For the year ended 31 December 2006

Standard Life Bank Limited Report and Accounts

STANDARD LIFE

Registered in Scotland Number SC173685

Contents

Statutory information

Directors:

Sir B Stewart KB, CBE, MSc, CA (Non-Executive Chairman)
Ms A M Gunther BSc, FCIOBS, ACIB, MBA (Chief Executive)
J Cook BA (Customer Service Director)
Ms A Crawford BA (Sales and Marketing Director)
A M Crombie FFA (Non-Executive Director)
J Cummins BA, MBA (Non-Executive Director)
J F Hylands BSc, FFA (Non-Executive Director)
P Joshi BSc, FFA (Finance Director)
Prof F Kirwan BA, MA (Non-Executive Director)
Ms A Mitchell BA (Non-Executive Director)
K Morris BSc, MACT, ACIB (Non-Executive Director)

Secretary:

M Connarty LLB, MBA

Auditors:

PricewaterhouseCoopers LLP
Erskine House
68-73 Queen Street
Edinburgh
EH2 4NH

Registered Office:

Standard Life House
30 Lothian Road
Edinburgh
EH1 2DH

Report by the Directors

The directors submit their Report and Accounts for the year ended 31 December 2006.

Annual General Meeting

As permitted by Section 366A of the Companies Act 1985, Standard Life Bank Limited ("the Company") has passed an elective resolution to dispense with the holding of an annual general meeting.

Results and dividends

The Company and its subsidiary companies ("the Group") made a profit for the year ended 31 December 2006 of £29.7m (2005 - £20.2m).

The directors did not recommend the payment of a dividend during the year. The directors consider the results to be satisfactory. The directors propose to pay a dividend of £40m to the parent company Standard Life Assurance Limited ("SLAL") during March 2007.

Principal activities and business review

The Company is a private limited company registered in Scotland. It is domiciled in the UK where all its retail activities take place.

The Group's business is that of providing mortgage and savings banking services to the UK market through the Company and the associated financial activities of its subsidiary companies (as defined in note 19 to the accounts). The directors aim to provide a competitive range of banking products and services at low cost while maintaining a consistently high level of customer service.

As well as originating its own mortgage assets, the Company is responsible for the administration of Futureperfect mortgages advanced by its parent company, SLAL (prior to 10 July 2006, The Standard Life Assurance Company "SLAC"), totalling £314 million as at 31 December 2006 (2005 - £473 million) and Lifetime mortgages advanced by another SLAL subsidiary, Standard Life Lifetime Mortgages Limited totalling £14 million as at 31 December 2006 (2005 - £13 million). Total Group mortgages under management were £10.4 billion as at 31 December 2006 (2005 - £10.6 billion). Council of Mortgage Lenders ("CML") figures indicate that the total amount of mortgages under management in the UK were £1,079 billion at the end of 2006 (2005 - £967 billion).

Report by the Directors *(continued)*

Business environment

The UK mortgage market ended 2006 with lending volumes at record highs and no sign that the two Bank of England base rate increases during the second half of 2006 had reduced mortgage lending activity.

In a very strong market, the Group's market share declined, with the Group's market share of gross lending for 2006 being 0.9% (2005 1.1%). Gross mortgage lending declined slightly in 2006 at £3.0 billion compared to 2005 at £3.1 billion. Gross lending for the UK mortgage market as a whole in 2006 is expected by the CML to be £345 billion (2005 - £288 billion).

In 2006 competitive market rates and increases in the Bank of England base rate made remortgaging an attractive proposition, particularly for those customers seeking a degree of security and certainty with fixed rates. As a result mortgage balance attrition increased from £2.7 billion in 2005 to £3.2 billion in 2006. This increase also reflected significant run off of 2 year discounted business written in 2004 which reached the end of its initial offer period during 2006 and the fact that overall levels of business written in 2004 were higher than in 2003. This attrition position led to a decrease in mortgage balances of £0.2 billion for 2006 compared to an increase of £0.4 billion in 2005.

CML industry arrears data indicated that arrears levels reduced during the year with the number of mortgages 3 or more payments in arrears as a percentage of total mortgages outstanding being 0.89% at the end of 2006 (2005 - 0.97%). Although the Group's arrears levels increased slightly they remained significantly below industry average at 0.17% (2005 - 0.14%). This was due to tight monitoring and control and high credit quality of the Group's mortgage assets.

Strategy

As a wholly owned subsidiary of SLAL, the Company's strategy is to enhance shareholder value via sustained and profitable growth as a secured mortgage lender and savings provider. The Group collaborates with other Standard Life Group businesses in the UK to maximise opportunities and ensure operational efficiencies. The Group aims to be capital self sufficient, subject to SLAL capital optimisation, and seeks to maximise return on equity whilst ensuring the future viability of the business. The achievement of the Group's strategy requires continual focus on the key strategic drivers of profitable growth, cost effectiveness and income generation, all whilst treating customers fairly and managing risk appropriately.

Future outlook

Group gross lending for 2006 ended on a stronger note than 2005. The last quarter of 2006 saw strong gross lending in comparison to the last quarter of 2005 (+10.3%) and equivalent gross lending to Q3 2006, when it would normally be expected to drop due to seasonal impacts. This performance should provide a stronger start to lending in Q1 2007 with an improved pipeline of business compared to Q1 2006.

The UK economy remains healthy with stable GDP growth and historically low levels of unemployment. Despite an unexpected Bank of England base rate rise in January 2007, the Group expects this relatively benign economic environment to continue, providing support for the UK mortgage market in 2007 with gross lending remaining strong in the first half of 2007. The Group considers that, based on existing market conditions and the management strategies in place, levels of performance will continue to improve in 2007 and beyond.

Report by the Directors *(continued)*

Key performance indicators ("KPIs")

The directors monitor progress in relation to the overall group strategy by relation to six KPIs. Performance during the year, together with historical trend data, is set out in the table below:

KPI	*2006*	*2005*	*Definition, method of calculation and analysis*
Profit after tax (PAT)	29.7m	20.2m	PAT = statutory profit after tax for the year per the income statement expressed in millions. This KPI directly measures the dividend paying capacity of the Group.
Analysis			PAT has increased primarily as a result of a wider interest margin during 2006.
Return on equity (ROE)	9.6%	7.4%	ROE = statutory profit after tax for the year as a % of opening shareholders equity at the start of the year. This KPI measures the return on equity capital being earned for the parent company SLAL.
Analysis			ROE has increased due to continued improvement in profitability in 2006. The Group plans to start paying dividends to the parent company SLAL from 2007.
Interest margin (IM)	74bps	63bps	IM = net interest income for the year as a % of average total assets during the year and is disclosed in basis points (1/100th of 1%). This KPI indicates how much margin the Group is making on its assets and measures the strategic driver of income generation.
Analysis			IM has improved during 2006 primarily as a result of increased margin on mortgage assets during the year. This was due to lower funding costs and the positive impact of the unwind of fees received within the mortgage effective interest rate. Bank of England base rate increases have also generated margin through the timing of rate changes on administered assets and liabilities. Potentially adverse impacts of the Base – LIBOR gap were further mitigated via the use of basis swaps during 2006.
Cost income ratio (CIR)	59%	68%	CIR = the ratio of total costs to total income for the year expressed as a %. This KPI indicates how much of total income is being employed to meet the Group's cost base and measures the strategic driver of cost effectiveness.
Analysis			CIR has improved primarily due to interest margin which has increased total income. Gains on net hedge ineffectiveness and other fair value gains and losses have also had a positive impact on CIR. The benefits of cost controls have also been realised through reduced average staff numbers during 2006.

Report by the Directors *(continued)*

Key performance indicators ("KPIs") *(continued)*

KPI	*2006*	*2005*	*Definition, method of calculation and analysis*
Mortgages under management (MUM)	10.4bn	10.6bn	MUM = total mortgages on balance sheet + mortgages administered at the year end at cost expressed in billions. This KPI indicates total mortgage assets which are a key contributor towards Group profitability and measures the strategic driver of asset growth.
Analysis			MUM has fallen during the year, despite similar levels of gross lending to 2005, because of the increase in redemptions experienced. This increase in redemptions was driven by the competitive UK mortgage market and the volume of mortgages reaching the end of tie in periods during 2006.
Mortgages 3 or more payments in arrears (Arrears)	17bps	14bps	Arrears is a mortgage industry measure of the number of mortgages more than 3 payments in arrears as a % of total mortgages at the year end and is disclosed in basis points (1/100th of 1%). This KPI is an indicator of the credit quality of business being written and potential future credit losses.
Analysis			Arrears levels remained stable during the year similar to the mortgage industry as a whole, although the Group's total arrears levels still remain less than a fifth of the industry average. Levels of individual and collective provisions remained similar to 2005.

Principal risks and uncertainties

The management of the business and the execution of the Group's strategy are subject to a number of risks as detailed below. All risks are subject to review by the Board and appropriate processes are put in place to monitor and mitigate them. The ultimate responsibility for managing risk resides with the Board of the Company and the directors review and agree policies for managing each of these risks. Further details on risk management are given in note 37 to the financial statements.

If a risk event occurs and the mitigating controls fail, it is possible that the overall effect of such an event would adversely effect the Group financially, reputationally or both.

Market and interest rate risk

The Group maintains a policy of monitoring global macroeconomic developments and the implications to the Group by using sensitivity and gap analyses. The Group's hedging policy is to manage interest rate exposure on its assets and liabilities by using interest rate swaps and forward rate agreements. The Group's policy is to use derivatives solely to manage asset and liability risk and not for speculative trading purposes.

Report by the Directors *(continued)*

Liquidity risk

The Group maintains a policy of ensuring funds are available at all times to meet the Group's financial obligations as they fall due, including the withdrawal of customer deposits, and also to fund growth in the balance sheet. The Group ensures it can meet its financial obligations by maintaining a suitable level of liquid assets and having diverse sources of funding available. Wholesale funding is raised for the Group by taking deposits from banks, issuance of certificates of deposit, securitisation of mortgage assets and the issuance of commercial paper and medium term notes via Standard Life Bank Funding BV ("SLBF BV").

Foreign currency risk

The Group is not exposed to material currency risk since the majority of the Group's operations are based in the UK. The Company's investment in SLBF BV, whose functional currency is in sterling, is not material. The Group's hedging policy is to use foreign exchange forwards and cross currency swaps in order to manage transactional foreign currency exposure that occurs via its wholesale funding activities.

Equity risk

The Group's hedging policy is to use equity swaps to manage equity exposures that occur via its retail funding activities.

Credit risk

The Group maintains a policy of investing in other debt programmes or with counterparties which are rated as investment grade by Standard and Poor's and Moody's. The Group is also exposed to credit risk on its lending to residential customers. This risk is mitigated by the credit policies of the Group and also the holding of a first charge over the property on which the loan is granted.

Operational risk

This is the risk of loss, resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk also includes legal, reputational and strategic/business risk. An Operational Risk Committee exists to focus and co-ordinate operational risk management activities and oversees the Company's risk profile. Senior management are responsible for the detailed management of operational risks in their area. Each business area undertakes risk self-assessment activities to identify and assess the key risks in its area including the adequacy of controls to manage the risks using a consistent Standard Life Group wide methodology.

Report by the Directors *(continued)*

Directors

The names of the current directors are listed on page 2.

Ms Crawford was appointed as Sales and Marketing Director on 25 July 2006.

Mr Williamson retired as Customer Services Director on 31 December 2006.

Mr Cook was appointed as Customer Services Director on 1 January 2007.

The directors are not subject to retirement by rotation. None of the directors has a beneficial interest in the shares of the Company, which is a wholly owned subsidiary of SLAL. The interests of directors in the shares of Standard Life plc ("SL plc"), the Company's ultimate parent undertaking, are detailed in note 36.

Employees

The Company is committed to an equal opportunities policy. The sole criterion for selection or promotion is the suitability of any applicant for the job regardless of ethnic origin, religion, religious belief, sex, sexual orientation, marital status or disablement. The Company will continue to employ and make reasonable adjustments to the working environment, arrange for retraining, or retire on disability pension, any member of staff who becomes disabled, as may be appropriate. It is the Company's policy to afford access to training, career development and promotion opportunities equally to all employees.

Employee involvement

It is the Company's policy to have effective communication and consultation with staff. Staff involvement is achieved through a variety of approaches, including meetings, briefings, executive open fora and newsletters that help to ensure that staff are kept fully aware of the Company's goals and results. Staff also elect representatives of Bank LINK who, in turn, elect a National LINK representative. Formal consultation processes take place with staff via the elected Bank LINK representatives and the National LINK representative also meets with members of the Bank Executive and senior managers on a regular basis to discuss matters of general staff interest or concern. Bank LINK also represents the Company's employees on the joint staff body CONNECT.

A share plan is available to qualifying staff offering acquisition of shares in SL plc to encourage their financial involvement in the Standard Life Group.

Report by the Directors *(continued)*

Financial instruments

In order to conduct its business operations the Group holds financial instruments as detailed below.

Financial assets: the principal financial assets held by the Group, other than mortgages, comprise loans and advances to banks and debt securities (certificates of deposit, gilts, floating rate notes and treasury bills). The main purpose of holding these financial assets as agreed by the directors is to ensure appropriate liquidity, ensuring the Group's liabilities are met as they fall due and to meet regulatory requirements in respect of liquidity management.

Financial liabilities: the principal financial liabilities of the Group, other than customer accounts, are deposits by other banks, certificates of deposit, commercial paper and medium term notes. The purpose of incurring these financial liabilities as agreed by the directors is to ensure the Group has flexible sources of diversified funding available. In addition the Group obtains funding through the issue of mortgage backed securities via securitisation of its mortgage assets.

Derivative transactions: the Group enters into derivative transactions (principally interest rate swaps, forward rate agreements, cross currency swaps, forward currency contracts and equity swaps) for the purpose of managing interest rate, currency and equity risks. The Group continues to maintain a policy of using derivatives to manage asset and liability risk and not for speculative trading purposes. Further details on derivatives are given in notes 14 and 37 to the financial statements.

International Financial Reporting Standards ("IFRS")

The Group for the year end 31 December 2006 has applied IFRS adopted for use in the European Union ("EU") and consequently comparatives for the transition year ending 31 December 2005 have been restated accordingly. The Group has adopted the 'carved-out' version of IAS 39 "Financial Instruments: Recognition and Measurement."

Supplier payment policy

It is the Company and Group's policy to negotiate payment terms with principal suppliers and to pay in accordance with the terms agreed. For other suppliers, where goods and services have been supplied to specification, payment is made in accordance with the terms offered by the supplier. The average duration of amounts owing to suppliers for the Standard Life Group is disclosed within the accounts of SL plc.

Report by the Directors *(continued)*

Statement of disclosure of information to auditors

So far as each Director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditors in connection with preparing 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 aware of that information.

Auditors

The auditors, PricewaterhouseCoopers LLP, Chartered Accountants are willing to continue in office.

On behalf of the Board of Directors
P Joshi, Finance Director
Edinburgh, 15 March 2007

Statement of Directors' Responsibilities

Company law requires the directors to prepare financial statement for each financial year that give a true and fair view of the state of affairs of the Group and the Company and of the profit or loss of the Group for that period. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state that the financial statements comply with IFRS as adopted by the EU; and
- prepare the financial statements on a going concern basis, unless it is inappropriate to presume that the Group will continue in business.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

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

The maintenance and integrity of the Company 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. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

On behalf of the Board of Directors
M Connarty, Company Secretary
Edinburgh, 15 March 2007

Consolidated income statement

For the year ended 31 December 2006	Notes	2006 £m	2005 £m
Interest and similar income	3	640.5	623.4
Interest expense and similar charges	3	(552.3)	(550.9)
Net interest income		**88.2**	**72.5**
Fee and commission income		13.2	10.3
Fee and commission expense		(2.9)	(6.0)
Net fee and commission income		**10.3**	**4.3**
Net hedge ineffectiveness and other fair value gains and losses	4	3.9	10.9
Total income		**102.4**	**87.7**
Administrative expenses	5	(59.5)	(59.0)
Operating expenses		**(59.5)**	**(59.0)**
Impairment losses on loans and advances	16	(0.5)	(0.8)
Profit before taxation		**42.4**	**27.9**
Taxation	7	(12.7)	(7.7)
Profit for the year attributable to the equity holder of the parent company	8	**29.7**	**20.2**

The notes on pages 18 to 86 form an integral part of these financial statements.

Consolidated balance sheet

As at 31 December 2006	Notes	2006 £m	2005 £m
Assets			
Cash and balances with the Bank of England	10	190.3	7.0
Treasury bills	11	157.3	183.0
Loans and advances to banks	12	819.2	698.5
Financial assets at fair value through profit or loss	13	717.1	598.2
Derivative financial instruments	14	38.6	37.2
Loans and advances to customers	15	10,088.7	10,158.9
Investment securities – held to maturity	18	51.6	78.8
Deferred tax asset	21	–	0.7
Intangible assets	20	3.0	0.9
Other assets	22	13.5	39.2
Total assets		**12,079.3**	**11,802.4**
Liabilities			
Deposits from banks	23	873.0	969.0
Customer accounts	24	4,198.5	4,165.2
Derivative financial instruments	14	169.7	110.4
Debt securities in issue			
Securitised notes	25	4,371.9	4,003.1
Other debt securities in issue	26	1,813.0	1,963.7
Deferred tax liability	21	9.8	–
Other liabilities	28	40.5	18.4
Provisions	29	0.7	–
Subordinated liabilities	27	253.1	266.5
Total liabilities		**11,730.2**	**11,496.3**
Equity			
Called up share capital	31	271.8	271.8
Other reserves	32	10.5	(2.8)
Retained earnings	32	66.8	37.1
Total shareholders' equity		**349.1**	**306.1**
Total equity and liabilities		**12,079.3**	**11,802.4**

The notes on pages 18 to 86 form an integral part of these financial statements.

Approved on behalf of the Board of Directors and authorised for issue on 15 March 2007 by the following director:

P Joshi, Finance Director
Edinburgh, 15 March 2007

Company balance sheet

As at 31 December 2006	Notes	2006 £m	2005 £m
Assets			
Cash and balances with the Bank of England	10	190.3	7.0
Treasury bills	11	157.3	183.0
Loans and advances to banks	12	563.7	450.4
Financial assets at fair value through profit or loss	13	717.1	598.2
Derivative financial instruments	14	38.6	18.4
Loans and advances to customers	15	10,088.7	10,158.9
Investment securities – held to maturity	18	51.6	78.8
Investment in subsidiaries	19	1.4	–
Deferred tax asset	21	–	4.1
Intangible assets	20	3.0	0.9
Other assets	22	108.5	127.6
Total assets		**11,920.2**	**11,627.3**
Liabilities			
Deposits from banks	23	873.0	969.0
Customer accounts	24	4,198.5	4,165.2
Derivative financial instruments	14	32.4	41.1
Debt securities in issue			
Other debt securities in issue	26	801.8	793.4
Deferred tax liability	21	5.9	–
Other liabilities	28	5,671.4	5,363.4
Provisions	29	0.7	–
Total liabilities		**11,583.7**	**11,332.1**
Equity			
Called up share capital	31	271.8	271.8
Other reserves	32	10.6	(2.6)
Retained earnings	32	54.1	26.0
Total shareholders' equity		**336.5**	**295.2**
Total equity and liabilities		**11,920.2**	**11,627.3**

The notes on pages 18 to 86 form an integral part of these financial statements.

Approved on behalf of the Board of Directors and authorised for issue on 15 March 2007 by the following director :

P Joshi, Finance Director
Edinburgh, 15 March 2007

Statement of recognised income and expense

For the year ended 31 December 2006	Notes	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Cash flow hedges	32				
Effective portion of changes in fair value taken to equity		(10.6)	(25.9)	(10.6)	(25.7)
Net gains / (losses) transferred to the income statement		29.5	22.0	29.4	22.0
Taxation on items through equity	21	(5.6)	1.1	(5.6)	1.1
Net income recognised directly in equity		13.3	(2.8)	13.2	(2.6)
Profit after tax	32	29.7	20.2	28.1	10.7
Total recognised income and expense attributable to equity holder of the parent company		**43.0**	**17.4**	**41.3**	**8.1**

The notes on pages 18 to 86 form an integral part of these financial statements.

Consolidated cash flow statement

For the year ended 31 December 2006	Notes	2006 £m	2005 £m
Cash flows from operating activities			
Profit before income tax		42.4	27.9
Adjusted for:			
Net hedge ineffectiveness and other fair value gains and losses		(3.9)	(10.9)
Impairment losses on loans and advances		0.5	0.8
Net interest income		(88.2)	(72.5)
Other non cash items		14.9	32.0
		(34.3)	**(22.7)**
Changes in operating assets			
Cash and balances with the Bank of England		0.4	0.3
Derivative financial instruments		(71.7)	78.4
Financial assets at fair value through profit or loss		277.7	235.9
Loans and advances to customers		30.4	(509.4)
Changes in other assets		25.2	43.6
		262.0	**(151.2)**
Changes in operating liabilities			
Deposits from banks		(96.0)	105.1
Customer accounts		35.2	(118.9)
Derivative financial instruments		59.3	(110.5)
Debt securities in issue – securitised notes		452.0	683.9
Debt securities in issue – other		(134.7)	(270.2)
Changes in other liabilities		14.6	(5.5)
		330.4	**283.9**
Interest received		648.2	636.6
Interest paid		(536.3)	(523.6)
Income tax paid		(0.4)	(0.4)
Net cash flows from operating activities		**669.6**	**222.6**
Cash flows from investing activities			
Net investment in intangible assets		(2.1)	(0.9)
Proceeds from maturity and redemption of held to maturity investment		25.0	50.0
Net cash flows from investing activities		**22.9**	**49.1**
Cash flows from financing activities			
Issue of shares		–	15.0
Issue of subordinated liabilities		–	265.0
Interest paid on subordinated debt		(16.3)	(16.4)
Repayment of subordinated liabilities		–	(230.0)
Net cash flows from financing activities		**(16.3)**	**33.6**
Net increase/(decrease) in cash and cash equivalents		**676.2**	**305.3**
Opening cash and cash equivalents	35	**900.6**	**595.3**
Closing cash and cash equivalents	35	**1,576.8**	**900.6**

The notes on pages 18 to 86 form an integral part of these financial statements.

Company cash flow statement

For the year ended 31 December 2006	Notes	2006 £m	2005 £m
Cash flows from operating activities			
Profit before income tax		40.2	14.5
Adjusted for:			
Net hedge ineffectiveness and other fair value gains and losses		(2.4)	8.3
Impairment losses on loans and advances		0.5	0.8
Net interest income		(59.9)	(45.1)
Other non cash items		38.7	(2.4)
		17.1	**(23.9)**
Changes in operating assets			
Cash and balances with the Bank of England		0.4	0.3
Derivative financial instruments		(1.8)	(23.6)
Financial assets at fair value through profit or loss		277.7	235.9
Loans and advances to customers		30.4	(509.4)
Changes in other assets		18.5	8.4
		325.2	**(288.4)**
Changes in operating liabilities			
Deposits from banks		(96.0)	105.1
Customer accounts		35.2	(118.9)
Derivative financial instruments		(8.7)	25.2
Debt securities in issue – other		13.6	(154.5)
Changes in other liabilities		300.4	654.7
		244.5	**511.6**
Interest received		389.5	393.2
Interest paid		(329.0)	(332.2)
Net cash flows from operating activities		**647.3**	**260.3**
Cash flows from investing activities			
Net investment in intangible assets		(2.1)	(0.9)
Investment in subsidiary undertaking		(1.4)	–
Proceeds from maturity and redemption of held to maturity investment securities		25.0	50.0
Net cash flows from investing activities		**21.5**	**49.1**
Cash flows from financing activities			
Issue of shares		–	15.0
Interest paid on subordinated debt		–	(8.3)
Repayment of subordinated liabilities		–	(230.0)
Net cash flows from financing activities		**–**	**(223.3)**
Net increase/(decrease) in cash and cash equivalents		**668.8**	**86.1**
Opening cash and cash equivalents	35	652.5	566.4
Closing cash and cash equivalents	35	**1,321.3**	**652.5**

The notes on pages 18 to 86 form an integral part of these financial statements.

Notes to the accounts

1. Principal accounting policies

(a) Accounting convention

At the start of the year the Group adopted IFRS. These are the Group's first consolidated financial statements under IFRS and in accordance with IFRS 1 "First Time Adoption of International Financial Reporting Standards", the financial effects of adopting IFRS are summarised in notes 38 and 39. Previously the Group reported under United Kingdom Generally Accepted Accounting Principles ("UK GAAP").

(b) Basis of preparation

The principal accounting policies set out below have been consistently applied to all financial reporting periods presented in these consolidated financial statements and by all Group entities, unless otherwise stated.

These financial statements have been prepared in accordance with IFRS as adopted by the EU; interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") and those parts of the Companies Act 1985 applicable to companies reporting under IFRS. The financial statements are prepared under the historical cost convention as modified by the revaluation of financial assets and liabilities (including derivative contracts) at fair value through profit or loss ("FVTPL").

Comparative figures for 2005 have been presented in accordance with IFRS as adopted by the EU.

Unless otherwise stated in the notes to these financial statements all amounts are expected to be settled or recovered after more than 12 months from the balance sheet date.

The financial statements and notes are presented in sterling and all values are rounded to the nearest hundred thousand pounds except when otherwise indicated.

In the process of applying the Group's accounting policies, management has used its judgement and made estimates and assumptions in determining the amounts recognised in the financial statements. These estimates and assumptions can affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, results ultimately may differ from those estimates. The most significant areas where judgements and estimates are made are discussed in note 2.

Once authorised for issue, the Group's owners do not have the power to amend the financial statements.

Standards, interpretations and amendments to published standards not yet effective

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

IFRS 7 "Financial Instruments: Disclosures", a complementary amendment to IAS 1 "Presentation of Financial Statements" on capital disclosures and complementary revised guidance on implementing IFRS 4 "Insurance Contracts" (all effective for annual periods beginning on or after 1 January 2007). IFRS 7 introduces disclosures relating to financial instruments and requires the disclosure of qualitative and quantitative information relating to exposure to risks arising from financial instruments, including specified disclosures about credit risk, market risk and liquidity risk. It replaces IAS 30, "Disclosures in the Financial Statements of Banks and Similar Financial Institutions", and disclosure requirements in IAS 32, "Financial Instruments: Disclosure and Presentation". The amendment to IAS 1 introduces disclosures about the level of an entity's capital, and how it manages it.

Notes to the accounts *(continued)*

1. Principal accounting policies *(continued)*

(b) Basis of preparation (continued)

IFRIC 8 "Scope of IFRS 2" (effective from 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 from 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 that 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 11 "IFRS 2 – Group and treasury share transactions" (effective from 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.

Standards and interpretations that are not relevant to the Group : IFRS 8 "Operating Segments" (effective 1 January 2009), IFRIC 7 "Applying IAS 29 Hyperinflationary economies" (effective 1 March 2006), IFRIC 10 "Interim Financial Reporting and Impairment" (effective 1 November 2006), and IFRIC 12 "Service concession arrangements" (effective 1 January 2008).

(c) Basis of consolidation

The Group financial statements consolidate the income statements and balance sheets of the Company and its subsidiaries.

Subsidiaries are all entities including special purpose entities ("SPEs") over which the Company has the power to govern the financial and operating policies, even where the Company holds no shareholding in that entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group, through to the date that control ceases. Upon consolidation, inter-company transactions and balances are eliminated.

Investments in subsidiary undertakings are stated in the Company accounts at cost less any provision for impairment. Any impairment on investments in subsidiaries held at cost is determined at each reporting date. Impairment losses are calculated and recorded on an individual basis in a manner consistent with the impairment policy described in accounting policy (i).

(d) Interest income and interest expense

For financial instruments measured at amortised cost, interest income or expense is recorded at the effective interest rate ("EIR"), which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The EIR calculation takes into account all contractual terms of the financial instrument, including any fees or incremental costs that are directly attributable to the instrument (for example, early redemption penalty charges), but not future credit losses. The calculation includes all amounts received or paid by the Group that are an integral part of the overall return, direct incremental transaction costs related to the acquisition or issue of a financial instrument and all other premiums and discounts.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the original EIR applied to the new carrying amount.

Notes to the accounts *(continued)*

1. Principal accounting policies *(continued)*

(d) Interest income and interest expense (continued)

Interest income and expense on derivatives and other financial assets at fair value through the income statement are included in interest income or expense as applicable. The detailed accounting policy in relation to derivative financial instruments is set out in accounting policy (m).

(e) Fee and commission income and expense

Fees payable and receivable in relation to the provision of loans are accounted for on an EIR basis where they are directly attributable to the acquisition of that loan. Where they are not included in the EIR calculation, fees and commissions are recognised on an accruals basis according to when the relevant service is provided or on the performance of a significant act.

(f) Financial instruments

Management determines the classification of financial assets at initial recognition. The Group has classified its financial assets into the following categories: loans and receivables, held to maturity and financial assets at fair value through profit or loss.

Deposits from banks, customer accounts, debt securities in issue, subordinated liabilities and other financial liabilities are classified as financial liabilities at amortised cost. The carrying value of financial liabilities which have been designated as part of a fair value hedge relationship will include an adjustment for the value of the hedged risk.

All regular way trades are accounted for on a trade date basis.

The Group classifies its financial assets and financial liabilities at inception into the following categories:

Loans and receivables and financial liabilities at amortised cost
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Deposits with credit institutions, mortgage assets and other financial asset balances (such as other debtors) are classified as loans and receivables. Deposits from banks, customer accounts, debt securities in issue, subordinated liabilities and other liabilities are classified as financial liabilities. Both loans and receivables and financial liabilities are measured on origination at fair value less directly attributable transaction costs. Subsequently, recognition is at amortised cost, using the EIR method, less, for loans and receivables, any impairment losses identified.

Held to maturity financial assets ("HTM")
HTM financial assets are non-derivative financial assets with fixed or determinable payments that the Group has the ability and intention to hold to maturity. Government gilt securities are classified as HTM financial assets. HTM financial assets are initially measured at fair value plus any directly attributable transaction costs incurred. Subsequent recognition is at amortised cost, using the EIR method, less any impairment losses identified.

Financial assets at fair value through profit or loss ("FVTPL")
This category consists of those assets designated at FVTPL at inception. Financial assets at FVTPL are so designated where the asset is managed on a fair value basis. The Group holds a portfolio of debt securities (treasury bills, certificates of deposit and floating rate notes) that are managed on a fair value basis as they are held for the short term in order to manage the Group's liquidity requirement. This portfolio is therefore categorised as FVTPL financial assets. FVTPL financial assets are initially measured at fair value, with transaction costs taken directly to the income statement. Subsequent measurement is at fair value, with changes in fair value recognised directly in the income statement.

Notes to the accounts *(continued)*

1. Principal accounting policies *(continued)*

(f) Financial instruments (continued)

All derivatives are categorised as economic hedges even if they are not categorised as hedges in accordance with IAS 39.

The impact of hedging on the measurement of financial assets and liabilities is detailed in the derivative accounting policy note (m).

The fair value for financial instruments traded in active markets at the balance sheet date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions).

If the market for a financial asset is not active and also for unlisted securities, the Group establishes fair value using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis and other valuation techniques commonly used by market participants.

(g) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet where there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or realise the asset and liability simultaneously.

(h) Impairment of financial assets

Loans originated by the Group are carried at amortised cost and are evaluated for objective evidence of impairment, arising as a result of one or more events that occurred after initial recognition, at each balance sheet date.

Impairment exists if the value of a loan or a portfolio of loans exceeds the present value of future cash flows. Total credit loss allowances consist of specific and collectively assessed impairment allowances.

Specific impairment allowances are made against loans on a case by case basis where the specified advance is one or more payments in arrears or where there is other objective evidence of impairment and recovery is therefore considered doubtful.

If there is no evidence of impairment on an individual basis, a collective impairment review is undertaken. Collective allowances (excluding any cases against which specific impairment allowances have been made) are calculated through segmentation of the total loan portfolio into distinct credit risk groups.

If there is objective evidence that an impairment loss on loans and receivables has been incurred an impairment allowance is calculated based upon the difference between management's best estimate of the present value of the future cash flows of the assets (discounted at the original EIR) and the loans or group of loans current carrying value. In assessing these cash flows a number of factors are taken into account, including historic loan default experience and emergence periods, the effect of changes in house prices and an allowance for any forced sales discounts. Impairment allowances are recorded within the income statement in "Impairment losses on loans and advances".

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account "Impairment losses on loans and advances".

Assets are written off when there is no realistic prospect of recovery. Write offs are charged against previously established allowances for impairment or directly to "Impairment losses on loans and advances". Recoveries in part or full of amounts previously written off are credited to "Impairment losses on loans and advances".

Notes to the accounts *(continued)*

1. Principal accounting policies *(continued)*

(i) Impairment of non financial assets

The carrying amounts of non financial assets (non interest bearing assets) are reviewed at each balance sheet date to determine whether there is any indication of impairment. If there is an impairment loss it is recognised in the income statement within "Impairment losses on non financial assets" for the amount that the assets carrying amount exceeds its recoverable value.

(j) Debt securities in issue and borrowings

Issued debt securities and borrowings are classified as liabilities where the contractual arrangements result in the Group having an obligation to deliver either cash or another financial asset to the security holder.

Issued debt securities and borrowings that are liabilities are classified as financial liabilities at amortised cost and are measured at fair value at the date of the issuance (being proceeds net of directly associated issue costs) and subsequently measured at amortised cost using the EIR method (see accounting policy (d)).

Hedge accounting adjustments are applied to debt securities in issue and borrowings where they form part of a fair value hedge relationship in order to adjust their carrying value for the value of the hedged risk.

(k) Foreign currency

The Group's financial statements are presented in sterling, the functional currency of the Company.

Foreign currency transactions are translated using the exchange rates prevailing at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date. Any related foreign exchange gains or losses are taken to "Net hedge ineffectiveness and other fair value gains and losses" in the income statement.

(l) Provisioning

A provision is recognised when the Group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources of economic benefits will be required to settle the obligation, and a reasonable estimate can be made of the amount of the obligation. Once a provision is recognised, it is measured as the amount that the Group would rationally pay to settle the obligation.

(m) Derivative financial instruments and hedge accounting

The Group enters into derivative contracts, which include interest rate swaps, cross currency swaps, forward foreign exchange contracts, forward rate agreements and equity swaps. All derivative transactions entered into by the Group relate to economic hedging transactions. The Company and its subsidiaries do not enter into speculative derivative contracts. Derivatives are reviewed regularly for their effectiveness as hedges and corrective action taken, if appropriate.

Derivatives are measured initially at fair value on the date the contract is entered into and subsequently remeasured at fair value.

Notes to the accounts *(continued)*

1. Principal accounting policies *(continued)*

(m) Derivative financial instruments and hedge accounting (continued)

The Group's criteria for a derivative instrument to be accounted for as hedging instrument within a fair value or cash flow hedge include:

- completion of formal documentation prior to entering into the derivative contract detailing the hedging instrument, hedged item, risk management objective, strategy, testing methodology and hedge relationship;
- that the hedge relationship is tested at inception and on a monthly basis thereafter to ensure that it is expected to be highly effective on a prospective basis in offsetting the risk in the hedged item;
- that the hedge relationship is tested on a monthly basis to ensure it is effective retrospectively; and
- for cash flow hedges, a forecast transaction that is the subject of a hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect profit and loss.

The Group discontinues hedge accounting when:

- it is evident from testing that a derivative is not, or has ceased to be, highly effective as a hedge;
- the derivative expires, or is sold, terminated or exercised; or
- the underlying hedged item matures or is sold or repaid.

Where derivatives are not designated as part of a hedging relationship, changes in fair value are recorded in the income statement within "Net hedge ineffectiveness and other fair value gains and losses". Where derivatives are designated within hedging relationships, the treatment of fair value changes depends on the nature of the hedging relationship as explained below.

Fair values are obtained from quoted market prices in active markets and where these are not available, from valuation techniques such as discounted cash flows models using market rates. All derivatives fair values include accrued interest and are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

(i) Fair value hedges

The Group has designated certain derivative positions as fair value hedges of financial instruments. These relationships hedge the changes in fair value of a recognised asset, portfolio of assets, liability or identified portion of such an asset or liability that is attributable to particular risk and could affect the income statement. A fair value hedge is therefore used to hedge exposures to variability in the fair value of financial assets and liabilities such as fixed rate loans.

The change in fair value of the underlying assets or liabilities relating to the hedged risk is recognised in the income statement within "Net hedge ineffectiveness and other fair value gains and losses" offsetting the change in fair value of the hedging derivative. The change in 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 within the balance sheet.

Interest paid and received and interest payable and receivable on derivative instruments within a fair value hedging relationship is included within "Interest and similar income" or "Interest expense and similar charges", as applicable, dependent on the nature of the hedged item in order to reflect the economic interest rate of the hedge relationship.

If a fair value hedge no longer meets the relevant hedging criteria, hedge accounting is discontinued and the adjustment to the carrying value of the hedged item is amortised to the income statement within "Net hedge ineffectiveness and other fair value gains and losses" over the remaining period to maturity.

Notes to the accounts *(continued)*

1. Principal accounting policies *(continued)*

(ii) Cash flow hedges

A cash flow hedge is used to hedge exposures to variability in cash flows such as those on variable rate assets and liabilities.

Where a derivative is designated and qualifies as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the effective part of any gain or loss resulting from the change in fair value of the derivative is recognised directly in reserves within "Cash flow hedge reserve". The relevant amount of ineffectiveness is recognised immediately within "Net hedge ineffectiveness and other fair value gains and losses" in the income statement. Amounts accumulated in reserves are recycled to the income statement in the periods in which the hedged item will affect the income statement within the same line item as the hedged item.

If a cash flow hedge no longer meets the relevant hedging criteria, hedge accounting is discontinued and no additional amounts are recorded in reserves. Amounts accumulated in reserves are recycled to the income statement in the periods in which the hedged item affects the income statement. Where the hedged item is no longer expected to occur, the associated gains and losses that were recognised directly in reserves are reclassified to the income statement within "Net hedge ineffectiveness and other fair value gains and losses".

Interest paid and received and interest payable and receivable on derivative instruments within a cash flow hedging relationship is included within "Interest and similar income" or "Interest expense and similar charges", as applicable, dependent on the nature of the hedged item in order to reflect the economic interest rate of the hedge relationship.

(iii) Hedge transition adjustments

The impact of transition adjustments relating to hedged items is recognised over time within "Net hedge ineffectiveness and other fair value gains and losses".

(iv) Embedded derivatives

Certain derivatives are embedded within other non derivative financial instruments creating a hybrid instrument. Embedded derivatives are separated and recognised as a derivative unless they are considered closely related to the host contract or the host contract is measured at fair value.

(n) Derecognition of financial assets and liabilities

Derecognition is the point at which the Group removes an asset or liability from the balance sheet.

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised where the rights to receive cash flows from the asset have expired. A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires.

(o) Securitisation

The Group enters into securitisation transactions in which it sells mortgages to SPEs and issues securities backed by the cash flows from the securitised mortgages. Although none of the equity of the SPEs is owned by the Group, the nature of these entities, which are in substance controlled by the Group, mean that the Group retains substantially all the risks and rewards of ownership of the securitised mortgages. As such the SPEs are consolidated on a line by line basis in the Group accounts. Within the Company accounts the securitised loans remain within the relevant balance sheet heading and the related inter company liability with the SPE is disclosed within "Other liabilities."

Notes to the accounts *(continued)*

1. Principal accounting policies *(continued)*

(p) Taxation

(i) Current tax

The current tax expense is based on the taxable results for the year, using tax rates enacted or substantively enacted at the balance sheet date, including any adjustments in respect of prior years.

(ii) Deferred tax

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 results will be available against which the temporary differences can be utilised.

(q) Intangible assets

Intangible assets, including internally developed software, 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. Internally developed software is capitalised as an intangible asset and amortised over its estimated useful life when it is either identified as separable (i.e. capable of being separated from the entity and sold, transferred, rented, or exchanged) or arises 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 lives of the asset, typically 4 years. Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets subject to amortisation are reviewed for impairment whenever events or circumstances indicate that the covering amount may not exceed the relevant future economic benefits. Impairment losses are calculated and recorded on an individual basis in a manner consistent with the impairment policy described in accounting policy (i).

(r) Pension costs and other post retirement benefits

The Standard Life 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.

(s) Employee share based payments

SL plc operates share incentive plans for all employees, share-based long term incentive plans for senior employees and awards annual performance shares when the SL plc group's profit exceeds target to all employees. The schemes are all in respect of SL plc shares and further details are set out in note 41. These schemes are treated as equity-settled share-based payment schemes under IFRS 2 "Share-based payments."

Notes to the accounts *(continued)*

1. Principal accounting policies *(continued)*

(s) Employee share based payments (continued)

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 SL plc to the Company as all employees who manage the affairs of the Group are employed by the Company.

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 amount due to SL plc.

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 amount due to SL plc.

(t) Segmental reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

(u) Cash and cash equivalents

For the purposes of the cash flow statement cash and cash equivalents include cash in hand, deposits held at call with banks, any highly liquid investments which have a maturity date within three months of the date of acquisition and bank overdrafts that are repayable on demand and form an integral part of the Group's cash management.

(v) Transition to IFRS

The Group's financial statements for the year ending 31 December 2006 are the first financial statements that comply with IFRS as adopted by the European Union. The Group's adoption date for IFRS is 1 January 2006 with a transition date of 1 January 2005 at which point the opening balance sheet has been prepared. Comparative figures for 31 December 2005 have been presented which comply with IFRS as adopted by the European Union. As described in the Report by the Directors the Group has adopted the 'carved-out' version of IAS 39.

Notes to the accounts *(continued)*

2. Significant accounting estimates and judgements

The most significant areas where judgements are made are detailed below.

Average life of secured mortgage lending

The valuation of assets or liabilities measured at amortised cost is calculated using the EIR method. The EIR method implies an interest rate which discounts the future forecast cash flows of an asset over its expected life back to its carrying value. The expected life of secured mortgage lending, which is subject to early repayment dependent on customer behaviour, is determined on the basis of historical redemption data and management judgement.

Fair value of derivatives and debt securities at FVTPL

Fair values are obtained from quoted market prices in active markets and where these are not available, from valuation techniques such as discounted cash flows models using market rates. The accuracy of the fair value calculation would therefore be affected by unexpected market movements or inaccuracies within the valuation models used.

Impairment of loans and advances

The Group regularly reviews its mortgage loan portfolio to assess the level of impairment. In determining whether an impairment loss should be recorded in the income statement, management make judgements as to whether there is any objective data indicating that there is a measurable impairment loss. Management also regularly reviews and where appropriate adjusts the underlying assumptions, such as probability of default rates, loss given default rates and the loss emergence period, which underpin the impairment calculations.

Taxation

Estimates are required in determining the provision for corporation tax due to the existence of transactions where the final tax determination is uncertain at the balance sheet date.

Notes to the accounts *(continued)*

3. Net Interest Income

	Group	
	2006 £m	2005 £m
Interest and similar income		
Loans and advances to customers	543.8	536.2
Investment and debt securities	96.7	87.2
	640.5	**623.4**
Interest expense and similar charges		
Customer accounts	(176.9)	(177.1)
Debt securities in issue	(313.2)	(301.3)
Subordinated liabilities	(16.8)	(8.2)
Other borrowings	(45.4)	(64.3)
	(552.3)	**(550.9)**
Net interest income	**88.2**	**72.5**

Included within interest income is £nil (2005: £0.4m) in respect of interest income accrued on impaired financial assets.

Interest paid and received and interest payable and receivable on derivative instruments is included within "Interest and similar income" or "Interest expense and similar charges", as applicable, dependent on the nature of the hedged item in order to reflect the economic interest rate of the hedged item.

Notes to the accounts *(continued)*

4. Net hedge ineffectiveness and other fair value gains and losses

	Group	
	2006 £m	2005 £m
Fair value movements on debt securities at FVTPL	(0.9)	0.6
Fair value movements on derivative financial instruments	(59.7)	129.8
Hedge accounting adjustments	(38.8)	9.2
Foreign currency translation gains and losses on underlying instruments	103.3	(128.7)
	3.9	**10.9**

The fair value movements of future cash flows (excluding interest flows) on financial assets at FVTPL and all derivatives are separately identified within "Net hedge ineffectiveness and other fair value gains and losses" together with translation gains and losses on financial instruments denominated in a foreign currency and hedge accounting adjustments.

Hedge accounting adjustments consist of adjustments relating to fair value hedge relationships, the ineffective elements of cash flow hedge relationships and the impact of transition and other adjustments relating to hedge relationships.

The Group enters into certain derivative financial instruments which although highly effective as economic hedges are not included in hedge accounting relationships due to the restrictive nature of IAS 39 hedging requirements. Fair value movements of future cash flows (excluding interest flows) on these derivatives are included within "Net hedge ineffectiveness and other fair value gains and losses".

Interest flows on derivatives are included within the income statement in the same line as the economically hedged item.

Notes to the accounts *(continued)*

5. Administrative expenses

	Group	
	2006	**2005**
	£m	**£m**
Staff costs including directors' remuneration (see note 6)	25.7	26.1
Marketing and advertising	3.2	2.6
Legal and professional services	6.3	3.4
Management charges	21.1	23.3
Other administrative expenses	3.2	3.6
	59.5	**59.0**

Auditors' remuneration is included within legal and professional services above and is analysed below (excluding VAT).

	Group	
	2006	**2005**
	£000	**£000**
Audit services – statutory audit of Company annual accounts	324	139
Audit services – statutory audit of subsidiary Company annual accounts	175	102
Other assurance services pursuant to legislation	–	8
Services related to corporate finance transactions (securitisation)	84	81
All other services	26	3
	609	**333**

The increase in statutory audit fees is due to additional work required in preparation for and following the introduction of IFRS. All non-audit services are subject to pre-approval by the Group Audit Committee.

The £84k in relation to corporate finance transactions has been included as part of the EIR calculation on the securitised notes issued as it represents a direct incremental transaction cost related to the issue of those financial instruments.

6. Staff costs

	Group	
	2006	**2005**
	£m	**£m**
Wages, salaries and staff bonuses	21.2	21.6
Social security costs	1.7	1.8
Pension costs	2.8	2.7
	25.7	**26.1**

Notes to the accounts *(continued)*

6. Staff costs *(continued)*

The staff who manage the affairs of the Group are employed by the Company. Their salary costs are borne by Standard Life Employee Services Limited ("SLESL") and are recharged to the Company. The amounts recharged are set out above.
The average number of employees for both the Group and the Company during the year was 729 (2005: 795). As at year end, the number of employees of both the Group and the Company was 687 (2005: 720).

Staff costs include director and key management personnel ("KMP") remuneration. Details of directors and KMP remuneration are given within note 36 to the financial statements.

7. Taxation

	Group	
	2006 **£m**	**2005** **£m**
(i) Current year tax charge		
UK corporation tax	7.8	0.4
Deferred tax charge (see note 21)	4.9	7.3
Taxation	**12.7**	**7.7**

	Group	
	2006 **£m**	**2005** **£m**
(ii) Tax provision		
Current tax liability	–	–

There is no current tax liability due to the surrender of losses from elsewhere in the Standard Life Group for which full payment will be made.

Notes to the accounts *(continued)*

7. Taxation *(continued)*

(iii) Reconciliation of UK corporation tax expense

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the standard rate of UK corporation tax of 30% (2005: 30%) as follows:

	Group	
	2006 **£m**	**2005** **£m**
Profit before income tax	42.4	27.9
UK corporation tax calculated at a rate of 30%	12.7	8.4
Permanent differences	0.2	0.3
Effect of group income	(0.4)	–
Effect of different tax rates in other countries	0.1	(0.5)
Difference on transition to IFRS	0.1	(0.5)
Taxation	**12.7**	**7.7**

As detailed in note 32, deferred tax has also been charged directly to equity. The deferred tax charge amount charged to equity was £5.6m (2005 £(1.1)m).

8. Profit for the year attributable to the equity holder of the parent company

Of the consolidated profit for the year attributable to the equity holder £28.1m (2005: £10.7m) has been dealt within the accounts of the Company. As permitted by Section 230 of the Companies Act 1985, the Income statement of the Company has not been presented separately.

9. Dividends

No interim dividends were paid in 2005 or 2006. The directors did not propose a final dividend in respect of 2005 and have not proposed a final dividend for 2006.

Notes to the accounts *(continued)*

10. Cash and balances with the Bank of England

	Group & Company	
	2006	2005
	£m	£m
Mandatory reserve deposits with the Bank of England	6.6	7.0
Other balances with the Bank of England	183.7	–
	190.3	**7.0**

Mandatory reserve deposits are not available for use in the Group's day to day operations and are non-interest bearing. Other balances are subject to variable interest rates based on the Bank of England base rate. The amount of balances with the Bank of England expected to be settled after 12 months is £6.6m (2005: £7.0m).

11. Treasury bills

	Group & Company	
	2006	2005
	£m	£m
UK treasury bills	**157.3**	**183.0**

Treasury bills are debt securities at fair value through profit or loss issued by the United Kingdom's treasury department for terms less than a year. Treasury bills are all subject to fixed interest rates. Treasury bills with a maturity on acquisition of less than 3 months are included in total cash and cash equivalents in note 35.

12. Loans and advances to banks

	Group		Company	
	2006	2005	2006	2005
	£m	£m	£m	£m
Loans to banks with a maturity on acquisition of :				
Less than 3 months	**819.2**	**698.5**	**563.7**	**450.4**

Loans and advances to banks are subject to fixed interest rates. Loans and advances to banks with a maturity on acquisition of less than 3 months are included in total cash and cash equivalents in note 35.

Notes to the accounts *(continued)*

13. Financial assets at fair value through profit or loss

	Group & Company	
	2006	2005
	£m	£m
Certificates of deposit	530.5	193.2
Floating rate notes	186.6	405.0
	717.1	**598.2**

Financial assets at fair value through profit and loss comprise debt securities which are subject to floating interest rates based upon 3 month LIBOR. These debt securities are held for liquidity purposes and as such are carried at fair value through profit and loss. All debt securities are listed. Debt securities with a maturity on acquisition of less than 3 months are included in total cash and cash equivalents in note 35. The amount of debt securities expected to be settled after 12 months is £95.1m (2005: £196.5m).

14. Derivative Financial Instruments

All derivative instruments are held for economic hedging purposes, although not all derivatives are designated as hedging instruments under the terms of IAS 39. Note 37 provides additional information in relation to the use of derivatives in risk mitigation. The tables below analyse derivatives between those designated as hedging instruments under IAS 39 and those which, whilst in economic hedging relationships, are not designated as hedging instruments for accounting purposes.

The fair value of derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market interest rates, equity indices or foreign exchange rates relative to their contractual terms. The aggregate contractual or notional amount of derivative financial instruments held, the extent to which instruments are favourable or unfavourable and, thus the aggregate fair values of derivative financial assets and liabilities can fluctuate significantly from time to time.

The notional amounts of derivative financial instruments provides a basis for comparison with related hedge items recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Group's exposure to interest rate, currency or equity risks.

Notes to the accounts *(continued)*

14. Derivative Financial Instruments *(continued)*

The contract notional amounts and fair values of derivative instruments held are set out in the following table (including accrued interest):

Group	2006 Contract Amount £m	2006 Fair Value Assets £m	2006 Fair Value Liabilities £m	2005 Contract Amount £m	2005 Fair Value Assets £m	2005 Fair Value Liabilities £m
Derivatives designated as fair value hedges						
Interest rate swaps	2,527.5	19.7	10.8	2,278.1	4.0	15.1
Cross currency interest rate swaps	2,083.7	–	144.1	2,079.2	21.0	84.6
Derivatives designated as cash flow hedges						
Interest rate swaps	1,401.0	14.9	–	450.0	0.1	4.2
Forward foreign exchange contracts	1,070.7	1.2	14.2	918.3	10.4	1.5
Other derivatives not in hedge accounting relationships						
Interest rate swaps	3,418.7	1.4	0.6	2,906.9	–	3.7
Cross currency swaps	6.6	0.7	–	16.1	0.8	1.3
Forward rate agreements	–	–	–	60.0	0.4	–
Equity swaps	4.4	0.7	–	4.4	0.5	–
Total	**10,512.6**	**38.6**	**169.7**	**8,713.0**	**37.2**	**110.4**

Based upon final maturity dates the amount of derivative fair value assets expected to be settled in more than 12 months is £33.1m (2005: £21.5m) and the amount of derivative fair value liabilities expected to be settled in more than 12 months is £155.2m (2005: £94.5m).

Notes to the accounts *(continued)*

14. Derivative Financial Instruments *(continued)*

Company	2006			2005		
	Contract Amount £m	Fair Value Assets £m	Fair Value Liabilities £m	Contract Amount £m	Fair Value Assets £m	Fair Value Liabilities £m
Derivatives designated as fair value hedges						
Interest rate swaps	2,527.5	19.7	10.8	2,278.1	4.0	15.1
Cross currency interest rate swaps	86.6	–	5.3	156.7	–	15.3
Derivatives designated as cash flow hedges						
Interest rate swaps	1,401.0	14.9	–	450.0	0.1	4.2
Forward foreign exchange contracts	1,070.7	1.2	14.2	918.3	10.4	1.5
Other derivatives not in hedge accounting relationships						
Interest rate swaps	7,902.5	1.4	2.1	6,939.0	2.2	3.7
Cross currency swaps	6.6	0.7	–	16.1	0.8	1.3
Forward rate agreements	–	–	–	60.0	0.4	–
Equity swaps	4.4	0.7	–	4.4	0.5	–
Total	**12,999.3**	**38.6**	**32.4**	**10,822.6**	**18.4**	**41.1**

Based upon final maturity dates the amount of derivative fair value assets expected to be settled in more than 12 months is £33.1m (2005: £7.6m) and the amount of derivative fair value liabilities expected to be settled in more than 12 months is £17.9m (2005: £25.2m).

Notes to the accounts *(continued)*

15. Loans and advances to customers

	Group & Company	
	2006	**2005**
	£m	**£m**
Loans not subject to securitisation	4,581.4	5,197.0
Loans subject to securitisation (see note 17)	5,528.9	4,949.7
Impairment losses on loans and advances to customers (see note 16)	(1.5)	(1.2)
	10,108.8	**10,145.5**
Fair value hedge adjustment	(20.1)	13.4
	10,088.7	**10,158.9**

All loans and advances to customers are fully secured on residential property.

Loans subject to variable rates of interest were £5,802.3m (2005: £7,023.2m) and fixed rates of interest were £4,306.5m (2005: £3,122.3m).

Based upon final maturity date the amount of loans and advances expected to be settled after 12 months is £10,085.0m (2005: £10,155.2m).

The fair value hedge adjustment relates to hedge accounting adjustments made to the portfolio of fixed rate mortgages which are hedged by interest rate swaps (refer to the Accounting Policies).

16. Impairment losses on loans and advances

	Group & Company Individual Provisions		Group & Company Collective Provisions	
	2006	**2005**	**2006**	**2005**
	£m	**£m**	**£m**	**£m**
At 1 January	(1.0)	(0.3)	(0.2)	(0.1)
Charge for year to income statement	(0.3)	(0.7)	(0.2)	(0.1)
Amounts written off during the year	0.2	–	–	–
At 31 December	**(1.1)**	**(1.0)**	**(0.4)**	**(0.2)**

Notes to the accounts *(continued)*

16. Impairment losses on loans and advances *(continued)*

	Group & Company Total Provisions 2006 £m	2005 £m
At 1 January	(1.2)	(0.4)
Charge for year to income statement	(0.5)	(0.8)
Amounts written off during the year	0.2	–
At 31 December	**(1.5)**	**(1.2)**

17. Securitisation

The Company has securitised part of its residential mortgage portfolio. Under this arrangement, the beneficial interest in these mortgages is transferred to Lothian Trustees Limited ("Trust"), a SPE. The Company continues to administer the mortgages as well as providing cash management services to the Trust and other SPEs and receives a fee for doing so. The issue of mortgage backed floating rate notes by the SPEs funds the purchase of the mortgages.

Although the Company does not directly or indirectly own any of the share capital of the SPEs, the nature of these entities, which are in substance controlled by the Company, means that the Company retains substantially all of the risks and rewards of the securitised mortgages. As such, the Group's results include the results of the SPEs and the Group's balance sheet includes the assets and liabilities of the securitisation SPEs consolidated on a line by line basis. Securitised mortgages continue to be recognised within the Company accounts within Loans and advances to customers.

The Company (as originator of the loans and advances) is not obliged to support any losses in respect of the loans and advances subject to securitisation, except as described below, nor does it intend to do so. This is clearly stated in the offering circular subscribed to by the note holders of the debt issued by the SPEs and in the legal agreements with the note holders. Losses are shared equally in accordance with the interests held in the Trust. The Company's interest in the Trust will only bear additional loss in limited exceptional circumstances set out in the offering circular (such as in the event of insolvency of the Company or the default and set-off by customers of the Company who are both mortgage and deposit holders).

The Company has made subordinated loans to Lothian Funding Limited ("Funding"), repayments of interest and capital on which are subordinated to the claims of the note holders of the debt issued by the SPEs.

The Company has an option (but not an obligation) to sell further mortgage loans to the Trust where at the end of any trust determination period the rate of repayment of principal exceeds the level agreed at the date of sale of the loans. The Company has no right or obligation to repurchase the benefit of any securitised loan except to the extent that the loan breaches representations and warranties given at the date of sale. It does, however, have the option (but not the obligation) to repurchase loans from the Trust, on being offered the opportunity to do so, where the borrower requests a further advance or a product switch.

Notes to the accounts *(continued)*

17. Securitisation *(continued)*

A summary of securitisation activity to date is provided in the table below.

Securitisation Entity	Date of securitisation	Gross assets securitised £m	Gross debt issued £m	Subordinated loans made by Company to Funding £m
Lothian Mortgages (No.1) plc	16 Apr 2003	1,367.0	1,000.0	14.0
Lothian Mortgages (No.2) plc	23 Sep 2003	2,205.0	1,500.0	20.7
Lothian Mortgages (No.3) plc	30 Jun 2004	1,041.0	1,250.0	4.4
Lothian Mortgages (No.4) plc	24 Feb 2005	2,187.0	1,250.0	1.9
Lothian Mortgages Master Issuer plc	10 May 2006	1,388.0	1,005.0	1.9
		8,188.0	**6,005.0**	**42.9**

Gross assets securitised and notes in issue as presented above reconcile to amounts included in the consolidated balance sheet within loans and advances to customers and debt securities in issue as follows:

	Note	Mortgage assets securitised £m	Gross debt issued £m
Total as above		8,188.0	6,005.0
Capital repayments		–	(1,521.0)
Movement in mortgage trust		(2,695.0)	–
Adjustments to bring carrying value to amortised cost		–	(112.1)
Total assets subject to securitisation		5,493.0	
Total securitised notes	25		**4,371.9**
Adjustments to bring carrying value to amortised cost		35.9	
Total advances subject to securitisation	15	**5,528.9**	

Loans and advances to bank within the Group included £254.8m (2005: £248.1m) held by SPEs.

Notes to the accounts *(continued)*

18. Investment securities – held to maturity

	Group & Company	
	2006	**2005**
	£m	**£m**
UK government gilts		
At 1 January	78.8	132.1
Maturities	(26.7)	(53.7)
Amortisation of premiums	(0.5)	0.4
At 31 December	**51.6**	**78.8**

UK government gilts are subject to fixed rates of interest. The amount of gilts expected to be settled after 12 months is £nil (2005: £51.6m).

19. Investments in subsidiaries

	Company	
	2006	**2005**
	£000	**£000**
Cost		
At 1 January	12	12
Additions	1,379	–
At 31 December	**1,391**	**12**

Notes to the accounts *(continued)*

19. Investments in subsidiaries *(continued)*

The following are particulars of the Group's subsidiaries which are wholly owned, unless otherwise stated:

Name of subsidiary	Country of registration or incorporation	Year end	Holding %	Nature of business
Standard Life Bank Funding BV	Netherlands	31-Dec	100	Financing
Lothian Mortgages (No.1) plc	England & Wales	31-Dec	–	Financing
Lothian Mortgages (No.2) plc	England & Wales	31-Dec	–	Financing
Lothian Mortgages (No.3) plc	England & Wales	31-Dec	–	Financing
Lothian Mortgages (No.4) plc	England & Wales	31-Dec	–	Financing
Lothian Mortgages Master Issuer plc	England & Wales	31-Dec	–	Financing
Lothian Funding Limited	England & Wales	31-Dec	–	Financing
Lothian Funding (No.2) Limited	England & Wales	31-Dec	–	Financing
Lothian Conduit (No.1) Limited	England & Wales	31-Dec	–	Financing
Lothian Mortgages Holdings Limited	England & Wales	31-Dec	–	Holding Company
Lothian Options Limited	England & Wales	31-Dec	–	Financing
Lothian Options (No.2) Limited	Jersey	31-Dec	–	Financing
Lothian Trustees Limited	Jersey	31-Dec	–	Trustee Company

The Group sponsors the formation of SPEs (the Lothian subsidiaries) for the purpose of securitisation of mortgage assets. The Group consolidates SPEs when the substance of the relationship is that it controls or has the power to control the entity. In assessing and determining if the Group controls such SPEs, judgement is made about the Group's exposure to the risks, rewards and its ability to make operational decisions.

Notes to the accounts *(continued)*

20. Intangible assets

	Group & Company	
	2006	**2005**
	£m	**£m**
Cost		
At 1 January	0.9	–
Additions	2.1	0.9
At 31 December	**3.0**	**0.9**
Amortisation		
At 1 January	–	–
Charged in year	–	–
At 31 December	–	–
Net book value		
At 1 January	0.9	–
At 31 December	**3.0**	**0.9**

No impairment losses have been recognised in the income statement in relation to these assets (2005 - £nil). The net book value of intangible assets consists of £2.3m (2005 - £0.2m) of internally developed and £0.7m (2005 - £0.7m) of externally acquired software.

21. Deferred tax

Deferred tax is calculated on all temporary differences under the liability method using the expected effective tax rate of 30% (2005: 30%). The movement on deferred tax is as follows:

	Group		Company	
	2006	**2005**	**2006**	**2005**
	£m	**£m**	**£m**	**£m**
At 1 January	0.7	6.9	4.1	6.7
Income statement charge	(4.9)	(7.3)	(4.4)	(3.7)
Deferred tax impact charged directly to equity on:				
Cash flow hedges	(5.6)	1.1	(5.6)	1.1
At 31 December	**(9.8)**	**0.7**	**(5.9)**	**4.1**

Notes to the accounts *(continued)*

21. Deferred tax *(continued)*

Deferred tax is attributable to the following items:

	Group		Company	
	2006	**2005**	**2006**	**2005**
	£m	**£m**	**£m**	**£m**
Deferred tax				
Accelerated tax depreciation	0.8	1.0	0.8	1.0
Valuation temporary differences	(10.9)	(5.0)	(7.0)	(1.6)
Tax losses carried forward	–	4.6	–	4.6
Other temporary differences	0.3	0.1	0.3	0.1
	(9.8)	**0.7**	**(5.9)**	**4.1**

The deferred tax charge in the income statement (see note 7) is comprised of the following temporary differences:

	Group	
	2006	**2005**
	£m	**£m**
Accelerated tax depreciation	0.2	0.3
Valuation temporary differences	0.2	0.8
Tax losses carried forward	4.6	6.3
Other temporary differences	(0.1)	(0.1)
	4.9	**7.3**

Deferred tax is recognised for tax losses carried forward only to the extent that realisation of the related tax benefit is probable. Deferred tax is anticipated to be recovered after 1 year.

Notes to the accounts *(continued)*

22. Other assets

	Group		Company	
	2006 £m	2005 £m	2006 £m	2005 £m
Prepayments	0.2	0.1	0.2	0.1
Accrued income	1.2	1.7	1.0	1.6
Market debtors – unsettled trades	4.9	37.1	4.9	37.1
Subordinated loan	–	–	43.4	41.4
Amounts due from group undertakings	0.3	–	0.3	–
Amounts due from subsidiary undertakings	–	–	51.9	47.0
Other debtors	6.9	0.3	6.8	0.4
	13.5	**39.2**	**108.5**	**127.6**

The amount of other assets that are expected to be recovered by the Group after 12 months is £nil (2005: £nil).
The amount of other assets that are expected to be recovered by the Company after 12 months is £95.3m (2005: £88.4m).

23. Deposits from banks

	Group & Company	
	2006 £m	2005 £m
Deposits from banks are repayable		
In less than 3 months	317.5	423.4
Between 3 months and 1 year	460.4	533.2
More than 1 year	95.1	12.4
	873.0	**969.0**

Deposits from banks are all subject to fixed interest rates.

Notes to the accounts *(continued)*

24. Customer accounts

	Group & Company	
	2006	2005
	£m	£m
Amounts due to customers are repayable		
In less than 3 months	3,962.3	3,928.2
Between 3 months and 1 year	177.5	175.5
In more than 1 year but not more than 5 years	58.7	61.5
	4,198.5	**4,165.2**

Amounts due to customers subject to variable rates of interest were £3,972.0m (2005: £3,926.1m) and fixed rates of interest were £226.5m (2005: £239.1m).

Included in customer accounts is £246.2m (2005: £82.0m) relating to self invested pension plan ("SIPP") balances transacted between the Group and SLAL (pre July 10, 2006: SLAC).

25. Debt securities in issue – securitised notes

	Group		Company	
	2006	2005	2006	2005
	£m	£m	£m	£m
Securitised notes are repayable				
Over 5 years	**4,371.9**	**4,003.1**	–	–

Securitised notes are subject to variable rates of interest based upon 3 month sterling LIBOR, 3 month US dollar LIBOR and 3 month EURIBOR.

Notes to the accounts *(continued)*

26. Debt securities in issue – other debt securities

	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Certificate of deposit repayable				
In less than 3 months	521.2	586.8	521.2	586.8
Between 3 months and 1 year	275.1	206.6	275.1	206.6
In more than 1 year but not more than 5 years	5.5	–	5.5	–
	801.8	793.4	801.8	793.4
Commercial paper repayable				
In less than 3 months	913.8	939.6	–	–
Between 3 months and 1 year	–	57.7	–	–
	913.8	997.3	–	–
Medium term notes repayable				
In less than 3 months	–	58.5	–	–
Between 3 months and 1 year	3.1	15.1	–	–
In more than 1 year but not more than 5 years	12.6	11.7	–	–
More than 5 years	81.7	87.7	–	–
	97.4	173.0	–	–
	1,813.0	**1,963.7**	**801.8**	**793.4**

Certificates of deposit and commercial paper are subject to fixed rates of interest and medium term notes variable rates of interest based upon 3 month sterling LIBOR and 3 month EURIBOR.

The Company issues sterling denominated certificates of deposit in the UK. Additionally through its wholly owned subsidiary SLBF BV the Group has issued commercial paper and medium term notes. The Company has guaranteed the liabilities of SLBF BV in relation to the issuance of this debt. The guarantee is in respect of notes issued and is for a maximum of 2 billion US dollars and 4 billion Euros in relation to the US commercial paper and Euro commercial paper programmes respectively, and 4 billion Euros in respect of the medium term note programme. This guarantee is classified as a financial guarantee under IAS39 and its fair value at 31 December 2006 was nil (2005 - nil).

Notes to the accounts *(continued)*

27. Subordinated liabilities

	Group		Company	
	2006 £m	2005 £m	2006 £m	2005 £m
Loan notes redeemable 29 June 2015	253.1	266.5	–	–

On 29 June 2005 the £230m of undated loan capital in issue was redeemed at par and SLBF BV, a wholly owned subsidiary of the Company, issued £265m of undated subordinated notes. Interest is payable on the subordinated notes at a fixed rate of 6.14%. Under the terms of a subordinated deed of guarantee, the Company guarantees the payment of all of the sums payable by SLBF BV on the subordinated notes. The rights and claims of all subordinated note holders are subordinated to the claims of all senior creditors of both SLBF BV and the Company. The terms of the subordinated notes require that payments of interest and any arrears of interest are required if interest is paid on a parity or more junior obligation of either the Company or SLBF BV, although there is an interest deferral clause exercisable at the sole discretion of the Company or SLBF BV. Interest non payment, subject to the interest deferral clause, is the only event of default on the subordinated notes.

The subordinated deed of guarantee is classified as a financial guarantee under IAS39 and the fair value at 31 December 2006 was nil (2005 - nil).

The subordinated 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 reset date.

No repayment of dated loan capital prior to its stated maturity and no purchase by the relevant undertaking of its subordinated debt may be made without the consent of the Financial Services Authority.

On 29 June 2005 a £100 subordinated loan note was issued by SLAC which was subsequently transferred to SLAL on 10 July 2006. The rights and claims of SLAL under the conditions of the note are subordinated to the rights and claims of all senior creditors of the Group including the subordinated loan notes detailed above. Interest is payable on the note at a fixed rate of 7% and coupon payments are mandatory. There is no fixed redemption date but the note is redeemable at the option of the Company at any time upon 15 days written notice to the investor.

Notes to the accounts *(continued)*

28. Other liabilities

	Group		Company	
	2006 £m	2005 £m	2006 £m	2005 £m
Accruals and deferred income	6.3	4.6	6.1	4.3
Amounts due to parent undertaking	7.4	–	7.6	–
Amounts due to group companies	6.5	7.8	7.4	7.3
Amounts due to subsidiary undertakings	–	–	5,610.0	5,329.6
Other liabilities	20.3	6.0	40.3	22.2
	40.5	**18.4**	**5,671.4**	**5,363.4**

The amount of other liabilities that are expected to be settled after 12 months by the Group is £nil (2005: £nil).
The amount of other liabilities that are expected to be settled after 12 months by the Company is £4,466.2m (2005: £4,102.5m).

29. Provisions

For Group and Company at 31st December 2006, a provision of £0.7m (2005: £nil) was made in relation to potential refunds of mortgage exit administration fees to mortgage customers following the FSA guidance of 26th January 2007.

30. Retirement benefit obligations

The employees who manage the affairs of the Group are members of a defined benefit pension scheme and a defined contribution pension scheme operated by the Standard Life Group ("SLG") 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 SLAL and therefore the net defined benefit cost of the scheme is recognised by SLAL. As a result the Group 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 year ended 31 December 2006 were £2.8m (2005: £2.7m).

The Group is required, under IAS 19 *"Employee Benefits"* to provide the following disclosures on the SLG defined benefit plan.

(a) Background – SLG defined benefit scheme

SLG 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. SLG 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. SLG 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.
SLG expects to contribute £64m to its defined benefit pension plans in 2007 inclusive of deficit reduction payments of £20m.

Notes to the accounts *(continued)*

30. Retirement benefit obligations *(continued)*

(b) Actuarial gains and losses recognised by SLG in the consolidated statement of recognised income and expense

The actuarial gains/(losses) recognised by SLG in the consolidated 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)
Actuarial gains/(losses) in the consolidated Statement of Recognised Income and Expenses	**(12)**	**22**

The cumulative amount of actuarial gains/(losses) recognised by SLG in the consolidated statement of recognised income and expense since 16 November 2003, the date of adoption of IFRS, is £(32)m (2005: £(20)m).

The actuarial gains/(losses) for the year ended 31 December 2005 of £22m and for the period from 1 January to 10 July 2006 of £(10)m were recognised directly in the unallocated divisible surplus when SLG 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.

(c) Analysis of amounts recognised by SLG in the consolidated balance sheet

The present value of the defined benefit obligation less the fair value of gross scheme assets is as follows:

		2006			2005	
	Europe £m	Canada £m	Total £m	Europe £m	Canada £m	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
Net liability on the balance sheet	**(174)**	**(46)**	**(220)**	**(217)**	**(169)**	**(386)**

The definition of plan assets excludes non-transferable financial instruments issued by SLG. 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 remainder excluded assets relate to the Canadian scheme.

Notes to the accounts *(continued)*

30. Retirement benefit obligations *(continued)*

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
Net liability on the balance sheet including all assets backing the scheme	**(220)**	**(275)**

(d) Defined benefit obligation

The movement in the present value of defined benefit obligation is as follows:

	2006 £m	2005 £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 £m	2005 £m
Wholly unfunded	44	46
Wholly funded	1,447	1,391
At 31 December	**1,491**	**1,437**

Notes to the accounts *(continued)*

30. Retirement benefit obligations *(continued)*

(e) Plan assets

The changes in the fair value of plan assets are as follows:

	2006 £m	2005 £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 SLG benefits paid disclosed in "Table d" and "Table e" is due to the exclusion of Canadian assets in "Table e".

In 2005, SLG entered into futures contracts in order to increase exposure to bonds and reduce exposure to equities.

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
Total	**1,271**	**1,051**

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).

Notes to the accounts *(continued)*

30. Retirement benefit obligations *(continued)*

(f) Principal assumptions

The principal assumptions used in determining pension benefit obligation for the SLG'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	6
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			2005		
	Europe %	Canada %	Total %	Europe %	Canada %	Total %
Equities	8	9	8	8	9	8
Bonds – government	5	6	5	4	6	4
Bonds – corporate	5	6	6	5	6	5
Property	8	6	8	8	6	8
Other	5	6	5	5	6	5

Notes to the accounts *(continued)*

31. Called up share capital

	Group and Company			
	2006 Quantity No. m	2006 Value £m	2005 Quantity No. m	2005 Value £m
Authorised share capital:				
Ordinary shares of £1 each	**386.8**	**386.8**	**386.8**	**386.8**
Issued, allotted and fully paid share capital:				
Ordinary shares of £1 each	**271.8**	**271.8**	**271.8**	**271.8**

The movements in the called up share capital were as follows:

	Group and Company		
	Quantity No. m	Nominal value £m	Share capital £m
At 1 January 2005	370.0	370.0	370.0
Proceeds from shares issued in cash	15.0	15.0	15.0
Shares cancelled during period	(113.2)	(113.2)	(113.2)
At 31 December 2005 and 31 December 2006	271.8	271.8	271.8

On the 29 June 2005, 15 million ordinary shares of £1 were issued for a consideration of £15m increasing the Group's total issued and fully paid up share capital from £370m to £385m.

By order of the court dated 14 October 2005, the Company reduced its share capital by 113,225,000 shares of £1 each and at the same time increased its reserves by the same amount. The reduction was effected by the cancellation of 113,225,000 of the authorised and issued share capital.

Notes to the accounts *(continued)*

32. Reconciliation of shareholders' equity

	Group			
	Share Capital	Cash flow hedge reserve	Retained earnings	Total
	£m	£m	£m	£m
At 1 January 2005	370.0	–	(96.3)	273.7
Profit for the period after tax	–	–	20.2	20.2
Cash flow hedges				
Effective portion of changes in fair value taken to equity	–	(25.9)	–	(25.9)
Net gains / (losses) transferred to the income statement	–	22.0	–	22.0
Deferred income tax taken to equity	–	1.1	–	1.1
Total recognised income and expense	**–**	**(2.8)**	**20.2**	**17.4**
Capital reduction	(113.2)	–	113.2	–
Issue of new shares	15.0	–	–	15.0
At 31 December 2005	**271.8**	**(2.8)**	**37.1**	**306.1**
At 1 January 2006	**271.8**	**(2.8)**	**37.1**	**306.1**
Profit for the period after tax	–	–	29.7	29.7
Cash flow hedges				
Effective portion of changes in fair value taken to equity	–	(10.6)	–	(10.6)
Net gains / (losses) transferred to the income statement	–	29.5	–	29.5
Deferred income tax taken to equity	–	(5.6)	–	(5.6)
Total recognised income and expense	**–**	**13.3**	**29.7**	**43.0**
At 31 December 2006	**271.8**	**10.5**	**66.8**	**349.1**

Notes to the accounts *(continued)*

32. Reconciliation of shareholders' equity *(continued)*

	Company			
	Share Capital £m	Cash flow hedge reserve £m	Retained earnings £m	Total £m
At 1 January 2005	370.0	–	(97.9)	272.1
Profit for the period after tax	–	–	10.7	10.7
Cash flow hedges				
Effective portion of changes in fair value taken to equity	–	(25.7)	–	(25.7)
Net gains/(losses) transferred to the income statement	–	22.0	–	22.0
Deferred income tax taken to equity	–	1.1	–	1.1
Total recognised income and expense	**–**	**(2.6)**	**10.7**	**8.1**
Capital reduction	(113.2)	–	113.2	–
Issue of new shares	15.0	–	–	15.0
At 31 December 2005	**271.8**	**(2.6)**	**26.0**	**295.2**
At 1 January 2006	**271.8**	**(2.6)**	**26.0**	**295.2**
Profit for the period after tax	–	–	28.1	28.1
Cash flow hedges				
Effective portion of changes in fair value taken to equity	–	(10.6)	–	(10.6)
Net gains/(losses) transferred to the income statement	–	29.4	–	29.4
Deferred income tax taken to equity	–	(5.6)	–	(5.6)
Total recognised income and expense	**–**	**13.2**	**28.1**	**41.3**
At 31 December 2006	**271.8**	**10.6**	**54.1**	**336.5**

Included within both Group and Company retained earnings are undistributable reserves of £8.8m (2005: £5.0m).

The cash flow hedging reserve within Group and Company represents the net gains/(losses) on effective cash flow hedging instruments that will be recycled to the income statement when the hedged transaction affects profit or loss.

Notes to the accounts *(continued)*

33. Contingent liabilities and commitments

(a) Legal proceedings and regulations

The Group like other banks 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 believes that it is unlikely that any significant loss will arise.

(b) Guarantees

Details of the guarantees of SLBF BV's debt issuance are given within notes 26 and 27.

(c) Capital commitments

At 31 December 2006, the Group had capital commitments of £ nil (2005: £ nil) in respect of equipment purchases.

(d) Memorandum items

The following indicates the contractual amounts of the Group's off-balance sheet financial instruments that it has committed to lend to customers and third parties, as at the year-end:

	Group & Company	
	2006	2005
	£m	£m
Undrawn mortgage loan facilities	**2,185.8**	**2,291.9**

34. Events after the balance sheet date

There are no significant non-adjusting events after the balance sheet date.

35. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances with less than three months maturity from the date of acquisition:

	Group		Company	
	2006	2005	2006	2005
	£m	£m	£m	£m
Cash and balances with the Bank of England	183.7	–	183.7	–
Treasury bills	157.3	183.0	157.3	183.0
Loans and advances to banks	819.2	698.5	563.7	450.4
Financial assets at fair value through profit or loss	416.6	19.1	416.6	19.1
	1,576.8	**900.6**	**1,321.3**	**652.5**

Notes to the accounts *(continued)*

36. Related party transactions

(a) Ultimate parent and shareholder

Prior to 10 July 2006 the Company's parent and ultimate controlling party was SLAC. On 10 July 2006 SLAC demutualised and a new holding company for the Standard Life Group, SL plc, was admitted to the London Stock Exchange. From 10 July 2006, the Company's immediate parent undertaking is SLAL and its ultimate controlling party is SL plc. SLAL is incorporated in Scotland. 100% of its ordinary share capital is owned by SL plc. The Company is a 100% owned subsidiary of SLAL.

(b) Transactions with related parties

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions.

(i) Transactions with Standard Life Group companies

A number of transactions are entered into with related parties within the Standard Life Group in the normal course of business and on an arms length basis. Balances between the Company and the parent and other group undertakings are detailed within notes 22 and 28 to the accounts. Details of related party transactions within the income statement are as follows:

	Parent undertaking		Other group companies	
	2006 £m	2005 £m	2006 £m	2005 £m
Interest paid on subordinated loans	–	(6.8)	–	–
Management charges paid	–	–	(21.3)	(23.3)
Mortgage administration fees received	1.2	1.8	0.1	0.1
	1.2	**(5.0)**	**(21.2)**	**(23.2)**

A share plan is available to most staff offering acquisition of shares in SL plc to encourage their financial involvement in the Standard Life Group. The charge from the ultimate parent undertaking to the Company for this plan is included in the management charges disclosed above.

Prior to 10 July 2006 the Group transacted with SLAC regarding non-insured SIPP business (i.e. cash placed on deposit with the Group) whilst after 10 July this arrangement was between SLB and SLAL. Balances outstanding are given in note 24.

The Company has entered into a subordinated loan note agreement with SLAL for £100, the details of which are disclosed within note 27.

Notes to the accounts *(continued)*

36. Related party transactions *(continued)*

(ii) Transactions with subsidiary companies

Transactions are entered into by the Company with its subsidiary undertakings in the normal course of business and at normal commercial terms. Details of subsidiary undertakings can be found in note 19 to these accounts. Balances between the Company and subsidiary companies are detailed within notes 22 and 28 to the accounts. Details of related party transactions within the income statement are as follows:

	Subsidiary companies	
	2006	**2005**
	£m	**£m**
Interest paid on intercompany loans	(64.2)	(31.7)
Interest received on intercompany loans	73.6	69.4
Management charges received	4.6	5.3
Other intercompany amounts	22.3	20.0
	36.3	**63.0**

(c) Key Management Personnel ("KMP")

(i) Compensation of KMP

KMP, being those having authority and responsibility for planning, directing and controlling the activities of the Group, comprise 15 people (2005: 17 people) and include all directors of the Group both executive and non-executive. The summary of compensation of KMP for the year is presented below.

	Group	
	2006	**2005**
	£000	**£000**
Salaries and other short-term employee benefits	2,459	2,202
Post-employment benefits	237	215
Share based payments	366	–
Other	361	172
	3,423	**2,589**

A number of the KMP of the Group are also KMP of a number of entities within the Standard Life Group. These KMP did not receive compensation from the Group for services rendered during 2006 (2005 - nil). For the purposes of this note an apportionment of their total compensation has been made based on an estimate of the services rendered. The KMP compensation apportioned to the Group was £0.1m (2005: £0.1m). Prior to demutualisation the long term incentive plan ("LTIP") was a cash based reward and is disclosed within other above. Post demutulisation the LTIP became a share based reward and is disclosed within share based payments above.

Notes to the accounts *(continued)*

36. Related party transactions *(continued)*

(ii) Compensation of directors

Of the amounts disclosed above the following is in respect of directors of the Group.

	Group	
	2006 **£000**	**2005** **£000**
Aggregate emoluments	1,595	1,543
Amounts paid as compensation for loss of office	168	–
Amounts receivable under long term incentive schemes	727	172
	2,490	**1,715**

All of the executive directors are participants in a long-term incentive plan operated by SL plc. Prior to demutualisation of SLAC this award took the form of a right to receive a cash payment in three years time provided that a performance condition is achieved. 2007 is the last year in which cash awards can be received. On demutualisation of SLAC the awards were converted into awards over SL plc shares. The benefits arising under the incentive plan are recorded in the year in which entitlement was accrued. 8 directors became entitled to receive share awards under the long-term incentive scheme during the year (2005: 8).

Retirement benefits are accruing to 4 directors in respect of their services to the Company under a defined benefit scheme operated by SLAL. Non executive directors are not entitled to retirement benefits in respect of their services to the Company.

(iii) Highest paid director

	Group	
	2006 **£000**	**2005** **£000**
Aggregate emoluments and benefits payable under long term incentive schemes	1,064	745
Defined benefit scheme – accrued pension at end of year	25	20

In addition, there was £nil (2005: £19k) accrued in respect of unfunded pension arrangements with SLAL.

Notes to the accounts *(continued)*

36. Related party transactions *(continued)*

(d) Transactions with key management personnel

All transactions between KMP and the Group during the year were on commercial terms which are equivalent to those available to all employees of the Group. Transactions entered into on normal commercial terms by the Company with directors of the Company, SLAL and SL plc are as follows:

	2006 Number of KMP	2006 £000	2005 Number of KMP	2005 £000
Mortgage loans outstanding at the year end	5	879	6	1,834
Mortgage interest charged during the year	5	45	6	39
Savings accounts outstanding at the year end	8	1,351	9	1,661
Savings interest income earned during the year	8	65	9	66

(e) Interests of directors

No director has any interest in the share capital of the Company. Beneficial interests of directors and their immediate family in ordinary shares of £1 each in SL plc, the Company's ultimate parent undertaking are as follows:

	2006 Shares	2005 Shares
Miss A M Gunther	68,282	–
Mr P Joshi	14,185	–
Prof F Kirwan	3,478	–
Mr K Morris	4,461	–
Mr I G Williamson	3,668	–
Ms A Crawford	185	–
Mr J Cummins	10,852	–
	105,111	–

Notes to the accounts *(continued)*

36. Related party transactions *(continued)*

	Number of options				
	At 10 Jul 2006	Granted	Exercised	Lapsed	At 31 Dec 2006
Miss A M Gunther	–	191,148	–	–	191,148
Mr P Joshi	–	83,324	–	–	83,324
Prof F Kirwan	–	–	–	–	–
Mr K Morris	–	–	–	–	–
Mr I G Williamson	–	38,599	–	(38,599)	–
Ms A Crawford	–	25,250	–	–	25,250
Mr J Cummins	–	–	–	–	–
	–	**338,321**	**–**	**(38,599)**	**299,722**

Sir B Stewart, Mr A M Crombie, Mr J F Hylands and Ms A Mitchell are also directors of SL plc and their interests are disclosed in financial statements of that Company.

37. Financial risk management

(a) Strategy in using financial instruments

Financial instruments comprise the vast majority of the Group's assets and liabilities. The Group accepts deposits from customers at both fixed and floating interest rates and also raises funding in the money and capital markets. The Group then seeks to earn an interest margin by investing these funds in high quality assets – predominantly residential mortgages. The Group seeks to manage interest margins by consolidating short term funds and lending for longer periods at higher rates whilst maintaining sufficient liquidity to meet all claims which might fall due. The Group does not trade in financial instruments.

In order to mitigate the risks inherent in the financial instruments used in day to day operations, the Board has authorised the use of derivative instruments for the purpose of supporting the strategic and operational business activities of the Group and reducing the risk of loss arising from changes in interest rates and exchange rates. All use of derivative instruments within the Group is to hedge risk exposure, and the Group takes no trading positions in derivatives.

The Asset and Liability Committee ("ALCO") is responsible for setting limits over the use of derivative products for managing exposure to interest rates, foreign exchange rates and equity indices. ALCO approves the Group credit policy and regularly monitors and reviews credit exposures arising in respect of non retail operations, including derivatives. Credit exposures arising on derivative contracts with certain counterparties are collateralised with cash deposits, to mitigate credit exposures. All Group derivative activity is contracted with appropriately rated financial institutions.

Notes to the accounts *(continued)*

37. Financial risk management *(continued)*

(a) Strategy in using financial instruments (continued)

The objective, when using any derivative instrument, is to ensure that the risk to reward profile of any transaction is optimised. The intention is to only use derivatives to create economically effective hedges. However, because of the specific requirements of IAS 39 to obtain hedge accounting, not all economic hedges are designated as accounting hedges, either because natural accounting offsets are expected or because obtaining hedge accounting would be especially onerous. For details of the derivative accounting policy see note 1 section (m). Where possible fair value hedge or cash flow hedge accounting is employed to mitigate the impact of the hedged risk within the financial statements.

The following table describes the significant activities undertaken by the Group, the risks associated with such activities and the types of derivatives which are typically used in managing such risks on an economic basis. Such risks may alternatively be managed using on balance sheet instruments as part of an integrated approach to risk management.

Activity	Risk	Type of derivative instrument used
Fixed rate mortgage lending	Sensitivity to changes in interest rates	Pay fixed rate interest rate swaps/ forward rate agreements
Variable rate mortgage lending	Sensitivity to changes in interest rates	Interest basis rate swaps
Fixed rate borrowing	Sensitivity to changes in interest rates	Receive fixed rate interest rate swaps
Foreign currency borrowing	Sensitivity to changes in currency rates	Cross currency interest rate/ forward foreign currency swaps
Equity linked customer deposits	Sensitivity to changes in equity indices	Equity swaps

(b) Risk management

The Group takes and manages risks to achieve its corporate, financial and regulatory objectives. The types of risk inherent in the pursuit of these objectives and the extent of exposure to these risks form the Group risk profile.

The Group manages risks through its risk management framework, which allows for the identification, assessment, control and monitoring of risks across the Group. The Group has established effective risk management systems and controls within the framework for the following high-level categories of risk: operational, interest rate, liquidity, currency and credit. The Board annually approves a separate Group risk policy for each category of risk specifying the procedures to be taken across the Group to identify, assess, control and monitor the risk.

The Board delegates responsibility for the implementation of the day-to-day process to manage risk across the Group, to the Chief Executive ("CE"). The CE is supported in this role by the Executive Committee and assisted by the ALCO, the Retail Credit Committee ("RCC") and the Operational Risk Committee ("ORC"). These committees are constituted with formal terms of reference.

The Group has an established risk management function whose role is to support the Board, the CE and the risk committees in meeting their risk management responsibilities. This centralised function is headed by the Head of Financial Risk, who reports directly to the Finance Director, who is the FSA Approved Person charged with reporting to the Board on setting and controlling risk exposures across the Group.

Notes to the accounts *(continued)*

37. Financial risk management *(continued)*

(c) Operational risk

Operational risk is the risk of loss, resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk also includes legal, reputational and business risk but excludes strategic risk. Strategic Risk is owned by the Group's Executive Committee. The ORC exists to focus and co-ordinate operational risk management activities and oversees the Company's risk profile. Senior management are responsible for the detailed management of operational risks in their area. Each business area undertakes risk self-assessment activities to identify and assess the key risks in its area including the adequacy of controls to manage the risks using a consistent Standard Life Group wide methodology.

(d) Interest rate risk

Interest rate risk arises from the Group offering mortgage and savings products with either fixed interest rates or variable rates linked to Bank of England base rate. Interest rate risk arises as a result of timing differences on the re-pricing of assets and liabilities (repricing risk), unexpected changes in the slope and shape of yield curves (yield curve risk), by changes in correlation of interest rates between different financial instruments (basis risk) and by prepayment options embedded in loans and advances to customers (optionality risk).

The Group closely monitors interest rate movements, the interest rate and re-pricing maturity structure of its interest bearing assets and liabilities and the level of non-interest bearing assets and liabilities.

Interest rate sensitivity refers to the relationship between interest rates and net interest income resulting from the periodic re-pricing of assets and liabilities. A negative interest rate sensitivity gap exists when more liabilities than assets reprice during a given period. Although a negative gap position tends to benefit net interest income in a declining interest rate environment, with the converse being true in a rising rate environment, the actual effect will depend on a number of factors, including the extent to which repayments are made earlier or later than the contracted date and variations in interest rate sensitivity within repricing periods. The Group manages the expected interest rate gap of its interest earning assets and interest bearing liabilities through the use of derivatives. The impact of prepayment risk is reduced by imposing early repayment charges if the customers terminate their contracts early.

Basis risk refers to the relationship between interest rates and net interest income resulting from the re-pricing of assets and liabilities on different interest rate bases. Where interest rates on assets are determined on a different basis from those on the related funding liability and these bases are not perfectly correlated, basis risk arises. The Group manages basis risk through the use of derivatives.

The Group uses a number of measures to monitor and control interest rate risk and sensitivity. One key measure evaluates the difference in principal value between assets and liabilities repricing in various gap periods. Part of the Group's return on financial instruments is obtained from controlled mismatching of the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rates or, if earlier, the dates on which the instruments mature.

The table following summarises these repricing mismatches as at 31 December 2006. Company tables are not presented as interest rate risk is managed on a Group basis and the directors do not consider that the risk on a Company basis is materially different. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity date.

Notes to the accounts *(continued)*

37. Financial risk management *(continued)*

(d) Interest rate risk (continued)

	At 31 December 2006						
	Within 3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	After 5 years £m	Non interest bearing £m	Total £m
Assets							
Cash and balances with the Bank of England	183.7	–	–	–	–	6.6	190.3
Treasury bills and other eligible bills	147.4	9.9	–	–	–	–	157.3
Loans and advances to banks	819.2	–	–	–	–	–	819.2
Financial assets at FVTPL	703.6	13.5	–	–	–	–	717.1
Derivative financial instruments	–	–	–	–	–	38.6	38.6
Loans and advances to customers	5,904.6	168.9	474.2	3,305.2	235.8	–	10,088.7
Investment securities – held to maturity	–	–	51.6	–	–	–	51.6
Intangible assets	–	–	–	–	–	3.0	3.0
Other assets	–	–	–	–	–	13.5	13.5
	7,758.5	**192.3**	**525.8**	**3,305.2**	**235.8**	**61.7**	**12,079.3**
Liabilities							
Deposits from banks	444.4	314.2	104.3	10.1	–	–	873.0
Customer accounts	4,021.8	58.5	64.0	54.2	–	–	4,198.5
Derivative financial instruments	–	–	–	–	–	169.7	169.7
Securitised notes	4,371.9	–	–	–	–	–	4,371.9
Other debt securities in issue	1,537.8	205.9	69.3	–	–	–	1,813.0
Deferred tax liability	–	–	–	–	–	9.8	9.8
Other liabilities	–	–	–	–	–	40.5	40.5
Provisions	–	–	–	–	–	0.7	0.7
Subordinated liabilities	–	–	–	–	253.1	–	253.1
Total shareholders' equity	–	–	–	–	–	349.1	349.1
	10,375.9	**578.6**	**237.6**	**64.3**	**253.1**	**569.8**	**12,079.3**
Balance sheet interest sensitivity gap	**(2,617.4)**	**(386.3)**	**288.2**	**3,240.9**	**(17.3)**	**(508.1)**	**–**
Net hedging derivatives	**2,778.4**	**195.0**	**(355.8)**	**(2,824.1)**	**206.5**	**–**	**–**
Total interest rate sensitivity gap	**161.0**	**(191.3)**	**(67.6)**	**416.8**	**189.2**	**(508.1)**	**–**
Cumulative interest rate sensitivity gap	**161.0**	**(30.3)**	**(97.9)**	**318.9**	**508.1**	**–**	**–**

The carrying amounts of derivative financial instruments are shown as non interest bearing. The notional principal amounts associated with those derivatives which are used to reduce the Group's exposure to interest rate movements are shown as part of net hedging derivatives. This includes derivatives held for economic hedging purposes which are not in formal hedge accounting relationships.

Notes to the accounts *(continued)*

37. Financial risk management *(continued)*

(d) Interest rate risk (continued)

	At 31 December 2005						
	Within 3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	After 5 years £m	Non interest bearing £m	Total £m
Assets							
Cash and balances with the Bank of England	–	–	–	–	–	7.0	7.0
Treasury bills and other eligible bills	133.9	49.1	–	–	–	–	183.0
Loans and advances to banks	681.5	17.0	–	–	–	–	698.5
Financial assets at FVTPL	574.9	23.3	–	–	–	–	598.2
Derivative financial instruments	–	–	–	–	–	37.2	37.2
Loans and advances to customers	7,142.4	127.1	332.6	2,371.3	185.5	–	10,158.9
Investment securities – held to maturity	–	–	25.8	53.0	–	–	78.8
Deferred tax asset	–	–	–	–	–	0.7	0.7
Intangible assets	–	–	–	–	–	0.9	0.9
Other assets	–	–	–	–	–	39.2	39.2
	8,532.7	**216.5**	**358.4**	**2,424.3**	**185.5**	**85.0**	**11,802.4**
Liabilities							
Deposits from banks	408.3	449.0	93.8	17.9	–	–	969.0
Customer accounts	3,934.2	82.6	89.3	59.1	–	–	4,165.2
Derivative financial instruments	–	–	–	–	–	110.4	110.4
Securitised notes	4,003.1	–	–	–	–	–	4,003.1
Other debt securities in issue	1,668.2	248.1	47.4	–	–	–	1,963.7
Other liabilities	–	–	–	–	–	18.4	18.4
Subordinated liabilities	–	–	–	–	266.5	–	266.5
Total shareholders' equity	–	–	–	–	–	306.1	306.1
	10,013.8	**779.7**	**230.5**	**77.0**	**266.5**	**434.9**	**11,802.4**
Balance sheet interest sensitivity gap	**(1,481.1)**	**(563.2)**	**127.9**	**2,347.3**	**(81.0)**	**(349.9)**	**–**
Net hedging derivatives	**2,036.4**	**(125.0)**	**(140.0)**	**(1,970.5)**	**199.1**	**–**	**–**
Total interest rate sensitivity gap	**555.3**	**(688.2)**	**(12.1)**	**376.8**	**118.1**	**(349.9)**	**–**
Cumulative interest rate sensitivity gap	**555.3**	**(132.9)**	**(145.0)**	**231.8**	**349.9**	**–**	**–**

Notes to the accounts *(continued)*

37. Financial risk management *(continued)*

(d) Interest rate risk (continued)

The table below summarises the effective average interest rate for financial instruments not carried at FVTPL:

	2006 %	2005 %
Assets		
Cash and balances with the Bank of England	5.0	–
Treasury bills and other eligible bills	5.0	4.4
Loans and advances to banks	5.3	4.6
Loans and advances to customers	5.1	4.2
Investment securities – held to maturity	4.1	4.4
Liabilities		
Deposits from banks	5.0	4.4
Customer accounts	4.2	4.6
Debt securities in issue		
Securitised notes	4.4	4.3
Other debt securities in issue	3.7	4.9
Subordinated liabilities	6.1	6.1

(e) Liquidity risk

Liquidity risk is the risk that the Group is not able to meet its financial obligations as they fall due or can do so only at an excessive cost. Liquidity risk arises from the mismatch in the cash flows generated from assets, liabilities and derivatives. The Board has policies to ensure that the Group is able to meet retail withdrawals and repay wholesale borrowings as they fall due and to meet current lending requirements. This is achieved by managing a portfolio of high quality liquid assets, diversified sources of funding and a balanced maturity profile of liquid assets, wholesale and retail funds.

Notes to the accounts *(continued)*

37. Financial risk management *(continued)*

(e) Liquidity risk (continued)

The table below summarises liquidity mismatches as at 31 December 2006. Items are allocated to time bands by reference to contractual maturity dates. Company tables are not presented as liquidity risk is managed on a Group basis and the directors do not consider that the risk on a Company basis is materially different.

	At 31 December 2006					
	Within 3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	After 5 years £m	Total £m
Assets						
Cash and balances with the Bank of England	183.7	–	–	–	6.6	190.3
Treasury bills and other eligible bills	157.3	–	–	–	–	157.3
Loans and advances to banks	819.2	–	–	–	–	819.2
Financial assets at FVTPL	416.6	83.7	121.7	95.1	–	717.1
Derivative financial instruments	1.2	–	4.3	31.8	1.3	38.6
Loans and advances to customers	–	0.7	3.0	221.8	9,863.2	10,088.7
Investment securities – held to maturity	–	–	51.6	–	–	51.6
Intangible assets	–	–	–	–	3.0	3.0
Other assets	13.5	–	–	–	–	13.5
	1,591.5	**84.4**	**180.6**	**348.7**	**9,874.1**	**12,079.3**
Liabilities						
Deposits from banks	317.5	336.1	124.3	95.1	–	873.0
Customer accounts	3,962.3	84.8	92.7	58.7	–	4,198.5
Derivative financial instruments	12.5	1.9	0.1	127.6	27.6	169.7
Securitised notes	–	–	–	–	4,371.9	4,371.9
Other debt securities in issue	1,435.0	205.9	72.3	18.1	81.7	1,813.0
Deferred tax liability	–	–	–	–	9.8	9.8
Other liabilities	40.5	–	–	–	–	40.5
Provisions	0.7	–	–	–	–	0.7
Subordinated liabilities	–	–	–	–	253.1	253.1
	5,768.5	**628.7**	**289.4**	**299.5**	**4,744.1**	**11,730.2**
Net liquidity gap	**(4,177.0)**	**(544.3)**	**(108.8)**	**49.2**	**5,130.0**	**349.1**

Notes to the accounts *(continued)*

37. Financial risk management *(continued)*

(e) Liquidity risk (continued)

	At 31 December 2005					
	Within 3 months £m	3-6 months £m	6-12 months £m	1-5 years £m	After 5 years £m	Total £m
Assets						
Cash and balances with the Bank of England	–	–	–	–	7.0	7.0
Treasury bills and other eligible bills	183.0	–	–	–	–	183.0
Loans and advances to banks	698.5	–	–	–	–	698.5
Financial assets at FVTPL	19.1	192.4	190.2	196.5	–	598.2
Derivative financial instruments	6.3	3.2	6.2	20.2	1.3	37.2
Loans and advances to customers	0.1	1.2	2.4	223.4	9,931.8	10,158.9
Investment securities – held to maturity	–	–	27.2	51.6	–	78.8
Deferred tax asset	–	–	–	–	0.7	0.7
Intangible assets	–	–	–	–	0.9	0.9
Other assets	39.2	–	–	–	–	39.2
	946.2	**196.8**	**226.0**	**491.7**	**9,941.7**	**11,802.4**
Liabilities						
Deposits from banks	423.4	400.3	132.9	12.4	–	969.0
Customer accounts	3,928.2	83.8	91.7	61.5	–	4,165.2
Derivative financial instruments	11.1	3.8	1.0	83.6	10.9	110.4
Securitised notes	–	–	–	–	4,003.1	4,003.1
Other debt securities in issue	1,584.9	206.8	72.6	11.7	87.7	1,963.7
Other liabilities	18.4	–	–	–	–	18.4
Subordinated liabilities	–	–	–	–	266.5	266.5
	5,966.0	**694.7**	**298.2**	**169.2**	**4,368.2**	**11,496.3**
Net liquidity gap	**(5,019.8)**	**(497.9)**	**(72.2)**	**322.5**	**5,573.5**	**306.1**

(f) Currency risk

Currency risk is the risk that the sterling value of, or net income from, assets or liabilities that are denominated in a foreign currency change as a consequence of changes to foreign exchange rates. Currency risk arises as a result of the Group having assets, liabilities and derivative items that are denominated in currencies other than sterling as a result of normal banking activities, primarily wholesale funding. In addition to raising funds through sterling money markets, capital markets and the domestic retail savings market, the Group raises funds through taking non sterling bank deposits and issuing non sterling denominated commercial paper, certificates of deposit, medium-term debt notes and securitised notes. The Group also invests funds in non sterling floating rate notes. The Group's policy is to fully mitigate all exchange rate exposures by using cross currency swaps and forward foreign exchange contracts, or to match liability exposures with assets denominated in the same currency.

Notes to the accounts *(continued)*

37. Financial risk management *(continued)*

(f) Currency risk (continued)

The table below gives values of assets and liabilities, at their sterling carrying values, denominated in different currencies at the balance sheet date. All currency exposures are subject to hedging by currency derivatives with matching terms which swap the currency back into a sterling based cost or return. Company tables are not presented as currency risk is managed on a Group basis and the directors do not consider that the risk on a Company basis is materially different.

	At 31 December 2006			
	GBP £m	**EUR £m**	**USD £m**	**Total £m**
Assets				
Cash and balances with the Bank of England	190.3	–	–	190.3
Treasury bills and other eligible bills	157.3	–	–	157.3
Loans and advances to banks	819.2	–	–	819.2
Financial assets at FVTPL	717.1	–	–	717.1
Derivative financial instruments	38.6	–	–	38.6
Loans and advances to customers	10,088.7	–	–	10,088.7
Investment securities – held to maturity	51.6	–	–	51.6
Intangible assets	3.0	–	–	3.0
Other assets	13.5	–	–	13.5
	12,079.3	**–**	**–**	**12,079.3**
Liabilities				
Deposits from banks	778.0	95.0	–	873.0
Customer accounts	4,198.5	–	–	4,198.5
Derivative financial instruments	169.7	–	–	169.7
Securitised notes	2,502.5	1,206.7	662.7	4,371.9
Other debt securities in issue	775.6	631.9	405.5	1,813.0
Deferred tax liability	9.8	–	–	9.8
Other liabilities	33.1	7.4	–	40.5
Provisions	0.7	–	–	0.7
Subordinated liabilities	253.1	–	–	253.1
	8,721.0	**1,941.0**	**1,068.2**	**11,730.2**
Net position	**3,358.3**	**(1,941.0)**	**(1,068.2)**	**349.1**

Notes to the accounts *(continued)*

37. Financial risk management *(continued)*

(f) Currency risk (continued)

	At 31 December 2005				
	GBP £m	EUR £m	USD £m	Other £m	Total £m
Assets					
Cash and balances with the Bank of England	7.0	–	–	–	7.0
Treasury bills and other eligible bills	183.0	–	–	–	183.0
Loans and advances to banks	698.5	–	–	–	698.5
Financial assets at FVTPL	588.7	9.5	–	–	598.2
Derivative financial instruments	37.2	–	–	–	37.2
Loans and advances to customers	10,158.9	–	–	–	10,158.9
Investment securities – held to maturity	78.8	–	–	–	78.8
Deferred tax asset	0.7	–	–	–	0.7
Intangible assets	0.9	–	–	–	0.9
Other assets	39.2	–	–	–	39.2
	11,792.9	**9.5**	**–**	**–**	**11,802.4**
Liabilities					
Deposits from banks	835.9	133.1	–	–	969.0
Customer accounts	4,165.2	–	–	–	4,165.2
Derivative financial instruments	110.4	–	–	–	110.4
Securitised notes	2,094.4	904.9	1,003.8	–	4,003.1
Other debt securities in issue	1,018.0	422.9	502.1	20.7	1,963.7
Other liabilities	11.1	7.3	–	–	18.4
Subordinated liabilities	266.5	–	–	–	266.5
	8,501.5	**1,468.2**	**1,505.9**	**20.7**	**11,496.3**
Net position	**3,291.4**	**(1,458.7)**	**(1,505.9)**	**(20.7)**	**306.1**

(g) Credit risk

The Group takes on exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. Impairment allowances are made for losses that have been incurred at the balance sheet date (see note 16). Significant changes in the economy, or a sector that represents a concentration in the Group's portfolio, could result in losses that are different from those provided for at the balance sheet date. Management therefore carefully manages its exposure to credit risk.

The Group maintains a policy of investing in non retail debt programmes or with counterparties which are rated as investment grade by Standard and Poor's and Moody's. The Group is also exposed to credit risk on its retail lending to residential mortgage customers. This risk is mitigated by the credit policies of the Group and also the holding of a first charge over the property on which the loan is granted. ALCO is responsible for setting and monitoring credit risk limits in relation to non retail credit exposures. The RCC is responsible for setting and monitoring credit risk limits in relation to retail credit exposures, primarily loans and advances to customers.

Notes to the accounts *(continued)*

37. Financial risk management *(continued)*

(g) Credit risk (continued)

Maximum credit risk exposure at 31 December 2006 approximates to the carrying value for all assets apart from loans and advances to customers where the carrying value includes a decrease of £20.1m (2005: uplift of £13.4m) in respect of hedged interest rate risk. The classes of financial instruments to which the Group are most exposed are loans and advances to customers, loans and advances to banks, financial assets at fair value through profit and loss and derivative financial instruments.

The Group monitors and controls exposure to concentrations of risk on loans and advances to customers by setting portfolio limits, e.g. on the maximum exposures to each UK geographical region. The Group also monitors and controls exposures to concentrations of risk in its investment activities, e.g. by setting individual and geographical counterparty limits.

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 Company 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. Where there is an event of default under the terms of the collateral agreements, any collateral balances will be included in the close-out calculation of net counterparty exposure. At the year-end, the Group pledged £6.8m (2005: £22.3m) of cash as collateral and had accepted £14.7m (2005: £4.9m) of cash as collateral.

(h) Fair value of financial assets and liabilities

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the Group's balance sheet at their fair value. For the table below the fair values of financial assets and financial liabilities are based on market prices where available, or are estimated using other valuation techniques. Where they are short term in nature or reprice frequently, fair value approximates to carrying value.

	Carrying value		Fair value	
	2006	2005	2006	2005
	£m	£m	£m	£m
Financial assets				
Cash and balances with the Bank of England	190.3	7.0	190.3	7.0
Loans and advances to banks	819.2	698.5	819.2	698.5
Loans and advances to customers	10,088.7	10,158.9	10,124.6	10,195.6
Investment securities – held to maturity	51.6	78.8	50.7	78.6
Financial liabilities				
Deposits from banks	873.0	969.0	873.0	969.0
Customer accounts	4,198.5	4,165.2	4,192.4	4,160.3
Securitised notes	4,371.9	4,003.1	4,491.3	4,028.0
Other debt securities in issue	1,813.0	1,963.7	1,797.2	1,959.4
Subordinated liabilities	253.1	266.5	261.9	277.2

Notes to the accounts *(continued)*

37. Financial risk management *(continued)*

(h) Fair value of financial assets and liabilities (continued)

Loans and advances are net of provisions for impairment. The fair value of loans with variable interest rates is considered to approximate to carrying value. For loans with fixed interest rates, the fair value represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value.

The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits and other borrowings without quoted market price is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

38. Reconciliation of IFRS to UK GAAP

The Group reported under UK GAAP in its previously published financial statements for the year ended 31 December 2005. As stated in the accounting policies the Group adopted IFRS on 1 January 2006 and as such these are the Group's first consolidated financial statements prepared in accordance with IFRS.

The following reconciliations and accompanying notes provide a quantification of the financial impact of the transition to IFRS. These are provided for the Group only as those for the Company are not significantly different from the Group disclosures.

In previous financial statements prepared under UK GAAP, the Group availed itself of the exemption outlined in paragraph 5(a) of FRS 1 "Cash Flow Statements" and consequently no cash flow statement was presented. Full cash flow statements are presented in these financial statements for the years ended 31 December 2005 and 2006 under IFRS. As such no reconciliation of IFRS to UK GAAP for the cash flow statement is required.

(a) Reconciliation of consolidated equity between IFRS and UK GAAP

	Note 39	1 January 2005 £m	31 December 2005 £m
Total equity as reported under UK GAAP		252.4	284.9
Valuation of financial instruments in accordance with IAS 39	b, d, e, i, k, l, n & o	27.0	25.6
Recognition of intangible assets in accordance with IAS 38	g	(0.8)	0.5
Recognition of deferred tax in accordance with IAS 12	f,m	6.9	1.0
Reversal of deferred tax recognised under UK GAAP	f	(11.7)	(5.5)
Other		(0.1)	(0.4)
Total equity under IFRS		**273.7**	**306.1**

Notes to the accounts *(continued)*

38. Reconciliation of IFRS to UK GAAP *(continued)*

(b) Consolidated balance sheet reconciliation between IFRS and UK GAAP

At 1 January 2005	Note 39	UK GAAP £m	Reclassification £m	Restatement £m	IFRS £m
Assets					
Cash and balances with the Bank of England	a	–	7.3	–	7.3
Treasury bills		86.8	–	–	86.8
Loans and advances to banks	c	530.7	(29.4)	–	501.3
Debt securities	d	956.5	(956.5)	–	–
Financial assets at fair value through profit or loss	d	–	822.3	(0.7)	821.6
Derivative financial instruments	b	–	(2.9)	14.6	11.7
Loans and advances to customers	e	9,567.7	53.1	31.5	9,652.3
Investment securities – held to maturity	d	–	131.7	–	131.7
Intangible assets	g	0.8	–	(0.8)	–
Deferred income tax asset	f	–	11.7	(4.8)	6.9
Fixed assets		0.1	–	–	0.1
Other assets	h	65.4	17.6	–	83.0
Prepayments and accrued income	h	75.3	(75.3)	–	–
Total assets		**11,283.3**	**(20.4)**	**39.8**	**11,302.7**
Liabilities					
Deposits from banks	i	–	863.9	–	863.9
Deposits by banks	i	867.0	(867.0)	–	–
Customer accounts	j	4,238.3	44.9	(0.1)	4,283.1
Derivative financial instruments	k	–	13.4	207.5	220.9
Debt securities in issue	l	5,564.6	(5,564.6)	–	–
Securitised notes	l	–	3,365.3	(179.7)	3,185.6
Other debt securities in issue	l	–	2,231.0	(9.3)	2,221.7
Other liabilities	n	12.3	11.4	0.1	23.8
Accruals and deferred income	n	118.7	(118.7)	–	–
Subordinated liabilities	o	230.0	–	–	230.0
Total liabilities		**11,030.9**	**(20.4)**	**18.5**	**11,029.0**
Equity					
Share capital		370.0	–	–	370.0
Other reserves	p	0.3	(0.3)	–	–
Retained earnings	q	(117.9)	0.3	21.3	(96.3)
Total shareholders' equity		**252.4**	–	**21.3**	**273.7**
Total equity and liabilities		**11,283.3**	**(20.4)**	**39.8**	**11,302.7**

Notes to the accounts *(continued)*

38. Reconciliation of IFRS to UK GAAP *(continued)*

(c) Consolidated balance sheet reconciliation between IFRS and UK GAAP

At 31 December 2005	Note 39	UK GAAP £m	Reclassification £m	Restatement £m	IFRS £m
Assets					
Cash and balances with the Bank of England	a	–	7.0	–	7.0
Treasury bills		183.0	–	–	183.0
Loans and advances to banks	c	705.0	(6.5)	–	698.5
Derivative financial instruments	b	–	34.9	2.3	37.2
Loans and advances to customers	e	10,071.6	52.5	34.8	10,158.9
Debt securities	d	678.0	(678.0)	–	–
Financial assets at fair value through profit or loss	d	–	600.3	(2.1)	598.2
Investment securities – held to maturity	d	–	78.8	–	78.8
Intangible assets	g	0.4	–	0.5	0.9
Deferred income tax asset	f	–	2.4	(1.7)	0.7
Other assets	h	51.0	(13.7)	1.9	39.2
Prepayments and accrued income	h	78.3	(78.3)	–	–
Total assets		**11,767.3**	**(0.6)**	**35.7**	**11,802.4**
Liabilities					
Deposits from banks	i	–	967.9	1.1	969.0
Deposits by banks	i	876.0	(876.0)	–	–
Customer accounts	j	4,210.9	(46.8)	1.1	4,165.2
Derivative financial instruments	k	–	46.4	64.0	110.4
Debt securities in issue	l	5,995.4	(5,995.4)	–	–
Securitised notes	l	–	4,058.4	(55.3)	4,003.1
Other debt securities in issue	l	–	1,968.5	(4.8)	1,963.7
Deferred income tax liability	m	–	(3.1)	3.1	–
Other liabilities	n	6.7	9.4	2.3	18.4
Accruals and deferred income	n	130.2	(130.2)	–	–
Subordinated liabilities	o	263.2	–	3.3	266.5
Total liabilities		**11,482.4**	**(0.9)**	**14.8**	**11,496.3**
Equity					
Share capital		271.8	–	–	271.8
Other reserves	P	0.3	(0.3)	(2.8)	(2.8)
Retained earnings	q	12.8	0.3	24.0	37.1
Total shareholders' equity		**284.9**	**–**	**21.2**	**306.1**
Total equity and liabilities		**11,767.3**	**(0.9)**	**36.0**	**11,802.4**

Notes to the accounts *(continued)*

38. Reconciliation of IFRS to UK GAAP *(continued)*

(d) Consolidated income statement reconciliation between IFRS and UK GAAP

Year to 31 December 2005	Note 39	UK GAAP £m	Reclassification £m	Restatement £m	IFRS £m
Interest and similar income		666.0	(3.7)	(38.9)	623.4
Interest expense and similar charges		(541.3)	(14.7)	5.1	(550.9)
Net interest income	r	**124.7**	**(18.4)**	**(33.8)**	**72.5**
Fee and commission income		23.8	–	(13.5)	10.3
Fee and commission expense		(6.3)	0.3	–	(6.0)
Net fee and commission income	s	**17.5**	**0.3**	**(13.5)**	**4.3**
Net hedge ineffectiveness and other fair value gains and losses	t	–	15.2	(4.3)	10.9
Other operating charges	t	(0.6)	0.6	–	–
Total Income		**141.6**	**(2.3)**	**(51.6)**	**87.7**
Administrative expenses	u	(61.6)	2.6	–	(59.0)
Amortisation	v	(55.2)	(3.3)	58.5	–
Operating expenses		**(116.8)**	**(0.7)**	**58.5**	**(59.0)**
Impairment losses on loans and advances	w	(0.9)	–	0.1	(0.8)
Profit before income tax		**23.9**	**(3.0)**	**7.0**	**27.9**
Taxation	x	(6.5)	–	(1.2)	(7.7)
Profit for the year attributable to equity holder of the parent company		**17.4**	**(3.0)**	**5.8**	**20.2**

The UK GAAP heading above, 'Interest and similar income', includes both 'Interest receivable and similar income arising from debt securities and other fixed income securities' and 'Other interest receivable and similar income' which were previously shown separately under UK GAAP.

Under UK GAAP, the equivalent heading to 'Interest expense and similar charges' was 'Interest payable' and the equivalent heading to 'Impairment losses on loans and advances' was 'Provisions for bad and doubtful debts'.

Notes to the accounts *(continued)*

39. Notes to the reconciliation of IFRS to UK GAAP

Detailed below are supplementary notes to note 38 that provide explanations of the Income Statement and Balance Sheet reclassifications and restatements and the total equity impact to reserves as a result of the transition to IFRS.

(a) Cash and balances with the Bank of England

	1 January 2005 £m	31 December 2005 £m
Reclassification of cash ratio deposit held with Bank of England	**7.3**	**7.0**

The Group has reclassified the cash ratio deposit held with the Bank of England from loans and advances to banks to cash and balances with the Bank of England.

(b) Derivative financial instruments

	1 January 2005 £m	31 December 2005 £m
Reclassification of the fair value of derivative financial instruments	(2.9)	34.9
Fair value adjustments of derivative financial instruments	14.6	2.3
	11.7	**37.2**

Under IFRS all derivative financial instruments are held at fair value. The fair value of derivatives as at 1 January 2005 have been calculated and opening reserves adjusted, with subsequent movements in fair values flowing through the income statement. The carrying value of derivatives have been reclassified under the balance sheet headings derivative financial assets or liabilities as appropriate.

(c) Loans and advances to banks

	1 January 2005 £m	31 December 2005 £m
Reclassification of cash ratio deposit held with Bank of England	(7.3)	(7.0)
Reclassification of collateral balances	(22.1)	0.5
	(29.4)	**(6.5)**

The Group has reclassified the cash ratio deposit held with the Bank of England from loans and advances to banks to cash and balances with the Bank of England.

In addition, collateral balances have been reclassified from loans and advances to banks to other assets or liabilities as appropriate.

Notes to the accounts *(continued)*

39. Notes to the reconciliation of IFRS to UK GAAP *(continued)*

(d) Financial assets at fair value through profit or loss and investment securities – held to maturity

	1 January 2005 £m	31 December 2005 £m
Reclassification of debt securities	(2.5)	1.1
Fair Value restatements of financial assets through profit or loss	(0.7)	(2.1)
	(3.2)	**(1.0)**

Under IFRS, debt securities have been reclassified under the balance sheet headings 'Financial assets at fair value through profit or loss' and 'Investment securities – held to maturity.' Assets valued at mid market rates under UK GAAP have been restated at BID market rates under IFRS.

(e) Loans and advances to customers

	1 January 2005 £m	31 December 2005 £m
Restatement of loans and advances to customers carrying value	31.5	34.8
Reclassification of accrued interest held in payments and accrued income	53.1	52.5
	84.6	**87.3**

The restatement of the carrying value of loans and advances to customers has two distinct elements.

Loans and advances to customers are held at amortised cost, so an EIR adjustment is recorded under IFRS relating to the impact of the EIR calculation on capitalisation of discounts and fees payable and receivable which form an integral part of the underlying interest rate. These items are then unwound within interest income over the expected duration of the related mortgage product. In addition, fixed rate mortgages are hedged using interest rate swaps. Under IFRS a fair value adjustment is made to the mortgage book in relation to the impact of hedge accounting of these derivatives.

The reclassification adjustment relates to accrued interest on loans and advances to customers which is part of the carrying value under IFRS as the assets are held at amortised cost.

(f) Deferred income tax asset

	1 January 2005 £m	31 December 2005 £m
Fair value movements on deferred tax	(4.8)	0.2
Reclassification to deferred tax	11.7	(4.8)
	6.9	**(4.6)**

Deferred tax has been recalculated in accordance with IAS 12 with all valuation adjustments made tax effected as appropriate.

Notes to the accounts *(continued)*

39. Notes to the reconciliation of IFRS to UK GAAP *(continued)*

(g) Intangible assets

	1 January 2005 £m	31 December 2005 £m
Capitalisation of intangible assets	**(0.8)**	**0.5**

Under IFRS qualifying project costs are capitalised 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.

(h) Other assets

	1 January 2005 £m	31 December 2005 £m
Reclassification of other assets and prepayments and accrued income	(57.7)	(86.5)
Restatement of other assets	–	1.9
	(57.5)	**(84.6)**

With the adoption of IFRS, various balances within other assets have been reallocated.

(i) Deposits from banks

	1 January 2005 £m	31 December 2005 £m
Fair value adjustment on deposits by banks	–	1.1
Reclassification of accrued interest to deposits from banks	(3.1)	91.9
	(3.1)	**93.0**

Under IFRS, the Group has reclassified accrued interest to the individual line items within the balance sheet.

(j) Customer accounts

	1 January 2005 £m	31 December 2005 £m
Reclassification of accrued interest to customer accounts	44.9	(46.8)
Restatement of customer accounts	(0.1)	1.1
	44.8	**(45.7)**

Under IFRS, the Group has reclassified accrued interest to the individual line items within the balance sheet.

Notes to the accounts *(continued)*

39. Notes to the reconciliation of IFRS to UK GAAP *(continued)*

(k) Derivative financial instruments

	1 January 2005 £m	31 December 2005 £m
Reclassification of the fair value of derivative financial instruments	13.4	46.4
Fair value adjustments of derivative financial instruments	207.5	64.0
	220.9	**110.4**

Under IFRS all derivative financial instruments are held at fair value. The fair value of derivatives as at 1 January 2005 have been calculated and opening reserves adjusted, with subsequent movements in fair values flowing through the income statement. The carrying value of derivatives have been reclassified under the balance sheet headings derivative financial assets or liabilities as appropriate.

(l) Debt securities in issue

	1 January 2005 £m	31 December 2005 £m
Reclassification of accrued interest included in accruals and deferred income	31.7	31.5
Fair value adjustment on debt securities in issue	(189.0)	(60.1)
	(157.3)	**(28.6)**

The Group has split disclosure of debt securities in issue into securitised notes and other debt securities in issue. Under IFRS, the Group has reclassified accrued interest to the individual line items within the balance sheet.

The fair value adjustment to debt securities in issue has two distinct elements. The first element is in relation to the translation of foreign currency debt at the spot rate ruling at the balance sheet date. The second element relates to fair value hedge accounting adjustments made to the carrying value of the debt in order to reflect the value of the hedged risk.

(m) Deferred income tax liability

	1 January 2005 £m	31 December 2005 £m
Reclassification to deferred tax liability	–	3.1
Restatement to deferred tax liability	–	(3.1)
	–	–

The Group has recalculated deferred tax in accordance with IAS 12.

Notes to the accounts *(continued)*

39. Notes to the reconciliation of IFRS to UK GAAP *(continued)*

(n) Other liabilities, accruals and deferred income

	1 January 2005 £m	31 December 2005 £m
Reclassification of accruals and deferred income	(107.3)	(120.8)
Fair value movements on other liabilities	(0.1)	2.3
	(107.4)	**(118.5)**

With the adoption of IFRS, various balances within other liabilities have been reallocated.

(o) Subordinated liabilities

	1 January 2005 £m	31 December 2005 £m
Fair value adjustments on subordinated liabilities	–	**3.3**

Subordinated debt is issued at a fixed rate and the related interest rate risk hedged through the use of interest rate swaps. The fair value adjustment relates to the fair value hedge accounting adjustment made to the carrying value of the debt in order to reflect the value of the hedged risk.

(p) Other reserves

	1 January 2005 £m	31 December 2005 £m
Reclassification of foreign exchange reserve	(0.3)	(0.3)
Effective portion of fair value movements taken to equity cash flow reserves	–	(2.8)
	(0.3)	**(3.1)**

The foreign exchange reserve held under UK GAAP was reclassified from other reserves to retained earnings.

IFRS cash flow hedge accounting was been adopted during 2005 so a cash flow hedge reserve has been created. This reserve contains the efficient element of fair value gains or losses on derivatives within cash flow hedging relationships which are recycled to the income statement at the same time as the hedged item will affect the income statement.

Notes to the accounts *(continued)*

39. Notes to the reconciliation of IFRS to UK GAAP *(continued)*

(q) Retained earnings

	1 January 2005 £m	31 December 2005 £m
Reclassification of foreign exchange reserve to retained earnings	0.3	0.3
Effect of valuation adjustments	21.3	24.0
	21.6	**24.3**

The foreign exchange reserve was reclassified from other reserves to retained earnings.

The total effect of all valuation adjustments on the previously described balance sheet headings impact retained earnings.

(r) Net interest income

	31 December 2005 £m
Reclassification of net interest income	(18.4)
Restatement of net interest income	(33.8)
	(52.2)

With the adoption of IFRS, various balances within net interest income have been reallocated.

The restatement of net interest income relates primarily to the impact of EIR on incentive costs and other fees forming an integral part of the interest rate on loans and advances to customers. Under UK GAAP these costs were capitalised and depreciated over a set term whereas under IFRS these costs form an integral part of the interest rate and unwind over the duration of the related mortgage product.

(s) Net fee and commission income

	31 December 2005 £m
Reclassification of net fee and commission income	0.3
Fair value restatement of net fee and commission income	(13.5)
	(13.2)

The restatement of net fee and commission income relates primarily to the impact of EIR on fees receivable which form an integral part of the interest rate on loans and advances to customers. Under UK GAAP these fees were recognised immediately whereas under IFRS these fees costs form an integral part of the interest rate and unwind into the income statement over the duration of the related mortgage product.

Notes to the accounts *(continued)*

39. Notes to the reconciliation of IFRS to UK GAAP *(continued)*

(t) Net hedge ineffectiveness and other fair value gains and losses

	31 December 2005 £m
Reclassification of net hedge ineffectiveness and other fair value gains and losses	15.2
Fair value restatement of net hedge ineffectiveness and other fair value gains and losses	(4.3)
	10.9

Under IFRS the fair value movements of future cash flows (excluding interest flows) on financial assets at FVTPL and derivatives, gains and losses on financial instruments denominated in foreign currencies and hedge accounting adjustments are separately identified within "Net hedge ineffectiveness and other fair value gains and losses".

(u) Administrative expenses

	31 December 2005 £m
Reclassification of administration expenses	**2.6**

With the adoption of IFRS, various balances within administrative expenses have been reallocated.

(v) Amortisation

	31 December 2005 £m
Restatement of amortisation due to change in IFRS	58.5
Reclassification of amortisation	(3.3)
	55.2

The restatement of amortisation relates primarily to the depreciation of capitalised mortgage incentive costs under UK GAAP. The costs form part of the EIR under IFRS and therefore form part of interest income. In addition amortisation of intangible assets which have been capitalised under IFRS is also charged to the income statement.

(w) Impairment losses on loans and advances

	31 December 2005 £m
Restatement of impairment losses	**0.1**

Under IFRS impairment losses must be calculated in accordance with IAS 39. The restatement of the UK GAAP provision brings the income statement charge to its IFRS equivalent.

Notes to the accounts *(continued)*

39. Notes to the reconciliation of IFRS to UK GAAP *(continued)*

(x) Taxation

	31 December 2005 £m
Restatement of deferred tax expense	**(1.2)**

Tax expense has been recalculated as a result of restatements due to IFRS.

40. Segmental Reporting

The Group's two main classes of business are banking services, conducted in the UK, and financing conducted in the UK and in Europe. A segmental analysis of the Group is given below.

Segmental results for year ended 31 December 2006	UK Banking Services £m	UK Financing £m	Europe Financing £m	Intra-group items £m	Group total £m
Net interest income	59.9	27.5	0.8	–	88.2
Net fee and commission income	10.3	–	–	–	10.3
Net hedge ineffectiveness and other fair value gains and losses	2.4	1.5	–	–	3.9
Total income	72.6	29.0	0.8	–	102.4
Results before taxation	40.2	1.7	0.5	–	42.4
Total assets	7,576.3	5,083.7	1,279.0	(1,859.7)	12,079.3
Net assets	336.5	9.6	4.2	(1.2)	349.1

Segmental results for year ended 31 December 2005	UK Banking Services £m	UK Financing £m	Europe Financing £m	Intra-group items £m	Group total £m
Net interest income	45.1	25.7	1.7	–	72.5
Net fee and commission income	4.3	–	–	–	4.3
Net hedge ineffectiveness and other fair value gains and losses	(8.3)	19.2	–	–	10.9
Total income	41.1	44.9	1.7	–	87.7
Results before taxation	14.5	12.1	1.3	–	27.9
Total assets	7,735.3	3,713.5	1,434.2	(1,080.6)	11,802.4
Net assets	295.2	8.4	2.5	–	306.1

Notes to the accounts *(continued)*

41. Employee share based payments

Prior to admittance of the Group's ultimate parent company, SL plc, to the London Stock Exchange, no employee share-based payment schemes were in operation. At the time of flotation, SL plc established a number of share-based payment schemes with employees. Details of these arrangements are as follows:

(i) Long Term Incentive Plan (LTIP)

The LTIP is an award scheme granted to senior executives of the Group. Prior to admittance of SL plc to the London Stock Exchange, the LTIP was a cash-based award dependent on certain performance conditions being achieved over a three year period. On admittance to the London Stock Exchange, the 2005 and 2006 plans were converted to awards of shares of SL plc 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.

Under the terms of the plan, share options are awarded to executives and senior management based on performance results of the SL plc over a three year period. The performance target is based on SL plc's return on capital which is a combination of return on underlying profit for the non-life businesses of SL plc and the return on European Embedded Value for the life businesses of SL plc. 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) Share Incentive Plans

SL plc 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. Standard Life 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 Company prior to completing three years of service from the date of grant.

(iii) Shares awarded on flotation

On admittance of SL plc to 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 has been incurred by SL plc.

Notes to the accounts *(continued)*

41. Employee share based payments *(continued)*

(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	Share incentive plans
Nature of arrangement	Grant of Share Options	Grant of Shares
Date of Grant	4-Aug-2006	Monthly
Number of instruments granted	461,684	8,445
Exercise price	Nil	n/a
Share price at date of grant	258.75p	2.91
Contractual life (years)	3.75 years	n/a
Vesting conditions	3 year service period Specified group performance	3 year service period
Settlement	Shares	Shares
Expected volatility	25%	n/a
Expected option life at grant date (years)	2.29 years	n/a
Risk-free interest rate	4.92%	n/a
Expected dividend (dividend yield)	2.67%	n/a
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 are expected to vest
Fair value per granted instrument determined at the grant date	2.44	2.91

(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 admittance of SL plc to 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. Exercise price of the options is nil.

2006		
Number of options ('000)	Weighted average remaining life	
	Expected	Contractual
422,555	2.29	2.79

Notes to the accounts *(continued)*

41. Employee share based payments *(continued)*

A reconciliation of movements in the number of share options granted to executives and senior management is set out in the table below.

		2006
	Number of options	Weighted average exercise price
Outstanding at start of year	461,684	–
Effect of modifications and cancellations	–	–
Effect of change in expected performance outcome	–	–
Granted	–	–
Forfeited	(39,129)	–
Exercised	–	–
Outstanding at end of year	422,555	–
Exercisable at year-end	–	–

Under the terms of the conversion these options have a nil exercise price.

The amounts recognised as an expense for share-based payment transactions with employees is as follows:

	2006 £m
Share options granted to executives and senior management	0.4
Matching shares granted under share incentive plans	–
Shares awarded on flotation	–
	0.4

Independent auditors' report

to the members of Standard Life Bank Limited

We have audited the Group and Company financial statements (the "financial statements") of Standard Life Bank Limited for the year ended 31 December 2006 which comprise the Consolidated Income Statement, the Consolidated Balance Sheet, the Company Balance Sheet, the Consolidated Statement of Recognised Income and Expense, the Company Statement of Recognised Income and Expense, the Consolidated Cash Flow Statement, the Company Cash Flow Statement and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

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

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). 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 in to 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 financial statements give a true and fair view and 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 Report by the Directors is consistent with the financial statements.

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

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Report by the Directors. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

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

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

Independent auditors' report

to the members of Standard Life Bank Limited (continued)

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRS's 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 Company financial statements give a true and fair view, in accordance with IFRS's as adopted by the European Union, as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent Company's affairs as at 31 December 2006 and cash flows for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information in the Report by the Directors is consistent with the financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Edinburgh
15 March 2007

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