Company Registration No: 00042133

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

DIRECTORS' REPORT AND FINANCIAL STATEMENTS

31 DECEMBER 2006

Group Secretariat
The Royal Bank of Scotland Group plc
3 Princess Way
Redhill
Surrey
RH1 1NP

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

CONTENTS **PAGES**

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

OFFICERS AND PROFESSIONAL ADVISERS

DIRECTORS	A D Cornish C R Crawford I Falconer M A Fisher M A Hesketh N C McLuskie C P Sullivan
SECRETARY	P A Hutchings
REGISTERED OFFICE	Crown House 145 City Road London EC1V 1LP
AUDITORS	Deloitte & Touche LLP London

Registered in England and Wales

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

DIRECTORS' REPORT

The directors present their report and the audited financial statements for the year ended 31 December 2006

The directors note with sadness the death of Mr P J Atkinson, Joint Company Secretary, on 21 January 2006

ACTIVITIES AND BUSINESS REVIEW

The principal activity of the Company continues to be the provision of general insurance

The Company is a member of The Royal Bank of Scotland Group plc which provides the Company with direction and access to all central resources it needs and determines policies in all key areas such as finance, risk, human resources or environment The directors have reviewed these policies and consider them to be appropriate The Company is also a member of the Insurance Division of The Royal Bank of Scotland Group plc and benefits from services provided by specialist team and risk management procedures and controls which are applied across the Insurance Division The annual reports of The Royal Bank of Scotland Group plc review these matters on a group basis Copies can be obtained from Group Secretariat, RBS Gogarburn, Edinburgh, EH12 1HQ, the Registrar of Companies or through the Group's web site at rbs com

Review of the year

Business review

The directors are satisfied with the Company's performance in the year The Company will be guided by its immediate parent company in seeking further opportunities for growth

A dividend of £nil was paid in 2006 (2005 £nil)

Financial performance

The Company's financial performance is presented in the Income Statement on page 6

Net earned premiums grew by £58 5 million and other income decreased by £14 5 million Net claims increased by £36 5 million Expenses decreased by £2 9 million The profit for the year was £45 0 million, an increase of 38% over 2005

The overall net loss ratio for the year remained constant at 72% in 2005 and 2006 The combined ratio in the year decreased from 108% in 2005 to 104% in 2006

At the end of the year, the financial position showed total assets of £2,298 0 million, including investments of £1,554 4 million which are income-generating assets, together representing an increase of 8 8% The net book value of property, plant and equipment was £0 5 million compared with £0 6 million at the end of the previous year

Other matters

The Company is funded by facilities from members of The Royal Bank of Scotland Group plc It seeks to minimise its exposure to external financial risks Further information on insurance and financial risk management policies and exposures is disclosed in note 4

SHARE CAPITAL

On 16 May 2006 the authorised share capital of the Company was increased from £255,000,000 to £275,000,000 by the creation of £20,000,000 new ordinary shares of £1 00, each ranking pari passu with the existing 255,000,000 ordinary shares

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

DIRECTORS' REPORT (Continued)

DIRECTORS AND SECRETARY

The present directors and secretary, who have served throughout the year except where noted below, are listed on page 1

From 1 January 2006 to date the following changes have taken place

	Appointed	Resigned
Directors		
B Higgins		5 January 2006
M A Hesketh	23 January 2006	
I H Chippendale		8 November 2006
A E Court		8 November 2006
C P Sullivan	14 November 2006	
R D Houghton		22 January 2007
A D Cornish	26 January 2007	

DIRECTORS' RESPONSIBILITIES

The Directors are required by the Companies Act 1985 to prepare a directors' report and financial statements for each financial year and have elected to prepare them in accordance with International Financial Reporting Standards, as adopted by the European Union They are responsible for preparing financial statements that present fairly the financial position, financial performance, and cash flows of the Company In preparing those 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 whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business

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

DISCLOSURE OF INFORMATION TO AUDITORS

Each of the directors of the Company holding office at the date of approval of this report confirm that

(1) so far as each of the directors are aware, there is no relevant audit information of which the Company's auditors are unaware, and

(2) so far as each of the directors are aware they have taken all the steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information

This confirmation is given and shall be interpreted in accordance with the provisions of S 234ZA of the Companies Act 1985

DIRECTORS' INDEMNITIES

In terms of Section 309C of the Companies Act 1985 (as amended), Mr I H Chippendale, Miss A E Court, Mr C R Crawford, Mr I Falconer, Mr M A Fisher, Mr M A Hesketh, Mr B Higgins, Mr R D Houghton, Mr N C McLuskie and Mr C P Sullivan had been granted Qualifying Third Party Indemnity Provisions by The Royal Bank of Scotland Group plc

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

DIRECTORS' REPORT (Continued)

DIRECTORS' INTERESTS

No director had an interest in the shares of the Company

The following director was beneficially interested in the ordinary shares of The Royal Bank of Scotland Group plc

	As at 1 January 2006	As at 31 December 2006
C R Crawford	4,890	13,468

Options to subscribe for ordinary shares of 25p each in The Royal Bank of Scotland Group plc granted to and exercised during the period by the following director of the Company and connected persons are

	As at 1 January 2006	Granted during the period Options	Price (p)	Exercised during the period Options	Price (p)	As at 31 December 2006
C R Crawford	23,224	13,499	1852	-	-	36,723

No director had an interest in any of the preference shares of The Royal Bank of Scotland Group plc during the year to 31 December 2006

The interests of Mr I Falconer, Mr M A Hesketh, Mr R D Houghton, Mr N C McLuskie and Mr C P Sullivan in the share capital of The Royal Bank of Scotland Group plc are disclosed in the financial statements of RBS Insurance Group Limited

The interests of Mr M A Fisher in the share capital of The Royal Bank of Scotland Group plc are disclosed in the financial statements of The Royal Bank of Scotland Group plc

Other than as disclosed, none of the directors in office at 31 December 2006 held any interest in the share or loan capital of the Company or any other group company

POLICY AND PRACTICE ON PAYMENT OF CREDITORS

The Company follows the policy and practice on payment of creditors determined by The Royal Bank of Scotland Group plc, ("RBSG"), as outlined below

In the year ending 31 December 2007, RBSG will adhere to the following payment policy in respect of all suppliers RBSG is committed to maintaining a sound commercial relationship with its suppliers Consequently, RBSG's policy to negotiate and agree terms and conditions with its suppliers, which includes the giving of an undertaking to pay suppliers within 30 days of receipt of a correctly prepared invoice submitted in accordance with the terms of the contract or such other payment period as may be agreed

ELECTIVE RESOLUTIONS

The Company has elected to dispense with the requirement to hold annual general meetings, lay accounts before a general meeting and re-appointment of auditors annually

AUDITORS

Deloitte & Touche LLP have expressed their willingness to continue in office as auditors

Approved by the Board of Directors
and signed on behalf of the Board

Director MARK HESKETH

28 February 2007

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

We have audited the financial statements of The National Insurance and Guarantee Corporation Limited ("the Company") for the year ended 31 December 2006 which comprise the income statement, the balance sheet, the statement of changes in equity, the cash flow statement, the accounting policies and the related notes to the accounts 2 to 33 These financial statements have been prepared under the accounting policies set out therein

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985 Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed

Respective responsibilities of directors and auditors

As described in the directors' report, the Company's directors are responsible for the preparation of the directors' report and the financial statements in accordance with applicable law and International Financial Reporting Standards ("IFRS") as adopted by the European Union Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland)

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985 We also report to you whether, in our opinion, the information given in the directors' report is consistent with the financial statements In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed

We read the directors' report for the above year and consider whether it is consistent with the audited financial statements We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements Our responsibilities do not extend to any information outside the directors' report

Basis of audit opinion

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

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

Opinion

In our opinion

1 the financial statements give a true and fair view of the state of the Company's affairs as at 31 December 2006 and of its profit for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union,

2 the financial statements have been properly prepared in accordance with the Companies Act 1985, and

3 the information given in the directors' report is consistent with the financial statements

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London, United Kingdom
28 February 2007

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	2006 £ Million	2005 £ Million
Insurance premium revenue	5	922 1	863 9
Insurance premium ceded to reinsurers	5	(219 0)	(219 3)
Net insurance premium revenue		**703 1**	**644 6**
Fee income	6	12 1	7 1
Investment income	7	76 6	63 6
Net realised gains on financial assets	8	0 1	0 4
Other operating income	9	(4 7)	27 5
Net income		**787 2**	**743 2**
Insurance claims and loss adjustment expenses	10	(631 8)	(607 0)
Insurance claims and loss adjustment expenses recovered from reinsurers	10	128 8	140 5
Net insurance claims		**(503 0)**	**(466.5)**
Commission expenses	11	(137 9)	(137 5)
Expenses for marketing and administration	11	(87 8)	(91 1)
Expenses		**(225 7)**	**(228 6)**
Results of operating activities		**58 5**	**48 1**
Finance costs	12	(3 9)	(0 2)
Profit before tax		**54 6**	**47 9**
Tax charge	13	(9 6)	(15 3)
Profit for the year	14	**45 0**	**32 6**

The profit for the year was entirely attributable to equity shareholders of the Company

The notes on pages 10 to 52 form part of these financial statements

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

BALANCE SHEET
AS AT 31 DECEMBER 2006

	Notes	2006 £ Million	Restated 2005 £ Million
ASSETS			
Plant and equipment	15	0 5	0 6
Investments in subsidiaries	17	1 3	27 5
Financial assets			
Available-for-sale debt securities	18	509 7	565 8
Loans and receivables	18	858 8	579 7
Insurance contracts			
Reinsurance assets	21, 26	338 9	315 0
Deferred acquisition costs	22	77 1	72 9
Cash and cash equivalents	23	511 7	549 8
Total assets		**2,298 0**	**2,111 3**
EQUITY			
Share capital	24	265 0	255 0
Other reserves	25	36 8	36 0
Retained earnings	25	59 9	21 4
Total equity		**361 7**	**312 4**
LIABILITIES			
Insurance contracts	26	1,577 7	1,562 7
Financial liabilities			
Borrowings	27	152 8	23 6
Trade and other payables including insurance payables	28	176 9	165 7
Current tax liabilities		1 4	23 6
Deferred tax liabilities	20	10 2	8 0
Provisions for other liabilities and charges	29	17 3	15 3
Total liabilities		**1,936 3**	**1,798 9**
Total equity and liabilities		**2,298 0**	**2,111 3**

The financial statements were approved by the Board of Directors and authorised for issue on 28 February 2007 They were signed on its behalf by

Director M.A. HESKETH

The notes on pages 10 to 52 form part of these financial statements

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	Share capital £ Million	Other reserves £ Million	Retained earnings £ Million	Total £ Million
Balance as at 1 January 2005		**255 0**	**26 8**	**(4 2)**	**277 6**
Net fair value gain on available-for-sale investments	25	-	2 5	-	2 5
Movement in claims equalisation reserves	25	-	7 0	(7 0)	-
Net income recognised directly in equity		-	9 5	(7 0)	2 5
Transfer to income statement on sale of available-for-sale investments	25	-	(0 3)	-	(0 3)
Profit for the year		-	-	32 6	32 6
Balance as at 31 December 2005		**255 0**	**36 0**	**21 4**	**312 4**
Net fair value loss on available-for-sale investments	25	-	(5 6)	-	(5 6)
Movement in claims equalisation reserves	25	-	6 5	(6 5)	-
Net income recognised directly in equity		-	0 9	(6 5)	(5 6)
Transfer to income statement on sale of available-for-sale investments	25	-	(0 1)	-	(0 1)
Profit for the year		-	-	45 0	45 0
Total recognised income and expense for the year		-	0 8	38 5	39 3
Issue of share capital	24	10 0	-	-	10 0
Balance as at 31 December 2006		**265 0**	**36 8**	**59 9**	**361 7**

Total recognised income and expense for the year was entirely attributable to equity shareholders of the Company

The notes on pages 10 to 52 form part of these financial statements

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	2006 £ Million	Restated 2005 £ Million
Profit for the year		45 0	32 6
Adjustments for			
Fee income	6	(12 1)	(7 1)
Investment revenues	7	(76 6)	(63 6)
Other operating income	9	4 7	(27 5)
Finance costs	12	3 9	0 2
Tax expense	13	9 6	15 3
Depreciation of property, plant and equipment	15	0 1	0 1
Impairment of investment in subsidiaries	17	(4 8)	-
Profit on sale of available-for-sale debt securities	8	(0 1)	(0 4)
Interest received		69 8	67 6
Income received from other investments		(4 9)	27 6
Proceeds on disposal/maturity of available-for-sale debt securities		164 6	89 7
Proceeds on disposal of investment property		-	0 3
Net increase in investment balances held with credit institutions		(248 1)	(79 9)
Purchases of debt securities		(119 9)	(80 6)
Operating cash flows before movements in working capital		**(168.8)**	**(25 7)**
Net decrease in insurance net assets		26 7	50 6
Net increase in reinsurance assets		(19 5)	(47 2)
Net decrease in loans and receivables		3 6	4 0
Net decrease/(increase) in other assets		2 3	(10 0)
Net increase in related party balances		(10 6)	(63 5)
Net increase/(decrease) in other operating liabilities		15 7	(15 8)
Cash used by operations		**(150.7)**	**(107 6)**
Taxes (paid)/refunded		(27 1)	24 7
Interest paid		(3 9)	(0 2)
Net cash used by operating activities		**(181.7)**	**(83 1)**
Cash flows from investing activities			
Dividends received/(refunded) from subsidiaries		4 2	(5 0)
Net cash generated from/(used by) investing activities		**4.2**	**(5 0)**
Cash flow from financing activities			
Proceeds on issue of shares		10 0	-
Proceeds from borrowings		127 2	0 2
Net cash generated from financing activities		**137 2**	**0 2**
Net decrease in cash and bank overdrafts		**(40 3)**	**(87 9)**
Cash and cash equivalents at the beginning of the year	23	530 9	618 7
Cash and bank overdrafts at the end of the year	23	**490 6**	**530 8**

The Company classifies the cash flows for the purchase and disposal of financial assets in its operating cash flows as the purchases are funded from the cash flows associated with the origination of insurance contracts, net of the cash flows from payment of insurance claims

The notes on pages 10 to 52 form part of these financial statements

1 ACCOUNTING POLICIES

1 1 Basis of accounting

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted for use in the European Union and therefore comply with EU IAS regulation The financial statements also comply with those parts of the Companies Act 1985 applicable to companies reporting under IFRS The financial statements have been prepared on the historical cost basis except available-for-sale financial assets, which are stated at their fair values

The Company is exempt from preparing consolidated accounts by virtue of section 228 of the Companies Act 1985 as the Company is included in the accounts of a larger group

1 2 Insurance premium revenue

Insurance premiums comprise the total premiums receivable for the whole period of cover provided by contracts incepted during the financial year, adjusted by an unearned premium provision, which represents the proportion of the premiums that relate to periods of insurance after the balance sheet date Unearned premiums are calculated over the period of exposure under the policy, on a daily basis, 24ths basis or allowing for the estimated incidence of exposure under policies which are longer than twelve months

Premiums collected by intermediaries, but not yet received, are assessed based on estimates from underwriting or past experience, and are included in insurance premiums Insurance premiums exclude insurance premium tax and are shown gross of any commission payable to intermediaries

1 3 Insurance claims and loss adjustment expenses

Insurance claims are recognised in the accounting period in which the loss occurs Provision is made for the full cost of settling outstanding claims at the balance sheet date including claims incurred but not yet reported at that date, net of salvage and subrogation recoveries Costs for both direct and indirect claims handling costs are also included

The estimation of insurance claims and loss adjustment expenses has been explained in note 2 1

1 4 Liability adequacy provision

Provision is made for unexpired risks arising where the expected value of claims and expenses attributable to the unexpired periods of policies in force at the balance sheet date exceeds the unearned premium provision in relation to such policies after the deduction of any acquisition costs deferred The expected value is determined by reference to recent experience and allowing for changes to the premium rates The provision for unexpired risks is calculated separately by reference to classes of business that are managed together after taking account of relevant investment returns

1 5 Special Risks business - reserves

The Special Risks business was put into run-off during 2003 Future levels of premiums, their earnings profile and claims are linked but subject to particular uncertainty This business has consequently been reserved on an ultimate result basis Premium and associated acquisition costs are deemed to be fully earned and a single reserve for claims, net of future premium movements but gross of reinsurance has been established Movements on the Special Risks' technical reserves are largely recoverable from a previous ultimate holding company Due to the nature of Special Risks' insurance contracts, claims reserves are reported on an underwriting year basis

1 6 Claims equalisation

A statutory claims equalisation reserve continues to be included as a non distributable reserve within Other Reserves in Equity This reserve is calculated in accordance with chapter 1 4 of the Prudential Sourcebook for Insurers (INSPRU)

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006

1 ACCOUNTING POLICIES (Continued)

1 7 Reinsurance

The Company cedes reinsurance in the normal course of business, with retention limits varying by line of business Outwards reinsurance premiums are accounted for in the same accounting period as the premiums for the related direct business being reinsured Outward reinsurance recoveries are accounted for in the same accounting period as the direct claims to which they relate

Reinsurance assets include balances due from reinsurance companies for ceded insurance liabilities Amounts recoverable from reinsurers are estimated in a consistent manner with the outstanding claims provisions or settled claims associated with the reinsured policies and in accordance with the relevant reinsurance contract

Where the Company is not certain about the collectability of a reinsurance asset or where the reinsurer's credit rating has been downgraded significantly, the Company reduces the carrying value of the asset accordingly and the impairment loss is recognised in the income statement

1 8 Deferred acquisition costs

Acquisition costs relating to new and renewing insurance policies are matched with the earning of the premiums to which they relate A proportion of acquisition costs incurred during the year is therefore deferred to the subsequent accounting period to match the extent to which premiums written during the year are unearned at the balance sheet date

The principal acquisition costs so deferred are commissions paid to brokers, third party administration fees, direct advertising expenditure and costs associated with the underwriting staff

1 9 Revenue recognition (non insurance)

Interest income on financial assets that are classified as loans and receivables or available-for-sale and interest expense on financial liabilities is determined using the effective interest rate method In the case of loans and receivables this is estimated using the Rule of 78 method and for available-for-sale assets estimates are based on the straight line method, both of which management has determined are a close approximation to the effective interest rate

Fees in respect of services are recognised as the right to consideration accrues through the provision of the service to the customer The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered The price is usually fixed and always determinable

1 10 Provisions
Regulatory levies – the Company accrues for all insurance industry levies, which are based on past underwriting levels at the best estimate given the available information at the balance sheet date Such amounts are not included within insurance liabilities but are included under provisions in the balance sheet They are charged to the income statement as an expense

1 11 Plant and equipment

Items of plant and equipment are stated at historical cost less accumulated depreciation (see below) and impairment losses Where an item of plant and equipment comprises major components having different useful lives, they are accounted for separately

1 ACCOUNTING POLICIES (Continued)

1 11 Plant and equipment (Continued)

Depreciation is charged to the income statement on a straight-line basis so as to write off the depreciable amount of plant and equipment (including assets owned and let on operating leases) over their estimated useful lives The depreciable amount is the cost of an asset less its residual value Estimated useful lives are as follows

- Vehicles	5 years
- Other equipment, including property adaptation costs	4 to 15 years

At each reporting date, the Company assesses whether there is any indication that its plant and equipment are impaired If any such indication exists, the Company estimates the recoverable amount of the asset and the impairment loss if any The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use Value in use is the present value of future cash flows from the asset or cash generating unit discounted at a rate that reflects market interest rates adjusted for risks specific to the asset or cash generating unit that have not been reflected in the estimation of future cash flows

If the recoverable amount of an asset is less than its carrying value, an impairment loss is recognised immediately in the income statement and the carrying value of the asset reduced by the amount of the loss

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised as income immediately, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase

1 12 Investment property

Investment property comprises freehold and long leasehold properties that are held to earn rentals or for capital appreciation or both It is not depreciated and is stated at fair value based on valuations by independent registered valuers Fair value is based on current prices in an active market for similar properties in the same location and condition Any gain or loss arising from a change in fair value is recognised in the income statement Rental income from investment property is recognised on a straight-line basis over the term of the lease Lease incentives granted are recognised as an integral part of the total rental income

1 13 Leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases

Rentals payable under operating leases are recognised in the income statement on a straight line basis over the term of the lease

Incentives received as an inducement to enter into an operating lease are spread on a straight line basis over the lease term

1 14 Investment in subsidiaries

Investments in subsidiary companies are stated at cost less any impairment in the value of individual investments, based on an annual assessment Any impairment is charged to the income statement

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006

1. ACCOUNTING POLICIES (Continued)

1 15 Financial assets

Financial assets are classified into available-for-sale financial assets or loans and receivables

Available-for-sale – available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs They are subsequently measured at fair value Exchange differences resulting from retranslating the amortised cost of currency monetary available-for-sale financial assets are recognised in the income statement

Changes in the fair value of available-for-sale financial assets are reported in a separate component of shareholders' equity Interest and premium/discount on acquisition are calculated using the straight line method (see note 1 9) and are recognised in the income statement

Regular way purchases of financial assets classified as loans and receivables are recognised on settlement date, all other regular way purchases are recognised on trade date

Fair value for a net open position in a financial asset that is quoted in an active market is the current bid price times the number of units of the instrument held Fair values for financial assets not quoted in an active market are determined using appropriate valuation techniques

Loans and receivables – financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables These include deposits with credit institutions which are long term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risks of change in value

Insurance receivables comprise outstanding insurance premiums where the policyholders have elected to pay in instalments or amounts due from brokers or third parties, where they have collected the money from the policyholder

Other loans and receivables principally comprise loans to related parties and receivables from related parties

1 16 Impairment of financial assets

The Company assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as available-for-sale or loans and receivables is impaired A financial asset or portfolio of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset

Financial assets carried at fair value – when a decline in the fair value of a financial asset classified as available-for-sale has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss is removed from equity and recognised in the income statement The loss is measured as the difference between the amortised cost of the financial asset and its current fair value Impairment losses on available-for-sale equity instruments are not reversed through the income statement, but those on available-for-sale debt instruments are reversed, if there is an increase in fair value that is objectively related to an event subsequent to the recognition of the impairment

Loans and receivables – If there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables has been incurred, the Company measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and its recoverable amount Impairment losses are assessed individually where significant or collectively for assets that are not individually significant

Impairment losses are recognised in the income statement and the carrying amount of the financial asset or group of financial assets is reduced by establishing an allowance for the impairment losses If in a subsequent period the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance

1 ACCOUNTING POLICIES (Continued)

1 16 Impairment of financial assets (Continued)

For debts due from intermediaries and brokers the bad debt provision is calculated based upon prior loss experience For all balances outstanding in excess of 6 months, a provision of 50% is made, with a full provision against all debts over one year old

1 17 Foreign currencies

The Company's financial statements are presented in sterling which is the functional and presentation currency of the Company

Transactions in foreign currencies are translated into sterling at the foreign exchange rate ruling at the date of the transaction Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date Foreign exchange differences arising on translation are recognised in the income statement Non-monetary items denominated in foreign currencies that are stated at fair value are translated into sterling at foreign exchange rates ruling at the dates the values were determined

1 18 Taxation

Provision is made for taxation at current enacted rates on taxable profits, arising in income or in equity, taking into account relief for overseas taxation where appropriate

Deferred taxation is accounted for in full for all temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes, except in relation to overseas earnings where remittance is controlled by the Group, and goodwill

Deferred tax assets are only recognised to the extent that it is probable that they will be recovered

1 19 Transactions with related parties

IFRS requires all entities to disclose related party transactions The Company's policy is to have regard to materiality from both the shareholder's and the related party's perspective

1 20 Cash and cash equivalents

Cash and cash equivalents comprises cash on hand and demand deposits with banks together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value

Under IAS 7 the Company is producing a cash flow statement using the indirect method This shows an explanation of the movement in cash and cash equivalents as defined above

1 21 Borrowings

Borrowings comprises bank overdrafts and inter company loans Interest on inter company loans is recognised in the income statement as finance costs

The Company classifies a financial instrument that it issues as a financial liability or an equity instrument in accordance with the substance of the contractual arrangement An instrument is classified as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms An instrument is classified as equity if it evidences a residual interest in the assets of the Company after the deduction of liabilities

1 ACCOUNTING POLICIES (Continued)

1 22 Accounting developments

The International Accounting Standards Board (IASB) issued IFRS 7 'Financial Instruments Disclosures' in August 2005 The standard replaces IAS 30 'Disclosures in the Financial Statements of Banks and Similar Financial Institutions' and the disclosure provisions in IAS 32 IFRS 7 requires disclosure of the significance of financial instruments for an entity's financial position and performance and of qualitative and quantitative information about exposure to risks arising from financial instruments The standard is effective for annual periods beginning on or after 1 January 2007

Also in August 2005, the IASB issued an amendment, Capital Disclosures', to IAS 1 'Presentation of Financial Statements' It requires disclosures about an entity's capital and the way it is managed This amendment is also effective for annual periods beginning on or after 1 January 2007

The Company is reviewing IFRS 7 and the amendment to IAS 1 to determine their effect on its financial reporting The standards will be adopted with effect from 1 January 2007

In addition to the above standards the Company has considered other new international accounting standards (IFRS 8 Operating Segments) and interpretations (IFRIC 8 to 12) issued during the year and has concluded these will not apply to the Company

2 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The reported results of the Company are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements The Company's principal accounting policies are set out on pages 10 to 15 UK company law and IFRS require the directors, in preparing the Company's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent In the absence of an applicable standard or interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's Framework for the Preparation and Presentation of Financial Statements

The judgements and assumptions involved in the Company's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below The use of estimates, assumptions or models that differ from those adopted by the Company would affect its reported results

2 1 Outstanding claims provisions and related reinsurance recoveries

Provisions are determined by management based on experience of claims settled and on statistical models which require certain assumptions to be made regarding the incidence, timing and amount of claims and any specific factors such as adverse weather conditions In order to calculate the total provision required, the historical development of claims is analysed using statistical methodology to extrapolate, within acceptable probability parameters, the value of outstanding claims (gross and net) at the balance sheet date Also included in the estimation of outstanding claims are factors such as the potential for judicial or legislative inflation In addition an allowance is made for reinsurance assets deemed not recoverable

For more recent claim periods the provisions will make use of techniques that incorporate expected loss ratios As periods mature, the reserves are increasingly driven by methods based on actual claims experience The approaches adopted take into account the nature, type and significance of the business and the type of data available, with large claims generally being assessed separately The data used for statistical modelling purposes is internally generated

2 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

2 1 Outstanding claims provisions and related reinsurance recoveries (Continued)

The calculation is particularly sensitive to the estimation of the ultimate cost of claims for the particular classes of business at gross and net levels, the estimation of future claims handling costs and the rate of investment return assumed in the calculation In addition in 2006, the directors revisited the methodology applied to estimate claims handling costs to make this more relevant to the business of the Company As a result of this change in accounting estimate the Company reduced the amount of loss adjustment expenses reserve held as at 31 December 2006 by £23 1 million with a corresponding increase in profit before tax of £23 1 million The impact of this change on retained earnings and net assets is an increase of £16 1 million at 31 December 2006

Management use the work of external actuaries to undertake their internal benchmark assessment of the level of gross and net outstanding claims provision required and adopt a measurement basis of reserves which results in a provision in excess of the external actuaries' best estimate

Actual claims experience may differ from the historical pattern on which the estimate is based and the cost of settling individual claims may exceed that assumed As a result management adopt a cautious view and set the reserves at a margin above the best estimate It is this amount that is recorded as claims reserves

Outstanding claims provisions net of related reinsurance recoveries at 31 December 2006 amounted to £857 8 million (2005 £848 8 million)

2 2 Impairment provisions – financial assets

Available-for-sale – the Company determines that available-for-sale financial assets are impaired when there has been a significant or prolonged decline in the fair value below its cost This determination of what is significant or prolonged requires judgement In making this judgement, the Company evaluates among other factors, the normal volatility of share price, the financial health of the investee, industry and sector performance, changes in technology and operational and financing cash flow Impairment may be appropriate when there is evidence of deterioration in these factors

Impairment provisions on available-for-sale financial assets at 31 December 2006 amounted to £nil (2005 £nil)

Had all the declines in fair values below cost been considered significant or prolonged, the Company would suffer a £381,978 loss in its 2006 financial statements (£8,988 loss in 2005), being the transfer of the total equity reserve for unrealised losses to the income statement

2 3 Impairment provisions - investments in subsidiaries

The Company considers that an investment in a subsidiary company is impaired when the recoverable value of the subsidiary company is less than the carrying amount Recoverable value is determined as the higher of the net realisable value or the discounted cash flow of future profits after tax Determining the discounted cash flow of future profits requires judgement in forecasting the level of future profits

Impairment provisions on investments in subsidiaries at 31 December 2006 amounted to £nil (2005 £4 8 million)

2 4 Fair value

Financial assets classified as available-for-sale are recognised in the financial statements at fair value In the balance sheet, financial assets carried at fair value are included within available-for-sale debt securities and equity shares Unrealised gains and losses on available-for-sale financial assets are recognised directly in equity unless an impairment loss is recognised

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006

2 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

2 4 Fair value (Continued)

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable willing parties in an arm's length transaction Fair values are determined by reference to observable market prices where available and reliable Where representative market prices for an instrument are not available or are unreliable because of poor liquidity, the fair value is derived from prices for its components using appropriate pricing or valuation models that are based on independently sourced market parameters

The fair value of available-for-sale financial assets at 31 December 2006 amounted to £509 7 million (2005 £565 8 million)

2 5 Provisions

The main regulatory levies, which are included under Provisions, are the Financial Services Compensation Scheme (FSCS) and the Motor Insurance Bureau (MIB) levies

The levy accruals are based on a percentage of gross premium written The Company will receive levy invoices from the Regulatory bodies based on the Company's market share of the industry, which is not known with certainty at the time of approval of these financial statements and, therefore some judgement is required

In 2006 the FSCS levy was accrued at an agreed percentage of forecast gross written premium

The MIB levy was calculated by apportioning the 'total levy' for the UK motor insurance industry (as communicated by the MIB) by the Company's estimated share of the UK motor insurance market

Total regulatory levy provisions at 31 December 2006 amounted to £12 3 million (2005 £15 3 million)

2 6 Deferred acquisition costs

As noted in paragraph 1 8, the Company defers a proportion of acquisition costs incurred during the year to subsequent accounting periods During the year, the directors revisited the methodology applied to estimate the deferral of acquisition costs to make this more relevant to the business of the Company As a result of this change in accounting estimate, the Company decreased the amount of deferred acquisition costs held at 31 December 2006 by £3 1 million with a corresponding decrease in the profit before tax of £3 1 million The impact of this change on the retained earnings and net assets is an decrease of £2 2 million at 31 December 2006

3 RESTATEMENT

The 2005 comparative numbers for 'Financial assets - loans and receivables' and 'Cash and cash equivalents' on the balance sheet have been restated to show deposits with credit institutions on a current maturity basis (the period to maturity at the balance sheet date) as opposed to the original maturity basis (period to maturity at the time of purchase)

The effect of the restatement on the 2005 comparative numbers is to decrease 'Financial assets - loans and receivables' by £330 0 million and to increase 'Cash and cash equivalents' by £330 0 million There is no impact on either the retained earnings or the net assets of the Company as reported in the 2005 financial statements

In addition, within the line 'Net (increase) in related party balances' in the 'Cash generated from/(used by) operations' section in the Cash Flow Statement above, an amount of £(11 9) million has been re-presented for 2005 This amount of £(11 9) million was previously shown in the line "Loan advances to related parties' line in the 'Cash flow from financing activities' section in the 2005 financial statements

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006

4 MANAGEMENT OF INSURANCE AND FINANCIAL RISK

The Company issues contracts that accept insurance risk in return for a premium It also has financial risk exposures This section summarises these risks and the way the Company manages these
The Company is a member of the Insurance Division of The Royal Bank of Scotland Group plc (RBSG) and benefits from services provided by specialist teams and risk management procedures and controls which are applied across the Division

4 1 Insurance risk

Insurance risk is the risk of fluctuations in the timing, frequency and/or severity of insured events, relative to the expectations of the Company at the time of underwriting This risk is managed according to the following separate components

- Underwriting and pricing risk
- Claims management risk
- Reinsurance risk
- Reserving risk

4 1 1 Underwriting and pricing risk

Underwriting and pricing risk is the risk that inappropriate business will be written and/or inappropriate prices charged

The classes and sectors of business written, underwriting criteria, and relevant limits, define underwriting risk appetite

Personal lines

The Company manages this risk through a wide range of processes and forums, some of which include

- Underwriting guidelines which exist for all business transacted restricting the types and classes of business that may be accepted
- Exception reports and other underwriting monitoring tools
- Comprehensive audit programmes
- Pricing policies which are set by management and implemented through pricing committees by product line and by brand
- Central control, within underwriting, of policy wordings and any subsequent changes
- Insurance risk framework that involves, among other things, regular minuted meetings where all aspects of insurance risk are discussed, and additional meetings where detailed claims data are examined and discussed
- Weekly monitoring within the business of key performance indicators by product and brand
- Formal monthly monitoring and reporting to the Executive, by product and brand
- Annual budgeting and quarterly re-forecasting, signed off by the Company Executive

Commercial lines

Commercial risks are written within a pre-defined strategy fully documented in underwriting guides and issued to all authorised underwriters The Company's strategy is towards low to medium risk trades within the small to medium enterprise (SME) market Higher risk trades are excluded by way of a decline list clearly documented within the underwriting guides The strategy is briefly described as follows

Underwriters are responsible for the adequacy of their risk selection, rating and risk control within Company guidelines This responsibility applies equally to new and renewal business Property risk exposures are generally written on a full sum insured basis to a maximum of £30 million All underwriters attaching risks to the Company operate within their signed Personal Underwriting Authority statement based on job role, competency and business need Regional underwriters are required to refer any risk with a maximum exposure in excess of £12 5 million to Head Office underwriting for authorisation This sum is reduced for higher risk trade categories All underwriters are assessed for competence via the annual Underwriting Competency Assessment Programme and the Company's monthly Technical Underwriting Audit Programme These technical audits are backed up by processing system referrals Prior to accepting business, the Company ensures that it has a full understanding of the risk characteristics and has sensibly assessed the risk Risk selection is monitored via the Company's Technical Underwriting Audit Programme

4 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

4 1 1 Underwriting and pricing risk (Continued)

The Company ensures that the premium it charges adequately reflects the risk exposure, by utilising both Underwriting Guides and the underwriter's experience when pricing a risk Product Managers are responsible for the setting of product underwriting and pricing criteria in accordance with the Company's overall Underwriting and Pricing philosophy The Company protects its book by purchasing a tailored programme of Risk Treaty and Catastrophe Reinsurance (as described elsewhere in these financial statements), supported where necessary by Facultative Reinsurance purchases for individual cases

Special Risks

This division of the business was discontinued and closed to new business in 2003 The Special Risks portfolio is now in run-off The lines of business underwritten in the Special Risks business were motor warranty, vehicle assistance, extended warranty, miscellaneous and pecuniary loss, legal expenses, miscellaneous property, miscellaneous accident, bonds & guarantees and travel No policies have renewal rights attached The longest policy terms are for miscellaneous property (land) insurance (25 years), bonds (20 years) and legal expense insurance (20 years)

Frequency and severity of specific risks

The following paragraphs explain the frequency and severity of specific risks under the key classes that the Company is exposed to

a) Motor insurance contracts

The causes of motor claims are theft of, or from, the vehicle, personal accident, accidental damage to the vehicle, third-party property damage and third-party personal injury To meet statutory requirements, policies of insurance provide unlimited exposure for policyholders' liability at law for third party bodily injury and reinsurance is purchased for the unlimited element over a suitable deductible

Claims experience is quite variable, due to a wide number of factors, such as the age, sex and experience of the driver, the type of vehicle and the area Contracts are issued typically on an annual basis, which means that our liability usually extends for a 12-month period, after which we are entitled to decline to renew or we can impose renewal terms by amending the premium or excess or both

b) Residential property insurance contracts

The major claim perils for residential property insurance are theft, flood, escape of water, fire, storm, subsidence, liability and various types of accidental damage

All contracts are written typically on an annual basis which means our commitment is usually for a 12-month period, after which we can decline to renew or can impose special renewal terms through increased premium or excesses, or both

c) Commercial motor insurance contracts

Commercial motor insurance contracts can include individual commercial vehicles, fleets of vehicles for businesses or motor trade risks

The causes of commercial motor claims are theft of, or from, the vehicle, personal accident, accidental damage to the vehicle, third party property damage and third party personal injury

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006

4 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

4 1 1 Underwriting and pricing risk (Continued)

Claims experience is quite variable, due to a wide number of factors, the principal ones are age and experience of driver, type of vehicle and use Contracts are typically issued on an annual basis, which means that our liability extends to a 12-month period, after which we are entitled to decline to renew or we can impose renewal terms by amending the premium, terms, excesses or a combination

d) Commercial other insurance contracts

Commercial claims come mainly from property loss or damage, business interruption and loss arising from the negligence of the Insured (liability insurance)

Property loss/damage claims come from causes such as fire, theft, storm, flood and other defined perils Business interruption losses come from the loss of income, revenue and/or profit as a result of the cause of the property damage claim These covers are generally written on a sum insured basis based on the values at risk

Liability insurance can be broken down between employers liability and public/products liability The first is to indemnify employees for injury caused as a result of the insured's negligence Public/products liability is to indemnify a third party for injury and/or damage as a result of the Insured's negligence Employers liability has a standard limit of indemnity of £10 million plus authorised costs, but can be increased to £25 million for larger policyholders on request

Public/products liability generally has a limit of up to £5 million, but can be increased to £10 million on request

Insurance contracts are typically issued on an annual basis which means that our liability is limited to a 12-month period, after which we can decline to renew the policy or can impose renewal terms such as increasing the premium or applying special terms such as an increased policy excess However, as liability insurance is written on an occurrence basis, these covers are still subject to claims that manifest over a substantial period of time, but where loss was in existence during the life of the policy (for example long-tail disease claims such as asbestosis)

e) Special Risks contracts

Loss reserve movements in the discontinued special risks portfolio are largely covered by an indemnity from the Company's former parent company, Winterthur Swiss Insurance

The portfolio comprises non-standard risk schemes and there are large variations in policy coverages across the range of schemes The wide variety of risks covered means that there is very little standardisation of terms between schemes Administrators are required to provide updates on the activity on individual schemes through regularly submitted bordereaux These provide details of claims for the period as well as exposure details such as the mix by policy term Scheme performance is reviewed regularly by internal and external actuaries and reserves are adjusted accordingly This involves best estimates based on the development of earning patterns by scheme and ultimate loss ratios based on available exposure information This requires analysis of the incidence of exposure in the underlying policies throughout the policy term

f) Creditor insurance contracts

Creditor insurance contracts are designed to cover payments on secured or unsecured lending, whether for individuals or in certain circumstances for sole traders and nominated individuals in small commercial companies

The causes of creditor insurance claims are loss of income through accident, sickness or unemployment or, in some circumstances, loss of life

The largest influence on claims experience is the economic environment Contracts are issued either on a monthly renewable basis (regular premium) and can be amended or cancelled by either party at any point during the contract, or for the full term of the loan (single premium) In the latter case, the customer has the option to cancel the contract at any point but generally the company is obligated for the full term of up to a maximum of 5 years

4 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

4 1 1 Underwriting and pricing risk (Continued)

Sources of uncertainty

The following paragraphs explain the source of uncertainty in respect of the specific key classes of business

a) Motor insurance contracts (both private and commercial)

There are various sources of uncertainty which will impact the Company's experience under Motor insurance, including operational risk, reserving risk, premium rates not matching claim inflation rates, the social, economic and legislative environment and reinsurance failure risks However, the Company has documented risk policies, coupled with governance frameworks to oversee and control those risks and hence minimise the losses

b) Property insurance contracts (both residential and commercial)

The major source of uncertainty in the performance of the Company's property account is the volatility of the weather Weather in the UK can affect the following causes of claims flood, storm, escape of water following freezing (burst pipes) and subsidence Our flood and subsidence strategies are being maintained in order to control these exposures

Over a longer period the strength of the economy is also a factor During tougher times as more businesses close down and unemployment increases, arson, theft and similar types of claims tend to increase

There are many other sources of uncertainty which include operational, reserving and reinsurance issues However, the Company has documented risk policies, coupled with governance frameworks to oversee and control those risks and hence minimise the losses

c) Commercial other insurance contracts

There are a number of uncertainties which will impact the Company's general liability account, such as changes in the social, economic and legislative environment and in particular court judgments and legislation (e g periodical payments under the Courts Act, a review of the Ogden tables used by courts when setting personal injury claim values), significant events (e g terrorist attacks), and any emerging new heads of damage or types of claim that are not envisaged when the policy is written

There are many other sources of uncertainty which include operational, reserving and reinsurance issues However, the Company has documented risk policies, coupled with governance frameworks to oversee and control those risks and hence minimise the losses

d) Special Risks contracts

The wide variety of risks covered means that there are a significant number of uncertainties which affect the underwriting performance of the special risks portfolio arising from the economic, social and legislative environment Reserving risk is monitored through regular review by internal and external actuaries The Company's exposure is mitigated through the indemnity from the Company's former parent

e) Creditor insurance contracts

The main source of uncertainty is the economic environment A recession could lead to an increased number and cost of unemployment and sickness claims

Other sources of uncertainty include operational and reserving issues We have documented risk policies and relevant frameworks to mitigate the losses

4 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

4 1 1 Underwriting and pricing risk (Continued)

4 1 2 Claims management risk

Claims management risk is the risk that claims are paid or handled inappropriately

Claims are managed utilising a range of IT system driven controls coupled with manual processes outlined in detailed policies and procedures to ensure claims are handled in an appropriate, timely and accurate manner

Each member of staff has a specified handling authority, with controls preventing claims staff handling or paying claims outside of their authorities, as well as controls to avoid paying invalid claims In addition, there are various outsourced claims handling arrangements all of which are monitored closely by management, with similar principles applying in terms of the controls and procedures

Loss adjustors are used in certain circumstances to handle claims to conclusion This involves liaison with the policyholder, third parties, suppliers and management

A process is in place to deal with severe weather / other catastrophic events, known as SWEP (Severe Weather Event Plan) SWEP is the collective name given to an incident which significantly impacts the volume and cost of claims reported to the claims management of the Company The plan covers triggers, stages of incident, operational impact, communication, and management information monitoring of the impact

4.1 3 Reinsurance risk

Reinsurance is used

- To protect the insurance results against the impact of major catastrophic events, e g flood, storm
- To protect the insurance results against unforeseen volumes of, or adverse trends in, large individual claims, in order to reduce volatility and to improve stability of earnings
- To transfer risk that is not within the Company's current risk appetite

The following types of reinsurance are used where appropriate

- Excess of loss 'per individual risk' reinsurance to protect against significantly large individual losses The upper limit of this protection is to be sufficient for the largest individual risks accepted The maximum amount of retention on these contracts is £3 million for the period to the end of 2006

- Excess of loss catastrophe 'per event' reinsurance to protect against major events, for example, windstorms or floods Various windstorm and flood simulation models are used to model a range of scenarios and calculate the Company's potential exposure to catastrophic events by class of business Cover will then be purchased with an upper limit equivalent to a windstorm return period of at least one in 150 years The 'per event' retention is within the estimated cost of an event that has been modelled to occur within a 1 in 16 year return period
- Quota share reinsurance to protect against unforeseen adverse trends, where the reinsurer takes an agreed percentage of premiums and claims
- Other forms of reinsurance may be utilised according to need, subject to approval by senior management or the board as appropriate

The acceptance criteria of reinsurers is based on internal assessments and information from security ratings agencies All reinsurers contracted with are subject to the Credit Risk Approval process as described in the Royal Bank of Scotland Insurance Credit Risk Policy manual Acceptable reinsurers are rated at A- or better unless specifically authorised by the Royal Bank of Scotland Insurance Board Reinsurers may not be rated where the reinsurer is a member of the Royal Bank of Scotland Group Where the reinsurer is rated below A-, a guarantee will be obtained in the form of a letter of credit, where considered necessary

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006

4 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

4 1 3 Reinsurance risk (Continued)

The rating profile of the top ten external reinsurers of the Company which accounts for 75 96% (2005 70 52%) of the total non The Royal Bank of Scotland Group plc ceded reinsurance premium is as follows

Rating from Standard & Poors	Number of Reinsurers 2006	Number of Reinsurers 2005
AAA	-	-
AA	-	2
AA-	5	2
A+	2	4
A	1	1
A-	1	-
Not rated	1	1

The quantification of reinsurer credit risk exposure is calculated taking into account various factors such as the current liability of the reinsurer, including outstanding claims and unexpired risk In addition, reinsurers are monitored and reviewed by the group Credit Risk Committee A provision is made against reinsurance debtors considered bad or doubtful

4 1 4 Reserving risk

Reserving risk relates to both premiums and claims It is the risk that reserves are assessed incorrectly such that insufficient funds have been retained to pay or handle claims as the amounts fall due, both in relation to those claims which have already occurred (in relation to the claims reserves, including claims handling expense reserves) or will occur in future periods of insurance (in relation to the premium reserves)

Categories of technical reserves

The main categories of technical reserves (both gross and net of reinsurance) held by the Company are

a) Premium reserves

- Unearned premium reserves is an amount set aside in the accounts that represents the amount of premium applicable to the unexpired portion of the policy net of reinsurance
- Deferred acquisition costs is when the company defers the sales costs that are associated with acquiring a customer over the term of the insurance contract

- Liability adequacy provisions are required to cover claims costs and related expenses which will emerge from unexpired risks where they are assessed to be greater than the unearned premium reserve (i e recent premiums are thought to be inadequate)

b) Claims reserves

- Claims reserves, including amounts in relation to claims which have occurred but not been reported, is the estimate of the amount required to pay ultimate net losses over and above the claims costs paid to date
- Claims handling expense reserve is the amount put aside to cover the estimated expenses that can be directly attributed to the settlement of claims which are not included within the claims cost

4 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

4 1 4 Reserving risk (Continued)

Reserving policy

Reserves are assessed in accordance with our internal reserving policy, namely

a) Premium reserves

In respect of premium reserves, it is the Company's policy to ensure that the unearned premium reserves, net of reinsurance and deferred acquisition costs, are adequate to meet the expected cost of claims and associated expenses in relation to the exposure after the balance sheet date

To the extent that the unearned premium reserves net of reinsurance and deferred acquisition expenses are inadequate a liability adequacy provision will be held

To estimate if any such additional provision is required, the Company estimates the cost of the unexpired risks for each class, which is based on our estimate of the claims experience, based on the performance in recent periods, seasonally adjusted and allowing for any premium rating changes, together with allowance for the continuing expense of administering the business and investment income Further, the requirement for such a reserve would be assessed by considering the premium reserves for classes of business which are managed together as one

b) Claims reserves

It is the Company's policy to hold undiscounted claims reserves (including reserves to cover claims which have occurred but not been reported (IBNR reserves)) for all classes at a sufficient level to meet all liabilities as they fall due

In particular, the Company's policy is to hold claims reserves for the major classes of business (namely motor, domestic property, creditor and commercial business) in excess of the actuarial best estimate For this purpose 'actuarial best estimate' is defined as the mean of the range of potential outcomes

The Company undertakes an actuarial review of the outstanding claims reserves using past claims data and current market knowledge to project statistically the likely ultimate claims arising from business already written on the basis of the information available utilising generally accepted actuarial methods The reserves set up by the Company for each class of business are then reviewed against a range of projected values taking account of the statistical uncertainty in the claims process

Details of the aggregate claims development are included in note 26

Key sources of reserving risk

The key sources of reserving risk are as follows

- Uncertainty in the number of claims incurred but not reported by the balance sheet date

4 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

4 1 4 Reserving risk (Continued)

- Uncertainty in the ultimate settlement amounts for claims that have already been reported by the balance sheet date
- Uncertainty in the ultimate settlement amounts for claims that have been incurred but not reported by the balance sheet date

The main causes of the uncertainty are as follows

- Inaccurate identification of changes in claims development patterns as a result of changes in claims handling practices and/or claimant reporting behaviour
- The incidence and severity of large claims
- The inflation of claim settlement amounts exceeds that anticipated in the reserving process
- The risk of new heads of damage and/or new types of claims that are unforeseen or unanticipated at the time of underwriting and reserving
- Legislative and common law changes which have a retrospective impact, (i e which impact claims that have already occurred but are not settled by the balance sheet date), including changes in the interpretation of policy wordings Such changes include a potential reduction in the Ogden discount rate used to assess the quantum of lump sum awards for personal injury claims The estimate of the retrospective impact on bodily injury claims costs of a further 1% reduction in the Ogden discount rate would be £6 0 million (2005 £2 8 million) reduction in the profit after tax and net assets on a net of excess of loss and quota share reinsurance basis

If the gross claims reserves carried in the balance sheet moved by 1% the impact on the income statement would be a change in profit after tax and net assets of £7 7 million (2005 £7 4 million)

Risk identification and control

Reserving risk is controlled through a range of processes, the most significant ones being

- Regular periodic reviews of the claims reserves for the main classes of business by the internal actuarial team
- The use of external actuaries to periodically review the adequacy of the reserves for the major classes
- Oversight of the reserving process by the Board of the Company

4 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

4 1 4 Reserving risk (Continued)

The following table summarises premiums earned and the claims incurred together with the corresponding loss ratios for each major class of business on a gross and net of reinsurance basis for the two most recent financial years

		2006			2005		
		Earned premiums £m	Claims Incurred £m	Loss Ratio %	Earned premiums £m	Claims Incurred £m	Loss Ratio %
Residential property	Gross	73 6	46 9	64	64 3	50 3	78
	Net	55 5	37 3	67	48 6	42 9	88
Motor	Gross	393 7	341 6	87	342 7	277 1	81
	Net	306 6	284 4	93	253 7	210 0	83
Commercial property	Gross	218 4	82 3	38	211 7	83 5	39
	Net	158 9	63 6	40	154 7	62 2	40
Commercial motor	Gross	90 2	63 3	70	102 1	45 8	45
	Net	70 5	50 9	72	83 5	31 0	37
Discontinued (Special Risks)	Gross	0 7	9 0	1286	(7 3)	42 8	-587
	Net	1 8	8 3	461	(9 4)	33 5	-357
Other	Gross	145 5	88 7	61	150 4	107 5	71
	Net	109 8	58 5	53	113 5	86 9	77
Total	**Gross**	922 1	631 8	69	863 9	607 0	70
	Net	703 1	503 0	72	644 6	466 5	72

4 2 Financial risk

The Company is member of the Insurance Division of the Royal Bank of Scotland Group As such, the Company benefits from services provided by specialist teams and risk management procedures and controls which are applied consistently across the Division

The Company is exposed to financial risk through its financial assets and financial liabilities (borrowings) The Company's financial risk is concentrated within its investment portfolio This portfolio is managed in accordance with the RBS Insurance Investment Policy and Investment Guidelines These are drawn up in compliance with the objectives and risk appetite parameters set by The Royal Bank of Scotland Group plc and are approved by the RBS Insurance Group Limited Board The Investment Policy is operated by the Investment Management Committee, which is made up of Senior Executives of both the Insurance Division and the Company, and executed on their behalf by the Funds Management Committee

The Investment Management Committee (IMC)

The IMC determines high level policy and controls, covering such areas as safety, liquidity and performance It meets half-yearly to evaluate risk exposure, the current strategy and to consider investment recommendations submitted to it Any strategy changes are included in a revised Terms of Reference for the Funds Management Committee and the Company's Investment Policy and Guidelines are updated to reflect the changes

4 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

4.2 Financial risk (Continued)

The Funds Management Committee (FMC)

The FMC's Terms of Reference includes

- To ensure that the day-to day investment management is carried out effectively in accordance with the Investment Policy and Investment Guidelines
- To develop and maintain an investment strategy that is appropriate to the circumstances of the Company and satisfies all regulators
- To review the appointment and dismissal of investment advisers and the suitability of investment and dealing recommendations having regard to the nature of the investment and the circumstances of the Company
- Report non compliance to the Company and the RBS Insurance Group Limited Board

The FMC generally meets on a monthly basis to review summary portfolios and to review any new investment proposals If there are any portfolio positions outside the investment strategy the fund manager is instructed to rectify the position

The Investment Policy sets out its objectives as

- The safety of the portfolio's principal both in economic terms and from an accounting and reporting perspective
- To maintain sufficient liquidity to provide cash need for operations
- To maximise the portfolio's total return within the constraints of the other objectives and the limits defined by the Investment Guidelines

To achieve these objectives the portfolio is required to be split between Operating Funds and Long-Term Funds Operating Funds are those needed for current business operations and to support identified liabilities, together with an adequate safety margin, and must always be at least 35% of the total portfolio The remainder of the portfolio is classified as long term Derivatives may only be used for the purposes of reducing investment risks and efficient portfolio management The Investment Guideline set out asset allocation rules and controls for each component part of the portfolio as follows

Operating Funds

a) Asset Allocation - The Operating Funds segment of the investment portfolio shall only be invested in high quality liquid fixed and floating rate interest securities and in cash (bank deposits) Qualifying investments include

- Bank Deposits
- Certificates of Deposit (CDs) and Commercial Paper (CP)
- Floating Rate Notes (FRNs)
- Government securities with maturities up to five years (including index linked)
- Listed Debt Securities with maturity up to five years

Investments should be managed to ensure a reasonably even spread of maturities over the forthcoming three-month period In addition, the maturity profile must take account of any potential market price reduction due to interest rate or credit risk

4 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

4 2 Financial risk (Continued)

- Investments must be denominated in Sterling
- Investments in subordinated debt issued by Institutions authorised by the FSA may be made up to the specific limits agreed with Royal Bank of Scotland Group Risk
- All debt securities must have a pre-determined fixed coupon or an unrestricted variable coupon positively linked to a recognised market rate They must also have a definitive maturity date
- The use of Futures and Forward Rate Agreements ("FRAs") are permitted strictly for the purpose of locking in yields or as an expedient method of investing in or hedging, subject to normal limits It is expressly forbidden to use Futures or Options for gearing purposes
- Stock lending of securities is permitted within the limits agreed with Royal Bank of Scotland Group Risk

b) Controls - Bank Deposits up to one year may be approved by one member of the FMC Other transactions must be approved by at least two members of the FMC Any investment not specifically named in the limits agreed with Royal Bank of Scotland Group Risk must be approved by at least three members of the FMC

Long Term Funds

a) Asset Allocation - To achieve its investment objective, the Long-Term Funds segment of the investment portfolio may be invested in the following asset classes, in addition to those mentioned in the Operating Funds

- Equities
- Property
- Fixed Interest Debt Securities (five to fifteen years)
- Floating Rate Debt Securities (up to forty years)

Opportunistic investments in individual equity stocks will also be allowed up to a maximum of £50m and will be held as an Individual Equity Fund This type of investment purchased for this portfolio would typically be those which are of undoubted credit quality and offer a good dividend yield It is likely that such stocks would be liquid and traded on one of the major world stock exchanges

b) Controls

- Investments will normally be denominated in Sterling Suitable opportunities to invest in other currencies are permitted up to 10% (by reference to market value) of total invested funds
- Apart from currency investments, no other currency transactions are permitted except those which are specifically designed to hedge the risk associated with an underlying currency investment
- Bank Deposits up to one year may be approved by one member of the FMC, where there is a specific credit limit in place
- All debt securities must have a pre-determined fixed coupon or an unrestricted variable coupon positively linked to a recognised market rate They must also have a definitive maturity date
- The use of Futures and Forward Rate Agreements ("FRAs") are permitted strictly for the purpose of locking in yields or as an expedient method of investing in or hedging, subject to normal limits It is expressly forbidden to use Futures or Options for gearing purposes
- Stock lending of securities is permitted within the limits agreed with Royal Bank of Scotland Group Risk
- All equity purchases, with the exception of the Individual Equity Fund, must be purchased through one of the Investment Managers retained to run the equity funds Any additional investments in any of the funds, other than reinvestment, must be approved by the FMC
- The Royal Bank of Scotland Insurance Board must approve any property purchased for the sole purpose of investment Other than owner occupied premises, property investments shall be restricted to single tenant occupied office buildings with a 'blue-chip' covenant
- Fixed interest investments with a maturity up to fifteen years may be purchased if approved by at least two members of the FMC and must be within the limits as agreed with Royal Bank of Scotland Group Risk Any investment where no specific prior limit has been approved by Royal Bank of Scotland Group Risk must be approved by at least three members of the FMC

4 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

4 2 Financial risk (Continued)

- Floating rate investments with a maturity up to forty years may be purchased if approved by at least two members of the FMC, and must be within the limits as agreed with Royal Bank of Scotland Group Risk Any investment where no specific prior limit has been approved by Royal Bank of Scotland Group Risk must be approved by at least three members of the FMC
- As mentioned above any purchase for the Individual Equity Fund must not exceed the portfolio limit of £50m and must be approved by the FMC plus either the Chairman of RBS Insurance Group Limited or the Chairman of the RBS Insurance IMC Due regard will be had to the regulator's admissibility limits and the total exposure aggregated with other debt or equity exposures to that name Where the investment is to be made in a foreign currency, it is likely that the cost price would be hedged in the underlying currency

In general, the long-term fund will be invested in a manner such that at least 90% (by market value) of the investments are admissible assets for regulatory purposes

The most important components of financial risk are market risk, credit risk and liquidity risk

4 2 1 Market risk (comprising interest rate risk)

Market risk encompasses any adverse movement in the value of assets as a consequence of market movements such as interest rates, credit spreads, foreign exchange rates, equity prices and property valuations

The Company is exposed to market risk because of positions held in its investment portfolio Exposure to market risk is managed in accordance with the guidelines set out in the Royal Bank of Scotland Insurance Investment Policy as detailed above
The following tables indicate financial assets that are exposed to interest rate risk together with the corresponding range of applicable interest rates

At 31 December 2006

Maturity date or contractual repricing date

	Within one year	After one but not more than two years	After two but not more than three years	After three but not more than four years	After four but not more than five years	More than five years	Total
	£ Million	£ Million	£ Million	£ Million	£ Million	£ Million	£ Million
Exposed to fair value interest rate risk							
Debt securities - fixed interest risk	92 7	75 5	75 5	13 5	37 8	62 5	**357 5**
Exposed to cash flow interest rate risk							
Debt securities - floating interest risk	152 2	-	-	-	-	-	**152 2**
Loans and receivables	1,028 2	-	-	-	-	-	**1,028 2**
Total fair value	**1,273 1**	**75 5**	**75 5**	**13 5**	**37.8**	**62 5**	**1,537 9**

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006

4 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

4 2 1 Market risk (comprising interest rate risk) (Continued)

Interest rate range

	Within one year	After one but not more than two years	After two but not more than three years	After three but not more than four years	After four but not more than five years	More than five years
	% Interest rate range	% Interest rate range	% Interest rate range	% Interest rate range	% Interest rate range	% Interest rate range
Debt securities - fixed interest risk	5 06-5 51	5 17-5 64	5 13-5 60	5 27-5 58	5 05-5 55	4 19-7 00
Debt securities - floating interest risk	5 06-5 67	n/a	n/a	n/a	n/a	n/a
Loans and receivables	3 53-5 51	n/a	n/a	n/a	n/a	n/a

At 31 December 2005

Maturity date or contractual repricing date

	Within one year	After one but not more than two years	After two but not more than three years	After three but not more than four years	After four but not more than five years	More than five years	Total
	£ Million	£ Million	£ Million	£ Million	£ Million	£ Million	£ Million
Exposed to fair value interest rate risk							
Debt securities - fixed interest risk	89 0	31 8	76 9	62 4	9 4	122 5	**392 0**
Exposed to cash flow interest rate risk							
Debt securities - floating interest risk	173 8	-	-	-	-	-	**173 8**
Loans and receivables	804 6	-	-	-	-	-	**804 6**
Total fair value	**1,067 4**	**31 8**	**76 9**	**62.4**	**9 4**	**122 5**	**1,370 4**

Interest rate range

	Within one year	After one but not more than two years	After two but not more than three years	After three but not more than four years	After four but not more than five years	More than five years
	% Interest rate range	% Interest rate range	% Interest rate range	% Interest rate range	% Interest rate range	% Interest rate range
Debt securities - fixed interest risk	4 07-4 47	4 27-4 57	4 17-4 66	4 19-4 68	4 51-4 63	4 11-4 88
Debt securities - floating interest risk	4 52-5 29	n/a	n/a	n/a	n/a	n/a
Loans and receivables	0 00-8 00	n/a	n/a	n/a	n/a	n/a

4 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

4.2 1 Market risk (comprising interest rate risk) (Continued)

The floating interest rate securities are stated at the contractual repricing date which is generally earlier than the maturity dates of these debt securities All floating interest rate securities are subject to repricing within 12 months

Investments in floating rate securities which are subject to an early repayment option have a market value of £82 6 million (2005 £80 7 million) This option lies with the issuer and the Investments would be redeemed at par The Company would reinvest any amounts received as a settlement from application of the early repayment options into similar investments that accord with the Company's Investment Strategy

4 2 2 Credit risk

Credit risk arises from the potential that losses are incurred from the failure of a counterparty to meet its credit obligations The main sources of credit risk for the Company are as follows

- Investment Counterparty – this arises from the investment of monies in the range of investment vehicles permitted by the Investment Policy
- Reinsurance Recoveries – credit exposure to reinsurance counterparties arises in respect of reinsurance claims that have been incurred but not yet settled or in respect of pre-paid reinsurance premiums
- Partnership Premiums – where the partner collects premiums from the policyholder and subsequently remits the premium to the underwriter
- Instalments – a facility provided to policyholders whereby the annual premium due is spread over the policy period
- Brokers – credit facilities provided to brokers, where premiums collected by the broker do not have to be paid over to the insurer until an agreed future date

The Royal Bank of Scotland Group plc risk management division sets standards for maintaining and developing credit risk management throughout the Group This is achieved via a combination of governance structures, credit risk policies, control processes and infrastructure collectively known as the Group's Credit Risk Management Framework ("CRMF")

Royal Bank of Scotland Insurance has established its own CRMF consistent with The Royal Bank of Scotland Group CRMF The Royal Bank of Scotland Insurance CRMF sets out the prior approval process for credit exposures and provides for appropriate analysis and reporting of these exposures at both the Company and Royal Bank of Scotland Group level Where appropriate, larger credit exposures are aggregated with other credit exposures, elsewhere in the Group for credit approval and monitoring purposes

The following table analyses the credit exposure of the Company by type of asset The table includes reinsurance exposure, after provision Refer to 4 1 3 for details of reinsurance credit risk management

At 31 December 2006	AAA £ Million	AA £ Million	A £ Million	BBB £ Million	Not rated £ Million	Total £ Million
Debt securities (note 17)	331 0	113 5	65 2	-	-	**509 7**
Deposits with credit institutions (note 17 & 22)	45 0	983 2	-	-	-	**1,028 2**
Insurance contracts - reinsurance asset (note 25)	8 6	32 1	14 4	2 0	180 8	**237 9**
Cash at bank and in hand (note 22)	-	16 5	-	-	-	**16 5**
Other loans and receivables (note 18)	-	-	-	-	325 8	**325 8**
Total assets bearing credit risk	**384 6**	**1,145 3**	**79 6**	**2 0**	**506 6**	**2,118 1**

4 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

4 2 2 Credit risk (Continued)

At 31 December 2005

	AAA £ Million	AA £ Million	A £ Million	BBB £ Million	Not rated £ Million	Total £ Million
Debt securities (note 17)	392 3	72 4	60 4	-	40 7	**565 8**
Deposits with credit institutions (note 17 & 22)	55 0	749 6	-	-	-	**804 6**
Insurance contracts - reinsurance asset (note 25)	8 4	6 5	44 2	0 4	154 6	**214 1**
Cash at bank and in hand (note 22)	-	30 1	-	-	-	**30 1**
Other loans and receivables (note 18)	-	-	-	-	294 8	**294 8**
Total assets bearing credit risk	**455 7**	**858 6**	**104 6**	**0 4**	**490 1**	**1,909 4**

Other loans and receivables due from policyholders, partners, agents, brokers and intermediaries generally do not have a credit rating

4 2 3 Liquidity risk

Liquidity risk is the potential that obligations cannot be met as they fall due as a consequence of having a timing mismatch

The management of liquidity risk within the Royal Bank of Scotland Insurance Division is undertaken within the limits and other policy parameters set out in the Investment Guidelines The asset class and maturity parameters contained within this policy are summarised above Compliance is monitored both in respect of the internal policy and the regulatory requirements of the FSA

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006

5 NET INSURANCE PREMIUM REVENUE

	2006 £ Million	2005 £ Million
Premium income from insurance contracts issued		
Premium receivables	918 9	909 1
Change in unearned premium provision	3 2	(45 2)
	922 1	863 9
Premium revenue ceded to reinsurers on insurance contracts issued		
Premium payables	(219 1)	(221 3)
Change in unearned premium provision	0 1	2 0
	(219 0)	(219 3)
Net insurance premium revenue	**703.1**	**644 6**

6 FEE INCOME

	2006 £ Million	2005 £ Million
Profit participation from related parties (note 33)	**12 1**	**7 1**

7 INVESTMENT INCOME

	2006 £ Million	2005 £ Million
Available-for-sale financial assets		
Interest income from debt securities	30 5	32 0
Interest income		
from policyholders	3 6	3 3
from loans to related parties (note 33)	1 3	1 2
from deposits with credit institutions	41 7	37 3
Dividend income/(refund) from subsidiaries (note 33)	4 2	(5 0)
Net amortisation of (discount)/premium on purchase of financial assets	(4 7)	(5 3)
Income from other investments	-	0 1
	76 6	**63 6**

The dividend refund of £5 0 million in 2005 is in respect of a reversal of an over accrual of dividend income in 2004

8 NET REALISED GAINS ON FINANCIAL ASSETS

	2006 £ Million	2005 £ Million
Net realised gains on financial assets - available-for-sale		
Debt securities	**0 1**	**0 4**

9 OTHER OPERATING INCOME

	2006 £ Million	2005 £ Million
Net foreign exchange translation gains	0 2	-
Other income	(4 9)	27 5
	(4 7)	27 5

Within the Other Income amount of £(4 9) million is an amount of £(5 3) million (2005 £26 6 million), relating to the (payment of funds to)/receipt of funds from the Company's former parent company, Winterthur Swiss Insurance (Winterthur), as part of an indemnity on loss movements within the Special Risks Division

Due to the nature of the indemnity with Winterthur, amounts can be payable to/from the Company depending on the performance in the year of the Special Risks division

10 INSURANCE CLAIMS AND LOSS ADJUSTMENT EXPENSES

	2006		
	Gross	Reinsurance	Net
	£ Million	£ Million	£ Million
Current accident year claims paid	254 6	(45 9)	208 7
Prior accident years' claims paid	339 3	(59 0)	280 3
Movement in current accident year claims provision	498 2	(104 5)	393 7
Movement in prior accident years' claims provision	(460 3)	80 6	(379 7)
	631 8	(128 8)	503 0

	Restated 2005		
	Gross	Reinsurance	Net
	£ Million	£ Million	£ Million
Current accident year claims paid	234 8	(47 2)	187 6
Prior accident years' claims paid	352 6	(51 3)	301 3
Movement in current accident year claims provision	453 6	(110 1)	343 5
Movement in prior accident years' claims provision	(434 0)	68 1	(365 9)
	607 0	(140.5)	466 5

Loss adjustment expenses for the year of £13 5 million (2005 £26 4 million) have been included in the accident year claims paid figures above

A movement in relation to liability adequacy provisions of £5 0 million has been included in the movement in current accident year claims provision

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006

11 EXPENSES

a) Commission expenses	2006 £ Million	2005 £ Million
Commission expenses	163 9	164 0
Expense contributions under quota share contracts	(26 0)	(26 5)
	137 9	**137 5**

b) Expenses for marketing and administration	2006 £ Million	2005 £ Million
Marketing and administration expenses	105 9	108 6
Depreciation (note 15)	0 1	0 1
Expense contributions under quota share contracts	(18 2)	(17 6)
	87 8	**91 1**

Expenses for marketing and administration include integration costs of £nil (2005 £18 3 million) arising from the integration of the Churchill Group of companies

12 FINANCE COSTS

	2006 £ Million	2005 £ Million
Interest expense		
Borrowings from related parties (note 33)	**3 9**	**0 2**

13 TAX CHARGE

	2006 £ Million	2005 £ Million
Current taxation		
Charge for the year	11 8	11 4
(Over)/under provision in respect of prior years	(4 4)	1 2
	7 4	12 6
Deferred taxation (note 20)		
Charge for the year	2 2	2 7
Tax charge for the year	**9 6**	**15 3**

The actual tax charge differs from the expected tax charge computed by applying the standard rate of UK corporation tax of 30% (2005 30%) as follows

	2006 £ Million	2005 £ Million
Expected tax charge	16 4	14 4
Effects of		
Non-taxable items	(2 4)	(0 3)
Adjustments in respect of prior periods	(4 4)	1 2
Tax charge	**9.6**	**15 3**

The aggregate current and deferred tax relating to items that are (credited) or charged to equity is (£2 5) million (2005 £1 0 million)

14 PROFIT FOR THE YEAR

Profit for the year is stated after charging	2006 £ Million	2005 £ Million
Depreciation of plant and equipment	0 1	0 1
Operating lease rentals (note 31)	3 7	3 8

Auditors' remuneration

Fees for audit and non-audit services, included within marketing and administration expenses, are borne and recharged by a related party, RBS Insurance Services Limited

Fees paid to the auditors with respect to the statutory audit of the Company amount to £237,000 (2005 £300,000)

Other services fees in respect of the audit of the FSA Return amount to £24,000 in 2006 (2005 £19,000)

Directors' emoluments

	2006 £ Million	2005 £ Million
Other emoluments	0 6	1 1
Company pension contributions	-	0 1
	0 6	**1 2**

Fees paid to directors during the year amounted to £8,452 (2005 £7,500), and company pension contributions amounted to £32,093 (2005 £145,981)

No directors who served during this or the previous financial year were remunerated by the Company The amounts disclosed above are those relating to their services as directors for the Company based on an estimated time allocation basis Emoluments in relation to services performed by the directors for other group companies are not disclosed in the Company's financial statements

Included in the above are emoluments, excluding pension contributions, paid to the highest paid director amounting to £182,895 (2005 £208,408)

A contribution of £1,394 (2005 £37,686) to a money purchase scheme was made on behalf of the highest paid director Eight other directors (2005 four directors) had retirement benefits accruing under money purchase pension schemes in respect of qualifying service and no directors (2005 one director) had benefits accruing under defined pension schemes

During the year seven directors have exercised share options (2005 three directors) Details of the share options of the directors in office at 31 December 2006 are disclosed within the directors' report

15 PLANT AND EQUIPMENT

	Vehicles £ Million	Other equipment £ Million	Total £ Million
Cost			
At 31 December 2006	0 4	9 0	**9 4**
Depreciation			
At 1 January 2005	0 3	8 4	**8 7**
Depreciation charge for the year	-	0 1	**0 1**
At 31 December 2005	0 3	8 5	**8 8**
Depreciation charge for the year	-	0 1	**0 1**
At 31 December 2006	0 3	8 6	**8 9**
Net book amount			
At 31 December 2006	**0 1**	**0.4**	**0 5**
At 31 December 2005	**0 1**	**0.5**	**0 6**

16 INVESTMENT PROPERTIES

	2006 £ Million	2005 £ Million
At 1 January	-	0 3
Disposals	-	(0 3)
At 31 December	-	-

Investment property comprised freehold property occupied by entities outside The Royal Bank of Scotland Group plc on an operating lease Operating lease rentals included in the income statement for the year were £nil (2005 £nil)

17 INVESTMENTS IN SUBSIDIARIES

	2006 £ Million	2005 £ Million
At 1 January	27 5	27 5
Disposals in the year	(31 0)	-
Reversal of previous impairment taken through income statement	4 8	-
At 31 December	1 3	27 5

17 INVESTMENTS IN SUBSIDIARIES (Continued)

Details of the Company's subsidiaries as at 31 December 2006 are as follows

Name of subsidiary	Place of incorporation and operation	Proportion of ownership interest		Proportion of voting power held	Principal activity
Finsure Premium Finance Limited	UK	100%	Ordinary Shares	100%	Premium finance company
set2print Limited	UK	100%	Ordinary Shares	100%	Printing company
All Risk Management Limited	UK				Risk management
		100%	"A" shares	100%	consultancy
		100%	"B" shares	100%	
		N/A	Deferred shares	N/A	

During the year the Company acquired the B ordinary shares of All Risk Management Limited for a consideration of £2 All Risk Management Limited is now a wholly owned subsidiary

The disposal in the year of £31 million represents the derecognition of the investment in the Company's subsidiary, NIG Hallmark Limited, which entered into Members Voluntary Liquidation on 30 September 2006 A dividend of £4 2m was received, by the Company from NIG Hallmark Limited upon liquidation

18 FINANCIAL ASSETS

	2006 £ Million	Restated (see note 3) 2005 £ Million
Available-for-sale investments		
Debt Securities		
Listed - fixed interest rate	357 5	392 0
Listed - floating interest rate	152 2	173 8
	509 7	**565 8**
Loans and receivables		
Deposits with credit institutions with maturities in excess of three months		
- third parties	508 0	284 9
- related parties (note 33)	25 0	-
	533 0	284 9
Other loans and receivables, including insurance receivables (note 19)	325 8	294 8
	858 8	**579 7**

19 OTHER LOANS AND RECEIVABLES INCLUDING INSURANCE RECEIVABLES

	2006 £ Million	Restated 2005 £ Million
Receivables arising from insurance and reinsurance contracts		
Due from policyholders	50 1	53 5
Less provision for impairment of receivables from policyholders	(0 4)	(0 2)
Due from agents, brokers and intermediaries	114 7	122 2
Less provision for impairment of receivables from agents, brokers and intermediaries	(0 5)	(6 3)
Due from reinsurers		
third party reinsurers	18 4	18 3
Other loans and receivables		
Accrued interest and rent	16 7	10 6
Receivables from related parties (note 33)	63 9	52 6
Loans to related parties (note 33)	47 4	26 3
Other prepayments and accrued income	(0 3)	8 9
Other debtors	15 8	8 9
Total loans and receivables including insurance receivables	**325 8**	**294 8**

20 DEFERRED TAXATION

The following are the deferred tax assets and liabilities recognised by the Company, and the movements thereon, during the current and prior reporting periods

	Accelerated capital £ Million	Provisions £ Million	Equalisation Reserve £ Million	Total £ Million
At 1 January 2005	1 0	1 1	(7 4)	**(5 3)**
Credit to income statement (note 13)	(0 3)	(0 3)	(2 1)	**(2 7)**
31 December 2005	**0 7**	**0 8**	**(9 5)**	**(8 0)**
Credit to income statement (note 13)	(0 2)	-	(2 0)	**(2 2)**
At 31 December 2006	**0 5**	**0 8**	**(11 5)**	**(10 2)**

The following is the analysis of the deferred tax balances (after offset)

	2006 £ Million	2005 £ Million
Deferred tax assets	1 3	1 5
Deferred tax liabilities	(11 5)	(9 5)
Deferred tax liabilities as shown on the balance sheet	**(10 2)**	**(8 0)**

Deferred tax assets of £5 0 million (2005 £nil) resulting from tax losses carried forward transferred from a subsidiary, Hallmark Insurance Company Limited, of £16 8 million (2005 £nil) have not been recognised as it is currently not probable that the assets will be recoverable These assets may be recoverable if the losses can be offset against suitable future taxable profits arising in the same tax jurisdiction

21 REINSURANCE ASSETS

	2006 £ Million	2005 £ Million
Reinsurers' share of insurance liabilities		
- third party reinsurers	75 5	79 3
- related parties (note 33)	269 7	237 5
Impairment provision	(6 3)	(1 8)
Total assets arising from reinsurance contracts	**338 9**	**315 0**

22 DEFERRED ACQUISITION COSTS

	2006 £ Million	2005 £ Million
At 1 January	72 9	59 8
Net credit to income statement	4 2	13 1
At 31 December	**77 1**	**72 9**

23 CASH AND CASH EQUIVALENTS

	2006 £ Million	Restated (see note 3) 2005 £ Million
Cash at bank and in hand		
- third parties	11 6	23 4
- related parties (note 33)	4 9	6 7
Short term deposits with credit institutions		
- third parties	340 0	442 3
- related parties (note 33)	155 2	77 4
	511 7	**549 8**

The effective interest rate on short term deposits with credit institutions was 4 31% (2005 4 53%) and has an average maturity of 28 days (2005 6 days)

For the purposes of the cash flow statement, cash and bank overdrafts are as follows

	2006 £ Million	2005 £ Million
Cash and cash equivalents	511 7	549 8
Bank overdrafts (note 27)	(21 0)	(18 9)
	490 7	**530 9**

24 SHARE CAPITAL

	2006 £ Million	2005 £ Million
Authorised		
Equity shares		
275 million ordinary shares of £1 each (2005 255 million ordinary shares of £1 each)	**275 0**	**255 0**
Issued and fully paid		
Equity shares		
265 million ordinary shares of £1 each (2005 255 million ordinary shares of £1 each)		
At 31 December	**265 0**	**255 0**

On 16 May 2006, the authorised ordinary share capital of the Company was increased from £255 million to £275 million by the creation of 20 million new ordinary shares of £1, each ranking pari passu with the existing 255 million ordinary shares

On 30 June 2006, the Company's issued ordinary share capital was increased from 255 million ordinary shares of £1 each to 265 million ordinary shares of £1 each These additional 10 million ordinary shares were issued at par and were fully paid

25 OTHER RESERVES AND RETAINED EARNINGS

	2006 £ Million	2005 £ Million
Reserve for revaluation of available-for-sale investments	(1 4)	4 2
Claims equalisation reserve	38 3	31 8
Other reserves at 31 December	**36 8**	**36 0**
Retained earnings at 31 December	**59 9**	**21 4**

Movements in the revaluation reserve for available-for-sale investments were as follows

	Debt securities £ Million
At 1 January 2005	2 0
Revaluation during the period - gross	3 6
Revaluation during the period - taxation	(1 1)
Net gains transferred to net profit on disposal and impairment - gross (note 8)	(0 4)
Net gains transferred to net profit on disposal and impairment - taxation (note 13)	0 1
At 31 December 2005	4 2
Revaluation during the period - gross	(8 0)
Revaluation during the period - taxation	2 5
Net gains transferred to net profit on disposal and impairment - gross (note 8)	(0 1)
Net gains transferred to net profit on disposal and impairment - taxation (note 13)	-
At 31 December 2006	**(1 4)**

Movements in the claims equalisation reserve were as follows

	£ Million
At 1 January 2005	24 8
Transfer from retained earnings for movement in year	7 0
At 31 December 2005	31 8
Transfer from retained earnings for movement in year	6 5
At 31 December 2006	**38 3**

26 INSURANCE CONTRACTS AND REINSURANCE ASSETS

	2006 £ Million	2005 £ Million
Gross		
Claims reported	624 4	577 2
Claims incurred but not reported	471 3	485 7
Loss adjustment expenses	20 2	39 8
Unearned premiums	456 8	460 0
Liability adequacy provision	5 0	-
Total insurance liabilities, gross	**1,577 7**	**1,562 7**
Recoverable from reinsurers		
Claims reported	(114 8)	(128 6)
Claims incurred but not reported	(123 1)	(85 5)
Unearned premiums	(101 0)	(100 9)
Total reinsurers' share of insurance liabilities	**(338 9)**	**(315 0)**

26 INSURANCE CONTRACTS AND REINSURANCE ASSETS (Continued)

	2006 £ Million	2005 £ Million
Net		
Claims reported	509 6	448 6
Claims incurred but not reported	348 2	400 2
Loss adjustment expenses	20 2	39 8
Unearned premiums	355 8	359 1
Liability adequacy provision	5 0	-
Total insurance liabilities, net	**1,238 8**	**1,247 7**

Net liabilities transferred from Hallmark Insurance Company Limited

In accordance with an order granted by the High Court, on 22 September 2006, under the insurance business transfer scheme in Part VII of the Financial Services Management Act 2000, the Company accepted a transfer of the insurance liabilities, together with the assets matching those liabilities, from Hallmark Insurance Company Limited, a subsidiary of the Company Under the terms of the transfer the Company assumed full responsibility for all of the administration and settlement of both current and any future claims arising in the business transferred The benefit of any re-insurance attaching to these claims will also accrue to the Company The transfer was completed on 30 September 2006 and comprised

Assets and liabilities transferred

	£ Million
Gross technical provisions	5 1
Reinsurance technical provisions	(0 1)
Other reinsurance balances	0 2
Cash	5 0
	5 1

26 INSURANCE CONTRACTS AND REINSURANCE ASSETS (Continued)

Insurance claims - gross

Accident year	2001	2002	2003	2004	2005	2006	Total
	£ Million	£ Million	£ Million	£ Million	£ Million	£ Million	£ Million
Estimate of ultimate claims costs							
At end of accident year	294 8	348 3	520 4	541 1	677 4	741 9	**3,123 9**
One year later	(7 3)	0 1	(66 1)	(72 5)	(73 6)	-	**(219 4)**
Two years later	8 7	(7 5)	(28 3)	(28 7)	-	-	**(55 8)**
Three years later	(8 1)	(13 7)	(27 5)	-	-	-	**(49 3)**
Four years later	(8 2)	(11 3)	-	-	-	-	**(19 5)**
Five years later	(6 2)	-	-	-	-	-	**(6 2)**
Current estimate of cumulative claims	273 7	315 9	398 5	439 9	603 8	741 9	**2,773 7**
Cumulative payments to date	(253 8)	(281 2)	(306 9)	(301 6)	(376 1)	(248 8)	**(1,768 4)**
Liability recognised in balance sheet	19 9	34 7	91 6	138 3	227 7	493 1	**1,005 3**
Liability in respect of prior years							29 0
Total liability included in the balance sheet							**1,034 3**

Insurance claims - net of reinsurance

Accident year	2001	2002	2003	2004	2005	2006	Total
	£ Million	£ Million	£ Million	£ Million	£ Million	£ Million	£ Million
Estimate of ultimate claims costs							
At end of accident year	286 6	340 5	421 0	418 6	520 1	591 7	**2,578 5**
One year later	(9 2)	(1 7)	(55 8)	(59 6)	(57 3)	-	**(183 6)**
Two years later	7 6	(8 5)	(20 6)	(26 0)	-	-	**(47 5)**
Three years later	(6 2)	(13 8)	(26 7)	-	-	-	**(46 7)**
Four years later	(6 5)	(10 8)	-	-	-	-	**(17 3)**
Five years later	(7 3)	-	-	-	-	-	**(7 3)**
Current estimate of cumulative claims	265 0	305 7	317 9	333 0	462 8	591 7	**2,276 1**
Cumulative payments to date	(250 4)	(278 4)	(246 9)	(234 0)	(291 8)	(202 9)	**(1,504 4)**
Liability recognised in balance sheet	14 6	27 3	71 0	99 0	171 0	388 8	**771 7**
Liability in respect of prior years							24 8
Total liability included in the balance sheet							**796 5**

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006

26 INSURANCE CONTRACTS AND REINSURANCE ASSETS (Continued)

Insurance claims - gross

Restated

Underwriting year	2001	2002	2003	2004	2005	2006	Total
	£ Million	£ Million	£ Million	£ Million	£ Million	£ Million	£ Million
Estimate of ultimate claims costs							
At end of underwriting year	88 2	102 1	64 9	2 1	-	-	**257 3**
One year later	50 0	66 9	55 7	0 4	-	-	**173 0**
Two years later	21 8	17 3	(6 3)	0 1	-	-	**32 9**
Three years later	32 6	39 9	3 4	-	-	-	**75 9**
Four years later	(3 9)	(2 6)	-	-	-	-	**(6 5)**
Five years later	2 4	-	-	-	-	-	**2 4**
Current estimate of cumulative claims	191 1	223 6	117 7	2 6	-	-	**535 0**
Cumulative payments to date	(179 1)	(199 7)	(105 2)	(0 2)	-	-	**(484 2)**
Liability recognised in balance sheet	12 0	23 9	12 5	2 4	-	-	**50 8**
Liability in respect of prior years							10 5
Total liability included in the balance sheet							61 3

Insurance claims - net of reinsurance

Restated

Underwriting year	2001	2002	2003	2004	2005	2006	Total
	£ Million	£ Million	£ Million	£ Million	£ Million	£ Million	£ Million
Estimate of ultimate claims costs							
At end of underwriting year	69 5	70 3	50 5	2 1	-	-	**192 4**
One year later	34 8	71 6	52 1	0 4	-	-	**158 9**
Two years later	26 3	13 1	(7 0)	0 1	-	-	**32 5**
Three years later	32 3	39 6	2 7	-	-	-	**74 6**
Four years later	(7 1)	(2 5)	-	-	-	-	**(9 6)**
Five years later	2 4	-	-	-	-	-	**2 4**
Current estimate of cumulative claims	158 2	192 1	98 3	2 6	-	-	**451 2**
Cumulative payments to date	(146 2)	(168 2)	(85 8)	(0 2)	-	-	**(400 4)**
Liability recognised in balance sheet	12 0	23 9	12 5	2 4	-	-	**50 8**
Liability in respect of prior years							10 5
Total liability included in the balance sheet							61 3

26 INSURANCE CONTRACTS AND REINSURANCE ASSETS (Continued)

Movements in insurance liabilities and reinsurance assets

(i) Claims and loss adjustment expenses	**Restated** Gross £ Million	Reinsurance £ Million	Net £ Million
Notified claims	542 3	(110 3)	432 0
Incurred but not reported	534 7	(61 8)	472 9
At 1 January 2005	**1,077 0**	**(172 1)**	**904 9**
Cash paid for claims settled in the year	(587 3)	98 5	(488 8)
Increase / (decrease) in liabilities			
- arising from current year claims	694 4	(157 3)	537 1
- arising from prior year claims	(81 4)	16 8	(64 6)
At 31 December 2005	**1,102 7**	**(214 1)**	**888 6**
Notified claims	617 0	(128 6)	488 4
Incurred but not reported	485 7	(85 5)	400 2
At 1 January 2006	**1,102 7**	**(214 1)**	**888 6**
Cash paid for claims settled in the year	(593 9)	104 9	(489 0)
Increase / (decrease) in liabilities			
- arising from current year claims	728 1	(150 4)	577 7
- arising from prior year claims	(126 0)	21 5	(104 5)
- from prior year claims transferred in from Hallmark Insurance Company Limited	5 0	0 1	5 1
At 31 December 2006	**1,115.9**	**(238 0)**	**877 9**
Notified claims	644 6	(114 9)	529 7
Incurred but not reported	471 3	(123 1)	348 2
At 31 December 2006	**1,115.9**	**(238 0)**	**877 9**

(ii) Provisions for unearned premiums and unexpired short term insurance risks

	Gross £ Million	Reinsurance £ Million	Net £ Million
Unearned premium provision			
At 1 January 2005	414 8	(98 8)	316 0
Net increase/(decrease) in the year	45 2	(2 1)	43 1
At 31 December 2005	**460.0**	**(100 9)**	**359 1**
Net (decrease) in the year	(3 2)	(0 1)	(3 3)
At 31 December 2006	**456.8**	**(101 0)**	**355 8**

26 INSURANCE CONTRACTS AND REINSURANCE ASSETS (Continued)

	Gross £ Million	Reinsurance £ Million	Net £ Million
Liability adequacy provision			
At 1 January 2005	-	-	-
Net increase in the year	-	-	-
At 31 December 2005	-	-	-
Net increase in the year	5 0	-	5 0
At 31 December 2006	5 0	-	5 0

27 BORROWINGS

	2006 £ Million	2005 £ Million
Loans from related parties (note 33)	131 8	4 7
Bank overdrafts from related parties (note 33)	21 0	18 9
	152 8	**23 6**

The borrowings are repayable as follows

On demand or within one year	**152 8**	**23 6**

Details of loans and bank overdrafts with related parties can be found in note 33

The carrying value of the short term borrowings approximates to their fair value

28 TRADE AND OTHER PAYABLES INCLUDING INSURANCE PAYABLES

	2006 £ Million	2005 £ Million
Due to agents, brokers and intermediaries		
third party	25 5	14 9
related parties (note 33)	-	0 8
Due to reinsurers		
related parties (note 33)	100 7	108 3
Due to related parties (note 33)	18 9	28 0
Trade creditors and accruals	5 8	(0 2)
Other creditors	15 0	5 3
Other taxes	11 0	8 6
	176 9	**165 7**

29. PROVISIONS FOR OTHER LIABILITIES AND CHARGES

	Regulatory levies £ Million
At 1 January 2005	**12 7**
Charged to the income statement	
- additional provisions	15 8
- unused amounts reversed	(2 6)
Used during year	(10 6)
At 31 December 2005	**15 3**
Charged to the income statement	
- additional provisions	15 9
- unused amounts reversed	(1 4)
Used during year	(12 5)
At 31 December 2006	**17 3**

30. CONTINGENT LIABILITIES

There are no contingent liabilities that require disclosure in these financial statements

31 COMMITMENTS

Operating lease commitments

The Company leases certain of its office properties under non-cancellable operating lease agreements The leases have varying terms, escalation clauses and renewal rights

The Company also leases vehicles and other assets under cancellable operating lease agreements

	2006 £ Million	2005 £ Million
Minimum lease payments under operating leases recognised as an expense in the year	3 7	4 0

At the balance sheet date, the Company had outstanding commitments under non-cancellable operating leases, which fall due as follows

	2006 £ Million	2005 £ Million
Within one year	0 1	-
In the second to fifth years inclusive	0 1	0 1
After five years	3 5	3 7
	3 7	3 8

32 IMMEDIATE PARENT COMPANIES

The Company's immediate parent company is RBS Insurance Group Limited

The Company's ultimate holding company, ultimate controlling party, and the parent of the largest and smallest group into which the Company is consolidated is The Royal Bank of Scotland Group plc, which is incorporated in Great Britain and registered in Scotland Financial statements for The Royal Bank of Scotland Group plc can be obtained from The Royal Bank of Scotland Group plc, Gogarburn, Edinburgh EH12 1HQ

33 RELATED PARTY TRANSACTIONS

The followıng transactıons were carrıed out wıth related partıes

ı Sales of ınsurance contracts and other servıces

	2006 £ Mıllıon	2005 £ Mıllıon
Sales of servıces		
Churchıll Insurance Company Lımıted	6 3	9 8
Fınsure Premıum Fınance Lımıted	15 7	8 1
NIG Hallmark Lımıted	4 2	5 0
The Royal Bank of Scotland plc	-	0 4
Set2prınt Lımıted	-	0 1
U K Insurance Lımıted	0 3	-
	26 5	**23 4**
Interest receıved (note 7)		
Fınsure Premıum Fınance Lımıted	0 8	1 2
Green Flag Group Lımıted	0 5	-
	1 3	**1 2**

Sales of servıces are provıded between related partıes on an arms length basıs
Interest ıncome receıved from deposıts held wıth related partıes were at rates rangıng from 5 15% to 5 23% (2005 4 54% to 4 78%)

ıı Purchases of products and servıces

	2006 £ Mıllıon	2005 £ Mıllıon
Purchases of servıces		
All Rısk Management Lımıted	0 2	-
Churchıll Insurance Company Lımıted	-	0 1
Churchıll Management Lımıted	(4 2)	-
Devıtt Insurance Servıces Lımıted	3 5	3 7
Dırect Lıne Accıdent Management Lımıted	-	0 1
Dırect Lıne Insurance plc	0 1	-
RBS Insurance Servıces Lımıted	134 3	143 5
RBS Busıness Insurance Servıce Lımıted	6 7	0 5
Set2prınt Lımıted	0 7	1 0
UK Assıstance Accıdent Repaır Centres Lımıted	15 3	9 6
	156 6	**158 5**
Interest paıd (note 12)		
NIG Hallmark Lımıted	0 1	0 2
The Royal Bank of Scotland plc	3 6	-
RBS Insurance Servıces Lımıted	0 2	-
	3 9	**0 2**

THE NATIONAL INSURANCE AND GUARANTEE CORPORATION LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006

33 RELATED PARTY TRANSACTIONS (Continued)

Purchases of services also includes payments made between companies determined by the levels of business generated and as agreed between the parties on an arm's length basis

All employees were employed by RBS Insurance Services Limited, a fellow subsidiary company Total employee costs, including directors' remuneration, recharged to the Company by RBS Insurance Services Limited during the year were £82 6 million (2005 £92 0 million)

Employee costs recharged by RBS Insurance Services Limited includes the full costs of key managers and other staff in respect of share-based payments The attribution among members of the RBS Group has regard to the needs of the group as a whole

iii Acquisition of reinsurance contracts

	2006 £ Million	2005 £ Million
In relation to Headrow Reinsurance Limited		
Purchases of reinsurance		
Written premium	184 8	185 1
Change in unearned premium provision	0 7	(16 1)
	185 5	169 0
Amounts recoverable in respect of		
Claims paid	84 4	70 2
Movement in claims provision	32 9	40 9
Expenses	44 2	44 1
Profit share receivable (note 6)	12 1	7 1
	173 6	162 3

iv Compensation of key management

The aggregate remuneration of directors and other members of key management during the year was as follows

	2006 £ Million	2005 £ Million
Other emoluments	0 9	1 4
Company pension contributions	0 1	0 2
	1 0	1 6

Fees paid to directors during the year amounted to £8,452 (2005 £7,500)

v Year-end balances arising from sales/purchases of products/services

	2006 £ Million	2005 £ Million
Bank deposits held with related parties (note 23)		
National Westminster Plc	4 9	6 6
The Royal Bank of Scotland plc	155 3	77 5
	160 2	84 1

33 RELATED PARTY TRANSACTIONS (Continued)

	2006 £ Million	2005 £ Million
Bank overdrafts held with related parties (note 27)		
National Westminster Plc	10 0	11 2
The Royal Bank of Scotland plc	11 0	7 7
	21 0	18 9

	2006 £ Million	2005 £ Million
Term deposits held with related parties (note 18)		
National Westminster Plc	25 0	-
	25 0	-

Movements in term deposits held with related parties were as follows

At 1 January	-	29 1
New deposits placed in the period	25 0	282 7
Received on maturity in the period	-	(312 3)
Interest received	-	0 5
At 31 December	25 0	-

	2006 £ Million	Restated 2005 £ Million
Receivables from related parties (note 19)		
All Risk Management Limited	-	0 1
Churchill Insurance Company Limited	7 1	10 8
Direct Line Insurance plc	-	0 6
Finsure Premium Finance Limited	56 8	41 1
	63 9	52 6

Movements in receivables from related parties were as follows

At 1 January	52 6	33 4
Transactions in the period	26 5	30 8
Reclassification	4 5	-
Settled in the year	(19 7)	(11 6)
At 31 December	63 9	52 6

Payables to related parties (note 28)

	2006 £ Million	2005 £ Million
Due to re-insurers		
Headrow Reinsurance Limited	100 7	108 3
	100 7	108 3

33 RELATED PARTY TRANSACTIONS (Continued)

	2006 £ Million	2005 £ Million
Due to other related parties		
NIG Hallmark Limited	-	4 2
RBS Business Insurance Services Limited	-	0 5
RBS Insurance Services Limited	15 2	23 3
Set2print Limited	0 2	-
UK Assistance Accident Repair Centres Limited	3 3	-
U K Insurance Limited	0 2	-
	18 9	28 0

	2006 £ Million	2005 £ Million
Movements in payables to Headrow Reinsurance Limited		
At 1 January	108 3	98 6
Transactions in the period	25 2	64 6
Settled in the year	(32 8)	(54 9)
At 31 December	100 7	108 3

	2006 £ Million	2005 £ Million
Movements in payables to other related parties were as follows		
At 1 January	28 0	71 6
Transactions in the period	156 6	146 4
Reclassification	(4 5)	-
Settled in the year	(161 2)	(190 0)
At 31 December	18 9	28 0

vi Loans to related parties

	2006 £ Million	2005 £ Million
Loans to related parties (note 19)		
Finsure Premium Finance Limited	20 6	26 3
Green Flag Group Limited	18 4	-
RBS Insurance Services Limited	8 4	-
	47 4	26 3

Movements in loans to related parties were as follows

	2006 £ Million	Restated 2005 £ Million
Loans to related parties (note 19)		
At 1 January	26 3	25 4
Loans advanced during year	27 4	1 0
Loan repayments received	(8 0)	(1 3)
Interest charged	0 4	-
Interest received (note 7)	1 3	1 2
At 31 December	47 4	26 3

33 RELATED PARTY TRANSACTIONS (Continued)

vii Loans from related parties

	2006 £ Million	2005 £ Million
Loans from related parties (note 27)		
NIG Hallmark Limited	-	4 7
RBS Insurance Group Limited	131 9	-
	131 9	4 7

Movements in loans from related parties were as follows

	2006 £ Million	2005 £ Million
Loans from related parties (note 27)		
At 1 January	4 7	4 5
Loans advanced during year	147 4	-
Loan repayments made	(24 1)	-
Interest charged (note 12)	3 9	0 2
	131 9	4 7

viii Reinsurance assets (note 21)

	2006 £ Million	2005 £ Million
In relation to Headrow Reinsurance Limited		
Amounts in respect of technical provisions		
Claims reported and incurred but not reported	175 3	142 4
Unearned premium	94 4	95 1
	269 7	237 5

Movements in reinsurance assets were as follows

	2006 £ Million	2005 £ Million
Reinsurance assets (note 21)		
At 1 January	237 5	180 5
Movement in claims provision	32 9	40 9
Change in unearned premium provision	(0 7)	16 1
At 31 December	269 7	237 5