Company Registration No: 2199286

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

DIRECTORS' REPORT AND FINANCIAL STATEMENTS

31 DECEMBER 2006

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

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

CONTENTS

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

OFFICERS AND PROFESSIONAL ADVISERS

DIRECTORS	M A Hesketh D A MacKechnie M N Quinton C P Sullivan
SECRETARY:	P A Hutchings
REGISTERED OFFICE:	3 Edridge Road Croydon Surrey CR9 1AG
AUDITORS	Deloitte & Touche LLP London, United Kingdom

Registered in England and Wales

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

DIRECTORS' REPORT

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

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

ACTIVITIES AND BUSINESS REVIEW

Activity

The Company transacts long term insurance falling within business classes I and IV of Annex 11 1 of chapter 11 in volume 1 of the FSA Interim Prudential Sourcebook Insurers The products currently provided are mortgage life cover, fixed term life cover, mortgage life cover with critical illness, and fixed term life cover with critical illness

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

Review of the year

Business review

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

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

Financial performance

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

The profit for the year was £12,730,000, an increase of 34% over 2005

At the end of the year, the financial position showed total assets of £191,279,000, including investments of £120,457,000 which are income-generating assets, together representing an decrease of 30 2% The net book value of property, plant and equipment was £126,000 compared with £204,000 at the end of the previous year

Principal risks and uncertainties

IFRS disclosure requirements for the company require a considerable degree of disclosure on the management of risk Information on insurance and financial risk management policies and exposures are disclosed in note 3

DIRECTORS AND SECRETARY

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

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

	Appointed	Resigned
Directors		
M A Hesketh	6 July 2006	
I H Chippendale		8 November 2006
A E Court		8 November 2006
C P Sullivan	20 December 2006	
R D Houghton		22 January 2007
C Moat		22 January 2007
M N Quinton	22 January 2007	

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

DIRECTORS' REPORT (Continued)

DIRECTORS' RESPONSIBILITIES

The Directors are required by the Companies Act 1985 to prepare a directors' report and financial statements for each financial year and have elected to prepare them in accordance with International Financial Reporting Standards, as adopted by the European Union They are responsible for preparing financial statements that present fairly the financial position, financial performance, and cash flows of the Company In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- state whether applicable accounting standards have been followed, subject to any material departures dislcosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the directors report and financial statements comply with the Companies Act 1985 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

DISCLOSURE OF INFORMATION TO AUDITORS

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

(1) so far as each of the directors are aware, there is no relevant audit information of which the Company's auditors are unaware, and
(2) so far as each of the directors are aware they have taken all the steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information

This confirmation is given and shall be interpreted in accordance with the provisions of S234ZA of the Companies Act 1985

DIRECTORS' INDEMNITIES

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

DIRECTORS' INTERESTS

No director had an interest in the shares of the Company

The opening balance of the ordinary shares of Mr C Moat has been restated

The following directors were beneficially interested in the ordinary shares of The Royal Bank of Scotland Group plc

	As at 1 January 2006*	As at 31 December 2006
M A Hesketh	11,419	14,017
C Moat	196	10,814

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

	As at 1 January 2006*	Granted during the period		Exercised during the period		As at 31 December 2006
		Options	Price (p)	Options	Price (p)	
M A Hesketh	55,950	348	1384	2,186	1287	53,741
				371	1364	
C Moat	32,020	14,849	1852	8,200	1237	38,519
				150	1563	

* or date of appointment if later

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

DIRECTORS' REPORT (Continued)

DIRECTORS' INTERESTS (Continued)

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

The interests of Mr D A MacKechnie in the share capital of The Royal Bank of Scotland Group plc are disclosed in the financial statements of Direct Line Life Holdings Limited

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

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

POLICY AND PRACTICE ON PAYMENT OF CREDITORS

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

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

ELECTIVE RESOLUTIONS

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

AUDITORS

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

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

Director

23 March 2007

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF DIRECT LINE LIFE INSURANCE COMPANY LIMITED

We have audited the financial statements of Direct Line Life Insurance Company Limited ("the Company") for the year ended 31 December 2006 which comprise the income statement, the balance sheet, the statement of changes in equity, the cash flow statement, the accounting policies and the related Notes 2 to 27 These financial statements have been prepared under the accounting policies set out therein

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

Respective responsibilities of directors and auditors

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

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

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

Basis of audit opinion

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

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

Opinion

In our opinion

- the financial statements give a true and fair view of the state of the Company's affairs as at 31 December 2006 and of its profit for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the directors' report is consistent with the financial statements

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London, United Kingdom
23 March 2007

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	2006 £'000	2005 £'000
Insurance premium revenue	4	94,676	122,148
Insurance premium ceded to reinsurers	4	(16,341)	(13,194)
Net insurance premium revenue		**78,335**	**108,954**
Investment income	5	5,614	5,112
Net income		**83,949**	**114,066**
Insurance benefits	6	85,346	(25,390)
Insurance benefits recovered from reinsurers	6	(84,543)	13,306
Net insurance benefits		**803**	**(12,084)**
Expenses for the acquisition of insurance contracts	7	(36,453)	(58,376)
Expenses for marketing and administration	7	(30,013)	(30,030)
Expenses		**(66,466)**	**(88,406)**
Profit before tax		**18,286**	**13,576**
Tax charge	8	(5,556)	(4,073)
Profit for the year	9	**12,730**	**9,503**

All results relate to continuing operations

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

The notes on pages 10 to 30 form part of these financial statements

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

BALANCE SHEET
AS AT 31 DECEMBER 2006

	Notes	2006 £'000	2005 £'000
ASSETS			
Property, plant and equipment	10	126	204
Investments	11	30,038	31,179
Insurance contracts			
Reinsurance assets	12	58,350	153,308
Deferred tax asset	13	72	85
Financial assets			
Loans and receivables	14	12,274	9,510
Cash and cash equivalents	15	90,419	79,943
Total assets		**191,279**	**274,229**
EQUITY			
Share capital	16	44,000	44,000
Other reserves	17	3,628	1,021
Retained earnings	17	26,183	13,453
Total equity		**73,811**	**58,474**
LIABILITIES			
Insurance contracts	18	102,311	208,776
Trade and other payables including insurance payables	19	9,621	2,931
Financial liabilities			
Borrowings	20	504	1,625
Current tax liabilities		5,032	2,423
Total liabilities		**117,468**	**215,755**
Total equity and liabilities		**191,279**	**274,229**

The financial statements were approved by the Board of Directors and authorised for issue on 23 March 2007
They were signed on its behalf by

Director DUNCAN MACKECHNIE

The notes on pages 10 to 30 form part of these financial statements

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

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

	Share capital £'000	Other reserves £'000	Retained earnings £'000	Total £'000
Balance as at 1 January 2005	**44,000**	**812**	**3,950**	**48,762**
Net fair value gain on available-for-sale investments	-	209	-	209
Net income recognised directly in equity	-	209	-	209
Profit for the year	-	-	9,503	9,503
Total recognised income and expense for the year	-	209	9,503	9,712
Balance as at 31 December 2005	**44,000**	**1,021**	**13,453**	**58,474**
Net fair value loss on available-for-sale investments	-	(893)	-	(893)
Net income recognised directly in equity	-	(893)	-	(893)
Profit for the year	-	-	12,730	12,730
Undated loan capital received	-	3,500	-	3,500
Total recognised income and expense for the year	-	2,607	12,730	15,337
Balance as at 31 December 2006	**44,000**	**3,628**	**26,183**	**73,811**

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

The notes on pages 10 to 30 form part of these financial statements

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	2006 £'000	2005 £'000
Profit for the year		12,730	9,503
Adjustments for			
Investment income		(5,614)	(5,112)
Income tax expense		5,556	4,073
Depreciation of property, plant and equipment		78	82
Operating cash flows before movements in working capital		12,750	8,546
Net (decrease) / increase in insurance liabilities		(106,465)	7,931
Net decrease / (increase) in reinsurance assets		94,958	(5,985)
Net increase in loans and receivables		(679)	(2,501)
Net decrease / (increase) in related party balances		2,791	(2,547)
Net increase in other operating liabilities		1,926	299
Cash generated from operations		5,281	5,743
Income taxes paid		(2,571)	(4,453)
Interest paid		(24)	(8)
Other operating activities		3,500	24
Net cash generated from operating activities		6,186	1,306
Cash flows from investing activities			
Interest received		5,510	5,128
Proceeds on maturity of available for sale debt securities		5,000	10,000
Purchases of property, plant and equipment		-	(1)
Purchases of debt securities		(5,099)	(10,258)
Net cash generated from investing activities		5,411	4,869
Net increase in cash and bank overdrafts		11,597	6,175
Cash and bank overdrafts at the beginning of the year		78,318	72,143
Cash and bank overdrafts at the end of the year	15	89,915	78,318

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

The notes on pages 10 to 30 form part of these financial statements

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

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

1 ACCOUNTING POLICIES

1 1 Basis of accounting

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted for use in the European Union and therefore comply with EU IAS regulation The financial statements also comply with those parts of the Companies Act 1985 applicable to companies reporting under IFRS

The financial statements have been prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value available-for-sale financial assets

1 2 Life assurance

The Company's long-term assurance contracts include whole-life and term assurance contracts that are expected to remain in force for an extended period of time These contracts insure events associated with human life (for example death or the occurrence of a critical illness)

a) Insurance premium revenue

Premiums are recognised as revenue when they become payable by the contract holder Premiums are shown before the deduction of commission

b) Insurance benefits

Benefits are recorded as an expense when the Company becomes aware of the claim Provision is made for the full cost of settling outstanding claims at the balance sheet date Costs for both direct and indirect claims handling costs are also included

c) Insurance contracts

A liability for contractual benefits that are expected to be incurred in the future is recorded when the premiums are recognised For contracts other than credit insurance business the liability is determined as the sum of the expected discounted value of future benefit payments and future administration expenses that are directly related to the insurance contract less the expected discounted value of premiums payable under the contract, based on the valuation assumptions used For regular premium credit insurance business the liability is taken as a multiple of premium For single premium credit insurance business the liability is taken as a proportion of the single premium, where the proportion reflects the outstanding term remaining on the contract

The liability is based on assumptions as to mortality, morbidity, maintenance expenses and investment income A margin for adverse deviations is included in the assumptions

Where contracts have a single premium the excess of the premiums payable over the valuation premium is deferred and recognised as income in line with the decrease of unexpired insurance risk of the contract in force

d) Reinsurance

The Company has reinsurance treaties that transfer significant insurance risk Reinsurance cash flows are recognised when they become payable

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

The benefits to which the Company is entitled under its reinsurance contracts held are recognised as reinsurance assets These assets consist of short-term balances due from reinsurers (classified within loans and receivables) as well as longer term receivables that are dependant on the expected benefits arising under the related reinsured contracts Amounts recoverable from reinsurers are estimated in a consistent manner with the outstanding claims provisions or settled claims associated with the reinsured policies and in accordance with the relevant reinsurance contract

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

1 ACCOUNTING POLICIES (Continued)

1 2 Life assurance (Continued)

e) Deferred acquisition costs

Acquisition expenses comprise direct costs and costs associated with obtaining and processing new business Costs are amortised over a period no longer than that in which they are expected to be recoverable out of margins in revenues from the related policies

1 3 Revenue recognition (non-insurance)

Interest income on financial assets that are classified as loans and receivables or available-for-sale and interest expense on financial liabilities is determined using the effective interest rate method

In the case of available-for-sale assets estimates are based on the straight line method, which management has determined is a close approximation to the effective interest rate

1 4 Plant and equipment

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

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

Computer equipment	5 years
Other equipment	10 years

1 5 Financial assets

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

Available-for-sale – available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs They are subsequently measured at fair value

Changes in the fair value of available-for-sale financial assets are reported in a separate component of shareholders' equity Interest calculated using the straight line method (see note 1 3 above) is recognised in the income statement

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

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

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

Insurance receivables comprise outstanding insurance premiums and reinsurance recoveries

1 6 Impairment of financial assets

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

1 ACCOUNTING POLICIES (Continued)

1 6 Impairment of financial assets (Continued)

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

Loans and receivables including insurance receivables - a system based hold and chase process is applied should a customer fail to pay a premium The relevant credit control department is notified automatically of any failed collections The customer is taken off cover until the issue is resolved After the third payment is missed the policy is cancelled Premiums are then adjusted for cancelled policies

1 7 Taxation

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

Deferred taxation is accounted for in full for all temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes

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

1 8 Transactions with related parties

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

1 9 Cash and cash equivalents

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

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

1 10 Borrowings

Borrowings comprises bank overdrafts and inter company loans

1 11 Accounting Developments

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

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

The Company is reviewing IFRS7 and the amendment to IAS1 to determine their effect on its financial reporting The standards will be adopted with effect from 1 January 2007

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

2 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The reported results of the Company are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements The Company's principal accounting policies are set out on pages 10 to 12 UK company law and IFRS require the directors, in preparing the Company's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent In the absence of an applicable standard or interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's Framework for the Preparation and Presentation of Financial Statements

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

2 1 Life Insurance Liabilities under long-term insurance contracts

Liabilities under long term insurance contracts are dependant on estimates made by the Company Estimates are made regarding the expected number of deaths or critical illness claims for each of the years for which the Company is exposed to the risk These estimates are based on standard industry and national mortality and morbidity tables which reflect recent historical mortality and morbidity experience Adjustments to these tables are then made to reflect the Company's own recent experience

The estimated number of deaths or critical illness claims determine the value of the benefit payments The main source of uncertainty being the effect of epidemics and wide ranging lifestyle changes such as eating, smoking and exercise habits on future mortality and morbidity Such factors could result in future mortality being significantly worse than in the past for age groups in which the Company has significant exposure

In determining the liabilities under long-term insurance contracts assumptions are also made regarding the level of expenses and the investment return on the assets backing the liabilities

Liabilities under long-term insurance contracts net of reinsurance at 31 December 2006 amounted to £43,066,000 (2005 £54,759,000)

2 2 Fair value

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

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

The fair value of available-for-sale financial assets at 31 December 2006 amounted to £30,038,000 (2005 £31,179,000)

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

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

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK

The Company issues contracts that accept insurance risk in return for a premium It also has financial risk exposures This section summarises these risks and the way the Company manages them

The Company is a member of the Insurance Division of The Royal Bank of Scotland Group plc (RBSG) and benefits from services provided by specialist teams and risk management procedures and controls which are applied across the Division

3 1 Insurance risk

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

- Underwriting, pricing and reserving risk
- Claims management risk
- Reinsurance risk

3 1 1 Underwriting, pricing and reserving risk

Underwriting and pricing risk is the risk that inappropriate business will be written and/or inappropriate prices charged The classes of business written, underwriting criteria and relevant limits, define underwriting risk appetite

Reserving risk is the risk that the reserves have been calculated incorrectly, or the assumptions used in the calculation turn out to be inappropriate

Long term insurance contracts

The Company manages these risks through a wide range of processes and forums, some of which include

- Underwriting guidelines which exist for all business transacted restricting the types and classes of business that may be accepted
- Medical selection is included in the Company's underwriting procedures and premiums vary to reflect the lifestyle, health and family medical history of the applicant
- Comprehensive audit programmes
- Pricing policies which are set by pricing committees by product line
- Central control of policy wordings and any subsequent changes
- Insurance risk framework that involves, among other things, minuted monthly meetings where all aspects of insurance risk are discussed
- Weekly monitoring of key performance indicators by product
- Formal monthly monitoring and reporting to the executive
- Annual budgeting and quarterly re-forecasting
- Reserves are calculated by an independent consulting firm of actuaries

Frequency and severity of specific risks - long term insurance contracts

For contracts where death or critical illness is the insured risk, the most significant factors that could increase the overall frequency of claims are epidemics or wide spread changes in lifestyle, such as eating, smoking and exercise habits, resulting in earlier or more claims than expected

For contracts with fixed benefits and fixed future premiums, there are no mitigating terms and conditions that reduce the insurance risk accepted

For contracts with reviewable premiums a mitigating factor is the reviewable nature of the premium Under the terms of the policy the retail premium can be adjusted to reflect claims experience, developments in medical technology and diagnosis and other related expenses

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3 1 1 Underwriting, pricing and reserving risk (Continued)

The table below presents the concentration of insured benefits across four bands per individual life assured The benefit insured figures are shown gross and net of the reinsurance contracts described above

Benefits assured per life assured at the end of 2006	Total benefits insured			
	Before reinsurance		After reinsurance	
£'000	£m		£m	
0 - 99	4,745	34 8%	944	43 9%
100 - 199	6,447	47 2%	913	42 5%
200 - 299	1,792	13 1%	220	10 2%
300 +	672	4 9%	72	3 4%
Total	13,656		2,149	

Benefits assured per life assured at the end of 2005	Total benefits insured			
	Before reinsurance		After reinsurance	
£'000	£m		£m	
0 - 99	4,837	37 2%	973	46 9%
100 - 199	5 962	46 0%	850	41 0%
200 - 299	1 578	12 2%	188	9 1%
300 +	591	4 6%	62	3 0%
Total	12,968		2,073	

The concentration in 2006 has not substantially changed from the prior year

Sources of uncertainty in the estimation of future benefit payments and premium receipts

Uncertainty in the estimation of future benefits and premium receipts for long-term insurance contracts arises from the unpredictability of long-term changes in overall levels of mortality and morbidity

The Company uses appropriate base tables of standard mortality and morbidity according to the type of contract being written and the territory in which the insured person resides An investigation into the Company's recent experience, in conjunction with a review of the continuous mortality and morbidity investigations performed by independent actuarial bodies, is carried out and a best estimate of expected mortality and morbidity for the future is derived

3 1 2 Claims management risk

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

Claims are managed utilising a range of controls and manual processes conducted by experienced staff, to ensure that claims are handled in a timely and accurate manner

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

3 1 3 Reinsurance risk

Reinsurance is used

- To protect the insurance results against unforeseen volumes of, or adverse trends in, claims in order to reduce volatility and to improve stability of earnings, and
- To transfer risk that is not within the Company's current risk appetite

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3 1 3 Reinsurance risk (Continued)

The following types of reinsurance are used where appropriate

- Quota share reinsurance where the reinsurer takes an agreed percentage of claims arising in return for specified reinsurance premiums which are based on reinsurance rates per £1000 sum assured,
- Excess of loss 'per individual risk' reinsurance to protect against significantly large individual losses, and
- Other forms of reinsurance may be utilised according to need, subject to approval by senior management or the board as appropriate

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

The rating profile of the Company's reinsurers which accounts for 100% of the total ceded reinsurance premiums is as follows

Rating from Standard & Poors	Number of Reinsurers 2006	Number of Reinsurers 2005
AA	-	1
AA-	4	1
A+	-	1
A	-	1

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

3 2 Financial risk

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

The Company is exposed to financial risk through its financial assets and financial liabilities (borrowings), reinsurance assets and insurance liabilities The Company's financial risk is concentrated within its investment portfolio, in particular the risk that the proceeds from its financial assets are not sufficient to fund the obligations arising from its insurance contracts

The Company's investment portfolio is managed in accordance with the RBS Insurance Investment Policy and Investment Guidelines These are drawn up in compliance with the objectives and risk appetite parameters set by The Royal Bank of Scotland Group plc and are approved by the RBS Insurance Group Limited Board The Investment Policy is operated by the Investment Management Committee, which is made up of Senior Executives of both the Insurance Division and the Company, and the Funds Management Committee

The Investment Management Committee (IMC)

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

The Funds Management Committee (FMC)

The FMC's Terms of Reference includes

- To ensure that the day-to day investment management is carried out effectively in accordance with the Investment Policy and Investment Guidelines,
- To develop and maintain an investment strategy that is appropriate to the circumstances of the Company and satisfies all regulators,

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3 2 Financial risk (Cotinued)

The Funds Management Committee (FMC) (Continued)

- To review the appointment and dismissal of investment advisers and the suitability of investment and dealing recommendations having regard to the nature of the investment and the circumstances of the Company, and
- Report non compliance to the Company and the RBS Insurance Group Limited Board

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

The Investment Policy sets out its objectives as

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

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

Details of the controls and asset allocation parameters for the Insurance Division of the Royal Bank of Scotland are set out below The Company's financial assets are managed within these guidelines but particular attention is paid to recommendations from the Actuarial Function Holder regarding the matching of the maturity of assets with the expected maturity of insurance liabilities

Operating Funds

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

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

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

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

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

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3 2 Financial risk (Cotinued)

Long term funds

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

- Equities
- Property
- Listed Debt Securities with maturities between five and fifteen years
- Floating Rate Debt Securities with maturities up to forty years

b) Controls

- Investments will normally be denominated in Sterling Suitable opportunities to invest in other currencies are permitted up to 10% (by reference to market value) of total invested funds
- Apart from currency investments, no other currency transactions are permitted except those which are specifically designed to hedge the risk associated with an underlying currency investment
- Bank Deposits up to one year may be approved by one member of the IMC, where there is a specific credit limit in place
- All debt securities must have a pre-determined fixed coupon or an unrestricted variable coupon positively linked to a recognised market rate They must also have a definitive maturity date
- The use of Futures and Forward Rate Agreements ("FRAs") are permitted strictly for the purpose of locking in yields or as an expedient method of investing in or hedging, subject to normal limits It is expressly forbidden to use Futures or Options for gearing purposes
- Stock lending of securities is permitted within the limits agreed with Royal Bank of Scotland Group plc Risk Division
- All equity purchases, with the exception of the Individual Equity Fund, must be purchased through one of the Investment Managers retained to run the equity funds Any additional investments in any of the funds, other than reinvestment, must be approved by the IMC
- The RBS Insurance Group Limited Board must approve any property purchased for the sole purpose of investment Other than owner occupied premises, property investments shall be restricted to single tenant occupied office buildings with a 'blue-chip' covenant
- Fixed interest investments with a maturity up to fifteen years may be purchased if approved by at least two members of the IMC and must be within the limits as agreed with Royal Bank of Scotland Group plc Risk Division Any investment where no specific prior limit has been approved by Royal Bank of Scotland Group plc Risk Division must be approved by at least three members of the IMC
- Floating rate investments with a maturity up to forty years may be purchased if approved by at least two members of the IMC, and must be within the limits as agreed with Royal Bank of Scotland Group plc Risk Division Any investment where no specific prior limit has been approved by Royal Bank of Scotland Group plc Risk Division must be approved by at least three members of the IMC
- As mentioned above any purchase for the Individual Equity Fund must not exceed the portfolio limit of £50m and must be approved by the IMC plus either the Chairman of RBS Insurance Group Limited or the Chairman of The Royal Bank of Scotland Group plc Due regard will be had to the regulator's admissibility limits and the total exposure aggregated with other debt or equity exposures to that name Where the investment is to be made in a foreign currency, it is likely that the cost price would be hedged in the underlying currency

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

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

3 2 1 Market risk (comprising interest rate risk)

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

The Company is exposed to market risk because of positions held in its investment portfolio Exposure to market risk is managed in accordance with the guidelines set out in the RBS Insurance Group Limited Investment Policy as detailed above

The following tables indicate financial assets that are exposed to interest rate risk together with the corresponding range of applicable interest rates

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

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

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3 2 1 Market risk (comprising interest rate risk) (Continued)

At 31 December 2006

Maturity date or contractual repricing date

	Within one year	After one but not more than two years	After two but not more than three years	After three but not more than four years	After four but not more than five years	More than five years	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Exposed to fair value interest rate risk							
Debt securities - fixed interest risk	-	-	6,038	4,899	5,040	14,061	30,038
Exposed to cash flow interest rate risk							
Deposits with credit institutions	90,419	-	-	-	-	-	90,419
Total fair value	**90,419**	**-**	**6,038**	**4,899**	**5,040**	**14,061**	**120,457**

Interest rate range

	Within one year	After one but not more than two years	After two but not more than three years	After three but not more than four years	After four but not more than five years	More than five years
	% Interest rate range	% Interest rate range	% Interest rate range	% Interest rate range	% Interest rate range	% Interest rate range
Debt securities - fixed interest risk	n/a	n/a	5 50 - 5 75	4 75	5 5	4 5 - 6 25
Deposits with credit institutions	4 97-5 24	n/a	n/a	n/a	n/a	n/a

At 31 December 2005

Maturity date or contractual repricing date

	Within one year	After one but not more than two years	After two but not more than three years	After three but not more than four years	After four but not more than five years	More than five years	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Exposed to fair value interest rate risk							
Debt securities - fixed interest risk	5,033	-	-	6,258	5,070	14,818	31,179
Exposed to cash flow interest rate risk							
Deposits with credit institutions	79,943	-	-	-	-	-	79,943
Total fair value	84,976	-	-	6,258	5,070	14,818	111,122

Interest rate range

	Within one year	After one but not more than two years	After two but not more than three years	After three but not more than four years	After four but not more than five years	More than five years
	% Interest rate range	% Interest rate range	% Interest rate range	% Interest rate range	% Interest rate range	% Interest rate range
Debt securities - fixed interest risk	5 00	n/a	n/a	5 50 - 5 75	4 75	4 5 - 6 25
Deposits with credit institutions	4 46-4 57	n/a	n/a	n/a	n/a	n/a

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

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

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3 2 1 Market risk (comprising interest rate risk) (Continued)

The Company's investment guidelines are determined with reference to an analysis of the term and nature of the liabilities Matching assets are then determined that produce a low market risk to the Company The guidelines are reviewed on a quarterly basis

3 2 2 Credit Risk

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

- Investment Counterparty – this arises from the investment of monies in the range of investment vehicles permitted by the Investment Policy
- Reinsurance Recoveries – credit exposure to reinsurance counterparties arises in respect of reinsurers' share of insurance liabilities and amounts due from reinsurers in respect of claims already paid

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

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

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

At 31 December 2006

	AAA £'000	AA+ £'000	AA £'000	AA- £'000	A+ £'000	A £'000	A- £'000
Debt securities	30,038	-	-	-	-	-	-
Insurance contracts reinsurance asset	-	-	-	58,350	-	-	-
Cash at bank and in hand	5,000	5,000	29,419	26,000	20,000	-	5,000
Reinsurance debtors included under loans and receivables	-	-	-	8,437	-	-	-
Total assets bearing credit risk	35,038	5,000	29,419	92,787	20,000	-	5,000

At 31 December 2005

	AAA £'000	AA+ £'000	AA £'000	AA- £'000	A+ £'000	A £'000	A- £'000
Debt securities	31,179	-	-	-	-	-	-
Insurance contracts reinsurance asset	-	-	125,189	17,740	7,423	2,956	-
Cash at bank and in hand	4,000	4,000	18,943	23,000	13,000	8,000	9,000
Reinsurance debtors included under loans and receivables	-	-	5,772	1,393	506	232	-
Total assets bearing credit risk	35,179	4,000	149,904	42,133	20,929	11,188	9,000

The Company's investment guidelines recommend that the total assets with any other counterparty should not exceed 20% of the sum of the total investments It is recommended that all assets are denominated in sterling

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3 2 3 Liquidity risk

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

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

An independent consulting firm of actuaries analyse the term of the liabilities and determine matching assets to ensure that liquidity risk is minimised In the investment guidelines it is recommended that the current liabilities, free assets and half the assets backing the creditor liability are invested in cash and short dated deposits

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

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

4 NET INSURANCE PREMIUM REVENUE

	2006 £'000	2005 £'000
Long-term insurance contracts		
Premium income from insurance contracts issued	94,676	122,148
Premium revenue ceded to reinsurers on insurance contracts issued	(16,341)	(13,194)
Net insurance premium revenue	**78,335**	**108,954**

5 INVESTMENT INCOME

	2006 £'000	2005 £'000
Available for sale financial assets		
Interest income from debt securities	1,563	1,697
Interest income		
From deposits with credit institutions	4,017	3,452
Net amortisation of premium / (discount) on purchase of financial assets	34	(37)
	5,614	5,112

6 INSURANCE BENEFITS

	At 31 December 2006		
	Gross £'000	Reinsurance £'000	Net £'000
Long-term insurance contracts with fixed and guaranteed terms			
- death benefits	21,898	(11,008)	10,890
- increase in liabilities	(107,244)	95,551	(11,693)
Total cost of policyholder benefits	(85,346)	84,543	(803)

	At 31 December 2005		
	Gross £'000	Reinsurance £'000	Net £'000
Long-term insurance contracts with fixed and guaranteed terms			
- death benefits	18,451	(8,456)	9,995
- increase in liabilities	6,939	(4,850)	2,089
Total cost of policyholder benefits	25,390	(13,306)	12,084

7 EXPENSES

a) Expenses for the acquisition of insurance contracts

	2006 £'000	2005 £'000
Cost incurred for the acquisition of insurance contracts expensed in the year	36,453	58,376
	36,453	58,376

b) Expenses for marketing and administration

	2006 £'000	2005 £'000
Marketing and administrative expenses	11,551	9,483
Depreciation (note 10)	78	82
Expenses incurred under profit participation (note 24)	18,384	20,465
	30,013	30,030

8 TAX CHARGE

	2006 £'000	2005 £'000
Current taxation		
Tax charge for the period	5,415	4,049
Under provision in respect of prior periods	128	-
	5,543	4,049
Deferred taxation (note 13)		
Charge for the period	13	24
	13	24
Current taxation	5,543	4,049
Deferred taxation (note 13)	13	24
Tax charge for the period	5,556	4,073

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

	2006 £'000	2005 £'000
Profit before tax	18,286	13,576
Expected tax charge	5,486	4,073
Effects of		
Adjustments in respect of prior periods	128	92
Other timing differences	(58)	(92)
Tax charge	5,556	4,073

9 PROFIT FOR THE YEAR

	2006	2005
Profit for the year is stated after charging	£'000	£'000
Depreciation of property, plant and equipment	78	82

Auditors' remuneration

Fees for audit and non-audit services, included within marketing and administration expenses, are borne and recharged by a related party There were no non-audit services incurred in the current or previous year

Fees paid to the auditors with respect to the statutory audit of the Company amount to £60,000 (2005 £57,000)

Other services fees in respect of the audit of the FSA Return amount to £58,000 (2005 £73,000)

The amounts recharged in respect of non-audit services relating to tax services amount to £14,000 (2005 £13,000)

Directors' emoluments

	2006 £'000	2005 £'000
Other emoluments	269	216
Company pension contributions	26	66
	295	282

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

Included in the above are emoluments, excluding pension contributions, paid to the highest paid director amounting to £269,339 (2005 £215,861)

A contribution of £26,348 (2005 £69,946) to a money purchase scheme was made on behalf of the highest paid director

During the year two directors exercised options (2005 nil) Details of these share options are disclosed within the directors' report

10 PROPERTY, PLANT AND EQUIPMENT

	Computer and other equipment £'000
Cost	
At 1 January 2005	669
Additions	1
At 1 January and 31 December 2006	**670**
Depreciation	
At 1 January 2005	(384)
Depreciation charge for the year	(82)
At 1 January 2006	**(466)**
Depreciation charge for the year	(78)
At 31 December 2006	**(544)**
Net book amount	
At 31 December 2006	**126**
At 31 December 2005	**204**

11 INVESTMENTS

	2006 £'000	2005 £'000
Available for sale investments		
Debt Securities		
Listed - fixed interest rate	**30,038**	**31,179**

12 REINSURANCE ASSETS

	2006 £'000	2005 £'000
Reinsurers' share of insurance liabilities	54,319	149,870
Reinsurers' share of claims outstanding	4,031	3,438
Total assets arising from reinsurance contracts	**58,350**	**153,308**

13 DEFERRED INCOME TAX

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

	Accelerated capital allowances £'000
At 1 January 2005	109
(Charge) / credit to income statement (note 8)	(24)
At 1 January 2006	**85**
(Charge) / credit to income statement (note 8)	(13)
At 31 December 2006	**72**

14 LOANS AND RECEIVABLES INCLUDING INSURANCE RECEIVABLES

	2006 £'000	2005 £'000
Receivables arising from insurance and reinsurance contracts		
Due from policyholders	542	360
Due from reinsurers	8,437	7,903
Other loans and receivables		
Accrued interest and rent	1,055	943
Receivables from related parties (Note 24)	2,172	199
Other prepayments and accrued income	68	105
Total loans and receivables including insurance receivables	**12,274**	**9,510**

15 CASH AND CASH EQUIVALENTS

	2006 £'000	2005 £'000
Cash at bank and in hand with related parties (note 24)	1,494	1,478
Short term deposits with financial institutions		
- third parties	85,000	76,000
- related parties (note 24)	3,925	2,465
	90,419	**79,943**

The effective interest rate on short term deposits with credit institutions was 4 97% - 5 24% (2005 4 46% - 4 57%) and has an average maturity of 90 days

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

	2006 £'000	2005 £'000
Cash and cash equivalents	90,419	79,943
Bank overdrafts (note 20)	(504)	(1,625)
	89,915	**78,318**

16 SHARE CAPITAL

	2006 £'000	2005 £'000
Authorised		
Equity shares		
44 million ordinary shares of £1 each	44,000	44,000
Issued and fully paid		
Equity shares		
44 million ordinary shares of £1 each		
At 1 January and 31 December	44,000	44,000

17 OTHER RESERVES AND RETAINED EARNINGS

	2006 £'000	2005 £'000
Undated loan capital	3,500	-
Reserve for revaluation of available-for-sale investments	128	1,021
Other reserves at 31 December	**3,628**	**1,021**
Retained earnings at 31 December	**26,183**	**13,453**

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

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17 OTHER RESERVES AND RETAINED EARNINGS (Continued)

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

	Debt Securities	
	2006	2005
	£'000	£'000
At 1 January	1,021	812
Revaluation during the period - gross	(1,275)	298
Revaluation during the period - taxation	382	(89)
At 31 December	128	1,021

18 INSURANCE CONTRACTS AND REINSURANCE ASSETS

	2006	2005
	£'000	£'000
Gross		
Long term insurance contracts		
- with fixed and guaranteed terms	97,385	204,629
- benefits outstanding	4,926	4,147
	102,311	208,776
Recoverable from reinsurers		
Long term insurance contracts		
- with fixed and guaranteed terms	(54,319)	(149,870)
- benefits outstanding	(4,031)	(3,438)
	(58,350)	(153,308)
Net		
Long term insurance contracts		
- with fixed and guaranteed terms	43,066	54,759
- benefits outstanding	895	709
	43,961	55,468
Current	12,321	11,865
Non-current	31,640	43,603
	43,961	55,468

18 1 Long term life insurance contracts - assumptions, change in assumptions and sensitivity

(a) Assumptions

The Company writes only non-profit long-term business where shareholders are entitled to 100% of the profits The gross premium method of actuarial valuation is used This makes explicit assumptions for interest and discount rates, mortality and morbidity, persistency and future expenses Assumptions are reviewed annually against actual experience and industry and economic trends

The key assumptions used for the insurance contracts, other than credit insurance business, disclosed in this note are as follows

Mortality & morbidity
Appropriate base tables of standard mortality and morbidity are chosen depending on the type of contract An investigation into the company's recent experience, in conjunction with a review of the continuous mortality investigations performed by independent actuarial bodies, is carried out and an appropriate level of the base table is derived

Investment returns
Valuation discount rate 3 50% net of tax (2005 3 25%)

Renewal expense level and inflation
The Company's current level of expenses, together with a margin for prudence, is taken as an appropriate expense base and an expense inflation rate of 4% (2005 4%) is applied

For regular premium credit insurance business we hold a multiple of premium as the reserve For single premium credit insurance business the reserve is taken as a proportion of the single premium, where the proportion reflects the outstanding term remaining on the contract

18 INSURANCE CONTRACTS AND REINSURANCE ASSETS (Continued)

18 1 Long term life insurance contracts - assumptions, change in assumptions and sensitivity (Continued)

(b) Change in assumptions during the year

The following estimates and assumptions used in determining assets and liabilities for insurance contracts were changed, and had the following effect on profit recognised for the year

	Effect on profit 2006 £'000
Adoption of PS06/14	4,578
Mortality/Morbidity for insurance contracts	841
Expenses	(26)
Valuation interest rate	41
Close down reserve	(24)
	5,410

(c) Sensitivity analysis

Life insurance results are inherently uncertain, due to actual experience being different to modelled assumptions Sensitivity analysis is provided below to illustrate the impact of changes in key assumptions

Sensitivity factor	Description of sensitivity factor applied
Interest rate & investment return	The impact of a change in market interest rates by +/- 1% (e g if a current interest rate is 5% the impact of an immediate change to 4% and 6%) The test allows consistently for similar changes to investment returns and movements in the market backing fixed interest securities
Expenses	The impact of an increase in maintenance expenses by 10%
Assurance mortality/morbidity	The impact of an increase in mortality/morbidity rates for assurance contracts by 5%

The table below demonstrates the effect of a change in a key assumption whilst other assumptions remain unaffected In reality, such an occurrence is unlikely due to correlation between the assumptions and other factors It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results The sensitivity analyses do not take into consideration that our assets and liabilities are actively managed and may vary at the time that any actual market movement occurs

	Variability	Impact on value of investments £'000	Impact on profit £'000	Impact on equity £'000
Interest rates +1%	+1%	(1,215)	90	(760)
Interest rates -1%	-1%	1,588	(99)	1,012
Expenses +10%	+10%	-	(100)	(100)
Assurance mortality/morbidity +5%	+5%	-	(335)	(335)

18 2 Movements in insurance liabilities and reinsurance assets

	At 31 December 2006		
	Gross £'000	Reinsurance £'000	Net £'000
At 1 January 2006	**204,629**	**(149,870)**	**54,759**
Provisions in respect of new business	58,222	(16,341)	41,881
Expected change in existing business provisions	10,206	(11 008)	(802)
Variance between actual and expected experience	(151,273)	135,338	(15,935)
Other movements	(24,399)	(12,438)	(36,837)
At 31 December 2006	**97,385**	**(54,319)**	**43,066**

18 INSURANCE CONTRACTS AND REINSURANCE ASSETS (Continued)

18 2 Movements in insurance liabilities and reinsurance assets (Continued)

	At 31 December 2005		
	Gross £'000	Reinsurance £'000	Net £'000
At 1 January 2005	**197,690**	**(145,020)**	**52,670**
Provisions in respect of new business	44,055	(21,329)	22,726
Expected change in existing business provisions	(9,935)	404	(9,531)
Variance between actual and expected experience	(11,128)	1,293	(9,835)
Other movements	(16,053)	14,782	(1,271)
At 31 December 2005	**204,629**	**(149,870)**	**54,759**

19 TRADE AND OTHER PAYABLES INCLUDING INSURANCE PAYABLES

	2006 £'000	2005 £'000
Due to reinsurers	31	68
Due to related parties (Note 24)	5,379	615
Trade creditors and accruals	4,134	2,207
Other creditors	77	41
	9,621	2,931

20 BORROWINGS

	2006 £'000	2005 £'000
Bank overdrafts with related parties (Note 24)	504	1,625

Bank overdrafts are repayable on demand or within one year

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

21 CONTINGENT LIABILITIES

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

22 COMMITMENTS

There was no capital expenditure contracted for at the balance sheet date

23 ULTIMATE PARENT COMPANIES

The Company's immediate parent company is Direct Line Life Holdings Limited

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

24 RELATED PARTY TRANSACTIONS

The following transactions were carried out with related parties

i Sales of insurance contracts and other services

	2006 £'000	2005 £'000
Sales of services		
- UK Insurance Limited	22,716	32,064
	22,716	**32,064**

24 RELATED PARTY TRANSACTIONS (Continued)

ii Purchases of products and services

	2006 £'000	2005 £'000
Purchases of services		
- RBS Insurance Services Limited	4,763	2,957
- UK Insurance Limited	13,665	20,465
- Tesco Personal Finance Limited	4,719	-
	23,147	23,422

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

Services with related parties are usually negotiated on a cost plus basis, allowing for a margin ranging from 0% to 6% (2005 0% to 6%)

All employees were employed by RBS Insurance Services Limited, a fellow subsidiary company Total employee costs, including directors' remuneration, recharged to the Company by RBS Insurance Services Limited during the year were £4,351,000 (2005 £2,801,000)

Employee costs recharged by RBS Insurance Services Limited includes the full costs of key managers and other staff in respect of share-based payments The attribution among members of the RBS Group has regard to the needs of the group as a whole It would be inappropriate to deem that any employees had received share-based payments as a result of their employment with this Company only

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

	2006 £'000	2005 £'000
Bank deposits held with related parties		
- The Royal Bank of Scotland plc	3,925	2,465
- The Royal Bank of Scotland International Limited	1,494	1,478
	5,419	3,943
Bank overdrafts held with related parties		
- The Royal Bank of Scotland plc	(504)	(1,625)
	(504)	(1,625)

	2006 £'000	2005 £'000
Receivables from related parties		
- Direct Line Unit Trusts Limited	55	85
- UK Insurance Limited	1,985	114
- RBS Group Corporate Functions PLC	132	-
	2,172	199

	2006 £'000	2005 £'000
Payables to related parties		
- RBS Insurance Services Limited	707	615
- UK Insurance Limited	3,683	-
- Tesco Personal Finance Limited	989	-
	5,379	615

25 EVENTS AFTER BALANCE SHEET DATE

There are no events after the Balance Sheet date that require reporting

26 CAPITAL RESOURCES

Under FRS27 the Company is required to produce a capital position statement, reconciling the capital resources of the life insurance business of the Company to the capital resources available on a regulatory basis All business of the Company is life insurance business

26 CAPITAL RESOURCES (Continued)

	2006 £'000	2005 £'000
Total shareholders' funds as at 31 December	73,811	58,474
Adjustments to regulatory basis	(672)	(585)
Total available capital resources as at 31 December	73,139	57,889

	2006 £'000	2005 £'000
Shareholders' funds held in long term business fund	46,525	35,638
Shareholders' funds outside long term business fund	26,614	22,251
	73,139	57,889

Movements in the capital resources were as follows

	2006 £'000	2005 £'000
Capital resources at 1 January	57,889	48,152
Changes in assumptions	5,410	890
New business and other factors	6,340	8,847
Injection of undated loan capital	3,500	-
Capital resources at 31 December	**73,139**	**57,889**

27 CAPITAL MANAGEMENT POLICY

The Company is required to meet minimum capital requirements at all times under the Financial Service Authority's Prudential Sourcebook The capital resources covering the regulatory requirement are not transferable to other areas of the Group To ensure that the capital requirement is satisfied at all times, the Company holds an additional voluntary buffer above the absolute minimum Sufficient capital resources are held to ensure that the capital requirements are covered over a specified projection period Life insurance results are inherently uncertain, due to actual experience being different to modelled assumptions Such differences affect regulatory capital resources, as do varying levels of new business Therefore, projections are formally reviewed twice a year Where there is a shortfall of capital projected, various options are available to provide new capital