FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED
REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2007 04096141

DIRECTORS

Sir ADRIAN MONTAGUE CBE, MA (Chairman)
S J CLAMP BA, R J W CROUCH BSc (Hons), MBA, A R G GUNN MA, FCII,
M A HAMPTON MA, FPMI, B HARRISON MA FIA, A P JACKSON BSc, FIA, R SEPE BSc, FIA,
J R SMART MBA, B Com, CPFA, FCCA, J STEVENS BSc, FIA,
P T TUNNICLIFFE MSc, J A WARD MA, K J WATKINS

SECRETARY

R G ELLIS MA, APMI Solicitor

PRINCIPAL ACTIVITY

Friends Provident Life and Pensions Limited (the Company) is a wholly owned subsidiary of Friends Provident plc It operates as part of the UK Life and Pensions segment of the Friends Provident Group (the Group)

The Company is authorised by the Financial Services Authority (FSA) to transact ordinary long-term insurance business in the United Kingdom No significant change in this activity is envisaged in the future

As the Company is not managed as a standalone entity, but as part of the Group's UK Life and Pensions segment, the directors believe that these financial statements should not be viewed in isolation from other Group undertakings Thus, where appropriate, reference has been made to Friends Provident plc's 2007 Group Annual Report and Accounts for further information and explanations

A fellow Group undertaking, Friends Provident Management Services Limited (FPMS), provides the Company's services and administration and employs all staff Accordingly, the Company has no direct employees

RESULTS AND BUSINESS REVIEW

Strategic review

The Group announced on 31 January 2008 the outcome of a significant strategic review The proposed strategy will see the Group focus on core segments of the UK and International life and pensions market and will no longer seek to build a presence in the UK wealth management sector, including Wraps

Within the UK protection market, the Company, through its subsidiaries, aims to maintain its market share and continue to enter new segments However, it will adopt a more tactical approach to the marketing of savings and investments offering them only when adequate returns are available In the group pensions market and vesting annuity market, the Company intends to enhance profitability by ceasing to pay initial commission on new schemes and focus on acquiring larger schemes It will adopt a more tactical approach to the marketing of individual pensions in the UK, offering them only when adequate returns are available Also it will no longer build a presence in the UK wealth management sector, other than by manufacturing and administering life and pensions products

The section 'The change in strategy explained' of Friends Provident plc's 2007 Group Annual Report and Accounts provides further information regarding the new Group strategy

RESULTS AND BUSINESS REVIEW (continued)

Trading performance and outlook

The Company is the holding company of Friends Provident Life Assurance Limited (FPLAL) and Friends Provident Pensions Limited (FPP) No consolidated accounts are prepared for the Company as it is a 100% owned subsidiary of Friends Provident plc Most UK new business is written directly by the companies FPLAL and FPP The decrease in earnings and fee and commission income that is earned by the Company is due to new business now being written directly to these other subsidiaries

The Company's results show 'earned premiums net of reinsurance' have decreased by 11% to £380m (2006 £423m) However, only premiums from insurance contracts are included within the long-term business technical account Fee and commission income generated by investment contracts has decreased by 51% to £18m (2006 £37m)

New business premiums on an APE basis (APE represents gross new regular premiums plus 10% of gross new single premiums) have increased by 8% to £40m (2006 £32m) including both insurance and investment contracts, mainly through increased pension sales

As part of the Annual Review within Friends Provident plc's 2007 Group Annual Report and Accounts, the sections of the Operational Review 'UK Protection', 'UK Pensions', 'UK Annuities' and 'UK Savings and Investments', of which the Company forms a part, outlines the Group's view of its strengths and strategies for operating in these market segments, and its outlook for these markets The section also reviews performance against Key Performance Indicators (KPIs)

The key strategies for UK Protection, UK Pensions, UK Annuities and UK Savings and Investments are

- **UK Protection** – to maintain its strong presence in individual protection and grow its share of the group protection market

- **UK Pensions** – to improve the economics of its UK pensions business by focusing on segments of the market that provide acceptable financial returns For Group pensions, the strategy is to cease to pay initial commission on new schemes and to focus on acquiring larger schemes written by distributors that do not typically receive initial commission For individual pensions the strategy is to write this business on a selective basis where it can improve overall financial returns The development of this market will be monitored carefully

- **UK Annuities** – to focus on offering competitively priced annuities, through maintaining and enhancing efficiency, to customers who have saved a pension with the Group with the objective of increasing the percentage of existing customers who purchase an annuity with us, and also to increase the number of potential vestings by growing the portfolio of group pensions schemes and individual pensions contracts that feed the annuity business

- **UK Savings and Investments** – to adopt a tactical approach to savings and investment products offering them only when adequate financial returns are available, improving profitability through reducing acquisition costs and being more selective about the terms of the new business written Investment bonds will continue to be sold and new products will be devised to attract pension savings and income drawdown prior to annuity purchase using existing expertise and franchise

RESULTS AND BUSINESS REVIEW (continued)

Financial performance (continued)

The 'loss on ordinary activities before tax' as set out on page 9, is £101m (2006 profit £509m) The transfer from the long-term business technical account to the non-technical account is £64m (2006 £269m) This amount includes tax movements arising within the long-term funds The transfer for the year results from

- net impact of other changes to actuarial reserving of £10m, including PS06/14 change to the regulatory reserving rules (see note 2 to the financial statements),
- profit released from the in-force business £63m being transferred to shareholders,
- shareholders' share (£11m) of the cost of the bonus, representing 1/9th of the total bonus allocated to the With-Profits Fund policyholders,
- release of long-term business provision for review of other sales of £14m,
- tax credit of £20m,

being offset by

- new business strain on a UK Generally Accepted Accounting Practice (UK GAAP) basis of £11m,
- widening of corporate bond yields as compared to yields on risk free government bonds causing the underlying value of assets to move by more than the corresponding movement in liabilities, reducing profit by £28m, and
- one-off pricing adjustment to unit linked assets of £15m

The non-technical account shows investment related losses before tax of £193m (2006 profit of £125m) largely resulting from the losses arising in other subsidiary companies in which the Company invests

Shareholders' funds have decreased to £2,499m (2006 £2,897m) representing a loss after tax for the year of £116m (2006 profit £387m) less a dividend payment of £250m (2006 £150m) and step-up tier one insurance capital securities (STICS) interest of £32m (2006 £32m)

Friends Provident plc's Group Annual Report and Accounts 2007 contains the section 'Financial review – profitability on the IFRS basis' This section includes UK Life and Pension key performance indicators that are monitored at that level This section has analysed the UK Life and Pensions underlying profit between its ongoing surplus, return on shareholders funds and principal reserving changes and one-off items Analysis is also provided within this section for new business strain and in-force surplus by product, on both a cash basis and IFRS basis

Financial strength

Assets and liabilities of the With-Profits Fund are calculated on a realistic basis Policyholder liabilities (including options and guarantees) are valued using a market consistent stochastic model

At 31 December 2007, surplus assets amounted to £274m and the Risk Capital Margin (RCM) was £247m The Company's objective is to manage the fund so that, over time, the RCM should be covered by assets within the Fund Accordingly the excess assets have been reserved for policyholders so that the surplus is equal to the RCM At 31 December 2006, surplus assets amounted to £254m and the RCM amounted to £220m leaving a surplus of £34m to be distributed through a reduction in policyholder charges

The Company's With-Profits Fund realistic balance sheet is resilient in the event of falls or rises in investment markets This is due in large measure to the actions we have taken to hedge the provisions made to cover the cost of guarantees and options

RESULTS AND BUSINESS REVIEW (continued)

Financial strength (continued)

The Free Asset Ratio (FAR), a common measure of financial strength is the ratio of assets less liabilities (including actuarial reserves but before the required regulatory solvency margin) expressed as a percentage of actuarial reserves On a FSA regulatory basis (which is a different basis to the UK GAAP basis under which the accounts have been prepared), this increased to 22 3% at the end of 2007 (2006 22 2%) and available assets to meet capital requirements decreased to £3,733m from £3,934m

The quality of the Company's regulatory capital is very high and does not include any implicit items

External agencies regularly perform independent assessments of the financial strength of life companies and publish their ratings Moody's has downgraded the Company's rating to A2 (strong) from A1 (strong) rating in January 2008, following the Group's strategic review, and its outlook changed from stable to negative At the same time both Standard and Poor's and Fitch downgraded their ratings of the Company to A (strong) from A+ (strong) and their outlook changed from stable to negative

The negative outlook is to be expected, as the ratings agencies will closely monitor the implementation of the strategy and further consider their views when the Group can demonstrate successful implementation of the strategy

Risks

Members of senior management are responsible for identifying and evaluating key risks facing their areas of the business Directors manage risks at both a segmental and individual business level The key operational risks facing the UK Life and Pensions segment and the responses to these risks that are applicable to the Company are

- **Changes to the distribution landscape** – UK Life and Pensions builds long-term relationships with distributors It has secured places on many best advice and multi-tie panels with leading distributor firms and innovative new entrants It has attracted all types of distributors by delivering excellent service, products and technology It monitors developments in the distribution sector and seeks to position itself in an appropriate way that plays to these strengths

- **Competitors develop more advanced IT solutions and service capability** – The UK Life and Pensions operating platform is highly regarded and its structure is designed for continuous development to be achieved UK Life and Pensions aims to retain its reputation for service and technology and monitors competitor activity carefully

- **Changes in volume or profitability in key market segments or emergence of new markets** – UK Life and Pensions monitors its relative product range and competitive position and analyses its experience of policy claims and lapses It uses this information to re-price its products or develop new ones, targeting those markets that it sees as most likely to grow and to be profitable

- **Changes or volatility in UK and global economic factors** – Changes in interest rates, house prices, earnings and price inflation and the availability of credit can all affect customers' disposable income UK Life and Pensions is not able to control the external economic environment but it monitors these factors so that it is able to adapt its approach to the market and expense base to help meet its targets and deliver on commitments to different stakeholders

- **Implementation of the Group's revised strategy** – An experienced team, led by senior management, is implementing the revised strategy Plans are being thoroughly assessed for risk and tested against a range of economic and investment scenarios to help ensure that the strategy is robust, well founded and capable of leading the refocused business forward UK Life and Pensions is seeking to ensure its people are engaged with and sympathetically led through the implementation process and that key skills and experience are retained in this time of change and uncertainty

The financial risks facing the Company are discussed in note 25 to the financial statements

FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED
REPORT OF THE DIRECTORS (continued)

RESULTS AND BUSINESS REVIEW (continued)

DIVIDEND

An ordinary dividend of £250m (2006 £150m) for the year ended 31 December 2007 was paid on 5 November 2007

DIRECTORS

Jim Smart was appointed director on 1 January 2007 James Ward, Kevin Watkins and Brian Harrison were appointed directors on 20 June 2007 Philip Moore resigned as director and chairman on 13 November 2007 having held office throughout the year to this date Sir Adrian Montague was appointed chairman and director on 19 December 2007 All other directors named on page 1 held office throughout the year

STATEMENT OF DISCLOSURE OF INFORMATION TO THE AUDITOR

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

AUDITOR

In accordance with section 487 of the Companies Act 2006, the Company has dispensed with the obligation to reappoint its auditors annually and KPMG Audit Plc will therefore continue in office

DIRECTORS AND OFFICERS – INDEMNITY AND INSURANCE

The Company maintains insurance cover with respect to directors' and officers' liabilities In addition, qualifying third party indemnity provisions (as defined in section 234 of the Companies Act 2006 and section 309B of the Companies Act 1985) are in force for the benefit of directors within the Group and were in force for the benefit of former directors of the Group during 2007 Copies of the indemnity are available for inspection at the company's registered office of Friends Provident plc

CREDITOR PAYMENT POLICY

Services and supplies to the Company are made through a fellow Group undertaking, FPMS, and accordingly, the Company does not have any trade creditors

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE REPORT OF THE DIRECTORS AND THE FINANCIAL STATEMENTS

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 financial statements for each financial year Under that law the directors have elected to prepare the financial statements in accordance with UK Accounting Standards

The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period In preparing these 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 applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business

The directors are responsible for keeping proper accounting records 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 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 Under applicable law the directors are also responsible for preparing a report of the directors that complies with that law

The directors confirm that they have complied with these requirements

ON BEHALF OF THE BOARD

R G ELLIS
SECRETARY

Pixham End
Dorking
Surrey
RH4 1QA

25 March 2008

Registered Number 4096141

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED

We have audited the financial statements of Friends Provident Life and Pensions Limited for the year ended 31 December 2007 which comprise the profit and loss account, the balance sheet 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 auditor

The directors' responsibilities for preparing the financial statements in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the statement of directors' responsibilities on page 6

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 information given in the report of the director 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 Report of the Directors 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 UK Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 December 2007 and of its loss for the year then ended,
- have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the report of the directors is consistent with the financial statements

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
London
Registered Auditor

25 March 2008

FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED
PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2007

LONG-TERM BUSINESS TECHNICAL ACCOUNT

	Notes	2007 £m	2006 £m
Earned premiums, net of reinsurance			
Gross premiums written	3	448	507
Outward reinsurance premiums	4	(68)	(84)
		380	423
Investment income	5	1,309	1,667
Other technical income, net of reinsurance	6	84	216
Total technical income		1,773	2,306
Claims incurred, net of reinsurance			
Claims paid			
- gross amount		1,485	1,515
- reinsurers' share		(188)	(198)
		1,297	1 317
Change in the provision for claims			
- gross amount		(6)	7
- reinsurers' share		-	1
		1,291	1,325
Change in other technical provisions, net of reinsurance			
Long-term business provision, net of reinsurance			
- gross amount	22,23	(616)	(913)
- reinsurers' share	22	8	344
		(608)	(569)
Technical provision for linked liabilities, net of reinsurance			
- gross amount	22,23	(13)	26
- reinsurers' share	22	30	(6)
		17	20
Investment contract liabilities, net of reinsurance			
- gross amount	22,23	83	1 425
- reinsurers' share	22	82	(886)
		165	539
		(426)	(10)
Net operating expenses	8	186	123
Investment expenses and charges	5	61	74
Unrealised losses on investments	5	530	459
Other technical charges, net of reinsurance	7	19	13
Tax attributable to the long-term business	9	3	58
Transfer to/(from) the fund for future appropriations		45	(5)
		844	722
Total technical charges		1,709	2,037
Balance on the long-term business technical account		64	269

Note:
All amounts above are in respect of continuing operations

The notes on pages 12 to 56 form an integral part of these financial statements

FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED
PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2007

NON-TECHNICAL ACCOUNT

	Notes	2007 £m	2006 £m
Balance on the long-term business technical account		64	269
Tax credit attributable to balance on long-term business technical account	9	27	115
Profit before tax from long-term business		91	384
Investment income	5	61	60
Unrealised gains on investments	5	-	81
Investment expenses and charges	5	(17)	(16)
Unrealised losses on investments	5	(236)	-
(Losses)/profit on ordinary activities before tax		(101)	509
Tax on (loss)/profit on ordinary activities	9	(15)	(122)
(Loss)/Profit for the financial year	21	(116)	387
Attributable to:			
Ordinary shareholders		(148)	355
Other equity holders	20	32	32
		(116)	387

Notes:

There are no recognised gains or losses for 2007 and 2006 other than the loss for the financial year Therefore no statement of total recognised gains and losses is presented

All of the amounts above are in respect of continuing operations

There is no difference between the results disclosed above and the results on a modified historical cost basis

The notes on pages 12 to 56 form an integral part of these financial statements

FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED
BALANCE SHEET
AS AT 31 DECEMBER 2007

ASSETS	Notes	2007 £m	2006 £m
Intangible assets			
Licence	11	-	1
Investments			
Land and buildings	12	358	428
Investments in Group undertakings and participating interests	13	2,745	2,953
Other financial investments	12	14,566	15,837
		17,669	19,218
Present value of acquired in-force business	14	34	37
Assets held to cover linked liabilities	12	4,370	4 060
Reinsurers' share of technical provisions			
Long-term business provision	22	534	542
Claims outstanding		7	7
Technical provisions for linked liabilities	22	150	180
Investment contract liabilities	22	5,549	5,628
		6,240	6,357
Debtors			
Debtors arising out of direct insurance operations			
- Policyholders		10	8
- Intermediaries		4	6
Other debtors	16	50	82
		64	96
Other assets			
Cash at bank and in hand		12	45
Prepayments and accrued income			
Accrued interest and rent		133	144
Deferred acquisition costs	17	62	154
Deferred fees and charges		-	5
Other prepayments and accrued income		4	2
		199	305
TOTAL ASSETS		28,588	30,119

The notes on pages 12 to 56 form an integral part of these financial statements

FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED
BALANCE SHEET
AS AT 31 DECEMBER 2007

LIABILITIES	Notes	2007 £m	2006 £m
Capital and reserves			
Called up share capital	18,21	654	654
Share premium account	21	721	721
Profit and loss account	21	613	1,011
Other equity	20,21	511	511
		2,499	2,897
Fund for future appropriations		341	296
Technical provisions			
Long-term business provision	22,23	9,933	10,549
Claims outstanding		55	61
		9,988	10,610
Technical provisions for linked liabilities	22,23	1,130	1,143
Investment contract liabilities	22,23	13,586	14,059
Provisions for other risks and charges	26	285	333
Creditors			
Preference shares	19	300	300
Creditors arising out of direct insurance operations		12	11
Creditors arising out of reinsurance operations		3	3
Other creditors including taxation and social security	27	432	464
		747	778
Accruals and deferred income		12	3
TOTAL LIABILITIES		28,588	30,119

Approved by the Board on 25 March 2008 and signed on its behalf by

SIR ADRIAN MONTAGUE
CHAIRMAN

The notes on pages 12 to 56 form an integral part of these financial statements

FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED
NOTES TO THE FINANCIAL STATEMENTS

1 ACCOUNTING POLICIES

(a) Basis of preparation

The financial statements have been prepared in accordance with section 255 of, and Schedule 9A to, the Companies Act 1985 with the exception set out in note 1(n) and comply with the Association of British Insurers (ABI) Statement of Recommended Practice on Accounting for Insurance Business (SORP) (Revised 2006)

The financial statements have also been prepared in accordance with applicable accounting standards and under the historical cost convention as modified by the revaluation of land and buildings, derivatives and financial assets and liabilities at fair value through profit and loss as set out in notes 1(n) and 1(u)

In accordance with Financial Reporting Standard (FRS) 1 Cash Flow Statements (Revised 1996), the Company is exempt from preparing a cash flow statement on the grounds that it is a wholly owned undertaking of a parent which provides a cash flow statement in its consolidated financial statements which are publicly available

The Company is exempt under section 228 of the Companies Act 1985 from the obligation to prepare group accounts as the Company is a wholly owned subsidiary of Friends Provident plc in whose consolidated accounts the Company is included Accordingly, the accounts present information about the Company as an individual entity and not about its group

All accounting policies have been reviewed for appropriateness in accordance with FRS 18 Accounting Policies The principal accounting policies set out below have been applied consistently throughout the year except for FRS 29 Financial Instruments Disclosures The adoption of this standard became applicable to the Company from 1 January 2007 The objective of FRS 29 is to enable users to understand the nature and extent of risks arising from financial instruments and provide information on what the Company manages as capital and how its objectives for managing capital are met There is no impact on the current or prior year's profit resulting from the adoption of this standard as its provisions relate to disclosure

(b) Product classification

(i) Insurance 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 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 of price or rates, a credit rating or credit index or other variable Insurance contracts may transfer some financial risk

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during the period 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 is more than 5% greater than the benefits payable if the insured event did not occur

(ii) Investment contracts

Policyholder contracts not considered insurance contracts are classified as investment contracts Contracts currently classified as investment contracts are either unit-linked or contracts with a Discretionary Participation Features (DPF) (mainly unitised with-profits contracts)

1. ACCOUNTING POLICIES (continued)

(b) **Product classification (continued)**

(iii) **Options and guarantees**

Options and guarantees are valued separately unless the option or guarantee itself meets the definition of an insurance contract, or it is a policyholder option to surrender an insurance contract for a fixed amount

For options and guarantees separated from the host contract, the Company measures them on a market consistent basis and includes the change in value in profit and loss on the same basis as for its other embedded derivatives

(c) **Foreign currencies**

Assets and liabilities held in foreign currencies at the balance sheet date are expressed in sterling at rates ruling on that date Income and expenditure denominated in foreign currencies are translated at rates ruling at the date on which the transaction occurs All resulting exchange gains and losses are included within that part of profit and loss in which the underlying transaction is reported

(d) **Premiums**

Premium income in respect of single premium business and pensions business not subject to contractual regular premiums is accounted for when the premiums are received For all other classes of business, premium income is accounted for in the year in which it falls due Further details relating to the classification of new business premiums are included in note 3(b)

(e) **Reinsurance**

Amounts due to and from reinsurers are accounted for in a manner consistent with the insurance policies and in accordance with the relevant reinsurance contract Premiums ceded and claims reimbursed are presented on a gross basis

(f) **Fee and commission income**

Insurance and investment contract policyholders are charged for policy administration services, investment management services and for surrenders Investment management services comprise primarily fees and charges from unit-linked investments

These fees and charges are recognised as revenue in the period in which the services are rendered

Front-end fees are charged at the inception of the contract The consideration received is deferred as a liability and recognised over the expected term of the contract on a straight-line basis

Regular fees charged to the policyholder periodically (monthly, quarterly or annually) are charged on a straight-line basis over the period in which the service is rendered

Fee and commission income are included in the long-term business technical account as part of 'other technical income'

(g) **Investment income**

Investment income includes dividends, interest, rents, gains and losses on the realisation of investments Such income includes any withholding tax but excludes other taxes such as attributable tax credits

Dividend income from listed and unlisted securities is recognised as income when the right to receive payment is established For listed securities this is the date the security is listed as ex-dividend For unlisted securities this is the due date of payment

FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED
NOTES TO THE FINANCIAL STATEMENTS (continued)

1. ACCOUNTING POLICIES (continued)

(g) Investment income (continued)

Interest income is recognised as income as it accrues, taking into account the effective yield of the asset or an applicable floating rate Interest income includes the amortisation of any discount or premium

Realised gains and losses on investments are calculated as the difference between the net sales proceeds and the carrying value of the investment determined in accordance with the accounting policies applicable to the investment

Investment income relating to investments, which are directly connected with the carrying on of long-term business, is recorded in the long-term business technical account Other than long-term business, investment income is recorded in the non-technical account

(h) Unrealised gains and losses on investments

Unrealised gains and losses on investments represent the difference between the valuation of investments designated as fair value through the profit and loss, derivatives and land and buildings, at the balance sheet date and their original cost, or if they have been previously fair valued, the valuation at the last balance sheet date The movement in unrealised gains and losses recognised in the period also includes the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period

Unrealised gains and losses relating to investments, which are directly connected with the carrying on of long-term business, are recorded in the long-term business technical account Other than long-term business unrealised gains and losses are recorded in the non-technical account

(i) Claims and surrenders

Insurance claims reflect the cost of all claims incurred during the year, including claims handling costs Death claims and surrenders are recorded on the basis of notifications received Maturities and annuity payments are recorded when due Claims and benefits recorded are accrued to the policyholder and included within insurance and investment contract liabilities

Claims handling costs include internal and external costs incurred in connection with the negotiation and settlement of claims Internal costs include all direct expenses of the claims department and any general administrative costs directly attributable to the claims function

Reinsurance recoveries are accounted for in the same period as the related claim

(j) Transaction costs

Transaction costs in respect of brokers fees, stamp duty fees and other expenses on investments are charged to profit and loss in the period in which they are payable

(k) Bonuses

Bonuses charged to the long-term business technical account in a given period comprise reversionary bonuses declared in respect of that period, which are provided within the calculation of the long-term business provision, and terminal bonuses paid, which are included within claims paid

(l) Taxation

Taxation in the non-technical account and long-term business technical account is based on profits and income for the period as determined in accordance with the relevant tax legislation, together with adjustments to provisions for prior periods

1. ACCOUNTING POLICIES (continued)

(l) Taxation (continued)

Provision is made for deferred taxation liabilities, using the liability method, on all material timing differences, including fair valuation adjustments recognised through profit and loss, as the investments are fair valued Deferred taxation is calculated at the rates at which it is expected that the tax will arise and discounted to take into account the likely timing of payments and pattern of expected realisation of investments Deferred tax liabilities are discounted using gilt yield rates appropriate to the estimated year in which the timing differences are expected to reverse Deferred taxation is recognised through profit and loss for the period

Deferred tax assets are recognised to the extent that they are regarded as recoverable

The transfer of the balance on the long-term business technical account to or from the non-technical account is grossed up by attributable tax, using the full rate of corporation tax applicable for the period

(m) Intangible assets

Licences acquired are capitalised in the balance sheet at cost and amortised through profit and loss over their expected useful economic life Charges for amortisation and any changes for impairment are recorded in 'other technical charges'

(n) Investments

Investments are shown in the balance sheet as follows

(i) Land and buildings

Land and buildings are valued each year on an open market basis by qualified Chartered Surveyors An external valuer values properties at least once every 5 years Those properties which are occupied by the Group are valued on an existing use basis and with vacant possession

In accordance with Statement of Standard Accounting Practice (SSAP) 19 Investment Properties, no depreciation is provided in respect of freehold investment properties or amortisation in respect of leasehold properties with over 20 years to expire This is a departure from the requirements of the Companies Act 1985 which requires all properties to be depreciated However, these properties are held solely for investment purposes and the directors consider that systematic annual depreciation would be inappropriate Depreciation or amortisation is only one of the factors reflected in the annual valuations of properties, and the amounts which might otherwise have been shown cannot reasonably be separately identified or quantified The accounting policy adopted is therefore necessary for the financial statements to give a true and fair view

(ii) Other financial investments

The Company classifies its financial investments into the following two categories financial investments at fair value through profit and loss and loans receivable The classification depends on the purpose for which the investments were acquired or originated

Purchases and sales of financial investments are recognised on the date the Company commits to purchase or sell the investment

1. ACCOUNTING POLICIES (continued)

(n) Investments (continued)

(ii) Other financial investments (continued)

- **Financial assets at fair value through profit and loss**

All financial assets at fair value through profit and loss, with the exception of derivatives, are designated on initial recognition as they are managed individually or together on a fair value basis Derivative financial instruments are classified as fair value through profit and loss as they are held for trading purposes

The fair value on initial recognition being the consideration given, excluding any transaction costs directly attributable to their acquisition Subsequent to initial recognition, all such financial investments are measured at fair value Movements in fair value are taken to profit and loss in the period in which they arise

Embedded derivatives are separated from the host contract (including embedded derivatives in insurance contracts), recognised as a stand-alone derivative and measured at fair value through profit and loss, when the following conditions are met

- the economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and the risks of the host contract,
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and
- the hybrid instrument is not measured at fair value with changes in fair value recognised through profit and loss

- **Loans receivable**

Loans receivable represent 'Loans secured by mortgages'

Loans receivable are financial investments with fixed or determinable payments that are not quoted in an active market Loans receivable are measured on initial recognition at the fair value of the consideration given plus incremental costs that are incurred on the acquisition of the investment Subsequent to the initial recognition, loans receivable are measured at amortised cost using the effective interest rate method

The amortised cost is the present value of the estimated future cash flows discounted at the original effective interest rate The amortised cost is reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable Any resulting impairment loss is recorded in profit and loss

FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED
NOTES TO THE FINANCIAL STATEMENTS (continued)

1. ACCOUNTING POLICIES (continued)

(o) Fair value of financial investments

Fair values of listed financial instruments are based on quoted bid values for assets and offer price for liabilities at the close of business on the balance sheet date

For unlisted financial instruments broker or dealer price quotations or published bid values are obtained If prices are not readily available, the fair value is based on a valuation technique

Certain financial investments, including derivatives, are valued using pricing models that Methods considered when determining fair values of unlisted shares and other variable securities include discounted cash flow techniques, net asset valuation or carrying value Valuation methods consider, among other factors, contractual and market prices, correlation, time value of money, credit risk, yield curve volatility factors and/or prepayment rates of the underlying positions The use of different pricing models and assumptions could produce materially different estimates of fair values

If the value of equity instruments cannot be reliably measured, they are measured at cost

For units in unit trusts and shares in open ended investment companies, fair value is calculated using published bid values

Participation in investment pools mainly relates to property investments Property is independently valued in accordance with the Royal Institute of Chartered Surveyor's guidelines on the basis of open market values as at each year end

The fair value of floating rate and overnight deposits with credit institutions is their carrying value The carrying value is the cost of the deposit and accrued interest

(p) Investments in Group undertakings and participating interests

Shares in and loans to Group undertakings and participating interests are held at current value

(q) Present value of acquired in-force business

On acquisition of a portfolio of insurance contracts or investment contracts, either directly or through the acquisition of a subsidiary undertaking, the net present value of the Company's interest in the expected pre-tax cash flows of the in-force business is capitalised in the balance sheet as an intangible asset This is amortised over the anticipated lives of the related contracts

The carrying value of the asset is assessed annually using current assumptions in order to determine whether any impairment has arisen compared to the amortised acquired value based on assumptions made at the time of the acquisition Any amortisation or impairment charge is recorded in the long-term business technical account within 'other technical charges'

1 ACCOUNTING POLICIES (continued)

(r) Other financial assets

Other financial assets primarily include insurance and other debtors, including amounts due from Group undertakings and cash at bank

Insurance and other debtors are recognised when due and are carried at fair value Cash at bank is also reported at fair value at the balance sheet date

(s) Deferred acquisition costs

For both insurance contracts and investment contracts with Discretionary Participation Features (DPF), acquisition costs comprise all direct and indirect costs arising from writing the contracts, which are incurred during a financial period Costs are deferred where their recovery has not already been reflected in the valuation of policyholder liabilities, but only to the extent they are recoverable out of future margins The rate of amortisation of deferred acquisition costs on such contracts is proportional to the future margins emerging in respect of the related policies, over the lifetime of those policies

For investment contracts without DPF, deferred acquisition costs comprise all incremental costs that are directly related to the writing of the contract, which are incurred during a financial period and are deferred to the extent that they are recoverable out of future margins Such deferred acquisition costs are amortised uniformly over the lifetime of the policy

Annual impairment reviews are performed to identify whether there are any circumstances that might indicate impairment If such circumstances exist, the carrying values are adjusted to the recoverable amounts and any resulting impairment losses are charged to profit and loss

(t) Funds for future appropriations (FFA)

The insurance and investment contract liabilities allow for discretionary benefit allocations to the extent that they are allowed within current bonus practices The FFA represents working capital and the value of future transfers to shareholders from the With-Profits Fund in respect of discretionary bonuses for the conventional with-profits business

(u) Financial liabilities

The Company classifies financial liabilities as either financial liabilities at fair value through profit and loss or financial liabilities carried at amortised cost

Financial liabilities at fair value through profit and loss, such as investment contracts, are designated on initial recognition when one of the following criteria is satisfied

- It eliminates or significantly reduces an accounting mismatch caused by financial assets and financial liabilities being measured on a different basis
- The financial liability or group of financial liabilities are managed individually or together on a fair value basis

A financial liability is recognised when, and only when, the Company becomes a party to the contractual provisions of a financial instrument A financial liability is derecognised when and only when the obligation specified in the contract is discharged or cancelled or expires

FRS 27 does not allow the decrease of actuarial liabilities in respect of capital units

1. ACCOUNTING POLICIES (continued)

(v) Insurance contracts

Insurance contracts are measured using accounting policies consistent with those previously adopted under the Modified Statutory Solvency (MSS) basis, as amended following the adoption of the principles contained in FRS 27 Life Assurance, for the Company's with-profits business

Insurance contract liabilities are disclosed separately from investment contract liabilities in the balance sheet Technical provisions disclosed in the balance sheet for the long-term business, claims outstanding and linked liabilities represent amounts only for insurance contracts Correspondingly, the change in other technical provisions in the long-term business technical account for long-term business and linked liabilities, including reinsurance amounts, is for insurance contracts only

The insurance contract liabilities are determined separately for each life fund following an annual investigation of the long-term funds at 31 December The liabilities are calculated in accordance with the relevant Financial Services Authority (FSA) rules for UK operations The valuations are subject to adjustments to reflect relevant accounting requirements as set out below

For the conventional with-profits business, the liabilities to policyholders are determined in accordance with the Realistic Balance Sheet (RBS) regulations and in accordance with the principles contained in FRS 27 These liabilities include both declared bonus and constructive obligations for future bonuses not yet declared (excluding the shareholders' share of future bonuses) and includes the cost of options and guarantees measured on a market-consistent basis The RBS basis of valuation does not recognise deferred acquisition costs, but allows for future profits of non-profit and unit-linked business written in the With-Profits Fund to be recognised

The calculation of liabilities to policyholders for non-profit contracts is on a gross premium basis and in accordance with the MSS basis These liabilities include explicit allowance for future expenses and allow for lapses, but exclude explicit allowance for future bonuses

The provision for insurance contract liabilities can never be definitive as to the overall level of liabilities or their timing and is subject to regular reassessment

The Company carries out an annual liability adequacy test on its insurance liabilities less related deferred acquisition costs and other related intangible assets to ensure that the carrying amount of its liabilities is sufficient in the light of estimated future cash flows Where a shortfall is identified, an additional provision is made

(w) Investment contracts

Currently investment contracts are either classified as unit-linked or contracts with a Discretionary Participation Feature (DPF) (mainly unitised with-profits contracts)

A unit-linked investment contract is valued by calculating the number of units allocated to the policyholders in each of the unit-linked funds multiplied by the unit price of those funds at the balance sheet date The fund assets and liabilities used to determine the unit prices at the balance sheet date are valued on a basis that is consistent with their measurement in the balance sheet, adjusted to take account of the effect on the liabilities of discounting for the time value of future tax on unrealised gains on assets held in the fund Provision is made for renewal commissions at the inception of an investment contract as intermediaries are not required to perform any service once the policy is incepted

Unitised with-profits investment contracts are measured using RBS principles as amended by FRS 27

1. ACCOUNTING POLICIES (continued)

(w) Investment contracts (continued)

A contract with DPF is a contractual right held by a policyholder to receive, as a supplement to guaranteed minimum payments, additional payments

(i) that are likely to be a significant portion of the total contractual payments, and
(ii) whose amount or timing is contractually at the discretion of the issuer and that are contractually based on
- the performance of a specified pool of contracts or specified type of contract, or
- realised and/or unrealised investment returns on a specified pool of assets held by the issuer, or
- the profit or loss of the Company that issues the contracts

Investment contracts with DPF held within the With-Profits Fund are measured on a basis consistent with a measurement basis for insurance contracts held within that Fund

Balances representing eligible surplus that has not yet been allocated to shareholders, or policyholders with DPF contracts, are retained as a policyholders' liability

(x) Classification of financial instruments between debt and equity

The classification of financial instruments between debt and equity is based on the principles in FRS 25 rather than the instruments' legal form or their commercial intent The Company applies these principles when classifying its financial instruments In order to be classified as debt, the financial instrument, in situations where the contract will not be settled by the Company's own shares, must have a contractual obligation to

(i) deliver cash or another financial asset to another entity, or
(ii) exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the Company

For some instruments the contractual obligation to pay cash or another financial asset is dependant on the occurrence or non-occurrence of some future event If this event is out of the control of the Company, then this usually means that the instrument still meets its definition of debt However, if the Company is only required to settle the obligation in the event of liquidation or if the likelihood of the event occurring (or not occurring) is so remote that is extremely unlikely that the obligation will be triggered then the Company treats the instruments as equity, as required by FRS 25 Payments on instruments classified as equity are not treated as expenses but as an appropriation of profit

(y) Other financial liabilities

Other financial liabilities primarily include creditors arising out of insurance and reinsurance operations and other obligations due to Group undertakings or third parties These are reported at the estimated amounts required to settle the obligation at the balance sheet date

2. CHANGES TO ESTIMATION TECHNIQUES

One off basis change: FSA Policy Statement (PS) 06/14 Prudential changes for insurers

Regulatory reserving rule changes arising from the adoption of the Prudential Requirements for Insurers (Amendment) instrument 2006 (2006/62) have been applied to the valuation of the remaining Life Protection Insurance contracts not covered in 2006, namely Income Protection business and other protection business reinsured on a risk premium basis PS06/14 permits negative reserves to be recognised to the extent they offset positive reserves within the same fund, reducing overall liabilities

Negative reserves represent all discounted future cash flows, including the recovery of acquisition costs, less a margin for prudence As a result, any related Deferred Acquisition Costs (DAC) will be fully amortised where negative reserves are recognised in full

The impact of completing the second stage of PS06/14 on profit before tax is an increase of £12 4m, arising from a reduction in net liabilities to policyholders of £88 4m and a write-down in DAC of £76m through operating expenses

3. SEGMENTAL INFORMATION

	2007 £m	2006 £m
Gross earned premiums on insurance contracts and investment contract deposits	1,377	1,657
Less investment contract deposits written	(929)	(1,150)
Gross earned premiums per the long-term technical account	448	507

(a) Gross premiums written by type

	2007 £m	2006 £m
Life		
Protection	138	148
Savings and investment	287	320
Pensions		
Individual pensions	7	17
Group pensions	9	18
Annuities	7	4
Total life and pensions	448	507
Premiums from non-participating contracts	156	161
Premiums from participating contracts	203	264
Premiums from investment linked contracts	89	82
Total life and pensions	448	507

(b) New business written by type

The new business written for the purpose of this note includes premiums on all types of contracts written by the Company (including gross premiums on investment contracts which have not been included as part of the 'gross premiums written' in the long-term business technical account, under paragraph 162 of the ABI SORP 12/2005)

	Regular premiums		Single premiums		APE	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Life						
Protection	8	3	-	-	8	3
Savings and investment	1	2	11	20	2	4
Pensions						
Individual pensions	1	2	112	131	12	15
Group pensions	15	5	19	41	17	9
Annuities	-	-	9	7	1	1
Total life and pensions	25	12	151	199	40	32

3. SEGMENTAL INFORMATION (continued)

(b) New business written by type (continued)

The new Life & Pensions APE represents gross new regular premiums plus 10% of gross new single premiums In classifying new business premiums the following basis of recognition is adopted

(i) single new business premiums consist of those contracts under which there is no expectation of continuing premiums being paid at regular intervals,
(ii) regular new business premiums consist of those contracts under which there is an expectation of continuing premiums being paid at regular intervals, including repeated or recurrent single premiums where the level of premiums is defined or where a regular pattern in the receipt of premiums has been established,
(iii) non-contractual increments under existing group pensions schemes are classified as new business premiums,
(iv) transfers between products where open market options are available are included as new business, and
(v) regular new business premiums are included on an annualised basis

(c) Life and pensions gross premiums

	2007 £m	2006 £m
Source		
United Kingdom	447	501
Rest of the World	1	6
	448	507
Destination		
United Kingdom	428	487
Rest of the World	20	20
	448	507

(d) Life and pensions new business

	Regular premiums		Single premiums	
	2007 £m	2006 £m	2007 £m	2006 £m
Source				
United Kingdom	24	7	144	187
Rest of the World	1	5	7	12
	25	12	151	199
Destination				
United Kingdom	9	2	132	177
Rest of the World	16	10	19	22
	25	12	151	199

3 SEGMENTAL INFORMATION (continued)

(e) Loss on ordinary activities before tax

	2007 £m	2006 £m
Source		
United Kingdom	(100)	500
Rest of the World	(1)	9
	(101)	509
Destination		
United Kingdom	(101)	509
Rest of the World	-	-
	(101)	509

(f) Net assets

The net assets supporting the Rest of the World geographical segment are the same as those supporting the United Kingdom segment and therefore have not been separated

4 OUTWARD REINSURANCE PREMIUMS

Outward reinsurance premiums are net of reinsurance premium rebates, net of a provision for clawbacks, of £1m (2006 £1m)

The aggregate of all reinsurance balances in the long-term business technical account for the year ended 31 December 2007 was a balance of £nil (2006 £661m credit balance)

5. INVESTMENT RETURN

	Technical account		Non-technical account	
	2007 £m	2006 £m	2007 £m	2006 £m
Investment income				
Income from land and buildings	24	22	-	-
Income from Group undertakings	17	224	1	12
Income from other investments	800	864	37	32
Gains on the realisation of investments	468	557	23	16
	1,309	1,667	61	60
Unrealised gains on investments	-	-	-	81
Investment expenses and charges				
Investment management expenses	(39)	(34)	(3)	(2)
Interest to Group undertakings	(20)	(38)	-	-
Other interest	(2)	(2)	-	-
Preference dividend	-	-	(14)	(14)
	(61)	(74)	(17)	(16)
Unrealised losses on investments	(530)	(459)	(236)	-
Total investment return	718	1,134	(192)	125

5. INVESTMENT RETURN (continued)

Included in 'total investment return' is an amount of £822m (2006 £892m) that represents interest and dividends on investments classified as 'fair value through profit and loss' and an amount of £20m (2006 £274m) that represents realised and unrealised gains/losses on other financial investments classified as 'fair value through profit and loss'

Included in unrealised losses is an amount of £24m (2006 £14m) arising on investments classified as 'fair value through profit and loss' that is determined using valuation techniques

6. OTHER TECHNICAL INCOME, NET OF REINSURANCE

Other technical income in the long-term business technical account comprises

	2007 £m	2006 £m
Friends Provident Pensions Limited (FPP) management charge	31	27
Provision for financial reinsurance in respect of Friends Provident Reinsurance Services Limited (FPRe) - (note 26)	35	152
Fee and commission income from service activities	18	37
	84	216

7. OTHER TECHNICAL CHARGES, NET OF REINSURANCE

Other technical charges in the long-term business technical account comprise

	2007 £m	2006 £m
Amortisation of present value of acquired in-force business	3	2
Amortisation of licence	1	2
Recharge from Friends Provident Life Assurance Limited (FPLAL)	(1)	(2)
Unit management charges payable to FPLAL	16	11
	19	13

The recharge from FPLAL shown above relates to amortisation of the licence (see note 11)

8 NET OPERATING EXPENSES

A fellow Group undertaking, Friends Provident Management Services Limited (FPMS) provides the Company's services and administration and employs all staff

(a) **Net operating expenses in the long-term business technical account,** including those on investment contracts, comprise

	2007 £m	2006 £m
Acquisition costs	11	14
Change in deferred acquisition costs (see note 17)	105	23
Administrative expenses	70	86
Net operating expenses	186	123

Total commissions for direct insurance accounted for by the Company during the year amounted to £9m (2006 £12m)

(b) **Auditor's remuneration**

	2007 £000	2006 £000
Audit fees – excluding VAT	435	421

Fees paid to the Company's auditor, KPMG Audit Plc and its associates for services other than the statutory audit of the Company and other Group undertakings is disclosed in note 8(b) of the consolidated accounts of Friends Provident plc

9 TAXATION

Profit and loss account

United Kingdom and overseas taxation has been charged in profit and loss on assessable profits and income, on the bases and rates appropriate to the various classes of business

(a) **Tax charged to the long-term business technical account and non-technical account comprises:**

	Technical account		Non-technical account	
	2007	2006	2007	2006
	£m	£m	£m	£m
Current taxation				
United Kingdom corporation tax (30%)	12	-	-	-
Adjustment in respect of prior years	(23)	(26)	-	-
	(11)	(26)	-	-
Overseas taxation	(1)	5	-	-
Tax credit attributable to balance on the long-term business technical account	-	-	27	115
Total current taxation	(12)	(21)	27	115
Deferred taxation				
Origination and reversal of timing differences	11	79	(12)	7
Effect of discount	4	-	-	-
Total deferred taxation	15	79	(12)	7
Total taxation	3	58	15	122

(b) **Factors affecting tax charge for the year**

The tax assessed for the year is lower than the standard rate of corporation tax in the UK (30%)

The differences are explained below

	2007	2006
	£m	£m
(Loss)/profit on ordinary activities before tax	(101)	509
(Loss)/profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30%	(30)	153
Effects of		
Origination and reversal of timing differences	12	(7)
Income not taxable	(20)	(35)
Deductions not allowable	65	-
Tax losses not given value	-	4
Current tax charge for the period	27	115

9. TAXATION (continued)

(c) Balance sheet

	2007 £m	2006 £m
Deferred taxation		
At 1 January	170	84
Charge in year	(1)	86
Effect of discounting	4	-
At 31 December	173	170

Details of the deferred tax asset are given below

	2007 £m	2006 £m
Fair valuation of investments	146	153
Tax on regulatory changes	9	6
Deferred acquisition costs (including those on investment contracts)	20	20
Discount on deferred acquisition costs (including those on investment contracts)	(2)	(9)
Discounted provision for deferred taxation	173	170

10 DIVIDEND

	2007 £m	2006 £m
2007 dividend of 38p per ordinary share (2006 23p)	250	150
	250	150

11 INTANGIBLE ASSETS

	2007 £m
Licence	
Cost	
At 1 January 2007	18
At 31 December 2007	18
Amortisation	
At 1 January 2007	17
Charge for the year	1
At 31 December 2007	18
Net book value	
At 1 January 2007	1
At 31 December 2007	-

11. INTANGIBLE ASSETS (continued)

The licence relates to an exclusive distribution agreement secured with Countrywide Assured Group Plc in August 2002 The agreement gives a 15-year exclusive right to distribute mortgage related protection products through Countrywide's 1,126 estate agency branches and its 887 licensed consultants

12. INVESTMENTS

	2007		2006	
	Fair value £m	Cost £m	Fair value £m	Cost £m
Land and buildings				
Owner occupied				
Freehold	44	57	45	57
Long leasehold	4	4	4	4
Other				
Freehold	310	134	299	140
Long leasehold	-	-	80	71
Total land and buildings	358	195	428	272
Other financial investments				
Shares and other variable yield securities and OEIC's	4,625	3,380	5,152	3,714
Debt and other fixed income securities	9,054	9,008	9,709	9,459
Participation in investment pools	112	60	136	62
Loans secured by mortgages	2	2	2	2
Deposits with credit institutions	623	623	647	647
Derivatives	150	162	191	164
Total other financial investments	14,566	13,235	15,837	14,048
Assets held to cover linked liabilities	4,370	3,628	4,060	3,250

During the year, all properties have been independently valued by a qualified valuer, principally DTZ Debenham Tie Leung, CB Richard Ellis and George Trollope, who are all chartered surveyors The valuation is prepared in accordance with the Royal Institute of Chartered Surveyors appraisal and valuation standards

In the carrying amounts above, £10,495m (2006 £11,555m) is expected to be recovered more than 12 months after the balance sheet date

Included in 'other financial investments' and 'assets held to cover linked liabilities' are investments, with cost of £374m (2006 £278m) and fair value of £469m (2006 £399m), whose year end values have been determined using valuation techniques and are not based on quoted prices

Included in 'other financial investments' and 'assets held to cover linked liabilities' are investments designated as 'fair value through profit and loss' with a fair value at year end of £18,934m (2006 £19,895m)

12. INVESTMENTS (continued)

Fair value of listed investments included in 'other financial investments' shown above comprise

	2007 £m	2006 £m
Shares and other variable yield securities	4,347	4,478
Debt securities and other fixed income securities	9,005	9,690
	13,352	14,168

Fair value of listed investments included in 'assets held to cover linked liabilities' amounted to £1,218m (£2006 £1,500m)

13. INVESTMENTS IN GROUP UNDERTAKINGS AND PARTICIPATING INTERESTS

	Shares in Group undertakings £m	Loans to Group undertakings £m	Shares in participating interests £m	Total £m
Current value				
At 1 January 2007	2 692	248	13	2,953
Additions	30	12	-	42
Disposals	(1)	-	-	(1)
Revaluations	(250)	-	1	(249)
At 31 December 2007	2,471	260	14	2,745
Cost				
At 1 January 2007	2,059	265	12	2 336
Additions	30	12	-	42
Disposals	(1)	-	-	(1)
At 31 December 2007	2,088	277	12	2,377

Principal Group undertakings and participating interests of the Company at 31 December 2007 are shown below Except where stated, each of these are direct holdings and incorporated in England and Wales

Group undertakings held by the shareholder fund	
Friends Provident Pensions Limited	100%
Friends Provident International Limited	100%
Friends Provident International Luxembourg SA**	100%
Friends Provident Life Assurance Limited	100%
Friends Provident Reinsurance Services Limited	60%
F&C Commercial Property Trust	
Ordinary shares - Indirect holding *	17%

13. INVESTMENTS IN GROUP UNDERTAKINGS AND PARTICIPATING INTERESTS (continued)

Group undertakings held in the long-term funds	
Friends Provident Investment Holdings plc	100%
FP Group Limited	100%
FP Finance Plc	100%
Friends Provident Marketing Limited	100%
Friends Provident Reinsurance Services Limited	40%
London Capital Holdings Limited	
Ordinary shares - Direct holding	65%
- Indirect holding *	35%
Deferred shares - Direct holding	84%
- Indirect holding *	16%
F&C Commercial Property Trust	
Ordinary shares - Direct holding	35%
Group undertakings held in assets held to cover linked liabilities	
AUB Commercial Property Limited	100%
Participating interests held in the long-term funds	
Tenet Group Limited	21%

* held in subsidiary ** incorporated in Luxembourg

14. PRESENT VALUE OF ACQUIRED IN-FORCE BUSINESS

	£m
Cost	
At 1 January 2007	72
At 31 December 2007	72
Amortisation	
At 1 January 2007	35
Amortisation during year	3
At 31 December 2007	38
Net book value	
At 1 January 2007	37
At 31 December 2007	34

15. ASSETS ATTRIBUTABLE TO THE LONG-TERM FUND

Of the total assets shown on the balance sheet on page 10, £26,058m (2006 £26,887m) is attributable to the long-term business fund

16. OTHER DEBTORS

	2007 £m	2006 £m
Amounts falling due within one year		
Investment income receivable	19	17
Investments sold for subsequent settlement	3	-
Taxation recoverable	11	54
Amounts due from Group undertakings	9	3
Other debtors	8	8
	50	82

All 'other debtors' amounts are expected to be recovered within 12 months after the balance sheet date except for 'amounts due from Group undertakings' that have no fixed payment terms

17. DEFERRED ACQUISITION COSTS

	Insurance contracts		Investment contracts		Total	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
At 1 January	83	96	71	81	154	177
Incurred and deferred in the year	-	-	1	2	1	2
Amortisation charge for the year	(77)	(13)	(28)	(12)	(105)	(25)
Other movements	-	-	12	-	12	-
At 31 December	6	83	56	71	62	154

Acquisition expenses that do not meet the criteria for deferral are expensed directly as incurred

18. CALLED-UP SHARE CAPITAL

	2007 £m	2006 £m
Authorised		
1,700m (2006 1,700m) ordinary shares of £1 each	1,700	1,700
Allotted and fully paid		
654m (2006 654m) ordinary shares of £1 each	654	654

19 PREFERENCE SHARES

	2007 £m	2006 £m
300m (2006 300m) 4 8125% non-cumulative preference shares of £1 each	300	300

Under FRS 25 it is necessary to treat the £300m non-cumulative preference shares as debt, as a contractual obligation exists to pay the shareholders the preference dividend The preference shares are perpetual shares and are only redeemable at the option of the Company on 21 November 2019 or on any dividend date thereafter

20. OTHER EQUITY – STEP-UP TIER ONE INSURANCE CAPITAL SECURITIES (STICS)

	£m
At 1 January 2007	511
Interest charged	32
Interest paid	(32)
At 31 December 2007	511

On 27 June 2005, the Company issued £495m of STICS, which will bear interest from 30 June 2005 to 30 June 2015 at a rate of 6 302% The STICS have no maturity date but are redeemable in the whole or part at the option of the Company on 1 July 2015, thereafter on every fifth anniversary of this date

The STICS are perpetual securities and are not redeemable at the option of the holders at any time For each coupon period after 1 July 2015, the STICS will bear interest that is reset every five years The STICS are carried at £511m being £495m principal plus interest due of £16m not yet paid to STICS holders Interest is payable annually in arrears on 30 June of each year

Under FRS 25 it is necessary to treat STICS as equity as there is no requirement to settle the obligation in cash or another financial asset

21 RECONCILIATION OF MOVEMENT IN TOTAL SHAREHOLDERS FUNDS AND STATEMENT OF MOVEMENTS ON RESERVES

	Share Capital	Share premium	Profit and loss account	Other Equity Reserve (STICS)	Total
	£m	£m	£m	£m	£m
At 1 January 2007	654	721	1,011	511	2,897
Loss for the year	-	-	(148)	32	(116)
Dividend on equity shares	-	-	(250)	-	(250)
Interest paid on STICS	-	-	-	(32)	(32)
At 31 December 2007	654	721	613	511	2,499

22. POLICYHOLDER LIABILITIES

	Long-term business provision £m	Technical provisions for linked liabilities £m	Investment contract liabilities £m
At 1 January 2007			
Gross	10,549	1 143	14,059
Reinsurance	(542)	(180)	(5,628)
Net	10,007	963	8,431
Movement during the year			
Gross	(616)	(13)	(473)
Reinsurance	8	30	79
Net	(608)	17	(394)
At 31 December 2007			
Gross	9,933	1 130	13,586
Reinsurance	(534)	(150)	(5,549)
Net	9 399	980	8,037

Included within 'investment contract liabilities' is an amount of £3,390m (2006 £3,097m) relating to assets held to cover linked liabilities

23. TECHNICAL PROVISIONS

Liabilities for insurance contracts and investment contracts with DPF

The provision for insurance contracts and investment contracts with a discretionary participation feature (DPF) is calculated on the basis of recognised actuarial methods with due regard to actuarial principles and best practice The methodology takes into account risks and uncertainties of the particular classes of long-term business written and the results are certified by the professionals undertaking the valuations

Calculations are generally made on an individual policy basis, however where any global provisions are made these are calculated using statistical or mathematical methods These results are expected to be approximately the same as if an individual liability was calculated for each long-term contract

For the Company's conventional with-profits business, including unitised with-profits business, the liabilities are determined on a realistic basis and in accordance with the principles contained in FRS 27 The main element of the realistic liabilities is the 'asset shares' of with-profits business, representing the premiums received to date together with the investment return earned less expenses and charges These asset shares move with the value of the underlying assets Other policyholder liabilities, including options and guarantees arising in the With-Profits Fund, are then valued on a market-consistent stochastic basis The main types of guarantees and options within the With-Profits Fund, are guarantees in respect of bonus additions and guaranteed annuity options The calculation of liabilities and management actions that would be taken in certain scenarios is in accordance with the Company's Principles and Practices of Financial Management (PPFM) and set out in more detail in note 24

Liabilities to policyholders in respect of non-profit insurance policies, primarily protection and annuity products, have been valued using a gross premium method

Single premium group income protection contracts have been valued at 90% of the last three years premiums plus an allowance for outstanding claims in respect of earlier premiums

23. TECHNICAL PROVISIONS (continued)

The principal assumptions underlying the calculation of the provisions are set out below

Valuation interest rates	**31 Dec 2007**	**31 Dec 2006**
	%	%
Class of business (all non-profit or unit-linked)		
Life fund	3 1	3 1
Individual income protection	3 3	3 8
Single premium group income protection	3 8	3 8
Pension business – other than annuities	3 9	3 9
Pension annuities in payment	4 75	4 56

As explained above, the Company's conventional with-profits business is valued in accordance with the FSA's realistic capital regulations

For regular premium life protection products the interest rate used in 2007 is 2 6% or 5 6%, depending on which is most onerous

The total cost of regular, interim and final bonuses attributable for the year ended 31 December 2007 was £277m (2006 £217m)

Mortality and morbidity assumptions

The liabilities allow for mortality and morbidity risk by making assumptions about the proportion of policyholders who die or become sick Allowance for future mortality has been made using the following percentages of the standard published tables

	2007	**2006**
Term assurances - smoker	126% TM92(5) / 116% TF92(5)	95% TM92(5) / 116% TF92 (5)
Term assurances - non-smoker	58% TM92(5) / 63% TF92(5)	58% TM92 (5) / 74% TF92 (5)
Critical illness	CIBT02 (i)	Same as term assurance
Other life assurances	80% AM/AF80 ult	80%AM/AF80 ult
Unitised policies	80% AM/AF80 ult	80%AM/AF80 ult
Pension policies	35% AM/AF80 ult	35%AM/AF80 ult
Individual income protection	60% AM/AF80 ult	60%AM/AF80 ult
Individual pension annuities in payment	RM/FV00 (ii)	75% RM/FV92 U2006 (iii)
Group pension annuities in payment	PCMA/PCFA00 (ii)	95% PM/FA92 U2006 (iii)

(i) The percentages of the table used differ by sex and smoker status

(ii) Age-related percentages of the mortality tables are used Future improvements in mortality are based on the following percentages of the average of CMI's Medium Cohort and Long Cohort

Males - 100% subject to a minimum of 1 5% per annum
Females - 75% subject to a minimum of 1 25% per annum

(iii) Plus additional 0 25% per annum and 0 5% per annum for individuals and group (males only) respectively from 31 December 2003 onwards

Individual income protection sickness and recovery rates are based on percentages of the CMI 12 (male and female) published tables Rates differentiate by smoker status, deferred period and occupational class

Critical illness morbidity rates are based on percentages of the published CIBT02 table The percentages used vary by sex and smoker status In addition, future deterioration in morbidity is allowed for by applying 1 25% per annum and 1 50% per annum to the critical illness rates, for males and females respectively

23 TECHNICAL PROVISIONS (continued)

Lapse rates for conventional and income protection business are based on recent experience with a prudent margin

Reviews for pension transfers and opt-outs have now been substantially completed An amount of £4 0m (2006 £5 9m) remains within the long-term business provision in respect of residual associated costs and contingencies No change to the total costs of the review have been assumed in 2007 or 2006

Included in the carrying amount of insurance contract liabilities, is £9,113m (2006 £9,819m) that is expected to be settled more than 12 months after the balance sheet date

Investment contracts

The provision for linked contracts is equal to the value of units, underlying assets, share index or reference value The fund liabilities at the balance sheet date are adjusted to take account of the effect of discounting for the time value of future tax on unrealised gains on assets held in the fund There is no significant difference between carrying values and maturity values of investment contract liabilities

Included in the carrying amount of investment contract liabilities is £7,115m (2006 £7 650m) that is expected to be settled more than 12 months after the balance sheet date

24. WITH-PROFITS BALANCE SHEET

The realistic balance sheet for the Company's with-profits business has been determined in accordance with the RBS regulations prescribed by the FSA This balance sheet is set out below and shows realistic assets of £12,397m (2006 £13 682m), realistic liabilities (including options and guarantees) of £12,150m (2006 £13,462m) resulting in an excess of realistic assets over realistic liabilities of £247m (2006 £220m) Disclosure of the capital position of the Company is contained in the report and accounts of the Company's ultimate parent undertaking Friends Provident plc

	2007 £m	**2006** £m
Total net assets	14 739	16,087
Less non-profit liabilities including share of resilience capital and long-term insurance capital requirements	(2,561)	(2,670)
Total regulatory assets	12,178	13,417
Additional assets arising on realistic basis	219	265
Total assets	12,397	13,682
Policyholder liabilities – asset shares	10,323	11,365
– financial guarantees (net of charges)	210	101
– options (guaranteed annuities)	628	747
Other liabilities	989	1,249
Total liabilities	12,150	13,462
Excess of assets over liabilities	247	220

At 31 December 2007, the surplus of realistic assets over realistic liabilities initially amounted to £274m (2006 £254m) with a Risk Capital Margin (RCM) of £247m (2006 £220m), the surplus assets have subsequently been reduced by £27m via a reduction in future guarantee charges leaving the working capital at £247m fully covering the RCM Adding back the shareholders' share of future bonuses totalling £94m (2006 £95m) and deducting adjustments to eliminate double counting of acquired PVIF of £0m (2006 £19m), the excess in accordance with FRS 27 amounted to £341m (2006 £296m)

FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED
NOTES TO THE FINANCIAL STATEMENTS (continued)

24. WITH-PROFITS BALANCE SHEET (continued)

The main element of the realistic liabilities is the asset shares of with-profits business This represents the premiums received to date together with the investment return earned less expenses and charges This is mainly calculated on an individual policy basis using historic information and in line with the Company's Principles and Practices of Financial Management (PPFM) Assets and realistic liabilities are closely matched since the realistic liabilities move with the value of the underlying assets

Policyholder liabilities (including options and guarantees) are then valued using a market-consistent stochastic model Included in liabilities are provisions for specific items such as mortgage endowment reviews and other liabilities of the fund Realistic valuations also allow for future profits of non-profit business written in the With-Profits Fund to be included In accordance with FRS 27, the value of future profits of non-profit business has been deducted from policyholder liabilities in the balance sheet

Options and guarantees are features of life assurance and pensions contracts that confer potentially valuable benefits to policyholders They are not unique to with-profits funds and can arise in non-participating funds They can expose an insurance company to two types of risk insurance (such as mortality/morbidity) and financial (such as market prices/interest rates) The value of an option or guarantee comprises two elements the intrinsic value and the time value The intrinsic value is the amount that would be payable if the option or guarantee was exercised immediately The time value is the additional value that reflects the possibility of the intrinsic value increasing in future, before the expiry of the option or guarantee

Under FSA rules, the Company's options and guarantees are valued on a market-consistent stochastic basis and included in policyholder liabilities There are two main types of guarantees and options in the Company's With-Profits Fund maturity guarantees and guaranteed annuity options Maturity guarantees are in respect of conventional with-profits business and unitised with-profits business and represent the sum assured and reversionary bonuses declared to date The cost of these guarantees, net of charges, has been calculated at £210m (2006 £101m) For certain with-profits pension policies issued, there are options guaranteeing the rates at which annuities can be purchased The cost of these guarantees has been calculated at £628m (2006 £747m)

The cost of the with-profits guarantees is assessed using a market-consistent stochastic model (using The Smith Plus Model as the scenario generator) and is calculated using 6,300 simulations The model has been calibrated using the gilt risk-free curve assuming interest rates of between 4 1% and 4 6% pa (2006 between 3 9% and 5 3% pa) and implied volatilities in the market The capital return has been calibrated and compared to the actual asset portfolio For equities, the capital return volatility varies by year with 26% pa (2006 20%pa) assumed in year 7, increasing to 26% pa (2006 23%pa) by year 14 and 27% pa (2006 25% pa) by year 21 Volatility for property total returns varies by year with 15% assumed in year 7 (2006 15% pa), increasing to 17% pa (2006 15% pa) by year 14 and 17% (2006 15%) by year 21

The cost of guarantees also depends on management actions that would be taken under various scenarios For example the future level of the equity-backing ratio (the ratio of funds held in equities and property to total investments) varies in each scenario depending on the ration of the guarantee cost to the asset share Similarly, the reversionary bonus rate is set each year such that, by maturity, guaranteed benefits are targeted as a prescribed fraction of the total asset share, leaving the remaining portion of the asset share to be paid as terminal bonus The management actions are in line with the PPFM and are programmed into the model

24. WITH-PROFITS BALANCE SHEET (continued)

The guarantee cost in respect of guaranteed annuity options is assessed using a market-consistent stochastic model and values both the current level of the guaranteed annuity rate benefit (allowing for future improvements in annuitant mortality) and the time value due to uncertainty in future interest rates The guarantee cost in each scenario is the value of the excess annuity benefit provided by the options relative to an annuity purchased in the open market In estimating the future open market annuity rate, the model allows for stochastic variation in interest rates and for future mortality improvements The stochastic interest rate assumption reflects that implied by current market interest rate derivative prices Future annuitant mortality has been derived from the premium basis at which annuities can be purchased from Friends Provident Pensions Limited, which allows for future mortality improvements Future improvements are difficult to assess, as there is no industry census

The guaranteed annuity options cost also depends upon other factors such as policy discontinuance and tax-free cash take up The factors are based on recent experience adjusted to reflect industry benchmarks and to anticipate trends in policyholder behaviour

A summary of the key assumptions is as follows

Policy discontinuances lapse, early retirement and paid-up rates vary by policy type and period and have been based on recent experience Policy lapses for pensions are generally in the range of 1% to 4% pa (2006 1% to 3% pa) with policy lapses for life business in the range of 3% to 10% pa (13% pa for mortgage endowment and with-profit bond policies) (2006 3% to 9% pa (13% pa for mortgage endowment policies)) Paid-up rates for pensions are generally in the range of 5% to 12% pa (2006 7% to 11% pa) with life policies generally in the region of 0 5% to 2% pa (2006 0 5% to 2% pa) Early retirement rates vary by age band and policy type and have been reviewed and amended in 2007 based on recent experience

Tax-free cash option where a guaranteed annuity option is more valuable than the cash equivalent it is assumed that 18% to 27% of the benefit is taken as tax-free, depending on type of business (2006 18% to 27%) This is based on recent experience

25. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS

The Company is exposed to market risk, credit risk and liquidity risk from its use of financial instruments and to insurance risk through the issuing of insurance contracts This note presents information about the Company's exposure to each of the above risks and the Company's objectives, policies and processes for measuring and managing risk Further quantitative disclosures are included throughout these financial statements

The board of the Company is ultimately responsible for the Company's system of internal control and risk management framework, and for reviewing their effectiveness The board of the Company reports on its risk management processes to the Group Risk Committee (GRC) of the parent company, which is responsible for developing, sponsoring and monitoring the risk management activities and processes of the companies within the Group The Company s board is authorised to determine its respective policies for the management of financial and operational risk, subject to the oversight of the GRC

The internal control systems are designed to manage rather than eliminate risk, as no business can be successful without taking some risk They can thus provide reasonable but not absolute assurance against material misstatement or loss

The Life & Pensions Financial Risk and Operational Risk Committees (FRC and ORC respectively), whose members include executive directors and senior managers of the company, oversee the management of financial and operational risk respectively The committees have detailed terms of reference that describe their roles in the identification, assessment, management and monitoring of risk These committees have authority to approve their respective risk policies

25. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

Approved policies are reviewed by the relevant committees, on at least an annual basis, to ensure they remain relevant to the changing demands of the business and the regulatory environment Risk management policies are framed at the highest level to encourage the use of a pragmatic approach to risk management and to allow for a suitable degree of flexibility to manage risk under changing conditions

The financial and insurance risk processes are aligned to the business planning process, with risk being identified and evaluated in relation to the achievement of business objectives The processes are run centrally by the Risk function in co-operation with key business units Risks are recorded by the Risk function, which co-ordinates quarterly reporting to the FRC Risks within the business change activities are identified and evaluated by the management of the change programme both in relation to the delivery of the programme and in terms of the change programme's effect on the business as a whole

Management is responsible for putting in place the ongoing management and monitoring disciplines for risks and activities under its control Through these mechanisms, risks are identified in a timely manner, their financial implications assessed, control procedures re-evaluated and, where appropriate, actions agreed and implemented to address these risks

The Group Asset Liability Committee reports to the Investment Committee of Friends Provident plc It comprises some executive directors of the Company, together with senior managers from the Life and Pensions and Asset Management businesses, and supervises the application of agreed risk appetite in respect of asset liability matching for both shareholder and policyholder funds It also reviews the investment of, and monitors market, liquidity and credit risk management in relation to, shareholder funds and makes recommendations to the Investment Committee in respect of policy on foreign exchange and interest rate hedging

The Audit and Compliance Committee (ACC) of Friends Provident plc oversees how management monitors compliance with the Group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Group The ACC is supported in its oversight role by Internal Audit, which undertakes both regular and ad hoc reviews of risk management controls and procedures, the results of which are reported to the ACC

Appropriate authority levels, limits and other processes are confirmed and developed where necessary, consistent with the risk appetite set by the board

Capital management

The Company's capital comprises of equity shareholders' funds , preference shares and STICS

The Company is a regulated entity subject to a number of regulatory capital tests Total available capital resources are calculated on a realistic basis for the With-Profits Fund The Company has complied with all regulatory capital requirements throughout the financial year

Capital and solvency is measured using the regulations prescribed by the Financial Services Authority (FSA) These regulatory capital tests are based upon required levels of solvency capital (Capital Resources Requirement (CRR)) and a series of prudent assumptions in respect of type of business written by the Company

25. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

Capital management (continued)

A reconciliation of Equity under UK Generally Accepted Accounting Practice (UK GAAP) attributable to equity holders of the Company and the excess of available capital resources to cover long-term insurance business is set out below

	2007 £m	2006 £m
Equity shareholders' funds per the balance sheet (UK GAAP basis)	2,499	2,898
Realistic excess capital	-	-
Realistic value of future transfers out of WPF	335	514
Step-up tier one insurance capital securities	300	300
Adjustments to subsidiary values	(1 050)	(1,135)
Remove deferred acquisition costs	(46)	(143)
Remove deferred front end fees	9	(6)
Remove acquired present value of in force business	(17)	(18)
Policy liability differences	(8)	26
Take credit for reinsurance to FP Re	61	81
Less Long term insurance capital requirement of the Non Profit Fund	(150)	(162)
Capital requirements of subsidiary companies	(266)	(238)
Excess of available capital resources to cover long-term insurance business (Per FSA Return, Form 2)	1,667	2,117

Sensitivity Analysis

Year ended 31 December 2007

	Notes	£m
Excess of available capital resources to cover long-term insurance business (Per FSA Return, Form 2)		1,667
10% reduction in market values of equity and property assets	(i)	(5)
10% increase in market values of equity and property assets	(i)	5
1% reduction in risk-free rates with corresponding change in fixed-interest asset values	(ii)	34
1% increase in risk-free rates with corresponding change in fixed-interest asset values	(ii)	(33)

Year ended 31 December 2006

	Notes	£m
Excess of available capital resources to cover long-term insurance business (Per FSA Return, Form 2)		2,117
10% reduction in market values of equity and property assets	(i)	(40)
10% increase in market values of equity and property assets	(i)	39
1% reduction in risk-free rates with corresponding change in fixed-interest asset values	(ii)	82
1% increase in risk-free rates with corresponding change in fixed-interest asset values	(ii)	(68)

25. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

Capital Management (continued)

(ı) A fall ın equıty and property values adversely affects the followıng
- exposure to equıtıes ın the Shareholder Fund
- the ımpact on the value of future charges of movements ın equıty and property values ın lınked funds

(ıı) A rıse ın ınterest rates reduces both the value of fixed ınterest assets and the value of lıabılıtıes The converse ıs true of a fall ın ınterest rates Therefore the net ımpact ıs sıgnıficantly less than the ımpact on assets alone

A summary of how each rısk ıs mıtıgated ıs provıded below wıth, where approprıate, quantıtatıve ınformatıon on the exposure to that rısk

(a) **Market rısk**

Market rısk ıs the rısk of loss arısıng from a change ın the values of, or the ıncome from, assets or ın ınterest or exchange rates A rısk of loss also arıses from changes ın the volatılıty of asset prıces, ınterest rates, or exchange rates Market Rısk ıncludes the followıng five elements

Equıty Rısk – the rısk of financıal loss arısıng from a change of or volatılıty ın equıty prıces or ıncome
Foreıgn Exchange Risk – the rısk of financıal loss arısıng from a change of or volatılıty ın exchange rates
Interest Rate Risk – the rısk of financıal loss arısıng from a change of or volatılıty ın ınterest rates
Property Risk – the rısk of financıal loss arısıng from a change of or volatılıty ın real estate values or ıncome
Commodıty Rısk – the rısk of financıal loss arısıng from a change of or volatılıty ın commodıty prıces

Market rısk arıses on guarantees and optıons offered on certaın of the Company's products The Company ıs exposed to guarantees on bonus addıtıons that become more valuable as ınvestment values fall In addıtıon, the Company ıs exposed to guaranteed cash and annuıty optıons on certaın pensıon polıcıes that become more valuable as ınterest rates fall

The Company manages market rısk attachıng to assets backıng specıfic polıcyholder lıabılıtıes and to assets held to delıver ıncome and gaıns for the shareholder Wıthın the unıt-lınked funds and wıth profit funds, the Company manages market rısk so as to provıde a return ın lıne wıth the expectatıons of polıcyholders The prıncıpal objectıve for shareholder assets ıs to manage them so that they meet the capıtal requırements of the Company, and support ıts future strategıc and operatıonal objectıves

Appetıte for market rısk varıes for dıfferent asset classes and by the nature of the lıabılıtıes or funds that they represent For example, ın relatıon to equıty rısk, appetıte varıes from takıng on the rısk when ıt ıs benefıcıal to do so for assets backıng wıth profits busıness ın wıth profits funds to not actıvely pursuıng the rısk to for assets backıng non-lınked, non-profit polıcıes

For assets backıng polıcyholder lıabılıtıes, market rısk ıs managed by matchıng, where possıble, the duratıon and profile of assets to the polıcyholder lıabılıtıes they are backıng Thıs helps manage market rısk to the extent that changes ın the values of assets are matched by a correspondıng movement ın the values of lıabılıtıes

25. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(a) Market risk (continued)

Shareholders earnings are further exposed to market risk to the extent that the income from policyholder funds is based on the value of financial assets held within those unit-linked funds or the With-Profits Fund

The following summarises the key actions undertaken by the Company to manage all aspects of market risk

The members of the Investment Committee of Friends Provident Plc oversee investment policy and strategy for all the Life and Pensions companies, which is actioned primarily through the use of investment fund mandates Day-to-day implementation of investment policy and strategy is managed predominantly by F&C Asset Management plc (F&C) in line with these approved mandates subject to robust monitoring

Mandates are set for each relevant fund within the Company and its insurance subsidiaries taking account of the relevant factors outlined above Unit-linked funds are managed in line with their underlying objectives as set out in policyholder contracts The mandates set limits on the level of market risk permitted using some or all of the following mechanisms

- defined performance benchmarks,
- a maximum proportion of the fund that can be held in equities and, for the With-Profits Fund, a minimum level,
- restrictions on the size of companies within which equity investment can be held (eg potentially restricting UK equity to FTSE 100 stocks)
- defined asset allocations between UK and overseas equity exposure in specific regions,
- restrictions on the variation of the duration of the portfolio of bonds from the benchmark duration

Equity derivatives may be held to facilitate efficient portfolio management or to reduce investment risk (without disproportionately increasing other types of risk), and appropriate approval must be obtained for their use Currency futures and other derivatives may be held to manage currency risk but only if permitted by individual fund mandates

In addition to the mandates, the Company undertakes a programme of asset/liability management For example in order to manage the impact of interest changes on profit, corporate bonds and gilts are held to match the duration of annuity and permanent health insurance policies held This provides matching of cash flows and valuation movements and is supplemented by the use of interest rate swaps to improve asset/liability matching as necessary

In order to manage the exposure arising from guarantees and options, the Company has purchased a number of derivatives, including interest rate swaps, equity put options and futures, to manage exposures to changes in interest rates or falls in equity prices Hedge accounting has not been applied to these derivatives, as movements in the fair value of these instruments will be offset by the movement in the valuation of the liability As noted, the majority of these guarantees arise in the With-Profits Fund and so any net valuation movement will be reflected in the FFA rather than within shareholders' funds

The following provides additional information on the exposure to equity and property risk, foreign exchange risk and interest rate risk

(i) Equity and property risk

Equity and property risk as defined above, are accepted in accordance with agreed risk appetite in order to achieve the desired level of return from policyholder assets For with-profits and unit-linked policies, the policyholders bear the majority of the investment risk and any change in asset values is matched by a broadly equivalent change in the liability Charges which are expressed as a percentage of fund values are also impacted by movements in equity and property prices Appetite for equity risk exposure for shareholder funds has reduced Shareholder tactical equities have been effectively hedged out by selling FTSE100 equities

25. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(a) Market risk (continued)

(i) Equity and property risk (continued)

The management of the Company's equity investments is largely undertaken on behalf of the Company by F&C Asset Management plc (F&C) In its decision-making on equity investments, F&C will assess the extent of equity risk required or allowed by the fund as set out in the fund objectives and relative to defined performance benchmarks The methodology followed by F&C to manage equity risk within each fund is an integral part of the asset management approach adopted

(ii) Foreign exchange risk

The Company is exposed to foreign exchange risk through its investment in foreign operations, investment in financial instruments denominated in currencies other than its functional currency (pounds sterling) and revenues receivable in foreign currencies Consequently the Company is exposed to the risk that the exchange rate of its measurement currency relative to other currencies may change in a manner that has an adverse effect on the value of the Company's financial assets and liabilities This risk is accepted, in accordance with the agreed risk appetite, as being consequential upon the Company following its agreed investment strategy

Exposure to foreign exchange risk through direct investment in overseas equities and debt securities is minimal due to restrictions through limits placed by investment mandates set by management

For unit-linked contracts, currency risk is borne by the policyholder As noted above, the shareholders are subject to currency risk only to the extent that income from policyholder funds is based on the value of the financial assets held in those funds The liability for non-linked insurance contracts in currencies other than sterling is immaterial

(iii) Interest rate risk

The Company is exposed to fair value interest rate risk where changes to interest rates result in changes to fair values rather than cash flows, for example fixed interest rate loans and assets and derivatives that convert floating rate interest payments to fixed rates Conversely, floating rate loans and derivatives that convert fixed interest rates to floating rates expose the Company to cash flow interest rate risk

Again, interest rate risk is accepted, in accordance with agreed risk appetite, as a consequence of the Company following its agreed investment strategy

Day to day investment decisions around the management of interest rate risk and its impact on the value of the Company's investments are largely undertaken on behalf of the Company by F&C, within the boundaries set by fund mandates In its decision making on gilt and corporate bond investments, F&C will assess the extent of interest rate risk required or allowed by the fund as set out in the fund objectives and relative to defined performance benchmarks The methodology followed by F&C to manage interest rate risk within each specific fund is an integral part of the asset management approach adopted

The Company may also be exposed to interest rate risk on its strategic investments, or any debt issuance As part of any proposal for strategic investment or debt capital raising, the interest rate risk to which the Company is exposed will be given careful consideration as one of the factors impacting on the final recommendation Any proposed non F&C managed investments or debt raising with significant interest rate risk is reviewed by the risk function Ultimate approval for any strategic investments or debt raising rests with Friends Provident plc Board

25. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(b) Policy cash flow risk

Policy cash flow risk consists of the following four main areas

Insurance risks

- mortality risk – risk of loss arising due to policyholder deaths experience being different from expectations, or for annuities, risk of annuitants living longer than expected (called annuity longevity risk),
- morbidity risk – risk of loss arising due to policyholder health experience being different from expectations

Other risks

- policyholder decision risk – risk of loss arising from experience of actual policyholder behaviour (e g lapses, option take-up) being different from expectations
- expense risk – risk of loss due to expense experience being different from expectations

The Company actively pursues mortality risk and morbidity risk in those areas where it believes it has a competitive advantage in managing these risks to generate shareholder value (without compromising the interests of policyholders and the need to treat customers fairly) Policyholder decision risk and expense risk are taken on when it is deemed financially beneficial for the Company to do so, or where the taking of these risks is in support of the Company's strategic objectives

Underpinning the Company's management of policy cash flow risk is

- adherence to an approved underwriting policy that takes into account the level of risk that the Company is prepared to accept,
- controls around the development of products and their pricing and
- regular analysis of actual mortality, morbidity and lapse experience which feeds into the development of products and policies

Most policies are written in the UK and so results are sensitive to changes in the UK insurance market and tax regime Otherwise the Company has a diverse range of policyholders and products on its books Overseas Life Assurance Business (OLAB) is the only overseas business

While significant cash flows often occur at the maturity date there are other cash flows which occur throughout the term of the contracts including income from investments, premiums, annuity payments, death and sickness payments, expenses and commission

Note 23 describes the main insurance contracts written by the Company and the basis of setting assumptions in measuring insurance liabilities, which takes into account the risks above The following sections describe how policyholder decision risk and expense risk are managed and provide an indication of the sensitivity of reported profit to the risk

(i) Policyholder decision risk

Persistency experience varies over time as well as from one type of contract to another Factors that will cause lapse rates to vary over time include changes in investment performance of the assets underlying the contract where appropriate regulatory changes that make alternative products more attractive, customer perceptions of the insurance industry in general and the UK Life and Pensions division in particular, and the general economic environment

The immediate impact on profit of a change in lapse rates is relatively small An increase in lapse rates will normally result in a small reduction in profit

25. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(i) **Policyholder decision risk (continued)**

The cost of guaranteed annuity options is dependent on decisions made by policyholders such as policy discontinuance and tax-free cash take-up These assumptions are set by reference to recent experience

(ii) **Expense risk**

The whole of the impact of changes in expense levels is borne by shareholders with the following exceptions In 2010 the charges made to the With-Profits Fund for managing policies will be reviewed to reflect market rates at the time Pre-demutualisation with-profits policyholders will bear the impact of any resulting changes to charges

Contractual terms for unit-linked and unitised with-profits products include provision for increases in charges Certain expenses (such as fees/commissions) are fixed at the time a contract is written

(c) Credit risk

Credit risk is the risk of loss due to the default of a company, individual or country, or a change in investors' risk appetite Credit risk includes the following seven elements

Investment credit risk – financial loss arising from a change in the value of an investment due to a rating downgrade, default, or widening of credit spreads

Derivative counterparty risk – financial loss arising from a derivative counterparty's default, or the deterioration of the derivative counterparty's financial position

Reinsurance counterparty risk – financial loss arising from a reinsurer's default, or the deterioration of the reinsurer's financial position

Deposit risk – financial loss arising from a deposit institution's default, or the deterioration of the deposit institution's financial position

Loan risk – financial loss arising from a debtor's inability to repay all, or part, of its loan obligations to the Company or the deterioration of the debtor's financial position

Country risk – financial loss arising from the most economic agents in a sovereign foreign country, including its government, being unable or unwilling to fulfil their international obligations due to a shortage of foreign exchange or another common reason such as currency inconvertibility

Settlement risk – financial loss arising from the failure or substantial delay of an expected settlement in a transfer system to take place, due to the party other than the Company defaulting/not delivering on its settlement obligations

The Company will take on investment credit risk and loan risk when it is deemed financially beneficial to do so in support of the Company's strategic objectives The Company is averse to most other types of credit risk, in particular that related to the default of derivative counterparties, reinsurers and deposit takers

The Company is exposed to investment credit risk on its investment portfolio, primarily from investments in corporate bonds Creditworthiness assessment for new and existing investments is largely undertaken on behalf of the Company by F&C In their decision making, F&C will assess the extent of investment credit risk required or allowed by each fund as set out in the fund mandates and relative to defined performance benchmarks

25. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(c) Credit risk (continued)

The global 'credit crunch' has had a minimal impact as the Company has very little exposure to the higher risk end of the market Exposure to directly held asset-backed securities is £1,181m, all of which are at investment grade Exposure to US sub-prime mortgage backed securities within the Group's investment portfolio is immaterial

Derivatives purchased over the counter expose the Company to substantial credit risk unless this risk is appropriately managed The Asset Liability Management function is responsible for recommending derivative strategies to the board, and putting into place the appropriate internal management processes (including independent valuation and payment verification procedures) As part of the analysis of any proposed derivative contracts, the credit risk arising will be given due consideration as one of the factors impacting on the final recommendation The Company will endeavour only to transact over-the-counter derivatives with highly rated counterparties as it has a risk adverse appetite for this risk

The Company is exposed to reinsurance counterparty risk of three different types

- as a result of debts arising from claims made by the Company but not yet paid by the reinsurer,
- from reinsurance premium payments made to the reinsurer in advance and
- as a result of reserves held by the reinsurer which would have to be met by the Company in the event of default

In addition there is potential for the Company's credit risk exposure to increase significantly under adverse insurance risk events eg if the Company received a large number of claims for which it needed to recover amounts from its reinsurers In order to mitigate reinsurance counterparty risk, the Company will give due consideration to the credit quality of a reinsurer before incepting a reinsurance treaty To facilitate this process, a list of acceptable reinsurers is maintained within Life & Pensions Finance

The Company is exposed to credit risk on the balances deposited with banks in the form of cash certificates of deposit and money market instruments Money market instruments issued by parties other than banks such as commercial paper are also covered under this heading Given the high credit quality of the deposit institutions and the short-dated nature of these credit risk exposures, the primary risk to the Company under this heading is concentration risk

The Company is exposed to loan risk in several different areas, the most material of which are

- loans to IFAs as part of strategic investments
- stocklending arrangements,
- other strategic loans,
- loans to appointed representatives,
- loans to brokers,
- agency debt (including debt arising as a result of clawback of commission)
- policyholder debt,
- rental income due

In general these quantitative credit exposures are relatively low but they can bear relatively high likelihoods of default

25. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(c) Credit risk (continued)

The Company is exposed to country risk in a number of key areas, the most significant of which are

- bonds issued by foreign governments in non-domestic currency,
- the inability of foreign entities to meet their obligations to the Company due to a shortage of foreign exchange

The management of country risk on the creditworthiness of our investments is largely undertaken on behalf of the Company by F&C

Settlement risk is a form of credit risk that arises at the settlement of a transaction, as a result of one party to the transaction (for example, the other counterparty, an exchange, or a bank) failing to perform its obligations to the Company The Company is exposed to settlement risk in the following key areas

- bank transfers, including foreign exchange transactions,
- the purchase or sale of investments,
- the purchase or sale of property,
- the purchase or sale of exchange-traded derivatives or the transfer of periodic payments under these contracts,
- the purchase or sale of over-the-counter derivatives or the transfer of periodic payments under these contracts,
- the settlement of derivative contracts

Settlement risk on assets that form part of F&C funds is managed as an integral part of the asset management approach adopted

To mitigate credit risk

- Investment mandates for many funds will have a prescribed minimum credit rating of bonds that may be held Investing in a diverse portfolio reduces the impact from individual companies defaulting
- Counterparty limits are set for investments, cash deposits, foreign exchange trade exposure and stock lending
- All derivative transactions are covered by collateral
- The Company regularly reviews the financial security of its reinsurers

The counterparty and individual issuer credit rating limits, and hence exposure to credit risk, by individual regulated entity are as follows

Credit rating	Limit
AAA	£1,000m
AA	£750m
A	£600m
BBB	£100m
Below	£20m

The exposure to individual counterparties is limited to specific percentages of total non-linked assets in the long term fund, based on regulatory categorisation of counterparties These are typically less than 4% of non-linked assets

Concentrations of credit risk might exist where the Company has significant exposure to a group of counterparties with similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic and other conditions

25. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(c) Credit risk (continued)

The amount disclosed in the balance sheet in respect of financial assets represents the Company's maximum exposure to credit risk

An indication of the Company s exposure to credit risk is the quality of the investments and counterparties with which it transacts The Company is most exposed to credit risk on debt and other fixed income securities, derivatives, deposits with credit institutions, reinsurance arrangements and cash at bank Debt and other fixed income securities mainly comprise government bonds and corporate bonds Given the nature of the Company's investments in government bonds the credit risk associated with these is considered small and the Company therefore focuses on monitoring the quality of its corporate bonds

The following table gives an indication of the level of creditworthiness of those categories of assets which are most exposed to credit risk using principally ratings prescribed by Standard & Poor's and Moody s Assets held within unit-linked funds have been excluded from the table below as the credit risk on these assets is borne by the policyholders rather than the shareholders Government bonds have also been excluded

31 December 2007

	AAA	AA	A	BBB	BB	B	Not rated	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Debt & other fixed interest securities	1,807	1,158	1,492	348	22	7	100	4,934
Derivatives	-	150	-	-	-	-	-	150
Reinsurance claims	-	7	-	-	-	-	-	7
Deposits with credit institutions	279	145	189	-	-	-	10	623
Cash at bank and in hand	-	12	-	-	-	-	-	12

31 December 2006

	AAA	AA	A	BBB	BB	B	Not rated	Total
	£m	£m	£m	£m	£m	£m	£m	£m
Debt & other fixed interest securities	1,935	1,144	1,590	511	7	5	165	5,357
Derivatives	-	191	-	-	-	-	-	191
Reinsurance claims	-	7	-	-	-	-	-	7
Deposits with credit institutions	127	348	172	-	-	-	-	647
Cash at bank and in hand	-	45	-	-	-	-	-	45

For over-the-counter derivative transactions undertaken by the Company, collateral is received from the counterparty if the contract is in-the-money (ie is an asset of the Company) This collateral can be sold or re-pledged by the Company and is repayable if the contract terminates or the contract's fair value falls Contractual agreements between the Company and each counterparty exist to protect the interests of each party, taking into consideration minimum threshold, asset class of collateral pledged and the frequency of valuation

At 31 December 2007 the fair value of such collateral held was £143m (2006 £181m) No collateral received from the counterparty has been sold or re-pledged

25. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(c) Credit risk (continued)

The following table shows the amount of 'debtors' and 'prepayments and accrued income (excluding 'deferred acquisition costs' (DAC) 'deferred fees and charges' (DFF)) that were not past due, past due but not impaired and impaired at the end of the year

As at 31 December 2007 (Amounts held in unit-linked funds have been excluded from the table)

	Debtors and prepayments and accrued income (excluding DAC and DFF)
Neither past due nor impaired	89 8%
Financial Assets that are past due:	
0-3 months past due	8 0%
3-6 months past due	0 1%
6-12 months past due	0 2%
More than 12 months past due	1 0%
Provisions for impairment	0 9%
Total (£m)	201

As at 31 December 2006 (Amounts held in unit-linked funds have been excluded from the table)

	Debtors and prepayments and accrued income (excluding DAC and DFF)
Neither past due nor impaired	94 1%
Financial Assets that are past due:	
0-3 months past due	4 7%
3-6 months past due	0 7%
6-12 months past due	0 2%
More than 12 months past due	0 1%
Provisions for impairment	0 2%
Total (£m)	242

(d) Liquidity risk

Liquidity risk is the risk that an entity, although solvent, either does not have sufficient financial resources available to it in order to meet its obligations when they fall due, or can secure them only at excessive cost

The Company faces two key types of liquidity risk shareholder liquidity risk (liquidity within funds managed for the benefit of shareholders, including shareholders' interests in long-term funds) and policyholder liquidity risk (liquidity within funds managed for the benefit of policyholders)

Longer-term shareholder liquidity risk is taken on when it is deemed financially beneficial for the Company to do so, or where the taking of this liquidity risk is in support of strategic objectives Short-term shareholder liquidity risk is avoided due to the need to satisfy dividend expectations whilst having a limited timeframe to raise capital Policyholder liquidity risk is not accepted, over either a short or longer-term timeframe, in all but the most extreme scenarios

25. RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(d) Liquidity risk (continued)

The Company is exposed to shareholder liquidity risk in a number of key areas For example

- the ability to support the liquidity requirements arising from new business,
- the capacity to maintain dividend payments/loan repayments and interest etc,
- the ability to cope with the liquidity implications of strategic initiatives such as merger and acquisition activity,
- the capacity to provide financial support across the Group,
- the ability to fund its day-to-day cash flow requirements

The overall objective of shareholder liquidity risk management is to ensure that there is sufficient liquidity over short (up to one year) and medium time horizons to meet the needs of the business This includes liquidity to cover, amongst other things, new business costs, servicing debt, paying dividends to the parent company as well as working capital to fund day-to-day cash flow requirements

For policyholder funds, liquidity risk arises from a number of potential areas, including

- a short-term mis-match between assets and liabilities,
- having to realise assets to meet liabilities during stressed market conditions
- investments in illiquid assets such as property and private placement debt,
- higher than expected level of lapses/surrenders caused by economic shock adverse reputational issues or other events,
- higher than expected payments of claims on insurance contracts

Exposure to policyholder liquidity risk can be split between non-linked and linked funds As a general rule, the Company is more likely to be significantly impacted by policyholder liquidity risk on non-linked funds, as opposed to linked funds where policyholder benefits are expressed directly as units held in an underlying fund

The overall objective of policyholder liquidity risk management is to ensure that sufficient liquid funds are available to meet cash flow requirements under all but the most extreme scenarios

Liquidity risk is managed in the following way

- Forecasts are prepared regularly to predict required liquidity levels over both the short and medium term
- Committed third party funding facilities are held to enable cash to be raised in a relatively short time-span
- Credit risk of cash deposits is managed by applying counterparty limits and imposing restrictions over the credit ratings of third parties with whom cash is deposited
- Assets of a suitable maturity and marketability are held to meet policyholder liabilities as they fall due
- Limits are set on the level of investment in securities that are not readily realisable These are typically restricted to 5% of non-linked assets

25 RISK MANAGEMENT OBJECTIVES AND POLICIES FOR MITIGATING RISKS (continued)

(d) Liquidity risk (continued)

The following table indicates the undiscounted expected contractual cashflows in respect of financial and insurance liabilities Where contracts have a surrender value (ie the policy is theoretically payable on demand) the current surrender value is shown in the within one year or payable on demand column

Year ended 31 December 2007

Contractual undiscounted cash flows:	Carrying value £m	Within 1 year or payable on demand £m	1-5 years £m	More than 5 years £m
Technical Provisions	9,953	7,635	643	2,816
Investment contract liabilities	13,586	14,055	-	-
Creditors arising out of direct insurance operations	12	12	-	-
Creditors arising out of reinsurance operations	3	3	-	-
Other creditors	43	43	-	-
Accruals and deferred income	12	4	8	-

All investment and insurance contract unit linked liabilities are payable on demand and have therefore been included 'within 1 year or payable on demand'

Amounts expected to be settled from the fund for future appropriation are excluded from the analysis above as there is no contractual obligation to settle the liability Of the carrying amount on the balance sheet in respect of the FFA, £302m (2006 £246m) is expected to be settled more than 12 months after the balance sheet date

'Amounts due to Group undertakings' have not been included in the analysis as they do not have any fixed repayment terms

Year ended 31 December 2006

Contractual undiscounted cash flows:	Carrying value £m	Within 1 year or payable on demand £m	1-5 years £m	More than 5 years £m
Technical Provisions	10,610	8,296	742	3,405
Investment contract liabilities	14,059	14,273	-	-
Creditors arising out of direct insurance operations	11	11	-	-
Creditors arising out of reinsurance operations	3	3	-	-
Other creditors	44	44	-	-
Accruals and deferred income	3	3	-	-

26. PROVISIONS FOR OTHER RISKS AND CHARGES

	£m
Vacant properties	
At 1 January 2007	4
Utilised in year	(1)
At 31 December 2007	3
Review of mortgage endowment complaints	
At 1 January 2007	20
Charge in year	(2)
Utilised in year	(11)
At 31 December 2007	7
Review of other sales	
At 1 January 2007	3
Charge in year	2
Utilised in year	(4)
At 31 December 2007	1
Financial reinsurance	
At 1 January 2007	136
Charge in year	(35)
At 31 December 2007	101
Deferred tax	
At 1 January 2007	170
Charge in year	(1)
Effect of discounting	4
At 31 December 2007	173
Total at 1 January 2007	333
Total at 31 December 2007	285

Vacant properties

The Company holds leases for a number of vacant and sub-let properties previously occupied by the Group Provision has been made for the residual lease commitments and for other outgoings where significant, after taking into account the existing and expected sub-tenant arrangements The remaining terms of the leases are up to 12 years Assumptions as to whether each leasehold property may be sub-let or assigned in the future have been made The discount rate applied to expected future cash flows is 5% (2006 5%)

Mortgage endowment complaints

Provision has been established for the estimated likely cost of redress, including administrative costs arising from the review of the suitability of mortgage endowment policies In addition to the accounting provision of £7m (2006 £20m), an actuarial reserve of £9m (2006 £17m) was held in the long-term business provision at 31 December 2007 in respect of estimated further endowment complaints

The majority of the mortgage endowment redress provisions are expected to be settled in the next two years

26. PROVISION FOR OTHER RISKS AND CHARGES (continued)

Review of other sales

Provisions have been established for the estimated likely redress, including administration costs, arising from the review of other sales In addition to the accounting provision of £1m (2006 £3m), an actuarial reserve of £6m (2006 £23m) was held in the long-term business provision in respect of future estimated complaints

Financial reinsurance

On 16 December 2004, the Company securitised the cash flows expected to emerge from a book of its life insurance policies by entering into a reinsurance contract with Friends Provident Reinsurance Services Limited (FPRe) The reinsurance agreement provides regulatory capital to the Company and enables funds to be released to finance new business growth As a consequence the long-term business provision decreased by £375m As future surpluses emerge on the book of life insurance policies the amounts due to FPRe under the reinsurance contract will be repaid The surplus offset against the provision in 2007 is £35m (2006 £152m)

The charge is reflected in 'other technical charges, net of reinsurance'

The Company has not provided any guarantee or commitment in respect of the reinsurance contract

27. OTHER CREDITORS INCLUDING TAXATION AND SOCIAL SECURITY

	2007 £m	2006 £m
Amounts falling due within one year		
Outstanding investment purchases	3	-
Amounts due to Group undertakings	387	420
Other creditors	42	44
	432	464

28 FINANCIAL COMMITMENTS

Annual commitments under non-cancelable operating leases for which no provision has been made in the financial statements were as follows

	2007 Land and buildings £m	2006 Land and buildings £m
Operating leases which expire in over five years	-	1 4

29. GUARANTEES

(a) 6 875% Step-up Tier one Insurance Capital Securities (STICS) issued by Friends Provident plc

On 21 November 2003, Friends Provident plc issued £300m of STICS, which will bear interest from 21 November 2003 to 20 November 2019 at a rate of 6 875% The STICS have no maturity date but will be redeemable at the option of the issuer Friends Provident plc on 21 November 2019 and thereafter on the coupon payment date falling on or nearest successive fifth anniversaries of this date The STICS are perpetual securities and are not redeemable at the option of the holder at any time The STICS are irrevocably guaranteed on a subordinated basis by the Company

The guarantee is intended to provide holders with rights against the Company in respect of the guaranteed payments which are as nearly as possible equivalent to those which they would have had if the STICS had been directly issued preference shares of the Company

This guarantee does not meet the definition of a financial guarantee under FRS 26 as the Company is able to defer its obligation to make payments under the guarantee to holders of STICS for an unlimited period, and the holders have no right to enforce the obligation on the Company

(b) 6 292% Step-up Tier one Insurance Capital Securities (STICS) issued by Friends Provident plc

On 27 June 2005, Friends Provident plc issued £500m of STICS, which will bear interest from 30 June 2005 to 30 June 2015 at a rate of 6 292% The STICS have no maturity date but will be redeemable at the option of the issuer Friends Provident plc on 1 July 2015 and thereafter on every fifth anniversary of this date The STICS are perpetual securities and are not redeemable at the option of the holder at any time The STICS are irrevocably guaranteed on a limited and subordinated basis by the Company

This guarantee does not meet the definition of a financial guarantee under FRS 26 as the Company is able to defer its obligation to make payments under the guarantee to holders of STICS for an unlimited period, and the holders have no right to enforce the obligation on the Company

30. DIRECTORS' EMOLUMENTS

The directors are employed by and receive their remuneration from FPMS, a fellow Group undertaking Included within the management recharges from FPMS for 2007, is an allowance for directors' emoluments in respect of their services to the Company, details of which are given below This is a proportion of the costs of the directors' salaries as incurred by the company

	2007 £000	2006 £000
All directors		
Management salaries and benefits in kind	494	452
Amounts receivable under annual bonus schemes	95	185
	589	637

As at 31 December 2007 retirement benefits were accruing to eleven directors (2006 ten) under a defined benefit scheme and one director (2006 one) received retirement benefits under an unfunded unapproved pension arrangement

Highest paid director

The total of salaries, benefits in kind, and result-related payments payable to directors includes £124,000 (2006 £116,000) in respect of the highest paid director, of which £nil (2006 £nil) relates to long-term incentive schemes This is a proportion of the costs incurred by the company in respect of the highest paid director and not their full salary Pension contributions to money purchase schemes include £nil (2006 £nil) for the highest paid director The highest paid director is a member of a defined benefit pension scheme, under which the total accrued pension to which such director would be entitled to from the normal retirement date if the director were to retire at the year end was £85,000 (2006 £76,000)

31. RELATED PARTY TRANSACTIONS

The Company is a wholly owned subsidiary undertaking of Friends Provident plc The results of both the Company and its subsidiaries are consolidated in the results of Friends Provident plc, the Company's ultimate parent and controlling company, whose financial statements are publicly available Accordingly, the Company is exempt from the requirements of FRS 8 Related Party Disclosures, concerning the disclosure of transactions with other companies, which qualify as related parties within the Group

Key management which includes their close family and undertakings controlled by them, had various transactions with the Company during the year Key management consists of all directors and executive management of the Company

Payments during the year by key management in respect of policies and investments issued or managed by the Company were as follows

	2007 £000	2006 £000
Periodic payments	63	39
Single payments	10	210
Payments by the Company	24	935

All these transactions were completed on terms, which were identical to those available to staff

32 CONTINGENT LIABILITIES

The Company has made provision for the estimated cost of settling complaints in respect of past sales (see note 26) Although the provisions are regularly reviewed, the final outcome could be different from the provisions established as these costs cannot be calculated with certainty and are influenced by external factors beyond the control of management Such uncertainties include future regulatory actions, media attention and investment performance The majority of the uncertainty relates to endowment mortgages although a number of other products are being reviewed as an ongoing process It is expected that the majority of endowment cases requiring compensation will be settled in the next two years

33. ULTIMATE PARENT UNDERTAKING

The Company's ultimate parent undertaking is Friends Provident plc which is incorporated in the United Kingdom Copies of the Group Annual Report and Accounts of Friends Provident plc can be obtained by writing to its Secretary at Pixham End, Dorking, Surrey RH4 1QA and can be viewed via its website at www friendsprovident com