SCOTTISH MUTUAL INTERNATIONAL LIMITED

REPORT AND FINANCIAL STATEMENTS

31 DECEMBER 2008

INCORPORATED IN THE REPUBLIC OF IRELAND

Registration No. EO242244

Directors' report

The Directors present their annual report on the affairs of the Company, together with the financial statements and auditors' report, for the year ended 31 December 2008.

Business review

Principal activities

The principal activity of the Company is the transaction of individual life assurance business. Having closed to new business in April 2003, the operations of the Company now principally involve the receipt of incremental premiums and processing of claims arising on in-force policies and the collection of related amounts due from reinsurers.

Corporate developments

On 1 May 2008, the Company's then ultimate parent company, Resolution plc (subsequently renamed Pearl Group Holdings (No. 1) Limited), was acquired by Impala Holdings Limited (IHL), a subsidiary of Pearl Group Limited (PGL), and from this date Pearl Group Limited became the Company's ultimate parent company.

Subsequent events

There were no significant events affecting the Company since the year end.

Operational activities and state of affairs

The Board and management monitor business performance via a range of performance indicators, the key financial reporting items being profits in comparison to annual and quarterly targets and solvency in comparison to internal and external capital requirements. Details of the loss for the year are set out on page 12 and the Company's capital management process and capital resources are outlined at note 29.

The Company's business is written in Ireland, the United Kingdom and Hong Kong (by the registered Hong Kong branch).

The Company transacts business in a number of currencies, but predominantly Sterling and Euros. As a consequence of the ongoing run off of the in-force business, during 2008, the profile of the business has changed such that Sterling now represents the principal currency in which the Company does business. Accordingly, with effect from 1 January 2008, the Company has changed its functional currency from Euro to Sterling. Prior year comparatives in the financial statements are presented on the basis of the Euro as the Company's functional currency.

Scottish Mutual International Limited has two principal sub funds, namely, a non profit fund and a shareholder fund.

The non profit sub fund is closed to new business, other than increments on certain existing business. At 31 December 2008, the non profit sub fund had admissible assets calculated in accordance with the Irish Financial Services Regulatory Authority standards of £650m (2007: £769m).

The investment element of the Company's unitised with-profits policies is partially reinsured with Scottish Mutual Assurance Limited, a fellow Pearl Group company.

The results of the Company for the year ended 31 December 2008 are set out on page 12. These are prepared under International Financial Reporting Standards (IFRS). These show that the Company generated a loss after tax of £8m for the year then ended (2007 profit: £11m). It is intended that this loss be transferred to reserves.

The financial position of the Company has been impacted during the year by the repayment of the £30m (2007: £80m) capital contributions previously gifted to the Company by Scottish Mutual International Holdings in accordance with section 45 of the Companies (Amendment) Act, 1983.

Shareholder net equity at 31 December 2008 was £62m (2007: £99m).

Principal risks

The Company's business is predominantly single premium investment products, incorporating single premium unit linked bonds, portfolio bond type investments, and unitised with-profits bonds.

The principal risk exposures for the shareholder relate to expense and operational risks, as well as the residual risk that the shareholder may have to contribute to meet the cost of guarantees on unitised with-profits business.

Directors' report continued

In relation to expense risk, the Company has a Participation Agreement with PGMS (Ireland) Limited in place to ensure close monitoring and management of the Company's expense base. However, as a significant element of the Company's in-force book is projected to run-off over the next few years, managing the fixed element of the cost base remains a significant challenge.

The Company faces operational risks, such as systems, processes and people and, inter alia, the complexity of its outsourced policy administration arrangements. These risks are managed by the use of skilled, specialist resources provided to the Company via the Participation Agreement and by the close monitoring of process and controls performance as part of the Company's risk management framework, including the use of management information and performance indicators.

Controlled investment risks are taken within unitised with-profits business with the aim of enhancing policyholder investment returns. The aim is to limit that risk, in line with the Company's risk policies, to that supportable by the with-profits business assets. The cost of guarantees is met by the shareholder; however, derivative backed hedge assets are in place to protect against the risk of guarantee costs being higher than expected.

Further information on risks is provided in the notes to the financial statements.

Material developments

The Company has been advised by the directors of its ultimate holding company, PGL, and PGL's 75% owned subsidiary, IHL, that discussions are taking place between the FSA, the Group's investors and other key stakeholders regarding the appropriate capital structure for the group, given the extreme market turbulence experienced in 2008 and 2009. These discussions include options to restructure the sources of finance for the Group.

These discussions are designed to facilitate an alignment of the obligations of the Group's investors with the availability of funding from the Group and to thus enable the Group to meet its obligations in the foreseeable future.

The Directors do not expect the results of these discussions to have a material effect on the financial position of the Company. In this regard, the Directors of the Company have considered the position of its parent.

Future developments

The Company will continue to be closed to new business and will not issue any new policies other than policy increments.

Going concern

The Directors' report summarises the activities of the Company, discusses the principal risks and uncertainties it faces and comments on material developments. Notes 28 and 29 to the financial statements summarise the Company's risk and capital management objectives and policies together with its financial risks.

After making enquiries and considering in detail the Company's individual regulatory capital requirements, together with the potential impact on these from issues arising elsewhere in the PGL Group, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

Dividends

The Directors do not propose the payment of a dividend for the year (2007: £nil).

Share capital

Details of the share capital structure of the Company are given in note 11 to the financial statements.

Employee information

PGMS (Ireland) Limited currently provides services to the Company and accordingly the Company had only one employee in the current and prior year. Employee policies and practices are managed on a group basis and are set out in the report and financial statements of the ultimate parent undertaking, Pearl Group Limited.

Directors

Except as shown, the Directors of the Company throughout the year were:

R H Burke	
N F Gallagher	
C M Garthwaite	(resigned 1 August 2008)
C P McGettrick	
G L Singleton	(resigned 30 September 2008)
M P Smith	
B D Woods	
M J S Eaton	(appointed 4 December 2008)
J S B Smith	(appointed 4 December 2008)

PGL has agreed to provide an Indemnity to certain persons within the Pearl Group. These persons include nominated directors and secretaries, subsidiary directors, subsidiary secretaries, and alternate directors. This indemnity will cover all losses, costs and expenses incurred by an indemnified person incurred in the exercise, execution and discharge of his duties, or connected to the same, to the fullest extent permitted, consistent with the UK Companies Act 2006, provided that if such indemnified person is also entitled to be indemnified under the terms of the Articles of another Pearl Group company, or pursuant to the terms of a indemnity granted by another Pearl Group company, then the indemnified person must first claim under that indemnity.

Directors, alternate directors and company secretaries of Pearl Group Holdings (No. 1) Limited and former subsidiaries of that company may still benefit from the provisions of an earlier Deed of Indemnity entered into by that company.

Transactions involving Directors

There were no contracts or arrangements of any significance in relation to the business of the Company in which Directors had any interest, as defined by the Companies Act, 1990, at any time during the year ended 31 December 2008.

Directors' and Secretary's interests

The Directors and Secretary who held office at 31 December 2008 had no beneficial interest in the share capital of the Company or any group companies as required to be disclosed in accordance with Section 63 of the Companies Act, 1990.

Statement of Directors' responsibilities

The Directors are responsible for preparing their report and the financial statements in accordance with applicable Irish law and International Financial Reporting Standards (IFRS) as adopted by the European Union.

International Accounting Standard 1 requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the Preparation and Presentation of Financial Statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRS.

Directors' report continued

Company law requires the Directors to prepare financial statements for each financial year, which 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 those 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;
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Company will continue in business; and,
- comply with applicable accounting standards, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping proper books of account which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements are prepared in accordance with IFRS and comply with Irish Statute comprising the Companies Acts, 1963 to 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Proper books of account

The Directors have taken appropriate measures to ensure compliance with Section 202 of the Companies Act, 1990. The specific measures taken are the employment of appropriately qualified accounting personnel and the maintenance of computerised accounting systems. The books of account are located at the Company's offices at Styne House, Upper Hatch Street, Dublin 2, Republic of Ireland.

Political donations

The Company did not make any political donations during the year.

Payment of suppliers

In the forthcoming year, goods and services will continue to be supplied to the Company by PGMS (Ireland) Limited, PGMS Limited, SPILA Services (Hong Kong) Limited and SPILA Services (Isle of Man) Limited. PGMS (Ireland) Limited will continue to be responsible for agreeing terms and conditions under which business is to be transacted and for making suppliers aware of these before business is contracted. It is the policy to ensure payments are made in accordance with legal and contractual obligations.

Details of payment policy and average creditor days are disclosed within the accounts of the appropriate service companies.

Auditors

The auditors, Ernst & Young, Registered Auditors, will continue in office in accordance with Section 160 (2) of the Companies Act, 1963.

Registered office

The registered office address is:

25-28 North Wall Quay
IFSC
Dublin 1
Republic of Ireland

On behalf of the Board
29 April 2009

Niall F Gallagher	**Ciaran P McGettrick**
Director	Director

Independent auditors' report to the members of Scottish Mutual International Limited

We have audited the Company financial statements of Scottish Mutual International Limited for the year ended 31 December 2008, which comprise the Income statement, the Statement of Recognised Income and Expense, the Balance sheet, the Cash flow statement, and the related notes 1 to 33. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with section 193 of the Companies Act, 1990. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

The Directors are responsible for the preparation of the financial statements in accordance with applicable Irish law and International Financial Reporting Standards (IFRS) as adopted by the European Union as set out in the Statement of Directors' Responsibilities.

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

We report to you our opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with the Companies Acts, 1963 to 2006. We also report to you our opinion as to: whether proper books of account have been kept by the Company; whether, at the balance sheet date, there exists a financial situation which may require the convening of an extraordinary general meeting of the Company; and whether the information given in the Directors' report is consistent with the financial statements. In addition, we state whether we have obtained all the information and explanations necessary for the purposes of our audit and whether the financial statements are in agreement with the books of account.

We also report to you if, in our opinion, any information specified by law regarding Directors' remuneration and other transactions is not disclosed and, where practicable, include such information in our report.

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

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements 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 IFRS as adopted by the European Union, of the state of affairs of the Company as at 31 December 2008 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Acts, 1963 to 2006.

We have obtained all the information and explanations we consider necessary for the purposes of our audit. In our opinion proper books of account have been kept by the Company. The financial statements are in agreement with the books of account.

In our opinion the information given in the Directors' report is consistent with the financial statements.

In our opinion, the balance sheet does not disclose a financial situation which under section 40(1) of the Companies (Amendment) Act, 1983 would require the convening of an extraordinary general meeting of the Company.

Ernst & Young
Registered Auditors
Dublin

29 April 2009

Accounting Policies

(a) Basis of preparation

The financial statements have been prepared on the going concern basis. In adopting the going concern basis the following significant matters have been taken into consideration:

- A comprehensive review of the valuation and liquidity of investments at the balance sheet date;
- Solvency and cash flow projections under normal and stressed conditions; and
- Impact of failures of material reinsurers, service providers and investment managers.

The Company has also considered the financial position of its ultimate parent company, Pearl Group Limited (PGL).

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. These financial statements are presented in pounds sterling, rounded to the nearest £'000.

The financial statements have been prepared under the historical cost convention except as modified by the application of the following:

- financial instruments at fair value through income; and
- insurance liabilities.

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates.

The International Accounting Standards Board has issued the following standards and interpretations, which apply from the dates shown. The Company has decided not to adopt any of these standards or interpretations where early adoption is permitted. The impact of adopting them is not expected to have a material effect on the results of the Company.

- IAS 1 *Presentation of Financial Statements (Revised)* (2009). This revises and enhances the presentation of information in the financial statements.
- IAS 32 *Financial Instruments: Presentation* and IAS 1 *Presentation of Financial Statements (Revised)* (2009). Amendments relating to the recognition of puttable financial instruments and obligations arising on liquidation.
- *Annual improvements* (2009 and 2010). This makes a number of minor improvements to existing standards.

These standards will be adopted by the Company on the effective date, if appropriate.

In addition, the following standards, amendments and interpretations have been issued but are not relevant to the Company:

- IFRS 1 *First-time Adoption of International Financial Reporting Standards – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (Amendments)* (2009)
- IFRS 2 *Share-based Payment – Vesting Conditions and Cancellations (Amendment)* (2009)
- IFRS 8 *Operating Segments* (2009)
- IAS 23 *Borrowing Costs (Revised)* (2009)
- IAS 27 *Consolidated and Separate Financial Statements* (2009)
- IFRS 3 *Business Combinations (Revised)* (2010)
- IAS 27 *Consolidated and Separate Financial Statements (Revised)* (2010)
- IAS 39 *Financial Instruments: Recognition and Measurement – Eligible hedged items (Amendment)* (2010)
- IFRIC 13 *Customer Loyalty Programmes* (2009)
- IFRIC 15 *Agreements for the Construction of Real Estate* (2009)
- IFRIC 16 *Hedges of a Net Investment in a Foreign Operation* (2009)
- IFRIC 17 *Distributions of Non-Cash Assets to Owners (2010)*

A capital position statement has not been presented as this is disclosed in the financial statements of the ultimate parent company, PGL.

Accounting Policies continued

(b) Critical accounting estimates and judgements

Critical accounting estimates are those which involve the most complex or subjective judgements or assessments. The areas of the Company's business that typically require such estimates are insurance and investment contract liabilities, determination of the fair value for financial assets and liabilities and taxes.

Insurance contract and investment contract liability accounting is discussed in more detail in note (e) with further detail of the key assumptions made in determining insurance contract and investment contract liabilities included in note 15.

The fair values of financial assets are classified and accounted for in accordance with the policies set out in accounting policy (h). They are valued on the basis of listed market prices in so far as this is possible. If prices are not readily determinable, fair value is based either on internal valuation models or management estimates of amounts that could be realised under current market conditions.

The accounting policy for tax is detailed in accounting policy (g).

(c) Foreign currency translation

The Company's functional currency is Sterling. With effect from 1 January 2008 the functional currency changed from Euro to Sterling as a result of a change in the main currency influencing the underlying transactions of the Company. In line with the requirements of IAS 21 on The Effect of Changes in Foreign Exchange Rates, this change has been applied in relation to 2008 only with no restatement of prior period comparatives.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Translation differences on debt securities and other monetary financial assets measured at fair value are included in foreign exchange gains and losses within net investment income. Translation differences on non-monetary items such as equities held for trading are reported as part of the fair value gain or loss.

(d) Classification of contracts

The Company issues insurance contracts and investment contracts.

Insurance contracts are those contracts, which transfer significant insurance risk. 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. Investment contracts are those contracts which carry no significant insurance risk.

A number of insurance and investment contracts contain a discretionary participation feature (DPF) which entitles the holder to receive, as a supplement to guaranteed benefits, additional benefits or bonuses that are likely to be a significant portion of the total contractual benefits and whose amount or timing is contractually at the discretion of the Company and based on the performance of specified assets. Contracts containing a DPF are also referred to as participating or with-profits contracts.

For insurance contracts and investment contracts with DPF, the Company continues to use the Modified Statutory Solvency Basis (MSSB) of accounting, modified as necessary to comply with the requirements of IFRS. For contracts with DPF, this includes the adoption of FRS 27 'Life Assurance'.

Accounting Policies continued

(e) Insurance contracts and investment contracts with DPF

The majority of the life assurance contracts issued by the Company are long-term life assurance contracts. Guaranteed benefits paid on occurrence of the specified insurance event are either fixed or linked to the extent of the economic loss suffered by the policyholder.

The significant accounting policies applied in relation to insurance contracts and investment contracts with DPF are:

Premiums
Premiums received in respect of insurance contracts and investment contracts with DPF are recognised as revenue when due and shown before deduction of commission. Reassurance premiums are charged when they become payable.

Claims
Death claims are recognised on receipt of notifications. Maturity payments are recorded when contractually due. Surrenders are recorded on the earlier of the date paid or date the policy benefit or part thereof ceases to be included within "Liabilities under insurance contracts". Claims on participating business include bonuses payable. Reinsurance recoveries are credited to match the relevant gross amounts.

Fees and commissions
Fee and charge income from services provided in respect of insurance contracts and investment contracts with DPF is recognised in the income statement within 'Change in insurance contract liabilities' when the services are performed.

Liabilities under insurance contracts
Insurance liabilities are determined by the Directors on the advice of the Company's Appointed Actuary following an annual investigation of the long-term business and reflect the value of related assets and the yield derived therefrom.

Insurance liabilities are calculated in accordance with the actuarial principles laid down in the European Communities (Life Assurance) Framework Regulations, 1994.

The figure for liabilities under insurance contracts includes legal and actuarial provisions.

Although the process for the establishment of insurance liabilities follows specified rules and guidelines, the provisions that result from the process are the subject of estimations. As a consequence, the eventual value of claims could vary from the amounts provided to cover future claims. The Company seeks to provide appropriate levels of contract liabilities taking known facts and experiences into account but, nevertheless, such liabilities remain uncertain.

Liabilities – insurance and investment contracts with DPF, are calculated as follows:

A liability for contractual benefits that are expected to be incurred in the future is recorded when the premium is recognised. The liabilities of the Company's unitised with-profits business are calculated as the lower of the current unit value and surrender value of each policy.

Assumptions are made in respect of all material factors affecting future cash flows, including future interest rates, mortality and costs. The unitised with-profits liabilities are partially reassured to Scottish Mutual Assurance Limited, a fellow company of the Pearl Group Limited.

Liability adequacy test
At each balance sheet date, liability adequacy tests are performed to ensure the adequacy of insurance contract and investment contract with DPF liabilities. In performing these tests, current best estimates of future contractual cash flows, claims handling and administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to income to establish an appropriate provision against these potential losses.

Embedded derivatives
Embedded derivative features contained within insurance contracts are accounted for at fair value and unrealised gains and losses arising on the embedded derivatives are reported in income. Where the risks and characteristics of embedded derivatives are not closely related to those of the host contract and the host contract is not carried at fair value, the embedded derivatives are accounted for separately.

(e) Insurance contracts and investment contracts with DPF continued

Reinsurance
The Company cedes reinsurance in the normal course of business. Reinsurance assets primarily include balances due from both insurance and reinsurance companies for ceded insurance liabilities. Amounts recoverable from or due to reinsurers are estimated in a manner consistent with the amounts associated with the reinsured policies and in accordance with the reinsurance contract. Premiums ceded and benefits reimbursed are presented on the balance sheet on a gross basis.

Contracts entered into by the Company with reinsurers under which the Company is compensated for losses on one or more contracts issued by the Company and that meet the classification requirements for insurance contracts are classified as reinsurance contracts held.

The benefits to which the Company expects to become entitled under its ceded reinsurance contracts are recognised as reinsurance assets. These assets consist of short-term balances due from reinsurers as well as longer-term receivables that are dependent on expected claims and benefits arising under the related reinsured insurance contracts.

Amounts recoverable from or due to reinsurers are measured consistently with the amounts associated with the reinsured insurance contracts and in accordance with the terms of each reinsurance contract. Reinsurance payables are primarily premiums payable for reinsurance contracts and are recognised as an expense when due.

The Company regularly assesses its long-term reinsurance assets for impairment. A reinsurance asset is impaired if there is objective evidence that the Company may not receive all amounts due to it under the terms of the contract and that event has a reliably measurable impact on the amounts that the Company will receive from the reinsurer.

Receivables and payables related to insurance contracts and investment contracts with DPF
Receivables and payables are recognised when due. These include amounts due to and from agents, brokers and insurance contract holders.

Unallocated surplus
The unallocated surplus comprises the excess of the assets over the policyholder liabilities of the with-profits business determined in accordance with FRS 27 in so far as it represents amounts which have yet to be allocated to equity holders.

(f) Net investment income

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accruals basis. Interest income includes coupons earned on fixed income financial assets. Dividend income is recognised in the income statement on the date the right to receive payment is established, which in the case of listed securities, is the ex-dividend date.

Realised gains and losses on investments are calculated as the difference between net sales proceeds and the original cost. Unrealised investment gains and losses are calculated as the difference between the valuation at the balance sheet date and their valuation at the last balance sheet date or purchase price, if acquired during the year.

Unrealised investment gains and losses include adjustments in respect of unrealised gains and losses recorded in prior years which have been realised during the year and are reported as realised gains and losses in the current income statement.

Outstanding derivative contracts, including forward foreign exchange contracts, are marked to market at the balance sheet date. Unrealised gains or losses thereon are included in the income statement as unrealised gains or losses on financial assets.

Accounting Policies continued

(g) Corporation tax

The tax expense represents the sum of tax currently payable and deferred tax. The tax currently payable is based on income and gains arising in the accounting period and comprises both shareholder tax and tax payable on behalf of policyholders.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets or liabilities using currently enacted tax rates.

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

(h) Financial assets at fair value through income

All invested financial assets were designated at fair value through income on the transition to IFRS as their performance is evaluated on a fair value basis in accordance with a documented investment strategy.

The fair values are determined by reference to quoted market bid prices or published bid prices. If quoted market prices or published prices are not available, fair values are determined or estimated by using various techniques, including but not limited to balance sheet analysis and comparison to similar quoted securities. Unlisted derivatives are valued on the basis of bid prices supplied by suitably qualified counterparties. The counterparties' valuation techniques rely on discounted cash flow models and option pricing models as appropriate.

Changes in fair value of the financial assets are recognised in the income statement in the period in which they occur.

Purchases and sales of financial assets at fair value through income are accounted for at trade date.

(i) Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, deposits held on call with banks and other short-term highly liquid investments with an original maturity term of 90 days or less. On the balance sheet, bank overdrafts with legal right of set off are included in cash and cash equivalents.

(j) Provisions

Provisions (which do not include insurance liabilities) are recognised when the Company has a present obligation (legal or constructive) as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made.

Where the effect of the time value of money is material, the amount provided is the present value of the expenditures expected to be required to settle the obligation.

Where the Company has a present legal or constructive obligation but it is not probable that there will be an outflow of resources to settle the obligation or the amount cannot be reliably estimated, this is disclosed as a contingent liability.

(k) Dividends

Dividends on ordinary shares are recognised in equity in the period in which they are declared.

(l) Offsetting financial assets and liabilities

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention that expected future cash flows will be settled on a net basis.

Income statement for the year ended 31 December 2008

	Notes	2008 £'000	2007 £'000
Gross premiums written		**2,577**	2,511
Less: premiums ceded to reinsurers		**(75)**	(70)
Net premiums written		**2,502**	2,441
Fees and commissions	1	**4,414**	3,738
Net investment income	2	**28,026**	75,824
Total revenue, net of reinsurance payable		**34,942**	82,003
Net income		**34,942**	82,003
Policyholder claims		**654,715**	419,762
Less: reinsurance recoveries		**(511,090)**	(173,340)
Change in insurance contract liabilities		**(88,170)**	(185,248)
Transfer from unallocated surplus	14	**(29,356)**	(8,633)
Net policyholder claims and benefits incurred		**26,099**	52,541
Acquisition costs	3	**2,795**	2,163
Administrative expenses	4	**13,560**	13,069
Total operating expenses		**42,454**	67,773
Operating (loss) / profit before financing costs and tax		**(7,512)**	14,230
Financing costs	5	**466**	876
(Loss) / profit for the year before taxes		**(7,978)**	13,354
Corporation taxes - shareholder tax (credit) / expense	9	**(103)**	2,596
(Loss) / profit for the year attributable to equity holders		**(7,875)**	10,758

All activities of the Company are classified as continuing.

Approved and authorised for issue by the Board of Directors on 29 April 2009 and signed on its behalf by:

Niall F Gallagher
Director

Ciaran P McGettrick
Director

Statement of recognised income and expense for the year ended 31 December 2008

	Notes	**2008** **£'000**	2007 £'000
Foreign currency translation	10	**-**	(4,057)
Net expense recognised directly in equity		**-**	(4,057)
(Loss) / profit for the year attributable to equity holders	10	**(7,875)**	10,758
Total recognised (expense) / income for the year attributable to equity holders		**(7,875)**	6,701

Balance sheet as at 31 December 2008

	Notes	2008 £'000	2007 £'000
EQUITY AND LIABILITIES			
Equity			
Share capital	11	**25,079**	25,079
Capital contribution reserve	12	**121,000**	151,000
Foreign currency translation reserve	12	**(3,347)**	(3,347)
Retained earnings	10	**(81,181)**	(73,306)
Total equity attributable to equity holders of the Company	10	**61,551**	99,426
Liabilities			
Insurance contracts			
Liabilities under insurance contracts	13	**931,016**	1,393,654
Unallocated surplus	14	**3,434**	32,790
		934,450	1,426,444
Reinsurance payables	16	**52**	53
Payables related to direct insurance contracts	17	**790**	3,538
Trade and other payables	18	**4,185**	6,196
Total liabilities		**939,477**	1,436,231
Total equity and liabilities		**1,001,028**	1,535,657

Balance sheet as at 31 December 2008 continued

	Notes	**2008 £'000**	2007 £'000
ASSETS			
Financial assets at fair value through income			
Loans and deposits	20	**36,656**	40,346
Derivatives	21	**259**	160
Equities		**124,287**	189,430
Fixed income securities		**186,836**	192,089
Collective investment schemes		**128,675**	172,865
	19	**476,713**	594,890
Insurance assets			
Reinsurers' share of insurance contract liabilities	13	**316,791**	716,310
Insurance contract receivables	22	**603**	1,914
		317,394	718,224
Deferred tax	23	**588**	503
Prepayments		**14,746**	3,890
Trade and other receivables	24	**2,244**	2,314
Cash and cash equivalents	25	**189,343**	215,836
Total assets		**1,001,028**	1,535,657

Approved and authorised for issue by the Board of Directors on 29 April 2009 and signed on its behalf by:

Niall F Gallagher
Director

Ciaran P McGettrick
Director

Cash flow statement for the year ended 31 December 2008

	Notes	2008 £'000	2007 £'000
Cash flows from operating activities			
Net decrease / (increase) in operating assets and liabilities	26	**3,930**	(85,478)
Finance costs		**(441)**	(918)
Taxation recoverable	9	**18**	-
Net cash flows from operating activities		**3,507**	(86,396)
Cash flows from financing activities			
Capital contribution repaid	10	**(30,000)**	(80,000)
Net cash flows from financing activities		**(30,000)**	(80,000)
Net decrease in cash and cash equivalents		**(26,493)**	(166,396)
Cash and cash equivalents at the beginning of the year		**215,836**	382,232
Cash and cash equivalents at the end of the year	25	**189,343**	215,836

Cash and cash equivalents comprise bank overdrafts, cash at bank and other short-term highly liquid investments with maturity of 90 days or less (note 25).

Notes to the financial statements

1. Fees and commissions

	2008	2007
	£'000	£'000
Other fees	**4,414**	3,738

2. Net investment income

	2008	2007
	£'000	£'000
Investment income on items valued at fair value through income	**26,948**	17,606
Fair value gains on items at fair value through income	**(92,372)**	19,416
Foreign exchange gains / losses	**93,450**	38,802
	28,026	75,824

3. Acquisition costs

	2008	2007
	£'000	£'000
Acquisition costs paid	**2,795**	2,163

4. Administrative expenses

	2008	2007
	£'000	£'000
Operating expenses	**12,549**	11,594
Management fee - Ignis Investment Services Limited (formerly Resolution Investment Services Limited)	**1,011**	1,475
	13,560	13,069

All administrative services were provided to the Company by PGMS (Ireland) Limited (formerly RMS (Ireland) Limited), SPILA Services (Hong Kong) Limited and SPILA Services (Isle of Man) Limited. From 2 June 2008 the services provided by SPILA Services (Isle of Man) Limited were supplied under a Service Agreement following the transfer of the company to The Royal London Mutual Insurance Society Limited. Administration charges included in the operating results amount to £7,277,473 (2007: £8,807,995).

The 2008 operating expenses include a credit of £1,250,000 (2007: £412,971) following finalisation of the Company's share of pension scheme payments, as required under the terms of the sale and purchase agreement between Resolution plc and Abbey National plc.

5. Financing costs

	2008	2007
	£'000	£'000
Interest expense on items valued at fair value through income	**466**	876

Notes to the financial statements continued

6. Employee information

The average number of persons (including Directors) employed by the Company during the year was:

	2008 Number	2007 Number
Administration	**1**	1

Staff costs for the above persons were:	**2008 £'000**	2007 £'000
Wages and salaries	**124**	98
Social security costs	**10**	10
Pension costs	**18**	14
	152	122

7. Directors' emoluments

The company has a related party relationship with its Directors and the Directors of its parent entities who are the key management personnel of the company.

	2008 £'000	2007 £'000
For services in connection with the management of the Company		
Fees / salaries	**513**	371
Other emoluments (including pension contributions and benefits in kind)	**306**	99
	819	470

Directors who are employed by other Pearl Group entities are not directly remunerated by the Company for their services to the Company.

8. (Loss) / profit for the year before taxes

	2008 £'000	2007 £'000
(Loss) / profit for the year before taxes is stated after charging:		
Auditors' remuneration (excluding VAT)	**92**	100

The results for the financial year arise mainly from the administration of in-force policies.

Notes to the financial statements continued

9. Corporation taxes

(a) Current year tax (credit) / charge

	2008	2007
	£'000	£'000
Current tax:		
Overseas tax	**(18)**	-
Deferred tax:		
(Addition) / reversal of temporary differences	**(85)**	2,596
Total tax (credit) / expense	**(103)**	2,596
Attributable to: equity holders	**(103)**	2,596

(b) Reconciliation of tax charge

	2008	2007
	£'000	£'000
(Loss) / profit before tax	**(7,978)**	13,354
Policyholder tax	**-**	-
(Loss) / profit after policyholder tax	**(7,978)**	13,354
Tax at standard rate (12.5%)	**(997)**	1,669
Disallowable expenses	**-**	348
Adjustment to tax charge in respect of prior years (deferred tax)	**(23)**	169
Overseas tax	**(18)**	-
Other – Increase in unprovided losses	**935**	410
Equity holder tax	**(103)**	2,596
Total tax (credit) / expense for the year	**(103)**	2,596

Notes to the financial statements continued

10. Statement of changes in equity

	Share Capital £'000	Capital Contribution Reserve £'000	Foreign Currency Translation Reserve £'000	Retained Earnings £'000	Total £'000
At 1 January 2007	25,079	231,000	710	(84,064)	172,725
Arising in the period:					
Foreign currency translation	-	-	(4,057)	-	(4,057)
Net income recognised directly in equity	-	-	(4,057)	-	(4,057)
Capital contributions repaid	-	(80,000)	-	-	(80,000)
Profit for the year	-	-	-	10,758	10,758
Total recognised income and expense for the year attributable to equity holders	-	(80,000)	(4,057)	10,758	(73,299)
Balance at 31 December 2007	25,079	151,000	(3,347)	(73,306)	99,426
Balance at 1 January 2008	**25,079**	**151,000**	**(3,347)**	**(73,306)**	**99,426**
Arising in the period:					
Capital contributions repaid	**-**	**(30,000)**	**-**	**-**	**(30,000)**
Loss for the year	**-**	**-**	**-**	**(7,875)**	**(7,875)**
Total recognised income and expense for the year attributable to equity holders	**-**	**(30,000)**	**-**	**(7,875)**	**(37,875)**
Balance at 31 December 2008	**25,079**	**121,000**	**(3,347)**	**(81,181)**	**61,551**

11. Share capital

	2008 £'000	2007 £'000
Authorised:		
44,500,000 ordinary share at £1 each	**44,500**	44,500
30,000 ordinary shares at €1.25 each	**31**	31
Issued and fully paid:		
25,048,000 ordinary shares at £1 each	**25,048**	25,048
30,000 ordinary shares at €1.25 each	**31**	31
	25,079	25,079

The holders of ordinary shares are entitled to receive dividends as declared from time to time but are not entitled to any voting rights. The ordinary shareholders are entitled to any residual assets on the winding up of the Company.

Notes to the financial statements continued

12. Other reserves

	2008	2007
	£'000	£'000
Capital contribution reserve	**121,000**	151,000
Foreign currency translation reserve	**(3,347)**	(3,347)
	117,653	147,653

The capital contribution reserve represents a capital contribution gifted from the Company's immediate parent in prior years. Subject to the Company having distributable reserves, the capital contribution can be repaid at the Company's discretion. £30m (2007: £80m) was repaid to Scottish Mutual International Holdings in May 2008.

13. Insurance contract liabilities

	Gross liabilities	**Reinsurers' share**
	2008	**2008**
	£'000	**£'000**
Insurance contracts	**715,232**	**316,721**
Investment contracts with DPF	**215,784**	**70**
	931,016	**316,791**
Amount due for settlement/recovery within 12 months	**438,540**	**211,170**
Amount due for settlement/recovery after 12 months	**492,476**	**105,621**

	Gross liabilities	Reinsurers' share
	2007	2007
	£'000	£'000
Insurance contracts	1,122,854	703,214
Investment contracts with DPF	270,800	13,096
	1,393,654	716,310
Amount due for settlement/recovery within 12 months	481,192	337,445
Amount due for settlement/recovery after 12 months	912,462	378,865

	Gross liabilities	**Reinsurers' share**
	2008	**2008**
	£'000	**£'000**
At 1 January 2008	**1,393,654**	**716,310**
Premiums	**2,577**	**75**
Claims	**(654,715)**	**(511,090)**
Other changes in liabilities	**189,500**	**111,496**
As at 31 December 2008	**931,016**	**316,791**

	Gross liabilities	Reinsurers' share
	2007	2007
	£'000	£'000
At 1 January 2007	1,672,920	810,328
Premiums	2,511	70
Claims	(419,762)	(173,340)
Other changes in liabilities	137,985	79,252
As at 31 December 2007	1,393,654	716,310

Notes to the financial statements continued

14. Unallocated surplus

	2008 £'000	2007 £'000
As at 1 January	**32,790**	41,423
Transfer to income statement	**(29,356)**	(8,633)
As at 31 December	**3,434**	32,790

15. Insurance contracts and investment contracts with DPF liabilities – assumptions and sensitivities

(a) Assumptions

Process used to determine 2008 assumptions
Best estimate demographic assumptions are determined after considering the Company's recent experience and/or relevant industry data. Demographic assumptions used to calculate liabilities are derived by adding a prudence margin to best estimate assumptions. Economic assumptions are prudent estimates of the returns expected to be achieved on the assets backing the liabilities.

As outlined below, particular attention was given to the impact of deteriorating credit ratings on corporate bonds.

A number of changes were made to assumptions during the year to reflect changes in expected experience, none of which had a material overall impact on liabilities.

Valuation interest rate
The method used to determine valuation interest rates are calculated in accordance with the actuarial principles laid down in the European Communities (Life Assurance) Framework Regulations, 1994. Assets are firstly hypothecated to classes of business being valued.

The valuation interest rates for each block of business are based on the expected returns of the hypothecated assets. The yield is then adjusted to make allowance for credit risk, reinvestment risk and investment management expenses. As a consequence of deteriorating credit ratings on corporate bonds, we have compared credit ratings of assets held against actual credit spreads and made an adjustment where appropriate. The impact is negligible. Valuation interest rates are generally in the following ranges:

Pension policies: 2.75% - 5.05%

As a consequence of a deterioration in credit ratings on corporate bonds, a comparison of the credit ratings of assets held against actual credit spreads was undertaken and adjustments made to valuation interest rates where appropriate. The impact of this was, however, immaterial.

Investment contracts with discretionary participation features are not measured at fair value, as there is currently no agreed definition of fair valuation for discretionary participation features under IFRS.

Expense inflation
Expenses are assumed to increase at the rate of increase in the CPI plus a fixed margin in accordance with the management service agreements (MSAs). CPI inflation is assumed to be 2.54% per annum. For MSA with contractual increases set by reference to national average earnings inflation, this is approximated as CPI inflation plus 1%. In instances in which inflation risk is not mitigated, a further margin for adverse deviations is then added to the rate of expense inflation.

Mortality and longevity rates
Mortality rates are based on published tables, adjusted appropriately to take account of changes in the underlying population mortality since the table was published, company experience and forecast changes in future mortality. Where appropriate, a margin is added to assurance mortality rates to allow for adverse future deviations.

Notes to the financial statements **continued**

15. Insurance contract and investment contract with DPF liabilities – assumptions and sensitivities continued

Lapse and surrender rates (persistency)

The assumed rates for surrender and voluntary premium discontinuance depend on the length of time a policy has been in force. Withdrawal rates used in the valuation of unitised with-profits policies are based on observed experience and adjusted when it is considered that future policyholder behaviour will be influenced by different considerations than in the past. In particular, it is assumed that withdrawal rates for unitised with-profits contracts will be higher on policy anniversaries on which market value adjustments do not apply.

(b) Sensitivities

The table below indicates the stand-alone impact of certain key assumption changes to insurance and investment contracts.

	Change in assumption %	Impact on profit before equity holders' tax £'000	Impact on equity holders' funds £'000
Fixed interest yield assumptions	-1%	(37)	(33)
Fixed interest yield assumptions	+1%	131	115
Equity and property values	-10%	(2,026)	(1,773)
Credit spread on corporate bonds	+1%	-	-

In reality, given the correlation between the assumptions, it is not often possible to demonstrate the effect of key assumptions whilst other assumptions remain unchanged. It should also be noted that, in some instances, these sensitivities are non-linear, consequently, larger or smaller impacts should not be interpolated or extrapolated from these results.

16. Reinsurance payables

	2008 £'000	2007 £'000
Reinsurance payables	**52**	53
Amount due for settlement within 12 months	**52**	53

17. Payables related to direct insurance contracts

	2008 £'000	2007 £'000
Payables related to direct insurance contracts	**790**	3,538
Amount due for settlement within 12 months	**790**	3,538

18. Trade and other payables

	2008 £'000	2007 £'000
Due to fellow subsidiaries	**1,538**	3,245
Net collateral loan	**620**	319
Other liabilities	**2,027**	2,632
	4,185	6,196
Amount due for settlement within 12 months	**3,967**	6,071
Amount due for settlement after 12 months	**218**	125

18. Trade and other payables continued

Net collateral loan

Collateral sums are deposited back to the Company by credit institutions in order to reduce the counterparty risk to the Company on particular assets held to back certain policyholder benefits. Interest on deposit back arrangements is payable on the amounts owed based on Sterling Overnight Index Average rates.

The table below provides analysis of the derivative assets and related collateral loans as described in note 21.

	2008			2007		
	£'000 Fair value assets	**£'000 Collateral Loan**	**£'000 Net fair value of liabilities**	£'000 Fair value assets	£'000 Collateral Loan	£'000 Net fair value of liabilities
Equity index contracts	**23,180**	**(23,800)**	**(620)**	4,681	(5,000)	(319)

19. Financial assets at fair value through income

	2008 £'000	2007 £'000
Financial assets at fair value through income	**476,713**	594,890
Amount recoverable within 12 months	**279,601**	415,164
Amount recoverable after 12 months	**197,112**	179,726

20. Loans and deposits

	2008 £'000	2007 £'000
At 1 January	**40,346**	13,434
Additions	**144,943**	26,912
Repayments	**(149,005)**	-
Foreign exchange adjustments	**372**	-
At 31 December	**36,656**	40,346
Amount recoverable within 12 months	**36,656**	40,346

21. Derivatives

	2008 £'000	2007 £'000
Exchange traded futures	**259**	160
Amount recoverable within 12 months	**259**	100
Amount recoverable after 12 months	**-**	60

21. Derivatives continued

(a) Hedges for policy guarantees (OTC options)

During the year, the Company held OTC derivative contracts with nominal values totalling £140m with Goldman Sachs (2007: £99m), to provide financial protection against a range of embedded policy guarantees. The contracts take the form of a number of options, specified to capture the material elements of the economic exposure of the with-profits business to costs of guarantees attributable to equity returns, interest rate movements and foreign exchange rate movements. The terms of the options have been determined to match as closely as possible central expectations regarding asset management, management actions and customer choices.

The option types, and range of maturity dates and strike levels are set out below.

Option guarantee type	Option type	Maturity date range
Maturity guarantees on conventional with-profits (CWP) policies and Market Value Adjustment (MVA) free guarantees on unitised with-profits (UWP) policies	European Equity Put Interest Rate Swaptions Equity Futures	Nov ‘09 - Nov ‘17 Nov ‘09 - Nov ‘13 Rolled every 3mths
CWP pensions maturity guarantees with guaranteed annuity options	European Equity Put Interest Rate Swaptions Equity Futures	Nov ‘09 - Nov ‘17 Nov ‘09 - Nov ‘13 Rolled every 3mths
CWP deferred annuity contracts without guaranteed commutation options	European Equity Put Interest Rate Swaptions Equity Futures	Nov ‘09 - Nov ‘17 Nov ‘09 - Nov ‘13 Rolled every 3mths

No premium was payable by the Company for the purchase of these options in 2008 (£7m : 2007).

As at 31 December 2008, there was an unrealised gain of £16m on the options held (2007: unrealised loss of £2m).

As security for the maturity proceeds of these derivatives, Goldman Sachs lent the Company sums amounting to £24m (2007: £5m). As there is a legal right of set off for the derivative assets and related collateral loans, and it is intended that settlement will be made on a net basis, the derivatives and collateral loans are presented as net derivative assets or net collateral loans as appropriate on the balance sheet and notes (see note 18).

(b) Equity index contracts

These are held to hedge against movements in the value of policyholder guarantees associated with certain with-profits bond contracts. The net collateral loan value is presented in note 18.

(c) Exchange traded futures

These are held for efficient portfolio management purposes.

22. Insurance contracts receivables

	2008 **£’000**	2007 £’000
Insurance contracts receivables	**603**	1,914
Amount recoverable within 12 months	**603**	1,914

Notes to the financial statements continued

23. Tax assets and liabilities

	2008	2007
	£'000	£'000
Deferred tax assets – unitised tax losses	**588**	503

Movements in deferred tax assets comprise:

	2008	2007
	£'000	£'000
At 1 January	**503**	3,099
Amounts credited / (charged) to the income statement	**85**	(2,596)
At 31 December	**588**	503

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 12.5%.

Deferred tax assets are recognised for tax loss carry forwards only to the extent that realisation of the related tax benefit is probable.

24. Trade and other receivables

	2008	2007
	£'000	£'000
Trade and other receivables	**666**	1,522
Taxation debtor	**18**	-
Due from fellow subsidiaries	**1,560**	792
Amount recoverable within 12 months	**2,244**	2,314

25. Cash and cash equivalents

	2008	2007
	£'000	£'000
Bank and cash balances	**71,100**	210,816
Short term deposits (including demand and time deposits)	**118,243**	5,020
	189,343	215,836

All deposits are subject to fixed interest rates. The carrying amounts approximate to fair value at the balance sheet date.

26. Cash flows

Cash flows from operating activities

	2008	2007
	£'000	£'000
(Loss) / profit for the year before taxes	**(7,978)**	13,354
Non-cash movements in loss for the year before taxes:		
Gain on sale of financial assets	**(17,345)**	(13,619)
Fair value loss / (gain) on financial assets	**7,940**	(58,797)
Net decrease / (increase) in working capital	**21,313**	(26,416)
Net decrease / (increase) in operating assets and liabilities	**3,930**	(85,478)

Notes to the financial statements continued

27. Related party transactions

Transactions with related parties which existed up to the date of acquisition by Pearl Group on 1 May 2008 are shown for the period up to the date of acquisition only. Transactions with companies which became related parties subsequent to the date of acquisition are presented showing transactions from that date.

	Notes	2008 £'000	2007 £'000
Net investment income			
Ignis Fund Managers Limited (formerly Resolution Fund Managers Limited)	(a)	**21,209**	(1,874)
Scottish Mutual International Fund Managers Limited	(a)	**(2,166)**	(1,559)
Scottish Mutual Investment Managers Limited	(a)	**3,935**	(539)
Reinsurance recoveries			
Scottish Provident Limited – Irish Branch	(b)	**(445)**	(3,568)
Scottish Mutual Assurance Limited	(b)	**(510,645)**	(168,915)
Change in insurance contract liabilities			
Scottish Provident Limited – Irish Branch	(c)	**6,256**	2,732
Scottish Mutual Assurance Limited	(c)	**397,139**	91,411
Administrative expenses			
Ignis Investment Services Limited (formerly Resolution Investment Services Limited)	(d)	**1,011**	1,475
PGMS (Ireland) Limited (formerly RMS (Ireland) Limited)	(d)	**8,579**	9,066
PGMS (Glasgow) Limited (formerly Resolution Management Services (Glasgow) Limited)	(d)	**(1,250)**	(413)

Notes:

(a) Values represent net unrealised and realised gains/(losses) in period with relevant counterparty.

(b) Reinsurers' share of claims with relevant counterparty. Included within this is £510m (2007: £173m) received in respect of unit liabilities of property-linked contracts invested in With-profits units, which were reinsured with Scottish Mutual Assurance Limited. The nature of the reinsurance contract is that the amount payable/receivable is based on net unit movements. As such, premiums and claims cannot be separately identified. The amount disclosed above is net of premiums and management charges.

(c) Values represents the movement on the internal reinsurance assets.

(d) Values represent business administration services, which were provided to the Company by the relevant counterparty.

The Company has a related party relationship with its Directors and the Directors of its parent entities who are the key management personnel of the Company.

Details of Directors' emoluments are set out in note 7.

Qualifying third party indemnity provisions are in place for the benefit of the Directors in relation to certain losses and liabilities, which they may potentially incur to third parties, in the course of their duties.

Transactions with the Company's parent are set out in note 10.

Notes to the financial statements continued

27. Related party transactions continued

The Company had the following outstanding related party balances at the year-end, which are included within the captions noted in the balance sheet:

	Notes	2008 £'000	2007 £'000
Financial assets			
Ignis Fund Managers Limited (formerly Resolution Fund Managers Limited)	(a)	**49,628**	50,048
Scottish Mutual International Fund Managers Limited	(a)	**37,560**	53,546
Scottish Mutual Investment Managers Limited	(a)	**6,686**	8,887
Reinsurers' share of insurance contract liabilities			
Scottish Mutual Assurance Limited	(b)	**302,645**	699,784
Scottish Provident Limited – Irish Branch	(b)	**13,972**	16,401
Trade and other receivables			
PGMS (Ireland) Limited (formerly RMS (Ireland) Limited)	(c)	**1**	-
Scottish Mutual Assurance Limited	(c)	**445**	-
Scottish Mutual Investment Managers Limited	(d)	**18**	-
Scottish Provident Limited – Irish Branch	(c)	**1,096**	-
Trade and other payables			
Ignis Investment Services Limited (formerly Resolution Investment Services Limited)	(c)	**-**	369
PGMS (Ireland) Limited (formerly RMS (Ireland) Limited)	(c)	**1,538**	2,876

Notes:

(a) Balances represent the market value of investments held with the relevant counterparty.
(b) Balances represent the intercompany reinsurance asset.
(c) Balance represents intercompany balances with relevant counterparty.
(d) Balance represents rebate income due from Scottish Mutual Investment Managers Limited.

The Company enters into transactions with related parties in the normal course of business. Transactions are carried out on an arms' length basis and settled in cash.

Notes to the financial statements continued

28. Risk management policies

Management of insurance and financial risk

The Company is part of Pearl Group. The Company issues contracts that transfer insurance risk or financial risk or both. This note summarises these risks and the way the Company manages them.

The Company has implemented processes and structures to support the effective management of risk. Board and Board sub-committee structures, membership and terms of reference have been implemented by PGL and have been adopted across the group. The Company's Directors are responsible for the system of risk management and internal control, including financial, operational and compliance controls and for reviewing its effectiveness. Due to the limitations that are inherent in any system of internal control, this system is designed to manage and control, rather than eliminate, risk completely. In assessing these risks, the Directors take into account any benefits that may accrue from risk acceptance before making a commercial decision to ensure that risks are commensurate with the anticipated returns.

Risk within the Pearl Group is overseen by the Risk Management function. The Risk Management function uses a hierarchy of Pearl Group-wide policy documents as the basis for its approach. Accompanying these, the Pearl Risk Management Framework sets out the high level arrangements for risk management, control, monitoring and assurance within Pearl Group. It is designed to provide a structured approach for identifying and managing financial and non-financial risk within Pearl Group.

The risk policy documents set out the nature and level of risks that are acceptable to PGL and its various businesses, and sets out the Board's tolerance for earnings volatility and possible losses. It provides a description of the types and quantum of risk that Pearl Group is prepared to take as a result of its various business operations.

The Pearl Group Finance, Risk and Capital Oversight Committee (FRCOC) meets on a monthly basis to ensure that all key risks impacting the Pearl Group are suitably monitored and managed.

Risk management policies were similarly applied prior to 1 May 2008, when the Company's ultimate parent and controlling party was Resolution plc.

Contracts are split into three categories, the key risks of which are summarised as follows:

Unitised with-profits

Controlled investment risk is taken with the aim of enhancing policyholder investment returns. The aim is to limit that risk, in line with the risk policies, to that supportable by the assets backing this business. The costs of guarantees are, in general, spread across the contracts, but there remains a risk that the shareholder may have to contribute capital. However, derivative backed hedge assets are in place to protect against this risk.

For unitised with-profits contracts, the Company receives an annual management charge, typically ranging between 0.5% and 1.5% per annum, so that the earnings risks to the shareholder are similar to unit linked contracts.

Unit linked

In relation to unit linked contracts, the policyholders carry all investment risks, with any changes in underlying investments being reflected by an equal and opposite change in the related contract liabilities. The Company receives an annual management charge (AMC), typically ranging between 0.5% and 1.5% per annum of the net asset value of the underlying funds. As a result of this, AMC income can increase or decrease depending on price movements within each underlying unit linked contract.

Non linked

The risk with non profit non linked contracts lie directly with the shareholder, in the event of assets not matching liabilities.

Further detail of the risks relevant to the above contract types and how they are controlled is set out below.

Notes to the financial statements continued

28. Risk management policies continued

(a) Insurance risk

Insurance risk is the possibility under any one insurance contract that the insured event occurs and the uncertainty of the amount of the resulting claim. It refers to the inherent uncertainties in insurance, including:

- the occurrence of any event specifically insured against;
- for long-term insurance business, adverse mortality, morbidity and persistency experience; and
- expense overruns relative to pricing or provisioning assumptions.

Those terms and conditions of insurance contracts that have a material effect on the Company's cash flows are as follows:

- fixed and guaranteed benefits for a fixed future premium;
- the option to pay reduced or no future premiums;
- the option to terminate the contract completely; and
- Market Value Adjustment free guarantees.

The Company controls insurance risk through the following:

- the use of actuarial models to calculate premiums and monitor claims patterns. Past experience, as well as statistical methods, are used;
- issued guidelines for concluding insurance contracts and assuming insurance risks;
- close monitoring of the management of assets and liabilities to attempt to match the expected pattern of claim payments with the maturity dates of assets; and
- stress and scenario testing to monitor insurance risk as part of regular investigation of the financial condition of the Company. Each main category of insurance risk is subject to a detailed experience analysis to ensure that all assumptions are reasonable.

(i) Sensitivity analysis

The nature of the insurance business is such that a number of assumptions have been made in compiling the financial statements.

The table at note 15(b) provides a sensitivity analysis in relation to certain assumptions.

The Company's exposure to movements in equity markets is limited by the use of derivative backed hedges. For unit linked contracts invested in equities, the investment risk is borne entirely by the contract holders. Accordingly, the Company's results are less sensitive to movements in equity markets.

Notes to the financial statements continued

28. Risk management policies continued

(a) Insurance risk continued

(ii) Concentrations of insurance risk

The table below presents an analysis of insured benefits across products.

	2008 Liability values	
	Gross liabilities £'000	Net of reinsurance £'000
Property linked	**178,227**	**164,255**
Traditional life non profit	**324**	**151**
Other non profit	**20,233**	**20,233**
With-profits	**732,232**	**429,586**
Total	**931,016**	**614,225**

	2007 Liability values	
	Gross liabilities £'000	Net of reinsurance £'000
Property linked	227,316	210,915
Traditional life non profit	249	124
Other non profit	17,022	17,022
With-profits	1,149,067	449,283
Total	1,393,654	677,344

(b) Financial risk

The Company is exposed to financial risk through its financial assets, financial liabilities, insurance assets and insurance liabilities.

The key financial risk is that the proceeds from its financial assets are not sufficient to fund the obligations arising from its insurance and investment contracts as they fall due. The most important components of this financial risk are market risk, credit risk and liquidity risk, as outlined in the following sections.

(i) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices and comprises three types of risk: interest rate risk, price risk and currency risk. These risks impact on the Company depending on the nature of the contracts written, as follows:

Insurance and investment contracts with DPF

The main market risks inherent in these contracts are dependent upon the asset allocation backing unitised with-profits business. The more invested in an asset class, the greater the risk attached to movements in the particular asset market.

The main market risks, reflecting the asset allocation backing unitised with-profits business are due to variations in:

- equity prices;
- interest rates and bond prices;
- corporate bond spreads; and
- equity price volatility affecting the value of policy guarantees.

There are currently no direct or indirect investments in property.

28. Risk management policies continued

(b) Financial risk continued

(i) Market risk continued

Non linked insurance contracts without DPF

The volume of business in this category is small and not material in value.

Unit linked insurance contracts without DPF

For unit linked policies, the asset values determine the liabilities and the policyholder, therefore, bears all the market risk.

Fee income to the Company from unit linked policies is normally taken as a percentage of funds under management, which is determined by cash flows, including the rate of asset growth. Therefore, if markets fall, the value of the fee income falls as the charges on the funds under management is reduced.

The level of market risk in the Company is monitored and a report on risk levels, including Risk Based Capital levels (both total risk and market risk), is provided regularly to the Executive Committee, the FRCOC and to the Asset and Liability Committee (ALCO).

A system of exposure limits is in place with clearly specified escalation procedures in the event of breaches. Risk positions against limits are included in the monthly reports to senior management. In relation to contracts with DPF, risk mitigation actions are likely to include switching the asset allocation into less risky assets or using derivatives to hedge positions.

Market risk can be further subdivided into the following components:

Interest rate risk

Interest rate risk is part of market risk and is the risk that the value of future cash flows of a financial instrument will fluctuate because of changes in interest rates.

The Pearl Group interest rate risk policy requires the Company to manage interest rate risk by maintaining an appropriate mix of fixed and variable rate instruments. The policy also requires it to manage the maturity profile of these assets consistent with liabilities to policyholders.

Currency risk

The Company's transactions are carried out in Euro and Sterling and, to a lesser extent, US dollars and HK dollars.

As part of a hedging programme, liabilities denominated in each currency are matched by assets held in the same currency. Therefore, on a net basis, foreign currency mismatch exposure is not significant.

Limited foreign currency risk does arise within the investment portfolios supporting the Company's Euro, Sterling and US dollar insurance and investment operations, where assets are held that are denominated in a foreign currency. These positions are deliberately taken to obtain diversification benefits and exposures are generally low in proportion to total fund size. The level of exposure in total and by currency is monitored daily.

Notes to the financial statements continued

28. Risk management policies continued

(b) Financial risk continued

(i) Market risk continued

Price risk

The Company's price risk exposure relates primarily to financial assets and liabilities whose values fluctuate as a result of changes to market prices other than from interest rate and currency fluctuations.

Equity price risk is primarily undertaken in respect of assets held in unit linked funds or in respect of with-profits business. For unit linked funds this risk is borne by policyholders as asset movements directly impact unit prices and hence policy values. For with-profits policyholders' future bonuses will be impacted by price risk via investment returns achieved. However, the Company has entered into counter derivative contracts to provide financial protection against volatility in a range of embedded policy guarantees in respect of the with-profits business.

There is also an exposure to credit spread changes affecting the prices of corporate bonds and derivatives. The exposure applies to the unit linked funds, unitised with-profits business and the shareholder fund.

The assets held in the shareholder fund that are exposed to price risk are primarily high rated short term liquid assets.

(ii) Credit risk

The Company has exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due.

The Company recognises that credit risk in its life insurance business arises from:

- cash deposits;
- holdings of debt (principally corporate bonds);
- the impact of credit default on equity holdings;
- reinsurance contracts; and
- derivatives transactions.

The Company structures the levels of credit risk it accepts by placing limits on its exposure to a single counterparty, or groups of counterparties, thereby ensuring concentrations of credit risk are minimised. These limits and exposures are subject to ongoing monitoring and frequent review in the context of the exposure limits placed and changes in credit ratings and spreads.

The tables below show the rating of fair value of assets held by the Company, which are subject to credit risk. Only credit risk on assets where risk is borne by the shareholder is shown, therefore, unit linked assets are excluded.

Notes to the financial statements continued

28. Risk management policies continued

(b) Financial risk continued

(ii) Credit risk continued

The credit risk borne by the shareholder on with-profits policies is minimal. The bonuses to with-profits policyholders are designed to distribute to policyholders a fair share of the return on the assets held in respect of the with-profits business together with other elements of relevant experience. With-profits policies are managed such that bonuses distributed to the policyholder are smoothed by building and dissolving returns over the years.

As at 31 December 2008	AAA	AA	A	BBB	BB & below	Not rated	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Financial assets:							
Loans and deposits	**-**	**82**	**6,739**	**-**	**-**	**-**	**6,821**
Derivative assets	**-**	**-**	**-**	**-**	**-**	**259**	**259**
Fixed interest securities	**185,013**	**-**	**-**	**-**	**-**	**-**	**185,013**
Insurance assets:							
Reinsurers' share of insurance contract liabilities	**-**	**-**	**-**	**-**	**-**	**316,791**	**316,791**
Reinsurance receivables	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Insurance contract receivables	**-**	**-**	**-**	**-**	**-**	**602**	**602**
Prepayments	**-**	**-**	**-**	**-**	**-**	**14,009**	**14,009**
Trade and other receivables	**-**	**-**	**-**	**-**	**-**	**2,242**	**2,242**
Cash and cash equivalents	**-**	**436**	**1,490**	**-**	**-**	**152,339**	**154,265**

As at 31 December 2007	AAA	AA	A	BBB	BB & below	Not rated	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Financial assets:							
Loans and deposits	-	9,028	-	-	-	-	9,028
Derivative assets	-	-	-	-	-	-	-
Fixed interest securities	180,238	-	-	-	-	-	180,238
Insurance assets:							
Reinsurers' share of insurance contract liabilities	-	-	-	-	-	716,310	716,310
Reinsurance receivables	-	-	-	-	-	-	-
Insurance contract receivables	-	-	-	-	-	1,808	1,808
Prepayments	-	-	-	-	-	1,704	1,704
Trade and other receivables	-	-	-	-	-	2,460	2,460
Cash and cash equivalents	5,020	-	-	-	-	178,344	183,364

(Source of Credit Ratings – Standard & Poor's / Moody's)

Credit ratings have not been disclosed in the above table for equities. Whilst the Company is exposed to the impact of credit default on its equity holdings, this risk is not considered significant due to the spread of holdings.

Credit risk in relation to loans and deposits, fixed income securities and cash and cash equivalents has been assessed on a look through basis where the exposure to the securities is via collective investment vehicles.

28. Risk management policies continued

(b) Financial risk continued

(iii) Liquidity risk

Liquidity risk is defined as the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities as they fall due.

The Company manages liquidity risk through a clearly articulated Liquidity Policy, Investment Guidelines and Investment Management Agreements. The Pearl Group Liquidity Policy has the objectives of ensuring low probability of loss due to liquidity risk events, documentation of systems and controls of liquidity risk and cost-efficient control of liquidity risk.

The Company effects operational control of liquidity risk through clearly documented and frequently monitored treasury guidelines.

Liquidity controls in the Company are monitored on a daily basis and breaches are escalated as provided for in the Liquidity Policy. A report on liquidity risk levels is included in the monthly risk reports submitted to the ALCO and the FRCOC.

The tables below summarise the maturity profile of the financial liabilities and insurance contract liabilities of the Company. The basis of presentation is such that investment contracts and insurance contracts are on a discounted basis consistent with the balance sheet. All the remaining financial liabilities are shown on an undiscounted basis.

As at 31 December 2008	**Up to 1 year**	**1-5 years**	**Greater than 5 years**	**Total**
	£'000	**£'000**	**£'000**	**£'000**
Insurance contract liabilities	**438,540**	**374,721**	**117,755**	**931,016**
Payables	**4,809**	**215**	**3**	**5,027**

As at 31 December 2007	Up to 1 year	1-5 years	Greater than 5 years	Total
	£'000	£'000	£'000	£'000
Insurance contract liabilities	481,192	618,329	294,133	1,393,654
Payables	9,662	125	-	9,787

29. Capital management

The Company's policy is to maintain a strong and flexible capital base so as to satisfy regulatory requirements whilst still creating shareholder and policyholder value.

The Company's capital position is monitored in the context of both the Financial Regulator (the Regulator) solvency requirements and the Pearl Group's own capital management requirements.

The Pearl Group has developed a capital management framework using Individual Capital Assessment Standard (ICA) principles for identifying the risks to which each of its business units and the Pearl Group as a whole are exposed and quantifying their impact on capital. The ICA process estimates the level of capital the Company should retain to ensure that there is only an extremely small risk that the Company will be unable to meet its liabilities.

The capital required is calculated based on extreme but foreseeable risk events over a 1-year timeframe. The Company then holds a further capital buffer above this to ensure it would be able to withstand a single stress event, whether that arose from market conditions or other causes and have sufficient capital resources to still meet the capital requirements set by the Regulator from internal resources.

29. Capital management continued

The Company's capital position is monitored by FRCOC and is reported to both the Executive Committee and the statutory Board. The FRCOC and the Executive Committee monitor the Company's capital composition and position against the Company targets, which are regularly reviewed to ensure they remain appropriate to optimise value for the policyholders and shareholders. The level of required capital of the Company is the greater of:

- the amount of capital required to meet the Regulator's regulatory capital adequacy requirements; and
- the capital required under the Company's capital management policy.

There have been no material changes in the Company's management of capital during the period. The capital policy has been established by the Company and is not externally imposed. However, external approval from the Regulator would be required before making any amendments to the policy.

The Company has complied with all externally and internally imposed capital requirements throughout the period.

The table below sets out the Company's capital resources position at 31 December 2008 as reported in the annual returns to the Regulator and compares this with total equity available to equity holders of the Company as reported on the IFRS balance sheet at that date:

	31 December 2008 £'000	31 December 2007 £'000
Total equity attributable to equity holders of the Company on an IFRS basis	61,551	99,426
Deferred tax asset	(588)	(503)
Resilience reserve	(7,521)	(133)
Capital resources on a regulatory basis	53,442	98,790

30. Contingent liabilities

The Company is registered with the Irish Tax and Customs as a member of a group for VAT purposes and, as a result, is jointly and severally liable on a continuing basis for amounts owing by any other member of that group in respect of unpaid VAT. As at 31 December 2008 any liability in this respect is considered to be remote.

31. Commitments

There are no outstanding calls, uncalled liabilities or underwriting commitments on securities held as at 31 December 2008 (2007: £nil).

32. Parent undertaking and controlling party

The Company's immediate parent is Scottish Mutual International Holdings, a company incorporated in the Republic of Ireland.

Prior to 1 May 2008, the Company's ultimate parent company and controlling party was Resolution plc (subsequently renamed Pearl Group Holdings (No. 1) Limited). From that date the Company's ultimate parent company and controlling party has been Pearl Group Limited, a company incorporated in the United Kingdom.

The only group in which the results of the Company are consolidated is headed by Pearl Group Limited.

The consolidated accounts of Pearl Group Limited are available to the public and may be obtained from Pearl Group Limited, The Pearl Centre, Lynchwood, Peterborough, PE2 6FY.

33. Approval of financial statements

The financial statements were approved by the Board of Directors on 29 April 2009.