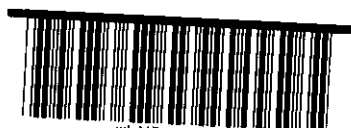


N M Rothschild & Sons Limited

Report of the Directors and Consolidated Financial Statements
for the year ended 31 March 2006

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COMPANIES HOUSE 25/08/2006

World Presence

The Rothschild banking group has offices in more than 30 countries and employs more than 2,000 people around the world.

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North America

Bermuda
British Virgin Islands
Cayman Islands
Mexico City
Montréal
New York
Toronto
Washington

South America

Santiago
São Paulo

Europe

Amsterdam
Athens
Birmingham
Budapest
Frankfurt
Geneva
Guernsey
Leeds
Lisbon
London
Luxembourg
Madrid
Manchester
Milan
Moscow
Paris
Prague
Rome
Warsaw
Zurich

Africa

Harare
Johannesburg

Asia Pacific

Beijing
Hong Kong
Jakarta
Kuala Lumpur
Melbourne
Mumbai
Shanghai
Singapore
Sydney
Tokyo

Directors

Chairman

David de Rothschild

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Executive Directors

Anthony Alt

Timothy Hancock

Peter Johns

Isobel Baxter

Nigel Higgins

Charles Keay

Anthony Chapman

Joshua Hoffman

Nicholas Wrigley

Andrew Didham

Non-Executive Directors

Eric de Rothschild

Lord Guthrie

Peter Smith

Leopold de Rothschild

Sir Graham Hearne

Sir Clive Whitmore

Lord George

Chairman's Statement

As the Chairman of a family-controlled business it falls to me to maintain the Rothschild tradition of safeguarding the interests of our clients and staff...

To this end, I am committed to achieving certain key financial targets, including sustainable high quality earnings growth from a well balanced portfolio of businesses...

Chairman's Statement

The Bank had a very good year, the highlight of which was an outstanding performance by our investment bankers. Further progress was also made in reshaping the business and its management structure. For all of this our hard-working and talented staff deserve great credit.

This year's financial statements are presented in accordance with International Financial Reporting Standards. The transition to this new and more complex form of financial reporting is a heavy burden for a business such as ours. Indeed, to provide a greater degree of year on year comparability a pro forma consolidated income statement has been provided for shareholders so the underlying business performance may be more clearly understood. Accordingly I refer to the more conservative pro forma figures in my statement.

Total operating income of £370 million is the highest in the Bank's history, and well up on last year's figure of £250 million. At the same time, costs were kept under control and increased less than revenues. The result is a record pre-tax profit of £83.2 million (£41.6 million in 2004-2005). These figures include the results of the Guernsey banking business and those of our asset finance business, the Five Arrows Finance group.

Investment Banking

UK investment banking has long been the main engine of growth of our business, both in the UK and for the Rothschild group as a whole. The M&A markets were buoyant, but the UK team did much more than rise with the tide. They generated record revenues from an increased market share, including a significant number of high value deals, once again emphasising the Group's ability to compete at the highest level. For the second consecutive year, our peers and the financial press chose the Bank as Best UK M&A House, whilst the group won the award of Best European M&A House.

We continued to build on our strengths in specific industry sectors, including Building Materials, FIG, Healthcare, Industrials, Mining and Metals, Oil and Gas, Property, Transport and Utilities, and our prominent position in the industry league tables underscores the success of this strategy. Restructuring is another sector in which we remain a market leader.

ABN AMRO Rothschild, our international equity capital markets collaboration, celebrates its tenth anniversary. This combines the research, trading and sales distribution resources of ABN AMRO with the origination and advisory skills of Rothschild. As a bulge bracket distributor of major equity issues it has maintained a top ten position in the European league tables.

Commercial Banking

Over the last two years the commercial banking business of the wider Rothschild group has been substantially reshaped, both in what it does and where. The business is now concentrated in the UK, and in 2005-2006 it maintained its recent record of consistent year on year growth in revenues and operating profits. However, we have changed the focus and some of the key components

Chairman's Statement

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of the UK business, partly in response to market developments but also to improve returns by concentrating on those sectors which best suit our skills and risk appetite.

Today, the Bank's commercial banking activities include the arranging and provision of debt finance across the leveraged finance, property, financial services and natural resources sectors. Asset financing, including leasing, invoice discounting and factoring, is provided through the Five Arrows Finance division.

Wealth Management and Merchant Banking

The private banking activities of the Bank's Guernsey subsidiary are now being developed through the wider Rothschild group Wealth Management arm, which in the UK operates as Rothschild Private Management and provides a wide range of services to our private clients. A successful, high quality wealth management business is one of the key components of our long-term business strategy. With this in mind we are building closer links between it and the other business lines so that private clients can have access to the full range of services and experience on offer in the group.

At the group level there is also an emerging principal investing or merchant banking business, which is to become the fourth core Rothschild business. In the course of our business and through our extensive network of relationships, opportunities arise for us to invest for our own account, often alongside clients and friends. In future we shall be doing more of this.

Board Changes

During the year there were two Board changes. *Sir John Collins*, the chairman of DSG International plc, stepped down but remains a director of our parent company, Rothschild's

Continuation Holdings AG, and continues his valuable work as a member of the Bank's Remuneration and Nominations Committee. After a distinguished career and 21 years of service, Paul Tuckwell handed over the reins as Head of UK Banking to his colleague Peter Johns, and retired from the Board. We are indebted to Paul for his contribution to the Bank's prosperity.

The Future

No business is sustainable if it does not generate returns which enable the shareholders to provide capital for the business to grow together with a decent return for themselves. To this end, I am committed to achieving certain key financial targets, including sustainable high quality earnings growth from a well balanced portfolio of businesses, which produces an acceptable return on shareholders' funds. This in turn requires a disciplined approach, both in building the appropriate mix of revenues and in controlling costs. Our property-related costs in particular are too high, and rebuilding New Court remains one of the options under consideration.

The year 2006-2007 has started well, but given the uncertain economic outlook it is difficult to look too far ahead. I am confident, however, that we are in good shape to respond to whatever tomorrow may bring.

David de Rothschild

15 June 2006

Business Review

Working together creating
intelligent solutions
and delivering advantage

The Rothschild commitment
is to the long-term success
of your business. We judge
our own achievements on
our ability to help you
realise your future

Business Review

Financial Review

International Financial Reporting Standards ("IFRS")

These financial statements are the first to have been prepared by the Group in accordance with IFRS. The Group has adopted IFRS with effect from 1 April 2004, with the exception of IAS 32 and IAS 39 (the standards relating to the measurement and disclosure of financial instruments), which have been adopted with effect from 1 April 2005. The comparative figures for the year ended 31 March 2005 have been restated to an IFRS basis, other than in respect of IAS 32 and IAS 39.

The impact of the Group's transition to IFRS is explained in note 2 to the financial statements. One of the key issues arising from the transition to IFRS concerns the treatment of the Group's subordinated debt instruments. Under UK GAAP, these instruments were accounted for as liabilities. As explained in note 21 to the financial statements, on adoption of IAS 32 on 1 April 2005, the subordinated debt instruments have been classified as equity minority interests and have been accounted for as such from 1 April 2005 to 30 March 2006.

IFRS requires financial instruments to be classified as liabilities or as equity in accordance with their legal form, rather than their economic characteristics. On 30 March 2006, the debt instruments were reclassified as liabilities following the issuance of a new class of redeemable preference shares which have the effect of making interest payments on the debt instruments compulsory, thereby causing them to be classified as liabilities under IAS 32. In presenting the results for the year to 31 March 2006, the Directors have chosen to include a pro forma income statement that shows the results as they would have been presented had the subordinated debt instruments

been classified as liabilities throughout the year, consistent with the previous year's results as well as those in future years. The following review of financial performance refers to the pro forma results unless otherwise stated.

Overview

The UK Rothschild Banking Group achieved record results in the year to 31 March 2006, with an extremely strong performance by our investment banking business. Pre-tax profits were £87.0 million (on a pro forma basis – IFRS compliant pre-tax profits were £101.6 million) compared to £42.2 million in the previous year. Profits after tax and minority interests increased from £29.9 million to £63.9 million.

The financial performance and strength of the Group depends on a number of factors. Our clients' confidence in us and in the markets in which we operate is key to the success of our businesses. Our performance is affected by the economic cycle and by market conditions; the uncertain outlook for the world economy and for financial markets means that the Group's performance could be adversely impacted by a worsening of economic conditions in the UK or overseas. Note 3 to the financial statements provides information on some of the key risks to which the Group is exposed.

Income

Total operating income was £370.0 million, a 48 per cent increase on the previous year.

Net fee and commission income increased from £172.2 million to £282.9 million, reflecting very strong growth in investment banking advisory fees in buoyant M&A markets.

Net interest income increased by 10.6 per cent from £69.5 million to £76.9 million. In accordance with IAS 39, net interest income in

Business Review

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the year to 31 March 2006 includes certain loan-related fees which are spread over the life of the loan; under UK GAAP, these fees were recognised when receivable in fees and commissions. Apart from this distorting effect of IFRS transition, there was an underlying increase in net interest income, primarily as a result of growth in book size and average margin in our banking loan portfolio.

Costs

Operating expenses (excluding profit share) increased by 8.8 per cent to £126.0 million. Within this total, staff costs increased by 8.2 per cent to £84.7 million mainly because of an increase in headcount, primarily in our investment banking business. Non-staff costs increased by 10.0 per cent to £41.3 million, partly as a result of the increased levels of business activity.

Directors' and employees' profit shares increased from £83.5 million to £153.4 million, reflecting the record performance achieved in the year.

Balance Sheet

Total assets of £5.5 billion at 31 March 2006 were marginally higher than at the previous year end.

The adoption of IAS 32 and IAS 39 on 1 April 2005 gave rise to changes to a number of balance sheet captions as a result of reclassifications of assets and liabilities, as explained in note 2 to the financial statements.

The Group's banking portfolio (including loans classified as "available for sale" and included in debt securities) increased by £0.2 billion over the year. Offsetting this, there was a reduction of £0.2 billion in securitised assets in the Real Estate Capital programme and other funding vehicles.

Under IFRS, the net liability in respect of defined benefit pension funds is recognised on the balance sheet. The Group recognised a total liability of £45 million (net of tax) at 31 March 2005; at

31 March 2006, the total liability was £27 million, the reduction being due primarily to the payment of special contributions of £21.5 million during the year.

Throughout the year, balance sheet liquidity remained above the minimum liquidity guidelines set by the Financial Services Authority. The risk asset ratio reduced during the year as a result of IFRS adjustments and the special pension contribution, but remains in excess of the minimum ratio prescribed by the Financial Services Authority.

Operating Divisions

Banking

Our commercial banking activities include the arranging and provision of senior and subordinated finance across the leveraged finance, property, financial services and natural resources sectors. Our loan portfolio mainly comprises loans to

Rothschild utilises a cross-section of financing techniques to assist its clients in achieving the most beneficial funding structures.

These include traditional balance sheet funding as well as innovative use of debt capital markets

Business Review

medium/large UK and other continental European companies, but we also provide project finance, structured commodity finance and asset based lending worldwide and conduct private lending through our Guernsey subsidiary, N M Rothschild & Sons (CI) Limited. Asset financing in the UK, including leasing, invoice discounting and factoring, is provided under the Five Arrows Finance label.

To underpin our property finance business, Rothschild has established the Real Estate Capital conduit through which a number of both single and multi borrower securitisations have been successfully brought to market. During the year we arranged a £1 billion commercial mortgage-backed securitisation for The Hercules Unit Trust, a Jersey based property fund advised by Pillar Property, a subsidiary of British Land plc.

In our leveraged finance business, we will later this year launch "Contego", our first managed CLO vehicle, following the success of the "Prospero I" CLO, to which we act as sub-adviser. Our arrangement with NorthWestern Mutual continued to develop and we provided

£20 million of mezzanine finance for the leveraged buy-out of Weetabix. During the year we also established a leveraged finance trading book, reflecting the relatively liquid secondary market in this sector.

We also arranged and provided substantial debt facilities in the property, leveraged finance and natural resources sectors. These included:

- ☐ the purchase of a £100 million portfolio of leveraged finance assets from the Royal Bank of Scotland plc;
- ☐ the purchase of a US\$70 million portfolio of structured commodity finance assets from ABSA Bank, for borrowers in the oil, gas and metals sectors;
- ☐ arranging a £457 million senior and junior debt facility on behalf of Insight Investment and Tishman International towards the acquisition of Plantation Place, a 550,000 sq ft office building in London EC3;

Our teams follow a relationship driven approach to property finance, which has led to many long term relationships being developed with a wide range of both quoted and private property companies

Business Review

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Our success comes from our leading market position and the quality and value of advice demonstrated by our strength and depth around the world

- a £118 million senior and junior debt facility on behalf of Protego Real Estate Investors LLP towards the acquisition of three shopping centres in Shrewsbury;
- a £73 million senior debt and mezzanine share-backed facility on behalf of Alburn to finance the corporate acquisition of a private property company; and
- substantial underwriting commitments to support the leveraged buy-outs of Gala Group and Orangina.

Investment Banking

Rothschild is the most active investment bank in Europe for the fourth consecutive year, with credit for more deals than any other investment bank. In addition to being financial adviser of choice, our performance was recognised by our peers and Financial News through awards for Best European M&A House and, for the second consecutive year, for Best UK M&A House and Best French M&A House.

Rothschild's continued focus on specific industry sectors, combining our in-depth global knowledge with our understanding of local markets, has enabled us to maintain strong positions in the European sector league tables. In 2005, according

to Thomson Financial, Rothschild ranked No.1 in Utilities, Transport and Building Materials and held top 5 positions in Oil & Gas, Healthcare, FIG, Industrials, Property and Mining & Metals.

Rothschild's active participation in restructuring deals is evident with major projects in Europe and America. Recognition in this area came from *Acquisitions Monthly* magazine, which named Rothschild the Restructuring Adviser of the Year as well as awarding us Restructuring Deal of the Year for the *KarstadtQuelle financial restructuring*.

Our success and leading market position is exemplified by the size and market profile of our long-term clients as well as more recent additions to our expanding client base. Excellence in our chosen

Rothschild M&A January to December 2005 (by value)

Country/Region	Rank
Europe	3
UK	2
France	2
Italy	1
Germany	8
Worldwide	10

Source: Thomson Financial/Dealogic

Business Review

Our restructuring clients include debtors, bondholders, creditors' committees, single creditor classes and secured creditors

markets and the quality and value of our expertise are demonstrated by Rothschild's advice to:

- ☐ Shell Transport and Trading on the US\$80 billion merger with Royal Dutch;
- ☐ P&O on the £5 billion cash offer from DP World and the €2.3 billion recommended cash offer from AP Moeller-Maersk for Royal P&O Nedlloyd;
- ☐ the Board of Directors of Telewest Global on providing a fairness opinion regarding the US\$9 billion sale to NTL;
- ☐ Deutsche Annington on the €7 billion acquisition of 100 per cent of Viterra from E.ON;
- ☐ BPB on the £4.4 billion defence of a hostile offer from Saint Gobain;
- ☐ Celtel on the US\$3.4 billion cash offer from MTC;
- ☐ National Grid Transco on the £5.5 billion disposal of 4 gas distribution networks;
- ☐ the independent directors of CP Ships on providing a fairness opinion regarding the US\$2.4 billion cash offer from TUI;
- ☐ BAA on the £1.3 billion acquisition of a 75 per cent stake in Budapest Airport;
- ☐ Lion Capital and Blackstone consortium on the €1.85 billion acquisition of the European soft drinks business of Cadbury Schweppes;
- ☐ Peel Ports on the £995 million acquisition of The Mersey Docks and Harbour Company;
- ☐ Doughty Hanson & Co on the £875 million disposal of the Priory Group to ABN AMRO Structured Capital;
- ☐ Texas Pacific on the £700 million recommended cash offer for British Vita;
- ☐ Chelys ("Energis") on the £837 million sale to Cable & Wireless;

Business Review

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- ☐ Red Football on the £790 million unconditional mandatory cash offer for Manchester United; and
- ☐ KarstadtQuelle on financial restructuring including: €1.75 billion bank loan; €535 million rights issue; €170 million convertible bond; €309 million second lien; and €675 million bridge loan.

ABN AMRO Rothschild ("AAR"), our equity capital markets collaboration with ABN AMRO, celebrates its tenth year. This unique arrangement in equity capital markets combines the research, trading and sales distribution of ABN AMRO with the origination and advisory ability of Rothschild. As a bulge bracket distributor of major equity issues it has maintained a top 10 position in the European league tables. In 2005, Dealogic ranked ABN AMRO Rothschild No.7 in the European Equities league table for bookrunner roles.

Recent headline equity capital market transactions include:

- ☐ KPN's €899 million accelerated bookbuilt offering, where AAR acted as Lead Manager and Sole Bookrunner;
- ☐ EDF's €6.1 billion initial public offering, where AAR acted as Joint Bookrunner and Adviser to EDF;
- ☐ Mercialys' €230 million initial public offering, where AAR acted as Joint Global Co-ordinator

and Joint Bookrunner, this being the first IPO of a REIT (Real Estate Investment Trust); Mercialys' €237.8 million accelerated bookbuilt offering, where AAR acted as Joint Global Co-ordinator and Joint Bookrunner;

- ☐ France Telecom's €3.4 billion accelerated bookbuilt offering, where AAR acted as Joint Bookrunner; and €3 billion share capital increase, where AAR acted as Joint Global Co-ordinator and Joint Bookrunner;
- ☐ TNT's €902.7 million accelerated bookbuilt offering, where AAR acted as Joint Lead Manager and Joint Bookrunner; and
- ☐ Munich Re's €377.2 million disposal of Allianz shares via an accelerated bookbuilt offering, where AAR acted as adviser to Munich Re.

We provide the highest quality financial advice and execution expertise, encompassing Mergers & Acquisitions, Restructuring, Private Placements, Privatisations and Equity Capital Markets

Business Review

Risk Management

The identification, measurement and containment of risk is integral to the management of our businesses. Our risk policies and procedures are regularly updated to meet changing business requirements and to comply with best practice.

The Group Risk Director co-ordinates risk policy and promotes the development and maintenance of effective procedures throughout the group. Our internal audit team reviews our internal control framework and reports its findings to the Audit Committee.

The responsibilities and membership of the Board Committees involved in the oversight of risk management are set out on pages 26 and 27.

Credit Risk

Credit risk arises from our lending and trading activities. The Credit Committee sets limits, reviews concentrations, monitors exceptions and makes recommendations on credit decisions to the Executive Committee.

Credit risk arising from dealing activities is measured on a real-time basis whereby all exposures relating to a particular counterparty are aggregated and monitored against limits. Credit risk on derivative transactions is measured by summing the current exposure with an allowance for potential future exposure.

Market Risk

Market risk arises as a result of our activities in currency, interest rate and equity markets. During the year, our exposure to market risk has continued to be small in relation to our capital, as our trading activities have been focused on servicing client requirements rather than on proprietary risk-taking. Market risk figures for the Company are set out in note 3.3 to the accounts with a description of the sensitivity-based value at risk methodology used to monitor and control market risk.

We use financial instruments to manage our exposure to market risks and to take or alter our views on future movements in exchange rates, interest rates and volatility levels. Interest rate derivatives are used to hedge interest rate exposures arising from our lending and corporate treasury activities.

Limits on market risk exposure are set by the Executive Committee using the value at risk methodology described in note 3.3. Monitoring of market risk limits and determination of trading profits are undertaken independently of the dealing area. Whilst value at risk is central to the communication and control of risk, it is complemented by other controls. These include stress testing, which estimates the losses which could occur when markets behave in unusually volatile ways and with little liquidity.

Liquidity Risk

Liquidity is measured by classifying assets, liabilities and other cashflows into future time bands using a series of prudent assumptions and calculating the resultant surplus or deficit in each period. The Group Assets and Liabilities Committee recommends policies and procedures for the management of liquidity risk. The Executive Committee has set deficit limits for each period, which are monitored daily independently of the dealing area.

Business Review

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Operational Risk

Operational risk, which is inherent in all business activities, is the risk of loss arising from the failure of internal controls, operational processes or systems, or from external events. Key to our management of operational risk is the maintenance of a strong framework of internal controls. These are subject to regular independent review by our internal audit department, whose findings are reported to the Audit Committee which monitors the implementation of any recommendations. Operational risk encompasses reputational risk, which is particularly relevant to our business. Reputational risk is managed through formal approval processes for new business and operational procedures for the conduct of business. The Group maintains insurance policies to mitigate loss in the event of certain operational risk events.

Report of the Directors

Committees

Statement of Directors'
Responsibilities in Relation
to the Report of the Directors
and the Financial Statements

Report of the
Independent Auditors

Report of the Directors

To be submitted at the thirty ninth Annual General Meeting of the shareholders on 15 June 2006.

The Directors present their Directors' report and financial statements for the year ended 31 March 2006.

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Principal Activities and Business Review

N M Rothschild & Sons Limited ("the Company") and its subsidiary undertakings ("the Group"), operating out of the UK and the Channel Islands, provide a comprehensive range of banking and financial services. A review of the activities of the Group for the year, including an indication of likely future developments, is contained in the Chairman's Statement on pages 9 to 10 and the Business Review on pages 11 to 20.

Results and Dividends

The operating profit of the Group for the financial year before directors' and employees' profit share and before tax amounted to £251,116,000 (2005: £125,057,000). The profit for the financial year attributable to shareholders after tax and minority interests was £65,380,000 (2005: £29,871,000). It is recommended that this amount be dealt with as follows:

	2006 £'000	2005 £'000
Ordinary dividends		
Final paid (in respect of prior year)	12,500	5,000
Interim paid	15,000	12,500
Final paid	25,000	-
Transfer to reserves	12,880	12,371
	65,380	29,871

Corporate and Social Responsibility

The Group is committed to supporting the principle of equal opportunities and opposes all forms of unlawful or unfair discrimination on the grounds of colour, race, nationality, ethnic origin, gender, marital status, disability, religion, age or sexual orientation. The Group's aim is to recruit, train and promote the best person for the job and to create a working environment free from unlawful discrimination, victimisation and harassment, and in which all employees are treated with dignity and respect.

The Group is committed to supporting charities both in the areas in which it operates and those in the wider community. The Charities Committee was established in 1975 to consider the hundreds of requests received every year from charities seeking financial support. The sum of £709,000 (2005: £862,000) was charged against the profits of the Group during the year in respect of gifts for charitable purposes. No political contributions were made during the year.

Report of the Directors

Corporate and Social Responsibility (continued)

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Typical beneficiaries continue to include organisations concerned with elderly people, healthcare, social welfare and education. Requests for support from staff in respect of charitable causes with which they are associated, or have an involvement, are actively encouraged.

Apart from making financial donations, the Group also provides charitable support in the form of the involvement of members of staff in various community programmes. In particular, it is a supporter of The Specialist Schools Trust (promoting a dialogue between educators and financial institutions) and The Prince's Trust (several members of staff being engaged as "business mentors" to Trust-sponsored businesses).

Staff

During the year the Group continued with its long-established policy of providing employees with information on matters of concern to them and on developments within the Group by a series of notices to staff. The Group encourages staff to put forward their views through a staff consultative committee. The interest of all staff in the performance of the Group is realised through the Group's profit sharing scheme in which staff at all levels participate.

Applications for employment by disabled persons are fully and fairly considered having regard to the aptitudes and abilities of each applicant. Efforts are made to enable employees who become disabled during employment to continue their career with the Group.

Directors

The names of the present Directors of the Company are shown on page 5. Brief biographical details of the Independent Non-Executive Directors are included on page 115.

No Directors have been appointed since the last Annual General Meeting.

The following Directors have resigned since the last Annual General Meeting: Sir John Collins (18 January 2006), Paul Tuckwell (28 February 2006).

Directors' Interests in Shares

Details of the interests of the directors of the Company in the shares of Group companies are set out in note 36 to the financial statements.

Report of the Directors

Financial Risk Management

The financial risk management objectives and policies of the Company and the Group in respect of the use of financial instruments, together with analyses of exposures to market risk, credit risk and liquidity risk, are set out in note 3 to the financial statements.

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Auditors

KPMG Audit Plc have indicated their willingness to continue in office and a resolution to re-appoint them and to authorise the directors to determine their remuneration will be proposed at the forthcoming Annual General Meeting, in accordance with Section 384 of the Companies Act 1985.

Audit Information

The Directors who held office at the date of approval of this report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware, and each Director has taken all the steps that he or she ought to have taken as a Director to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

By Order of the Board

Jonathan Westcott, Secretary



New Court, St. Swithin's Lane, London EC4P 4DU
15 June 2006

Committees

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As part of a review of the corporate governance framework of the wider Rothschild group, a number of changes have been made in the structure of the committees to which the Board delegates authority for the administration of the Company's and the Group's affairs. The terms of reference and membership of the key committees are summarised below:

Group Management Committee

The Group Management Committee reports to the Board of Rothschilds Continuation Holdings AG. Its purposes are to formulate strategy for the Rothschild group's businesses, to assess the delivery of that strategy, to ensure the proper and effective functioning of group governance structures, operating policies and procedures, to define the group's risk appetite and to be responsible for the management of risk.

Membership: David de Rothschild (Chairman), Eric de Rothschild, Anthony Alt, Michael Bussey, Anthony Chapman, Andrew Didham, François Henrot, Nigel Higgins, Joshua Hoffman, Peter Johns, Richard Martin, Gerald Rosenfeld, Nicholas Wrigley.

Executive Committee

This committee meets twice a week, and as required, to approve key underwriting commitments, loans, credit decisions, dealing limits, new clients and new products, and to consider major business and market developments and operational risk.

Membership: Anthony Alt (Chairman), Leopold de Rothschild, Julia Ashworth, Isobel Baxter, Glenn Beatham, Christopher Coleman, Graham Curds, Paul Duffy, Jonathan Eddis, Timothy Hancock, Peter Johns, Charles Keay, Simon Linnett, Charles Mercey, James Vaux, Jonathan Westcott, Philip Yeates.

Credit Committee

This committee authorises and reviews all credit exposure to new and existing counterparties. Exposures exceeding certain limits are subject to ratification by the Executive Committee.

Membership: Christopher Coleman (Chairman), Leopold de Rothschild, Glenn Beatham, Graham Curds, Peter Griggs, Peter Johns, Charles Keay, Debra Lewis, Andrew Radkiewicz, David Street, Philip Yeates.

Committees

Group Assets and Liabilities Committee

This committee reports to the Group Management Committee. It is responsible for ensuring that the Group has prudent funding and liquidity strategies, for the efficient management and deployment of capital resources within regulatory constraints, and for the oversight of the management of the Group's balance sheet.

Membership: Andrew Didham (Chairman), Anthony Alt, Isobel Baxter, Graham Curds, Timothy Hancock, Peter Johns, Noland Carter.

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Audit Committee

This committee of the board of Rothschilds Continuation Holdings AG supervises and reviews the Group's internal audit arrangements, liaises with the Group's external auditors and monitors the overall system and standards of internal control.

Membership: Peter Smith (Chairman), Sir Graham Hearne, Bernard Myers, Sir Clive Whitmore.

Remuneration and Nominations Committee

This committee approves the appointment, and sets the remuneration, of executive directors and other senior executives and approves guidelines for the Company's annual pay reviews and profit sharing scheme.

Membership: Sir Clive Whitmore (Chairman), David de Rothschild, Eric de Rothschild, Sir John Collins, Sir Graham Hearne.

Statement of Directors' Responsibilities in Relation to the Report of the Directors and the Financial Statements

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The Directors are responsible for preparing the Report of the Directors and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Parent Company financial statements for each financial year. Under that law the Directors have elected to prepare both the Group and the Parent Company financial statements in accordance with IFRS as adopted by the EU.

The Group and Parent Company financial statements are required by law and IFRS as adopted by the EU to present fairly the financial position of the Group and the Parent Company and the performance for the period; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing each of the Group and Parent Company 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 they have been prepared in accordance with IFRS as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Report of the Independent Auditors, KPMG Audit Plc, to the Members of N M Rothschild & Sons Limited

We have audited the Group and Parent Company financial statements (the “financial statements”) of N M Rothschild & Sons Limited for the year ended 31 March 2006 which comprise the Consolidated Income Statement (including the pro forma information), the Consolidated and Parent Company Balance Sheets, the Consolidated and Parent Company Cash Flow Statements, the Consolidated and Parent Company Statements of Recognised Income and Expense and the related notes. These financial statements have been prepared under the accounting policies set out therein.

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This report is made solely to the Company’s members, as a body, in accordance with section 235 of the Companies Act 1985 and the terms of our engagement. 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 auditor’s 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

The directors’ responsibilities for preparing the Directors’ Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU are set out in the Statement of Directors’ Responsibilities on page 28.

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 are properly prepared in accordance with the Companies Act 1985. We also report to you whether, in our opinion, the Directors’ Report is consistent with the financial statements. The information given in the Directors’ Report includes that specific information presented in the Business Review that is cross-referenced from the Principal Activities and Business Review section of the Directors’ Report. We also report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors’ remuneration and other transactions is not disclosed.

We read the Directors’ Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Report of the Independent Auditors, KPMG Audit Plc, to the Members of N M Rothschild & Sons Limited

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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 Group's and Company's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRS as adopted by the EU, of the state of the Group's affairs as at 31 March 2006, and of its profit for the year then ended;
- the Parent Company financial statements give a true and fair view, in accordance with IFRS as adopted by the EU as applied in accordance with the Companies Act 1985, of the state of the Parent Company's affairs as at 31 March 2006;
- the financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London


15 June 2006

Consolidated Income Statement

For the year ended 31 March 2006

	Note	2006 £'000	2006 Pro forma £'000	2005 £'000
Interest and similar income	4	296,972	296,972	272,424
Interest expense and similar charges	4	(207,581)	(220,087)	(202,896)
Net interest income		89,391	76,885	69,528
Fee and commission income	5	311,616	311,616	177,919
Fee and commission expense	5	(28,729)	(28,729)	(5,749)
Dividend income	6	270	270	181
Net trading income	7	6,118	4,041	3,419
Gains less losses from debt and equity securities	14	108	108	–
Other operating income		5,846	5,846	5,033
Total operating income		384,620	370,037	250,331
Impairment losses on loans and advances	13	(3,264)	(3,264)	(4,409)
Impairment losses on debt and equity securities	14	(588)	(588)	783
Net operating income		380,768	366,185	246,705
Operating expenses (excluding profit share)	8	(125,988)	(125,988)	(115,842)
Directors' and employees' profit share	9	(153,358)	(153,358)	(83,474)
Depreciation and amortisation	17, 18	(3,664)	(3,664)	(5,806)
Operating profit before profit share and tax	251,116	236,533	125,057	
Directors' and employees' profit share	9 (153,358)	(153,358)	(83,474)	
Operating profit before tax		97,758	83,175	41,583
Loss on disposal of subsidiary undertaking		–	–	(226)
Share of profit of associated undertakings	15	3,826	3,826	798
Profit before income tax		101,584	87,001	42,155
Income tax expense	10	(26,978)	(22,603)	(11,660)
Profit for the financial year		74,606	64,398	30,495
Attributable to				
Equity holders of the parent company		65,380	63,927	29,871
Minority interest	31	9,226	471	624
		74,606	64,398	30,495

In accordance with IFRS, subordinated debt instruments of the Group and the Company have been accounted for as equity minority interests in the period 1 April 2005 to 30 March 2006. With effect from 30 March 2006, the subordinated debt instruments have been reclassified as liabilities following the issuance of cumulative redeemable preference shares. It is the view of the Directors that accounting for these instruments as equity minority interests in 2005-2006 does not fully reflect their economic characteristics and makes year on year comparison of the results difficult, because the instruments were treated as liabilities in 2004-2005 and will be treated as liabilities again in 2006-2007. Accordingly, the pro forma income statement above shows the results for the year as they would have been presented had the subordinated debt instruments been classified as liabilities throughout the year. Note 21 on page 93 provides further explanation of this matter.

The notes on pages 38 to 111 form an integral part of these financial statements

Consolidated Balance Sheet

At 31 March 2006

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	Note	2006 £'000	2005 £'000
Assets			
Cash and balances at central banks		24	1,511
Derivative financial instruments	12	17,646	—
Loans and advances to banks	13	81,250	446,280
Loans and advances to customers	13	2,077,020	2,258,609
Debt and equity securities	14	3,073,520	2,438,338
Investments in associated undertakings	15	12,119	8,823
Intangible assets	17	5,034	3,480
Property, plant and equipment	18	9,971	11,408
Deferred tax assets	23	46,579	36,462
Other assets	19	155,311	191,536
Total assets		5,478,474	5,396,447
Liabilities			
Deposits by banks		2,127,256	1,665,648
Due to customers		1,448,225	1,384,935
Derivative financial instruments	12	40,550	—
Debt securities in issue	20	1,033,539	1,507,513
Subordinated liabilities	21	232,296	230,980
Other liabilities	22	72,735	160,008
Current tax liabilities		14,790	4,383
Accruals and deferred income		215,290	159,755
Total liabilities		5,184,681	5,113,222
Shareholders' equity			
Share capital		50,000	50,000
Retained earnings		239,252	229,377
Other reserves		4,090	201
Total shareholders' equity attributable to equity holders of the parent	32	293,342	279,578
Minority interests	31	451	3,647
Total equity and liabilities		5,478,474	5,396,447

The accounts on pages 33 to 111 were approved by the Board of Directors on 15 June 2006 and were signed on its behalf by:



Isobel Baxter, Finance Director

The notes on pages 38 to 111 form an integral part of these financial statements

Company Balance Sheet

At 31 March 2006

	Note	2006 £'000	2005 £'000
Assets			
Cash and balances at central banks		24	27
Derivative financial instruments	12	13,315	–
Loans and advances to banks	13	31,351	246,211
Loans and advances to customers	13	1,306,150	1,419,791
Debt and equity securities	14	2,533,516	1,786,035
Shares in subsidiary undertakings	33	34,786	34,786
Investments in associated undertakings	15	7,803	7,303
Investments in joint ventures	16	429	429
Property, plant and equipment	18	3,008	3,570
Deferred tax assets	23	40,253	30,855
Other assets	19	131,503	162,604
Total assets		4,102,138	3,691,611
Liabilities			
Deposits by banks		2,008,889	1,466,270
Due to customers		1,014,463	1,078,560
Derivative financial instruments	12	19,637	–
Debt securities in issue	20	371,170	450,595
Subordinated liabilities	21	232,296	230,980
Other liabilities	22	48,973	137,747
Current tax liabilities		10,727	1,091
Accruals and deferred income		195,433	128,123
Total liabilities		3,901,588	3,493,366
Shareholders' equity			
Share capital		50,000	50,000
Retained earnings		148,408	148,245
Other reserves		2,142	–
Total shareholders' equity	32	200,550	198,245
Total equity and liabilities		4,102,138	3,691,611

The accounts on pages 33 to 111 were approved by the Board of Directors on 15 June 2006 and were signed on its behalf by:



Isobel Baxter, Finance Director

The notes on pages 38 to 111 form an integral part of these financial statements

Statements of Recognised Income and Expense

For the year ended 31 March 2006

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	Note	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
Net income recognised directly in equity					
Available-for-sale investments					
Gains/(losses) from changes in fair value		(557)	(319)	—	—
(Gains)/losses transferred to income on disposal and impairment		(900)	(873)	—	—
Cash flow hedges					
Gains/(losses) from changes in fair value of effective portion of cash flow hedges		(57)	(98)	—	—
Net (gains)/losses transferred to income on disposal and impairment		113	113	—	—
Other items recognised directly in equity					
Actuarial gains/(losses) on defined benefit pension funds	24	3,069	4,221	(17,490)	(16,647)
Exchange differences on translation of foreign operations	32	218	—	201	—
Aggregate tax effect of items taken directly to or transferred from equity		(567)	(887)	5,110	4,995
		1,319	2,157	(12,179)	(11,652)
Profit for the financial year		74,606	62,353	30,495	30,483
Total recognised income and expense for the financial year		75,925	64,510	18,316	18,831
Attributable to					
– Equity shareholders of the parent		66,699	55,755	17,692	18,831
– Minority interests		9,226	8,755	624	—
		75,925	64,510	18,316	18,831
Effect of changes in accounting policy					
Adoption of IAS 32 and IAS 39 on 1 April 2005	2	(1,361)	(1,876)	—	—
		74,564	62,634	18,316	18,831

The notes on pages 38 to 111 form an integral part of these financial statements

Cash Flow Statements

For the year ended 31 March 2006

	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
Note				
Cash flow from operating activities				
Net profit for the financial year	71,606	62,353	30,495	30,183
Adjustments to reconcile net profit to cash flow from operating activities				
Non-cash items included in net profit and other adjustments				
Depreciation and amortisation	3,664	1,453	5,806	2,136
Share of operating profit of associated undertakings	(3,826)	–	(798)	–
Impairment of financial and other assets (net of recovery)	3,852	4,501	3,626	4,577
Income tax expense	26,978	23,008	11,660	11,040
Loss on disposal of subsidiaries	–	–	226	–
Unrealised exchange (gains)/losses	286	450	(1,390)	(1,389)
Profit on disposal of fixed assets	(218)	(5)	(184)	(49)
	30,736	29,407	18,946	16,315
Net (increase)/decrease in operating assets				
Net due to/from banks (excluding cash equivalents)	494,198	543,585	(128,931)	188,201
Derivatives	54,803	50,847	–	–
Debt and equity securities	(440,585)	(555,110)	(254,831)	(347,627)
Loans and advances to customers	(15,274)	(83,097)	(74,087)	(159,099)
Accrued income, prepaid expenses and other assets	(33,332)	(32,016)	362,325	365,631
	59,810	(75,791)	(95,524)	47,106
Net increase/(decrease) in operating liabilities				
Customer deposits	63,415	(64,069)	(55,412)	(29,930)
Derivatives	(34,903)	(48,136)	–	–
Issued debt securities	(473,049)	(79,392)	436,381	117,255
Accrued expenses and other liabilities	34,864	42,079	(271,802)	(270,857)
Income taxes paid	(18,114)	(14,269)	(17,801)	(12,856)
	(427,787)	(163,787)	91,366	(196,388)
Net cash flow from operating activities*	(262,635)	(147,818)	45,283	(102,484)
Cash flow from/(used in) investing activities				
Acquisition/increase in stake of subsidiaries and associated undertakings	(5,884)	(500)	(1,857)	(1,775)
Dividends received from associated undertakings	1,194	–	1,034	–
Proceeds from disposal of subsidiaries	–	–	19,375	–
Purchase of property and other fixed assets	(3,608)	(929)	(6,396)	(647)
Disposal of property and other fixed assets	1,699	43	2,667	322
Net cash flow from/(used in) investing activities	(6,599)	(1,386)	14,823	(2,100)
Cash flow from/(used in) financing activities				
Cash from issuance of subordinated debt	–	–	103,011	103,011
Cash from issuance of preference shares	100	100	–	–
Dividends paid	(52,500)	(52,500)	(17,500)	(17,500)
Subordinated debt interest due to minority	(12,506)	(12,506)	–	–
Net cash flow from/(used in) financing activities	(64,906)	(64,906)	85,511	85,511
Net increase/(decrease) in cash equivalents	(334,140)	(214,110)	145,617	(19,073)
Cash and cash equivalents at 1 April	403,310	238,620	257,693	257,693
Cash and cash equivalents at 31 March	29	69,170	403,310	238,620

* Group: cash paid and received for interest during 2006 was £218,858,000 (2005: £200,082,000) and £302,576,000 (2005: 258,317,000) respectively.

* Company: cash paid and received for interest during 2006 was £132,700,000 (2005: £115,414,000) and £167,985,000 (2005: £132,823,000) respectively.

The notes on pages 38 to 111 form an integral part of these financial statements

Notes to the Financial Statements

(forming part of the Financial Statements)

For the year ended 31 March 2006

I. Summary of Significant Accounting Policies

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N M Rothschild & Sons Limited ("the Company") is a company incorporated in the United Kingdom. The Group financial statements consolidate those of the Company and its subsidiaries and jointly-controlled entities (together referred to as "the Group") and equity account for the Group's interests in associates. The Parent Company financial statements present information about the Company as a separate entity and not about its group.

The IASB has issued IFRS 7 Financial Instruments: Disclosures for application in accounting periods beginning on or after 1 January 2007. The new disclosures will be adopted by the Group in the year ending 31 March 2008.

The Group has not adopted, in relation to financial guarantee contracts, amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts, which will apply for periods commencing on or after 1 January 2006. Where one Group company enters into financial guarantee contracts to guarantee the indebtedness of other companies within the Group, that company considers these to be insurance arrangements and accounts for them as such. In this respect, the Group company treats the guarantee contract as a contingent liability until such time as it becomes probable that they will be required to make a payment under the guarantee. It is not expected that the amendments will have any impact on the financial statements for the period commencing 1 April 2006.

Basis of preparation

Both the Parent Company and the Group financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and International Financial Reporting Interpretations Committee ("IFRIC") interpretations, endorsed by the European Union ("EU") and with those requirements of the Companies Act 1985 applicable to companies reporting under IFRS. The financial statements are prepared under the historical cost convention, except for available-for-sale investments, financial assets held for trading and all derivative contracts, which are stated at their fair value.

The principal accounting policies set out below have been consistently applied in the presentation of the Group financial statements, except for those relating to the measurement and classification of financial instruments as the Group has elected not to restate the comparative figures for the year ended 31 March 2005 for IAS 32 and IAS 39. The policies applied to financial instruments for 2005 and 2006 are disclosed separately below.

Both the Group and the Company have adopted IFRS for the year ended 31 March 2006 and the comparative financial statements for the year ended 31 March 2005 have been restated in accordance with IFRS. An explanation of how the transition to IFRS has affected the reported financial position and financial performance of the Group is provided in note 2.

Notes to the Financial Statements

(forming part of the Financial Statements)

I. Summary of Significant Accounting Policies (continued)

Basis of consolidation

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The financial statements of the Group are made up to 31 March 2006 and consolidate the audited financial statements of the Company and its subsidiary undertakings. In order to avoid undue delay in the preparation of the consolidated financial statements, the financial statements of certain subsidiary undertakings are made up to 31 December each year.

Subsidiary undertakings

Subsidiary undertakings are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies, generally as a result of a shareholding of more than one half of the voting rights, so as to obtain benefits from the activities of the entity. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. Subsidiary undertakings are fully consolidated from the date on which the Group acquires control, and cease to be consolidated from the date that control ceases.

The Group uses the purchase method of accounting for the acquisition of subsidiary undertakings. The cost of an acquisition is measured as the fair value of the assets given as consideration, shares issued or liabilities undertaken at the date of acquisition, plus any costs directly attributable to the acquisition. The excess of the cost of acquisition over the fair value of the net identifiable assets of the subsidiary undertaking acquired is recorded as goodwill. All inter-company transactions, balances and unrealised surpluses and deficits on transactions between group companies are eliminated on consolidation. The accounting policies used by subsidiaries are consistent with the policies adopted by the Group.

The financial statements of the Group's subsidiaries are made up to a date not earlier than three months before the balance sheet date and are adjusted, where necessary, to conform with the accounting policies of the Group and for any material transactions or events that occur between the two dates.

Associated undertakings

An associated undertaking is an entity in which the Group has significant influence, but not control, over the operating and financial management policy decisions. This is generally demonstrated by the Group holding in excess of 20 per cent, but no more than 50 per cent, of the voting rights.

The Group's investments in associated undertakings are initially recorded at cost. Subsequently they are increased or decreased by the Group's share of the post-acquisition profit or loss, or by other movements reflected directly in the equity of the associated undertakings. When the Group's share of losses in an associated undertaking equals or exceeds its interest in the associated undertaking, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associated undertaking. Goodwill arising on the acquisition of an associated undertaking is included in the cost of the investment (net of any accumulated impairment loss).

The Group's share of the post-tax results of associated undertakings is based on financial statements made up to a date not earlier than three months before the balance sheet date, adjusted to conform with the accounting policies of the Group and for any material transactions or events that occur between the two dates.

Notes to the Financial Statements

(forming part of the Financial Statements)

I. Summary of Significant Accounting Policies (continued)

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Basis of consolidation (continued)

Joint Ventures

Joint ventures, in which the Group has a contractual arrangement with one or more parties to undertake activities jointly, may take the form of a jointly controlled entity or a jointly controlled operation.

A jointly controlled entity is a joint venture that involves the establishment of an entity in which each venturer has an interest. Jointly controlled entities are consolidated using the proportional consolidation method, under which the Group's financial statements include its share of the joint venture's assets, liabilities, income and expenses on a line-by-line basis. Proportional consolidation is discontinued when the Group no longer exercises joint control over the entity.

Jointly controlled operations are those joint ventures involving the use of the assets and other resources of the venturers themselves, rather than the establishment of an entity. The Company includes in its individual financial statements (and therefore in the Group's consolidated financial statements) all the assets that it controls and the liabilities and expenses that it incurs in the course of pursuing the joint operation, and its share of the income from the joint operation.

Foreign exchange

The consolidated financial statements are presented in sterling, which is the Company's functional currency and the Group's reporting currency. Items included in the financial statements of each of the Group's entities are measured using their functional currency. The functional currency is the currency of the primary economic environment in which the entity operates.

Income statements and cash flows of foreign operations are translated into the Group's reporting currency at average exchange rates for the period where this rate approximates to the foreign exchange rates ruling at the date of the transactions and their balance sheets are translated at the exchange rate at the end of the period. Exchange differences arising from the translation of the net investment in foreign subsidiaries, associates and joint ventures are taken to shareholders' equity. On disposal of a foreign operation, these translation differences are recognised in the income statement as part of the gain or loss on sale.

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transaction. Gains and losses resulting from the settlement of such transactions, and from the translation at period end exchange rates of monetary items that are denominated in foreign currencies, are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated at foreign exchange rates ruling at the dates when the fair value was determined.

Translation differences on equities classified as at fair value through profit or loss are reported as part of the fair value gain or loss in the income statement. Translation differences on equities classified as available-for-sale are included in the available-for-sale reserve in equity.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and are translated at the closing rate.

Notes to the Financial Statements

(forming part of the Financial Statements)

I. Summary of Significant Accounting Policies (continued)

Derivative financial instruments and hedge accounting

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From 1 April 2004 to 31 March 2005

Derivatives

Foreign exchange, bullion and interest rate contracts used in trading activities are carried at fair value and all gains and losses are taken to the profit and loss account. Fair values are based on quoted market prices when available. Where no quoted prices are available for a particular derivative, its fair value is determined by reference to quoted market prices for its component parts. Fair values reflect adjustments for credit risk and market risk. Credit risk adjustments are made by reference to default probabilities based on the counterparty's credit rating. Market risk adjustments reflect the cost which would be incurred in closing out market risk positions.

Derivative instruments are used to hedge exposures in the non-trading book. In order to qualify as a hedge, a transaction must be designated as such at inception and be demonstrably effective as a hedge by reducing exposure. The accounting treatment of such instruments reflects the accounting treatment of the assets and liabilities being hedged. If the underlying position matures or is extinguished, the hedge is transferred to the trading book at fair value and any gain or loss is taken to the profit and loss account. If a hedge ceases to be effective through the sale, termination, maturity or extinguishing of the hedge position, any gain or loss is deferred and amortised in the profit and loss account over the original life of the hedge.

From 1 April 2005

Derivatives

Derivatives are initially recognised at fair value and are subsequently measured at fair value with changes in fair value recognised in the income statement. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged (see below).

Embedded derivatives

Some hybrid contracts contain both a derivative and a non-derivative component. In such cases, the derivative component is termed an embedded derivative. Where the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract, and where the hybrid contract itself is not carried at fair value through profit or loss, the embedded derivative is separated and reported at fair value with gains and losses being recognised in the income statement.

Hedge accounting

The Group may apply either fair value or cash flow hedge accounting when transactions meet the criteria for hedge accounting treatment set out in IAS 39. At the inception of the hedge, the Group assesses whether the hedging derivatives meet the effectiveness criteria of IAS 39 in offsetting changes in the fair value or cash flows of the hedged items. The Group then documents the relationship between the hedging instrument and the hedged item. It also records its risk management objectives, its strategy for undertaking the hedge transaction and the methods used to assess the effectiveness of the hedging relationship.

After inception effectiveness is tested on an on-going basis. Hedge accounting is discontinued when it is determined that a derivative has ceased to be highly effective, or when the derivative or the hedged item is derecognised, or when the forecast transaction is no longer expected to occur.

Notes to the Financial Statements

(forming part of the Financial Statements)

I. Summary of Significant Accounting Policies (continued)

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Derivative financial instruments and hedge accounting (continued)

Fair value hedge accounting

Changes in value of fair value hedge derivatives are recorded in the income statement, together with fair value changes to the underlying hedged item in respect of the risk being hedged.

If the hedge no longer meets the criteria for hedge accounting, the difference between the carrying value of the hedged item on termination of the hedging relationship and the value at which it would have been carried had the hedge never existed is amortised to profit or loss over the period to maturity where the hedged item is accounted for using the effective interest rate method. Where the hedged item is an available-for-sale equity security, the adjustment remains in retained earnings until the disposal of the equity security.

Cash flow hedge accounting

Changes in the fair value of the effective portion of derivatives designated as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised in the income statement. Amounts accumulated in equity are recycled to the income statement when the item being hedged impacts profit or loss.

When hedge accounting is discontinued, any cumulative gain or loss in equity remains in equity and is only recognised in the income statement when the forecast transaction is recognised in the income statement. When the forecast transaction is no longer expected to occur, the cumulative balance in equity is immediately transferred to the income statement.

Net investment hedge

Hedges of net investments in foreign operations are accounted for in a way similar to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in equity; the gain or loss relating to the ineffective portion is recognised immediately in the income statement. Gains and losses accumulated in equity are included in the income statement when the foreign operation is disposed of.

Trading income

From 1 April 2004 to 31 March 2005

Dealing profits arising from trading activities are reported on a mark to market basis after deduction of related funding costs.

From 1 April 2005

Trading income arises from movements in the fair value of financial assets held for trading and financial assets designated at fair value through profit or loss, and from hedging strategies.

Fee and commission income

The Group earns fee and commission income from services provided to clients. Fee income from advisory and other services can be divided into two broad categories; fees earned from services that are provided over a period of time, which are recognised over the period in which the service is provided; and fees that are earned on completion of a significant act or on the occurrence of an event, such as the completion of a transaction, which are recognised when the act is completed or the event occurs.

Notes to the Financial Statements

(forming part of the Financial Statements)

I. Summary of Significant Accounting Policies (continued)

Fee and commission income (continued)

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From 1 April 2004 to 31 March 2005

Fees relating to loans, guarantees and acceptances are recognised over the period of the loan facility or exposure, except for fees in respect of work performed at the inception of the transaction which are recognised when receivable.

From 1 April 2005

Fees and commissions that are an integral part of a loan are deferred (together with related direct costs) and recognised over the life of the loan as an adjustment to the effective interest rate.

Interest income and expense

From 1 April 2004 to 31 March 2005

Interest receivable and payable represents all interest arising out of banking activities, including lending and deposit-taking business, interest on related hedging transactions and interest on debt securities. Interest on all financial instruments is accounted for on an accruals basis.

From 1 April 2005

Interest receivable and payable represents interest arising out of banking activities, including lending and deposit-taking business, interest on related hedging transactions and interest on debt securities. Interest on financial instruments, except those classified as held for trading or designated at fair value through profit or loss, is recognised in the income statement using the effective interest rate method.

The effective interest rate is the rate that exactly discounts the estimated future cash flows of a financial instrument to its net carrying amount. It is used to calculate the amortised cost of a financial asset or a financial liability and to allocate the interest over the relevant period (usually the expected life of the instrument). When calculating the effective interest rate, the Group considers all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes any premiums or discounts, as well as all fees and transaction costs that are an integral part of the loan.

Financial assets and liabilities

Financial assets and liabilities are recognised on trade dates and derecognised on either trade date, if applicable, or on maturity or repayment.

From 1 April 2004 to 31 March 2005

Debt securities and equity shares

Debt securities and equity shares which are held for the longer term or until maturity are classified as investment securities. They are stated at cost less any amounts written off to reflect impairment in value. The cost of dated investment securities is adjusted to reflect amortisation and accretion of premiums and discounts on acquisition on a straight-line basis over the residual period to maturity. The amortisation and accretion of premiums and discounts is included in interest income.

Debt securities and equity shares other than investment securities are classified as dealing securities and are held at market value in the case of listed securities, or directors' estimate of market value in the case of unlisted securities.

Notes to the Financial Statements

(forming part of the Financial Statements)

I. Summary of Significant Accounting Policies (continued)

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Financial assets and liabilities (continued)

From 1 April 2005

On initial recognition, IAS 39 requires that financial assets be classified into the following categories; at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale.

Financial assets at fair value through profit or loss

This category comprises financial assets held for trading, (i.e. primarily acquired for the purpose of selling in the short term), derivatives that are not designated as cash flow or net investment hedges, and any financial assets that are designated as fair value through profit and loss on inception. These financial assets are initially recognised at fair value, with transaction costs recorded immediately in the income statement and are subsequently measured at fair value. Gains and losses arising from changes in fair value are recognised in the income statement as net trading income.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans which are intended to be sold in the short term are recorded at fair value through profit or loss.

Loans and receivables are initially recorded at fair value, including any transaction costs, and are subsequently measured at amortised cost using the effective interest rate method.

Available-for-sale investments

Available-for-sale investments comprise non-derivative financial assets that are either designated as available-for-sale on initial recognition or are not classified into the categories described above. They are initially recognised at fair value, including direct and incremental transaction costs, and are subsequently measured at fair value.

Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised in equity until the financial asset is sold, at which time the cumulative gain or loss is transferred to the income statement. Interest (determined using the effective interest rate method), impairment losses and translation differences on monetary items are recognised in the income statement as they arise. Dividends on available-for-sale equity instruments are recognised in the income statement when the Group's right to receive payment is established.

Determination of fair value

The fair value of quoted investments in active markets is based on current bid prices. For other financial assets, the Group establishes fair value by using appropriate valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation methods commonly used by market participants. The fair value of short-term debtors is equal to invoice value.

Financial liabilities

Except for derivatives, which are classified as at fair value through profit or loss on initial recognition, all financial liabilities are carried at amortised cost.

Notes to the Financial Statements

(forming part of the Financial Statements)

I. Summary of Significant Accounting Policies (continued)

Financial assets and liabilities (continued)

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Derecognition

The Group derecognises a financial asset when:

- i. the contractual rights to cash flows arising from the financial assets have expired; or
- ii. it transfers the financial asset including substantially all of the risks and rewards of the ownership of the asset; or
- iii. it transfers the financial asset, neither retaining nor transferring substantially all the risks and rewards of the asset, but no longer retains control of the asset.

Securitisation transactions

The Group has issued debt securities or has entered into funding arrangements with lenders in order to finance specific financial assets.

In general, both the assets and the related liabilities from these transactions are held on the Group's balance sheet. However, to the extent that the risks and returns associated with the financial instruments have been transferred to a third party, the assets and liabilities are derecognised in whole or in part.

Interests in securitised financial assets may be retained or taken in the form of senior or subordinated tranches, or other residual interests. Such retained interests are primarily recorded as available-for-sale assets.

Transactions that were previously disclosed in the balance sheet with linked presentation, as required under UK GAAP, are presented under IFRS with separate recognition of the gross assets and the related funding.

Impairment of financial assets

From 1 April 2004 to 31 March 2005

Provisions for bad and doubtful debts are made as considered necessary having regard to both specific and general factors. Specific provisions are made on a case by case basis where the repayment of identified loans is in doubt, and reflect estimates of the amount needed to reduce the carrying value of the asset to the estimated net realisable value. Provisions made less amounts released during the year are charged against profits. Provisions are applied to write off advances, in part or in whole, when they are considered irrecoverable.

The general bad debt provision augments specific provisions and relates to the inherent risk of losses which, although not separately identified, is known from experience to be present in any loan portfolio, and to those identified loans where material uncertainty exists as to the quantum of specific provisions required. The amount of the general bad debt provision is assessed in relation to the size and asset quality of the loan portfolio.

Interest on loans and advances is accrued to income until such time as reasonable doubt exists about its collectability; thereafter, and until all or part of the loan is written off, interest continues to accrue on loans and advances, but is not included in income.

Notes to the Financial Statements

(forming part of the Financial Statements)

I. Summary of Significant Accounting Policies (continued)

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Impairment of financial assets (continued)

From 1 April 2005

Assets carried at amortised cost are assessed at each balance sheet date to determine whether there is objective evidence that a financial asset or group of financial assets is impaired.

Impairment losses are incurred if there is objective evidence of impairment as a result of one or more events occurring after initial recognition of the asset (a 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data about the following loss events:

- i. significant financial difficulty of the issuer;
- ii. a breach of contract, such as a default or delinquency in interest or principal repayment;
- iii. granting to the borrower a concession, for economic or legal reasons relating to the borrower's financial difficulty, a concession that the lender would not otherwise consider;
- iv. it becoming probable that the borrower will enter bankruptcy or other financial reorganisation.

Impairment of loans and receivables

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant and individually or collectively for financial assets that are not individually significant. Impairment losses are calculated on a collective basis in respect of losses that have been incurred but not yet identified on loans that are subject to individual assessment for impairment and for homogeneous groups of loans that are not considered individually significant. If no objective evidence of impairment exists for an individually assessed financial asset, it is included in a collective assessment for impairment with other assets with similar risk characteristics.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial asset's *original effective interest rate*. The carrying amount of the asset is reduced, the loss being recognised in the income statement.

The calculation of the present value of the estimated future cash flows of a financial asset reflects the cash flows that may result from scheduled interest payments, principal repayments, or other payments due, including liquidation of collateral where available. In estimating these cash flows, management makes judgments about a counterparty's financial situation and the fair value of any underlying collateral or guarantees in the Group's favour. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable are reviewed by the Credit Committee on a quarterly basis. The methodology and assumptions used for estimating both the amount and the timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Collectively assessed credit risk allowances cover credit losses inherent in portfolios of claims with similar economic characteristics where there is objective evidence to suggest that they contain impaired claims but the individual impaired items cannot yet be identified. For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics. Future cash flows are estimated on the basis of historical loss experience. These estimates are subject to regular review and adjusted to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Notes to the Financial Statements

(forming part of the Financial Statements)

I. Summary of Significant Accounting Policies (continued)

Impairment of financial assets (continued)

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The accuracy of the allowances and provisions made depends on how accurately the Group estimates future cash flows for specific counterparty allowances and provisions and the model assumptions and parameters used in determining collective allowances. While this necessarily involves judgment, the Group believes that its allowances and provisions are reasonable and supportable.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the original effective interest rate which was used to discount the future cash flows for the purpose of measuring the impairment loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related to an objective event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance for loan impairment. The amount of the reversal is recognised in the income statement.

When a loan is uncollectable, it is written off against the related allowance for loan impairment. Recoveries received in respect of loans previously written off are recorded as a decrease in the impairment losses on loans and advances and recorded in the income statement in the year in which the recovery was made.

Impairment of available-for-sale assets

Available-for-sale assets are assessed at each balance sheet date to determine whether there is objective evidence that a financial asset or group of financial assets is impaired.

For equity shares classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered evidence of impairment. If any such evidence exists, the cumulative loss is removed from equity and recognised in the income statement. Recognised impairment losses on equity shares classified as available-for-sale are not reversed through the income statement, but are recorded in equity.

Impairment of available-for-sale debt securities is based on the same criteria as for all other financial assets. If in a subsequent period the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement.

The loss recognised in the income statement is the difference between the acquisition cost and current fair value, less any impairment loss on that financial asset previously recognised in the income statement.

Debt/equity classification

From 1 April 2004 to 31 March 2005

Under UK GAAP, a financial instrument is classified as a liability when the substance of a transaction is such that there is an obligation to deliver economic benefits, except in the case of preference shares, which are required to be described as shareholder funds under the Companies Act.

Notes to the Financial Statements

(forming part of the Financial Statements)

I. Summary of Significant Accounting Policies (continued)

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Debt/equity classification (continued)

From 1 April 2005

Under IFRS the critical feature in differentiating a debt instrument from an equity instrument is the existence of a contractual obligation of the Group to deliver cash (or another financial asset) to another entity. Where there is no such contractual obligation, the Group will classify the financial instrument as equity, otherwise it will be classified as a liability and carried at amortised cost. Under IFRS the legal form of the transaction takes precedence over its economic substance in determining how it should be classified.

Goodwill and intangible assets

- i. Goodwill in an associate or subsidiary represents the excess, at the date of acquisition, of an acquisition's cost over the fair value of the Group's share of net identifiable assets acquired. Identifiable intangible assets are those which can be sold separately or which arise from legal rights regardless of whether those rights are separate.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is tested annually for impairment, or more frequently when circumstances indicate that its carrying amount is too high. Goodwill is allocated to cash-generating units for the purposes of impairment testing. If the net present values of the cash-generating units' forecast cash flows are insufficient to support their carrying value, then the goodwill is impaired. Impairment losses on goodwill are recognised in the income statement and are not reversed.

Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

- ii. Intangible assets comprise acquired intellectual property rights, which are carried at cost less accumulated amortisation and impairment losses. The costs are amortised on the basis of an estimated useful life of 10 years. Intellectual property rights are reviewed at each reporting date to determine whether there is any objective evidence of impairment. If such evidence exists, an impairment test is performed.

Property, plant and equipment

All property, plant and equipment is stated at cost or deemed cost less accumulated depreciation and impairment losses. Cost includes expenditure that is directly attributable to the acquisition of the asset.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to write down the cost of assets to their residual values over their estimated useful lives, as follows:

Computer equipment	3-5 years
Cars	3-5 years
Fixtures and fittings	3-10 years
Leasehold improvements	5-15 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Gains and losses on disposals are determined by comparing proceeds with carrying amounts. These gains and losses are recognised in the income statement.

Notes to the Financial Statements

(forming part of the Financial Statements)

I. Summary of Significant Accounting Policies (continued)

Impairment of property, plant and equipment

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At each balance sheet date, or more frequently where events or changes in circumstances dictate, property, plant and equipment is assessed for indications of impairment. If such indications are present, these assets are subject to an impairment review. If impaired, the carrying values of assets are written down by the amount of any impairment and the loss is recognised in the income statement in the period in which it occurs. A previously recognised impairment loss relating to a fixed asset may be reversed when a change in circumstances leads to a change in the estimates used to determine the fixed asset's recoverable amount. The carrying amount of the fixed asset is only increased up to the amount that it would have been had the original impairment not been recognised.

Finance and operating leases

Where the group is the lessor

Finance leases

When assets are held subject to a finance lease, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method (before tax), which reflects a constant periodic rate of return.

Operating leases

Assets acquired for use by customers under operating lease agreements, including initial direct costs incurred by lessors in negotiating an operating lease, are capitalised and included in the relevant category of fixed assets. Depreciation is charged on a straight-line basis to write the value of the asset down to the expected residual value over a period consistent with other assets of a similar type.

Operating lease income and the initial direct costs are then recognised on a straight-line basis over the period of the lease.

Where the Group is the lessee

The Group has entered into operating leases in respect of property, plant and equipment. The total payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with original maturities of less than three months, including cash and non-restricted balances with central banks, certificates of deposits and loans and advances to banks.

Pensions

The Group's post-retirement benefit arrangements are described in note 24. The Group operates a number of pension and other post-retirement benefit schemes, both funded and unfunded, and of the defined benefit and defined contribution types. For defined contribution schemes, the contribution payable in respect of the accounting period is recognised in the income statement.

Notes to the Financial Statements

(forming part of the Financial Statements)

I. Summary of Significant Accounting Policies (continued)

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Pensions (continued)

The defined benefit schemes are accounted for using the option permitted by the amendment made to IAS 19 Employee Benefits, which the Group has adopted early, whereby actuarial gains and losses are recognised outside profit or loss and presented in the statement of recognised income and expense. The amount recognised in the balance sheet in respect of defined benefit schemes is the difference between the present value of the defined benefit obligation at the balance sheet date, and the fair value of the plan's assets, if any. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The principal assumptions are set out in note 24. The obligation's present value is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related pension liability.

Share based payments

The Group has entered into a cash-settled share based payment transaction for the acquisition of a minority interest in a subsidiary company from employees of that subsidiary.

The fair value of the services provided by the minority shareholders is measured as the change in the fair value of options over the minority shareholdings. The fair value is determined by reference to the valuation of the business and the terms and conditions of the options. The cost of the services is recognised at each reporting date and is re-measured at each reporting date and at the date of settlement. Any vesting rights are taken into account when determining the rights to payment.

Taxation

Tax payable on profits is recognised in the income statement, except to the extent that it relates to items that are recognised in equity.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts. Deferred tax is determined using tax rates and laws that are expected to apply when the related deferred tax asset is realised, or the deferred tax liability is settled.

The principal temporary differences arise from depreciation of property, plant and equipment, revaluation of certain financial instruments including derivative contracts, provisions for post-retirement benefits and tax losses carried forward.

Deferred tax assets, including the tax effects of income tax losses available for carry forward, are only recognised where it is probable that future taxable profits will be available against which the temporary differences can be utilised. Deferred tax is not provided on temporary differences arising from investments in subsidiaries and associates, unless the timing of the reversal of the temporary difference is controlled by a third party and it is probable that the difference will reverse in the foreseeable future.

Dividends

Dividends on ordinary shares are recognised in equity in the period in which they are declared by the Company's shareholders at the Annual General Meeting or, in the case of interim dividends, when they are paid.

Notes to the Financial Statements

(forming part of the Financial Statements)

1. Summary of Significant Accounting Policies (continued)

Fiduciary activities

The Group acts as custodian and in other fiduciary capacities that result in the holding or placing of assets on behalf of customers. These assets and the income arising therefrom are excluded from these financial statements, as they are not assets of the Group.

Provisions and contingencies

Provisions are recognised only when the Group has a present obligation (legal or constructive) as a result of past events. In addition, it must be probable that a transfer of economic benefits will be required to settle the obligation, and it must also be possible to make a reliable estimate of the amount of the obligation.

The Group recognises provisions in respect of onerous contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract.

Contingent liabilities are possible obligations arising from past events whose existence will be confirmed by one or more uncertain future events not wholly with the Group's control, or present obligations that are not recognised either because it is not probable that an outflow of resources will be required to settle the obligation or the amount of the obligation cannot be reliably estimated. Contingent liabilities are disclosed unless the possibility of a transfer of economic benefits is remote.

2. Transition to IFRS

2.1 Application of IFRS 1

As stated in note 1, the Group's financial statements for the year ended 31 March 2006 are the first annual financial statements that are prepared in accordance with IFRS. The Group has applied the provisions of IFRS 1 First-time Adoption of International Financial Reporting Standards in preparing these consolidated financial statements. The Group's IFRS transition date is 1 April 2004, and the Group prepared its opening IFRS balance sheet at that date. In its transition to IFRS, the Group has applied the mandatory exceptions and certain of the optional exemptions from full retrospective application of IFRS set out in IFRS 1.

2.2 Exemptions from full retrospective application of IFRS

The Group applied the following exemptions permitted by IFRS 1:

Exemption from restatement of comparatives for IAS 32 and IAS 39

The Group has elected not to apply IAS 32 Financial Instruments: Disclosure and Presentation and IAS 39 Financial Instruments: Recognition and Measurement to the comparative figures for the year ended 31 March 2005. IAS 32 and IAS 39 were adopted with effect from 1 April 2005 and their impact is reflected through adjustments to shareholders' equity as at 1 April 2005, as set out in section 2.4 below. Comparative figures for financial instruments have been prepared in accordance with UK generally accepted accounting principles ("UK GAAP").

Notes to the Financial Statements

(forming part of the Financial Statements)

2. Transition to IFRS (continued)

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2.2 Exemptions from full retrospective application of IFRS (continued)

Business combinations

The Group has elected to not apply IFRS 3 Business Combinations retrospectively to past business combinations.

Cumulative translation differences

The cumulative translation differences for all foreign operations are deemed to be zero at 1 April 2004.

Property, plant and equipment

The Group has elected to treat the fair value of certain leasehold improvements included in property, plant and equipment as their deemed cost at the IFRS transition date of 1 April 2004.

Share based payments

The Group has applied an exemption so that share options granted prior to 7 November 2002 are not accounted for.

2.3 Reconciliations between UK GAAP and IFRS

The following reconciliations provide a quantification of the effect of the transition to IFRS:

- Shareholders' equity as at 1 April 2004 and 31 March 2005 – excluding the effect of IAS 32 and IAS 39, which the Group has adopted with effect from 1 April 2005.

	1 April 2004		31 March 2005	
	Group	Company	Group	Company
	£'000	£'000	£'000	£'000
Shareholders' equity – UK GAAP	317,675	317,675	321,394	321,394
IFRS adjustments to shareholders' equity				
Pensions	(46,596)	(44,487)	(63,516)	(60,410)
Tax effect of pensions adjustments	13,636	13,346	18,550	18,123
	(32,960)	(31,141)	(44,966)	(42,287)
Dividends	5,000	5,000	12,500	12,500
Property, plant and equipment written down to deemed cost	(13,120)	(13,120)	(13,120)	(13,120)
Leasing fees	(126)	–	(97)	–
Share based payments	(335)	–	(1,288)	–
Depreciation	(220)	–	1,313	1,344
Reduction in carrying value of investment in joint ventures	–	(3,567)	–	(411)
Reduction in carrying value of subsidiaries	–	(79,690)	–	(82,647)
Reduction in carrying value of associated undertakings	–	(1,554)	–	(1,520)
Other	–	–	231	–
Dividends receivable	–	–	2	2
Reversal of goodwill amortisation	–	–	531	–
Tax effect of adjustments	3,416	3,312	2,999	2,990
Minority interest	56	–	79	–
Shareholders' equity – IFRS	279,386	196,915	279,578	198,245

Notes to the Financial Statements

(forming part of the Financial Statements)

2. Transition to IFRS (continued)

2.3 Reconciliations between UK GAAP and IFRS (continued)

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ii. Income Statement for the year to 31 March 2005

	Group £'000	Company £'000
Profit for the financial year – UK GAAP	28,930	25,796
Attributable to		
– Equity holders of the parent company	28,283	25,796
– Minority interest	647	–
	28,930	25,796
IFRS adjustments		
Pensions	571	724
Goodwill	531	–
Leasing	29	–
Foreign exchange translation	234	–
Depreciation	1,533	1,344
Joint ventures	–	3,155
Valuation of employee share options	(953)	–
Other	159	3
Tax effect	(539)	(539)
	1,565	4,687
Profit for the financial year – IFRS	30,495	30,483
Attributable to		
– Equity holders of the parent company	29,871	30,483
– Minority interest	624	–
	30,495	30,483

Notes to the Financial Statements

(forming part of the Financial Statements)

2. Transition to IFRS (continued)

2.4 Effect of transition to IAS 32 and IAS 39 at 1 April 2005

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Group	31 March 2005 IFRS £'000	Reclass- ifications £'000	Fair Value £'000	Effective Interest £'000	Impairment £'000	Derivatives Loan & Hedge Accounting £'000	1 April 2005 IFRS £'000
Assets							
Cash and balances at central banks	1,511	—	—	—	—	—	1,511
Derivative financial instruments	—	68,414	—	—	—	4,035	72,449
Loans and advances to banks	446,280	—	—	—	—	—	446,280
Loans and advances to customers	2,258,609	(191,889)	—	(6,374)	1,469	3,195	2,065,010
Debt and equity securities	2,438,338	190,276	6,966	(1,578)	—	978	2,634,980
Investments in associated undertakings	8,823	—	—	—	—	—	8,823
Intangible assets	3,480	—	—	—	—	—	3,480
Property, plant and equipment	11,408	—	—	—	—	—	11,408
Deferred tax assets	36,462	—	(2,090)	2,395	1,760	1,633	40,160
Other assets	191,536	(67,338)	—	—	—	(2,219)	121,979
Total assets	5,396,447	(537)	4,876	(5,557)	3,229	7,622	5,406,080
Liabilities							
Deposits by banks	1,665,648	(59)	—	—	—	(154)	1,665,435
Due to customers	1,384,935	—	—	—	—	(125)	1,384,810
Derivative financial instruments	—	61,666	—	—	—	13,787	75,453
Debt securities in issue	1,507,513	(1,355)	—	—	—	430	1,506,588
Subordinated liabilities	230,980	(230,980)	—	—	—	—	—
Other liabilities	160,008	(60,794)	—	—	—	(98)	99,116
Current tax liabilities	4,383	—	—	—	—	—	4,383
Accruals and deferred income	159,755	5	—	35	—	(2,407)	157,388
Total liabilities	5,113,222	(231,517)	—	35	—	11,433	4,893,173
Shareholders' equity							
Share capital	50,000	—	—	—	—	—	50,000
Retained earnings	229,377	—	—	(5,581)	3,152	(3,552)	223,396
Translation reserve	201	—	—	—	—	—	201
Available-for-sale reserve	—	—	1,876	—	—	—	1,876
Hedging reserve	—	—	—	—	—	(256)	(256)
Total shareholders' equity	279,578	—	4,876	(5,581)	3,152	(3,808)	278,217
Minority interests	3,647	230,980	—	(11)	77	(3)	234,690
Total equity and liabilities	5,396,447	(537)	4,876	(5,557)	3,229	7,622	5,406,080

Notes to the Financial Statements

(forming part of the Financial Statements)

2. Transition to IFRS (continued)

2.4 Effect of transition to IAS 32 and IAS 39 at 1 April 2005 (continued)

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Company	31 March 2005 IFRS £'000	Reclass- ifications £'000	Fair Value £'000	Effective Interest £'000	Loan Impairment £'000	Derivatives & Hedge Accounting £'000	1 April 2005 IFRS £'000
Assets							
Cash and balances at central banks	27	—	—	—	—	—	27
Derivative financial instruments	—	60,790	—	—	—	3,372	64,162
Loans and advances to banks	246,211	—	—	—	—	—	246,211
Loans and advances to customers	1,419,791	(190,152)	—	(4,686)	459	1,554	1,226,966
Debt and equity securities	1,786,035	190,200	4,551	(1,578)	—	978	1,980,186
Shares in subsidiary undertakings	34,786	—	—	—	—	—	34,786
Investments in associated undertakings	7,303	—	—	—	—	—	7,303
Investments in joint ventures	429	—	—	—	—	—	429
Property, plant and equipment	3,570	—	—	—	—	—	3,570
Deferred tax assets	30,855	—	(1,366)	1,889	2,063	1,359	34,800
Other assets	162,604	(60,898)	—	—	—	(2,219)	99,487
Total assets	3,691,611	(60)	3,185	(4,375)	2,522	5,044	3,697,927
Liabilities							
Deposits by banks	1,466,270	—	—	—	—	(213)	1,466,057
Due to customers	1,078,560	—	—	—	—	(28)	1,078,532
Derivative financial instruments	—	56,908	—	—	—	10,865	67,773
Debt securities in issue	450,595	—	—	—	—	(33)	450,562
Subordinated liabilities	230,980	(230,980)	—	—	—	—	—
Other liabilities	137,747	(56,954)	—	—	—	(98)	80,695
Current tax liabilities	1,091	—	—	—	—	—	1,091
Accruals and deferred income	128,123	(14)	—	35	—	(2,276)	125,868
Total liabilities	3,493,366	(231,040)	—	35	—	8,217	3,270,578
Shareholders' equity							
Share capital	50,000	—	—	—	—	—	50,000
Retained earnings	148,245	—	—	(1,410)	2,522	(2,946)	143,411
Translation reserve	—	—	—	—	—	—	—
Available-for-sale reserve	—	—	3,185	—	—	—	3,185
Hedging reserve	—	—	—	—	—	(227)	(227)
Total shareholders' equity	198,245	—	3,185	(4,410)	2,522	(3,173)	196,369
Minority interest	—	230,980	—	—	—	—	230,980
Total equity and liabilities	3,691,611	(60)	3,185	(4,375)	2,522	5,044	3,697,927

Notes to the Financial Statements

(forming part of the Financial Statements)

2. Transition to IFRS (continued)

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2.5 Differences between UK GAAP and IFRS

The significant differences between the Group's accounting policies under UK GAAP and under IFRS are described below, together with a description of the impact of the changes in accounting policy.

Consolidation and presentation

Under UK GAAP, securitisation and other off-balance sheet financing transactions were presented in the balance sheet with linked presentation as permitted by FRS 5, whereby the non-recourse finance was deducted from the securitised assets on the balance sheet. Under IFRS, such linked presentation is not permitted, and the assets and non-recourse finance are presented gross on the balance sheet. The effect of this change is to increase both total assets and total liabilities by £688 million at 1 April 2004 and by £590 million at 31 March 2005.

Investments in subsidiary and associated undertakings

In accordance with the alternative accounting rules allowed in the Companies Act, the Company's investments in subsidiary and associated undertakings were stated at the Company's share of net asset value in its individual financial statements under UK GAAP. Under IFRS, these investments are carried at cost in accordance with IAS 27 Consolidated and Separate Financial Statements and IAS 28 Investments in Associates. At 1 April 2004, the carrying value of the Company's investments in subsidiary and associated undertakings reduced by £81,244,000, with a corresponding reduction in the revaluation reserve. At 31 March 2005, the equivalent adjustment was £84,167,000. Associated undertakings are included in the consolidated financial statements using the equity method; losses in excess of the Group's interest in associates are not recognised.

Joint ventures

Certain joint arrangements have been classified as jointly controlled entities under IAS 31 Interests in Joint Ventures. Under UK GAAP, the Company recognised its share of income, expenses, assets and liabilities arising from these joint ventures in its individual accounts; under IFRS, the Company's investment in these joint ventures is carried at cost. The jointly controlled entities are included in the consolidated accounts using the proportionate consolidation method. The effect of this change on the Company's profit or loss and balance sheets is negligible.

Goodwill

Under UK GAAP, goodwill arising on the purchase of subsidiary undertakings is capitalised and amortised over its useful economic life. Under IFRS, such goodwill is not amortised; it is tested annually for impairment. At 1 April 2004, carrying value of goodwill was carried forward without adjustment at its UK GAAP carrying value, being deemed cost after testing for impairment. The effect of the reversal of goodwill amortisation in the year to 31 March 2005 was to increase profits of the Group by £531,000.

Notes to the Financial Statements

(forming part of the Financial Statements)

2. Transition to IFRS (continued)

Property plant and equipment

On initial recognition, IAS 16 Accounting for Property, Plant and Equipment requires an entity to measure property, plant and equipment at cost and subsequently to measure it at its depreciated cost. At the date of transition to IFRS, IFRS 1 allows an entity to measure an item of property, plant and equipment at fair value and to use that fair value as the asset's deemed cost at that date. The Company elected to measure certain leasehold improvements at fair value at 1 April 2004, the date of transition to IFRS, which resulted in a decrease in retained earnings of the Group and the Company of £13,120,000 (£9,808,000 net of tax). Because of a reduced depreciation charge, the effect at 31 March 2005 was to increase the Group and Company's profit by £1,344,000 (£1,022,000 net of tax) and to reduce retained earnings by £11,776,000 (£8,786,000 net of tax).

Pensions and other post-retirement benefits

IAS 19 Employee Benefits requires defined benefit pension fund assets to be measured at fair value at the balance sheet date, and liabilities to be measured under current actuarial assumptions using the projected unit credit method, discounted at the rate of interest on a high quality corporate bond. The net liability is recognised on the balance sheet. The Group has elected to adopt early the amendments to IAS 19 Employee Benefits: Actuarial Gains and Losses, Group Plans and Disclosures and will recognise all actuarial gains and losses immediately in the Statement of Recognised Income and Expense. Under UK GAAP, pension costs were recognised on a systematic basis over employees' remaining service lives; defined benefit pension liabilities were not recognised on the balance sheet.

At 1 April 2004 the Group recognised a defined benefit pension liability of £46,596,000 (£32,960,000 net of deferred tax) and at 31 March 2005 a liability of £63,516,000 (£44,966,000 net of deferred tax). The Company recognised a liability of £44,487,000 (£31,141,000 net of deferred tax) at 1 April 2004 and a liability of £60,410,000 (£42,287,000 net of deferred tax) at 31 March 2005.

The pension cost in the income statement is determined differently under UK GAAP and IFRS, and the transition to IFRS resulted in a reduction of £571,000 (£375,000 net of tax) in the Group's pension cost for the year to 31 March 2005. The Company's pension cost reduced by £724,000 (£507,000 net of tax) in the year to 31 March 2005.

Share based payments

IFRS 2 requires cash-settled share based payment transactions to be recorded as a liability measured at fair value on the balance sheet. As the employees render service, the cost of that service is measured as the change in fair value of the liability at each reporting date and at the date of settlement, and is recognised in the income statement.

The impact on the Group's retained earnings at 1 April 2004 of recording share based payment transactions in the balance sheet under IFRS was a decrease of £335,000. The Group's liability increased by a further £953,000 at 31 March 2005 with a corresponding charge to the income statement.

Dividends

IAS 10 Events after the Balance Sheet Date does not permit the recognition of a liability in respect of dividends declared after the balance sheet date; accordingly, the liability for dividends proposed at the balance sheet date has been reversed, increasing reported shareholders' equity of the Group and the Company by £5,000,000 at 1 April 2004 and by £12,500,000 at 31 March 2005. Under IFRS, dividends receivable are recognised only when the Group's right to recognise payment is established.

Notes to the Financial Statements

(forming part of the Financial Statements)

2. Transition to IFRS (continued)

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Leasing

Under IAS 17 Leases, finance lease income is recognised so as to give a constant rate of return on the net investment in the lease without taking account of tax payments and receipts.

Under UK GAAP, fees charged by lessors are recorded in the income statement when they fall due, either at the beginning or end of the finance lease agreement. However, under IAS 17, fees charged for negotiating finance leases are included in the measurement of the finance lease receivable, and are recognised in the income statement on the same basis as finance lease income. At 1 April 2004, the effect of recognising fees charged on an actuarial before tax method was to reduce Group finance lease receivables by £126,000 with a corresponding reduction in the Group's retained earnings. The effect on the Group's income statement for the year to 31 March 2005 was negligible.

Under UK GAAP, operating lease fees charged by lessors are recorded in the income statement when they are receivable; under IFRS, such fees are spread on a straight-line basis over the life of the lease. The impact of this change in timing of fee recognition on shareholders' equity of the Group at 1 April 2004 and in the income statement of the Group for the year ended 31 March 2005 was negligible.

Depreciation

Assets held by lessors under operating leases have been depreciated using the reverse annuity method under UK GAAP. Under IAS 16, these assets are depreciated on a straight-line basis; the impact of the change in depreciation method under IAS 16 at 1 April 2004 was to reduce the carrying value of the Group's tangible assets by £220,000, with a corresponding reduction in retained earnings. The effect in the year to 31 March 2005 was to reduce the charge for depreciation in the income statement by £189,000 and to increase the carrying value of tangible fixed assets by the same amount.

Deferred tax

UK GAAP requires deferred tax to be provided for all material timing differences between accounting profit and taxable profit except where such timing differences are permanent or are not expected to reverse in future periods. Under IFRS, deferred tax is provided in full in respect of all temporary differences, being the difference between an asset's carrying value and its tax base.

The impact of adopting IFRS was to increase the deferred tax assets of the Group at 1 April 2004 by £17,052,000 and £21,549,000 at 31 March 2005. On the adoption of IAS 39 at 1 April 2005, the Group's deferred tax assets increased by a further £3,698,000. The Company's deferred tax assets increased by £16,658,000 at 1 April 2004 and £21,113,000 at 31 March 2005. At 1 April 2005, the Company's deferred tax assets increased by a further £3,945,000. The majority of the increase in the deferred tax assets of the Group and Company are a result of recognising the defined benefit pension liability on the balance sheet under IFRS.

Foreign currency translation

The functional currency of certain subsidiaries within the Group determined in accordance with IAS 21 The Effect of Changes in Foreign Exchange Rates is different from the local currency previously determined under UK GAAP. This change in functional currency resulted in foreign exchange translation gains of £234,000 that were recognised directly in equity under UK GAAP being recognised instead in the Group income statement under IFRS.

Notes to the Financial Statements

(forming part of the Financial Statements)

2. Transition to IFRS (continued)

Foreign currency translation (continued)

Translation gains and losses on foreign currency operations are recognised in a separate component of equity under IFRS. The Group has elected, under IFRS 1, not to apply retrospectively IAS 21 to such translation gains and losses, and the cumulative translation gains and losses at 1 April 2004 have been set to zero. At 31 March 2005, foreign currency gains and losses of £201,000 were reported in a separate component of the Group's equity, having been included in retained earnings under UK GAAP.

Financial instruments – classification and measurement

IAS 39 Financial Instruments: Recognition and Measurement requires financial instruments to be classified into categories which determine their accounting treatment. Adoption of IAS 39 has resulted in a number of changes to the accounting treatment of the Group's financial instruments.

Debt and equity securities and certain loan assets which were carried at amortised cost under UK GAAP have been classified as available-for-sale under IFRS. Under IFRS, the assets are measured at fair value in the balance sheet, with changes to fair value being recorded directly in equity. At 1 April 2005, the effective date of IAS 39 adoption, the impact of this change in accounting policy was to increase the carrying value of debt and equity securities of the Group and Company by £6,966,000 and £4,551,000 respectively.

Derivatives and hedge accounting

Under UK GAAP, derivative financial instruments used in trading activities are recorded in the balance sheet at fair value with all gains and losses recorded in net trading income. Derivatives used to hedge exposures in the non-trading book are accounted for on the same basis as the hedged exposure; under UK GAAP, the Group accounted for certain interest rate swaps used for hedging purposes on an accruals basis.

IAS 39 requires all derivative financial instruments to be carried on the balance sheet at fair value. Changes in fair value, excluding changes relating to derivatives that are part of an effective hedging relationship, are recorded in net trading income. Changes in the fair value of derivatives used as cashflow hedges are recorded in equity. Where a fair value hedging relationship exists, changes in the fair value of the derivative and the hedged item are recognised in the income statement as net interest income. Fair value gains and losses on the ineffective portion of fair value and cashflow hedges are recognised in net trading income.

Certain derivative assets and liabilities accounted for as hedges under UK GAAP do not meet the stringent criteria for hedge accounting set out in IAS 39. The assets and liabilities, previously accounted for on an accruals basis, were recognised in the balance sheet at fair value at 1 April 2005, with a decrease in the Group's and Company's retained earnings of £3,552,000 and £2,946,000 respectively. Derivative assets and liabilities qualifying as cash flow hedges were also recognised in the balance sheet at 1 April 2005, resulting in a decrease in equity of £256,000 for the Group and £227,000 for the Company. The changes in fair value on derivatives held in cash flow hedging relationships are recorded in a separate reserve in equity.

Notes to the Financial Statements

(forming part of the Financial Statements)

2. Transition to IFRS (continued)

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Loan impairment

Under UK GAAP, specific provisions are made where the repayment of identified loans is in doubt, and reflect estimates of the amount needed to reduce the carrying value of the asset to the estimated net realisable value. The general bad debt provision augments specific provisions and relates to the inherent risk of losses which, although not separately identified, are known from experience to be present in any loan portfolio.

Under IFRS, impairment losses are recognised only where there is objective evidence of impairment at the balance sheet date as a result of one or more loss events that occurred after the initial recognition of the asset. Impairment is measured as the difference between the carrying value of the asset and the present value of future cashflows discounted at the original effective interest rate. Impairment is measured individually for assets that are individually significant and individually or collectively for other assets. The adoption of IAS 39 resulted in a decrease of £1,469,000 in loan loss provisions at the Group level and £459,000 at the Company level.

Effective interest method

Under IAS 39, the amortised cost of a financial asset and liability is calculated using the effective interest rate method, which allocates interest income and expense over the relevant period by applying the effective interest rate to the carrying amount of the asset or liability.

The effective interest rate is the rate that exactly discounts the estimated future cash flows of a financial instrument to its net carrying amount. The effective interest rate method results in fees that are an integral part of the yield on a financial asset being recognised over the expected life of that asset.

Under UK GAAP, certain types of loan-related fees are recognised when receivable, usually at the inception or termination of a loan. Under IFRS, these fees are included in the effective yield on the loan and are hence recognised in the income statement over the expected life of the loan. The change in the timing of fee recognition resulted in a reduction in the Group's and Company's retained earnings at 1 April 2005 of £5,581,000 and £4,410,000 respectively.

Cash flow statement

The Group and Company are not exempt from preparing a cash flow statement under IFRS.

Notes to the Financial Statements

(forming part of the Financial Statements)

3. Financial Risk Management

3.1 Strategy in using financial instruments

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The use of financial instruments, including derivatives, is fundamental to the Group's banking and treasury activities. The Group provides a range of lending products to its clients and funds these activities by means of deposit-taking, medium term note issuance and other borrowings. The Group invests in debt securities in order to profit from the interest margin over its cost of funds and to provide a portfolio of liquid assets to assist in the management of liquidity risk and to hedge forecast cashflows. Further information on derivative contracts and the Group's hedging strategies is set out in note 12. The Group uses derivative financial instruments to meet clients' requirements, for proprietary trading and to manage its exposure to interest rate and currency risk. The key risks arising from the Group's activities involving financial instruments are as follows:

- Market risk – exposure to changes in market variables such as interest rates, currency exchange rates and equity prices.
- Credit risk – the risk of loss arising from client or counterparty default.
- Liquidity and funding risk – the risk that the Group is unable to meet its obligations as they fall due, or that it is unable to borrow in the market at an acceptable price to fund its commitments.

The identification, measurement and containment of risk is integral to the management of the Group's business. Risk policies and procedures are regularly updated to meet changing business requirements.

3.2 Credit risk

Credit risk arises from all exposures to clients and counterparties relating to the Group's lending, trading and investment activities. The Credit Committee sets limits, reviews concentrations and makes recommendations on credit decisions to the Executive Committee. Credit risk limits are set, where appropriate, in respect of exposures to individual clients or counterparties, to industry sectors and to countries.

Exposure to credit risk is managed by detailed analysis of client and counterparty creditworthiness prior to entering into an exposure, and by continued monitoring thereafter. A significant proportion of the Group's lending exposures is secured on property or other assets; the Group monitors the value of any collateral obtained. The Group also uses netting agreements to restrict credit exposure to counterparties. For internal monitoring purposes, credit exposure on loans and debt securities is measured as the principal amount outstanding plus accrued interest. Credit exposure on derivatives is measured as the current replacement value plus an allowance for the potential change in replacement value.

Notes to the Financial Statements

(forming part of the Financial Statements)

3. Financial Risk Management (continued)

3.2 Credit risk (continued)

The following table discloses the maximum exposure to credit risk on assets and off balance sheet items by geographic area:

At 31 March 2006	Loans to Customers £'000	Derivative Financial Instruments £'000	Debt and Equity Securities £'000	Other Assets £'000	Total £'000	Commitments/ Guarantees £'000
Group						
United Kingdom	1,162,789	7,755	1,029,380	192,303	2,392,227	173,358
Europe	621,537	7,244	1,601,009	105,593	2,335,383	215,217
US and Canada	126,614	489	302,822	9,832	439,757	162,876
Australasia	10,359	38	93,420	742	104,559	25,598
South-East Asia	37,121	—	—	810	37,931	22,332
Other countries	118,600	2,120	46,889	1,008	168,617	3,652
Total	2,077,020	17,646	3,073,520	310,288	5,478,474	603,033
Company						
United Kingdom	943,258	7,698	910,836	165,035	2,026,827	870,470
Europe	213,989	3,455	1,302,079	72,580	1,592,103	154,812
US and Canada	71,448	4	229,429	9,789	310,670	162,852
Australasia	7,550	38	45,183	672	53,443	25,092
South-East Asia	—	—	—	215	215	21,811
Other countries	69,905	2,120	45,989	866	118,880	2,850
Total	1,306,150	13,315	2,533,516	249,157	4,102,138	1,237,887

3.3 Market risk

Market risk arises as a result of the Group's activities in interest rate, currency and equity markets and comprises interest rate, foreign exchange and equity position risk. During the year, exposure to market risk has continued to be small in relation to capital, as trading activities have been focused on servicing client requirements rather than on proprietary risk-taking.

Limits on market risk exposure are set by the Executive Committee using the value at risk methodology described below. Monitoring of market risk limits and determination of trading profits are undertaken independently of the dealing area. Whilst value at risk is central to the communication and control of risk, it is complemented by other measures and controls. These include stress testing, which estimates the losses that could occur when markets behave in unusually volatile ways and with little liquidity. The key assumptions underlying the calculation of value at risk are set out below. Market risk in the Company's subsidiary undertakings N M Rothschild & Sons (CI) Limited and the Five Arrows Finance Limited group is measured on a gap basis and is not included in the figures below. The market risk arising in the Company's other subsidiary undertakings is immaterial.

Notes to the Financial Statements

(forming part of the Financial Statements)

3. Financial Risk Management (continued)

3.3 Market risk (continued)

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Company	12 months to 31 March 2006		
	Average £'000	High £'000	Low £'000
Interest rate risk	920	1,135	547
Foreign exchange risk	5	17	1
Total value at risk	925	1,152	548

The following disclosures were made in accordance with the requirements of UK GAAP for the year ended 31 March 2005:

The Company's consolidated market risk comprises:

	Trading 2005 £'000	Non Trading 2005 £'000	Total 2005 £'000
At 31 March	16	720	715
Highest	1,953	1,446	3,406
Lowest	5	720	715
Average	259	1,119	1,373

The market risk figures above are derived from weekly figures covering the year to 31 March. Market risk in the Company's subsidiary undertakings, N M Rothschild & Sons (CI) Limited and the Five Arrows Finance Limited group, is measured on a gap basis. The market risk arising in the other subsidiaries of the Company is immaterial.

Market risk is measured daily using a sensitivity-based value at risk approach, which determines the effect of changes in market price factors, including currency prices, interest rates and volatilities, on positions. Shifts in market price factors and correlations are calculated weekly, or more frequently in turbulent markets, using the industry standard of 99 per cent probability over a ten day holding period for all risks except currency position risk, which is measured using a 99 per cent probability over a one day holding period.

The main assumption used in the calculation is that price factors are normally distributed. This is a common assumption in value at risk calculations but is known to be tenuous particularly for interest rates and volatilities and is one of the reasons for the use of a high probability over a long holding period. While value at risk is the principal means of measuring, limiting and communicating risk, it is complemented by a number of other measurement methods and controls. We also measure risk using 99 per cent probability over a one day holding period; on this basis, total consolidated market risk at 31 March 2005 was £233,000. The Group's approach to market risk management is described above.

Foreign exchange and interest rate contracts are used for hedging purposes within the trading book. The maturity of such hedges ranges from short dates to greater than five years. These hedges are accounted for using the accounting policies described in note 1.

Notes to the Financial Statements

(forming part of the Financial Statements)

3. Financial Risk Management (continued)

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3.4 Currency risk

The Group takes on exposure to the effects of fluctuations in foreign currency exchange rates on its financial position and cash flows. The Executive Committee sets limits on the level of exposure by currency and in total for both overnight and intra-day positions. The table below summarises exposure to foreign currency exchange rate risk at 31 March 2006. Included in the table are financial assets and liabilities at carrying amounts (apart from derivatives, which are included at their notional principal value), categorised by currency.

At 31 March 2006	£ £'000	US\$ £'000	€ £'000	Other £'000	Total £'000
Group					
Assets					
Cash and balances at central banks	15	1	8	--	24
Loans and advances to banks	24,351	29,902	7,634	19,363	81,250
Derivative financial instruments*	410,584	230,208	282,148	39,070	962,010
Loans and advances to customers	1,377,571	317,154	377,770	4,525	2,077,020
Debt and equity securities	1,207,354	547,577	1,313,170	5,419	3,073,520
Liabilities					
Deposits by banks	1,034,636	563,670	521,700	7,250	2,127,256
Due to customers	870,609	327,843	214,263	35,510	1,448,225
Derivative financial instruments*	196,642	156,077	607,150	25,032	984,901
Debt securities in issue	439,401	36,170	557,968	--	1,033,539
Subordinated liabilities	99,470	43,162	89,664	--	232,296
Company					
Assets					
Cash and balances at central banks	15	1	8	--	24
Loans and advances to banks	--	21,328	4,576	5,447	31,351
Derivative financial instruments*	7,097	33,579	15,562	9,614	65,852
Loans and advances to customers	1,032,829	222,468	49,789	1,064	1,306,150
Debt and equity securities	962,814	442,866	1,123,294	4,542	2,533,516
Liabilities					
Deposits by banks	975,048	519,458	512,891	1,492	2,008,889
Due to customers	338,363	91,764	574,393	9,943	1,014,463
Derivative financial instruments*	7,536	30,287	24,730	9,608	72,161
Debt securities in issue	335,000	36,170	--	--	371,170
Subordinated liabilities	99,470	43,162	89,664	--	232,296

* notional value

Notes to the Financial Statements

(forming part of the Financial Statements)

3. Financial Risk Management (continued)

3.4 Currency risk (continued)

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The following disclosures were made in accordance with the requirements of UK GAAP for the year ended 31 March 2005:

The Company and its subsidiary undertakings, N M Rothschild & Sons (CI) Limited and the Five Arrows Finance Limited group, hold currency exposures in the non-trading book. At 31 March 2005, non-trading book currency positions arising on monetary assets and liabilities, after taking account of off-balance sheet hedges, comprise:

Group	2005 £'000
US\$	1,394
Euro	3,972
Canadian \$	(7)
Rand	90
Australian \$	2
New Zealand \$	3
Other	36

3.5 Interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Executive Committee sets limits on the level of interest rate risk, using the value at risk methodology described above, and by setting limits on interest rate exposures by time band.

Notes to the Financial Statements

(forming part of the Financial Statements)

3. Financial Risk Management (continued)

3.5 Interest rate risk (continued)

The table below summarises exposure to interest rate risk and effective interest rates for monetary financial instruments not carried at fair value through profit and loss. Included in the table are the Group's interest-earning assets and interest-bearing liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity date.

At 31 March 2006	Effective interest rate %	Up to 1 month £'000	1-3 months £'000	3-12 months £'000	1-5 years £'000	Over 5 years £'000	Non-interest bearing £'000	Total £'000
Group								
Assets								
Cash and balances at central banks	—	—	—	—	—	—	24	24
Loans and advances to banks	3.67	65,207	15,547	—	—	—	496	81,250
Derivative financial instruments								
– Hedging*	(0.71)	442,723	94,125	(21,112)	(384,357)	(131,379)	2,355	2,355
– Trading*	—	69,626	26,346	9,578	(105,550)	—	15,291	15,291
Loans and advances to customers	6.82	893,396	382,581	172,693	476,618	164,965	(13,233)	2,077,020
Debt and equity securities	4.31	777,381	1,388,681	780,937	111,347	7,802	7,372	3,073,520
Other assets	—	653	—	—	—	—	228,361	229,014
Total		2,248,986	1,907,280	942,096	98,058	41,388	240,666	5,478,474
Liabilities								
Deposits by banks	4.11	1,555,241	380,267	191,882	—	—	(134)	2,127,256
Due to customers	4.16	1,182,324	95,628	144,275	20,571	5,427	—	1,418,225
Derivative financial instruments								
– Hedging*	0.29	(23,162)	(4,779)	42,011	(14,070)	—	22,884	22,884
– Trading*	—	(143,916)	(66,980)	120,896	90,000	—	17,666	17,666
Debt securities in issue	3.87	289,401	744,138	—	—	—	—	1,033,539
Subordinated liabilities	5.89	—	104,619	57,549	—	75,100	(1,972)	232,296
Other liabilities	—	2,861	—	—	—	—	300,405	303,266
Shareholders' equity	—	—	—	—	—	—	293,342	293,342
Total		2,862,749	1,252,893	556,613	96,501	80,527	629,191	5,478,474
Gap		(613,763)	654,387	385,483	1,557	(39,139)	(388,525)	
Cumulative gap		(613,763)	40,624	426,107	427,664	388,525	—	

* notional value

The figures above do not demonstrate exposure to particular interest rates as the assets and liabilities included above have been consolidated across all currencies.

Notes to the Financial Statements

(forming part of the Financial Statements)

3. Financial Risk Management (continued)

3.5 Interest rate risk (continued)

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At 31 March 2006	Effective interest rate %	Up to 1 month £'000	1-3 months £'000	3-12 months £'000	1-5 years £'000	Over 5 years £'000	Non- interest bearing £'000	Total £'000
Company								
Assets								
Cash and balances at central banks	—	—	—	—	—	—	24	24
Loans and advances to banks	4.45	30,938	—	—	—	—	413	31,351
Derivative financial instruments								
— hedging*	(0.60)	81,616	80,563	(19,949)	(117,986)	(24,244)	1,335	1,335
— trading*	—	46,300	11,500	10,000	(67,800)	—	11,980	11,980
Loans and advances to customers	6.73	614,539	406,645	153,080	119,144	28,227	(15,485)	1,306,150
Debt and equity securities	4.36	605,126	1,156,811	666,941	91,600	7,802	5,236	2,533,516
Other assets	—	—	—	—	—	—	217,782	217,782
Total		1,378,519	1,655,519	810,072	24,958	11,785	221,285	4,102,138
Liabilities								
Deposits by banks	4.13	1,405,098	367,604	233,721	2,600	—	(134)	2,008,889
Due to customers	3.60	401,537	590,193	22,733	—	—	—	1,014,463
Derivative financial instruments								
— hedging*	0.34	(43,162)	(5,930)	43,162	5,930	—	9,744	9,744
— trading*	—	(143,916)	(66,980)	120,896	90,000	—	9,893	9,893
Debt securities in issue	4.55	185,000	186,170	—	—	—	—	371,170
Subordinated liabilities	5.89	—	104,619	57,549	—	75,100	(4,972)	232,296
Other liabilities	—	—	—	—	—	—	255,133	255,133
Shareholders' equity	—	—	—	—	—	—	200,550	200,550
Total		1,804,557	1,175,676	478,061	98,530	75,100	470,214	4,102,138
Gap		(426,038)	479,843	332,011	(73,572)	(63,315)	(248,929)	
Cumulative gap		(426,038)	53,805	385,816	312,244	248,929		

* notional value

The figures above do not demonstrate exposure to particular interest rates as the assets and liabilities included above have been consolidated across all currencies.

Notes to the Financial Statements

(forming part of the Financial Statements)

3. Financial Risk Management (continued)

3.5 Interest rate risk (continued)

The table below shows assets and liabilities according to the type of interest rate risk to which they are exposed:

	Fair value interest rate risk £'000	Cash flow Up to 1 month £'000	interest rate risk 1-3 months £'000	3-12 months £'000	Not directly exposed to interest rate risk £'000
At 31 March 2006					
Group					
Assets					
Cash and balances at central banks	—	—	—	—	24
Loans and advances to banks	48,754	32,000	—	—	496
Derivative financial instruments*	244,096	(93,995)	(5,930)	(144,171)	17,646
Loans and advances to customers	1,680,199	334,488	62,885	12,674	(13,226)
Debt and equity securities	121,009	835,852	1,330,735	778,552	7,372
Other assets	653	—	—	—	228,361
Total	2,094,711	1,108,345	1,387,690	647,055	240,673
Liabilities					
Deposits by banks	2,005,034	122,356	—	—	(134)
Due to customers	1,205,882	242,343	—	—	—
Derivative financial instruments*	(308,282)	248,870	79,412	(20,000)	40,550
Debt securities in issue	371,170	104,401	557,968	—	—
Subordinated liabilities	75,100	—	104,619	57,549	(4,972)
Other liabilities	1,073	—	—	—	301,742
Total	3,349,977	717,970	741,999	37,549	337,186
Company					
Assets					
Cash and balances at central banks	—	—	—	—	24
Loans and advances to banks	7,148	23,790	—	—	413
Derivative financial instruments*	49,092	(43,162)	(5,930)	—	13,315
Loans and advances to customers	1,310,821	10,814	—	—	(15,485)
Debt and equity securities	104,560	660,299	1,098,865	664,556	5,236
Other assets	—	—	—	—	217,782
Total	1,471,621	651,741	1,092,935	664,556	221,285
Liabilities					
Deposits by banks	2,002,838	6,185	—	—	(134)
Due to customers	1,014,463	—	—	—	—
Derivative financial instruments*	(162,179)	81,616	80,563	—	19,637
Debt securities in issue	371,170	—	—	—	—
Subordinated liabilities	75,100	—	104,619	57,549	(4,972)
Other liabilities	—	—	—	—	255,133
Total	3,301,392	87,801	185,182	57,549	269,664

* notional value

Notes to the Financial Statements

(forming part of the Financial Statements)

3. Financial Risk Management (continued)

3.5 Interest rate risk (continued)

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The following disclosures are in accordance with the requirements of IFRS prior to the adoption of IAS 32 and IAS 39 for the year ended 31 March 2005:

Non-Trading Book Interest Rate Risk

The Company and its subsidiary undertakings, N M Rothschild & Sons (CI) Limited and the Five Arrows Finance Limited group, hold interest rate exposure in the non-trading book. Instruments are allocated to time bands by reference to the earlier of their next contractual interest rate repricing date and their maturity date. Non-trading book interest rate risk, after taking account of off-balance sheet hedges, comprises:

	3 months or less	More than 3 months but not more than 6 months	More than 6 months but not more than 1 year	More than 1 year but not more than 5 years	More than 5 years	Non- interest bearing	Trading	Total
At 31 March 2005	£m	£m	£m	£m	£m	£m	£m	£m
Loans and advances to banks	436	10	—	—	—	—	—	446
Loans and advances to customers	1,652	57	92	381	77	—	—	2,259
Debt securities	1,739	224	345	111	15	—	—	2,434
Other assets	—	—	—	—	—	200	57	257
Assets	3,827	291	437	492	92	200	57	5,396
Deposits by banks	(1,532)	(90)	(43)	(1)	—	—	—	(1,666)
Customer accounts	(1,227)	(58)	(80)	(20)	—	—	—	(1,385)
Debt securities in issue	(1,427)	(71)	(10)	—	—	—	—	(1,508)
Subordinated liabilities	(103)	(53)	—	—	(75)	—	—	(231)
Shareholders' funds	—	—	—	—	—	(280)	—	(280)
Other liabilities	—	—	—	—	—	(269)	(57)	(326)
Liabilities	(4,289)	(272)	(133)	(21)	(75)	(549)	(57)	(5,396)
Off-balance sheet hedges	(3)	123	36	(93)	(63)	—	—	—
Gap	(465)	142	340	378	(46)	(349)	—	—
Cumulative gap	(465)	(323)	17	395	349	—	—	—

Notes to the Financial Statements

(forming part of the Financial Statements)

3. Financial Risk Management (continued)

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3.6 Liquidity risk

Liquidity is measured by classifying assets, liabilities and other cashflows into future time bands using a series of prudent assumptions and calculating the resultant surplus or deficit in each period. The Group Assets and Liabilities Committee recommends policies and procedures for the management of liquidity risk. The Executive Committee has set deficit limits for each period.

The table below analyses financial assets and liabilities into relevant maturity groupings based on the remaining period, at the balance sheet date, to the contractual maturity date.

	Repayable on demand £'000	3 months or less but not repayable on demand £'000	1 year or less but over 3 months £'000	5 years or less but over 1 year £'000	Over 5 years £'000	Non- financial assets and liabilities £'000	Total £'000
At 31 March 2006							
Group							
Assets							
Cash and balances at central banks	24	–	–	–	–	–	24
Loans and advances to banks	59,183	22,067	–	–	–	–	81,250
Derivative financial instruments	–	6,359	2,768	7,270	1,249	–	17,646
Loans and advances to customers	11,747	105,918	443,460	1,176,199	339,696	–	2,077,020
Debt and equity securities	7,372	415,659	766,562	1,267,735	616,192	–	3,073,520
Other assets	77,496	61,479	3,683	31,545	21,162	33,649	229,014
Total assets	155,822	611,482	1,216,473	2,482,749	978,299	33,649	5,478,474
Liabilities							
Deposits by banks	17,641	1,802,419	191,752	115,444	–	–	2,127,256
Due to customers	205,058	1,071,585	144,276	21,879	5,427	–	1,448,225
Derivative financial instruments	2,698	7,228	3,887	14,232	12,505	–	40,550
Debt securities in issue	–	371,170	174,365	383,603	104,401	–	1,033,539
Subordinated liabilities	–	–	–	–	232,296	–	232,296
Other liabilities	14,168	183,485	18,135	50,707	36,205	115	302,815
Total liabilities	239,565	3,435,887	532,415	585,865	390,834	115	5,184,681
Net liquidity gap	(83,743)	(2,824,405)	684,058	1,896,884	587,465		
Cumulative liquidity gap	(83,743)	(2,908,148)	(2,224,090)	(327,206)	260,259		

Notes to the Financial Statements

(forming part of the Financial Statements)

3. Financial Risk Management (continued)

3.6 Liquidity risk (continued)

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	Repayable on demand	3 months or less but not repayable on demand	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Non- financial assets and liabilities	Total
At 31 March 2006	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Company							
Assets							
Cash and balances at central banks	24	—	—	—	—	—	24
Loans and advances to banks	24,832	6,519	—	—	—	—	31,351
Derivative financial instruments	—	4,430	1,747	6,424	714	—	13,315
Loans and advances to customers	3,841	88,962	374,130	694,741	144,476	—	1,306,150
Debt and equity securities	5,236	365,462	557,028	1,051,667	554,123	—	2,533,516
Other assets	76,243	49,185	—	20,018	20,235	52,101	217,782
Total assets	110,176	514,558	932,905	1,772,850	719,548	52,101	4,102,138
Liabilities							
Deposits by banks	7,074	1,765,625	233,590	2,600	—	—	2,008,889
Due to customers	113,520	320,238	197,099	383,606	—	—	1,014,463
Derivative financial instruments	—	3,373	2,827	4,051	9,386	—	19,637
Debt securities in issue	—	371,170	—	—	—	—	371,170
Subordinated liabilities	—	—	—	—	232,296	—	232,296
Other liabilities	13,037	157,846	10,912	37,379	35,844	115	255,133
Total liabilities	133,631	2,618,252	444,428	427,636	277,526	115	3,901,588
Net liquidity gap	(23,455)	(2,103,694)	488,477	1,345,214	442,022		
Cumulative liquidity gap	(23,455)	(2,127,149)	(1,638,672)	(293,458)	148,564		

Notes to the Financial Statements

(forming part of the Financial Statements)

3. Financial Risk Management (continued)

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3.7 Fair value of financial instruments

The fair value of each class of financial asset and liability at 31 March 2006 is the same as the carrying value, except for debt securities in issue where the values are as follows:

	Carrying value 2006 £'000	Fair value 2006 £'000
Group		
Debt securities in issue	1,033,539	1,033,725
Company		
Debt securities in issue	371,170	371,356

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. For financial instruments carried at fair value, market prices or rates are used to determine fair value where an active market exists (such as a recognised exchange), as it is the best evidence of the fair value of a financial instrument. Market prices are not, however, available for certain financial assets and liabilities held or issued by the Group. Where no active market price or rate is available, fair values are estimated using present value or other valuation techniques, using inputs based on market conditions existing at the balance sheet date.

Valuation techniques are generally applied to over the counter derivative transactions and unlisted debt and equity securities, trading portfolio assets and liabilities. The most frequently applied pricing models and valuation techniques include discounted cashflow techniques and option valuation models. The values derived from applying these techniques are significantly affected by the choice of valuation model used and the assumptions made concerning factors such as the amounts and timing of future cash flows, discount rates, volatility, and credit quality.

The change in fair value recognised in the income statement for financial instruments whose fair value was determined using a valuation technique was £6,118,000.

Notes to the Financial Statements

(forming part of the Financial Statements)

3. Financial Risk Management (continued)

3.7 Fair value of financial instruments (continued)

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The following disclosures are in accordance with the requirements of IFRS prior to the adoption of IAS 32 and IAS 39 for the year ended 31 March 2005.

The fair value of the financial assets and liabilities of the Group at 31 March 2005 comprises:

	2005 Book value £'000	2005 Fair value £'000
Trading book financial assets and liabilities		
Assets		
Cash and balances at central banks	1,511	1,511
Interest rate contracts	4,192	4,192
Foreign exchange contracts	7,127	7,127
Commodities contracts	52,471	52,471
Equity shares	712	712
Liabilities		
Interest rate contracts	(3,864)	(3,864)
Foreign exchange contracts	(4,520)	(4,520)
Commodities contracts	(52,471)	(52,471)
Non-trading book financial assets and liabilities		
Derivative financial instruments		
Interest rate contracts		
– With positive fair values	7,042	9,015
– With negative fair values	(212)	(11,639)
Listed securities and other assets for which an active and liquid market exists		
Marketable assets		
Debt securities	2,434,039	2,392,650
Equity shares	362	978
Liabilities for which an active and liquid market exists		
Debt securities in issue	(1,507,513)	(1,507,430)

All financial assets and liabilities held or issued for trading purposes are carried in the financial statements at fair value. For those financial assets and liabilities in the non-trading book, fair values have been determined by valuation against mid-market prices or by discounting forward cash flows.

3.8 Fiduciary activities

The Group provides custody and other fiduciary services to customers. Those assets that are held in a fiduciary capacity are not included in these financial statements. At the balance sheet date, these amounted to approximately £1,209 million (2005: £969 million).

Notes to the Financial Statements

(forming part of the Financial Statements)

4. Net Interest Income

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	2006 £'000	2005 £'000
Interest income		
Interest earned on loans and advances	192,401	191,524
Interest earned on investment securities	104,571	80,889
Other interest income	-	11
	296,972	272,424
Interest expense		
Interest on amounts due to banks and customers	155,360	135,168
Interest on debt securities in issue	52,182	57,592
Interest on subordinated liabilities	39	10,136
	207,581	202,896

Included within interest income is £2,059,000 in respect of interest income accrued on impaired financial assets.

5. Net Fee and Commission Income

	2006 £'000	2005 £'000
Fee and commission income		
Banking and credit-related fees and commissions	13,644	19,422
Fees for advisory work and other services	294,346	155,929
Other fees	3,626	2,568
	311,616	177,919
Fee and commission expense		
Investment banking advisory fees paid	27,191	5,073
Other fees paid	1,538	676
	28,729	5,749

Investment banking advisory fees paid represent fees paid to other members of the Rothschild group where the Company has worked in collaboration with another group company in a transaction, or fees paid to any subcontracted parties outside the Rothschild group.

6. Dividend Income

	2006 £'000
Available-for-sale securities	167
Assets held at fair value through profit or loss	103
	270

Dividend income for the year ended 31 March 2005 was £181,000.

Notes to the Financial Statements

(forming part of the Financial Statements)

7. Net Trading Income

	2006 £'000	2005 £'000
Foreign exchange contracts	6,929	886
Interest rate instruments - trading	(1,483)	(106)
Interest rate instruments - hedging	370	—
Commodities contracts	—	2,642
Equities	302	(3)
	6,118	3,419

Net trading income arises from the movements in fair value of financial assets held for trading and financial assets designated at fair value through profit or loss, and from hedging strategies. The following activities give rise to net trading income:

- Trading in foreign exchange spot, forward and option contracts and interest rate futures, swaps and forward rate agreements.
- Holding equities for trading purposes and positions arising from the underwriting of equity and equity-related issues.
- Ineffectiveness in interest rate hedging relationships; gains and losses on the ineffective portion of designated hedging relationships are recognised in net trading income.

8. Operating Expenses

	Note	2006 £'000	2005 £'000
Staff costs (excluding profit share)	9	84,654	78,264
Administrative expenses		41,334	37,578
		125,988	115,842

The auditor's remuneration was £556,000 (2005: £581,000) of which £243,000 (2005: £229,000) related to the Company. Remuneration payable to the auditor and its associates for non-audit work for the Company and its UK subsidiary undertakings was £677,000 (2005: £255,000), and comprised fees for; tax advice £250,000 (2005: £47,000), regulatory advice £54,000 (2005: £18,000), transaction support £50,000 (2005: £127,000), accounting advice £214,000 (2005: £nil) and other work £109,000 (2005: £63,000).

Notes to the Financial Statements

(forming part of the Financial Statements)

9. Staff Costs

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	Note	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
Salaries (excluding profit share)		58,389	44,338	55,065	41,582
Social security costs		5,509	4,378	5,201	3,952
Staff benefits and other staff costs		8,045	6,763	7,325	5,122
Pension costs					
– Defined benefit plans	24	10,466	9,916	8,680	8,066
– Defined contribution plans	24	1,596	1,014	1,214	647
Post-retirement benefits		649	649	779	779
Staff costs (excluding profit share)		84,654	67,058	78,264	60,148
Directors' and employees' annual profit share		124,858	122,210	69,009	67,530
Long term profit share schemes		28,500	28,171	14,465	14,204
Directors' and employees' profit share		153,358	150,381	83,474	81,734
Total staff costs		238,012	217,439	161,738	141,882

The average number of persons employed by the Group during the year was 916 (2005: 914). The number of persons employed at 31 March 2006 was 944 (2005: 862). The average number of persons employed by the Company during the year was 640 (2005: 611). The number of persons employed by the Company at 31 March 2006 was 662 (2005: 605).

10. Taxation

Tax charged to the income statement:

	2006 £'000	2005 £'000
Current tax		
– Current period	32,706	16,488
– Prior year adjustments	1,362	(747)
Total current tax	34,068	15,741
Deferred tax		
– Origination and reversal of timing differences	(4,750)	(5,204)
– Prior year adjustments	(2,146)	1,123
Changes in tax rates or tax laws	(194)	-
Total deferred tax	(7,090)	(4,081)
Total tax charged to income statement	26,978	11,660

Notes to the Financial Statements

(forming part of the Financial Statements)

10. Taxation (continued)

Tax on items credited/(charged) to equity:

	2006 £'000	2005 £'000
Deferred tax credit on available-for-sale investments	365	-
Current tax credit on available-for-sale investments	104	-
Current tax on subordinated debt interest/exchange movements	5,443	-
Deferred tax on cash flow hedges	(17)	-
Deferred tax on actuarial gains and losses on defined benefit pension schemes	(1,019)	5,110
Total tax credited to equity	4,876	5,110

The tax charged on income differs from the theoretical amount that would arise using the standard tax rate as follows:

	2006 £'000	2005 £'000
Profit before tax	101,584	42,155
Tax calculated at the UK corporation tax rate of 30% (2005: 30%)	30,475	12,647
Adjustment to tax charge in respect of prior years	(784)	376
Adjustment to deferred tax rate	(194)	-
Income from associate recorded net of tax in profit before tax	(1,148)	(239)
Non tax deductible expenses	865	452
Effect of different tax rates in other countries	(554)	72
Income not subject to tax	(266)	(238)
Previously unrecorded deferred tax now recognised	(1,471)	(1,455)
Other	55	45
Total tax charged to income statement	26,978	11,660

Further information about deferred tax is presented in note 23.

11. Group Profit Dealt with in the Financial Statements of the Company

£53,598,000 (2005: £30,483,000) of the Group profit attributable to ordinary shareholders has been dealt with in the accounts of the Company. As permitted by Section 230 of the Companies Act 1985, the income statement of the Company has not been presented separately.

Notes to the Financial Statements

(forming part of the Financial Statements)

12. Derivative Financial Instruments

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The Group's use of financial instruments, including derivatives, is set out in note 3. A derivative is a financial instrument, the value of which is derived from the value of another financial instrument, an index or some other variable (the "underlying"). Typically the underlying is an interest rate, a currency exchange rate or the price of a debt or equity security. The majority of derivative contracts are negotiated as to amount, tenor and price between the Group and its counterparties, whether other professionals or customers, and are known as "over the counter" ("OTC") derivatives. The remainder are standardised in terms of their amounts and settlement dates and are bought and sold in organised markets, and are known as exchange traded derivatives.

Derivative instruments are carried at fair value, shown in the balance sheet as separate totals of positive replacement values (assets) and negative replacement values (liabilities). Positive replacement values represent the cost to the Group of replacing all transactions with a fair value in the Group's favour if the counterparties default. Negative replacement values represent the cost to the Group's counterparties of replacing all their transactions with the Group with a fair value in the counterparties' favour if the Group were to default. Positive and negative replacement values on different transactions are only netted if there is a legal right of set-off, the transactions are with the same counterparty and the cash flows will be settled on a net basis. Changes in replacement values of derivative instruments are recognised in trading income unless they qualify as hedges for accounting purposes.

The Group uses the following derivative financial instruments for both trading and hedging purposes:

- Forwards and futures – contractual obligations to buy or sell financial instruments on a future date at a specified price. Forward contracts are OTC contracts, whereas futures are exchange traded derivatives.
- Interest rate swaps – transactions in which two parties exchange interest cash flows on a specified notional amount for a predetermined period. Most swaps are OTC instruments. Interest rate swap contracts generally entail the contractual exchange of fixed and floating rate interest payments in a single currency.
- Options – contractual agreements under which the seller grants the purchaser the right but not the obligation to buy or sell by or at a future date a specified quantity of a financial instrument at a predetermined price. The purchaser pays a premium to the seller for this right. Options may be transacted OTC or on a regulated exchange.

Derivatives may be transacted for trading or hedging purposes. Trading involves taking positions with the intention of profiting from changes in market variables such as interest rates. The Group also enters into derivative transactions for the purpose of hedging exposures in the non-trading book. The accounting treatment of hedge transactions depends on the nature of the hedging relationship and whether the hedge qualifies as such for accounting purposes. Derivative transactions may qualify as hedges for accounting purposes as either fair value or cash flow hedges.

Notes to the Financial Statements

(forming part of the Financial Statements)

12. Derivative Financial Instruments (continued)

Fair Value Hedges

The Group's fair value hedges consist of interest rate swaps that are used to protect against changes in the fair value of fixed rate lending, fixed rate debt securities and fixed rate borrowing.

For the year ended 31 March 2006 the Group recognised a net gain of £370,000 representing the change in fair value of the ineffective portions of fair value hedges. The fair value of derivatives designated as fair value hedges at 31 March 2006 was £11,701,000.

Cashflow Hedges

The Group is exposed to variability in future interest cash flows on non-trading assets and issued debt which receive or pay interest at variable rates.

Gains and losses on the effective portion of interest rate swaps designated as cash flow hedges are recorded in shareholders' equity. Gains or losses on any ineffective portion of these swaps is recognised immediately in the income statement.

No gains or losses were recognised in the income statement in respect of the ineffective portion of cash flow hedges.

The fair value of derivatives designated as cash flow hedges at 31 March 2006 was (£8,828,000). At 31 March 2006, an unrecognised fair value loss of £310,000 associated with these derivatives has remained deferred in shareholders' equity and will be transferred to the income statement when the hedged cash flows affect profit or loss.

The schedule of forecast principal balances as at 31 March 2006 on which the expected interest cash flows arise is as follows:

	1 year or less	More than 1 year but not more than 3 years	More than 3 years but not more than 5 years	More than 5 years but not more than 10 years	More than 10 years
As at 31 March 2006	£'000	£'000	£'000	£'000	£'000
Group and Company					
Cash inflows (assets)	—	—	—	—	—
Cash outflows (liabilities)	—	—	—	—	(104,619)
Net cash flows	—	—	—	—	(104,619)

Notes to the Financial Statements

(forming part of the Financial Statements)

12. Derivative Financial Instruments (continued)

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The table below shows positive and negative replacement values for derivative contracts held at 31 March.

Group	Contracts held for trading purposes					
	Notional principal		Positive fair value		Negative fair value	
	2006 £'000	2005 £'000	2006 £'000	2005 £'000	2006 £'000	2005 £'000
Foreign exchange contracts						
Forward foreign exchange deals	762,932	405,677	3,341	7,014	(7,730)	(4,407)
OTC options bought and sold	4,604	108,056	–	113	–	(113)
	767,536	513,733	3,341	7,127	(7,730)	(4,520)
Interest rate contracts						
Swaps	922,288	585,149	6,869	4,087	(4,925)	(3,793)
OTC options bought and sold	478,337	134,947	1,815	10	(1,815)	(10)
	1,400,625	720,096	8,684	4,097	(6,740)	(3,803)
Exchange traded futures	55,500	209,886	29	95	(28)	(61)
	1,456,125	929,982	8,713	4,192	(6,768)	(3,864)
Commodities contracts						
Forward commodities contracts	9,340	578,910	2,180	52,358	(2,343)	(52,358)
OTC options bought and sold	7,738	54,754	825	113	(825)	(113)
	17,078	633,664	3,005	52,471	(3,168)	(52,471)
Equity contracts						
Warrants	16	–	232	–	–	–
Total	2,240,755	2,077,379	15,291	63,790	(17,666)	(60,855)
Company						
Foreign exchange contracts						
Forward foreign exchange deals	52,537	90,488	87	687	(84)	(679)
	52,537	90,488	87	687	(84)	(679)
Interest rate contracts						
Swaps	883,861	585,149	6,812	4,087	(4,798)	(3,793)
OTC options bought and sold	478,337	134,947	1,815	10	(1,815)	(10)
	1,362,198	720,096	8,627	4,097	(6,613)	(3,803)
Exchange traded futures	55,500	209,886	29	95	(28)	(61)
	1,417,698	929,982	8,656	4,192	(6,641)	(3,864)
Commodities contracts						
Forward commodities contracts	9,340	578,910	2,180	52,358	(2,343)	(52,358)
OTC options bought and sold	7,738	54,754	825	113	(825)	(113)
	17,078	633,664	3,005	52,471	(3,168)	(52,471)
Equity contracts						
Warrants	16	–	232	–	–	–
Total	1,487,329	1,654,134	11,980	57,350	(9,893)	(57,014)

Notes to the Financial Statements

(forming part of the Financial Statements)

12. Derivative Financial Instruments (continued)

	Notional principal 2006 £'000	Positive fair value 2006 £'000	Negative fair value 2006 £'000
Contracts held for hedging purposes			
Group			
Interest rate contracts			
Swaps	724,546	2,355	(22,884)
	724,546	2,355	(22,884)
Company			
Interest rate contracts			
Swaps	315,890	1,335	(9,744)
	315,890	1,335	(9,744)

The following disclosures were made in accordance with the requirements of UK GAAP for the year ended 31 March 2005:

An analysis of the movement of unrecognised gains and losses on 'contracts held for hedging purposes' comprises:

	Gains 2005 £'000	Losses 2005 £'000	Net 2005 £'000
Unrecognised gains & losses brought forward	2,366	5,141	(2,775)
Recognised in period	(3,701)	(3,151)	(550)
Recognised by reclassification to trading contracts	--	(91)	91
Gains & losses arising in period but not recognised	3,308	9,528	(6,220)
Unrecognised gains & losses carried forward	1,973	11,427	(9,454)
Expected to be recognised in next 12 months	1,300	3,156	(1,856)
Recognised in greater than 12 months	673	8,271	(7,598)
	1,973	11,427	(9,454)

Notes to the Financial Statements

(forming part of the Financial Statements)

13. Loans and Advances

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	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
Loans and advances to banks	81,250	31,351	446,280	246,211

Loans and advances to customers:

	Note	Group £'000	Company £'000
At 31 March 2005		2,258,609	1,419,791
Adoption of IAS 32 and IAS 39	2	(193,599)	(192,825)
At 1 April 2005		2,065,010	1,226,966
Loans and advances to customers		2,090,033	1,315,736
Allowance for credit losses		(13,013)	(9,586)
At 31 March 2006		2,077,020	1,306,150

Loans and advances to customers include finance lease receivables:

Group	2006 £'000	2005 £'000
Gross investment in finance leases, receivable:		
1 year or less	42,179	43,132
5 years or less but over 1 year	92,164	83,283
Over 5 years	2,302	1,620
	136,645	128,035
Unearned future finance income on finance leases	(25,456)	(24,013)
Net investment in finance leases	111,189	104,022

The net investment in finance leases may be analysed as follows:

Group	2006 £'000	2005 £'000
1 year or less	30,369	34,265
5 years or less but over 1 year	78,640	68,357
Over 5 years	2,180	1,400
	111,189	104,022

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(forming part of the Financial Statements)

13. Loans and Advances (continued)

Allowance for credit losses

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	Group				Company			
	Specific £'000	General £'000	Collective £'000	Total £'000	Specific £'000	General £'000	Collective £'000	Total £'000
At 31 March 2005	18,655	9,963	–	28,618	16,655	7,833	–	24,488
Adoption of IAS 32 and IAS 39 (note 2)	(98)	(9,963)	8,592	(1,469)	(255)	(7,833)	7,629	(459)
At 1 April 2005	18,557	–	8,592	27,149	16,400	–	7,629	24,029
Charge to income statement	4,090	–	(826)	3,264	4,561	–	(648)	3,913
Amounts written off	(20,062)	–	–	(20,062)	(18,151)	–	–	(18,151)
Unwind of discount	(323)	–	–	(323)	(323)	–	–	(323)
Recoveries	2,953	–	–	2,953	86	–	–	86
Foreign currency translation and other adjustments	32	–	–	32	32	–	–	32
At 31 March 2006	5,247	–	7,766	13,013	2,605	–	6,981	9,586

Interest income on impaired loans and advances to customers was £1,987,000.

Allowance for credit losses relates to loans to customers.

The following disclosures were made in accordance with the requirements of UK GAAP for the year ended 31 March 2005:

Provision for bad and doubtful debts

	Group			Company		
	Specific £'000	General £'000	Total £'000	Specific £'000	General £'000	Total £'000
At 1 April 2004	12,888	11,935	24,823	12,394	7,833	20,227
Charge against profits	5,463	(1,054)	4,409	5,360	–	5,360
Amounts written off	(1,343)	–	(1,343)	(1,112)	–	(1,112)
Recoveries	1,661	–	1,661	27	–	27
Exchange adjustments	(14)	–	(14)	(14)	–	(14)
Disposal of subsidiary undertakings	–	(918)	(918)	–	–	–
At 31 March 2005	18,655	9,963	28,618	16,655	7,833	24,488

Specific and general bad debt provisions relate to loans to customers.

Notes to the Financial Statements

(forming part of the Financial Statements)

13. Loans and Advances (continued)

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Non-performing lending excluding problem country exposure

	2005 Group £'000	2005 Company £'000
Gross non-performing lending	14,716	13,176
Interest in suspense	(2,223)	(2,223)
	12,493	10,953
Provisions	(8,811)	(8,692)
Net non-performing lending	3,682	2,261

Problem country exposure

	2005 £'000
Group and Company	£'000
Exposure to problem countries	5,652

Exposure is stated after taking into account provisions against commercial risk. 'Problem country' means a country that is having difficulty servicing its external debt as evidenced, for example, by rescheduling or arrears of interest or principal payments. Exposures to problem countries include advances to counterparties in problem countries and debt securities issued by borrowers in problem countries.

14. Debt and Equity Securities

	2006 Group £'000	2006 Company £'000
Securities available-for-sale		
Debt securities – at fair value		
– Listed	1,823,785	1,447,441
– Unlisted	962,763	801,239
Equity securities – at fair value		
– Listed	1,331	145
– Unlisted	6,041	5,091
Loans and advances – at fair value	280,175	280,175
Allowance for impairment	(575)	(575)
Total securities available-for-sale	3,073,520	2,533,516
Total debt and equity securities	3,073,520	2,533,516

Notes to the Financial Statements

(forming part of the Financial Statements)

14. Debt and Equity Securities (continued)

Available-for-sale debt securities of £619,136,000 were pledged as security for liabilities of the Group.

Gains and losses from debt and equity securities comprise:

	2006 Group £'000	2006 Company £'000
Disposal of available-for-sale securities	(3,931)	(3,747)
Exchange gains and losses	4,039	4,039
	108	292

The movement in debt and equity securities may be summarised as follows:

	Note	Available- for-sale £'000	Fair value through profit or loss £'000	Total £'000
Group				
At 31 March 2005		—	—	—
Adoption of IAS 32 and IAS 39	2	2,634,268	712	2,634,980
At 1 April 2005		2,634,268	712	2,634,980
Exchange differences		66,202	36	66,238
Additions		2,425,718	166	2,425,884
Disposals (sale and redemption)		(2,043,143)	(914)	(2,044,057)
Losses from changes in fair value		(8,937)	—	(8,937)
Allowance for impairment		(588)	—	(588)
At 31 March 2006		3,073,520	—	3,073,520
Company				
At 31 March 2005		—	—	—
Adoption of IAS 32 and IAS 39	2	1,979,474	712	1,980,186
At 1 April 2005		1,979,474	712	1,980,186
Exchange differences		53,771	36	53,807
Additions		1,623,602	166	1,623,768
Disposals (sale and redemption)		(1,114,424)	(914)	(1,115,338)
Losses from changes in fair value		(8,319)	—	(8,319)
Allowance for impairment		(588)	—	(588)
At 31 March 2006		2,533,516	—	2,533,516

Notes to the Financial Statements

(forming part of the Financial Statements)

14. Debt and Equity Securities (continued)

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The following disclosures are in accordance with the requirements of IFRS prior to IAS 32 and IAS 39 adjustments for the year ended 31 March 2005:

Debt securities

	Group		Company	
	Balance Sheet	Market Value	Balance Sheet	Market Value
	£'000	£'000	£'000	£'000
2005				
Analysed by issuer				
Investment securities				
– Bank and building society certificates of deposit	865,850	865,157	615,019	614,326
– Other debt securities	1,568,189	1,572,416	1,167,103	1,170,978
	2,434,039	2,437,573	1,782,122	1,785,304
Total debt securities	2,434,039	2,437,573	1,782,122	1,785,304
Analysed by listing status				
Investment securities				
– listed on a recognised UK exchange	602,790	604,501	422,606	424,136
– listed elsewhere	781,774	783,349	577,772	579,207
– unlisted	1,049,475	1,049,723	781,744	781,961
	2,434,039	2,437,573	1,782,122	1,785,304
Analysed by maturity				
Due within one year	1,069,004		766,116	
Due one year and over	1,365,035		1,016,006	
	2,434,039		1,782,122	
Unamortised premiums (net of discounts)				
on investment securities	2,232		2,204	

Debt securities with a book value of £59,983,000 were charged as security for liabilities of the Company. Movements in investment securities were as follows:

	Group	Company
	£'000	£'000
At 1 April 2004	2,181,157	1,436,447
Exchange adjustments and amortisation of premiums and discounts	5,491	6,794
Acquisitions	2,705,661	908,665
Disposal and maturities	(2,458,270)	(569,784)
At 31 March 2005	2,434,039	1,782,122

Notes to the Financial Statements

(forming part of the Financial Statements)

14. Debt and Equity Securities (continued)

Equity shares

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	Group		Company	
	Balance Sheet	Market Value	Balance Sheet	Market Value
	£'000	£'000	£'000	£'000
2005				
Investment securities				
- listed on a recognised UK exchange	170	786	115	115
- listed on a recognised exchange overseas	192	192	192	192
- unlisted	3,225	3,300	2,894	2,969
	3,587	4,278	3,201	3,276
Other securities				
- listed on a recognised UK exchange	--	--	--	--
- listed on a recognised exchange overseas	712	--	712	--
Total equity shares	4,299		3,913	

Movements on investment securities were as follows:

	Cost	Provisions	Carrying Value
	£'000	£'000	£'000
Group			
At 1 April 2004	3,717	2,179	1,538
Additions	2,245	--	2,245
Disposals	(220)	--	(220)
Exchange movements	6	27	(21)
Provisions released	--	(45)	45
At 31 March 2005	5,748	2,161	3,587
Company			
At 1 April 2004	3,323	2,174	1,149
Additions	2,245	--	2,245
Disposals	(220)	--	(220)
Exchange movements	9	27	(18)
Provisions released	--	(45)	45
At 31 March 2005	5,357	2,156	3,201

Notes to the Financial Statements

(forming part of the Financial Statements)

15. Investments in Associated Undertakings

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	2006 £'000	2005 £'000
Group		
At 1 April	8,823	7,082
Additions	500	1,775
Share of results (net of tax)	3,826	798
Dividends	(1,194)	(1,034)
Exchange differences	164	202
At 31 March	12,119	8,823

The Group's interests in its principal associated undertakings, which are unlisted, are as follows:

	2006 £'000	2005 £'000
Assets	32,254	23,651
Liabilities	19,386	14,828
Revenues	28,540	18,024
Share of results (net of tax)	3,826	798

The Company has a holding of 50.0 per cent (2005: 50.0 per cent) of the issued ordinary share capital of Rothschild Europe BV. Rothschild Europe BV, incorporated in The Netherlands, is a holding company whose subsidiary undertakings carry out investment banking advisory activities in continental Europe. The Company also holds 21.3 per cent (2005: 21.3 per cent) of the beneficial interest in Boar Lane Estates Limited, 49.4 per cent (2005: 49.4 per cent) of the beneficial interest in Cavendish Estates Limited and 35.7 per cent (2005: 0.0 per cent) of the beneficial interest in Carlisle Limited. These companies are incorporated in the United Kingdom and are special purpose vehicles that hold properties in trust for the beneficiaries.

The Group's interests in associated undertakings are held by the Company at historical cost of £7,803,000 (2005: £7,303,000).

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(forming part of the Financial Statements)

16. Investments in Joint Ventures

a. Jointly controlled entities

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The company holds a 50.0 per cent interest in N M Rothschild Europe Partnership, an English partnership, and a 50.0 per cent interest in Rothschild Europe SNC, a French partnership. These partnerships undertake investment banking advisory activities in continental Europe and are accounted for as jointly controlled entities in accordance with IAS 31 using the proportionate consolidation method. The Group's share of assets, liabilities, income and expenses of the partnerships is as follows:

	2006 £'000	2005 £'000
Current assets	6,506	3,112
Current liabilities	5,742	2,271
Income	9,496	4,717
Expenses	(4,919)	(2,767)

The Group's interest in the jointly controlled entities is held directly by the Company at historical cost of £429,000 (2005: £429,000).

b. Jointly controlled operations

The company has entered into a collaboration with ABN AMRO Bank NV pursuant to which the equity capital markets activities of the ABN AMRO group and the Rothschild group are conducted jointly in the name of ABN AMRO Rothschild. The Group's share of underwriting commitments arising from the ABN AMRO Rothschild arrangement is disclosed in note 25.

Notes to the Financial Statements

(forming part of the Financial Statements)

17. Intangible Assets

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Group	Intellectual Property Rights £'000	Goodwill £'000	Total £'000
Cost at 1 April 2005	1,000	2,755	3,755
Additions	—	1,654	1,654
At 31 March 2006	1,000	4,409	5,409
Accumulated amortisation at 1 April 2005	275	—	275
Amortisation charge	100	—	100
At 31 March 2006	375	—	375
Net book value at 31 March 2006	625	4,409	5,034
Cost at 1 April 2004	1,000	2,756	3,756
Disposals	—	(1)	(1)
At 31 March 2005	1,000	2,755	3,755
Accumulated amortisation at 1 April 2004	175	—	175
Amortisation charge	100	—	100
Disposals	—	—	—
At 31 March 2005	275	—	275
Net book value at 31 March 2005	725	2,755	3,480

The additions to goodwill result from the purchase of a minority interest in Five Arrows Leasing Group Limited in December 2005.

At 31 March 2006, there were contractual commitments of £nil (2005: £nil) for the acquisition of intangible assets.

Notes to the Financial Statements

(forming part of the Financial Statements)

18. Property, Plant and Equipment

Group	Owner Occupied Property £'000	Leasehold Improvements £'000	Cars, Fixtures and Fittings £'000	Computer Equipment £'000	Total £'000
Cost at 1 April 2005	2,490	2,168	21,435	21,360	47,453
Additions	–	54	2,369	1,185	3,608
Disposals	(508)	–	(4,447)	(1,600)	(6,555)
At 31 March 2006	1,982	2,222	19,357	20,945	44,506
Accumulated depreciation at 1 April 2005	268	1,462	14,481	19,834	36,045
Disposals	–	–	(3,482)	(1,592)	(5,074)
Depreciation charge	135	387	2,097	945	3,564
At 31 March 2006	403	1,849	13,096	19,187	34,535
Net book value at 31 March 2006	1,579	373	6,261	1,758	9,971
Cost at 1 April 2004	3,135	2,118	24,577	22,050	51,880
Additions	11	50	5,693	642	6,396
Disposals	(656)	–	(4,998)	(382)	(6,036)
Disposal of subsidiary undertaking	–	–	(3,837)	(950)	(4,787)
At 31 March 2005	2,490	2,168	21,435	21,360	47,453
Accumulated depreciation at 1 April 2004	134	1,051	15,434	19,385	36,004
Disposals	–	–	(3,193)	(360)	(3,553)
Disposal of subsidiary undertaking	–	–	(1,341)	(771)	(2,112)
Depreciation charge	134	411	3,581	1,580	5,706
At 31 March 2005	268	1,462	14,481	19,834	36,045
Net book value at 31 March 2005	2,222	706	6,954	1,526	11,408

Included within the net book value of cars, fixtures and fittings for the Group as at 31 March 2006 is £3,291,000 (2005: £3,493,000) relating to assets held for use in operating leases.

Notes to the Financial Statements

(forming part of the Financial Statements)

18. Property, Plant and Equipment (continued)

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Company	Leasehold Improvements £'000	Cars, Fixtures and Fittings £'000	Computer Equipment £'000	Total £'000
Cost at 1 April 2005	2,168	11,353	19,025	32,546
Additions	–	60	869	929
Disposals	–	(95)	(1,306)	(1,401)
At 31 March 2006	2,168	11,318	18,588	32,074
Accumulated depreciation at 1 April 2005	1,462	9,499	18,015	28,976
Disposals	–	(63)	(1,300)	(1,363)
Depreciation charge	387	509	557	1,453
At 31 March 2006	1,849	9,945	17,272	29,066
Net book value at 31 March 2006	319	1,373	1,316	3,008
Cost at 1 April 2004	2,118	11,938	18,615	32,671
Additions	50	184	413	647
Disposals	–	(769)	(3)	(772)
At 31 March 2005	2,168	11,353	19,025	32,546
Accumulated depreciation at 1 April 2004	1,051	9,220	17,068	27,339
Disposals	–	(498)	(1)	(499)
Depreciation charge	411	777	948	2,136
At 31 March 2005	1,462	9,499	18,015	28,976
Net book value at 31 March 2005	706	1,854	1,010	3,570

19. Other Assets

	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
Accounts receivable and prepayments (net of allowances of £1,116,000 (2005: £1,722,000))	101,437	89,117	59,569	53,162
Accrued income	52,778	41,758	62,866	46,094
Derivative contracts	–	–	63,790	57,350
Other	1,096	628	5,311	5,998
	155,311	131,503	191,536	162,604

Notes to the Financial Statements

(forming part of the Financial Statements)

20. Debt Securities in Issue

	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
Medium term floating rate notes	557,968	—	549,390	—
Certificates of deposit in issue	371,170	371,170	450,595	450,595
Commercial mortgage-backed notes	104,401	—	336,700	—
Other asset-backed notes	—	—	28,755	—
Commercial paper	—	—	142,073	—
	1,033,539	371,170	1,507,513	450,595

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Medium term notes are issued under the Group's Euro Medium Term Note programme. The notes are issued at a floating rate of interest and had residual maturities of between 6 months and 4 years as at 31 March 2006. Certificates of deposit issued by the Company had residual maturity dates of up to 3 months as at 31 March 2006 and are issued at a fixed rate of interest. Commercial mortgage-backed notes are issued by special purpose entities as part of the Real Estate Capital securitisation programme and are floating rate notes with contractual maturity dates of July 2015; these notes were repaid in April 2006 as the underlying loan assets were repaid earlier than their scheduled maturity dates.

21. Subordinated Liabilities

	Note	Group and Company £'000
At 31 March 2005		230,980
Reclassification on adoption of IAS 32 and IAS 39	2	(230,980)
At 1 April 2005		—
Issuance of preference shares		100
Reclassification of subordinated debt instruments		231,746
Exchange movements		450
At 31 March 2006		232,296

	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
Preference shares				
£100,000 Cumulative Redeemable Preference Shares	100	100	—	—
Subordinated notes				
Perpetual Floating Rate Subordinated Notes (€150 million)	89,664	—	103,011	—
Due to fellow subsidiary undertakings				
Perpetual Floating Rate Subordinated Loan (€150 million)	—	89,664	—	103,011
Perpetual Floating Rate Subordinated Loan (US\$100 million)	43,162	43,162	52,969	52,969
Perpetual Fixed Rate Subordinated Loan (£75 million)	99,370	99,370	75,000	75,000
	232,296	232,296	230,980	230,980

Notes to the Financial Statements

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21. Subordinated Liabilities (continued)

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The €150 million perpetual floating rate subordinated notes were issued by Rothschilds Continuation Finance PLC, a subsidiary undertaking of the Company. The notes are guaranteed by the Company, and the proceeds of the note issue have been lent to the Company as a perpetual floating rate subordinated loan. The US\$100 million perpetual floating rate subordinated loan is due to Rothschilds Continuation Finance BV. The £75 million perpetual fixed rate subordinated loan is due to Rothschilds Continuation Finance (C.I.) Limited; the interest rate has been fixed at $9 \frac{1}{64}$ per cent. The subordinated notes and subordinated loans are recorded in the balance sheet at 31 March 2006 at their fair value as at 30 March 2006, as explained below.

In accordance with the requirements of IAS 32 Financial Instruments: Disclosure and Presentation, the subordinated debt instruments have been accounted for as equity minority interests from 1 April 2005 (the date of adoption of IAS 32 and IAS 39) to 30 March 2006.

IAS 32 requires financial instruments to be accounted for as equity instruments where there is no contractual obligation to repay principal or to pay interest. As the subordinated debt instruments are perpetual, there is no contractual obligation to repay principal. The terms of the instruments permit interest payments to be waived unless the Company has paid a dividend in the preceding six months. The payment of dividends on ordinary shares is not considered sufficient to cause the instruments to be classified as liabilities because the Group controls the payment of dividends on ordinary shares. On 30 March 2006, the Company issued £100,000 cumulative redeemable preference shares with mandatory 5 per cent dividends, payable quarterly. Because the payment of interest on the preference shares is compulsory, the payment of interest on the subordinated debt instruments is also, in effect, compulsory and the subordinated debt instruments have been reclassified as liabilities on 30 March 2006. In accordance with the requirements of IAS 39, on reclassification the debt instruments have been recognised as liabilities at their fair value on 30 March 2006.

It is the view of the Directors that accounting for the subordinated debt instruments as equity instruments in the period from 1 April 2005 to 30 March 2006 does not fully reflect their economic characteristics; although there is no contractual obligation to pay interest, there is a clear economic compulsion to do so. For a bank, the interest payments are in effect an obligation except in extremis.

The pro forma income statement on page 33 shows the results for the year as they would have been presented had the subordinated debt instruments been classified as liabilities throughout the year in a manner consistent with the prior period. The key differences between the pro forma results and those reflected in the financial statements are as follows:

- i. Interest payable on the subordinated debt for the period 1 April 2005 to 30 March 2006 of £12,506,000 has been treated as an amount due to a minority interest. In the pro forma results, the interest is treated as an expense.
- ii. An interest rate swap that hedges the interest rate exposure on one of the subordinated debt instruments does not qualify for hedge accounting until the debt is reclassified as a liability. Losses on the swap contract for the period to 30 March 2006 of £3,562,000 are reflected in net trading income in the income statement. In the pro forma results, the interest rate swap is treated as a cash flow hedge throughout the year, with gains and losses on the effective portion of the hedge reflected in the hedging reserve.
- iii. Foreign exchange translation losses of £5,639,000 on the subordinated debt instruments in the period 1 April 2005 to 30 March 2006 have been recognised directly in retained earnings; in the pro forma results, these losses are recognised in net trading income in the income statement.

Notes to the Financial Statements

(forming part of the Financial Statements)

22. Other Liabilities

	Note	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
Accounts payable		31,158	11,871	31,147	19,501
Defined benefit pension liabilities	24	38,667	35,844	63,591	60,484
Derivative contracts		—	—	60,855	57,015
Other liabilities		2,910	1,258	4,415	747
		72,735	48,973	160,008	137,747

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23. Deferred Income Taxes

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 30 per cent (2005: 30 per cent).

The movement on the deferred tax account is as follows:

	Note	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
At 1 April		36,462	30,855	27,526	24,273
Recognised in income					
Income statement credit		7,090	6,444	4,081	1,587
Recognised in equity					
Defined benefit pension arrangements		(1,019)	(1,248)	5,110	4,995
Available-for-sale securities					
– Fair value measurement		204	106	—	—
– Transfer to income		161	156	—	—
Cash flow hedges					
– Fair value measurement		21	29	—	—
– Transfer to income		(38)	(34)	—	—
Disposal of subsidiary		—	—	(255)	—
Deferred tax effects on adoption of IAS 32 and IAS 39	2	3,698	3,945	—	—
At 31 March		46,579	40,253	36,462	30,855

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(forming part of the Financial Statements)

23. Deferred Income Taxes (continued)

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Deferred tax assets are attributable to the following items:

	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
Accelerated tax depreciation	9,681	3,480	9,063	3,783
Deferred profit share arrangements	16,645	16,401	8,795	8,795
Pension and other post retirement benefits	15,813	15,253	18,550	18,123
Available-for-sale securities	(2,056)	(1,437)	—	—
Cash flow hedges	93	93	—	—
Allowance for credit losses	2,097	2,212	150	150
Other temporary differences	4,306	4,251	(96)	4
	46,579	40,253	36,462	30,855

The deferred tax charge in the income statement comprises the following temporary differences:

	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
Accelerated tax depreciation	618	(303)	1,541	(990)
Deferred profit share arrangements	7,850	7,606	4,870	4,870
Available-for-sale securities	(331)	(331)	—	—
Pensions and other post retirement benefits	(1,718)	(1,626)	296	275
Allowance for credit losses	20	—	—	—
Other temporary differences	651	1,098	(2,626)	(2,567)
	7,090	6,444	4,081	1,588

The amount of deductible temporary difference for which no deferred tax asset has been recognised is £2,228,000 (2005: £3,773,000).

Deferred tax liabilities have not been recognised for the withholding tax and other taxes that would be payable on the unremitted earnings of certain subsidiaries and other interests as it is not anticipated that such profits will be distributed in the foreseeable future. If such earnings were remitted, tax of £9,300,000 (2005: £9,200,000) would be payable.

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(forming part of the Financial Statements)

24. Retirement Benefit Obligations

Defined benefit pension plans and other post-retirement benefits

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The Company is a member of a group pension scheme, the NMR Pension Fund ("the Fund"), which is operated by the Company for the benefit of employees of certain Rothschild group companies in the United Kingdom. The Fund comprises a defined benefit section, which closed to new entrants in April 2003, and a defined contribution section established with effect from April 2003. The Company has unfunded obligations in respect of pensions and other post-retirement benefits.

The Company's subsidiary undertaking, N M Rothschild & Sons (CI) Limited, participates in the NMR Overseas Pension Fund, a defined benefit scheme operated for the benefit of employees of certain Rothschild group companies outside the United Kingdom. N M Rothschild & Sons (CI) Limited has accounted for its share of the assets, liabilities and costs of the NMR Overseas Pension Fund ("the Overseas Fund"), that share being determined by reference to the active, deferred and pensioner membership of the Fund. The figures set out below for the Group include the proportion of the Overseas Fund attributable to N M Rothschild & Sons (CI) Limited. At 31 March 2006, the total assets of the Overseas Fund were £35.8 million (2005: £28.6 million) and the total liabilities were £41.6 million (2005: £35.0 million). The Group balance sheet includes assets of £17.4 million (2005: £13.9 million) and liabilities of £20.2 million (2005: £17.0 million) in respect of the Overseas Fund.

The Group and the Company have adopted the revisions to IAS 19 which were published in December 2004. Actuarial gains and losses are recognised in full in the period in which they occur, outside the income statement through the statement of recognised income and expense.

The latest formal actuarial valuations of the Fund and the Overseas Fund were carried out as at 31 March 2004 and have been updated for IAS 19 purposes to 31 March 2006 by qualified independent actuaries. As required by IAS 19, the value of the defined benefit obligation and current service cost have been measured using the projected unit credit method.

The principal actuarial assumptions used as at the balance sheet date were as follows:

Group and Company	2006	2005	2004
Discount rate	5.00%	5.50%	5.70%
Retail price inflation	2.90%	2.90%	2.80%
Expected return on plan assets	6.50%	7.10%	7.10%
Expected rate of salary increases	3.90%	3.90%	3.80%
Expected rate of pensions increases	2.90%	2.90%	2.80%

The post-retirement mortality assumptions allow for future improvements in mortality. The mortality table used implies that a 60 year old man currently has an expected future lifetime of 23.5 years (2005: 23.4 years, 2004: 21.7 years), and that a 60 year old woman currently has an expected future lifetime of 26.6 years (2005: 26.4 years, 2004: 25.4 years). The assumed expected future lifetime of a 60 year old man in 20 years' time is 24.8 years (2005: 24.8 years, 2004: 21.9 years) and that of a 60 year old woman in 20 years' time is 27.8 years (2005: 27.8 years, 2004: 25.8 years).

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24. Retirement Benefit Obligations (continued)

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Amounts recognised in the balance sheet:

	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000	2004 Group £'000	2004 Company £'000
Present value of funded obligations	457,165	436,970	397,053	380,073	348,447	333,898
Fair value of plan assets	(420,984)	(403,612)	(336,305)	(322,432)	(304,669)	(292,230)
	36,181	33,358	60,748	57,641	43,778	41,668
Present value of unfunded obligations	2,486	2,486	2,843	2,843	1,193	1,193
Balance sheet liability	38,667	35,844	63,591	60,484	44,971	42,861

Movement in defined benefit obligation:

	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
At 1 April	399,895	382,916	349,640	335,091
Current service cost (net of contributions paid by other plan participants)	8,545	7,974	8,013	7,376
Current service cost relating to other plan participants	1,310	1,310	955	955
Interest cost	21,742	20,817	19,844	19,007
Actuarial gains and losses	43,463	40,842	31,483	30,151
Benefits paid	(18,375)	(17,474)	(12,039)	(11,664)
Past service costs	3,071	3,071	2,000	2,000
At 31 March	459,651	439,456	399,896	382,916

Movement in plan assets:

	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
At 1 April	336,305	322,432	304,669	292,230
Expected return on plan assets	22,892	21,946	21,177	20,317
Actuarial gains and losses	46,532	45,063	13,993	13,504
Contributions by the Group	32,320	30,335	7,550	7,090
Contributions by other plan participants	1,310	1,310	955	955
Benefits paid	(18,375)	(17,474)	(12,039)	(11,664)
At 31 March	420,984	403,612	336,305	322,432

Notes to the Financial Statements

(forming part of the Financial Statements)

24. Retirement Benefit Obligations (continued)

At 31 March, the fair value of plan assets comprised:

	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
Equities	244,104	232,482	226,503	217,650
Bonds	55,483	53,397	41,122	39,562
Gilts/cash	83,485	79,921	52,773	49,400
Property	18,439	18,339	15,907	15,820
Hedge funds	19,473	19,473	—	—
	420,984	403,612	336,305	322,432

The expected return on assets for the financial year ended 31 March 2006 was 6.5% p.a. (2005: 7.1%). The rate of return is derived from the weighted average of the long term expected rates of return on the asset classes in the Trustees' intended long-term investment strategy. A deduction was then made from the expected return on assets for the expenses incurred in running the schemes.

The actual return on plan assets in the year was £67.0 million (2005: £33.8 million).

Amounts recognised in income statement:

	Note	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
Current service cost		8,545	7,974	8,013	7,376
Interest cost		21,742	20,817	19,844	19,007
Expected return on plan assets		(22,892)	(21,946)	(21,177)	(20,317)
Past service cost		3,071	3,071	2,000	2,000
Total (included in staff costs)	9	10,466	9,916	8,680	8,066

Amounts recognised in statement of recognised income and expense:

	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
Actuarial gains and (losses) recognised in the year	3,069	4,221	(17,490)	(16,647)
Cumulative actuarial losses recognised in the statement of recognised income and expense	(14,421)	(12,426)	(17,490)	(16,647)

During the year, the Company paid a special contribution of £20.0 million in addition to its regular contributions. It is estimated that total contributions of £13.8 million will be paid to the defined benefit pension schemes in the year ending 31 March 2007, of which it is estimated that the Company will pay £7.8 million.

The highest paid director was a member of a defined benefit pension scheme under which his accrued pension at the year end was £156,000 (2005: £101,000).

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(forming part of the Financial Statements)

24. Retirement Benefit Obligations (continued)

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Defined contribution schemes

	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
Contributions paid	1,596	1,014	1,214	647

These amounts represent contributions to the defined contribution section of the NMR Pension Fund and other defined contribution pension arrangements.

25. Contingent Liabilities and Commitments

	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
Guarantees				
Guarantees and irrevocable letters of credit	76,622	721,114	76,617	724,427
Commitments				
Undrawn formal standby facilities, credit lines and other commitments to lend	472,142	462,504	287,147	266,853
Underwriting commitments	54,269	54,269	-	-
	526,411	516,773	287,147	266,853

Underwriting commitments represent the Group's share of ABN AMRO Rothschild's underwriting commitments in equity capital markets transactions.

From time to time the Group is involved in judicial proceedings or receives claims arising from the conduct of its business. Based upon available information and, where appropriate, legal advice, the directors do not believe that there are any potential or actual proceedings or other claims which will have a material adverse impact on the Group's financial position.

Assets pledged

	Asset		Related liability	
Group and Company	2006 £'000	2005 £'000	2006 £'000	2005 £'000
Investment securities	619,136	59,983	613,000	-

Assets are pledged as security over Euroclear overdraft facilities and as collateral to secure liabilities under repurchase agreements.

A mandatory reserve deposit of £680,000 (2005: £814,000) is held with the Bank of England in accordance with statutory requirements. This deposit is not available to finance the Group's day to day operations.

Notes to the Financial Statements

(forming part of the Financial Statements)

26. Operating Lease Commitments

At 31 March 2006, the Group was obligated under a number of non-cancellable operating leases for premises and equipment used primarily for banking purposes. The significant premises leases usually include renewal options and escalation clauses in line with general office rental market conditions as well as rent adjustments based on price indices.

Minimum commitments for non-cancellable leases of premises and equipment are as follows:

Group	Land and Buildings		Computer Equipment	
	2006 £'000	2005 £'000	2006 £'000	2005 £'000
Up to 1 year	7,147	7,040	135	91
Between 1 and 5 years	27,274	27,379	—	—
More than 5 years	45,376	52,490	—	—
	79,797	86,909	135	91

Operating expenses include operating lease rentals of £8,368,000 (2005: £8,624,000).

27. Share Based Payments

Certain directors of the Group participate in a group Employee Share Option Plan ("ESOP") administered by its parent undertaking, Rothschilds Continuation Holdings AG. On first time adoption of IFRS, the Group has used the exemption in IFRS 1, whereby the requirements of IFRS 2 are not applied to share options granted prior to 7 November 2002. As such, the share options issued to directors of the Group are not recognised in the financial statements.

Certain directors of the Group have options over 99,350 (2005: 102,550) shares in Rothschilds Continuation Holdings AG, which were granted between 1995 and 2002. The options vest after being held for 3 years. An external valuation of the underlying shares is performed annually and vested options may be exercised during the three month period following the valuation. The options have a contractual life of 10 years.

Movements in the number of share options outstanding are as follows:

Group and Company	2006		2005	
	Number	Weighted Average Exercise Price SFr	Number	Weighted Average Exercise Price SFr
At 1 April	102,550	1,335	102,850	1,329
Forfeited	(500)	1,250	(340)	1,250
Expired	(2,700)	600	—	—
Exercised	—	—	(660)	627
Net transferred	—	—	700	1,385
At 31 March	99,350	1,356	102,550	1,335
Exercisable at the end of the year	99,350	1,356	82,800	1,355

Notes to the Financial Statements

(forming part of the Financial Statements)

27. Share Based Payments (continued)

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Share options outstanding at 31 March were as follows:

Exercise price range SFr	Group and Company			
	2006	2005	2006	2005
	Number of Options Outstanding	Weighted Average Contractual Life (Years)	Number of Options Outstanding	Weighted Average Contractual Life (Years)
501 – 750	1,100	0.1	3,800	0.4
751 – 1000	1,940	1.1	1,940	2.1
1001 – 1250	35,660	4.7	36,160	5.7
1251 – 1500	60,650	4.4	60,650	5.4
	99,350	4.4	102,550	5.3

Certain directors of the Group are parties to cash settled share based payment arrangements. The benefits of these arrangements vest after 30 September 2008 provided that certain conditions regarding the growth in the value of the relevant group company are met.

	2006 £'000	2005 £'000
The cost of share based payment arrangements charged to the income statement	803	953
Carrying value of the liability arising under share based payment arrangements	1,941	1,288

In calculating the charge to the income statement the value of the arrangements was calculated by reference to an estimated value of the company based upon an average of prior year, current and forecast post tax profits and the price/earnings ratios of recent market transactions for businesses of a similar type.

28. Dividends Per Share

	2006 per share	2006 £'000	2005 per share	2005 £'000
Equity Interests				
Final dividend prior year (paid)	25p	12,500	10p	5,000
Interim dividend (paid)	30p	15,000	25p	12,500
Final dividend (paid)	50p	25,000	–	–
	105p	52,500	35p	17,500

Notes to the Financial Statements

(forming part of the Financial Statements)

29. Cash and Cash Equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances with less than three months' original maturity.

	2006 Group £'000	2006 Company £'000	2005 Group £'000	2005 Company £'000
Cash and balances at central banks	24	24	1,511	27
Loans and advances to banks	69,146	24,486	401,799	238,593
	69,170	24,510	403,310	238,620

30. Transactions with Related Parties

Group

Transactions with key management personnel (and their connected persons) of the Group are as follows:

	2006 £'000	2005 £'000
At 31 March		
Loans	892	814
Deposits	2,279	1,652

Key management personnel are the directors of the Company and of parent companies.

Loans to directors are secured and are made in the ordinary course of business on normal commercial terms, with the exception of travel season ticket loans of £7,000 (2005: £8,000) which are unsecured and provided on an interest-free basis. Deposits are also taken on normal commercial terms.

	2006 £'000	2005 £'000
Key management personnel compensation		
Short-term employee benefits	20,203	17,354
Post-employment benefits	487	829
Other long-term employee benefits	5,962	4,366
Termination benefits	1,221	2,245

Details of share based payments are disclosed in note 27.

Notes to the Financial Statements

(forming part of the Financial Statements)

30. Transactions with Related Parties (continued)

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Amounts receivable from parent, associates, joint ventures and other related parties of the Group are as follows:

	2006		2005	
	Loans and advances £'000	Other assets £'000	Loans and advances £'000	Other assets £'000
At 31 March				
Amounts due from parent companies	—	205	—	2,396
Amounts due from associates	—	3,320	—	3,992
Amounts due from other related parties	54,950	11,658	40,256	7,965

Other related parties are fellow subsidiaries of Concordia BV.

Amounts receivable include loans and amounts recoverable from related parties in respect of expenses incurred on their behalf and services provided. Loans are made in the ordinary course of business and on substantially the same terms as comparable transactions with third parties.

Amounts payable to parent, associates, joint ventures and other related parties of the Group are as follows:

	2006			2005		
	Deposits £'000	Subordinated loan capital £'000	Other liabilities £'000	Deposits £'000	Subordinated loan capital £'000	Other liabilities £'000
At 31 March						
Amounts due to parent companies	11,735	—	875	35,271	—	—
Amounts due to joint ventures	1,729	—	—	1,218	—	—
Amounts due to associates	—	—	2,633	—	—	1,233
Amounts due to pension funds	23,833	—	89	1,916	—	7
Amounts due to other related parties						
— subordinated	—	142,532	—	—	127,969	—
— other	30,984	—	4,331	30,224	—	5,363

Amounts payable consist of deposits and bank account balances taken in the ordinary course of business and on substantially the same terms as comparable transactions with third parties. £142,532,000 (2005: £127,969,000) relate to amounts loaned to the Group on a subordinated basis, the terms of which are set out in note 21.

The Group has also entered into lease agreements with a fellow subsidiary of the Concordia BV group for the rental of office space. The lease agreements expire in 2014 and 2018 and are on normal commercial terms.

Notes to the Financial Statements

(forming part of the Financial Statements)

30. Transactions with Related Parties (continued)

Amounts recognised in the income statement of the Group in respect of related party transactions are as follows:

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	Parent companies £'000	Joint ventures £'000	Associates £'000	Pension funds £'000	Other related parties £'000	Total £'000
2006						
Interest receivable	--	--	--	--	2,651	2,651
Interest payable	777	63	--	292	1,935	3,067
Fees and commissions receivable	--	--	--	--	228	228
Fees and commissions payable	--	4,275	6,490	--	17,661	28,426
Recoverable expenses	2,349	--	--	--	4,895	7,244
2005						
Interest receivable	--	--	--	--	2,719	2,719
Interest payable	1,228	121	--	121	2,252	3,722
Fees and commissions receivable	--	--	--	--	265	265
Fees and commissions payable	--	1,324	697	--	4,385	6,406
Recoverable expenses	3,639	--	--	--	4,806	8,445

Fees and commissions receivable/payable relate to transactions where the Group has worked in collaboration with other related parties.

Company

Amounts receivable from parent, subsidiaries, joint ventures and other related parties of the Company are as follows:

	2006		2005	
	Loans and advances £'000	Other assets £'000	Loans and advances £'000	Other assets £'000
At 31 March				
Amounts due from parent companies	--	205	--	2,396
Amounts due from subsidiaries	135,539	1,693	129,014	1,037
Amounts due from associates	--	3,320	--	3,992
Amounts due from other related parties	43,893	11,627	39,681	7,965

Amounts receivable include loans and amounts recoverable from related parties in respect of expenses incurred on their behalf and services provided. Loans are made in the ordinary course of business and on substantially the same terms as comparable transactions with third parties.

Notes to the Financial Statements

(forming part of the Financial Statements)

30. Transactions with Related Parties (continued)

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The Company has introduced commercial mortgage loans to Real Estate Capital Limited ("REC"), a special purpose company owned by a charitable trust, established to advance loans meeting certain pre-defined eligibility criteria. The beneficial interest in the loans has been assigned to Real Estate Capital No. 2 plc ("REC2") and Real Estate Capital Funding No. 6 Limited ("REC6"), also special purpose companies owned by charitable trusts. To fund the acquisition of this beneficial interest, REC2 issued floating rate notes and REC6 is funded by third party banks and by a subordinated loan facility provided by the Company.

The Company has received fees for the introduction and servicing of the commercial loans and has made subordinated loans of £1.8 million and £20.0 million to REC2 and REC6 respectively.

Amounts payable to parent, subsidiaries, joint ventures and other related parties of the Company are as follows:

	2006			2005		
	Deposits	Subordinated	Other	Deposits	Subordinated	Other
	£'000	loan capital	liabilities	£'000	loan capital	liabilities
	£'000	£'000	£'000	£'000	£'000	£'000
At 31 March						
Amounts due to parent companies	11,735	—	875	35,271	—	—
Amounts due to subsidiaries						
— subordinated	—	89,664	—	—	103,011	—
— other	676,127	—	505	615,454	—	285
Amounts due to joint ventures	3,459	—	—	2,437	—	—
Amounts due to associates	—	—	2,633	—	—	1,233
Amounts due to pension funds	23,833	—	89	1,916	—	7
Amounts due to other related parties						
— subordinated	—	142,532	—	—	127,969	—
— other	26,100	—	4,319	20,208	—	5,300

Amounts payable consist of deposits and bank account balances taken in the ordinary course of business and on substantially the same terms as comparable transactions with third parties. £232,196,000 (2005: £230,980,000) relate to amounts loaned to the Company on a subordinated basis, the terms of which are set out in note 21.

The Company has also entered into lease agreements with a fellow subsidiary of the Concordia BV Group for the rental of office space. The lease agreements expire in 2014 and 2018 and are on normal commercial terms.

Notes to the Financial Statements

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30. Transactions with Related Parties (continued)

Guarantees made on behalf of and received from subsidiaries of the Company are as follows:

At 31 March	2006 £'000	2005 £'000
Guarantees made on behalf of subsidiaries	664,107	653,385
Guarantees received from subsidiaries	57,000	57,497

The Company has guaranteed £104,619,000 (2005: £103,011,000) of perpetual floating rate subordinated notes and £557,968,000 (2005: £549,390,000) of medium term notes issued by Rothschilds Continuation Finance PLC. The issue proceeds have been placed on deposit with the Company on terms similar to those of the notes issued. Other guarantees are made on behalf of subsidiaries in the ordinary course of the Company's business.

The Company has received guarantees from a subsidiary of the Company in respect of certain customer loans.

Amounts recognised in the income statement of the Company in respect of related party transactions are as follows:

	Parent companies £'000	Subsidiaries £'000	Joint ventures £'000	Associates £'000	Pension funds £'000	Other related parties £'000	Total £'000
2006							
Interest receivable	—	6,697	—	—	—	2,433	9,130
Interest payable	777	18,567	126	—	292	1,414	21,176
Fees and commissions receivable	—	716	—	—	—	—	716
Fees and commissions payable	—	—	8,550	6,490	—	17,661	32,701
Recoverable expenses	2,349	578	—	—	—	4,895	7,822
2005							
Interest receivable	—	4,235	—	—	—	2,719	6,954
Interest payable	1,228	18,983	241	—	121	2,252	22,825
Fees and commissions receivable	—	2,297	—	—	—	265	265
Fees and commissions payable	—	—	2,648	697	—	4,385	7,730
Recoverable expenses	3,639	523	—	—	—	4,806	8,968

Fees and commissions receivable/payable relate to transactions where the Company has worked in collaboration with other group companies.

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31. Minority Interests

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Group	Note	£'000
At 1 April 2004		3,105
Profit attributable to minority interests		624
Reduction in minority		(82)
At 31 March 2005		3,647
Adoption of IAS 32 and IAS 39	2	231,043
At 1 April 2005		234,690
Profit attributable to minority interests		9,226
Amounts paid to minority interests – subordinated debt interest		(8,755)
Reclassification of subordinated debt	21	(230,980)
Reduction in minority		(3,730)
At 31 March 2006		451

The reduction in minority interests during the year to 31 March 2006 relates to the purchase by the Group of a minority interest in Five Arrows Leasing Group Limited.

32. Reconciliation of Movements in Shareholders' Equity

Group	Share Capital £'000	Retained Earnings £'000	Translation Reserve £'000	Available-For-Sale Reserve £'000	Hedging Reserve £'000	Total £'000
At 1 April 2004	50,000	229,386	–	–	–	279,386
Profit for the period	–	30,495	–	–	–	30,495
Minority interest	–	(624)	–	–	–	(624)
Shareholders' dividends	–	(17,500)	–	–	–	(17,500)
Actuarial losses on defined benefit pension obligations	–	(12,380)	–	–	–	(12,380)
Exchange differences on translation of foreign operations	–	–	201	–	–	201
At 31 March 2005	50,000	229,377	201	–	–	279,578
Adoption of IAS 32 and IAS 39 (note 2)	–	(5,981)	–	4,876	(256)	(1,361)
At 1 April 2005	50,000	223,396	201	4,876	(256)	278,217
Profit for the period	–	74,606	–	–	–	74,606
Minority interest	–	(9,226)	–	–	–	(9,226)
Shareholders' dividends	–	(52,500)	–	–	–	(52,500)
Actuarial gains on defined benefit pension obligations	–	2,050	–	–	–	2,050
Losses from changes in fair value	–	–	–	(353)	(36)	(389)
Gains/(losses) transferred to income on disposal and impairment	–	–	–	(635)	75	(560)
Fair value changes in subordinated liabilities	–	926	–	–	–	926
Exchange differences on translation of foreign operations	–	–	218	–	–	218
At 31 March 2006	50,000	239,252	419	3,888	(217)	293,342

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32. Reconciliation of Movements in Shareholders' Equity (continued)

Company	Share Capital £'000	Retained Earnings £'000	Translation Reserve £'000	Available-For-Sale Reserve £'000	Hedging Reserve £'000	Total £'000
At 1 April 2004	50,000	146,915	—	—	—	196,915
Profit for the period	—	30,483	—	—	—	30,483
Shareholders' dividends	—	(17,500)	—	—	—	(17,500)
Actuarial losses on defined benefit pension funds	—	(11,653)	—	—	—	(11,653)
At 31 March 2005	50,000	148,245	—	—	—	198,245
Adoption of IAS 32 and IAS 39 (note 2)	—	(4,834)	—	3,185	(227)	(1,876)
At 1 April 2005	50,000	143,411	—	3,185	(227)	196,369
Profit for the period	—	62,353	—	—	—	62,353
Minority interests	—	(8,755)	—	—	—	(8,755)
Shareholders' dividends	—	(52,500)	—	—	—	(52,500)
Actuarial gains on defined benefit pension funds	—	2,973	—	—	—	2,973
Losses from changes in fair value	—	—	—	(213)	(69)	(282)
Fair value changes in subordinated liabilities	—	926	—	—	—	926
(Gains)/losses transferred to income on disposal and impairment	—	—	—	(613)	79	(534)
At 31 March 2006	50,000	148,408	—	2,359	(217)	200,550

Reserves consist of the following (all net of taxes):

Available-For-Sale Reserve – cumulative net unrealised gains/(losses) on fair value changes of available-for-sale investments until the investment is derecognised.

Translation Reserve – net gains/(losses) arising from the translation of the financial statements of foreign operations.

Hedging Reserve – effective portion of the cumulative change in fair value of derivative instruments designated as cashflow hedges.

Share capital

	2006	2005
Authorised, allotted, called up and fully paid ordinary shares of £1 each	50,000,000	50,000,000

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33. Principal Subsidiary Undertakings

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The principal subsidiary undertakings of the Company are detailed below. All the principal subsidiary undertakings are registered in England and Wales except where otherwise indicated. The Company's remaining subsidiary undertakings are not material and accordingly no disclosure has been made in respect of these entities.

	Percentage held
N M Rothschild & Sons (Ct) Limited (Merchant banking) (Registered in Guernsey, Channel Islands)	100
Five Arrows Finance Limited (Investment holding company)	100
Five Arrows Leasing Group Limited (Lease portfolio management)	100
Five Arrows Commercial Finance Limited (Invoice discounting)	100
Five Arrows Leasing Limited (Asset finance)	100
State Securities plc (Asset finance)	97.64
Specialist Fleet Services Finance Limited (Contract hire and maintenance)	100
Rothschilds Continuation Finance PLC (Finance company)	100

The following subsidiary undertakings are special purpose companies, established to advance loans or to purchase loans from the Group (see also note 30). Although the Group has no direct or indirect ownership interest in these companies, they are regarded as subsidiaries under UK company law and IFRS.

Real Estate Capital Limited
Real Estate Capital Funding No. 6 Limited
Real Estate Capital No. 2 plc
Glass MTN Funding I Limited
Guernsey Loan Asset Securitisation Scheme Limited

The historical cost of the investments in subsidiary undertakings was £34,786,000 (2005: £34,786,000)

	2006 £'000	2005 £'000
Of which		
– Banks	70	70
– Other	34,716	34,716
	34,786	34,786

34. Parent Undertaking and Ultimate Holding Company

The largest group in which the results of the Company are consolidated is that headed by Concordia BV, incorporated in The Netherlands. The smallest group in which they are consolidated is that headed by Rothschilds Continuation Limited, registered in England and Wales. The consolidated financial statements of this group are available to the public and may be obtained from Companies House.

The Company's ultimate parent company is Concordia BV which is incorporated in The Netherlands. Throughout the year, Concordia BV was controlled by the Rothschild family and their interests.

Notes to the Financial Statements

(forming part of the Financial Statements)

35. Remuneration of Directors

	2006 £'000	2005 £'000
Directors' emoluments	19,406	16,972
Amounts receivable under long term profit share schemes	5,906	4,361
	25,312	21,333
Pension contributions to money purchase schemes	485	127
Compensation for loss of office	1,221	2,245
	27,018	23,705

The emoluments of the highest paid director were £8,251,000 (2005: £3,442,000).

	2006	2005
Retirement benefits are accruing to the following number of directors under		
Money purchase schemes	5	6
Defined benefit schemes	9	12

36. Directors' Interests

Leopold de Rothschild is a director of Rothschilds Continuation Limited, and his interests in the shares of Group companies are disclosed in the financial statements of that company. The following other director of the Company at 31 March 2006 was, according to the Register kept by the Company in accordance with Section 325 of the Companies Act 1985, interested in the shares shown below:

	Concordia BV		Rothschilds Continuation Limited Cumulative Second Preference shares of 10p each		5.25% Cumulative Preference shares of £1 each	
	2006	2005	2006	2005	2006	2005
Sir Graham Hearne*	320,609	320,609	1,436,596	1,436,596	300,700	300,700

* As trustee

Independent Non-Executive Directors

Independent Non-Executive Directors

Brief biographical details of the Independent Non-Executive Directors are as follows:

Lord George

Lord George was Governor of the Bank of England from 1993 to 2003, having joined the Bank in 1962. He is a Non-Executive Director of Grosvenor Group Holdings Limited and Nestlé SA.

Lord Guthrie

Lord Guthrie was Chief of the Defence Staff from 1997 to 2001, having previously been Chief of the General Staff of the UK army from 1994 to 1997.

Sir Graham Hearne

Sir Graham Hearne is Non-Executive Chairman of Braemar Seascopes Group Plc and Catlin Group Limited and is Deputy Chairman of Gallaher Group Plc. He was previously Chairman of Enterprise Oil Plc (1991 to 2002) and Chief Executive (1984 to 1991). He was appointed to the Board of N M Rothschild & Sons Limited in September 1970, becoming Non-Executive in July 1977.

Peter Smith

Peter Smith is Chairman of Savills plc, a Non-Executive Director of Templeton Emerging Markets Investment Trust plc, and a Non-Executive Director and Deputy Chairman of the Equitable Life Assurance Society. He was Senior Partner of PricewaterhouseCoopers (and previously Coopers & Lybrand) from 1994 to 2000.

Sir Clive Whitmore

Sir Clive Whitmore was Permanent Secretary of the Ministry of Defence from 1983 to 1988 and of the Home Office from 1988 to 1994.

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