Marks and Spencer Life Assurance Limited

Annual Report and Accounts

31 December 2006

Company Registration Number 2868383

Annual Report and Accounts 2006

Contents

Company Registration Number 2868383

Report of the Directors

Principal Activities

The principal activity of the Company is the undertaking of ordinary long-term insurance business in the United Kingdom, namely life assurance, pensions and permanent health.

Business Review

The Company's results for the year under review are as detailed in the statement of profit and loss shown in these accounts. The directors did not recommend the payment of a dividend in respect of the year ended 31 December 2006 (31 December 2005: nil).

Following the purchase of the Company by HSBC Bank plc in November 2004, the Company's products are not actively marketed. The number of new business sales during the period was therefore low (400 policies) compared with the extant book size (85,500 policies). New business sales are expected to decrease further as M&S branded term assurances have ceased to be written through the Company from May 2006. They are instead being written through HSBC Life (UK) Limited.

The total assets of the Company at 31 December 2006 were £382m (2005: £334m), as set out in the balance sheet on page 9 of the accounts. The Company's capital position remains very strong with total shareholders' equity of £89.3m (2005 £69.4m).

The financial services industry remains closely regulated and, as such, the UK regulators may take actions that could result in changes to industry practices, sales and pricing. The Company maintains a strong compliance culture and monitors the regulatory environment closely to respond proactively to changes and reduce risks to the business.

The Company is exposed to insurance risk and to financial risks, principally market risk, credit risk and liquidity risk. The risk management objectives and policies of the Company, together with an analysis of the exposure to the key risks, are set out in Note 4 to the financial statements.

The Company has adopted the HSBC Group's Risk Management Framework, which covers risk identification, categorisation, evaluation and reporting. A comprehensive risk log is maintained, summarising all of the key risks impacting the Company and describing the controls in place, as well as an overall assessment of the potential impact of each risk. The management of risk is embedded within the business and Risk Committees have been established to exercise appropriate oversight and control over the risk management process.

For significant business proposals that involve a change in the risk profile of the Company, a formal Business Case is prepared. The Company undertook two major initiatives during the year under review:

- A major restructuring of the Company's reinsurance arrangements resulted in a significant reduction in mortality risk

- The Company successfully transferred its policy administration system from its existing platform to HSBC platforms.

The Company has developed a series of Key Performance Indicators (KPIs) for use by management in monitoring performance. The principal KPIs are expense levels, lapse rates and comparison to the Company's strategic plan.

The Company is proactive in ensuring that it complies with the FSA principles of Treating Customers Fairly (TCF). Compliance with TCF principles is a key objective of senior managers and management monitors key TCF indicators at each stage of the product lifecycle, taking action where appropriate.

Directors

The directors who served during the year were as follows:

Name	Appointed	Resigned
S G Troop (Chairman)	27 July 2006	
V Armson		
C A Colton		
B A Cook		
B D Goldberg	22 February 2006	
M J L M Hawes		11 December 2006
H S Karlcut (Chairman)		27 July 2006
D I W Reynolds*		
R I Waugh**	12 September 2006	

*Independent non-executive director

**Alternate to B A Cook

The Articles of Association of the Company provide that in certain circumstances the directors are entitled to be indemnified out of the assets of the Company against claims from third parties in respect of certain liabilities arising in connection with the performance of their functions, in accordance with the provisions of the UK Companies Act 1985. Indemnity provisions of this nature have been in place during the financial year but have not been utilised by the directors.

Directors' Interests

All the directors' interests in the share and loan capital of HSBC Holdings plc, the ultimate parent undertaking and subsidiary undertakings, required to be disclosed under the Companies Act 1985, are set out below:

	HSBC Holdings plc Ordinary shares of US$0.50 each	
	1 January 2006 (or appointment date if later)	31 December 2006
V Armson	1,622	1,073
C A Colton	1,119	1,119
B Cook	21,233	34,246
B D Goldberg	1,399	-
D I W Reynolds	1,639	1,805
S G Troop	13,739	13,795

	Hang Seng Bank Limited Ordinary shares of HKD 5.00 each	
	1 January 2006 (or appointment date if later)	31 December 2006
S G Troop	390	390

Report of the Directors (continued)

During the year (or since appointment), options over HSBC Holdings plc ordinary shares of US$0.50 each were granted/exercised as follows:

	Granted	Exercised
V Armson	-	5,000
C A Colton	-	12,500
B A Cook	-	32,508
B D Goldberg	1,049	1,249

The terms of a number of Employee Benefit Trusts provide that all employees of HSBC Holdings plc and any of its subsidiary undertakings are potential beneficiaries of the Trusts. As potential beneficiaries of the Trusts, each director of the Company, with the exception of the independent non-executive director, is deemed to have a technical interest in all of the HSBC Holdings plc ordinary shares of US$0.50 each held by the Trusts. At 31 December 2006 the Trusts held a total of 133,346,569 ordinary shares of US$0.50 each (31 December 2005: 130,812,676).

Supplier Payment Policy

The Company subscribes to the Better Payment Practice Code, the four principles of which are: to agree payment terms at the outset and stick to them; to explain payment procedures to suppliers; to pay bills in accordance with any contract agreed with the supplier or as required by law; and to tell suppliers without delay when an invoice is contested and settle disputes quickly. Copies of, and information about, the Code are available from: The Department of Trade and Industry, 1 Victoria Street, London SW1H 0ET.

It is Company practice to organise payment to its suppliers through central purchasing units operated by HSBC Bank plc and Marks and Spencer Financial Services plc. The payment performance of those units is incorporated within the results of those companies.

Disclosure of information to auditors

Each person who is a director at the date of approval of this report confirms that so far as the director is aware, there is no relevant audit information of which the Company's auditors are unaware; and the director has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of Section 234ZA of the Companies Act 1985.

Statement of Directors' Responsibilities in Relation to Financial Statements

The following statement, which should be read in conjunction with the auditors' statement of their responsibilities set out in their report on page 6, is made with a view to distinguishing for the shareholder the respective responsibilities of the directors and of the auditors in relation to the financial statements.

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU and applicable laws.

The financial statements are required by law to present fairly the financial position and the performance of the Company. 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 the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the 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 Company and to prevent and detect fraud and other irregularities.

On behalf of the Board

27 February 2007

Peter J Harvey, *Secretary*

Registered Office
Kings Meadow
Chester
Cheshire
CH99 9FB

Independent Auditors' Report to the Members of Marks and Spencer Life Assurance Limited

We have audited the financial statements of Marks and Spencer Life Assurance Limited for the year ended 31 December 2006 which comprise the Income Statement, the Balance Sheet, the Cash Flow Statement, the Statement of Change in Shareholders' Equity and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an 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 financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 4.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

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

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

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the 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 financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Company's affairs as at 31 December 2006 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985 ; and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor

27 February 2007

8 Salisbury Square
London EC4Y 8BB

Income statement for the Year Ended 31 December 2006

	Note	2006 £000	2005 £000
Insurance premium revenue	5	**16,184**	16,266
Insurance premium ceded to reinsurers	5	**(7,374)**	(5,122)
Net insurance premium revenue	5	**8,810**	11,144
Fees and commission income	6	**4,235**	4,443
Financial income	7	**19,484**	36,061
Net income		**32,529**	51,648
Claims and benefits incurred	8	**7,297**	(11,787)
Reinsurers' share of claims and benefits incurred	8	**18,209**	4,407
Net policyholder claims and benefits incurred	8	**25,506**	(7,380)
Investment contract benefits	9	**(18,705)**	(30,659)
Acquisition costs	10	**(5,789)**	(2,574)
Administrative expenses	10	**(4,670)**	(3,373)
Expenses for asset management services		**(234)**	(345)
		(10,693)	(6,292)
Profit before income taxes		**28,637**	7,317
Income taxes	12	**(8,737)**	(814)
Profit for the year		**19,900**	6,503

The accounting policies and notes on pages 11 to 31 form an integral part of these financial statements.

Statement of change in shareholders' equity for the Year Ended 31 December 2006

	Share capital	*Retained earnings*	*Total*
	£000	**£000**	**£000**
Year ended 31 December 2005			
Balance at 1 January 2005	**80,500**	**(17,554)**	**62,946**
Profit and total income and expenses for the year	—	**6,503**	**6,503**
Balance at 31 December 2005	**80,500**	**(11,051)**	**69,449**
Year ended 31 December 2006			
Balance at 1 January 2006	**80,500**	**(11,051)**	**69,449**
Profit and total income and expenses for the year	—	**19,900**	**19,900**
Balance at 31 December 2006	**80,500**	**8,849**	**89,349**

The accounting policies and notes on pages 11 to 31 form an integral part of these financial statements

Balance Sheet at 31 December 2006

		2006	2005
Assets	*Note*	**£000**	£000
Intangible assets			
— Deferred acquisition costs	*13*	**9,456**	14,959
Financial assets	*14*		
— Debt securities – fixed rate	*14*	**72,042**	78,456
— Debt securities – floating rate	*14*	**23,890**	9,965
— Collective investment schemes	*14*	**197,150**	170,811
		293,082	259,232
Insurance and other receivables	*15*	**6,964**	3,431
Reinsurance assets	*19*	**17,928**	3,427
Income taxes		—	811
Cash and cash equivalents	*16*	**54,558**	51,908
Total assets		**381,988**	333,768
Equity			
Capital and reserves attributable to the Company's equity holders			
Share capital	*17*	**80,500**	80,500
Retained earnings	*18*	**8,849**	(11,051)
Total shareholders' equity		**89,349**	69,449
Liabilities			
Insurance contract provisions	*19*	**43,353**	54,961
Financial liabilities			
— Investment contracts	*20*	**224,149**	195,589
— Bank overdrafts	*21*	—	608
Insurance, other payables and deferred income	*22*	**10,377**	6,393
Deferred income tax liabilities	*23*	**4,637**	6,768
Current income tax liabilities		**10,123**	—
Total liabilities		**292,639**	264,319
Total equity and liabilities		**381,988**	333,768

The financial statements were approved by the board of directors on 27 February 2007 and were signed on its behalf by:

C A Colton
Managing Director

The accounting policies and notes on pages 11 to 31 form an integral part of these financial statements.

Statement of Cash Flows – Indirect Method for the Year Ended 31 December 2006

	2006	2005
Cash flows from operating activities	**£000**	£000
Profit for the period	**19,900**	6,503
Adjustments for:		
— interest receivable	**(7,790)**	(6,881)
— dividends receivable	**(1,674)**	(1,427)
— tax expense (Note 12)	**10,868**	1,057
— amortisation of deferred acquisition costs (Note 13)	**5,621**	1,896
— Deferred income tax expense (Note 12)	**(2,131)**	(243)
Net fair value gains on financial assets	**(10,046)**	(27,729)
Changes in operating assets and liabilities		
Net (increase) in reinsurance assets	**(14,501)**	(980)
Net (increase) in insurance and other receivables	**(3,080)**	(254)
Net (increase) in collective investment schemes	**(13,554)**	(14,931)
Net (increase) in debt securities	**(10,250)**	(5,891)
Net (increase) in intangible assets	**(118)**	(177)
Net increase/(decrease) in insurance liabilities	**(11,608)**	4,229
Net increase in investment contracts liabilities	**28,560**	43,613
Net increase in loans and borrowings	**(608)**	608
Net (decrease) in deferred income	**(46)**	(238)
Net increase in other operating liabilities	**3,597**	604
Net increase/(decrease) in other provisions	**432**	1,006
Cash generated from/(used in) operations	**(6,428)**	765
Interest received on investments	**7,337**	6,722
Dividends received on investments	**1,674**	1,427
Income taxes paid	**67**	(3,764)
Net increase/(decrease) in cash and cash equivalents	**2,650**	5,150
Cash and cash equivalents at 1 January	**51,908**	46,758
Cash and cash equivalents at 31 December	**54,558**	51,908

The Company classifies the net acquisition of financial assets as operating cash flows, as these are funded from the net cash flows associated with insurance and investment contracts.

The accounting policies and notes on pages 11 to 31 form an integral part of these financial statements.

Notes to the financial statements

1 General information

Marks and Spencer Life Assurance Limited is a company incorporated and domiciled in the United Kingdom.

The financial statements were authorised for issue by the directors on 27 February 2007.

2 Significant accounting policies

(a) *Statement of compliance*

The financial statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union.

The Company has not applied IFRS 7 Financial Instruments: Disclosures. The standard is effective from 1 January 2007 and the Company intends to implement it from this date. The effect of implementation will be to change some of the disclosures relating to the Company's financial instruments and related risk management.

The company chose not to early adopt the recent 'Amendments to IAS 1Presentation of Financial Statements: Capital disclosures'. This amendment becomes effective for periods beginning on or after 1 January 2007. This amendment was endorsed by the EU on the 11 January 2006. The effect of implementation will be to include additional disclosures relating to the Company's management of capital.

(b) *Basis of preparation*

The financial statements are presented in Pounds Sterling, rounded to the nearest thousand. They are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: financial instruments at fair value through profit or loss.

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised if the revision affects only that year, or in the year of the revision and future years if the revision affects both current and future years.

Information about significant areas of estimation uncertainty that have a significant risk of causing material adjustment to the carrying amount of assets and liabilities within the next financial year and critical judgements made by management in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements are discussed in note 3.

The accounting policies set out below, unless otherwise stated, have been applied consistently to all years presented in these financial statements.

(c) *Classification of contracts*

Contracts under which the Company accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder, are classified as insurance contracts. As a general guideline the Company defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event that are at least 10% more than the benefits payable if the insured event did not occur. Insurance risk is risk other than financial risk. Financial risk is the risk of a possible future change in one or more of a specified interest rate, security price, commodity price, foreign exchange rate, index or prices or rates, a credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. Insurance contracts may also transfer some financial risk.

Contracts under which the transfer of insurance risk to the Company from the policyholder is not significant are classified as investment contracts.

Notes to the Financial Statements (continued)

(d) *Recognition and measurement of contracts*

Long-term insurance contracts with fixed and guaranteed benefits

These contracts insure events associated with human life (for example death or survival) over a long duration. Premiums are recognised as revenue when they become payable by the contract holder. Claims are recorded as an expense on the basis of notification received up to the balance sheet date.

A liability for contract benefits that are expected to be incurred in the future is recorded when the premiums are recognised. The liability is computed using a gross premium valuation method, having due regard to the actuarial principles laid down in Council Directive 2002/83/EC. The liability is determined as the sum of the expected discounted value of the benefit payments and the future administration expenses that are directly related to the contract, less the expected discounted value of the future premiums based on the valuation assumptions used. The liability is based on latest assumptions as to mortality, maintenance expenses and investment income, including a margin for prudence.

Reinsurance

The Company cedes reinsurance in the normal course of business for the purpose of limiting its net loss potential through the diversification of its risks. Reinsurance arrangements do not relieve the Company from its direct obligations to its policyholders.

Premiums ceded and benefits reimbursed are presented in the income statement and balance sheet on a gross basis.

Only contracts that give rise to a significant transfer of insurance risk are accounted for as insurance. Amounts recoverable under such contracts are recognised in the same year as the related claim. Contracts that do not transfer significant insurance risk (e.g. financial reinsurance), are accounted for as a financial asset.

The benefits to which the Company is entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers (classified within 'insurance and other receivables'), as well as longer term receivables (classified as 'reinsurance assets') that are dependent on expected claims and benefits arising under the related reinsured insurance contracts. Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured insurance contracts and in accordance with the terms of each reinsurance contract. Reinsurance liabilities (included within 'insurance, other payables and deferred income') are primarily premiums payable for reinsurance contracts and are recognised as an expense when due. Gains and losses on the purchase of reinsurance are taken to the income statement in the period in which they arise.

Liabilities and related assets under liability adequacy test

Insurance contracts are tested for adequacy by discounting current estimates of all future contractual cash flows and comparing this amount to the carrying value of the liability net of any deferred acquisition costs. Where a shortfall is identified, an additional provision is made and the Company recognises the deficiency in income for the year.

Investment contracts

Amounts collected on investment contracts, which primarily involve the transfer of financial risk, are accounted for using deposit accounting, under which the amounts collected are credited directly to the balance sheet as an adjustment to the liability to the policyholder.

Some investment contracts issued include the provision of investment management services. These services are accounted for in accordance with IAS 18 where the revenue associated with the service component is recognised by reference to the stage of completion of the transaction. The Company recognises annual management fees, based on the policyholder's account value, when due. Any front-end fees deducted from premiums received, prior to allocation of units to the policy, are spread over the expected period of the contract.

Liability measurement

Liabilities in relation to unit-linked investment contracts are designated on initial recognition as at fair value through profit and loss. The financial liability is measured using a valuation technique, based on the carrying value of the assets and liabilities that are held to back the contract, adjusted to take account of the effect on the liabilities of the discounting for the time value of tax payments on assets sold in the fund.

These liabilities are designated at fair value through profit and loss as this group of liabilities, together with the related unit-linked assets, are managed, and their performance evaluated, on a fair value basis.

(e) *Revenue*

Revenue comprises insurance contract premiums, fees from investment management services and financial income.

The accounting policy in relation to revenue from insurance contracts is disclosed in note 2(d).

Fees and commission income

Fees and commission income includes fees on investment management services contracts that are recognised as the services are provided (see note 2(d)).

Fees and commissions that do not require the Company to render further service are recognised as revenue by the Company when they become receivable.

The accounting policy in relation to financial income is disclosed in note 2 (j).

(f) *Expenses*

Commissions payable on the sales of insurance and investment products are recognised in the income statement in full at the commencement of the policy, for both single and regular premium business.

(g) *Employee benefits*

The Company does not employ any staff. All staff undertaking work on behalf of the Company are employed by the Company's parent, HSBC Bank plc, and another group company, Marks and Spencer Financial Services plc, both of which make recharges to this Company for the services provided.

(h) *Income taxes*

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case the related income tax is also recognised in equity.

Current tax is the expected tax payable on the taxable profit for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided in full, using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes, and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax assets and liabilities are not discounted.

(i) *Intangible assets*

Deferred acquisition costs – insurance contracts

Acquisition costs comprise the direct and indirect costs arising as a result of obtaining and processing new insurance policies, including commissions payable. Deferred acquisition costs comprise the costs of acquiring insurance policies which are incurred during a financial year but relate to a subsequent financial year.

Notes to the Financial Statements (continued)

For non-linked business these costs are deferred as an explicit deferred acquisition cost asset, gross of tax, which is amortised over the full period in which the costs are expected to be recoverable. The full period referred to is usually the full contract term on each individual policy concerned.

Deferral of costs has been limited to the extent that:

- the costs in question have already been recovered (for example where the design of the policy provides for the recovery of costs as incurred);
- the costs in question are not recoverable against future margins from the related policies in force at the balance sheet date; and
- the receipt of future premiums or the achievement of future margins is insufficiently certain based on prudent estimates of future experience.

Deferred acquisition costs – investment contracts

There were no material acquisition costs in respect of investment contracts as no incremental costs are incurred on acquisition.

Amortisation

Amortisation is recognised in the income statement on a straight-line basis over the estimated useful lives of the contracts.

(j) *Financial assets*

Financial assets are classified into the following categories:

- Financial assets at fair value through profit or loss are financial assets that, on initial recognition, are designated by the Company as being at fair value through profit or loss;
- Loans and receivables are non-derivative financial assets with fixed determinable payments that are not quoted in an active market, other than those that the Company upon initial recognition designates as at fair value through profit or loss.

All financial assets designated at fair value through profit or loss are managed, and their performance evaluated, on a fair value basis.

Purchases of financial assets are recognised on the trade date, which is when the Company commits to purchase the assets. Financial assets are de-recognised when contractual rights to receive cash flows from the investments expire, or when the investments, together with substantially all the risks and rewards of ownership, have been transferred.

Financial assets are initially measured at fair value plus, in the case of all financial assets not at fair value through profit or loss, transaction costs that are directly attributable to their acquisition. After initial recognition, the Company measures financial assets classified at fair value through profit or loss at fair value, without any deduction for transaction costs it may incur on disposal. The fair value of quoted investments is their quoted bid prices at the balance sheet date.

Realised gains and losses, and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss, are included in the income statement in the period in which they arise. Net fair value gains/losses on financial assets designated at fair value through profit or loss are reported in the income statement inclusive of interest received and receivable from debt securities.

Dividends are included in income on the date that the securities are quoted ex dividend. Interest income represents interest calculated on an effective yield basis.

Loans and receivables are stated after initial recognition at amortised cost less impairment losses (see note 2 (m)).

(k) *Other receivables*

Other receivables are stated at their cost less impairment losses (see note 2 (m)).

(l) *Cash and cash equivalents*

Cash and cash equivalents comprise cash balances and short term deposits.

(m) *Impairment*

The carrying amounts of the Company's assets, other than financial assets classified as fair value through profit and loss, are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the recoverable amount is estimated and the carrying value is reduced to the estimated recoverable amount by means of a charge to the income statement.

An impairment loss in respect of a financial asset classified as a loan and receivable is reversed if the subsequent increase in value can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of other assets is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(n) *Provisions*

A provision is recognised in the balance sheet when the Company has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. Where appropriate, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and risks specific to the liability.

Onerous contracts

A provision for onerous contracts is recognised when the expected benefits to be derived by the Company from a contract are lower than the unavoidable cost of meeting its obligations under the contract.

(o) *Other payables*

Other payables are stated at cost.

3 Critical accounting estimates and judgements in applying accounting policies

The Company makes estimates and assumptions concerning the future that have a significant risk of causing a material adjustment to the reported amounts of assets and liabilities within the next financial year. Estimates and assumptions are continually evaluated and based on prudent assessments of historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Policyholder claims and benefits

The estimation of future benefit payments and premiums arising from long-term insurance contracts is the Company's most critical accounting estimate. The determination of the liabilities under long-term insurance contracts is dependent on estimates made by the Company.

Estimates are made as to the expected number of deaths for each of the years in which the Company is exposed to risk. The Company bases these estimates on standard industry and national mortality tables that reflect recent historical mortality experience, adjusted where appropriate to reflect the Company's own experience. The estimated number of deaths determines the value of the benefit payments. The main source of uncertainty is that epidemics such as AIDS, SARS and wide-ranging lifestyle changes, such as in eating, smoking and exercise habits, could result in future mortality being significantly worse than in the past for the age groups in which the Company has exposure to mortality risk.

During the year under review, the Company has taken steps to significantly reduce its exposure to mortality risk by restructuring its reinsurance arrangements.

Notes to the Financial Statements (continued)

Estimates are also made as to the expected number of critical illness claims for each of the years in which the Company is exposed to risk. The Company bases these estimates on reinsurer rates, adjusted where appropriate to reflect the Company's own experience. The estimated number of claims determines the total value of the benefit payments. The main source of uncertainty is that medical advancements and widescale public health screening programs could lead to a significant increase in the early diagnosis and treatment of the diseases covered in the policy conditions.

Estimates are also made as to future investment income arising from the assets backing long-term insurance contracts. These estimates are based on current market returns as well as expectations about future economic and financial developments. The average estimated rate of investment return is 4.1%. Were the average future investment returns to reduce from management's estimates, the insurance liability would increase although this would be offset by corresponding asset movements.

Accounting for tax

The tax basis of the Company is the I minus E basis. Notwithstanding, due to uncertainty over application of current tax law and revenue practice, the current tax estimate has been made on the assumption that tax would be payable on the Company's profit for the year.

4 Management of insurance and financial risk

The Company issues contracts that transfer insurance risk or financial risk or both. This section summarises these risks and the way the Company manages them.

Insurance risk

The insurance contracts sold by the Company offer a lump sum payable on death or on diagnosis of certain specified critical illnesses. The customer premium is generally guaranteed throughout the term of the contract irrespective of any variations in experience.

The risk under any one insurance contract is the possibility that the insured event occurs and, in some cases, the uncertainty of the amount of the resulting claim. By the very nature of an individual insurance contract, this risk is random and therefore unpredictable.

The Company does not actively operate in the group protection market and the spread of business is generally geographically diverse within the United Kingdom. As a result of this, there is no significant concentration of insurance risk.

The Company, which is now effectively operating as a closed book, managed its insurance risk through strict underwriting procedures and claims management. Medical selection was included in the Company's underwriting procedures, with premium varied to reflect the health condition and family medical history of the applicants.

Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability about the expected outcome will be. The Company uses reinsurance appropriately to reduce variability of the losses incurred by the Company and has reinsurance contracts in place to mitigate a proportion of mortality and morbidity risk and all longevity risk. In addition, reinsurance is used where it is judged to be economically advantageous to do so.

For term business, following a restructuring of the Company's reinsurance arrangements during the year under review, almost all of the Company's mortality risk is fully reinsured. The Company's whole of life book ("Over-50's Plan") is not reinsured, although the average sum assured per life assured is small (approximately £4,000).

The Company's current reinsurance arrangements are as follows:

Business Type	Operating Type	Retention
Mortality (Term business)	Quota Share	Nil
Morbidity	Quota Share plus Surplus	50% to a max. of £75k
Longevity	Quota Share	Nil

Financial risk

The Company is exposed to financial risk through its financial assets, financial liabilities (investment contracts), reinsurance assets and insurance liabilities. In particular, the key financial risk is that the proceeds from its financial assets are not sufficient to fund the obligations arising from its insurance and investment contracts. The most important components of this financial risk are market risk, credit risk and liquidity risk.

Asset/liability matching

The Company actively manages its assets using an approach that balances quality, diversification, asset/liability matching, liquidity and investment return. The goal of the investment process is to optimise the net of taxes, risk-adjusted investment income and risk-adjusted total return, whilst ensuring that the assets and liabilities are managed on a cash flow and duration basis. The Company's senior management reviews and approves target portfolios on a periodic basis, establishing investment guidelines and limits, and providing oversight of the asset/liability management process.

For unit-linked insurance and investment contracts, the Company matches all the assets on which the unit prices are based with assets in the unit-linked portfolios. There is therefore no net equity price, currency, interest rate or credit risk exposure for these contracts.

The following table analyses the Company's assets and liabilities between the main insurance and investment contract types.

At 31 December 2006

	Insurance contracts Non-linked	Investment Contracts Unit-linked	Other	Total
	£000	**£000**	**£000**	**£000**
Assets				
Intangible assets	—	—	**9,456**	**9,456**
Financial assets	**25,425**	**218,556**	**49,101**	**293,082**
Reinsurance assets	**17,928**	—	—	**17,928**
Cash and cash equivalents	—	**5,501**	**49,057**	**54,558**
Other assets	—	**327**	**6,637**	**6,964**
Total assets	**43,353**	**224,384**	**114,251**	**381,988**
Liabilities				
Insurance contract provisions	**43,353**	—	—	**43,353**
Financial liabilities	—	**224,149**	—	**224,149**
Other liabilities	—	**235**	**24,902**	**25,137**
Total liabilities	**43,353**	**224,384**	**24,902**	**292,639**

At 31 December 2005

	Insurance contracts Non-linked	Investment contracts Unit-linked	Other	Total
	£000	**£000**	**£000**	**£000**
Assets				
Intangible assets	—	—	14,959	14,959
Financial assets	51,534	190,020	17,678	259,232
Reinsurance assets	3,427	—	—	3,427
Cash and cash equivalents	—	5,820	46,088	51,908
Other assets	—	—	3,431	3,431
Income taxes	—	—	811	811
Total assets	54,961	195,840	82,967	333,768

Notes to the Financial Statements (continued)

	Insurance contracts Non-linked	Investment contracts Unit-linked	Other	Total
	£000	£000	£000	£000
Liabilities				
Insurance contract provisions	54,961	—	—	54,961
Financial liabilities	—	195,589	608	196,197
Other liabilities	—	251	12,910	13,161
Total liabilities	54,961	195,840	13,518	264,319

'Other' relates to balances attributable to shareholders.

Market risk

Market risk can be described as the risk of change in fair value of a financial instrument due to changes in interest rates, equity prices or foreign currency exchange rates. Equity and foreign exchange exposure is all contained within the unit-linked funds and the risk is borne by the policyholders.

Interest rate risk

The Company's exposure to market risk from changes in interest rate is concentrated in its non-linked and 'other' investment portfolios. However, changes in investment values attributable to interest rate changes are mitigated by partially offsetting changes in the economic value of insurance provisions. The Company monitors this exposure through periodic reviews of its asset and liability positions. Estimates of cash flows, as well as the impact of interest rate fluctuations relating to its investment portfolio and insurance liabilities, are modelled and reviewed quarterly. The overall objective of these strategies is to limit the net changes in the value of assets and liabilities arising from interest rate movements.

Credit risk

The Company has exposure to credit risk which is the risk that a counterparty will be unable to pay amounts in full when due. The main areas where the Company is exposed to credit risk are:

- the default risk of a corporate bond provider, in which the non-linked and 'other' funds invest;
- the default risk of a deposit provider, in which the non-linked and 'other' funds invest; and
- the default risk of a reinsurer currently used by the Company.

The Company's guidelines for the investment of non-linked assets and the selection of reinsurers, include restrictions designed to minimise the risk of credit exposure. For this purpose, the Company sets internal limits on exposure to a single counterparty, by reference to the credit rating of the counterparty.

The carrying value of assets represents the maximum amount of credit risk exposure. The only significant concentrations of credit risk are in relation to the Company's reinsurers. Exposures to individual reinsurers are managed within regulatory limits. Further information on exposures to reinsurers is set out in note 19.

Liquidity risk

The Company has to meet daily calls on its cash resources, notably from claims arising on its insurance and investment contracts. There is therefore a risk that cash will not be available to settle liabilities when due.

The Company's policy for managing this risk is to ensure that all securities are capable of meeting the FSA's definition of 'readily realisable' to the extent that they are capable of being realised for a value equivalent to at least 97.5% of their current market value within a period of seven days.

The Company also holds a sufficient level of cash balances at all times, such that normal operational cash flows can be met without the sale of investments.

Short-term liquidity management is undertaken on a daily basis. Longer-term liquidity risk is managed on an ongoing basis through the regular review of the investment portfolio to align the maturity profile with that of the projected actuarial liabilities.

Operational Risk

Operational risk management responsibility is assigned at senior management level within the business operation. Operational risks are identified by assessments of risks inherent in processes, activities and products. Risk assessment incorporates a regular review of identified risks to monitor significant changes.

5 Net insurance premium revenue

All business is written in the UK.

Premiums written

	2006			2005		
	Gross	***Reinsurance***	***Net***	*Gross*	*Reinsurance*	*Net*
	£000	**£000**	**£000**	£000	£000	£000
Long-term insurance contracts and annuities						
Non-linked contracts — periodic premium	**14,609**	**5,799**	**8,810**	15,345	4,201	11,144
Annuities	**1,575**	**1,575**	**—**	921	921	—
Net insurance premium revenue	**16,184**	**7,374**	**8,810**	16,266	5,122	11,144

6 Fees and commission income

	2006	2005
	£000	£000
Fee income		
Fund management based fees	**1,459**	1,199
Front-end fees recognised in the year	**46**	238
Commission income		
Reinsurance commission	**—**	707
Rebated annual management charges	**2,730**	2,299
	4,235	4,443

7 Financial income

	2006	2005
	£000	£000
Interest income	**1,165**	665
Dividend income	**1,674**	1,427
Net fair value gains on assets designated at fair value	**16,645**	33,969
	19,484	36,061

Comparatives in respect of 2005 have been restated by the reallocation of £5,096,000 from 'Interest' income to 'Net fair value gains on assets designated at fair value'.

Notes to the Financial Statements (continued)

8 Insurance Claims and Benefits

	2006	2005
	£000	£000
Long-term insurance contracts		
— claims and benefits paid	**4,820**	8,542
— (decrease)/increase in liabilities	**(12,117)**	3,245
Total cost of policyholder claims and benefits	**(7,297)**	11,787
Reinsurers' share of claims and benefits paid		
— claims and benefits paid	**(4,217)**	(4,407)
— (increase) in asset	**(13,992)**	—
Total cost of policyholder benefits	**(25,506)**	7,380

9 Investment contract benefits

Investment contract benefits of £18,705,000 (2005: £30,659,000) represents changes in the fair value of investment contract liabilities. All investment contracts are designated as at fair value through profit or loss.

This amount represents the total amount recognised in the income statement for the change in fair value of liabilities estimated using a valuation technique.

10 Acquisition costs and administrative expenses

a) Expenses for the acquisition of insurance and investment contracts	2006 £000	2005 £000
Amortisation of intangible asset (Note 13)	**5,621**	1,896
Costs incurred for the acquisition of insurance contracts expensed in the year	**168**	629
Costs incurred for the acquisition of investment contracts expensed in the year	—	49
Total acquisition expenses	**5,789**	2,574

b) Administrative expenses	2006 £000	2005 £000
Purchase of goods and services	**2,296**	1,138
Other costs	**2,374**	2,235
Total administrative expenses	**4,670**	3,373

Acquisition costs and administrative expenses comprise the following:

c) Expenses by nature	**2006** **£000**	2005 £000
Amortisation of intangible assets	**5,621**	1,896
Increase in intangible asset	**(118)**	(177)
Commission payable	**114**	335
Purchase of goods and services	**2,296**	1,138
Other expenses	**2,546**	2,755
Total acquisition costs and administrative expenses	**10,459**	5,947

Administrative expenses include:

d) Audit fees	**2006** **£000**	2005 £000
Amounts receivable by the auditors in respect of the audit of these financial statements	**68**	70
Amounts receivable by the auditors and their associates in respect of:		
— Other services pursuant to legislation	**56**	35
— Other Services	**1**	5
	125	110

11 Directors' remuneration

The Chairman and three other directors who served during the year (2005: seven) were remunerated by other Group undertakings which made no specific charge to this Company for their services. The emoluments of the other directors in respect of their services to the Company are shown below.

	2006 **£000**	2005 £000
Emoluments	**103**	82
Pension scheme contributions	**3**	2
	106	84

Details of directors who exercised share options during the year are given in the directors' report on page 3.

The Company does not have any direct employees. The directors and staff are all employees of other Group undertakings.

With the exception of the independent non-executive director, retirement benefits are accruing to the directors under schemes operated by their employing companies. Retirement benefits are accruing to four directors under defined benefit schemes and to two directors under money purchase schemes at 31 December 2006 (2005: three and two respectively). The directors are members of retirement benefit schemes operated by HSBC Bank plc. Details of these schemes can be found in the Annual Report and Accounts of HSBC Bank plc. The Company does not receive any explicit charges in respect of the costs of contributions to the retirement benefit schemes for the directors and staff. It has no liability in respect of any deficit within the scheme, although any surplus or deficit may affect the level of costs recharged to the Company in future periods.

Notes to the Financial Statements (continued)

12 Income tax expense

a *Recognised in the income statement*

	2006	2005
	£000	£000
Current tax expense		
Current year	10,722	1,453
Adjustments for prior years	146	(396)
Total current tax	10,868	1,057
Deferred tax expense		
Origination and reversal of temporary differences	(2,131)	(243)
Total deferred tax	(2,131)	(243)
Total income tax expense in income statement	8,737	814

b *Reconciliation of effective tax rate*

The tax assessed for the year is different to the standard rate of corporation tax in the UK (30 per cent). The differences are explained below:

	2006	2005
	£000	£000
Profit before tax	28,637	7,317
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30% (2005: 30%)	8,591	2,195
Effects of:		
Deferred tax	—	(243)
UK tax bases of insurance profits	—	(742)
Adjustments for prior years	146	(396)
Tax charge for the period	8,737	814

13 Intangible assets

As part of the Company's insurance business, certain acquisition costs are deferred. An analysis of these assets is set out below.

	Insurance contracts deferred acquisition costs
	£000
Year ended 31 December 2005	
Balance at 1 January 2005	16,678
Additions	177
Amortisation	(1,896)
Balance at 31 December 2005	14,959

	£000
Year ended 31 December 2006	
Balance at 1 January 2006	**14,959**
Additions	**118**
Amortisation	**(5,621)**
Balance at 31 December 2006	**9,456**

The deferred acquisition costs are amortised over the remaining expected life of each insurance contract. This is estimated using appropriate assumptions for terminations and lapses. The average amortisation period is 16 years. The amortisation has increased significantly from 2005 to 2006. This is because deferral of costs is limited to the extent that the costs in question are not recoverable against future margins from the related policies in force at the balance sheet date. The reinsurance restructure during 2006 has decreased the amount of such future margins.

14 Financial assets

The Company's financial assets are summarised below by measurement category.

	2006	2005
	£000	£000
Designated at fair value through profit or loss	**293,082**	259,232
Total financial assets	**293,082**	259,232

Financial assets at fair value through profit or loss	**2006**	2005
	£000	£000
Debt securities – fixed interest rate:		
- government bonds	**72,042**	78,456
Debt securities – floating interest rate:		
- government bonds	—	9,965
- listed	**23,890**	—
Collective investment schemes - unlisted	**197,150**	170,811
Total financial assets at fair value through profit or loss	**293,082**	259,232
Expected to be recovered in no more than one year	**30,389**	35,085
Expected to be recovered after more than one year	**262,693**	224,147
	293,082	259,232

The Company does not hold any financial assets for trading.

The fair value of the unlisted collective investment schemes are determined from daily prices quoted by Marks and Spencer Unit Trust Management Limited, in whose funds these financial assets are invested.

Notes to the Financial Statements (continued)

15 Insurance and other receivables

	2006	2005
	£000	£000
Receivables arising from insurance and reinsurance contracts:		
- due from contract holders	463	485
- due from reinsurers	4,892	1,788
Other loans and receivables:		
- accrued income	1,599	1,146
- receivables due from related parties (Note 24)	9	8
- other receivables	1	4
	6,964	3,431
Expected to be recovered in less than one year	6,964	3,431
Expected to be recovered after one year	—	—
	6,964	3,431

The carrying amount of loans and receivables is considered to be a reasonable approximation of their fair value.

16 Cash and cash equivalents

	2006	2005
	£000	£000
Bank and cash balances	6,790	8,608
Short-term bank deposits	47,768	43,300
Cash and cash equivalents in the statement of cash flows	54,558	51,908

The effective interest rate on short-term bank deposit was 5.1% (2005: 4.6%), with an average maturity of 10 days (2005: 10 days).

17 Share capital

	2006	2005
	£000	£000
Authorised:		
100,000,000 ordinary shares of £1 each	100,000	100,000
Allotted, called up and fully paid:		
80,500,000 ordinary shares of £1 each	80,500	80,500

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. All shares rank equally with regard to repayment of capital.

18 Retained earnings

	2006 £000	2005 £000
Retained earnings	**8,849**	(11,051)

The retained earnings balance is not distributable as it must be kept in compliance with the solvency capital regulations that the Company is subject to.

19 Insurance liabilities and reinsurance assets

	2006 £000	2005 £000
Gross		
Long-term insurance contracts:		
— non-linked	**38,534**	51,534
Annuities	**4,819**	3,427
Total insurance liabilities, gross	**43,353**	54,961
Reinsurance		
Long-term insurance contracts:		
— non-linked	**13,109**	—
Annuities	**4,819**	3,427
	17,928	3,427
Net		
Long-term insurance contracts:		
— non-linked	**25,425**	51,534
Annuities	—	—
Total insurance liabilities – net	**25,425**	51,534
Amounts expected to be settled in less than one year	—	6,500
Amounts expected to be settled after one year	**25,425**	45,034
	25,425	51,534

Long-term life insurance contracts – assumptions, change in assumptions and sensitivity

(a) **Process used to decide on assumptions**
For the non-linked liabilities the insurance contract provisions are calculated using a gross premium basis. The provision is calculated by subtracting the present value of future premiums from the present value of future benefits payable under the policy until it ceases on maturity or at death if earlier. The gross premium method makes explicit allowance for future commission and policy maintenance costs (with an appropriate allowance for inflation).

The principal assumptions underlying the calculation of the insurance contract provisions are:

Mortality
A base mortality table is selected which is most appropriate for each type of contract. The mortality rates reflected in this table are adjusted by the expected mortality based on a statistical investigation into the Company's mortality experience over the most recent five years. Margins for prudence of 25% are added to the best estimate of experience.

Notes to the Financial Statements (continued)

Morbidity (Critical Illness)
An appropriate basis table, based on the rate table produced by the Company's reinsurers, is selected for each type of contract. Margins for prudence of 25% are added to the best estimate of experience.

Persistency

The long-term liabilities are calculated assuming that there are no policy lapses.

Discount rates

	2006	2005
Non-linked	3.90%	3.60%

For many of the life insurance products, the interest rate risk is managed through asset/liability management strategies that seek to match the interest rate sensitivity of the assets to that of the underlying liabilities. The overall objective of these strategies is to limit the net change in value of assets and liabilities arising from interest rate movements. While it is more difficult to measure the interest rate sensitivity of the Company's insurance liabilities than those of the related assets, to the extent that the Company can measure such sensitivities, it believes that interest rate movements will generate asset value changes that substantially offset changes in value of the liabilities relating to the underlying products.

Renewal expenses and inflation
There has been a strengthening of the expense basis based on current and anticipated levels of activities and costs for 2005 and 2006.

Expense inflation is assumed to be 1.9% above expected long term inflation rates in the UK. This margin over expected long term rates recognises that the Company has an inflation risk in respect of it being largely closed to new business.

Taxation
The Company has assumed that the application of current tax legislation and rates will not change.

Key assumptions
The principal assumptions (including margins of prudence) used to value the main classes of business were as follows (assumptions for 2005 are shown in brackets where these have changed):

Class of business	Renewal expenses (p.a.)	Mortality	Morbidity	Interest rate (p.a.) (before tax)
Term assurance – non-convertible	£29.20 (£24.20)	67% TM92 Ult male non-smoker[1] (72% TM92 Ult male non-smoker[1])	N/a	3.90% (3.60%)
Term assurance – convertible	£29.20 (£24.20)	115% of non-convertible rates	N/a	3.90% (3.60%)
Whole of Life	£29.20 (£24.20)	103% AM80 Ult male non-smoker[1] (121% AM80 Ult male non-smoker[1])	N/a	3.90% (3.60%)
Critical Illness Plan	£29.20 (£24.20)	N/a	155% of Reinsurance Rates, with no allowance for policyholder premium increases[2] 145% of Reinsurance Rates, with no allowance for policyholder premium increases[2]	3.90% (3.60%)

[1] Rates are adjusted for gender and by smoker/non-smoker differentials.
[2] Rates vary by gender and by smoker status.

(b) Change in assumptions

Overall there has been a weakening in the basis for Insurance business.

The reduction in the long-term insurance liability as a result of changes in assumptions was £3,276,000 (net of reinsurance). The following table gives an analysis of this movement by source:

	Net Liability Movement
	£000
Economic assumptions	(495)
Mortality and morbidity assumptions	(1,400)
Expense assumptions	
- Maintenance expenses	1,900
- Expense inflation	1,500
- Release of System Transfer project expenses	(5,500)
- Group Insurance System project expenses	719
Total movement resulting from assumption changes	**(3,276)**

(c) Sensitivity analysis

	Profit impact (before tax)	
	2006	2005
Base Stress	**£000**	£000
Interest rates increasing 100 basis points	**(2,340)**	(446)
Interest rates reducing 100 basis points	**2,851**	416
All mortality and morbidity rates increasing by 10%	**(1,010)**	(10,966)
All mortality and morbidity rates reducing by 10%	**1,059**	10,482
Long-term expense assumptions increase by 10%	**(1,892)**	(1,746)
Long-term expense assumptions reduce by 10%	**1,831**	1,721

The analysis above allows for corresponding changes in the value of related assets but assumes all other assumptions remain constant.

Both the increased sensitivity to interest rate changes and the reduced sensitivity to changes in mortality/morbidity rates result from the restructure of the company's reinsurance arrangements during 2006.

Movements in insurance liabilities and reinsurance assets

Long-term – Non-linked	**Gross £000**	**Reinsured £000**	**Net £000**
At 1 January 2005	50,732	2,447	48,285
Reserve held in respect of business written in 2005	1,534	1,284	250
Development of existing business	4,574	(304)	4,878
Changes to bases	(1,643)	—	(1,643)
Changes to modelling	393	—	393
Other movements	(629)	—	(629)
At 31 December 2005	54,961	3,427	51,534

Notes to the Financial Statements (continued)

Long-term – Non-linked	Gross £000	Reinsured £000	Net £000
At 1 January 2006	54,961	3,427	51,534
Reserve held in respect of business written in 2006	1,967	1,767	200
Development of existing business	3,136	(375)	3,511
Changes to bases	(16,711)	(13,435)	(3,276)
Other movements	—	26,544	(26,544)
At 31 December 2006	43,353	17,928	25,425

'Other movements' of £26,544,000 relates soley to the restructure of the Company's reinsurance arrangements.

A summary of the reinsurer exposure by credit rating is shown below (the figures shown are the reinsurers' share of insurance liabilities and amounts due from reinsurers).

At 31 December 2006	Non-linked insurance £000
AA- to AA+	18,001
A- to A+	4,819
	22,820

At 31 December 2005	Non-linked insurance £000
AA- to AA+	1,788
A- to A+	3,427
	5,215

20 Investment contract liabilities

	2006 £000	2005 £000
Investment contracts at fair value through income (unit-linked)	224,149	195,589
Amounts expected to be settled in no more than one year	6,954	6,552
Amounts expected to be settled in more than one year	217,195	189,037
	224,149	195,589

The benefits offered under the Company's unit-linked investment contracts are based on the returns on selected equities, debt securities and cash deposits. The investment mix is unique and cannot be associated to an individual benchmark index with a sufficiently high correlation with the asset selection operated by the Company for its linked funds.

All financial liabilities at fair value through profit or loss are designated by the Company to be in this measurement category.

The maturity value of these financial liabilities is determined by the fair value of the linked assets at maturity date. There will be no difference between the carrying amount and the maturity amount at maturity date.

21 Bank overdrafts

	2006 £000	2005 £000
Unsecured bank facility	—	608

22 Insurance, other payables and deferred income

	2006 £000	2005 £000
Direct insurance contract payables	**3,252**	4,134
Reinsurance contract payables	**4,791**	312
Amounts due to related parties (Note 24)	**1,488**	1,120
Other payables and accrued expenses	**480**	415
Deferred income	**366**	412
	10,377	6,393
Amounts expected to be settled in less than one year	**10,011**	5,981
Amounts expected to be settled after one year	**366**	412
	10,377	6,393

Deferred income relates to front-end fees received from investment contract holders as a prepayment for asset management and related services. These amounts are non-refundable and are released to income as the services are rendered (Note 6).

The carrying amount of insurance, other payables and deferred income is considered to be a reasonable approximation of their fair value.

23 Deferred income tax

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following:

	Assets		Liabilities		Net	
	2006 £000	2005 £000	2006 £000	2005 £000	2006 £000	2005 £000
Intangible assets	—	—	**2,837**	4,488	**(2,837)**	(4,488)
Insurance contract provisions	—	—	**1,910**	2,404	**(1,910)**	(2,404)
Deferred income	**110**	124	—	—	**110**	124
	110	124	**4,747**	6,892	**(4,637)**	(6,768)

Notes to the Financial Statements (continued)

Unrecognised deferred tax assets

	2006	2005
	£000	£000
Tax losses	6,517	6,803

A deferred tax asset has not been recognised in respect of these losses as the directors consider that it is unlikely that taxable income will exceed expenses in the short term in normal trading.

Movement in temporary differences during the year

	2006	2005
	£000	£000
Balance at 1 January	6,768	7,011
Recognised in income	(2,131)	(243)
At 31 December	4,637	6,768

24 Related-party transactions

The Company is controlled by Marks and Spencer Retail Financial Services Holdings Ltd. (incorporated in England and Wales) which owns 100% of the Company's shares. The ultimate parent company is HSBC Holdings plc (incorporated in England and Wales). HSBC Bank plc (incorporated in England and Wales) is the parent company of the smallest group to consolidate these financial statements. The consolidated accounts of HSBC Holdings plc and HSBC Bank plc are available to the public and may be obtained from the registered office at 8 Canada Square London E14 5HQ.

Transactions with related parties are summarised as follows:

a) Income

	2006	2005
	£000	£000
Fees and commission income:		
Other group companies	2,730	2,189

Income from related party transactions arises from annual management charges rebated to the Company in respect of its holdings in collective investment schemes managed by other group companies.

b) Expenditure

	2006	2005
	£000	£000
Acquisition costs:		
Other group companies	114	335
Administrative expenses:		
Other group companies	3,632	3,799
Expenses for asset management services:		
Other group companies	96	41
	3,842	4,175

Expenditure from related party transactions arises from:

- Commission payable to another group company for sales of the Company's products. The Company's products are marketed and sold primarily by Marks and Spencer Financial Services plc through its sales channels. Commission is payable on commencement of the policy.
- Costs charged to the Company for the provision of management services. These include product management, customer services, risk management, actuarial, finance, human resources, property services and IT. The Company is recharged for the actual costs incurred in undertaking these activities.
- Reimbursements made relating to the Company's direct costs paid by other group companies.
- Costs charged to the Company by other group companies for the provision of investment accounting and unit pricing services.

c) Key management compensation

The Company does not have any direct employees. The directors and staff are all employees of other group companies. The costs recharged to the Company include amounts in respect of key management compensation relating to directors services to the Company, which are disclosed in Note 11.

Key management transact with the Company and other companies within the HSBC group through the purchase of standard products in the ordinary course of business and on substantially the same terms as for comparable transactions with persons of a similar standing or, where applicable, with other employees of the group.

d) Year-end balances with related parties

	2006	2005
	£000	£000
Assets		
Insurance and other receivables:		
Other group companies	**9**	8
Liabilities		
Insurance, other payables and deferred income:		
Other group companies	**1,488**	1,120