

For the period ended 31 December 2005

# Report and Accounts from Standard Life Bank





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# Statutory information

## Directors:

Sir B Stewart KB, CBE, MSc, CA (Non-Executive Chairman)  
Miss A M Gunther BSc, FCI OBS, ACIB, MBA (Chief Executive)  
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)  
I G Williamson BSc, FFA (Customer Service 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 2005.

## Annual General Meeting

As permitted by Section 366A of the Companies Act 1985, the Company has passed an elective resolution to dispense with the holding of an annual general meeting.

## Results and dividends

Standard Life Bank Group ("the Group") made a profit for the year ended 31 December 2005 of £17.5m (period to 31 December 2004 – £6.8m).

The directors do not recommend the payment of a dividend for the year. The directors consider the results to be satisfactory.

## Principal activities and business review

The Group's business is that of providing banking services through the Company and the associated financial activities of its subsidiary companies (as defined in Note 16 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 service and efficiency. The Company is also responsible for the administration of Futureperfect mortgages advanced by its parent company, The Standard Life Assurance Company ("SLAC"), totalling £482 million as at 31 December 2005 (2004 – £581 million) and Lifetime mortgages advanced by another SLAC subsidiary, Standard Life Lifetime Mortgages Limited totalling £13 million as at 31 December 2005 (2004 – £6 million). Total mortgages under administration were £10.6 billion as at 31 December 2005 (2004 – £10.2 billion).

On 17 October 2005, the Board of SLAC, the Company's parent undertaking confirmed it intends to recommend to members that SLAC should demutualise and list on the London Stock Exchange, subject to satisfactory completion of all legal, regulatory and other requirements. A Special General Meeting is expected to take place in May or June 2006 to seek members' approval of the demutualisation and flotation plans.

On 29 June 2005, the Company issued 15,000,000 ordinary shares of £1 for £15,000,000, increasing the issued and fully paid up share capital from £370,000,000 to £385,000,000 (see Note 25).

On 29 June 2005, Standard Life Funding BV ("SLF BV"), a wholly owned subsidiary of Standard Life Bank, issued £265m of undated subordinated loan notes (see Note 24). The notes are redeemable at par at the auction of the issuer on 29 June 2015.

On 14 October 2005, the Company, by Members Resolution, reduced its authorised and issued share capital from 500,000,000 ordinary shares of £1 each, of which 385,000,000 had been issued and were fully paid, to 386,775,000 ordinary shares of £1 each, of which 271,775,000 have been issued and are fully paid up. The reduction was effected by the cancellation of 113,225,000 of the authorised and issued shares (see Note 25).

The Group will prepare its financial statements under International Financial Reporting Standards ("IFRS") from 1 January 2006. Due to the requirements of IFRS to fair value financial instruments, particularly derivatives, greater volatility in reported results is anticipated going forward. This volatility will not alter the underlying cash flows of the Group or the way the Group does business.

# Report by the Directors *(continued)*

## Directors

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

Sir Nicholas Monck retired as a Non-Executive Director on 17 March 2005.

Mr Macmillan resigned from his post as an Executive Director on 15 November 2005.

Mr Johnstone resigned as Company Secretary on 23 February 2005.

Mr Milne was appointed as Company Secretary on 23 February 2005 and resigned on 29 April 2005.

Mr Connarty was appointed as Company Secretary on 29 April 2005.

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 SLAC.

## 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, arrange for retraining, or retire on disability pension, any member of staff who becomes disabled, as may be appropriate.

## Employee involvement

It is the Company's policy to have effective communication and consultation with our people. Involvement is achieved through a variety of approaches, including meetings, briefings, executive open fora and newsletters that help to ensure that employees are kept fully aware of the Company's goals and results. Our people also elect representatives of Bank LINK who, in turn, elect a National LINK representative. Formal consultation processes take place with our people 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 employee interest or concern.

## Financial instruments

**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, treasury bills and eligible 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, financial futures, cross currency swaps, forward currency contracts and equity swaps) for the purpose, as agreed by the directors, 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 Note 29.

# Report by the Directors *(continued)*

## Group risks

The main risks arising from the Group's activities are summarised below. The ultimate responsibility for managing risk resides with the board of Standard Life Bank Limited and the directors review and agree policies for managing each of these risks.

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 interest rate exposure on its assets and liabilities is managed using interest rate swaps, financial futures and forward rate agreements.

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 its subsidiary undertaking.

Foreign currency risk: the Group is not exposed to material structural currency exposure since the majority of the Group's operations are based in the UK. The Company's investment in its subsidiary undertaking, whose functional currency is in euros, is not material. The Group uses foreign exchange forwards and cross currency swaps to manage transactional foreign currency exposure that occurs via its wholesale funding activities.

Equity risk: the Group uses equity swaps to manage equity exposure that occurs 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.

Operational risk: this is the risk of loss, resulting from inadequate or failed internal processes, people and systems or from external events. In the Company, 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.

## Supplier payment policy

It is the Standard Life 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.

## 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, 21 March 2006

# Directors' responsibilities

Company law requires the directors to prepare accounts, for each financial period, which comply with the Companies Act 1985, are in accordance with applicable United Kingdom accounting standards and 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 addition, the directors should take all reasonable steps to ensure that adequate accounting records are maintained, that the assets of the Group and Company are safeguarded and that fraud and other irregularities are detected or prevented.

The directors confirm that suitable accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, have been used in the preparation of the accounts of the Group and Company for the year ended 31 December 2005. The directors also confirm that the accounts have been appropriately prepared on a going concern basis and that applicable accounting standards have been followed as described in the Accounting Policies.

The maintenance and integrity of the Standard Life Bank 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.

# Consolidated profit and loss account

For the year ended 31 December 2005

	Notes	12 months to 31 December 2005 £000	Restated 13½ months to 31 December 2004 £000
Interest receivable:			
– Interest receivable and similar income arising from debt securities and other fixed income securities		75,536	69,841
– Other interest receivable and similar income		590,395	567,940
Interest payable		(541,278)	(506,267)
Net interest income		124,653	131,514
Fees and commissions receivable		23,828	18,619
Fees and commissions payable		(6,281)	(8,277)
Dealing profit		27	125
Net operating income		142,227	141,981
Administrative expenses	4	(61,613)	(72,674)
Depreciation and amortisation	7	(55,214)	(59,122)
Other operating charges		(588)	(213)
Provision for bad and doubtful debts	14	(863)	(802)
Profit on ordinary activities before tax	7	23,949	9,170
Tax on profit on ordinary activities	8	(6,499)	(2,331)
Profit for period	9, 26	17,450	6,839

The result for the period relates wholly to continuing activities. There is no difference between the profit stated above and the historical cost equivalent.

# Consolidated balance sheet

As at 31 December 2005

	Notes	31 December 2005 £000	Restated 31 December 2004 £000
<b>Assets</b>			
Treasury bills and other eligible bills	10	183,019	86,781
Loans and advances to banks	11	705,014	530,658
Loans and advances to customers	12	10,071,553	9,567,677
Debt securities	15	678,054	956,564
Intangible fixed assets	17	386	827
Tangible fixed assets	17	–	80
Other assets	18	51,009	65,456
Prepayments and accrued income	19	78,264	75,271
Total assets		<u>11,767,299</u>	<u>11,283,314</u>
<b>Liabilities</b>			
Deposits by banks	20	876,140	866,961
Customer accounts	21	4,210,872	4,238,294
Debt securities in issue	22	5,995,422	5,564,663
Other liabilities	23	6,673	12,358
Accruals and deferred income		130,134	118,655
Subordinated liabilities	24	263,201	230,000
		<u>11,482,442</u>	<u>11,030,931</u>
Called up share capital	25	271,775	370,000
Reserves	26	335	311
Profit and loss account	26	12,747	(117,928)
Total shareholder's funds	27	<u>284,857</u>	<u>252,383</u>
Total liabilities		<u>11,767,299</u>	<u>11,283,314</u>
Memorandum items			
Contingent liabilities:			
– Guarantees	28	5,224,657	5,424,280
Other commitments:			
– Commitments to lend	28	2,291,914	2,307,779

On behalf of the Board of Directors  
P Joshi, Finance Director  
21 March 2006

# Company balance sheet

As at 31 December 2005

	Notes	31 December 2005 £000	Restated 31 December 2004 £000
<b>Assets</b>			
Treasury bills and other eligible bills	10	183,019	86,781
Loans and advances to banks	11	456,875	335,751
Loans and advances to customers	12	10,071,553	9,567,677
Debt securities	15	678,054	956,564
Shares in group undertakings	16	12	12
Intangible fixed assets	17	386	827
Tangible fixed assets	17	–	80
Other assets	18	92,059	104,556
Prepayments and accrued income	19	50,586	67,907
Total assets		<u>11,532,544</u>	<u>11,120,155</u>
<b>Liabilities</b>			
Deposits by banks	20	876,140	866,961
Customer accounts	21	4,210,872	4,238,294
Debt securities in issue	22	785,500	940,000
Other liabilities	23	5,296,108	4,516,695
Accruals and deferred income		81,832	77,410
Subordinated liabilities	24	–	230,000
		<u>11,250,452</u>	<u>10,869,360</u>
Called up share capital	25	271,775	370,000
Profit and loss account	26	10,317	(119,205)
Total shareholder's funds	27	<u>282,092</u>	<u>250,795</u>
Total liabilities		<u>11,532,544</u>	<u>11,120,155</u>
Memorandum items			
Contingent liabilities:			
– Guarantees	28	6,661,763	6,705,438
Other commitments:			
– Commitments to lend	28	2,291,914	2,307,779

On behalf of the Board of Directors  
P Joshi, Finance Director  
21 March 2006

# Consolidated statement of total recognised gains and losses

For the period ended 31 December 2005

	Notes	Year to 31 December 2005 £000
Profit attributable to ordinary shareholders		17,450
Foreign currency gain on investment in subsidiary	26	<u>24</u>
Total recognised gains for the period		<u>17,474</u>
Total recognised gains since last annual report		<u>17,474</u>

# Notes to the accounts

## 1. Accounting policies

### (a) Accounting convention

The accounts have been prepared under the historical cost convention in accordance with applicable Accounting Standards, all Statements of Recommended Accounting Practice issued by the British Bankers' Association, and in accordance with Section 255A and Schedule 9 to the Companies Act 1985.

### (b) Basis of consolidation

The consolidated accounts consolidate the profit and loss account and balance sheet of the Company and its subsidiary undertakings.

### (c) Shares in subsidiary undertakings

Shares in subsidiary undertakings are valued at cost less any permanent diminution in value.

### (d) Provision for bad and doubtful debts

Specific provisions are made against loans and advances (including securitised advances where appropriate) on a case by case basis where the specified advance is more than two payments in arrears and recovery is therefore considered doubtful. The specific provision is calculated as the amount required to reduce the current loan balance to the estimated net realisable value of the advance. The estimated net realisable value is calculated by adjusting the last valuation of the security by reference to movements in an appropriate house price index and deducting, on the basis of past experience, legal and other costs expected to be incurred in realising the security.

General provision is made in respect of losses which although not yet specifically identified, are known from experience to be present in the portfolio of customer advances (including securitised advances where appropriate). Such provisions are calculated by segmenting the total portfolio (excluding cases already specifically provided for) according to risk profiles reflecting product characteristics, borrower credit-worthiness and loan to value ratios. This segmentation is then considered under various scenarios in light of past loss experience.

Interest, receipt of which is considered to be doubtful, is not credited to the profit and loss account when applied to a customer's account but is held in suspense until collection is assured.

Loans and advances are written off when there is no realistic prospect of recovery. Loans and advances are stated net of specific and general provisions and of interest in suspense in the balance sheet.

### (e) Foreign currencies

Assets and liabilities denominated in foreign currencies are translated into sterling at the exchange rates ruling at the balance sheet date or if appropriate at the contracted rate under a forward contract or cross currency swap. The results of the overseas subsidiary undertaking are translated using an average exchange rate. Exchange differences resulting from the translation of opening reserves are dealt with as a movement in reserves. Other exchange differences arising on the translation of the overseas subsidiary are dealt with in the profit and loss account.

Other foreign currency transactions are translated at the rate of exchange ruling on the date on which the transaction occurred.

# Notes to the accounts *(continued)*

## 1. Accounting policies *(continued)*

### (f) Fixed assets

Tangible and intangible fixed assets are capitalised and depreciated on a straight line basis over their estimated useful lives which range from two to four years.

### (g) Deferred taxation

Deferred tax is recognised on a discounted basis for all timing differences that have originated but not reversed at the balance sheet date. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered.

The value of the deferred tax asset is calculated using the average tax rates expected to be applicable in the periods in which the timing differences are expected to reverse. The value of the tax asset is then discounted at the corresponding gilt rates extant at the period end in order to reflect the time value of money.

### (h) Mortgage incentives

Repayment of legal and valuation fees to mortgage customers and discounts offered on mortgage products are deferred and amortised to the profit and loss account over either 12 months or the early redemption charge period of the product. Mortgage incentive costs relating to advances which are considered bad or doubtful are however written off to the profit and loss account immediately.

### (i) Debt securities and other eligible bills

Where debt securities are held for the short term, they are included in the balance sheet at market value. Any changes in the market value of such assets are recognised in the profit and loss account as dealing profits or losses as they arise.

### (j) Interest

Interest income and interest payable are recognised on an accruals basis.

### (k) Cashflow statement

A cashflow statement has not been provided as the Group has taken advantage of the exemption contained in Financial Reporting Standard 1 (Revised) "Cashflow Statements" as consolidated accounts in which the Group is included are available (see Note 32).

### (l) Pensions

Charges in respect of employer's contributions are calculated on a basis which spreads the cost over the service lives of scheme members.

### (m) Commission

Commission payable on savings accounts and regular commission on mortgage accounts is recognised as it is incurred. Initial commission payable on mortgage accounts is included in prepayments in the balance sheet and is amortised to the profit and loss account over three years.

### (n) Operating leases

All rental payments under operating leases are charged to 'Administrative expenses' within the profit and loss account on a straight line basis over the lease term.

# Notes to the accounts *(continued)*

## 1. Accounting policies *(continued)*

### (o) Securitisation transactions

The Group enters into securitisation transactions (see Note 13) in which it sells mortgages to the Lothian special purpose vehicles ("SPVs" – see Note 16 for details) and issues securities backed by the cashflows from the securitised mortgages. Although the equity of the SPVs is not 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 securitised mortgages continue to be recognised within the Company accounts as loans and advances to customers with a liability recognised for the consideration received. Income in relation to the securitised assets and amounts payable to the SPVs are recognised on an accruals basis within the Profit and Loss account. Amounts due to the SPVs are recognised as part of the securitisation liability within 'Other liabilities.' Amounts due from the SPVs are recognised within 'Other assets.'

Within the Group accounts the the SPVs are consolidated on a line by line basis.

### (p) Derivatives

Transactions are undertaken in derivative financial instruments, 'derivatives', which include interest rate swaps, equity swaps, forward rate agreements, interest rate futures, cross currency swaps and forward foreign exchange contracts, for non-trading purposes only. In addition there are non-trading interest rate swaps transacted to hedge reset risk on mortgage backed securities in issue which are accounted for on a mark to market basis with changes in fair value taken directly to the profit and loss account and reported within 'Other operating income' or 'Other operating charges'.

Derivatives classified as non-trading are those entered into for the purpose of matching or reducing risk from potential movements in foreign exchange rates, equity indices and interest rates inherent in the Company's non-trading assets and liabilities. Non-trading assets and liabilities are those intended for use on an ongoing basis in the retail banking activities of the Company. Where non-trading assets are held for the short term, they are included in the balance sheet at market value. Non-trading derivatives hedging such assets are also held at market value in order to offset the market value movement in the underlying instrument being hedged.

A derivative is designated as non-trading where there is an offset between the effects of potential movements in market rates on the derivative and the designated non-trading asset or liability being hedged. Non-trading derivatives are reviewed regularly for their effectiveness as hedges. Non-trading derivatives are accounted for on a basis consistent with the assets or liabilities being hedged. Where used to hedge foreign currency debt issues, the debt is recorded at the contracted spot rate of the associated hedge. Income and expense on non-trading derivatives are recognised as they accrue over the life of the instruments as an adjustment to 'Interest receivable' or 'Interest payable'. Where a non-trading derivative no longer represents a hedge because either the underlying non-trading asset or liability has been derecognised, or transferred into a trading portfolio it is restated at fair value and any change in value is taken directly to the profit and loss account and reported within 'Other operating income' or 'Other operating charges'.

Once a non-trading derivative is deemed to no longer constitute a hedge, the derivative can either be classified as trading or if subsequently found to be appropriate, redesignated as a hedge of a non-trading item and accounted for accordingly. If a non-trading derivative is terminated early, the realised gain or loss is deferred and amortised to earnings over the remaining life of the underlying instrument.

Derivatives hedging anticipatory transactions are accounted for on a basis consistent with the relevant type of transaction. Where anticipatory transactions do not actually occur, related derivatives are either re-classified as trading or re-designated as a hedge of a non-trading item and accounted for accordingly.

# Notes to the accounts *(continued)*

## 2. Change in accounting policy

The Company has adopted Financial Reporting Standard 2 (revised 2004) "Accounting for subsidiary undertakings" ("FRS2") in these financial statements after its revision as a result of changes to the Companies Act 1985 made by statutory instrument SI2004/2947. The adoption of this revised standard represents a change in accounting policy and comparable figures have been restated in accordance with Financial Reporting Standard 28 "Corresponding Amounts". Details of the impact of the prior year adjustment are given in Note 13. As a result of the adoption of this standard, securitisation vehicles previously treated as quasi subsidiaries are now fully consolidated as subsidiaries on a line by line basis. These entities meet the revised definition of a subsidiary undertaking as set out in FRS2 (revised 2004) as dominant influence is exercised by the Company.

The Company has also adopted Financial Reporting Standard 25 "Financial Instruments: Disclosure and presentation" in these financial statements. The adoption of this standard has resulted in the presentation of detailed maturity profiles of Company borrowings.

# Notes to the accounts *(continued)*

## 3. 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 12 months to 31/12/05	UK Banking Services £000	UK Financing £000	Europe Financing £000	Intra-group items £000	Group total £000
Interest receivable	356,823	309,108	40,112	(40,112)	665,931
Fees and commissions receivable	23,828	182	–	(182)	23,828
Dealing profit	27	–	–	–	27
Total gross income	<u>380,678</u>	<u>309,290</u>	<u>40,112</u>	<u>(40,294)</u>	<u>689,786</u>
Results before taxation	<u>22,475</u>	<u>180</u>	<u>1,294</u>	<u>–</u>	<u>23,949</u>
Total assets	<u>6,616,778</u>	<u>5,191,614</u>	<u>1,433,863</u>	<u>(1,474,956)</u>	<u>11,767,299</u>
Net assets	<u>282,092</u>	<u>352</u>	<u>2,520</u>	<u>(107)</u>	<u>284,857</u>
Restated segmental results for 13½ months to 31/12/04	UK Banking Services £000	UK Financing £000	Europe Financing £000	Intra-group items £000	Group total £000
Interest receivable	404,684	233,093	45,240	(45,236)	637,781
Fees and commissions receivable	18,619	–	–	–	18,619
Dealing profit	125	–	–	–	125
Total gross income	<u>423,428</u>	<u>233,093</u>	<u>45,240</u>	<u>(45,236)</u>	<u>656,525</u>
Results before taxation	<u>8,521</u>	<u>142</u>	<u>1,426</u>	<u>(919)</u>	<u>9,170</u>
Total assets	<u>7,225,669</u>	<u>4,074,441</u>	<u>1,267,416</u>	<u>(1,284,212)</u>	<u>11,283,314</u>
Net assets	<u>250,669</u>	<u>126</u>	<u>1,670</u>	<u>(82)</u>	<u>252,383</u>

# Notes to the accounts *(continued)*

## 4. Administrative expenses

	12 months to 31 December 2005 £000	Restated 13½ months to 31 December 2004 £000
Staff costs:		
– Wages and salaries	21,903	22,175
– Social security costs	1,836	1,683
– Other pension costs	2,661	3,255
– Other administrative expenses	<u>35,213</u>	<u>45,561</u>
	<u>61,613</u>	<u>72,674</u>

The staff who manage the affairs of the Group are employed by both the ultimate parent undertaking and the Company. Their costs are recharged from the parent undertaking to the Company and the amounts recharged are set out above. There are no staff employed by the Company's subsidiary undertakings. The staff numbers during the period averaged 795 (2004 – 899).

## 5. Directors' remuneration

	12 months to 31 December 2005 £000	13½ months to 31 December 2004 £000
Aggregate emoluments	1,543	975
Amounts receivable under long-term incentive schemes	172	134

All of the executive directors are participants in a long-term incentive plan operated by SLAC. The benefits arising under the incentive plan are recorded in the period in which entitlement was determined.

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

	12 months to 31 December 2005 £000	13½ months to 31 December 2004 £000
Highest paid director		
Aggregate emoluments and benefits payable under long-term incentive schemes	745	465
Defined benefit pension scheme: Accrued pension at end of period	20	5

In addition, there were £19k of amounts (2004 – £13k) accrued in respect of unfunded pension arrangements with SLAC.

# Notes to the accounts *(continued)*

## 6. Pension costs

SLAC operates a pension scheme for its employees and those of its subsidiaries providing benefits based on final pensionable pay. The contributions to the scheme are determined on the basis of advice from qualified actuaries using the projected unit credit method. With effect from 16 November 2004 the UK defined benefit scheme was closed to new entrants and new employees are eligible to join a defined contribution scheme. As the UK scheme is now closed to new entrants, the projected unit credit method will result in the current service cost increasing as members of the scheme approach retirement.

FRS17 ("Retirement Benefits") became mandatory for accounting periods beginning on or after 1 January 2005. The Company's employees are part of the multi-employer scheme operated by SLAC. It is not practicable to split the assets and liabilities of the scheme, therefore the Company has applied paragraph 9(b) of FRS17 and accounts for its pension contributions as if they were made to a defined contribution scheme.

Full details of the parent undertaking's pension scheme are contained in the financial statements of SLAC.

## 7. Profit on ordinary activities before tax

	12 months to 31 December 2005 £000	13½ months to 31 December 2004 £000
Interest payable with respect to subordinated liabilities	15,049	14,416
Auditors' remuneration		
– Audit services	241	132
– Further assurance services	92	117
Depreciation and amortisation		
– Tangible fixed assets	16	230
– Intangible fixed assets	441	496
– Prepayments	54,757	58,396
	55,214	59,122
Profit on disposal of fixed assets	172	–
Charges under operating leases		
– Other	74	–

# Notes to the accounts *(continued)*

## 8. Tax on profit on ordinary activities

	12 months to 31 December 2005 £000	Restated 13½ months to 31 December 2004 £000
Current tax:		
– UK corporation tax on profits of the period	54	412
– Double tax relief	–	(370)
– Group relief in respect of prior year	–	(1,560)
– Overseas taxes	393	504
Total current tax	<u>447</u>	<u>(1,014)</u>
Deferred tax:		
– Origination and reversal of timing differences	6,448	3,813
– Movement in discount	(396)	(468)
Tax on profit on ordinary activities	<u>6,499</u>	<u>2,331</u>

There is no current year charge to tax in the Company due to prior year losses. There is a current year charge to UK tax in relation to the Lothian subsidiaries (see Note 13).

There is no deferred tax liability in the year due to the availability of tax losses. The discounted deferred tax asset of £5.5m (2004 – £11.5m) in respect of these losses and other timing differences has been recognised as an asset within the Group and the corresponding tax credit taken to the profit and loss account. The directors fully expect that there will be taxable profits in future years against which the deferred tax asset can be recovered. There is an additional deferred tax asset of £1,302k (2004 – £1,129k) which has not been recognised on the bad debt provision on the basis that it is unlikely to reverse in the foreseeable future.

A reconciliation of current tax on profit on ordinary activities at the standard UK corporation tax rate to the Group's actual current tax charge is as follows.

# Notes to the accounts *(continued)*

## 8. Tax on profit on ordinary activities *(continued)*

	12 months to 31 December 2005 £000	Restated 13½ months to 31 December 2004 £000
Profit on ordinary activities before tax	23,949	9,170
Profit on ordinary activities multiplied by the standard rate of corporation tax of 30%	7,185	2,751
Effects of:		
– Expenses not deductible for tax purposes	310	113
– Capital allowances for period in excess of depreciation	(295)	(388)
– Offsetting prior year losses	(6,294)	(2,006)
– Effect of group income	(464)	–
– Adjustment in respect of previous periods	–	(1,560)
– Higher/(lower) tax rate in overseas subsidiary	5	76
Current tax charge/(credit)	<u>447</u>	<u>(1,014)</u>

## 9. Profit for the year ended 31 December 2005

Of the consolidated profit for the 12 month period ended 31 December 2005, £16.4m (13½ month period ended 31 December 2004, £6.8m) has been dealt with in the accounts of the Company.

As permitted by Section 230 of the Companies Act 1985, the profit and loss account of the Company has not been presented separately.

# Notes to the accounts *(continued)*

## 10. Treasury bills

	Consolidated & Company			
	Carrying value		Market value	
	31 December 2005 £000	31 December 2004 £000	31 December 2005 £000	31 December 2004 £000
Investment securities:				
– Treasury bills and similar securities	<u>183,019</u>	<u>86,781</u>	<u>182,761</u>	<u>86,729</u>

	Consolidated & Company		
	Cost	Amortised discounts	Carrying value
	£000	£000	£000
Investment securities:			
At 31 December 2004	85,830	951	86,781
Acquisitions	430,102	4,687	434,789
Disposals and redemptions	<u>(333,943)</u>	<u>(4,608)</u>	<u>(338,551)</u>
At 31 December 2005	<u>181,989</u>	<u>1,030</u>	<u>183,019</u>
	2005	2004	
	£000	£000	
Unamortised discounts on treasury bills	<u>1,634</u>	<u>744</u>	

## 11. Loans and advances to banks

	Consolidated		Company	
	31 December 2005 £000	Restated	31 December 2005 £000	31 December 2004 £000
		31 December 2004 £000		
Repayable:				
– On demand	327,235	258,883	79,114	64,243
– Within 3 months	360,786	264,510	360,768	264,243
– Between 3 months and one year	16,993	7,265	16,993	7,265
	<u>705,014</u>	<u>530,658</u>	<u>456,875</u>	<u>335,751</u>

# Notes to the accounts *(continued)*

## 12. Loans and advances to customers

	Consolidated & Company	
	31 December 2005 £000	Restated 31 December 2004 £000
Remaining maturity:		
– Over 5 years	9,846,414	9,402,472
– 5 years or less but over 1 year	221,454	165,070
– 1 year or less but over 3 months	7,309	3,319
– 3 months or less excluding on demand	954	705
– On demand	1,100	577
Provisions (Note 14)	(5,007)	(4,200)
Suspended interest (Note 14)	(671)	(266)
	<u>10,071,553</u>	<u>9,567,677</u>

	Consolidated & Company	
	31 December 2005 £000	Restated 31 December 2004 £000
Loans and advances to customers on which interest is being placed in suspense:		
– Loans and advances before provisions	34,809	18,389
– Loans and advances after provisions	34,167	17,954

# Notes to the accounts *(continued)*

## 13. Securitisation

The Company securitises mortgage loans secured on residential property in England, Wales and Scotland via its Lothian master trust structure.

During the year, the Company sold a further portfolio of residential mortgage loans with a book value of £2.20 billion to Lothian Trustees Limited (the "Trust") Lothian Funding Limited ("Funding") and the Company each acquired, at book value, a beneficial interest in the trust property. Funding's beneficial interest was acquired on 24 February 2005, for £1.25 billion. Funding financed its acquisition through borrowing from its subsidiary company, Lothian Mortgages (No.4) plc. This company financed its loan to Funding via the issue of mortgage backed floating rate notes. A summary of securitisation activity to date through the Lothian programme is provided in the table below.

Securitisation Entity	Date of Securitisation	Gross debt issued £m	Subordinated loans made by Company £m
Lothian Mortgages (No.1) PLC	16 April 2003	1,000	14.0
Lothian Mortgages (No.2) PLC	23 September 2003	1,500	20.7
Lothian Mortgages (No.3) PLC	30 June 2004	1,250	4.4
Lothian Mortgages (No.4) PLC	24 February 2005	1,250	1.9

Post sale, the Company continues to administer the securitised mortgages under the terms of a servicing agreement with the Trust. The Company provides various representations and warranties, as set out in the offering circular, in relation to the characteristics of the mortgage assets at the point of sale and in relation to any subsequent transfer.

These special purpose vehicles ("SPVs") are part of a group of which Lothian Mortgages Holdings Limited is the parent company. The Company does not own directly or indirectly any of the share capital of these special purposes vehicles or of their parent. The nature of these entities, which are in substance controlled by the Company, mean that the Company retains substantially all the risks and rewards of ownership of the securitised mortgages. As such the securitised mortgages continue to be recognised within the Company accounts in accordance with applicable accounting standards, these special purpose vehicles are consolidated as subsidiaries of the Group.

The Company (as originator of the securitised advances) is not obliged to support any losses in respect of the securitised advances, except as described below, nor does it intend to do so. This is clearly stated in the offering circular subscribed to by the holders of the notes issued by the SPVs and in the legal agreements with the noteholders. Losses are shared equally in accordance with the beneficial interest 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 who are both mortgage and savings deposit holders).

# Notes to the accounts *(continued)*

## 13. **Securitisation** *(continued)*

The Company has made start-up loans to Funding, repayments of interest and capital on which are subordinated to the claims of the noteholders of the debt issued by the special purpose vehicles.

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 repayments 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.

The Company has entered into an interest rate swap with Funding. This swap converts fixed and variable interest flows from the mortgage loans held by the special purpose vehicles, into LIBOR based interest flows to match the interest flows payable on the floating rate notes.

The Company receives administration fees for servicing the mortgage portfolio and providing cash management services. In addition, any residual income arising after the claims of the bondholders and other creditors of these SPVs are met, is due to the Company as deferred purchase consideration for the residential mortgages sold to the Trust.

As at 31 December 2005, loans and advances to customers in the balance sheet of the Group and the Company included outstanding balances of securitised mortgages of £4,916m (2004 – £3,895m). Loans and advances to bank within the Group included £248m (2004 – £195m) held by the SPVs.

As at 31 December 2005, the maximum amount of the Company's exposure to credit losses on the securitised mortgages was £57m (2004 – £45m).

The interest rate risks and currency risks associated with the securitised mortgages and the related financial liabilities are detailed in Note 29.

# Notes to the accounts *(continued)*

## 13. Securitisation *(continued)*

### Change In Accounting Policy

The adoption of FRS2 (revised 2004) has caused a net impact of nil to the restated profit and loss account for 2004. A reconciliation between the original and restated comparatives is set out below.

	13½ months to 31 December 2004 £000	Adjustment for change in accounting policy £000	13½ months to 31 December 2004 Restated £000
– Interest receivable and similar income arising from debt securities and other fixed income securities	69,841	–	69,841
– Other interest receivable and similar income	410,102	157,838	567,940
Interest payable	<u>(348,651)</u>	<u>(157,616)</u>	<u>(506,267)</u>
Net interest income	131,292	222	131,514
Fees and commissions receivable	18,619	–	18,619
Fees and commissions payable	(8,203)	(74)	(8,277)
Dealing profit	<u>125</u>	<u>–</u>	<u>125</u>
Net operating income	141,833	148	141,981
Administrative expenses	(72,568)	(106)	(72,674)
Depreciation and amortisation	(59,122)	–	(59,122)
Other operating charges	(213)	–	(213)
Provision for bad and doubtful debts	<u>(802)</u>	<u>–</u>	<u>(802)</u>
Profit on ordinary activities before tax	9,128	42	9,170
Tax on profit on ordinary activities	(2,289)	(42)	(2,331)
Profit for period	<u>6,839</u>	<u>–</u>	<u>6,839</u>

# Notes to the accounts *(continued)*

## 14. Provisions for bad and doubtful debts

	Specific £000	Consolidated & Company General £000	Total £000
At 31 December 2004	436	3,764	4,200
Charge against profits	289	574	863
Amounts written off	(56)	–	(56)
At 31 December 2005	<u>669</u>	<u>4,338</u>	<u>5,007</u>
			£000
Interest in suspense:			
At 31 December 2004			266
Interest suspended during the period			<u>405</u>
At 31 December 2005			<u>671</u>

Included in the bad and doubtful debt provision is £1.20m in respect of securitised advances (2004 – £1.02m).

Included within suspended interest is £43k in respect of securitised advances (2004 – £48k).

# Notes to the accounts *(continued)*

## 15. Debt securities

	Consolidated & Company			
	Carrying value		Market value	
	31 December 2005 £000	31 December 2004 £000	31 December 2005 £000	31 December 2004 £000
Issued by public bodies				
Investment securities:				
– Government securities	<u>78,164</u>	<u>131,855</u>	<u>78,565</u>	<u>132,053</u>
	<u>78,164</u>	<u>131,855</u>	<u>78,565</u>	<u>132,053</u>
	Market value		Cost	
	31 December 2005 £000	31 December 2004 £000	31 December 2005 £000	31 December 2004 £000
Issued by other issuers				
Other securities:				
– Bank and building society certificates of deposit	193,236	387,758	191,572	385,304
– Other debt securities	<u>406,654</u>	<u>436,951</u>	<u>404,749</u>	<u>434,681</u>
	<u>599,890</u>	<u>824,709</u>	<u>596,321</u>	<u>819,985</u>

All debt securities are listed.

	Consolidated & Company	
	31 December 2005 £000	31 December 2004 £000
Due within 1 year	428,946	595,057
Due 1 year and over	<u>249,108</u>	<u>361,507</u>
	<u>678,054</u>	<u>956,564</u>
Unamortised premiums on investment securities	<u>3,164</u>	<u>6,855</u>

# Notes to the accounts *(continued)*

## 15. Debt securities *(continued)*

	Consolidated & Company		
	Cost £000	Amortised Premiums £000	Carrying value £000
Investment securities:			
At 31 December 2004	137,546	(5,691)	131,855
Disposals and redemptions	(53,728)	3,728	(50,000)
Amortisation of premiums	–	(3,691)	(3,691)
At 31 December 2005	83,818	(5,654)	78,164

## 16. Shares in group undertakings

As at 31 December 2004	£000	12
Additions		–
As at 31 December 2005		12

All shares held by the Company in Group undertakings are in the subsidiary undertakings and are unlisted.

The subsidiary undertakings are as follows:

Subsidiary	Percentage of equity capital and voting rights held	Country of incorporation	Principal activity	Year end
Standard Life Funding B.V.	100%	Netherlands	Financing	31–Dec
Lothian Mortgages (No.1) Plc	0%	England & Wales	Financing	31–Dec
Lothian Mortgages (No.2) Plc	0%	England & Wales	Financing	31–Dec
Lothian Mortgages (No.3) Plc	0%	England & Wales	Financing	31–Dec
Lothian Mortgages (No.4) Plc	0%	England & Wales	Financing	31–Dec
Lothian Funding Limited	0%	England & Wales	Financing	31–Dec
Lothian Funding (No.2) Limited	0%	England & Wales	Financing	31–Dec
Lothian Conduit (No.1) Limited	0%	England & Wales	Financing	31–Dec
Lothian Mortgages Holdings Limited	0%	England & Wales	Financing	31–Dec
Lothian Options Limited	0%	England & Wales	Financing	31–Dec
Lothian Trustees Limited	0%	Jersey	Financing	31–Dec

The Lothian subsidiary undertakings, which were previously accounted for as quasi subsidiaries, are now consolidated as full subsidiaries within the Group as a result of changes to FRS2 “Accounting For Subsidiary Undertakings” as detailed in Note 2.

# Notes to the accounts *(continued)*

## 17. Fixed assets

	Consolidated & Company		
	Tangible assets	Intangible assets	Total
	Computers & other equipment	Licences	
	£000	£000	£000
Cost or valuation:			
At 31 December 2004	835	1,763	2,598
Additions	70	–	70
Disposals	(102)	–	(102)
At 31 December 2005	<u>803</u>	<u>1,763</u>	<u>2,566</u>
Depreciation:			
At 31 December 2004	755	936	1,691
Charge for the period	67	441	508
Disposals	(19)	–	(19)
At 31 December 2005	<u>803</u>	<u>1,377</u>	<u>2,180</u>
Net book value:			
At 31 December 2005	<u>–</u>	<u>386</u>	<u>386</u>
At 31 December 2004	<u>80</u>	<u>827</u>	<u>907</u>

## 18. Other assets

	Consolidated		Company	
	31 December 2005 £000	31 December 2004 £000	31 December 2005 £000	Restated 31 December 2004 £000
Market debtors – unsettled trades	37,083	45,000	37,083	45,000
Deferred tax asset	5,476	11,528	5,476	11,528
Subordinated loan	–	–	41,000	39,100
Other assets	<u>8,450</u>	<u>8,928</u>	<u>8,500</u>	<u>8,928</u>
	<u>51,009</u>	<u>65,456</u>	<u>92,059</u>	<u>104,556</u>

# Notes to the accounts *(continued)*

## 18. Other assets *(continued)*

	Consolidated & Company	
	31 December 2005 £000	31 December 2004 £000
Deferred tax asset:		
Excess depreciation over capital allowances	1,017	1,337
Tax losses carried forward	4,612	10,865
Other timing differences	125	–
Undiscounted deferred tax asset	<u>5,754</u>	<u>12,202</u>
Discount	<u>(278)</u>	<u>(674)</u>
Discounted deferred tax asset	<u>5,476</u>	<u>11,528</u>
Opening deferred tax asset	11,528	14,873
Movement in period	<u>(6,052)</u>	<u>(3,345)</u>
Closing deferred tax asset	<u>5,476</u>	<u>11,528</u>

## 19. Prepayments and accrued income

	Consolidated		Company	
	31 December 2005 £000	Restated 31 December 2004 £000	31 December 2005 £000	Restated 31 December 2004 £000
Prepayments	19,726	21,818	19,726	21,818
Accrued income	<u>58,538</u>	<u>53,453</u>	<u>30,860</u>	<u>46,089</u>
	<u>78,264</u>	<u>75,271</u>	<u>50,586</u>	<u>67,907</u>

Included in prepayments above are unamortised mortgage incentive costs of £3.0m (2004 – £3.7m). If all mortgage incentive costs had been written off in the period in which they were incurred, £0.1m more (2004 – £0.1m more) would have been charged to the profit and loss account in 2005, decreasing the profit after tax for the period to £17.4m (2004 – decreasing the profit to £6.7m).

# Notes to the accounts *(continued)*

## 20. Deposits by banks

	Consolidated & Company	
	31 December 2005 £000	31 December 2004 £000
Repayable:		
– 3 months or less but not repayable on demand	369,226	378,591
– Between 3 months and 1 year	490,706	480,507
– 5 years or less but over 1 year	16,208	7,863
	<u>876,140</u>	<u>866,961</u>

## 21. Customer accounts

	Consolidated & Company	
	31 December 2005 £000	31 December 2004 £000
Repayable:		
– On demand	2,194,661	2,259,124
– 3 months or less but not repayable on demand	1,782,712	1,797,485
– Between 3 months and 1 year	173,692	141,750
– 5 years or less but over 1 year	59,807	39,935
	<u>4,210,872</u>	<u>4,238,294</u>

# Notes to the accounts *(continued)*

## 22. Debt securities in issue

	Consolidated		Company	
	31 December 2005 £000	Restated 31 December 2004 £000	31 December 2005 £000	31 December 2004 £000
Bonds and medium term notes	187,347	593,507	–	–
Mortgage backed securities	4,027,983	3,343,504	–	–
Other debt securities	<u>1,780,092</u>	<u>1,627,652</u>	<u>785,500</u>	<u>940,000</u>
	<u>5,995,422</u>	<u>5,564,663</u>	<u>785,500</u>	<u>940,000</u>
Maturity analysis:				
Bonds and medium term notes:				
– 3 months or less	–	199,987	–	–
– Between 3 months and 1 year	15,000	210,169	–	–
– Between 1 year and 2 years	3,080	85,101	–	–
– Between 2 years and 5 years	8,590	11,670	–	–
– Over 5 years	<u>160,676</u>	<u>86,580</u>	–	–
	<u>187,346</u>	<u>593,507</u>	–	–
Mortgage backed securities:				
– Over 5 years	<u>4,027,983</u>	<u>3,343,504</u>	–	–
	<u>4,027,983</u>	<u>3,343,504</u>	–	–
Other debt securities in issue:				
– 3 months or less	1,499,031	1,327,514	581,000	711,000
– Between 3 months and 1 year	281,062	285,138	204,500	214,000
– Between 1 year and 2 years	–	15,000	–	15,000
	<u>1,780,093</u>	<u>1,627,652</u>	<u>785,500</u>	<u>940,000</u>
	<u>5,995,422</u>	<u>5,564,663</u>	<u>785,500</u>	<u>940,000</u>

The Company issues sterling denominated certificates of deposit in the UK. The Group also issues short term commercial paper in the US and Euro CP markets and medium term notes via its subsidiary undertaking. Additional financing activity is undertaken through the issue of mortgage backed securities via the Lothian securitisation programme as detailed in Note 13.

# Notes to the accounts *(continued)*

## 23. Other Liabilities

	Consolidated		Company	
	31 December 2005 £000	Restated 31 December 2004 £000	31 December 2005 £000	Restated 31 December 2004 £000
Due within 1 year				
Taxation	5,246	2,705	5,191	2,617
Amount due to group companies	520	9,004	1,017,424	1,106,812
Other liabilities	907	649	803	594
	<u>6,673</u>	<u>12,358</u>	<u>1,023,418</u>	<u>1,110,023</u>
Due in 1-5 years				
Amount due to subsidiary undertakings	–	–	11,670	96,771
	<u>–</u>	<u>–</u>	<u>11,670</u>	<u>96,771</u>
Due after more than 5 years				
Amount due to subsidiary undertakings	–	–	4,261,020	3,309,901
	<u>–</u>	<u>–</u>	<u>4,261,020</u>	<u>3,309,901</u>
	<u>6,673</u>	<u>12,358</u>	<u>5,296,108</u>	<u>4,516,695</u>

Included within amounts due to group companies is an amount of £nil (2004 £1.6m) in respect of prior period group relief.

# Notes to the accounts *(continued)*

## 24. Subordinated Liabilities

	Consolidated		Company	
	31 December 2005 £000	31 December 2004 £000	31 December 2005 £000	31 December 2004 £000
Loan notes redeemable 29 June 2015	263,201	–	–	–
Undated loan capital	–	230,000	–	230,000

On 29 June 2005, the £230m of undated loan capital in issue was redeemed at par and SLF 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 SLF BV on the subordinated notes. The rights and claims of all subordinated noteholders are subordinated to the claims of all senior creditors of both SLF 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 SLB BV, although there is an interest deferral clause exercisable at the sole discretion of the Company or SLF BV. Interest non payment, subject to the interest deferral clause, is the only event of default on the subordinated notes.

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.

On 29 June 2005, a £100 subordinated loan note was issued by the Company to SLAC. The rights and claims of SLAC 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)*

## 25. Called up share capital

	Consolidated & Company	
	31 December 2005 £000	31 December 2004 £000
Authorised:		
Ordinary shares of £1 each	<u>386,775</u>	<u>500,000</u>
Issued, allotted and fully paid:		
Ordinary shares of £1 each	<u>271,775</u>	<u>370,000</u>

On 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.

All shares are beneficially owned by the parent undertaking, SLAC.

## 26. Reserves

	Consolidated £000	Company £000
Profit and loss account:		
At 31 December 2004	(117,928)	(119,205)
Profit for the period	17,450	16,297
Capital reduction (see Note 25)	<u>113,225</u>	<u>113,225</u>
	<u>12,747</u>	<u>10,317</u>
Reserves:		
At 31 December 2004	311	–
Exchange gain on translation of foreign subsidiary	<u>24</u>	–
At 31 December 2005	<u>335</u>	–

Included within profit and loss reserves are undistributable reserves of £5m (2004 – nil).

# Notes to the accounts *(continued)*

## 27. Reconciliation of movements in shareholder's funds

	Consolidated		Company	
	31 December 2005 £000	31 December 2004 £000	31 December 2005 £000	31 December 2004 £000
Opening shareholder's funds	252,383	245,488	250,795	243,960
Gain on translation of foreign subsidiary	24	56	–	–
Profit attributable to members	17,450	6,839	16,297	6,835
Share issue (see Note 25)	15,000	–	15,000	–
Closing shareholder's funds	<u>284,857</u>	<u>252,383</u>	<u>282,092</u>	<u>250,795</u>

## 28. Other commitments and memorandum terms

The Group had commitments due in the next year under non-cancellable operating leases as set out below.

	Consolidated & Company	
	12 months to 31 December 2005 £000	13½ months to 31 December 2004 £000
– Leases maturing within 1 year	92	–
– Leases maturing in 1 to 5 years	56	–
	<u>148</u>	<u>–</u>

The Company has guaranteed the liabilities of its subsidiary undertaking, SLF BV, in connection with the subsidiary undertaking's issuance of commercial paper, medium term notes and subordinated notes. The guarantee for commercial paper and medium term notes is in respect of notes issued and is for a maximum of US dollar 2 billion and Euro 4 billion in relation to the US commercial paper and Euro commercial paper programmes respectively, and Euro 4 billion in respect of the medium term note programme. There are Sterling 265 million subordinated notes in issue and under the terms of a Subordinated Deed of Guarantee, the Company guarantees the payment of all sums payable by SLF BV under the Subordinated Notes.

Commitments to lend disclosed on the face of the balance sheets relate to the total undrawn mortgage loan facilities available to customers at the balance sheet date.

# Notes to the accounts *(continued)*

## 29. Financial instruments

A description of the risks faced by the Group is given on page 4. All the derivatives relate to the non-trading book of the Group.

### Interest rate sensitivity gap analysis

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 below summarises these repricing mismatches on the Group's non-trading book as at 31 December 2005. Items are allocated to time bands by reference to the earlier of the next contractual interest rate repricing date and the maturity date.

As at 31 December 2005

	Not more than three months £000	More than three months but not more than six months £000	More than six months but not more than one year £000	More than one year but not more than five years £000	Five years or more £000	Non-interest bearing £000	Total £000
<b>Assets:</b>							
Treasury bills and other eligible bills	133,872	49,147	–	–	–	–	183,019
Loans and advances to banks	688,021	16,993	–	–	–	–	705,014
Loans and advances to customers	7,080,971	126,041	329,817	2,350,873	183,851	–	10,071,553
Debt securities	574,654	25,236	25,590	52,574	–	–	678,054
Other assets	–	–	–	–	–	129,659	129,659
<b>Total assets</b>	<b>8,477,518</b>	<b>217,417</b>	<b>355,407</b>	<b>2,403,447</b>	<b>183,851</b>	<b>129,659</b>	<b>11,767,299</b>
<b>Liabilities:</b>							
Deposits by banks	369,226	405,911	84,795	16,208	–	–	876,140
Customer accounts	3,977,374	83,502	90,189	59,807	–	–	4,210,872
Debt securities in issue	5,699,360	248,562	47,500	–	–	–	5,995,422
Subordinated liabilities	–	–	–	–	263,201	–	263,201
Other liabilities	–	–	–	–	–	136,807	136,807
Shareholder's funds	–	–	–	–	–	284,857	284,857
<b>Total liabilities</b>	<b>10,045,960</b>	<b>737,975</b>	<b>222,484</b>	<b>76,015</b>	<b>263,201</b>	<b>421,664</b>	<b>11,767,299</b>
Off balance sheet items	2,036,415	(125,000)	(140,000)	(1,970,515)	199,100	–	–
Interest rate sensitivity gap	467,973	(645,558)	(7,077)	356,917	119,750	(292,005)	–
Cumulative gap	467,973	(177,585)	(184,662)	172,255	292,005	–	–

# Notes to the accounts *(continued)*

## 29. Financial instruments *(continued)*

As at 31 December 2004 Restated

	Not more than three months £000	More than three months but not more than six months £000	More than six months but not more than one year £000	More than one year but not more than five years £000	Five years or more £000	Non-interest bearing £000	Total £000
<b>Assets:</b>							
Treasury bills and other eligible bills	62,786	23,995	–	–	–	–	86,781
Loans and advances to banks	523,393	7,265	–	–	–	–	530,658
Loans and advances to customers	7,764,278	93,705	35,589	1,536,628	137,477	–	9,567,677
Debt securities	824,709	–	51,729	80,126	–	–	956,564
Other assets	–	–	–	–	–	141,634	141,634
<b>Total assets</b>	<b>9,175,166</b>	<b>124,965</b>	<b>87,318</b>	<b>1,616,754</b>	<b>137,477</b>	<b>141,634</b>	<b>11,283,314</b>
<b>Liabilities:</b>							
Deposits by banks	378,591	358,819	121,688	1,100	6,763	–	866,961
Customer accounts	4,056,609	74,663	67,087	39,935	–	–	4,238,294
Debt securities in issue	5,162,945	285,138	–	30,000	86,580	–	5,564,663
Subordinated liabilities	230,000	–	–	–	–	–	230,000
Other liabilities	–	–	–	–	–	131,013	131,013
Shareholder's funds	–	–	–	–	–	252,383	252,383
<b>Total liabilities</b>	<b>9,828,145</b>	<b>718,620</b>	<b>188,775</b>	<b>71,035</b>	<b>93,343</b>	<b>383,396</b>	<b>11,283,314</b>
Off balance sheet items	1,261,785	55,000	–	(1,338,100)	21,315	–	–
Interest rate sensitivity gap	608,806	(538,655)	(101,457)	207,619	65,449	(241,762)	–
Cumulative gap	608,806	70,151	(31,306)	176,313	241,762	–	–

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.

# Notes to the accounts *(continued)*

## 29. Financial instruments *(continued)*

### Currency risk

#### Transactional currency exposures

Having taken into account the forward contracts and the cross currency swaps entered into to manage these currency exposures the Group has no significant transactional currency exposures. The net assets at 31 December 2005 of £285m (2003 – £252m) were predominantly sterling denominated.

#### Hedging

Derivatives are measured on a basis consistent with the assets or liabilities being hedged. Where used to hedge debt issues, the translation of the debt is recorded at the contracted rate of the associated hedging derivative. The gains and losses on these instruments (arising from changes in fair value) are recorded in line with the treatment applied to the underlying transaction. They are either not recognised at all or are recognised and carried forward in the balance sheet; then, when the hedged transaction occurs, the gain or loss is recognised in the profit and loss account at the same time as the hedged item. Where non-trading derivatives are reclassified as trading or where non-trading derivatives are terminated prior to the end of the life of the asset, liability or cashflow being hedged, they are measured at fair value. Any gains or losses are deferred and amortised into interest income or expense over the remaining life of the item previously being hedged.

Non-trading derivatives used to hedge the reset risk within mortgage backed securities are accounted for on a mark to market basis. As the fair value of these instruments was immaterial at the period end no further disclosures have been made.

The table below summarises the unrecognised gains and losses on hedges at 31 December 2005 and the movements therein during the period. The table shows the gains and losses on off balance sheet non-trading derivatives used for hedging by the Group. The gains and losses do not therefore represent absolute gains or losses expected by the Group, as they will be substantially offset by corresponding gains or losses on the underlying balance sheet asset or liability being hedged.

<i>Unrecognised gains and losses on hedges 31/12/2005</i>	Gains £000	Losses £000	Total net gains/(losses) £000
Unrecognised gains and losses on hedges at 31 December 2004	6,777	(18,609)	(11,832)
Of which recognised in the period to 31 December 2005	<u>(55,357)</u>	<u>93,594</u>	<u>38,237</u>
Gains and losses arising before 31 December 2004 not recognised in the period to 31 December 2005	(48,580)	74,985	26,405
Gains and losses arising in the period to 31 December 2005 not recognised in that period	<u>55,473</u>	<u>(94,402)</u>	<u>(38,929)</u>
Unrecognised gains and losses on hedges at 31 December 2005	<u>6,893</u>	<u>(19,417)</u>	<u>(12,524)</u>
Of which expected to be recognised in the year to 31 December 2006	<u>5,235</u>	<u>(44,724)</u>	<u>(39,489)</u>

There are deferred gains of £15.3m (2004 – £12.5m) and deferred losses of £13.8m (2004 – £3.3m) carried forward in the balance sheet that are expected to be recognised in the profit and loss account during the year to 31 December 2006.

# Notes to the accounts *(continued)*

## 29. Financial instruments *(continued)*

<i>Unrecognised gains and losses on hedges 31/12/2004</i>	Gains £000	Losses £000	Total net gains/(losses) £000
Unrecognised gains and losses on hedges at 16 November 2003	13,027	(2,084)	10,943
Of which recognised in the period to 31 December 2004	<u>(14,794)</u>	<u>71,081</u>	<u>56,287</u>
Gains and losses arising before 16 November 2003 not recognised in the period to 31 December 2004	(1,767)	68,997	67,230
Gains and losses arising in the period to 31 December 2004 not recognised in that period	<u>8,544</u>	<u>(87,606)</u>	<u>(79,062)</u>
Unrecognised gains and losses on hedges at 31 December 2004	<u>6,777</u>	<u>(18,609)</u>	<u>(11,832)</u>
Of which expected to be recognised in the year to 31 December 2005	<u>55,357</u>	<u>(93,594)</u>	<u>(38,237)</u>

### **Fair values of financial assets and financial liabilities**

Set out below is a comparison by category of book values and fair values of all of the Group's non-trading financial assets and financial liabilities.

	Non-trading fair value 31 December 2005 £000	Non-trading book value 31 December 2005 £000	Non-trading fair value 31 December 2004 £000	Non-trading book value 31 December 2004 £000
<b>Assets:</b>				
Treasury bills and other eligible bills	182,761	183,019	86,729	86,781
Debt securities	678,455	678,054	956,762	956,564
Derivatives (see non-trading derivatives below)	37,626	30,733	16,523	9,746
<b>Liabilities:</b>				
Debt securities in issue	1,959,373	1,949,034	2,214,129	2,200,679
Mortgage backed securities	4,027,983	3,986,528	3,343,504	3,513,489
Subordinated liabilities	263,201	263,201	230,000	230,000
Derivatives (see non-trading derivatives below)	109,704	90,287	224,567	205,958

No financial instruments were held or issued for trading purposes.

Market values have been used to determine the fair value of all debt securities, swaps and forward foreign currency contracts. Due to the short-term nature or repricing periods of all other financial assets and liabilities the directors do not consider that there is any significant difference between the fair value and the book value.

# Notes to the accounts *(continued)*

## 29. Financial instruments *(continued)*

### Derivatives held for non-trading purposes

At 31 December 2005 the notional principal amounts, fair values and book values of non-trading instruments entered into with third parties were as follows:

	Notional principal amount £000	Period-end positive fair value £000	Period-end positive book value £000	Period-end negative fair value £000	Period-end negative book value £000
Foreign exchange derivatives:					
Forward foreign exchange	918,323	10,603	9,367	(1,518)	(3,357)
Cross currency swaps	2,095,317	21,908	21,253	(85,296)	(85,424)
	<u>3,013,640</u>	<u>32,511</u>	<u>30,620</u>	<u>(86,814)</u>	<u>(88,781)</u>
Interest rate derivatives:					
Interest rate swaps	5,634,950	4,764	113	(22,210)	(1,486)
Forward rate agreements	60,000	351	–	–	–
	<u>5,694,950</u>	<u>5,115</u>	<u>113</u>	<u>(22,210)</u>	<u>(1,486)</u>
Equity derivatives:					
Equity swaps	4,446	–	–	(680)	(20)
Total non-trading derivatives	<u>8,713,036</u>	<u>37,626</u>	<u>30,733</u>	<u>(109,704)</u>	<u>(90,287)</u>

# Notes to the accounts *(continued)*

## 29. Financial instruments *(continued)*

### *Derivatives held for non-trading purposes (continued)*

At 31 December 2004

	Notional principal amount £000	Period-end positive fair value £000	Period-end positive book value £000	Period-end negative fair value £000	Period-end negative book value £000
Foreign exchange derivatives:					
Forward foreign exchange	842,261	12,145	7,465	3,043	4,061
Cross currency swaps	2,186,529	1,497	2,005	208,723	200,956
	<u>3,028,790</u>	<u>13,642</u>	<u>9,470</u>	<u>211,766</u>	<u>205,017</u>
Interest rate derivatives:					
Interest rate swaps	2,856,900	2,604	276	11,982	919
Forward rate agreements	60,000	277	–	–	–
	<u>2,916,900</u>	<u>2,881</u>	<u>276</u>	<u>11,982</u>	<u>919</u>
Equity derivatives:					
Equity swaps	4,446	–	–	819	22
Total non-trading derivatives	<u>5,950,136</u>	<u>16,523</u>	<u>9,746</u>	<u>224,567</u>	<u>205,958</u>

# Notes to the accounts *(continued)*

## 29. Financial instruments *(continued)*

### Maturity of notional principal amounts

At 31 December 2005 the notional principal amounts, by residual maturity, of the Group's non-trading derivatives were as follows:

	One year or less £000	Over one year but not more than five years £000	Over five years £000	Total £000
Foreign exchange derivatives:				
Forward foreign exchange	918,323	–	–	918,323
Cross currency swaps	131,126	1,877,611	86,580	2,095,317
	<u>1,049,449</u>	<u>1,877,611</u>	<u>86,580</u>	<u>3,013,640</u>
Interest rate derivatives:				
Interest rate swaps	515,000	4,789,050	330,900	5,634,950
Forward rate agreements	60,000	–	–	60,000
	<u>575,000</u>	<u>4,789,050</u>	<u>330,900</u>	<u>5,694,950</u>
Equity derivatives:				
Equity swaps	–	4,446	–	4,446
Total non-trading derivatives	<u>1,624,449</u>	<u>6,671,107</u>	<u>417,480</u>	<u>8,713,036</u>

# Notes to the accounts *(continued)*

## 29. Financial instruments *(continued)*

### Maturity of notional principal amounts *(continued)*

At 31 December 2004 the notional principal amounts, by residual maturity, of the Group's non-trading derivatives were as follows:

	One year or less £000	Over one year but not more than five years £000	Over five years £000	Total £000
Foreign exchange derivatives:				
Forward foreign exchange	842,261	–	–	842,261
Cross currency swaps	339,938	1,753,376	93,215	2,186,529
	<u>1,182,199</u>	<u>1,753,376</u>	<u>93,215</u>	<u>3,028,790</u>
Interest rate derivatives:				
Interest rate swaps	1,275,000	1,510,000	71,900	2,856,900
Forward rate agreements	–	60,000	–	60,000
	<u>1,275,000</u>	<u>1,570,000</u>	<u>71,900</u>	<u>2,916,900</u>
Equity derivatives:				
Equity swaps	–	4,446	–	4,446
Total non-trading derivatives	<u>2,457,199</u>	<u>3,327,822</u>	<u>165,115</u>	<u>5,950,136</u>

### Maturity analyses of net replacement cost

At 31 December 2005

	One year or less £000	Over one year but not more than five years £000	Over five years £000	Total £000
Foreign exchange derivatives	15,440	17,071	–	32,511
Interest rate derivatives	461	1,020	3,634	5,115
Equity derivatives	–	–	–	–
	<u>15,901</u>	<u>18,091</u>	<u>3,634</u>	<u>37,626</u>

# Notes to the accounts *(continued)*

## 29. Financial instruments *(continued)*

### *Maturity analyses of net replacement cost (continued)*

At 31 December 2004

	One year or less £000	Over one year but not more than five years £000	Over five years £000	Total £000
Foreign exchange derivatives	13,642	–	–	13,642
Interest rate derivatives	308	2,573	–	2,881
Equity derivatives	–	–	–	–
	<u>13,950</u>	<u>2,573</u>	<u>–</u>	<u>16,523</u>

# Notes to the accounts *(continued)*

## 30. Arrangements with directors

As at 31 December 2005, the aggregate amounts outstanding under transactions, arrangements and agreements entered into on normal commercial terms by the Company with directors of the Company and SLAC were:

	Number of persons	£000
Directors' loans	3	435

## 31. Related party transactions

The Group has taken advantage of the exemption under Paragraph 3(c) of Financial Reporting Standard 8 from disclosing transactions with other undertakings of the Standard Life Group.

## 32. Parent undertaking

The Company is a wholly owned subsidiary of SLAC.

Copies of the accounts of SLAC can be obtained at Standard Life House, 30 Lothian Road, Edinburgh EH1 2DH.

# Audit report

## Independent auditors' report to the members of Standard Life Bank Limited

We have audited the Group and parent Company financial statements (the "financial statements") of Standard Life Bank for the year ended 31 December 2005, which comprise the Group Profit and Loss Account, the Group and Company Balance Sheets, the Group Statement of Total Recognised Gains and Losses 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 United Kingdom accounting standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

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

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if 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 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. This other information comprises only the Directors' Report.

We consider the implications for our report if we become aware of any apparent misstatement or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

## Basis of audit opinion

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

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

# Audit report *(continued)*

## Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Group's and the parent Company's affairs as at 31 December 2005 and of the Group's profit for the year then ended;
- have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP  
Chartered Accountants and Registered Auditors  
Edinburgh  
21 March 2006

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Standard Life Bank Limited is a company registered in Scotland (number SC173685), Registered Office: Standard Life House, 30 Lothian Road, Edinburgh EH1 2DH and is authorised and regulated by the Financial Services Authority. Standard Life Bank Limited is a wholly owned subsidiary of The Standard Life Assurance Company and is a member of the Standard Life group of companies.

*Telephone calls may be monitored and recorded to help us improve customer service.*

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