of the evidence for the Board to support the sign off of the *Annual Report and Accounts*.

The assessment of operational risk exposures is performed on a qualitative basis using a combination of impact and likelihood, and on a quantitative basis using objective and verifiable measures. Limits for exposure are set using both quantitative limits, e.g. financial impact, and also qualitative statements of principle that articulate the event, or effect, that needs to be limited.

The operational risks faced by each Group company and its exposure to these risks forms its operational risk profile. Each Group company is required to understand and review its profile by monitoring its key operational risk exposures, its loss experience and the results of control self assessment.

The impact of a new product, a significant change or any one off transaction on the operational risk profile of each Group company should be assessed and managed in accordance with established guidelines or standards.

## **40. Contingencies**

### **(a) Legal proceedings and regulations**

The Group, like other financial organisations, is subject to legal proceedings in the normal course of its business. While it is not practicable to forecast or determine the final results of all pending or threatened legal proceedings, management does not believe that such proceedings (including litigations) will have a material effect on the results and financial position of the Group.

The Group is subject to insurance solvency regulations in all the territories in which it issues insurance and investment contracts, and it has complied with all the local solvency regulations. Therefore there are no contingencies in respect of these regulations.

### **(b) Warranties**

The Group has potential obligations in relation to certain warranties given in connection with the disposal of a book of business during the 2005 financial year. The Company's total liability in respect of all relevant claims under these warranties is limited to a total of £21m and extends to a maximum period of 30 months from 30 September 2005. The likelihood of payments being made under these warranties is considered to be low.

### **(c) Joint ventures and associates**

The Group has entered into agreements to share in the assets and liabilities of joint venture and associate investments. The Directors do not anticipate any material losses from such investments and the operations of such investments are not material in relation to the operations of the Group.

The Group's share of contingent liabilities of the joint ventures and associates is not significant in relation to the operations of the Group.

### **(d) Issued Share Capital**

The Scheme of Demutualisation sets a ten year time limit for those eligible members of The Standard Life Assurance Company who were not allocated shares at the date of demutualisation to claim their entitlement. As future issues of these shares are dependent upon the actions of eligible members, it is not practical to estimate the financial effect of this potential obligation.

## 41. Commitments

### (a) Capital commitments

The Group's capital commitments as at the year-end are

	2006 £m	2005 £m
Authorised and contracted for but not provided and incurred		
Investment properties	137	264
Property, plant and equipment	587	55

£121m (2005 £249m) and £16m (2005 £15m) relates to the contractual obligations to purchase, construct or develop investment property and repair, maintain or enhance investment property respectively

### (b) Off balance sheet instruments

The following indicates the contractual amounts of the Group's off balance sheet financial instruments that commit it to customers and third parties, as at the year end

	2006 £m	2005 £m
Guarantees and stand by letters of credit		8
Commitments to extend credit		
Original term to maturity of more than one year	2,218	2,299
Other commitments	555	505

Guarantees and letters of credit include guarantees in relation to the Group's Canadian operations. Revised IAS 39 *Financial Instruments Recognition and Measurement*, effective 1 January 2006, results in these guarantees being considered financial guarantee contracts and initially recognised at fair value. The fair value at 31 December 2006 is £nil (2005 £nil).

Included in 'Other commitments' is £196m (2005 £296m) committed by certain subsidiaries which are not fully owned by the Group. These commitments are funded through (contractually agreed) additional investments in the subsidiary by the Group and the minority interest. The levels of funding are not necessarily in line with the relevant percentage holdings.

### (c) Operating lease commitments

The Group has entered into commercial non cancellable leases on certain property, plant and equipment where it is not in the best interest of the Group to purchase these assets. Such leases have varying terms, escalation clauses and renewal rights.

The future aggregate minimum lease payments under non-cancellable operating leases are as follows

	2006 £m	2005 £m
Not later than one year	12	9
Later than one year and no later than five years	13	15
Later than five years	7	6
<b>Total operating lease commitments</b>	<b>32</b>	<b>30</b>

## 42. Employee share based payments

Prior to the listing of the Company's shares on the London Stock Exchange, the Group did not operate any employee share based payment schemes. At the time of flotation, the Group established a number of share-based payment schemes with employees. Details of these arrangements are as follows:

### (i) Long Term Incentive Plan (LTIP)

Details of the LTIP are set out in the Directors' Remuneration Report on page 70. Prior to the listing of the Company's shares on the London Stock Exchange, the LTIP was a cash based award dependent on certain performance conditions being achieved over a three year period. On the listing of the Company's shares on the London Stock Exchange, the 2005 and 2006 plans were converted to awards of shares of the Company and in future years the LTIP will be a share-based payment scheme. Under the terms of the conversion, the number of options awarded, which will have a nil exercise price was based on the average share price over the initial 20 days of trading. The relevant performance periods for the 2005 and 2006 plans commence on 1 January 2005 and 1 January 2006 respectively, and this remains unchanged by the conversion. An additional grant under the 2006 plan was made on 1 November 2006.

Under the terms of the plan, share options are awarded to executives and senior management based on performance results of the Group over a three year period. The performance target is based on the Group's return on capital which is a combination of return on underlying profit for the non life businesses of the Group and the return on European Embedded Value for the life businesses of the Group. At the grant date the participants are advised of the range of options that will be awarded. The actual number of options that ultimately vest is determined at the end of the three year performance period. The terms and conditions of the LTIP listed below assume the maximum number of options available to vest.

### (ii) Annual Performance Awards

All employees are awarded annual performance shares when Group profit exceeds target. Group profit is defined in the same way as for the LTIP. The Remuneration Committee agreed on 28 February 2007 to grant an award of annual performance shares in respect of services from employees for the year ended 31 December 2006. A cost of £3.2m has been reflected in the consolidated income statement in respect of the grant of these awards.

### (iii) Share Incentive Plans

The Group operates share incentive plans, allowing employees the opportunity to buy shares from their salary each month. The maximum purchase that an employee can make in any year is £1,500. The Group offers to match the first £25 of shares bought each month. The matching shares awarded under the Share Incentive Plan are granted at the end of each month. The first grant occurred at the end of October 2006.

The matching shares are generally subject to a three year service period, and an employee may forfeit some or all of the matching shares if they leave the Group prior to completing three years of service from the date of grant.

### (iv) Shares awarded on flotation

On the listing of the Company's shares on the London Stock Exchange, each qualifying employee was awarded 185 shares. There were no vesting conditions attaching to these shares and therefore all these shares vested on 10 July and the cost of £4m has been reflected in the period 1 January to 10 July income statement.

**(a) Terms and conditions of the share based payment schemes**

The terms and conditions attaching to each of the on going arrangements are set out in the table below. The assumptions set out are based on the weighted average number of awards.

Arrangement	LTIP share options granted to executives	Annual performance awards target profits achieved	Share incentive plans
Nature of arrangement	Grant of share options	Grant of shares	Grant of shares
Date of Grant	4 August 2006 1 November 2006	28 February 2007	Monthly
Number of instruments granted	7,285,761 118,729	1,070,300	126,383*
Exercise price	nil		
Share price at date of grant	258.75p 284.5p	302p	291p
Contractual life (years)	3.75 years		
Vesting conditions	3 year service period, specified Group performance		3 year service period
Settlement	Shares	Shares	Shares
Expected volatility	25%		
Expected option life at grant date (years)	2.19 years		
Risk free interest rate	4.92%		
Expected dividend (dividend yield)	2.67%		
Expected departures (grant date)	None at grant date Leavers accounted for on departure		None at grant date Leavers accounted for on departure
Expected outcome of meeting performance criteria (at the grant date)	75%		At grant date, all awards expected to vest
Fair value per granted instrument determined at the grant date	244p	302p	291p

\* Included in the number of instruments granted are 13,880 rights to shares granted to eligible employees in Canada, Germany and Austria.

**(b) Long term incentive plan – share options**

The Black Scholes option pricing model is used to value the options granted under the LTIP. The expected volatility for the share options has been determined following consideration of historical volatility since the listing of the Company's shares on the London Stock Exchange, together with the volatility of a group of peer companies over a comparable period in their history.

The risk free interest rate was based on the yields attaching to UK government bonds at the grant date. These had a similar term to the expected life of the options at the grant date.

No share options were exercised during the period. The information in the table that follows applies to the maximum number of options outstanding at the end of the period.

Range of exercise prices	Weighted average exercise price	Number of options	Weighted average remaining life (years) Expected	Contractual
nil	nil	6,900,828	2.19	2.70

## 42. Employee share based payments

### (b) Long term incentive plan – share options continued

A reconciliation of movements in the number of share options granted to executives and senior management is set out in the table below

	Number of options	Weighted average exercise price
Outstanding at start of year	7,285,761	
Effect of modifications and cancellations		
Granted	118,729	
Forfeited	(503,662)	
Exercised		
Expired		
Outstanding at end of year	6,900,828	
Exercisable at year end		

Under the terms of the conversion these options have a nil price

The amounts recognised as an expense in Note 6 for share-based payment transactions with employees are as follows

	2006 £m
Share options granted to executives and senior management	6
Shares awarded on flotation	4
Annual performance awards	3
	13

## 43. Related party transactions

### (a) Transactions with/from and balances from/(to) related parties

In the normal course of business, the Group enters into transactions with related parties that relate to insurance, banking and investment management business. Such related party transactions are at arm's length

Transactions with related parties carried out by the Group during the year were as follows

	2006 £m	2005 £m
<b>Sale to</b>		
Associates	10,524	5,478
Joint ventures	12	53
	10,536	5,531
<b>Purchase from</b>		
Associates	11,030	6,037
Joint ventures	23	51
	11,053	6,088

Transactions shown above relate primarily to the sale and purchase of holdings in Standard Life Investments (Global Liquidity Funds) plc, which is an associate of the Group

The year end balances with related parties arising from transactions carried out by the Group with related parties are as follows

	2006	2005
	£m	£m
<b>Due from related parties</b>		
Joint ventures	13	11
Other	241	230
	254	241

At the year end £241m (2005 £230m) was due from related parties relating to the Group's defined benefit pension scheme

**(b) Compensation of key management personnel**

Key management personnel, comprising 18 people (2005 21 people) of the Group, include all Directors, both executive and non-executive and the direct reports of the Group Chief Executive. Detailed disclosures of Directors' remuneration for the year and transactions in which the Directors are interested are contained within the audited section of the Directors' Remuneration Report on pages 70 to 83.

The summary of compensation of the key management personnel is as follows

	2006	2005
	£m	£m
Salaries and other short term employee benefits	9	9
Post employment benefits	2	5
Other long term benefits	2	1
Share-based payments	2	
<b>Total compensation of key management personnel</b>	15	15

**(c) Transactions with/from and balances from/(to) key management personnel**

The detailed disclosures of transactions incurred by the Group with key management personnel during the year and year end balances arising from such transactions are contained within the audited section of the Directors' Remuneration Report on pages 70 to 83.

All transactions between the key management and the Group during the year are on commercial terms which are equivalent to those available to all employees of the Group.

During the period to 31 December 2006, the key management personnel contributed £1.3m (2005 £6.3m) to products sold by the Group. This primarily relates to investments in SIPP products with the transfer of funds from an external provider.

At 31 December 2006 key management personnel had outstanding loans of £nil (2005 £40,000).

#### 44. Business combinations

On 1 April 2006, the Group acquired the private medical insurance business of FirstAssist. The acquired business contributed revenues of £49m and a loss before impairment and restructuring charges of £4m to the Group for the period from 1 April 2006 to 31 December 2006.

The purchase cost comprised

	£m
Cash paid	27
Direct costs relating to the acquisition	1
<b>Total purchase consideration</b>	<b>28</b>

The excess of the consideration over the fair value of the identifiable net assets acquired was £24m, which was recorded as goodwill arising on acquisition. The goodwill has subsequently been impaired by £8m. A restructuring charge of £13m, relating primarily to office closure costs, has also been reflected in the income statement for the year ended 31 December 2006.

#### 45. Collateral

Collateral is accepted from and provided to certain market counterparties to mitigate counterparty risk in the event of default. The use of collateral in these circumstances is governed by formal bilateral agreements between the parties. The amount of collateral required by either party is calculated daily based on the value of derivative transactions in accordance with these agreements and collateral is moved on a daily basis to ensure there is full collateralisation. Any collateral moved under the terms of these agreements is transferred outright. With regard to either collateral pledged or accepted the Group may request the return of, or be required to return, collateral to the extent it differs from that required under the daily margin calculations. Furthermore, alternative collateral may be provided if acceptable to both parties.

At 31 December 2006, the Group had pledged £110m (2005: £184m) of cash as collateral for liabilities.

At 31 December 2006, the Group had accepted £2,874m (2005: £1,801m) of cash and £6,327m (2005: £6,900m) of securities as collateral. Included within these amounts is collateral which has been accepted in relation to stock lending. At 31 December 2006 the Group had accepted £2,850m (2005: £1,749m) of cash and £6,327m (2005: £6,878m) of securities in relation to stock lending. None of the above securities were sold or repledged at the year-end.

Where there is an event of default under the terms of the agreements, any collateral balances will be included in the closeout calculation of net counterparty exposure.

#### 46. Fair value of financial assets and liabilities

The estimated fair values of financial assets and liabilities whose carrying value does not approximate fair value are as follows

	2006	2006
	Carrying value	Fair value
	£m	£m
<b>Financial assets</b>		
Loans secured by mortgages	6,352	6,415
Loans secured by mortgages subject to securitisation	5,525	5,533
<b>Financial liabilities</b>		
Loan notes backing securitisations	4,383	4,492
Subordinated guaranteed bonds	1,016	1,114
Subordinated notes	253	262
Mutual Assurance Capital Securities	565	577

	2005	2005
	Carrying value	Fair value
	£m	£m
<b>Financial assets</b>		
Loans secured by mortgages	7,333	7,455
Loans secured by mortgages subject to securitisation	4,968	4,989
<b>Financial liabilities</b>		
Loan notes backing securitisations	4,025	4,041
Subordinated guaranteed bonds	1,032	1,203
Subordinated notes	267	277
Mutual Assurance Capital Securities	579	627

The estimated fair values are calculated by discounting the expected future cash flows at current market rates

It is not possible to reliably calculate the fair value of participating investment contract liabilities. The assumptions and methods used in the calculation of these liabilities are set out in the accounting policies and Note 28. The carrying value of investment contract liabilities at 31 December 2006 was £69,494m (2005: £59,005m)

The carrying value of all other financial assets and liabilities approximates their fair value

## 47. Capital statement

### Capital position

The Financial Services Authority (FSA) requires all insurance companies and financial conglomerates to maintain Capital Resources (CR) in excess of their Capital Resources Requirement (CRR). CR includes the assets in excess of liabilities, valued on a regulatory basis, and certain other components of capital. Certain items that are classified as liabilities under IAS 32 *Financial Instruments Disclosure and Presentation* are treated as capital under the regulatory basis. For the Group this applies to its subordinated guaranteed bonds, subordinated notes and mutual assurance capital securities. The CRR represents the total of the individual capital resources requirements (ICRR) of each regulated company in the Group. The Group's capital position is analysed between UK regulated life business, overseas life operations and other activities. The UK regulated life business is analysed by the nature of the underlying funds. German and Irish business is written by branches of UK regulated companies, and hence this business is included either in the HWPF (business written prior to demutualisation) or other long term business funds as appropriate (business written post demutualisation). Other activities comprise investment management, general insurance and Group Corporate Centre. Standard Life Bank is a subsidiary of Standard Life Assurance Limited and therefore its capital resources are included within Life business shareholders' funds. The Group's capital position is set out on page 197.

	UK regulated life businesses				Total UK regulated life business	Overseas life operations	Total life business	Other activities	2006 Group Total	2005 Group Total
	Hentage With Profits Fund	Other with profits funds	Proprietary business funds	Life business shareholders funds						
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
<b>Available capital resources</b>										
<b>Shareholders' funds</b>										
Held outside life assurance funds				976	976	822	1,798	890	2,688	
Held within life assurance funds			171		171	19	190		190	
<b>Equity attributable to ordinary equity holders</b>			171	976	1,147	841	1,988	890	2,878	
Unallocated divisible surplus	1,208				1,208		1,208		1,208	4,827
<b>Other qualifying capital</b>										
Subordinated guaranteed bonds				1,016	1,016		1,016		1,016	1,032
Subordinated members' accounts				565	565		565		565	579
Subordinated notes				260	260	176	436	(183)	253	263
Implicit item for future profits										200
				1,841	1,841	176	2,017	(183)	1,834	2,074
<b>Adjustments onto regulatory basis</b>										
Changes to the valuation of contract liabilities	4,669		12		4,681	319	5,000		5,000	2,012
Exclusion of present value of future results on non-participating contracts										(1,528)
Exclusion of deferred acquisition costs and other inadmissible assets	(211)		(201)	(24)	(436)	(44)	(480)	(27)	(507)	(347)
Exclusion of deferred income	196		42		238		238		238	223
Changes to the valuation of other assets and liabilities	19		75	32	126	(512)	(386)	(22)	(408)	(191)
	4,673		(72)	8	4,609	(237)	4,372	(49)	4,323	169
<b>Total available capital resources to meet regulatory requirement</b>	5,881		99	2,825	8,805	780	9,585	658	10,243	7,070
Capital not subject to constraints				2,522	2,522	347	2,869	585	3,454	6,185
Capital subject to constraints	5,881		99	303	6,283	433	6,716	73	6,789	885
<b>Total available Capital Resources</b>	5,881		99	2,825	8,805	780	9,585	658	10,243	7,070
<b>Regulatory capital resources requirement*</b>					3,951	360	4,311	73	4,384	2,898
<b>Excess of available capital resources over regulatory requirement</b>					4,854	420	5,274	585	5,859	4,172
<b>Analysis of contract liabilities</b>										
<b>Participating</b>										
Insurance contracts	19,759	25			19,784	441	20,225		20,225	19,633
Investment contracts	18,557	1			18,558	5	18,563		18,563	18,076
<b>Total participating contract liabilities</b>	38,316	26			38,342	446	38,788		38,788	37,709
<b>Unit linked</b>										
Insurance contracts	1,544		2		1,546	1,095	2,641		2,641	2,486
Investment contracts	38,541		4,726		43,267	5,502	48,769		48,769	38,503
<b>Total unit linked liabilities</b>	40,085		4,728		44,813	6,597	51,410		51,410	40,989
<b>Other non-participating</b>										
Insurance contracts	13,198		410		13,608	3,798	17,406	155	17,561	18,672
Investment contracts	399		45		444	1,718	2,162		2,162	2,426
<b>Total other non participating liabilities</b>	13,597		455		14,052	5,516	19,568	155	19,723	21,098
<b>Total contract liabilities</b>	91,998	26	5,183		97,207	12,559	109,766	155	109,921	99,796

\* The regulatory capital resource requirement is shown for the UK regulated life business as a whole, as the CRR applies at Company level

## 47. Capital statement

### Capital position *continued*

The Company is classified as a financial conglomerate by the FSA by virtue of the significant regulated activities of the Group, including insurance, investment management and banking operations. The largest regulated entity within the Group is SLAL, which undertakes life assurance and pension business principally in the UK, Ireland and Germany. SLAL's regulatory solvency position is determined using the FSA's 'twin peaks' approach, which requires liabilities to be valued on both a realistic and a regulatory basis. The realistic basis removes some of the margins for prudence included in calculations under the regulatory basis. However, it requires discretionary benefits that are not considered under the regulatory basis, such as final bonuses, to be valued. The extent to which the realistic peak is more onerous than the regulatory peak, increases the amount of the CRR. At 31 December 2006, the realistic peak was more onerous than the regulatory peak resulting in a With Profits Insurance Capital Component (WPICC) of £1.6bn. The WPICC is one of the components of CRR (2005 the regulatory peak exceeded the realistic peak by £791m resulting in no WPICC). As a consequence, SLAL's CRR in 2006 is increased by £1.6bn. The capital resources shown in the capital statement are based on the value of assets and liabilities valued on a regulatory basis, however, the CRR reflects the higher value required as a result of the application of the realistic peak.

In addition to the requirement to maintain CR in excess of its CRR, the FSA requires that each regulated company in the Group identifies the major risks it faces and, if appropriate, quantifies the amount and type of capital it believes is appropriate to mitigate those risks. This individual capital assessment reflects each company's view of the adequacy of its CR. The determination of the liabilities includes various actuarial and other assumptions including potential changes in market conditions and the actions management might take as a result of those changes.

Changes in market conditions and other variables have the potential to affect significantly the capital position. Poor investment returns could depress CR, but this could be mitigated by changing the asset portfolio and by the level of bonuses declared. Future annuitant mortality could be significantly different from that assumed in the calculation of the liabilities. The interaction between the 'twin peak' under the FSA's approach and EU developments on solvency requirements could also have a significant impact on the future capital position.

The majority of life assurance and pensions business undertaken by UK regulated entities is written within long term business funds within each regulated company. These long term business funds are distinct from the equity holders' funds. The HWPF's capital resources of £5,881m and future surplus arising can be used to provide support for the HWPF, enhance payments to with profits policyholders or, in relation to the recourse cash flows (as defined in Note 1), transfer defined amounts out of the fund to accrue to the benefit of equity holders. Additional restrictions are placed on the HWPF by the Scheme, which provides that the recourse cash flows will be subject to a solvency test which prevents transfers of the recourse cash flows if, as a result of the transfer, the HWPF would have a realistic deficit or would have a regulatory surplus below the level which the board of SLAL considers necessary to declare bonuses in accordance with reasonable benefit expectations of with profits policyholders without creating a regulatory deficit.

Any surplus within the Proprietary business funds is attributable to equity holders. Capital within the Proprietary business funds may be made available to meet requirements elsewhere in the Group subject to meeting the regulatory requirements of the fund and any further restrictions imposed by the Scheme.

Capital subject to constraints of £6,789m (2005 £885m) represents capital resources held within long term business funds, or for other regulated entities the amount of the CRR.

Standard Life Bank is owned by SLAL and therefore its capital resources are included within Life business shareholders' funds.

Standard Life Bank's Capital Resources exceed its Capital Resource Requirement by £314m (2005 £225m), and the excess can therefore be used to meet the requirements of the life assurance business.

The Group, through subsidiaries and joint ventures, provides insurance and other financial services in the UK, Canada, India and China and also through branches, provides such services in Ireland and Germany. With the exception of the requirements of the Scheme and the intra group subordinated debt referred to below and the capital support mechanisms, there are no formal arrangements to provide capital to particular funds or business units. Any allocations of capital would need to be approved on a case by case basis by the Board.

SLAL has issued a subordinated loan note to Standard Life plc (see Note 33), which SLAL treats as capital for regulatory purposes. SLCC and SLI have issued subordinated debt of £176m and £15m respectively, to the Company. These amounts of subordinated debt are included within the capital resources of those businesses, but at Group level only subordinated debt issued to external parties is included in the Group's Capital Resources.

### Contract liabilities

The process used to determine the assumptions that have the greatest effect on the measurement of contract liabilities (including options and guarantees), the quantified disclosure of those assumptions, and the terms and conditions of options and guarantees relating to life assurance contracts that could in aggregate have a material effect on future cash flows are disclosed in Note 28 and Note 29

The sensitivity of contract liabilities to changes in market conditions, key assumptions and other variables, and assumptions about management actions in response to changes in market conditions, are disclosed in Note 31

### Movements in capital

The movements in the total life business Capital resources shown in the capital statement are set out below

	UK regulated life businesses					Total UK regulated life business	Overseas life operations	Total life business
	The Standard Life Assurance Company	Heritage With Profits Fund*	Other with profits funds	Proprietary business funds	Life business shareholders' funds			
	£m	£m	£m	£m	£m	£m	£m	£m
<b>At 1 January 2006</b>	7,070					7,070		7,070
Methodology/modelling changes	(304)					(304)		(304)
Change in assumptions used to measure life assurance contract liabilities	88					88		88
New business	(196)					(196)		(196)
Investment surplus	1,423					1,423		1,423
Repayment of subordinated debt	(1,620)					(1,620)		(1,620)
Other factors	(660)					(660)		(660)
<b>At 10 July before demutualisation</b>	5,801					5,801		5,801
Capital transferred as a result of demutualisation	(5,801)	4,045		521	338	(897)	684	(213)
Issue of subordinated debt					1,631	1,631		1,631
Issue of share capital					557	557		557
Impact on available capital of the Scheme of Demutualisation		285		(374)		(89)		(89)
<b>At 10 July after demutualisation</b>		4,330		147	2,526	7,003	684	7,687
Methodology/modelling changes		(53)		8		(45)	(18)	(63)
Change in assumptions used to measure life assurance contract liabilities and experience differences		34		21		55	21	76
Changes in management policy							(39)	(39)
New business		(40)		(183)		(223)	(45)	(268)
Investment surplus		1,856		12	14	1,882	57	1,939
Shareholder/Inter fund transfers		(209)		201	8			
Dividend transfers							(25)	(25)
Other factors		(37)		(107)	277	133	145	278
<b>At 31 December 2006</b>		5,881		99	2,825	8,805	780	9,585

\* Includes SLAC following demutualisation

## 47. Capital statement

### Movements in capital continued

For the period from 1 January 2006 to 10 July 2006, The Standard Life Assurance Company (SLAC) was a mutual organisation and was the principal insurance company within the Group. Its with profits fund owned all the subsidiaries of the Group. All business, including non participating business, was written within this fund. The capital resources of the regulated subsidiaries are included when calculating SLAC's capital resources. Therefore, the movement in capital from 1 January to 10 July is presented in a single column. At demutualisation capital was transferred from SLAC, the mutual company, as a result of the Scheme of Demutualisation (described in Note 1). After the date of demutualisation, analysis of the movements in capital in the Group's life business reflects the Group's new corporate and fund structure.

Immediately prior to demutualisation SLAC repaid its subordinated liabilities which resulted in a reduction of capital within SLAC of £1,620m. On demutualisation the Company entered into a subordinated loan with SLAL shareholder fund, resulting in an increase in capital resources of £1,631m. On demutualisation SLAL's shareholder fund issued share capital to the Company for £737m. £180m of this amount is inadmissible on demutualisation. The amount became admissible on 13 July 2006 and is reflected as a movement in 'Other factors'. As discussed in Note 1, certain operating subsidiaries which had been transferred to SLAL on demutualisation, were transferred by a dividend in specie to entities outside the life business of the Group.

The impact of demutualisation on the capital resources available to the life business was to decrease it by £89m, which primarily represents the removal of the implicit item (£200m) and changes to the value of assets and liabilities as a result of the new corporate and fund structure.

The investment surplus arises from changes in market conditions, and reflects the total returns earned on the assets compared with the valuation interest rates previously assumed. It also reflects the consequent change in liabilities as a result of the change in the yield currently available on the assets and therefore the current valuation interest rates, and the differences in the assumptions under the resilience tests.

Strains of writing new business and supporting bonus rates arise under the regulatory peak. Prior to demutualisation £196m of new business strain arose with £268m arising following demutualisation.

Changes in assumptions used to measure contract liabilities have not had a significant impact on Capital Resources.

Shareholder/Interfund transfers include the transfer of £158m from the HWPF to the shareholder fund in respect of the recourse cash flows for UK and Ireland and £51m to the Proprietary business fund in relation to additional expenses charged on German unutilised with profits business. In addition, £151m was transferred from the shareholder fund to the Proprietary business fund.

### Capital management policies and risk management objectives

Managing capital is the on going process of determining and maintaining the quantity and quality of capital appropriate for the Group, and ensuring capital is deployed in a manner consistent with the expectations of our stakeholders. For these purposes, we consider our key stakeholders to be the providers of capital (our equity holders, policyholders and holders of our subordinated liabilities) and the FSA.

There are two primary objectives of capital management within the Group. The first objective is to ensure that capital is, and will continue to be, adequate to maintain the required level of safety and stability of the Group and hence to provide an appropriate degree of security to our customers. The second objective is to support the development of the business by ensuring that the returns generated on capital investment are sufficient to provide adequate compensation to the providers of capital, after allowing for the risks to which that capital is exposed.

The capital requirements of each business unit are routinely forecast on a periodic basis, and the requirements are assessed against both the forecast available capital. In addition, internal rates of return achieved on capital invested are assessed against hurdle rates, which are intended to represent the minimum acceptable return given the risks associated with each investment.

The capital planning process is the responsibility of the Group Finance Director. Capital plans are ultimately subject to approval by the Board.

The formal procedures for identifying and assessing risks that could affect the capital position of the Group are described in the risk management policies set out in Note 39.

#### 48. Investment in subsidiaries

The following are particulars of the Company's principal subsidiaries which are unlisted entities except where indicated

Name of subsidiary	Country of incorporation or residence	% of interest held	Nature of business
Standard Life Healthcare Limited	England	100	General insurance
Standard Life Investment Holdings Ltd	Scotland	100	Holding company
Standard Life (Mauritius Holdings) 2006 Ltd	Mauritius	100	Investment management
Standard Life Oversea Holdings Ltd	Scotland	100	Holding company
Standard Life Employee Services Limited	Scotland	100	Employee support services
Standard Life Assurance Limited	Scotland	100	Life assurance
Standard Life Bank Limited	Scotland	100	Banking
Standard Life Lifetime Mortgages Limited	Scotland	100	Mortgage finance
Standard Life Pension Funds Limited	Scotland	100	Life assurance
Standard Life Savings Limited	Scotland	100	Investment management
Standard Life European Private Equity Trust PLC** ***	Scotland	51	Investment trust
Standard Life Investment Funds Limited	Scotland	100	Life assurance
The Standard Life Assurance Company 2006* ***	Scotland	100	Life assurance
Standard Life International Limited	Ireland	100	Life assurance
The Standard Life Assurance Company of Canada	Canada	100	Life assurance
Standard Life Client Management Scotland Limited	Scotland	100	Direct Sales

\* The Standard Life Assurance Company 2006 is a sole member company with Standard Life Assurance Limited being the sole member

\*\* Indicates listed entity

\*\*\* Indicates the entity has had a different reporting date to the Group but has been consolidated consistently at 31 December

In certain circumstances, the Group sponsors the formation of special purpose entities primarily for the purpose of securitisation of assets for raising finance. The Group consolidates special purpose entities when the substance of the relationship is that it controls or has the power to control the entity. In assessing and determining whether the Group controls such special purpose entities, judgement is made about the Group's exposure to the risks, benefits and ability to control the operating and financial decisions of the entity.

#### 49. Event after the balance sheet date

The Chancellor of the Exchequer, in his Budget statement on 21 March 2007, announced a number of proposed changes to tax legislation, including a reduction in the rate of UK corporation tax from 30% to 28% with effect from April 2008. These proposed changes in legislation are subject to enactment.

Due to the nature of this event, it is non adjusting. No estimate of its financial effect has been made for these consolidated financial statements.

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## Independent auditors' report to the Directors of Standard Life plc (the 'Company') on the supplementary financial statements

We have audited the supplementary financial statements for the period 10 July 2006 to 31 December 2006 that comprise the EEV consolidated income statement, the EEV consolidated statement of recognised income and expense, the EEV consolidated balance sheet and the relevant notes 1 to 13 which have been prepared in accordance with the European Embedded Value basis set out in pages 206 and 218 to 222, and which should be read in conjunction with the audited consolidated financial statements prepared on an IFRS basis

### Respective responsibilities of Directors and auditors

The Directors are responsible for preparing the Annual Report, including the consolidated financial statements prepared on an IFRS basis. Our responsibilities in relation to the Annual Report, including those consolidated financial statements, are set out in the Independent auditors' report to the members of the Company. The Directors are also responsible for preparing the supplementary financial statements on the European Embedded Value basis.

Our responsibilities, as independent auditors, in relation to the supplementary financial statements are, as set out in our letter of engagement dated 18 December 2006, to report to you our opinion as to whether the supplementary financial statements have been properly prepared in accordance with the European Embedded Value basis set out in pages 206 and 218 to 222. We also report to you if we have not received all the information and explanations we require for our audit of the supplementary financial statements. This report, including the opinion, has been prepared for and only for the Directors in accordance with our letter of engagement dated 18 December 2006 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We also read the other information in the Annual Report and consider the implication for our report if we become aware of any apparent misstatements or material inconsistencies with the supplementary financial statements.

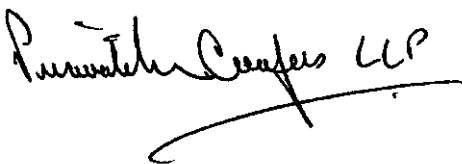
### Basis of opinion

We conducted our audit in accordance with International Standards on Auditing ('ISA') (UK and Ireland) issued by the Auditing Practices Board. Our audit included examination, on a test basis, of evidence relevant to the amounts and disclosures in the supplementary financial statements. This evidence included an assessment of the significant estimates and judgements made by the Directors in the preparation of the supplementary financial statements, and of whether the basis of preparation is appropriate to the Group's circumstances, consistently applied and adequately disclosed.

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

### Opinion

In our opinion, the supplementary financial statements have been properly prepared in accordance with the European Embedded Value basis set out in pages 206 and 218 to 222.



PricewaterhouseCoopers LLP  
Chartered Accountants  
Edinburgh  
22 March 2007

## EEV consolidated income statement

For the period 10 July 2006 to 31 December 2006

Period 10 July 2006 to  
31 December 2006

£m

<b>Life and pensions</b>	
UK	214
Europe	11
Canada	80
Other	(7)
HWPF TVOG	31
<b>Life and pensions operating profit</b>	<b>329</b>
Investment management*	23
Banking	21
Healthcare and general insurance	13
Group corporate centre costs	(47)
Other	7
<b>Operating profit before tax</b>	<b>346</b>
<b>Other non operating items</b>	
Long term investment return and tax variances	229
Effect of economic assumption changes	140
Impairment of acquired intangible assets	(4)
Restructuring expenses	(12)
Volatility arising on different asset and liability valuation bases	29
<b>Profit before tax</b>	<b>728</b>
Attributed tax	(213)
<b>Profit after tax</b>	<b>515</b>

\* Investment management operating profit before tax is stated after excluding profits of £14m which have been generated by the life and pensions businesses

## EEV earnings per share

For the period 10 July 2006 to 31 December 2006

	Period 10 July 2006 to 31 December 2006
EEV operating profit after tax attributable to equity holders of Standard Life plc (£m)	248
Basic EPS (pence)	11.8
Weighted average number of ordinary shares in issue (millions)	2,102
Diluted EPS (pence)	11.4
Weighted average number of ordinary shares on a diluted basis (millions)*	2,173

\* Includes the full dilutive effect of bonus shares committed to at the time of the demutualisation of The Standard Life Assurance Company and the flotation of Standard Life plc and share awards and share options

## EEV consolidated statement of recognised income and expense

For the period 10 July 2006 to 31 December 2006

	Notes	Period 10 July 2006 to 31 December 2006 £m
Fair value gains/(losses) on cash flow hedges		4
Actuarial (losses)/gains on defined benefit pension schemes		(2)
Foreign exchange rate movements*		(105)
Aggregate tax effect of items not recognised in income statement		(6)
Net (expense)/income recognised directly in consolidated balance sheet		(109)
Profit after tax		515
<b>Total recognised income and expense for the period attributable to equity holders</b>	<b>7</b>	<b>406</b>

\* Foreign exchange rate movements primarily relate to Canada

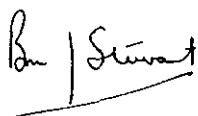
# EEV consolidated balance sheet

As at 31 December 2006

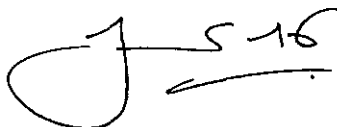
	Notes	31 December 2006 £m	10 July 2006 £m
<b>Covered business</b>			
Free surplus		720	742
Required capital		562	560
<b>Net worth</b>		<b>1,282</b>	<b>1,302</b>
Present value of in force		3,480	3,163
Cost of required capital		(263)	(282)
<b>Total embedded value of covered business</b>	1(c)	<b>4,499</b>	<b>4,183</b>
<b>Non covered business</b>			
Investment management		149	120
Banking		355	322
Healthcare and general insurance		119	120
Group corporate centre		553	371
Other		73	76
UK pension scheme deficit		(140)	(197)
<b>Total net assets of non covered business</b>		<b>1,109</b>	<b>812</b>
<b>Total Group embedded value</b>	7	<b>5,608</b>	<b>4,995</b>
<b>Equity</b>			
Share capital		210	202
Share premium reserve		799	615
Other reserves		1,869	1,650
EEV reserves		2,730	2,528
<b>Total equity*</b>		<b>5,608</b>	<b>4,995</b>

\* Embedded value equity per share is 258p as at 31 December 2006 compared to 239p as at 10 July 2006 based on diluted share totals of 2,177m as at 31 December 2006 and 2,094 as at 10 July 2006

Approved on behalf of the Board of Directors on 22 March 2007 by the following Directors



Sir Brian Stewart, Chairman



David Nish, Group Finance Director

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## Notes to the EEV financial information

### **Basis of preparation**

The European Embedded Value (EEV) basis results have been prepared in accordance with the EEV Principles and Guidance issued in May 2004 by the CFO Forum of European Insurance Companies and the Additional Guidance issued in October 2005. EEV reports the value of business in force based on a set of best estimate assumptions, allowing for the impact of uncertainty inherent in future assumptions, the cost of holding required capital and the value of free surplus. The total profit recognised over the lifetime of a policy is the same as under International Financial Reporting Standards (IFRS), but the timing of recognition of profits is different.

The results for the period 10 July 2006 to 31 December 2006 have been audited by our auditors, PricewaterhouseCoopers LLP. Their report in respect of this period is included on page 202 of this document.

The EEV results have been calculated on the basis that demutualisation took place before the start of the period, and therefore the net capital raised from the flotation has been reflected. The post demutualisation structure is in place for the period.

EEV includes the net assets of the businesses that are owned by shareholders of Standard Life plc plus the present value of future profits expected to arise from in force long term insurance policies (PVIF) where these future profits are attributable to shareholders under the Scheme of Demutualisation (the Scheme) or from sales of new business since 10 July 2006.

The opening and closing EEV numbers, and therefore the profit arising in the period, for the covered business are determined on an after tax basis. The tax assumptions are based upon the best estimate of the actual tax expected to arise. Profit before tax is derived by grossing up profit after tax at the standard rate of corporation tax appropriate to each territory. Whilst for some territories this rate does not equate to the actual effective rate of tax used in the calculation of after tax profits, it provides a consistent grossing up basis upon which to compare results from one year to another and is in line with the Group's expectation of the rate of tax applicable to business sold after demutualisation.

A detailed description of EEV methodology is provided in Appendix 1 on page 218.

### **Covered business**

For the purposes of EEV reporting, a distinction is drawn between covered business to which EEV methodology is applied and non covered business where results and balances are based on those determined under IFRS and included in the IFRS financial statements shown in the Annual Report and Accounts, unless otherwise stated.

The Group's covered business is its life assurance and pensions businesses in the United Kingdom, Europe (Germany and Ireland), Other (including Asia) and Canada, as well as the current and future profits and losses from Standard Life Investments (SLI) arising on its management of funds relating to the life and pensions businesses. As the businesses included in 'other' are not material in the context of the Group they have been included at their IFRS value.

UK covered business also includes

- Non insured Self Invested Personal Pension (SIPP) business
- Those elements of Wrap business that are contained within a long term product wrapper i.e. bonds, SIPPs and mutual funds

The Group's non-covered business mainly includes the business of Standard Life Bank (SLB), Standard Life Healthcare (SLH), the third party investment management business of SLI as well as other non life and pensions entities.

## 1. Segmental analysis – covered business

### (a) Segmental EEV income statement

10 July 2006 to 31 December 2006		UK	Europe	Canada	Other	HWPF TVOG	Total
	Notes	£m	£m	£m	£m	£m	£m
Contribution from new business	2	84	4	17			105
Contribution from in force business							
Expected return on existing business		136	15	47			198
Experience variances	3	49	(7)	(8)		28	62
Operating assumption changes	4	(55)	5	27		3	(20)
Development costs		(6)	(7)				(13)
Expected return on free surplus		6	1	(3)	(7)		(3)
<b>Operating profit before tax</b>		<b>214</b>	<b>11</b>	<b>80</b>	<b>(7)</b>	<b>31</b>	<b>329</b>
Investment return and tax variances		142	6	55		26	229
Effect of economic assumption changes		159	14	(36)		3	140
<b>Profit before tax</b>		<b>515</b>	<b>31</b>	<b>99</b>	<b>(7)</b>	<b>60</b>	<b>698</b>
Attributed tax		(154)	(9)	(30)	1	(18)	(210)
<b>Profit after tax</b>		<b>361</b>	<b>22</b>	<b>69</b>	<b>(6)</b>	<b>42</b>	<b>488</b>

An analysis of profit after tax by territory is provided in note 9

HWPF TVOG represents the time value of financial options and guarantees (TVOG) arising from the Heritage With Profits Fund (HWPF). Although this fund includes business written by UK, Germany and Ireland, it is managed at a combined level and therefore is not included within the results of each individual territory. The results for Canada include the cost of the Canadian TVOG, and the results for Europe include the cost of TVOG arising on business written outside of the HWPF in Germany.

The principal effect of determining the pre tax results using the standard rate of tax compared to the actual effective rate is to increase the Effect of economic assumption changes by £46m (UK £45m, Europe £1m), arising from the impact of investment related increases in the value of the tax effects that have been assumed to arise as a result of funding HWPF transfers out of unallocated surplus.

### (b) Segmental analysis of movements in EEV

10 July 2006 to 31 December 2006	UK	Europe	Canada	Other	HWPF TVOG	Total
	£m	£m	£m	£m	£m	£m
Opening EEV	3,082	263	917	55	(134)	4,183
Profit after tax	361	22	69	(6)	42	488
Capital injections/(dividends)	7	(7)				
Transfers (to)/from non-covered business	(73)			2		(71)
Foreign exchange rate movements	2	(8)	(94)	(2)		(102)
Transfer back of surplus to SLI	(9)					(9)
Actuarial gains/(losses) on defined benefit pension schemes		1	9			10
<b>Closing EEV</b>	<b>3,370</b>	<b>271</b>	<b>901</b>	<b>49</b>	<b>(92)</b>	<b>4,499</b>

Transfers (to)/from non covered business from UK life and pensions include £60m transferred to the UK pension scheme, and £13m transferred to Standard Life Savings, the mutual funds and Wrap company.

**1. Segmental analysis – covered business continued****(c) Segmental analysis of opening and closing EEV**

	UK £m	Europe £m	Canada £m	Other £m	HWPF TVOG £m	Total £m
<b>Analysis of EEV</b>						
Free surplus	686	(11)	12	55		742
PVIF	2,388	274	635		(134)	3,163
Required capital	15		545			560
Cost of capital	(7)		(275)			(282)
<b>Opening EEV at 10 July 2006</b>	<b>3,082</b>	<b>263</b>	<b>917</b>	<b>55</b>	<b>(134)</b>	<b>4,183</b>
<b>Analysis of EEV</b>						
Free surplus	656	(9)	24	49		720
PVIF	2,693	278	601		(92)	3,480
Required capital	32	4	526			562
Cost of capital	(11)	(2)	(250)			(263)
<b>Closing EEV at 31 December 2006</b>	<b>3,370</b>	<b>271</b>	<b>901</b>	<b>49</b>	<b>(92)</b>	<b>4,499</b>

The opening EEV at 10 July 2006 has been determined in accordance with the provisions of the Scheme and reflects that part of the net proceeds raised as part of the Initial Public Offering (IPO) which has been allocated to covered business. This amount was £737m and is included within UK life and pensions.

**2. Analysis of new business contribution**

The following table sets out the premium volumes and contribution from new business written by the life and related businesses, consistent with the definition of new business set out in Appendix 1 on page 218.

New business contribution is shown after the effect of required capital.

10 July 2006 to 31 December 2006	New Business Contribution		New Business Sales		PVNB Margin
	Post Cost of Capital		PVNB	APE	Post Cost of Capital
	£m	£m	£m	£m	%
Pensions Retail	51	3,648	494		1.4
Pensions – Institutional	1	1,580	158		0.1
Life	12	950	95		1.2
Annuities	28	262	26		10.6
Protection	(8)	19	3		(45.0)
<b>UK total</b>	<b>84</b>	<b>6,459</b>	<b>776</b>		<b>1.3</b>
Europe	4	466	53		1.0
Canada	17	810	70		2.1
Other		138	16		
<b>Total</b>	<b>105</b>	<b>7,873</b>	<b>915</b>		<b>1.3</b>

### 3. Experience variances

10 July 2006 to 31 December 2006	UK	Europe	Canada	HWPf TVOG	Total
	£m	£m	£m	£m	£m
Lapses	(7)	(3)			(10)
Maintenance expenses	2		3		5
Mortality and morbidity	28				28
Tax	(3)		14		11
Other	29	(4)	(25)	28	28
<b>Total</b>	<b>49</b>	<b>(7)</b>	<b>(8)</b>	<b>28</b>	<b>62</b>

UK lapse variances reflect the excess of life business claims above the long term assumptions and the provision included in the opening balance sheet

UK mortality variances arise from profits on annuity business and the impact of changes in deferred annuity reserving bases

Other UK variances represent a number of different variances, including reinvestment of demutualisation benefits on pension policies and the impact of legislative changes

Negative experiences in Europe were due to lapses in Ireland and other small negative variances

Other Canada variances mainly arise from modelling variances within group savings and retirement products

Positive experience variances in relation to HWPf TVOG reflect the net impact of management actions taken to hedge guarantees and change equity backing ratios for with profits business

### 4. Operating assumption changes

10 July 2006 to 31 December 2006	UK	Europe	Canada	HWPf TVOG	Total
	£m	£m	£m	£m	£m
Lapses	(107)	(4)	(49)		(160)
Maintenance expenses	26	12	22		60
Mortality and morbidity	26	2	35		63
Other		(5)	19	3	17
<b>Total</b>	<b>(55)</b>	<b>5</b>	<b>27</b>	<b>3</b>	<b>(20)</b>

The UK lapse assumption change includes charges of £59m for pensions, reflecting increases in exit rates as a result of the greater freedom now available to customers in the approach to retirement, and £48m arising from increased withdrawal rates for with profits life policies. The maintenance expenses change reflects continued efficiency gains in the business. The main change in mortality assumption is in respect of annuities, reflecting the combined effect of a number of factors including changes to the underlying mortality tables and a widening in margins between statutory valuation and best estimate assumptions.

The positive £5m change for Europe is driven mainly from expense assumption changes in Ireland, offset by lapse assumption changes, also in Ireland.

In Canada, changes in lapse rates mainly applied to group savings and retirement products. In addition, there was £35m from improvements in mortality and morbidity, primarily in relation to individual and group insurance products. Other assumption changes include the release of annuity provisions offset by modelling changes for group insurance.

## 5. Time value of options and guarantees (TVOG)

	31 December 2006	10 July 2006
	£m	£m
UK and Europe HWPF	(92)	(134)
Europe other	(2)	
Canada	(13)	(17)
<b>Total</b>	<b>(107)</b>	<b>(151)</b>

## 6. Non covered business

Non-covered business includes various non life and pension companies, including mutual fund companies, on an IFRS basis together with income on assets held in the Group's holding company, Standard Life plc

## 7. EEV – reconciliation of movements in consolidated balance sheet

	10 July 2006 to 31 December 2006
	£m
<b>Opening EEV</b>	<b>4,995</b>
Total recognised income and expense for the period	406
Capital injections/(dividends)	192
Reserves credit for employee share-based payment schemes	15
<b>Closing EEV</b>	<b>5,608</b>

The capital injection mainly represents the proceeds from the sale of additional shares in Standard Life plc above the original share allocation

## 8. Reconciliation of EEV net assets to IFRS net assets

	31 December 2006
	£m
<b>Net assets on an EEV basis</b>	<b>5,608</b>
Present value of in force life and pensions business	(3,217)
Adjustment of long term debt to market value	92
Canadian mark to market	273
Deferred acquisition costs/(Deferred income reserve)	98
Other	24
<b>Net assets on an IFRS basis</b>	<b>2,878</b>

Reconciling items are shown net of tax where appropriate

## 9. Analysis of life and pensions EEV PVIF and net worth movements (net of tax)

### (a) Total

10 July 2006 to 31 December 2006

	Free surplus £m	Required capital £m	Net worth £m	PVIF net of cost of capital £m	Total £m
<b>Opening EEV</b>	742	560	1,302	2,881	4,183
Contribution from new business	(184)	22	(162)	235	73
Contribution from in force business					
Expected return on existing business		12	12	125	137
Expected return transfer to net worth	255	(20)	235	(235)	
Experience variances	8	10	18	27	45
Operating assumption changes	37	(12)	25	(39)	(14)
Development costs	(9)		(9)		(9)
Expected return on free surplus	(2)		(2)		(2)
<b>Operating profit after tax</b>	105	12	117	113	230
Investment return and tax variances	2	31	33	128	161
Economic assumption changes	(54)	11	(43)	140	97
<b>Profit after tax</b>	53	54	107	381	488
Capital injections/(dividends)	(3)	3			
Transfers (to)/from non-covered business	(71)		(71)		(71)
Foreign exchange rate movements	(2)	(55)	(57)	(45)	(102)
Transfer back of surplus to SLI	(9)		(9)		(9)
Actuarial gains/(losses) on defined benefit pension schemes	10		10		10
<b>Closing EEV</b>	720	562	1,282	3,217	4,499

### (b) UK and HWPF TVOG

10 July 2006 to 31 December 2006

	Free surplus £m	Required capital £m	Net worth £m	PVIF net of cost of capital £m	Total £m
<b>Opening EEV</b>	686	15	701	2,247	2,948
Contribution from new business	(150)	14	(136)	194	58
Contribution from in force business					
Expected return on existing business				95	95
Expected return transfer to net worth	172		172	(172)	
Experience variances	13	2	15	40	55
Operating assumption changes	12		12	(49)	(37)
Development costs	(4)		(4)		(4)
Expected return on free surplus	5		5		5
<b>Operating profit after tax</b>	48	16	64	108	172
Investment return and tax variances	8	1	9	109	118
Economic assumption changes	(13)		(13)	126	113
<b>Profit after tax</b>	43	17	60	343	403
Capital injections/(dividends)	7		7		7
Transfers (to)/from non-covered business	(73)		(73)		(73)
Foreign exchange rate movements	2		2		2
Transfer back of surplus to SLI	(9)		(9)		(9)
Actuarial gains/(losses) on defined benefit pension schemes					
<b>Closing EEV</b>	656	32	688	2,590	3,278

**9 Analysis of life and pensions EEV PVIF and net worth movements (net of tax) continued****(c) Europe and Other**

10 July 2006 to 31 December 2006

	Free surplus £m	Required capital £m	Net worth £m	PVIF net of cost of capital £m	Total £m
<b>Opening EEV</b>	44		44	274	318
Contribution from new business	(27)	1	(26)	29	3
Contribution from in force business					
Expected return on existing business				9	9
Expected return transfer to net worth	42		42	(42)	
Experience variances	(6)		(6)	2	(4)
Operating assumption changes	7		7	(3)	4
Development costs	(5)		(5)		(5)
Expected return on free surplus	(5)		(5)		(5)
<b>Operating profit after tax</b>	6	1	7	(5)	2
Investment return and tax variances	(1)		(1)	6	5
Economic assumption changes				9	9
<b>Profit after tax</b>	5	1	6	10	16
Capital injections/(dividends)	(10)	3	(7)		(7)
Transfers (to)/from non covered business	2		2		2
Foreign exchange rate movements	(2)		(2)	(8)	(10)
Transfer back of surplus to SLI					
Actuarial gains/(losses) on defined benefit pension schemes	1		1		1
<b>Closing EEV</b>	40	4	44	276	320

**(d) Canada**

10 July 2006 to 31 December 2006

	Free surplus £m	Required capital £m	Net worth £m	PVIF net of cost of capital £m	Total £m
<b>Opening EEV</b>	12	545	557	360	917
Contribution from new business	(7)	7		12	12
Contribution from in force business					
Expected return on existing business		12	12	21	33
Expected return transfer to net worth	41	(20)	21	(21)	
Experience variances	1	8	9	(15)	(6)
Operating assumption changes	18	(12)	6	13	19
Development costs					
Expected return on free surplus	(2)		(2)		(2)
<b>Operating profit after tax</b>	51	(5)	46	10	56
Investment return and tax variances	(5)	30	25	13	38
Economic assumption changes	(41)	11	(30)	5	(25)
<b>Profit after tax</b>	5	36	41	28	69
Capital injections/(dividends)					
Transfers (to)/from non-covered business					
Foreign exchange rate movements	(2)	(55)	(57)	(37)	(94)
Transfer back of surplus to SLI					
Actuarial gains/(losses) on defined benefit pension schemes	9		9		9
<b>Closing EEV</b>	24	526	550	351	901

## 10. Market value of subordinated liabilities within covered business

	31 December 2006	10 July 2006
	£m	£m
UK	(1,691)	(1,742)
Canada	(198)	(201)
<b>Total</b>	<b>(1,889)</b>	<b>(1,943)</b>

Subordinated liabilities within the EEV are based on the market value of the debt and are part of covered business. The free surplus shown in note 1(c) is net of these liabilities.

## 11. Principal economic assumptions – deterministic calculations – life and pensions

### (a) Gross investment returns and expense inflation

31 December 2006	UK	Europe	Canada
	%	%	%
<b>Gross investment returns</b>			
Risk free	4.83	3.95	4.11
Corporate bonds	5.40	n/a	*
Equities	7.83	6.95	8.60
Property	6.83	5.95	8.60
<b>Other</b>			
Expense inflation	3.97		**
Germany		2.55	
Ireland		3.46	

\* Current holdings are assumed to yield in future years the earned rate for the year preceding the valuation. Future reinvestments are assumed to be in government bonds.

\*\* 1.69% in 2006 decreasing by 0.10% per year to 1.19% in 2011 and later years.

10 July 2006	UK	Europe	Canada
	%	%	%
<b>Gross investment returns</b>			
Risk free	4.67	4.23	4.60
Corporate bonds	5.23	n/a	*
Equities	7.67	7.23	8.60
Property	6.67	6.23	8.10
<b>Other</b>			
Expense inflation	3.97		**
Germany		2.66	
Ireland		3.89	

\* Current holdings are assumed to yield in future years the earned rate for the year preceding the valuation. Future reinvestments are assumed to be in government bonds.

\*\* 2.14% in 2006 decreasing by 0.10% per year to 1.64% in 2011 and later years.

## 11. Principal economic assumptions – deterministic calculations – life and pensions *continued*

### (b) Risk discount rates – in force business

31 December 2006	UK HWPF %	UK shareholder owned funds %	Europe HWPF %	Europe shareholder owned funds %	Canada %
<b>Risk margin – in force business</b>					
Risk margin before cost of capital adjustment					
Market risk	1.75	1.55	1.75	1.55	1.70
Non market risk	1.30	0.25	1.30	0.25	1.80
<b>Total</b>	<b>3.05</b>	<b>1.80</b>	<b>3.05</b>	<b>1.80</b>	<b>3.50</b>
Cost of capital adjustment	(0.05)	(0.10)	(0.05)	(0.10)	(1.00)
<b>Risk margin after cost of capital adjustment</b>	<b>3.00</b>	<b>1.70</b>	<b>3.00</b>	<b>1.70</b>	<b>2.50</b>
<b>Risk discount rates – in force business</b>					
Risk free	4.83	4.83	3.95	3.95	4.11
Risk margin	3.00	1.70	3.00	1.70	2.50
<b>Risk discount rate</b>	<b>7.83</b>	<b>6.53</b>	<b>6.95</b>	<b>5.65</b>	<b>6.61</b>

10 July 2006	UK HWPF %	UK shareholder owned funds %	Europe HWPF %	Europe shareholder owned funds %	Canada %
<b>Risk margin – in force business</b>					
Risk margin before cost of capital adjustment					
Market risk	2.35	2.35	2.35	2.35	1.95
Non market risk	1.15	1.15	1.15	1.15	1.55
<b>Total</b>	<b>3.50</b>	<b>3.50</b>	<b>3.50</b>	<b>3.50</b>	<b>3.50</b>
Cost of capital adjustment					(1.00)
<b>Risk margin after cost of capital adjustment</b>	<b>3.50</b>	<b>3.50</b>	<b>3.50</b>	<b>3.50</b>	<b>2.50</b>
<b>Risk discount rates – in force business</b>					
Risk free	4.67	4.67	4.23	4.23	4.60
Risk margin	3.50	3.50	3.50	3.50	2.50
<b>Risk discount rate</b>	<b>8.17</b>	<b>8.17</b>	<b>7.73</b>	<b>7.73</b>	<b>7.10</b>

The reductions in the HWPF risk margins from 3.5% to 3.0% arise from a reduction in market risk offset by an increase in non market risk. These movements include the impact of the finalisation of the shareholder interest in German HWPF business, which now has limited exposure to market risk.

The reduction in the UK and Europe risk margins in shareholder owned funds reflect finalisation of the terms of the Scheme. The PVIF of this business was less than £100m at 10 July 2006.

The impact of these changes in risk discount rates has been included in the Effect of economic assumption changes shown in Note 1(a). The amounts within these totals that relate to the changes in risk discount rates are UK (£112m positive), Europe (£18m positive) and Canada (£77m positive).

**(c) Risk discount rates – new business**

10 July to 31 December 2006

	UK HWPF %	UK shareholder owned funds %	Europe HWPF %	Europe shareholder owned funds %	Canada %
<b>Risk margin – new business</b>					
<b>Risk margin before cost of capital adjustment</b>					
Market risk	2.05	1.80	2.05	1.80	1.60
Non market risk	0.35	1.10	0.35	1.10	2.05
<b>Total</b>	<b>2.40</b>	<b>2.90</b>	<b>2.40</b>	<b>2.90</b>	<b>3.65</b>
Cost of capital adjustment		(0.10)		(0.10)	(0.95)
<b>Risk margin after cost of capital adjustment</b>	<b>2.40</b>	<b>2.80</b>	<b>2.40</b>	<b>2.80</b>	<b>2.70</b>
<b>Risk discount rates – new business</b>					
Risk free	4.67	4.67	4.23	4.23	4.60
Risk margin	2.40	2.80	2.40	2.80	2.70
<b>Risk discount rate</b>	<b>7.07</b>	<b>7.47</b>	<b>6.63</b>	<b>7.03</b>	<b>7.30</b>

## 12. Principal economic assumptions – stochastic calculations

### Characteristics of economic scenario generator used for HWPF TVOG UK and Europe life and pensions

The asset model simulates economic time series using a monthly time-step over 40 years. The time series produced includes a cash account index, a gross redemption yield term structure, an equity total return index, a property total return index, equity dividend yields, property rental yields, price inflation and earnings inflation. Investment returns for corporate bonds are allowed for implicitly in the projection of asset shares. The asset model allows option pricing techniques to be used to value the guarantees embedded within policies. The model is run in a risk neutral universe where, on average, all assets return the risk free rate of return. This risk free rate of return is taken to be the return on the cash account.

### Choice of parameters and justification

#### Nominal Short Rate

The parameters required to specify the Black Karasinski model are determined by optimisation to achieve a satisfactory fit to the following calibration instruments:

- Bank of England Gilt spot rate term structure (25 year term structure extrapolated to 40 years using a constant forward rate assumption) adjusted to allow for 'convenience premium' associated with Gilt prices
- Ten year swap swaption implied volatility for option terms out to 30 years increased to allow for a proportion of the fixed interest portfolio being invested in credit risky bonds

#### Real Short Rate

The parameters required to specify the Vasicek model are determined by optimisation to achieve a satisfactory fit to the Bank of England Index Linked Gilt real spot rate term structure (25 year term structure extrapolated to 40 years using a constant forward rate assumption) adjusted to maintain the market nominal yield/ real yield gap. The volatility of the process is controlled with best estimate parameters.

#### Equity Volatility

The calibration implied volatilities were supplied by investment banks based on FTSE 100 price return options. The calibration data included options with a range of terms and strike prices.

#### Property Volatility

As there is no property option market it is not possible to determine implied market property volatility, so a level best estimate is used. The property volatility is determined using Investment Property Databank (IPD) UK data and de-smoothing it to determine an estimate for true underlying property return volatility.

#### Income Yields

Long term estimates for income yields on property and equity cannot be derived from market instruments. However, these parameters are not of significant consequence as the guarantees being valued are based on total return rather than capital return.

#### Correlations

The correlations between asset class returns are implied by specifying the correlations between the random innovations driving the various stochastic processes within the asset model.

The correlations between the major asset classes are targeted at:

- Equity/Property = 0.2
- Equity/Bonds = 0.2
- Property/Bonds = 0.1

These correlations are determined from historical analysis of asset class returns. It should be noted that the limited quantity of data results in large confidence intervals for the values of the correlations.

### 13. Sensitivity analysis – economic and non economic assumptions

The tables below show the sensitivity of the embedded value and the new business contribution

The sensitivities tested were

- One percentage point increase and decrease in the risk discount rates,
- Interest rates 1% higher and lower than base case, with consequential changes in fixed interest asset values, reserving assumptions, risk discount rates and investment returns on equities and properties,
- 10% fall in market value of equity and property assets (not applicable for new business contribution),
- 10% decrease in maintenance expenses (a 10% sensitivity on a base expense assumption of £10 p a would represent an expense assumption of £9 p a ) Where there is a 'look through' into service company expenses, the fee charged by the service company is unchanged while the underlying expense decreases,
- 10% decrease in lapse rates (a 10% sensitivity on a base assumption of 5% p a would represent a lapse rate of 4.5% p a ),
- 5% decrease in both mortality and morbidity rates for annuitant and non annuitant policies,
- EEV results assuming only prescribed minimum capital (where economic capital has been used in the EEV calculations)

31 December 2006	UK £m	Europe £m	Canada £m	Other £m	HWPF TVOG £m	Total £m
<b>Embedded value</b>	<b>3,370</b>	<b>271</b>	<b>901</b>	<b>49</b>	<b>(92)</b>	<b>4,499</b>
Risk discount rate +1%	(175)	(15)	(99)			(289)
Risk discount rate -1%	200	14	128			342
Interest returns +1%	(115)	(8)	7		7	(109)
Interest returns -1%	151	5	(48)		(5)	103
Fall in equity / property market values by 10%	(157)	(6)	(42)			(205)
Maintenance expenses -10%	94	7	53			154
Lapse rates -10%	65	7	61			133
Annuitant mortality -5%	(94)	(3)	(27)			(124)
Non annuitant mortality -5%	12		26		(8)	30
Prescribed minimum capital			61			61

10 July 2006 to 31 December 2006	UK £m	Europe £m	Canada £m	Other £m	HWPF TVOG £m	Total £m
<b>New business contribution</b>	<b>84</b>	<b>4</b>	<b>17</b>			<b>105</b>
Risk discount rate +1%	(22)	(3)	(2)			(27)
Risk discount rate -1%	26	4	3			33
Interest returns +1%	(1)		(1)			(2)
Interest returns -1%	2					2
Maintenance expenses -10%	10	2	2			14
Lapse rates -10%	8	1	3			12
Annuitant mortality -5%	(1)					(1)
Non annuitant mortality -5%	1					1
Prescribed minimum capital			1			1

Sensitivities to higher and lower assumed equity and property risk premiums in future investment earnings have not been calculated, as the effect of the risk premium is removed in setting the market risk margin in the risk discount rate

The demographic sensitivities shown above represent a standard change to the assumptions for all products. Different products will be more or less sensitive to the change, and impacts may partially offset

## **Appendix 1**

### **European embedded value methodology**

#### **Value of in force covered business**

The value of future shareholder cash flows is calculated for each material business unit on an after tax basis, projected using best estimate future assumptions as described below

Allowance is made for external reinsurance and reinsurance within the Group. The cash flows include the profits and losses arising in Group companies providing investment management and other services where these relate to covered business. This is referred to as the 'look through' into service company expenses

The projected cash flows are discounted to the valuation date using a risk discount rate which is intended to make sufficient allowance for the risks associated with the emergence of these cash flows, other than those risks allowed for elsewhere in the EEV calculations. In particular, a deduction is made from the present value of the best estimate cash flows to reflect the risks associated with the existence of financial options and guarantees, this deduction being assessed using stochastic techniques as described below

#### **Free surplus**

The free surplus is the market value of any assets allocated to, but not required to support, the in force covered business at the valuation date. In the UK, this comprises the market value of the assets in the shareholders' fund, plus the value of the shareholders' interest in the surplus of the long term fund, after appropriate allowance for tax, less the required capital supporting the covered business

Where market value is not the normal basis for accounting, as in Canada, the free surplus is restated to market value, adjusted as required to allow for the present value of any tax which would become payable if the assets were realised

#### **Allowance for risk**

Under the EEV Principles and Guidance, risks within the covered business are allowed for in the following ways

- application of risk discount rates to projected cash flows, which are derived by adding a risk margin to a risk free rate,
- holding of required capital for the covered business, determined by reference to both regulatory requirements and internal economic capital assessments, and
- allowing for TVOG

#### **Risk discount rates**

Under the EEV methodology, a risk discount rate is required to calculate the present value of expected future distributable profits as a single value at a particular date. The risk discount rate comprises a risk free rate which reflects the time value of money and a risk margin allowing for the risk that experience in future years may differ from that assumed. In particular, a risk margin is added to allow for the risk that expected additional returns on certain asset classes are not achieved

Risk discount rates have been determined as the risk free government bond yield plus a risk margin. The risk margins have been determined for market risk and non market risk separately. For market risk, the Group has opted for an approach whereby the risk margin is determined such that the PVIF, excluding the allowance for the TVOG, calculated using expected 'real world' asset returns equates with the PVIF calculated using 'risk neutral' investment returns and discount rates. In this way, the benefits of assuming higher than risk free returns on future cash flows are offset by using a higher discount rate. However, when returns above the risk free rate arise from the additional returns available from investing in illiquid assets, namely corporate bonds and mortgages, where they are matched to appropriate liabilities, these are not offset in determining discount rate. Allowance has then been made for non market risk by applying stress tests to the PVIF using the Group's internal capital model, and quantifying an additional risk margin based on the results of the stress tests. The main elements of non market risk which are stress tested are lapse, mortality, expense and credit risk assumptions. Benefits of diversification between risk types are allowed for in deriving the risk margins in line with the Group's internal capital model

Separate risk discount rates have been calculated for in force and new business and for the principal geographic segments (UK, Europe and Canada). Within the UK and Europe, separate risk margins are calculated for profits emerging on policies inside the HWPF (regardless of whether these profits emerge directly from the HWPF or by reinsurance into other Group entities) and on policies that are in shareholder owned funds. For HWPF policies, the significant inter Group reinsurance item is the mortality surpluses on annuities, which are reassured out of the HWPF. The HWPF risk margin anticipates diversification benefits including the annuity mortality risk, since the overall capital structure also benefits from this diversification. The risk margins are also reduced

to allow for any cost of required capital (excluding double taxation cost) which is already reflected within the EEV  
Market risk margins are reviewed at each valuation date, allowing for changes in risk profile arising from movements in asset mix  
Non market risk margins are reviewed in detail once a year

The values of the risk discount rates used for this reporting period are provided in Note 11

### **Required capital**

Required capital represents the amount of assets over and above those required to back the liabilities in respect of the covered business whose distribution to shareholders is restricted. As a minimum, this will represent the capital requirement of the local regulator.

The Group has set required capital to be the higher of regulatory capital and its own internally assessed risk based capital requirement. In determining the required capital for purposes of assessing EEV, the Group excludes any required capital which is provided by the existing surplus in the HWPF, as this capital is provided by policyholders. Any required capital in excess of that provided by the existing surplus in the HWPF would need to be provided by assets in the Shareholder Fund. Projections show that the surplus in the HWPF is expected, on best estimate assumptions, to cover this level of required capital at the valuation date and in future years.

The levels of required capital in the current EEV calculations are therefore as follows:

- UK and Europe (business in HWPF) – no capital requirement in excess of statutory reserves or asset shares is valued in the EEV
- UK and Europe (business in shareholder owned funds) – 100% of EU minimum regulatory capital, which is higher in aggregate than Standard Life's internal risk based capital requirement
- Canada – the level of required capital is taken as 150% of minimum continuing capital and surplus requirements (MCCSR)

### **Time value of financial options and guarantees**

The TVOG represents the potential additional cost to shareholders where a financial option exists which affects policyholder benefits and is exercisable at the option of the policyholder.

#### **UK and Europe – HWPF**

The main source of TVOG in the Group EEV arises from the HWPF. Under the terms of the Scheme, this type of option for the UK, Germany and Ireland arises only when the HWPF has insufficient assets to pay guaranteed policy benefits and the shareholders must therefore forgo receipt of expected shareholder cash flows from the HWPF. The main options and guarantees within the HWPF in respect of UK and European business relate to with profits business and include minimum guaranteed rates of return.

The value of the TVOG arising from the HWPF at any point in time will be sensitive to:

- the level of the residual estate (working capital in HWPF),
- investment conditions in terms of bond yields, equity and property values and implied market volatility, and
- the investment profile of the assets backing the applicable policies at the time the TVOG is calculated.

The level of the TVOG has been calculated by a model which projects the HWPF under a large number of different future economic scenarios. Particular features of this calculation are:

- the projected economic scenarios and the methodology used to discount shareholder cash flows are based on market consistent assumptions,
- the total cost includes an allowance for non market risk, including credit risk arising from holding non risk free bonds,
- changes in policyholder behaviour are allowed for according to the particular economic scenario,
- changes in management actions, including the dynamic guarantee deductions, are allowed for according to the particular economic scenario, such actions being expected to be consistent with the way that the HWPF will be managed in future as described in the Scheme and in the Principles and Practices of Financial Management (PPFM), and
- each projection allows for the gradual release of the residual estate over time to policyholders where there are sufficient funds to do so.

#### **UK and Europe – Other**

Most with profits business written post-demutualisation is managed in a number of new with profits funds. For the present reporting period, the only significant volumes of this type of new business have arisen in Germany. These policies have guarantees relating to benefits available on the policy maturity date. These guarantees increase each year with the addition of bonuses.

## **European embedded value methodology**

### **UK and Europe – Other** *continued*

Shareholder assets are at risk if the resources of these with profits funds are insufficient to pay the guaranteed benefits. The level of the TVOG has been calculated using stochastic techniques. The TVOG has reduced both the new business contribution (NBC) as well as the closing present value of in force (PVIF) for Europe.

### **Canada**

The main options and guarantees within the Canadian business are in respect of minimum investment returns, guaranteed maturity and death benefits, and vested bonuses, which apply to certain investment and insurance contracts.

### **Other economic assumptions**

The assumed investment returns reflect the Group's estimates of expected returns on principal asset classes, and are in general, based on market conditions at the date of calculation of the EEV.

The inflation rates assumed are, in general, based on the market implied long term price inflation plus a margin to allow for salary inflation.

Details of the assumptions used for this reporting period are provided in Note 11.

### **Expense assumptions**

Expense assumptions on a per policy basis have been derived based on an analysis of management expenses performed by each business, and are split between acquisition and maintenance assumptions. No future productivity gains have been anticipated in deriving expense assumptions.

In determining future expenses in relation to covered business, no allowance has been made in the EEV or the NBC for any allocation of Group corporate centre costs.

Development costs represent specific costs incurred which are considered temporary in nature and are not expected to occur again.

Costs related to demutualisation and restructuring have been excluded from the EEV results where it has been agreed that these costs are to be met by the HWPF and therefore would not form part of the surplus cash flows.

Investment management expenses are also allowed for, and the assumptions for these reflect the actual investment expenses of Standard Life Investments in providing investment management services to the life and pensions business rather than the investment fees actually charged.

### **Expenses – pension scheme deficits**

Pension scheme deficits have been included in accordance with International Accounting Standard (IAS) 19 *Employee Benefits*.

### **Other non-economic experience assumptions**

Assumptions are made in respect of future levels of mortality, morbidity, premium terminations, option take up, surrenders and withdrawals. The assumptions reflect the Directors' best estimates of the likely future experience, and are based on recent experience and relevant industry data, where available.

Lapse rate assumptions in the UK have been set by reference to expected future trends. For some contracts this includes an assumption that current lapse levels are temporarily high due to the effect of demutualisation and other market features, and that these will reduce over time to a lower long term rate.

Annuitant mortality assumptions use a combination of base mortality rates, which are generally set by reference to recent experience, and expected future changes in mortality. The latter uses data provided by the Continuous Mortality Investigation Bureau in the UK and the Canadian Institute of Actuaries in Canada along with other company specific considerations.

Assumptions regarding option take up, surrenders and withdrawals are assumed to vary, where appropriate, according to the investment scenario under consideration when deriving the TVOG, to reflect the Directors' best estimate of how policyholder behaviour may vary in such circumstances.

## **New business**

New business includes new policies written during the period and some increments to existing policies (as discussed below)

For the UK, classification as new or existing business is determined as follows (using the approach used for the published new business figures)

- New recurrent single premium business is classified as new regular premium business to the extent that it is deemed likely to renew
- Department of Work and Pensions (DWP) rebates are deemed to be new single premiums
- Pensions vesting into annuity contracts under existing group defined benefits contracts are not included as new business
- Pensions vesting under other group contracts and individual pensions are included as new business
- Products substituted due to the exercise of standard contract terms are not deemed to be new business
- All increments and indexations to existing policies, including new members, and increments and indexations paid by existing members of group schemes, are deemed to be new business

For Germany, new business comprises

- New contracts written during the period
- Increases to premium indexation i.e. increases to premium above those assumed at policy inception

Consistent with this categorisation of new business, the new business contribution for Germany is calculated assuming a specific level of future premium indexation. Similarly, it is assumed that premiums on 'Low Start' policies increase at the end of the low start period

For Ireland, new business comprises

- New contracts written during the period
- New premiums on recurrent single premium contracts
- Pensions vesting into annuity contracts under existing group defined benefits contracts are not included as new business
- Pensions vesting under other group contracts and individual pensions are included as new business
- All increments and indexations to existing policies, including new members, and increments and indexations paid by existing members of group schemes, are deemed to be new business

For Canada, business is deemed to be 'new business' if a contract has been issued during the reporting period. The new business contribution also includes the value of renewal premiums for a new contract, where the renewal premiums are (i) contractual, (ii) non-contractual but reasonably predictable, or (iii) recurrent single premiums that are pre-defined and reasonably predictable. The present value of future net income attributable to renewal premiums on existing group pension and savings contracts, including those from new members, is not included as new business. Since all deposits (new and renewal) in individual segregated funds business attract a new business/first year commission, this business is treated as new business for EEV purposes.

The contribution generated by new business written during the period is the present value of the projected stream of after tax distributable profit from that business. NBC before tax is calculated by grossing up the contribution after tax at the full corporation tax rate for UK business and at other equivalent rates of tax for other countries.

The economic assumptions used are those at the start of the reporting period, and the non economic assumptions are those at the end of the reporting period. An exception to this policy is annuity business in the UK, where to ensure consistency between the economic assumptions used in new business contribution and those used in pricing the business and in the calculation of mathematical reserves, the economic assumptions used are updated at the beginning of each quarter during the reporting period.

New business sales are expressed on two bases: Annual Premium Equivalent (APE) and Present Value of New Business Premiums (PVNBP). The PVNBP calculation is equal to total single premium sales received in the period plus the discounted value of regular premiums expected to be received over the term of the new contracts, and is expressed at the point of sale. The premium volumes and projection assumptions used to calculate the present value of regular premiums for each product are the same as those used to calculate NBC, except that the PVNBP is discounted using the relevant opening risk free rate rather than the risk discount rate.

## European embedded value methodology continued

### Tax

The opening and closing EEV numbers for the covered business are determined on an after tax basis. The tax assumptions used are based upon the best estimate of the actual tax expected to arise. Attributed tax and profit before tax are derived by grossing up profit after tax at the standard rate of corporation tax appropriate to each territory. Whilst for some territories this rate does not equate to the actual effective rate of tax used in the calculation of after tax profits, it provides a consistent grossing up basis upon which to compare results from one year to another and is in line with the Group's expectation of the rate of tax applicable to business sold after demutualisation.

Transfers to shareholders from the HWPF will, in the first instance, be funded from unallocated surplus transferred from SLAC on demutualisation. The profit after tax result is stated after allowing for this and takes into account the risk of markets moving adversely in the future which would reduce the amount that can be transferred to shareholders from the unallocated surplus. These transfers can be made without shareholder tax arising for a number of years. Over time the actual effective tax rate on these transfers will move toward the standard rate of corporation tax.

For non-covered business, attributed tax is consistent with the IFRS financial statements shown in the *Annual Report and Accounts*, unless otherwise stated.

### Subordinated liabilities

On demutualisation UK subordinated liabilities and subordinated members' accounts were transferred to Standard Life plc on an adjusted cost basis with assets equal in value to this amount. The liability in respect of this plus subordinated debt issued by the Canadian companies forms part of covered business and has been deducted at market value within the EEV (less an adjustment for tax where appropriate).

For non-covered business, no adjustment is made to the IFRS valuation of debt.

### Foreign exchange

Embedded value and other balance sheet items denominated in foreign currencies have been translated in to sterling using the appropriate closing exchange rates. NBC and other profit and loss account items have been translated using average exchange rates. Differences arising from foreign exchange movements are excluded from the EEV consolidated income statement and are presented separately within the EEV consolidated statement of recognised income and expenses.

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## **Independent auditors' report to the members of Standard Life plc**

We have audited the parent company financial statements of Standard Life plc for the year ended 31 December 2006 which comprise the Income statement, the Balance sheet, the Reconciliation of movements in total equity, the Cash flow statement and the related notes. These parent company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

We have reported separately on the consolidated financial statements of Standard Life plc for the year ended 31 December 2006.

### **Respective responsibilities of Directors and auditors**

The Directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the parent company financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' responsibilities.

Our responsibility is to audit the parent company financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' report is consistent with the parent company financial statements. The information given in the Directors' report includes that specific information cross referred from the Directors' report to the business review.

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

We read other information contained in the Annual Report and consider whether it is consistent with the audited parent company financial statements. The other information comprises of the Chairman's Statement, the Group Chief Executive's Statement, the business review, the Directors' report, the unaudited sections of the Directors' Remuneration Report and the other information as listed on the contents page. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

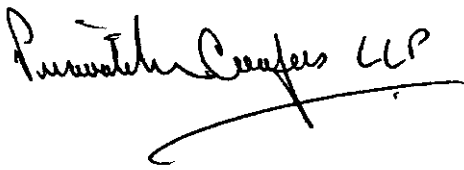
### **Basis of audit opinion**

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

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

**In our opinion.**

- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the Company's affairs as at 31 December 2006 and of its loss and cash flows for the year then ended,
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' report is consistent with the parent company financial statements

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive style and is underlined with a single horizontal stroke.

PricewaterhouseCoopers LLP  
Chartered Accountants and Registered Auditors  
Edinburgh  
22 March 2007

- (a) The maintenance and integrity of the Standard Life website is the responsibility of the directors, the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website
- (b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

## Company income statement

For the year ended 31 December 2006

	Notes	2006 £m
<b>Revenue</b>		
Net investment return	A	65
Other income		7
<b>Total revenue</b>		<b>72</b>
<b>Expenses</b>		
Administrative expenses	B	55
Interest payable on subordinated liabilities		48
<b>Total expenses</b>		<b>103</b>
<b>Loss before tax</b>		<b>(31)</b>
Income tax credit	F	8
<b>Loss for the year</b>		<b>(23)</b>

The Company did not trade in 2005 and therefore there are no comparatives. The Company commenced trading on 10 July 2006.

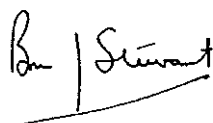
# Company balance sheet

As at 31 December 2006

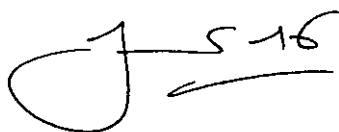
	Notes	2006 £m
<b>Assets</b>		
Investments in subsidiaries	G	4,163
Investments in associates	H	14
Loans to subsidiaries		1,772
Current tax recoverable	I	2
Deferred tax assets	I	1
Derivative financial assets	J	1
Investment securities	K	18
Other assets	L	25
Cash and cash equivalents	M	382
<b>Total assets</b>		<b>6,378</b>
<b>Equity</b>		
Share capital	N	210
Share premium reserve	O	799
Retained earnings	P	(19)
Other reserves	Q	3,725
<b>Total equity</b>		<b>4,715</b>
<b>Liabilities</b>		
Subordinated liabilities	R	1,581
Deferred tax liabilities	I	1
Amounts owed to controlled entities	V	72
Other liabilities		9
<b>Total liabilities</b>		<b>1,663</b>
<b>Total equity and liabilities</b>		<b>6,378</b>

In 2005 the Company held other assets of £2 and share capital of £2

Approved on behalf of the Board of Directors on 22 March 2007 by the following Directors



Sir Brian Stewart, Chairman



David Nish, Group Finance Director

The notes on pages 229 to 243 are an integral part of these financial statements

## Company reconciliation of movements in total equity

For the year ended 31 December 2006

	Notes	2006 £m
<b>Balance at 1 January</b>		
Loss for the period	P	(23)
Issue of share capital for cash, net of transaction costs	N	1,363
Issue of share capital other than in cash	N	146
Merger relief on issue of demutualisation shares	Q	3,214
Reserves credit for employee share based payment schemes	Q	15
<b>Balance at 31 December</b>		<b>4,715</b>

The Company issued 2 ordinary shares for £2 for cash in 2005

## Company cash flow statement

For the year ended 31 December 2006

	Notes	2006 £m
<b>Cash flows from operating activities</b>		
Loss before tax		(31)
Fair value movements on investment securities and derivatives		(4)
Net foreign exchange gains on investment activities		1
Net decrease in other assets and liabilities		78
Adjustment for investment income		(3)
<b>Net cash flows from operating activities</b>		<b>41</b>
<b>Cash flows from investing activities</b>		
Loans to subsidiaries		(190)
Capital injection in subsidiaries		(743)
Interest received on loans to subsidiaries		67
Purchase of investment securities		(21)
Sale of investment securities		5
Acquisition of investment in associates and joint ventures		(14)
<b>Net cash flows from investing activities</b>		<b>(896)</b>
<b>Cash flows from financing activities</b>		
Interest paid		(67)
Proceeds from issue of ordinary share capital, net of transaction costs	N, O	1,363
Consideration paid to eligible members in non permitted countries		(59)
<b>Net cash flows from financing activities</b>		<b>1,237</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>382</b>
Cash and cash equivalents at the beginning of the year		382
<b>Cash and cash equivalents at the end of the year</b>	M	<b>382</b>
<b>Supplemental disclosures on cash flow from operating activities</b>		
Interest received		58

The Company did not hold cash and cash equivalents during 2005 and therefore there are no comparatives

On 10 July 2006, the Company assumed the obligations under the subordinated guaranteed bonds and mutual assurance capital securities previously issued by The Standard Life Assurance Company and the instruments were relisted on the London Stock Exchange with the Company as the issuer. On the same date, the Company entered into a loan agreement to lend the proceeds it had received for assuming the obligations under the instruments to Standard Life Assurance Limited ('SLAL'). The proceeds involved in these transactions were of a non cash nature and therefore the transactions are not reflected in the cash flow statement

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## Notes to the company financial statements

### Accounting policies

#### (a) Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') and interpretations issued by the International Accounting Standards Board ('IASB') as endorsed by the European Union ('EU') and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS

The financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and liabilities (including derivative instruments) at fair value through profit or loss ('FVTPL') These are the Company's first financial statements under IFRS and IFRS 1 *First Time Adoption of International Financial Statements* has been applied The comparative balances for the year ended 31 December 2005 are also shown under IFRS

The date of transition to IFRS is 30 June 2005, the date of incorporation of the Company There were no differences between UK GAAP and IFRS at 30 June 2005 or 31 December 2005

The principal accounting policies set out below have been consistently applied to all financial reporting periods presented in these financial statements, unless otherwise stated

#### (i) Standards, interpretations and amendments to published standards that are not yet effective and have not been early adopted by the Company

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the Company's accounting periods beginning on or after 1 January 2007 or later periods The Company has not early adopted these standards, amendments and interpretations as described below

*IFRS 7 Financial Instruments Disclosures* and a complementary amendment to *IAS 1 Presentation of Financial Statements* on capital disclosures and revised guidance on implementing *IFRS 4, Insurance Contracts* (all effective from 1 January 2007) *IFRS 7* introduces new disclosures to the information on financial instruments and the revision to *IFRS 4* reflects the changes made by *IFRS 7* and affects the disclosure section of this guidance The amendment to *IAS 1* introduces disclosures on the level of management of capital resources This will be applied by the Company for annual periods beginning 1 January 2007 The Standard has no financial impact but will change the disclosures surrounding the Company's financial instruments

*IFRIC 8 Scope of IFRS 2* (effective for annual periods beginning on or after 1 May 2006)

The interpretation requires consideration of transactions involving the issuance of equity instruments – where the identifiable consideration received is less than the fair value of the equity instruments issued – to establish whether they fall within the scope of *IFRS 2* The Company will apply *IFRIC 8* from 1 January 2007, but it is not expected to have a significant impact on the Company's financial statements

*IFRIC 9 Reassessment of embedded derivatives* (effective for annual periods beginning on or after 1 June 2006)

The interpretation requires an assessment of whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the Company first becomes a party to the contract Subsequent reassessment is prohibited, unless there is a change in the contract's terms, in which case it is required The Company will apply *IFRIC 9* from 1 January 2007, but it is not expected to have a significant impact on the Company's financial statements

*IFRIC 10 Interim Financial Reporting and Impairment* (effective for annual periods beginning on or after 1 November 2006)

The interpretation prohibits the impairment losses recognised in an interim period on goodwill and investments in equity instruments and in financial assets carried at cost to be reversed at a subsequent balance sheet date The Company will apply *IFRIC 10* from 1 January 2007 but it is not expected to have any impact on the Company's financial statements

*IFRIC 11 IFRS 2 – Group and treasury share transactions* (effective for annual periods beginning on or after 1 March 2007)

The interpretation provides guidance on accounting for share based transactions involving treasury shares or involving group entities and considers accounting for such transactions as equity settled and as cash settled share-based payment transactions The Company will apply *IFRIC 11* from 1 January 2008, but it is not expected to have a significant impact on the Company's financial statements

## Accounting policies

### (a) Basis of preparation continued

*IFRS 8 Operating Segments* (effective from 1 January 2009)

IFRS 8 will replace IAS 14, Segment reporting and proposes that the 'management approach' is adopted for reporting the financial performance of operating segments. The Company is not required to adopt this standard since it is not included in the standard's scope.

*IFRIC 7 Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies* (effective for annual periods beginning on or after 1 March 2006)

The interpretation is not deemed relevant to the Company's operations since the Company does not operate in hyperinflationary economies.

*IFRIC 12 Service concession arrangements* (effective for annual periods beginning on or after 1 January 2008)

The interpretation applies to contractual arrangements whereby a private sector operator participates in the development, financing, operation and maintenance of infrastructure for public sector services and as such is not relevant to the Company's operations.

### (b) Subsidiaries

Subsidiaries are all entities, including special purpose entities, over which the Company has the power to govern the financial and operating policies. Such power, generally but not exclusively, accompanies a shareholding of more than one half of the voting rights.

The Company uses the purchase method of accounting for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition.

The Company has two categories of investments in subsidiaries: operating subsidiaries that undertake the activities of the Group and investment subsidiaries whose primary function is to generate capital or income growth through holding investments. Operating subsidiaries are held at cost and investment subsidiaries are held at fair value through profit or loss ('FVTPL') since they are managed on a fair value basis.

### (c) Foreign currency translation

The financial statements are presented in millions pounds Sterling, which is the Company's presentation currency.

Foreign currency transactions are translated at the exchange rate prevailing at the date of the transaction. Gains and losses arising from such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Translation differences on non-monetary items, such as equities held at FVTPL, are reported as part of the fair value gain or loss in the income statement. Translation differences on financial assets and liabilities held at amortised cost are included in foreign exchange gains or losses in the income statement.

### (d) Revenue recognition

Gains and losses resulting from changes in both market value and foreign exchange on investments classified as FVTPL are recognised in the income statement in the period in which they occur.

Changes in the fair value of derivative financial instruments are recognised immediately in the income statement.

For loans and receivables measured at amortised cost, interest income recognised in the income statement is calculated using the effective interest rate (EIR) method.

Dividend income is recognised when the right to receive payment is established.

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**(e) Impairment of non financial assets**

The carrying amounts of non financial assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, at least at each balance sheet date. An impairment loss is recognised in the income statement for the amount by which the asset's carrying amount exceeds its recoverable amount.

The recoverable amount of an asset is the greater of its net selling price (fair value less costs to sell) and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit, or group of units, to which the asset belongs.

**(f) Income tax**

The current tax expense is based on the taxable profits for the year. Amounts are charged or credited to the income statement or equity as appropriate.

Deferred tax is provided, using the balance sheet liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised.

Temporary differences arising from investments in subsidiaries and associates give rise to deferred tax only to the extent that it is probable that the temporary difference will reverse in the foreseeable future or the timing of the reversal of that difference cannot be controlled.

Deferred tax is recognised in the income statement except when it relates to items recognised directly in the statement of recognised income and expense in which case it is credited or charged directly to equity through the statement of recognised income and expense.

The income tax expense is determined using rates enacted or substantively enacted at the balance sheet date.

**(g) Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than those that the Company intends to sell in the short term or that it has designated as FVTPL. Financial assets classified as loans and receivables include deposits with credit institutions, loans secured by mortgages and loans secured on policies.

Loans and receivables are initially measured at fair value less directly attributable transaction costs. Subsequently, they are measured at amortised cost, using the EIR method, less any impairment losses. Revenue from financial assets classified as loans and receivables is recognised in the income statement on an EIR basis.

Impairment on individual loans is determined, at each reporting date, by an evaluation of the exposure on a case-by case basis. The impairment loss is calculated as the difference between the present value of future cash flows, discounted at the loan's original effective rate, and the loan's current carrying value. Any impairment loss identified is recognised in the income statement. Subsequent recoveries are credited to the income statement.

**(h) Investment securities and derivatives**

Management determines the classification of investment securities and derivatives at initial recognition. The Company has designated its investment securities and derivatives as fair value through the profit and loss. Investment securities are designated at FVTPL where the asset or liability is part of a group of assets that are evaluated and managed on a fair value basis.

The Company uses derivative financial instruments including forwards, swaps, futures, and options for the purposes of matching contractual liabilities, reducing investment risks and for efficient portfolio management activities. In accordance with its treasury policy, the Company does not hold or issue derivative financial instruments for speculative trading purposes.

The Company recognises investment securities and derivatives at fair value on the trade date of the transaction. In the case of derivatives where no initial premium is paid or received the initial measurement value is nil. Directly attributable transaction costs are not included in the initial measurement value but are recognised in the income statement.

## **Accounting policies**

### **(h) Investment securities and derivatives** *continued*

Fair values are based upon the current quoted bid price where an active market exists. Where a quoted price in an active market cannot be obtained an appropriate market consistent valuation technique (for example discounted cash flows and recent market transactions) is used to determine fair value. If a price/technique is not available to provide a reliable fair value the investment is carried at cost less a provision for impairment.

### **(i) Embedded derivatives**

Options, guarantees and other derivatives embedded in a host contract are separated and recognised as a derivative unless they are either considered closely related to the host contract, meet the definition of an insurance contract or if the host contract itself is measured at fair value with changes in fair value recognised in income.

### **(j) Cash and cash equivalents**

Cash and cash equivalents include cash in hand, deposits held at call with banks and any highly liquid investments with less than three months to maturity from the date of acquisition. For the purposes of the cash flow statement, cash and cash equivalents also include bank overdrafts.

### **(k) Equity**

#### **(i) Share capital and treasury shares**

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Shares are classified as equity instruments when there is no contractual obligation to deliver cash or other assets to another entity on terms that may be unfavourable. The difference between the proceeds received on issue of the shares and the nominal value of the share issued is recorded in the share premium account. Incremental costs directly attributable to the issue of new equity instruments are shown in share premium account as a deduction from the proceeds, net of tax. Incremental costs directly attributable to the issue of equity instruments in a business combination are included in the cost of acquisition.

If the Company purchases any of its equity instruments, the consideration paid is treated as a deduction from total equity. Where such shares are sold, if the proceeds are equal to or less than the purchase price paid, the proceeds are treated as a realised profit. If the proceeds exceed the purchase price, the excess over the purchase price is transferred to the share premium account.

#### **(ii) Merger reserve**

If the Company issues shares at a premium and the conditions for merger relief under s131 of the UK Companies Act 1985 are met, a sum equal to the difference between the issue value and nominal value is transferred to a 'merger reserve'.

### **(l) Subordinated liabilities**

Subordinated liabilities are initially recognised at the value of proceeds received net of transaction costs. The total finance costs are charged to the income statement over the relevant term of the instrument on an EIR basis. The carrying amount of the debt is increased by the finance cost in respect of the reporting period and reduced by payments made in respect of the debt in the period.

### **(m) Pension costs and other post retirement benefit**

The Group operates a number of defined benefit and defined contribution plans, the assets of which are held in separate trustee-administered funds. The pension plans are funded by payments from employees and by the Group companies, determined by periodic actuarial calculations.

The Company is unable to identify its share of the underlying assets and liabilities in the UK defined benefit scheme on a consistent and reasonable basis, therefore it treats this scheme as a defined contribution scheme. Consequently the costs of this scheme and the UK defined contribution scheme represent the contributions payable for the accounting period.

For the defined contribution scheme, the Company pays contributions to separately administered pension insurance schemes. The contributions are recognised in staff expenses when they are due.

#### **(n) Provisions and contingent liabilities**

Provisions for restructuring costs and legal claims are recognised when the Company has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount has been reliably estimated. Provisions are not recognised for future operating losses. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole.

Contingent liabilities are disclosed if the future obligation is probable and the amount cannot be reasonably estimated.

#### **(o) Dividend distribution**

Final dividends on share capital classified as equity instruments are recognised in equity when they have been approved by shareholders. Interim dividends on these shares are recognised in equity in the period in which they are paid.

#### **(p) Employee share based payments**

The Group operates share incentive plans for all employees, share based long term incentive plans for senior employees and awards annual performance shares when the Group's profit exceeds target to all employees. The schemes are all in respect of Standard Life plc shares and further details are set out in Note 42 of the consolidated financial statements. These schemes are treated as equity settled share based payment schemes under IFRS 2 *Share based Payment*.

For equity settled share-based payment employee transactions, the services received as compensation are measured at their fair value. This fair value is measured by reference to the fair value of the equity instruments granted. The fair value of those equity instruments is measured at the grant date, which is the date that the Group and the employees have a shared understanding of the terms and conditions of the award. If that award is subject to an approval process then the grant date is the date when that approval is obtained. The charge in respect of the services received is recharged by the Company to the subsidiary which receives the services of the employees.

If the equity instruments granted vest immediately, the employees become unconditionally entitled to those equity instruments. Therefore, the Company immediately recognises an amount due from subsidiaries in respect of the services received in full with a corresponding credit to equity compensation reserve.

If the equity instruments do not vest until the employee has fulfilled specified vesting conditions, the Group presumes that the services to be rendered by the employee as consideration for those equity instruments will be received in the future, during the period of those vesting conditions ('vesting period'). Therefore, the Company recognises the amount due from subsidiaries in respect of those services as they are rendered during the vesting period with a corresponding amount credit to the equity compensation reserve.

At the time the equity instruments vest, the amount recognised in the equity compensation reserve in respect of those equity instruments is transferred to retained earnings.

#### **(q) Derecognition and offset of financial assets and liabilities**

A financial asset (or a part of a group of similar financial assets) is derecognised where

- The rights to receive cash flows from the asset have expired,
- The Company retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass through' arrangement, or
- The Company has transferred its rights to receive cash flows from the asset and has either transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Financial assets and liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

**A. Net investment return**

2006

£m

		2006
		£m
<b>(a) Financial instruments other than those at fair value through profit or loss</b>		
<b>Interest income</b>		
Cash and cash equivalents		13
Loans and receivables		49
		<b>62</b>
<b>(b) Net foreign exchange transaction losses</b>		
		<b>(1)</b>
<b>(c) Gains on financial assets at fair value through profit or loss</b>		
Equity securities and interests in pooled investment funds		3
Derivative financial instruments		1
		<b>4</b>
<b>Net investment return</b>		<b>65</b>

**B Administrative expenses**

2006

£m

	Notes	2006
		£m
Staff costs and other employee related costs	C	20
Stamp duty paid on sale of demutualisation shares		5
Auditors' remuneration	E	
Other administrative expenses		30
<b>Total administrative expenses</b>		<b>55</b>

**C Staff costs and other employee related costs**

2006

£m

	Notes	2006
		£m
<b>The aggregate remuneration payable in respect of employees was</b>		
Wages and salaries		16
Social security costs		1
Pension costs	D	2
Employee share based payments		1
<b>Total staff costs and other employee related costs</b>		<b>20</b>

The staff who manage the affairs of the Company are employed by Standard Life Employee Services Limited (SLESL), a subsidiary of the Company. These costs are recharged to the Company and the amounts recharged are set out above.

The information required to be disclosed under the Companies Act 1985 in respect of Directors' remuneration is provided in Note V (c).

Details of the employee share-based payment schemes operated by the Group are given in Note 42 of the consolidated financial statements.

## D. Pension and other post retirement benefit provisions

The staff who manage the affairs of the Company are members of a defined benefit pension scheme and a defined contribution pension scheme operated by the Group for its employees in the United Kingdom. There is no contractual agreement or policy for charging the net defined benefit cost of the defined benefit scheme across the participating UK companies. The sponsoring employer for the defined benefit scheme is Standard Life Assurance Limited (SLAL), and therefore the net defined benefit cost of the scheme is recognised by SLAL. As a result the Company treats its participation in the defined benefit plan as a defined contribution plan. Contributions to defined contribution plans are expensed when employees have rendered services in exchange for such contributions, generally in the year of contribution. The contributions to the defined contribution and the defined benefit plans recognised as an expense for the period ended 31 December 2006 were £2m.

Further information on the Group's pension schemes is given in Note 34 of the consolidated financial statements.

## E. Auditors' remuneration

In 2006 auditors' remuneration amounted to £0.5m in respect of the audit of the Company's financial statements. Auditors' remuneration for services other than the statutory audit of the Company are disclosed in Note 7 of the consolidated financial statements.

## F. Tax credit

### (a) Current year tax credit

	2006
	£m
Current tax credit – United Kingdom	(9)
Deferred tax expenses arising from the current period	1
<b>Total income tax credit</b>	<b>(8)</b>

The aggregate tax effect of items credited directly to equity is £1m. This is deferred tax relating to employee benefits.

### (b) Reconciliation of tax credit

	2006
	£m
Loss before tax	(31)
Tax at 30%	(9)
Permanent differences	1
<b>Total tax credit for the year</b>	<b>(8)</b>

**G Investments in subsidiaries**

	2006 £m
<b>At 1 January</b>	
Acquisition of SLAL	3,420
Dividend in specie	2,008
Reduction in carrying value of SLAL following dividend in specie	(2,008)
Capital injections	743
<b>At 31 December</b>	<b>4,163</b>

On demutualisation of The Standard Life Assurance Company (SLAC) on 10 July 2006, the eligible members of SLAC received shares (demutualisation shares) in the Company. The Company acquired the ordinary share capital of SLAL as compensation for the issue of the demutualisation shares. On the same date, SLAL distributed as a dividend in specie, certain subsidiaries to the Company which had been transferred to it on the demutualisation of SLAC. These subsidiaries, which are all unlisted, are shown below.

Name of subsidiary	Country of incorporation or residence	% of interest held	Nature of business
Standard Life Assurance Limited	Scotland	100	Life assurance
Standard Life Employee Services Limited	Scotland	100	Employee services
Standard Life Healthcare Limited	England	100	General insurance
Standard Life Investments (Holdings) Limited	Scotland	100	Investment management
Standard Life Oversea Holdings Limited	Scotland	100	Holding company
Standard Life (Mauritius Holdings) 2006 Ltd	Mauritius	100	Holding company

**H. Investments in associates**

The following are particulars of the Company's significant associates which were acquired during the year and are unlisted.

Name of associate	Country of incorporation or registration	% interest held
Tenet Group Limited	England	23

**I. Tax assets and liabilities**

	2006 £m
Current tax recoverable	2
Deferred tax asset	1
<b>Total tax assets</b>	<b>3</b>
Deferred tax liabilities	1
<b>Total tax liabilities</b>	<b>1</b>

There are no current tax liabilities due to losses incurred

The Company has surrendered the benefit of tax losses to underlying subsidiaries for a consideration of £7m which will be receivable within one year. Accordingly, no tax losses are available for carry forward. The Company has provided deferred tax amounting to £1m in respect of unrealised gains on investment securities.

Recognised deferred tax	2006 £m
<b>Deferred tax assets comprises</b>	
Employee benefits	1
<b>Net deferred tax assets</b>	<b>1</b>
<b>Deferred tax liabilities comprises</b>	
Unrealised gains on investments	1
<b>Net deferred tax liabilities</b>	<b>1</b>
<b>Movements in deferred tax liabilities comprise</b>	
At 1 January	
Amounts charged to net profit	(1)
Amounts credited to equity	1
<b>At 31 December</b>	

## J Derivative financial instruments

The Company uses derivative financial instruments in order to reduce the risk from potential movements in foreign exchange rates. These instruments are designated as held for trading.

A forward foreign exchange derivative with fair value of £1m and contract of £177m was held at the end of the period. This derivative asset of £1m is expected to be recovered within 12 months.

## K. Investment securities

	2006 £m
<b>Equity securities and interests in pooled investment funds</b>	
Listed	12
Unlisted	5
<b>Equity securities and interests in pooled investment funds</b>	<b>17</b>
<b>Debt securities</b>	
At fair value through profit and loss	
Unlisted	1
<b>Debt securities</b>	<b>1</b>
<b>Total investment securities</b>	<b>18</b>

The amount of debt securities expected to be recovered after more than 12 months is £1m.

## L. Other assets

	Notes	2006 £m
Outstanding sales of investment securities		5
Outstanding receipt of proceeds from share issue		4
Due from related parties	V	9
Accrued income		4
Other		3
<b>Total other assets</b>		<b>25</b>

The Company held other assets of £2 in 2005

The carrying amounts disclosed above reasonably approximate the fair values as at the year end

All other assets are expected to be recovered within twelve months

## M. Cash and cash equivalents

	2006 £m
Demand and term deposits with original maturity of less than 3 months	191
Other short term investments	191
<b>Total cash and cash equivalents</b>	<b>382</b>

Demand and term deposits with original maturity of less than 3 months are subject to variable interest rates

Other short term investments include the Company's investments in Standard Life Investments (Global Liquidity Funds) plc, which are subject to a mixture of fixed and variable interest rates

## N. Share capital

Details of the Company's share capital are given in Note 23 of the consolidated financial statements

## O. Share premium reserve

Details of the premium arising on the shares issued by the Company during the year are given in Note 24 of the consolidated financial statements

## P. Retained earnings

	2006 £m
At 1 January	
Loss for the year attributable to equity holders	(23)
Transfer from equity compensation reserve for vested employee share-based payments	4
<b>At 31 December</b>	<b>(19)</b>

## Q. Reconciliation of movements in other reserves

	Merger reserve £m	Equity compensation reserve £m	Special reserve £m	Total £m
<b>At 1 January 2006</b>				
Merger relief on issue of demutualisation shares	3,214			3,214
Release of merger relief on demutualisation shares	(1,872)			(1,872)
Merger relief on ordinary shares acquired in operating subsidiaries following dividend in specie	1,872			1,872
Share premium reduction			500	500
Reserves credit for employee share based payment schemes		15		15
Transfer to retained earnings for vested employee share-based payments		(4)		(4)
<b>At 31 December 2006</b>	<b>3,214</b>	<b>11</b>	<b>500</b>	<b>3,725</b>

Further information on these reserves is given in Note 26 of the consolidated financial statements

## R. Subordinated Liabilities

	2006 £m
<b>Subordinated guaranteed bonds</b>	
6 75% £500,000,000 Fixed rate perpetual	502
6 375% €750,000,000 Fixed/floating rate 12 July 2022	514
<b>Mutual Assurance Capital Securities</b>	
6 546% £300,000,000 Fixed rate perpetual	314
5 314% €360,000,000 Fixed rate perpetual	251
<b>Total subordinated liabilities</b>	<b>1,581</b>

The total of subordinated liabilities is expected to be settled after more than twelve months

Further information on the terms and conditions of the subordinated liabilities is given in Note 33 of the consolidated financial statements

## S. Risk management policies

### (a) Overview

The Group Risk Management Framework provides a structured approach to identify, assess, control and monitor financial and non financial risk and is an integral part of the Group's Internal Risk and Control Framework. Further details relating to the Group risk management policies are set out in Note 39 of the consolidated financial statements. The Company's risk management policies and approach to managing risks is driven by, and structured within, the Group Policies and the Group Risk Management Framework.

The Group has classified its key risks into the following categories: credit risk, market risk, liquidity risk, insurance risk, operational risk, strategic risk and group risk.

The business of the Company is managing its investments in, and balances with subsidiaries, managing subordinated liabilities which are used to finance the Group's activities and investing surplus funds. The Company is most specifically exposed to credit risk and market risk from the key risks identified by the Group.

**S. Risk management policies** continued**(b) Credit Risk**

Credit risk is the risk of exposure to loss if a counterparty fails to perform its financial obligations, including failure to perform those obligations in a timely manner

The following table provides information regarding the credit risk exposure of the Company at 31 December 2006, by classifying the following financial assets, according to credit ratings of the counterparties. AAA is the highest possible rating. Rated financial assets that fall outside the range of AAA to BBB are classified as below BBB.

31 December 2006	Credit rating					Not rated	Total
	AAA	AA	A	BBB	Below BBB		
	£m	£m	£m	£m	£m		
Cash and cash equivalents	205	64	85			28	382
Investment in associates						14	14
Debt securities						1	1

Credit risk is primarily concentrated in the United Kingdom within the Government and Financial Services Industry sectors. Counterparty risk is monitored in accordance with the Group Credit Risk Policy.

Included in cash and cash equivalents is the Company's investment in Standard Life Investments (Global Liquidity Funds) plc, which is accounted for at fair value through the profit and loss in accordance with IAS 39.

**(c) Market Risk**

Market risk is the risk that as a result of market movements there is exposure to fluctuations in the value of assets, the amount of liabilities or the income from their assets. General market risks include movements in interest rates, equity values and exchange rates. Specific market risk refers to the risk that arises from fluctuations in the value or income from a specific asset.

The primary market risk facing the Company is interest rate risk. The Company has no significant exposure to currency risk as all financial assets and liabilities of the Company are denominated in sterling with the exception of some small cash balances held in other currencies. Investments in subsidiaries are stated at cost.

The following table sets out for the Company's assets and liabilities exposed to interest rate risk the time to contractual maturity or repricing date, whichever is the earliest.

31 December 2006	Term to maturity/repricing								Total
	Within 1 year	1-5 years	5-10 years	10-15 years	> 15 years	Inter company	No fixed term	N/A	
	£m	£m	£m	£m	£m	£m	£m	£m	
<b>Financial Assets</b>									
Fair value interest rate risk	191								191
Non interest bearing financial instruments	8					9	18	8	43
Non financial assets	69		751	294	662	4,163		205	6,144
<b>Total assets</b>	<b>268</b>		<b>751</b>	<b>294</b>	<b>662</b>	<b>4,172</b>	<b>18</b>	<b>213</b>	<b>6,378</b>
<b>Financial Liabilities</b>									
Fair value interest rate risk	64		737	294	486				1,581
Non interest bearing financial instruments	10					72			82
<b>Total liabilities</b>	<b>74</b>		<b>737</b>	<b>294</b>	<b>486</b>	<b>72</b>			<b>1,663</b>
<b>Total assets less liabilities</b>	<b>194</b>		<b>14</b>		<b>176</b>	<b>4,100</b>	<b>18</b>	<b>213</b>	<b>4,715</b>

Included in non interest bearing financial instruments is the Company's investment in Standard Life Investments (Global Liquidity Funds) plc, which is accounted for at fair value through the profit and loss in accordance with IAS 39 (*Financial Instruments Recognition and Measurement*). This investment will expose the Company to both fair value and cash flow interest risk as the underlying investments within the fund are a mixture of fixed and floating rate cash investments. Investments in subsidiaries are included in non financial assets.

Financial assets subject to interest rate risk include cash and cash equivalents, debt securities and loans to subsidiaries. Financial liabilities include subordinated liabilities. Loans to subsidiaries are included in the appropriate maturity/repricing period.

Inter company balances which arise in the normal course of business, are generally cleared on a monthly basis, do not attract any interest and are disclosed as part of non interest bearing financial instruments in the column 'intercompany'.

Financial instruments classified as exposed to fair value interest rate risk are those with a fixed rate of interest. Financial instruments classified as exposed to cash flow interest rate risk are those with a floating interest rate, which is reset as market rates change.

The Company's weighted average effective interest rates is shown for assets and liabilities valued at amortised cost. The applicable rates are as follows:

	2006
	%
<b>Assets</b>	
Cash and cash equivalents	5.18
Loans to subsidiaries	6.53
<b>Liabilities</b>	
Subordinated liabilities	6.53

## T. Contingencies

### (a) Legal proceedings and regulations

The Company, like other financial organisations is subject to legal proceeding in the normal course of its business. While it is not practicable to forecast or determine the final results of all pending or threatened legal proceedings, management does not believe that such proceedings (including litigations) will have a material effect on the results and financial position of the Company.

### (b) Joint ventures and associates

The Company has entered into agreements to share in the assets and liabilities of joint venture and associate investments. The Directors do not anticipate any material losses from such investments, and the operations of such investments are not material in relation to the operations of the Company.

The Company's share of contingent liabilities of the joint ventures and associates is not significant in relation to the operations of the Company.

### (c) Issued share capital

The Scheme of Demutualisation of SLAC sets a ten year time limit for those eligible members of SLAC who were not allocated shares at the date of demutualisation to claim their entitlement. As future issues of these shares are dependent upon the actions of eligible members, it is not practical to estimate the financial effect of this potential obligation.

## U. Commitments

Under the trust deed in respect of the Group's UK defined benefit pension scheme, SLES (the principal employer) must pay contributions to the pension scheme as the trustees' actuary may certify necessary. The Company has guaranteed the obligations of SLES to the UK defined benefit pension scheme for a period of 15 years from 10 July 2006.

## V. Related party transactions

### (a) Transactions with/from and balances from/(to) related parties

In the normal course of business, the Company enters into transactions with related parties that relate to insurance, banking and investment management business. Such related party transactions are at arms length.

The year end balances with related parties arising from transactions carried out by the Group with related parties are as follows:

	2006 £m
<b>Due from related parties</b>	
Subsidiaries	9
Loans to subsidiaries	
UK	1,596
Canada	176
	<b>1,781</b>
<b>Due to related parties</b>	
Subsidiaries	72
	<b>72</b>

### (b) Compensation of key management personnel

Key management personnel of the Company, comprising 18 people, include all Directors, both executive and non-executive, and the direct reports of the Group Chief Executive.

The summary of compensation of key management personnel is as follows:

	2006 £m
Salaries and other short term employee benefits	2
Post employment benefits	
Other long term benefits	1
Share based payments	1
<b>Total compensation of key management personnel</b>	<b>4</b>

A number of key management personnel of the Company are also key management personnel of other entities within the Standard Life Group. However, for the purposes of the information above an apportionment of the total compensation paid to the key management personnel of the Company by the Group has been made based on an estimate of the services rendered to the Company.

### (c) Directors remuneration

The remuneration paid to the Directors for the period 10 July to 31 December 2006 was as follows

	2006
	£m
Aggregate emoluments	3
Amounts receivable under cash based long term incentive schemes	1

The directors are participants in a long term incentive plan ("LTIP") operated by the Group. Prior to demutualisation of SLAC on 10 July 2006, the LTIP was a cash based award dependant on certain performance conditions being achieved over a three year period. 2007 is the last year in which cash awards can be received. On demutualisation of SLAC the cash awards were converted into awards over shares of the Company and in future years the LTIP will be a share-based scheme. The conversion was based on the average middle market share price during the twenty dealing days following demutualisation. The benefits arising under the incentive plan are recorded in the year in which entitlement was determined.

The shares awarded under LTIP schemes only become receivable by the Directors when the performance conditions are met at the end of the three year vesting period, therefore no amounts in respect of these awards are disclosed above.

Retirement benefits are accruing to 5 directors under a defined benefit scheme operated by the Company.

Reference should be made to the Directors' Remuneration report for details of directors interests, including share options, in the share capital of the Company. The Directors' Remuneration Report is presented for the year to 31 December 2006. It shows remuneration paid to Directors over that period and, except as stated, reflects remuneration paid by The Standard Life Assurance Company and its subsidiaries prior to demutualisation on 10 July 2006 and by the Company and its subsidiaries after that date.

### (d) Transactions with/from and balances from/(to) key management personnel

The detailed disclosures of transactions incurred by the Company with key management personnel during the year and year-end balances arising from such transactions are contained within the audited section of the Directors' Remuneration Report on pages 70 to 83.

All transactions between the key management and the Company during the year are on commercial terms which are equivalent to those available to all employees of the Group.

During the period to 31 December 2006, the key management personnel contributed £1.3m to products sold by the Group. This primarily relates to investments in Self Invested Personal Pension (SIPP) products with the transfer of funds from an external provider.

At 31 December 2006 key management personnel had no outstanding loans.

### W. Fair value of financial assets and liabilities

The estimated fair values of financial assets and liabilities whose carrying value does not approximate fair value are as follows:

		2006	2006
		Carrying value	Fair value
	Notes	£m	£m
<b>Financial liabilities</b>			
Subordinated guaranteed bonds	R	1,016	1,114
Mutual Assurance Capital Securities	R	565	577

The estimated fair values are calculated by discounting the expected future cash flows at current market rates. The carrying amount of all financial assets and liabilities approximates their fair value.

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# Glossary of technical terms

## **Annuity**

A periodic payment made for an agreed period of time (usually up to the death of the recipient) in return for a cash sum. The cash sum can be paid as one amount or as a series of premiums. If the annuity commences immediately after the payment of the sum, it is termed an immediate annuity. If it commences at some future date it is termed a deferred annuity.

## **Annual premium equivalent (APE)**

The total of new annualised regular premiums plus 10% of single premiums written during the applicable period.

## **Assumptions**

Variables applied to data used to project expected outcomes.

## **Board**

Board of Directors of the Company.

## **Company**

Standard Life plc.

## **Covered business**

The business covered by the European Embedded Value Methodology. This should include any contracts that are regarded by local insurance supervisors as long term or life insurance business and may cover other long term life insurance, short term life insurance such as group risk business and long term accident and health business. Where short term healthcare is regarded as part of or ancillary to a company's long term life insurance business, then it may be regarded as long term business.

## **Deferred acquisition costs (DAC)**

The method of accounting whereby acquisition costs on long term business are accounted for as an asset and amortised over the life of those contracts. This leads to a smoothing of up front expenses.

## **Deferred income reserve (DIR)**

Recognised in relation to front end fees, that relate to services (on investment management services contracts) to be provided in future periods over the life of the contract, in order to recognise the income over the life of the contract.

## **Director**

A Director of the Company.

## **Discounting**

The reduction to present value at a given date of a future cash transaction at an assumed rate, using a discount factor reflecting the time value of money. The choice of a discount rate will usually greatly influence the value of insurance provisions, and may give indications on the conservatism of provisioning methods.

## **Economic assumptions**

Assumptions in relation to future interest rates, investment returns, inflation and tax. These assumptions and variances in relation to these assumptions are treated as non-operating profits/(losses).

## **European Embedded Value (EEV)**

The value to shareholders of the net assets plus the expected future profits on in force business from a life assurance and pensions business. Prepared in accordance with the EEV Principles and Guidance issued in May 2004 by the CFO Forum of European Insurance Companies and the Additional Guidance Issued in October 2005. EEV reports the value of business in force based on a set of best estimate assumptions, allowing for the impact of uncertainty inherent in future assumptions, the costs of holding required capital, the value of free surplus and TVOG.

## **EEV operating profit**

New business contribution, expected return on in force and net worth, development costs plus assumptions changes and experience variances arising in relation to existing expense and other operating assumptions.

## **Experience variances**

Current period differences between the actual experience incurred over the period and the assumptions used in the calculation of the embedded value excluding new business experience variances which are captured in new business contribution.

## **Financial options and guarantees**

Terms relating to covered business conferring potentially valuable guarantees underlying, or options to change, the level and nature of policyholder benefits and exercisable at the discretion of the policyholder, whose potential value is impacted by the behaviour of financial variables.

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### **Free surplus**

The amount of capital and any surplus allocated to, but not required to support, the in force business covered by the EEV

### **Group, Standard Life Group, or Standard Life**

Prior to the listing date SLAC and its subsidiaries, and from the listing date the Company and its subsidiaries

### **Group assets under management**

Total assets managed by the Group, including those not held on the balance sheet, i.e. this includes assets managed for third parties outside the context of insurance which are reported as off balance sheet assets under management

### **Heritage with profits fund (HWPF)**

The heritage with profits fund contains all existing business – both with profits and non profit – written before demutualisation in the UK, Irish or German branches, with the exception of the classes of business which the Scheme allocated to the Proprietary Business Fund. This fund also contains increments to existing business allocated to the heritage with profits fund

### **In force**

Long term business which has been written before the period end and which has not terminated before the period end

### **Listing date**

10 July 2006

### **Mutual fund**

A collective investment vehicle enabling investors to pool their money, which is then invested in a diverse portfolio of stocks or bonds, enabling investors to achieve a more diversified portfolio than they otherwise might have done by making an individual investment. There are many kinds of mutual funds, each with its own goals and methodologies. A mutual fund may be either an actively managed fund or an indexed mutual fund. Actively managed funds are changed on a regular basis by a fund manager in the attempt to maximise their profitability. The fund manager looks at the market and the sectors a fund invests in and redistributes the fund accordingly. An indexed fund simply takes one of the major indexes and buys according to that index. Indexed funds change much less frequently than actively managed funds, but in theory an active fund has more potential for profit

### **Net worth**

The market value of shareholders' funds and the shareholders' interest in the surplus held in the non profit component of the long term business funds, determined on a statutory solvency basis and adjusted to add back any non-admissible assets per regulatory returns

### **New business contribution (NBC)**

The expected present value of all future cash flows attributable to the shareholder from new business, as included within EEV operating profit

### **New business strain (NBS)**

The situation where costs involved in acquiring new business (such as commission payments to intermediaries, expenses, reserves etc.) are outlaid when that new business is acquired and therefore affect the insurance company's financial position at that point, but the income from that new business (premiums, investment income, etc.) has not yet been received and will not be received until a point in the future

### **Non covered business**

Mainly includes investment management, banking, healthcare and other businesses not associated with the life assurance and pensions business. Non covered business is excluded from the EEV methodology

### **Non profit policy**

A policy, including a unit linked policy, which is not a with profits policy

### **Present value of in force business (PVIF)**

The present value of the projected future after tax distributable profits attributable to shareholders from the Covered Business in force at the valuation date, adjusted where appropriate, to take account of TVOG

### **Present value of new business premiums (PVNBP)**

The measure of insurance sales under the EEV methodology. It is calculated as 100% of single premiums plus the expected present value of new regular premiums

### **Pro forma profit**

Pre-demutualisation IFRS mutual figures adjusted to derive a profit in order to provide illustrative financial information for full year 2006 and 2005. This information is unaudited and is prepared for illustrative purposes only. See section 5 of the Business Review

### **Proprietary Business Fund**

The Proprietary Business Fund contains, among other things, certain existing proprietary business classes of business – pension contribution insurance policies, income protection plan policies and a number of SIPP policies written before demutualisation, as well as most new insurance business written after demutualisation in the UK, Ireland and Germany

### **PVNB margin**

PVNB margin is NBC expressed as a percentage of PVNB

### **Recourse cash flow (RCF)**

Certain cash flows arising in the HWPF on specified blocks of UK and Irish business, which are transferred out of the fund and accrue to the ultimate benefit of shareholders, as determined by the Scheme of demutualisation

### **Regular premium**

A regular premium contract (as opposed to a single contract), is one where the policyholder agrees at inception to make a regular payments throughout the term of the contract

### **Required capital**

The amount of assets, over and above the value placed on liabilities in respect of covered business, whose distribution to shareholders is restricted

### **Return on EEV (ROEV)**

The annualised post tax operating profit on European Embedded Value basis expressed as a percentage of the opening embedded value

### **Single premium**

A single premium contract (as opposed to a regular premium contract (see above), involves the payment of one premium at inception with no obligation for the policyholder to make subsequent additional payments

### **SIPP**

A self invested personal pension which provides the beneficiary with greater choice and flexibility as to the range of investments made, how those investments are managed, the administration of those assets and how retirement benefits are taken

### **SLAC**

The Standard Life Assurance Company

### **Time value of options and guarantees (TVOG)**

Represents the potential additional cost to shareholders where a financial option or guarantee exists which affects policyholder benefits and is exercisable at the option of the policyholder

### **Underlying profit**

A 'normalised' profit measure the Group uses to provide a more meaningful analysis of the underlying business performance. Underlying profit is calculated by adjusting profit attributable to shareholders before tax for items such as volatility arising from accounting mismatches, impairment of intangibles and certain restructuring expenses

### **Unit linked policy**

A policy where the benefits are determined by reference to the investment performance of a specified pool of assets referred to as the unit linked fund

### **With profits policy**

A policy where, in addition to guaranteed benefits specified in the policy, additional bonuses may be payable from relevant surplus. The declaration of such bonuses (usually annually) reflects, amongst other things, the overall investment performance of the fund of which the policy forms part

### **Wrap platform**

An investment platform which is essentially a trading platform enabling investment funds, pensions, direct equity holdings and some life assurance contracts to be held in the same administrative account rather than as separate holdings

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# Shareholder information

## Dividends

The Board is recommending the payment of a final dividend for 2006 of 5 4p per share on 31 May 2007

You can choose to receive your dividends in one of the following ways

### 1 Reinvest your dividends in Standard Life plc shares

Standard Life plc is introducing a dividend reinvestment plan – sometimes referred to as DRIP. This will give shareholders the opportunity to use their cash dividend to buy more shares in the Company through a special dealing arrangement – and means you will receive additional shares instead of cash.

This is only available to shareholders in the UK, Ireland, Canada, Germany and Austria.

### 2 Receive a cash dividend payment in your bank or building society account

You can have your dividend paid directly into the bank or building society account of your choice – this means the money will usually be available to use more quickly than if you receive your dividends in the form of a cheque. The money will be transferred straight into your bank account on the day the dividend is paid.

### 3 Receive a cash dividend payment by cheque

If you don't choose to receive your dividends as shares, or paid directly into your bank account, you will receive a cheque for the relevant amount. You may be charged a fee to present this cheque, particularly if you live outside of the UK.

## Bonus shares

If you received ordinary shares in Standard Life plc as Demutualisation Shares, Employee Shares or Ordinary Shares bought at a discounted price in the Preferential Offer (as such terms were defined in the Prospectus of 15 June 2006), you will be eligible to receive one free bonus share for every complete 20 shares you received, and which you hold continuously until 10 July 2007.

For those shareholders who hold their Demutualisation Shares, Employee Shares or Ordinary Shares bought at a discounted price in the Preferential Offer through the Standard Life Share Account, Computershare Investor Services PLC, the operator of the Standard Life Share Account, will claim on their behalf any bonus shares for which they are eligible.

Please note that persons who hold their ordinary shares outside the Standard Life Share Account may be required to satisfy the Company that they are eligible to receive bonus shares.

## Receive shareholder communications by e mail and website

You can choose to take part in our Treemail initiative and receive future shareholder communications by e mail and website by registering with Investor Centre – an e-communications service run by Computershare. Registering is easy, secure and free – just go to [www.computershare.com/uk/register](http://www.computershare.com/uk/register) and follow the on screen instructions. The service allows you to

- Choose to receive an e-mail when the Annual Report and Accounts, Annual Review and AGM guide are available on our website. You can then read these online instead of receiving paper copies in the post.
- Check your Standard Life shareholding
- Find out information about your dividends
- Work out the value of your shareholdings
- Change your address details
- Set up a new dividend mandate, or change your existing details
- Send your Annual General Meeting voting instructions electronically

When you register with Investor Centre you can choose how you'd like us to keep in touch with you – by post or e mail. Any information you receive electronically will be the same as the paper version. This will help us save your money – and conserve natural resources.

## Preventing unsolicited mail

By law, the Company has to make its share register publicly available. Because of this, some registered shareholders may receive unsolicited mail. You could also be targeted by fraudulent 'investment specialists' using high pressure cold calling sales techniques – these are sometimes called 'boiler room scams' – you can find more information at the Office of Fair Trading website [www.offt.gov.uk/consumer/scams](http://www.offt.gov.uk/consumer/scams)

Using a nominee company can help protect your privacy. You can transfer your shares into the Company sponsored nominee – the Standard Life Share Account – by contacting Computershare. Or get in touch with your broker to find out about their nominee services.

## Analysis of registered shareholdings as at 31 December 2006

Size of shareholding	Number of holders	% of total holders	Number of shares	% of total shares
1 - 1000	69,297	53.79	35,615,249	1.69
1,001 - 5,000	52,676	40.89	107,800,436	5.12
5,001 - 10,000	3,950	3.07	27,221,605	1.29
10,001 - 100,000	2,521	1.96	49,434,415	2.35
* 100,001 +	376	0.29	1,885,998,764	89.55
<b>Totals</b>	<b>128,820</b>	<b>100</b>	<b>2,106,070,469</b>	<b>100</b>

\* At 31 December 2006 the Standard Life Share Account had 1,393,306 members holding 1,088,106,997 shares, with individual investors holding 99.63% of those shares

## Financial calendar for 2007

<b>Announcement of 2006 results and dividend</b>	<b>22 March</b>
<b>Ex dividend date for final dividend</b>	<b>28 March</b>
<b>Record date for final dividend for 2006</b>	<b>30 March</b>

The number of shares you hold on this date will be used to calculate your total dividend payment for the year to 31 December 2006

<b>Annual General Meeting</b>	<b>29 May</b>
<b>Final dividend payment date</b>	<b>31 May</b>
<b>Qualifying date for bonus shares</b>	<b>10 July</b>
<b>Announcement of interim results and dividend</b>	<b>4 September</b>
<b>Ex dividend date for interim dividend</b>	<b>12 September</b>
<b>Record date for interim dividend for 2007</b>	<b>14 September</b>

The number of shares you hold on this date will be used to calculate your total dividend payment for the half year to 30 June 2007

<b>Interim dividend payment date</b>	<b>30 November</b>
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## Contact details

We want to make sure you have answers to all your questions

For questions on dividends and your shareholding, please contact our registrar, Computershare

### UK

Visit [www.computershare.com](http://www.computershare.com)  
E mail at [sl\\_queries@computershare.co.uk](mailto:sl_queries@computershare.co.uk)  
Call Computershare on 0845 113 0045  
or +353 (0)1 431 9829

### Ireland

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### Germany and Austria

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### Canada

Visit [www.computershare.com](http://www.computershare.com)  
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Call Computershare on 1 866-982 9939  
or at the local number 514-982 9939

### Registrar

Computershare Investor Services PLC  
PO BOX 2656  
The Pavilions  
Bridgwater Road  
Bristol  
BS3 9BG

If you have any questions about voting at the Annual General Meeting, please contact Standard Life

### UK

Visit [www.standardlife.com](http://www.standardlife.com)  
E mail at [shareholders@standardlife.com](mailto:shareholders@standardlife.com)  
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### Ireland

Visit [www.standardlife.com](http://www.standardlife.com)  
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### Germany

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### Austria

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Call on 0810-53 00 45


### Canada

Visit [www.standardlife.ca](http://www.standardlife.ca)  
E mail at [csc@standardlife.ca](mailto:csc@standardlife.ca)  
Call on 1 888 841-6633

Lines are open from 8 30am to 5 30pm,  
Monday to Friday Please note call charges  
may vary

### Secretary, registered office and head office:

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Please remember that the value of shares can go down as well as up and you may not get back the full amount invested or any income from it  
All figures and share price information have been calculated as at 31/12/06 (unless otherwise indicated)

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