Company Registration No: 02199286

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

DIRECTORS' REPORT AND FINANCIAL STATEMENTS

31 DECEMBER 2008

Group Secretariat
The Royal Bank of Scotland Group plc
Gogarburn
P.O. Box 1000
Edinburgh EH12 1HQ

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

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DIRECT LINE LIFE INSURANCE COMPANY LIMITED

OFFICERS AND PROFESSIONAL ADVISERS

DIRECTORS:	M A Hesketh C P Sullivan
SECRETARY:	P A Hutchings
REGISTERED OFFICE:	3 Edridge Road Croydon Surrey CR9 1AG
AUDITORS:	Deloitte LLP London

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 2008.

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, fixed term life cover with critical illness and over 50's life cover.

The Company is a subsidiary 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. For this reason, the directors believe that performance indicators specific to the Company are not necessary or appropriate for an understanding of the development, performance or position of the business. The annual reports of The Royal Bank of Scotland Group plc review these matters on a Group basis. Copies can be obtained from Group Secretariat, RBS Gogarburn, Edinburgh, EH12 1HQ, the Registar of Companies or through the Group's web site at rbs.com.

Review of the year

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

An interim dividend of £20 million was paid in 2008 (2007: £nil). The directors do not recommend the payment of a final dividend (2007: £nil).

The Company's financial performance is presented in the Income Statement on Page 5. At the end of the year, the financial position showed total assets of £193,043,000 (2007: £194,741,000), including income-generating assets comprising investments of £113,717,000 representing a decrease of 3.8% from 2007, and total equity of £75,399,000 (2007: £81,418,000).

The Company is funded by facilities from The Royal Bank of Scotland Group plc. It seeks to minimise its exposure to external financial risks other than credit risk, further information is disclosed in Note 3. It also has exposure to asset risk on the residual value of property, plant and equipment.

The directors, having made such enquiries as they considered appropriate, including regarding the continuing availability of sufficient Group resources, have prepared the financial statements on a going concern basis. They considered the financial statements of The Royal Bank of Scotland Group plc for the year ended 31 December 2008, approved on 25 February 2009, which were prepared on a going concern basis.

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 2008 to date the following changes have taken place:

	Appointed	Resigned
Directors		
R C Ramsden		12 February 2008
D A MacKechnie		22 April 2008

DIRECTORS' RESPONSIBILITIES

The directors are required by the Companies Act 1985 and 2006 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 disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

DIRECTORS' REPORT (Continued)

DIRECTORS' RESPONSIBILITIES (Continued)

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 requirements of the Companies Act 1985 and 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.

DISCLOSURE OF INFORMATION TO AUDITORS

Each of the directors at the date of approval of this report confirms that:

a) so far as he / she is aware there is no relevant audit information of which the Company's auditors are unaware; and
b) the director has taken all the steps that he / she ought to have taken to make himself / herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given and shall be interpreted in accordance with the provisions of section 234ZA of the Companies Act 1985.

DIRECTORS' INDEMNITIES

In terms of section 236 of the Companies Act 2006, Mr M A Hesketh, Mr D A MacKechnie, Mr R C Ramsden and Mr C P Sullivan had been granted Qualifying Third Party Indemnity Provisions by The Royal Bank of Scotland Group plc.

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.

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.

AUDITORS

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

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

M A Hesketh
Director

25 March 2009

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 2008 which comprise the income statement, the balance sheet, the cash flow statement, the statement of changes in equity, the accounting policies and the related Notes 2 to 30. 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

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are 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 whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether, in our opinion, the information given in the directors' report is consistent with the financial statements. In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the directors' report 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, in accordance with IFRSs as adopted by the European Union, of the state of the company's affairs as at 31 December 2008 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the financial statements.

Deloitte LLP

Deloitte LLP
Chartered Accountants and Registered Auditors
London, United Kingdom
25 March 2009

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2008

	Notes	2008 £'000	2007 £'000
Insurance premium revenue	5	88,043	94,081
Insurance premium ceded to reinsurers	5	(21,212)	(17,922)
Net insurance premium revenue		**66,831**	**76,159**
Investment income	6	6,339	6,848
Net income		**73,170**	**83,007**
Insurance benefits	7	(24,191)	(19,467)
Insurance benefits recovered from reinsurers	7	19,025	9,595
Net insurance benefits		**(5,166)**	**(9,872)**
Expenses for the acquisition of insurance contracts	8	(26,563)	(32,625)
Expenses for marketing and administration	8	(23,613)	(29,949)
Expenses		**(50,176)**	**(62,574)**
Profit before tax		**17,828**	**10,561**
Tax charge	9	(5,040)	(3,235)
Profit for the year	10	**12,788**	**7,326**

The profit for the year was entirely attributable to equity shareholders of the Company and is derived from continuing operations.

The notes on pages 9 to 32 form part of these financial statements.

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

BALANCE SHEET
AS AT 31 DECEMBER 2008

	Notes	2008 £'000	2007 £'000
ASSETS			
Property, plant and equipment	13	34	62
Investments	14	37,104	30,448
Reinsurance assets	15	63,568	57,558
Deferred tax asset	16	49	64
Loans and receivables	17	15,604	15,636
Cash and cash equivalents	18	76,684	90,973
Total assets		**193,043**	**194,741**
EQUITY			
Share capital	19	44,000	44,000
Other reserves	20	5,102	3,909
Retained earnings	20	26,297	33,509
Total equity		**75,399**	**81,418**
LIABILITIES			
Insurance contracts	21	101,643	100,675
Trade and other payables including insurance payables	22	10,280	8,999
Borrowings	23	61	357
Current tax liabilities		5,660	3,292
Total liabilities		**117,644**	**113,323**
Total equity and liabilities		**193,043**	**194,741**

The financial statements were approved by the Board of Directors and authorised for issue on 25 March 2009. They were signed on its behalf by:

M A Hesketh
Director

The notes on pages 9 to 32 form part of these financial statements.

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2008

	Notes	Share capital £'000	Other reserves £'000	Retained earnings £'000	Total £'000
Balance as at 1 January 2007		**44,000**	**3,628**	**26,183**	**73,811**
Net fair value loss on available-for-sale investments		-	281	-	281
Net income recognised directly in equity		-	281	-	281
Profit for the year		-	-	7,326	7,326
Undated loan capital received		-	-	-	-
Total recognised income and expense for the year		-	281	7,326	7,607
Balance as at 31 December 2007		**44,000**	**3,909**	**33,509**	**81,418**
Net fair value gain on available-for-sale investments		-	1,193	-	1,193
Net income recognised directly in equity		-	1,193	-	1,193
Profit for the year		-	-	12,788	12,788
Total recognised income and expense for the year		-	1,193	12,788	13,981
Dividends	11			(20,000)	(20,000)
Balance as at 31 December 2008		**44,000**	**5,102**	**26,297**	**75,399**

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

The notes on pages 9 to 32 form part of these financial statements.

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2008

	Notes	2008 £'000	2007 £'000
Profit for the year		12,788	7,326
Adjustments for:			
Investment revenues		(6,339)	(6,848)
Tax expense		5,040	3,235
Depreciation of property, plant and equipment		28	64
Operating cash flows before movements in working capital		11,517	3,777
Net increase / (decrease) in insurance liabilities		968	(1,636)
Net (increase) / decrease in reinsurance assets		(6,010)	792
Net decrease / (increase) in loans and receivables		1,475	(2,867)
Net increase in related party balances		(210)	(205)
Net decrease in other operating liabilities		(181)	(916)
Cash generated from / (consumed by) operations		7,559	(1,055)
Taxes paid		(3,093)	(5,110)
Interest paid		(31)	(22)
Other operating activities		(5)	-
Net cash generated from / (consumed by) operating activities		4,430	(6,187)
Cash flows from investing activities			
Interest received		6,568	6,888
Purchases of debt securities		(4,991)	-
Net cash generated from investing activities		1,577	6,888
Cash flows from financing activities			
Dividends paid		(20,000)	-
Net cash consumed by financing activities		(20,000)	-
Net (decrease) / increase in cash and bank overdrafts		(13,993)	701
Cash and bank overdrafts at the beginning of the year		90,616	89,915
Cash and bank overdrafts at the end of the year	18	**76,623**	**90,616**

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 the cash flows from payment of insurance claims.

The notes on pages 9 to 32 form part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008

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 available-for-sale financial assets are stated at their fair value.

The accounts are prepared on a going concern basis and in accordance with IFRS. The Company's business activities, together with the factors likely to affect its future development, performance and position are set out in the Activities and Business Review section of the Directors' Report on page 2. In addition notes 3 and 4 to the financial statements include the Company's objectives, policies and processes for managing its insurance and financial risks and capital.

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

Insurance contracts are defined as those containing significant insurance risk if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance, at the inception of the contract. Such contracts remain insurance contracts until all rights and obligations are extinguished or expire. Contracts can be reclassified as insurance contracts after inception if insurance risk becomes significant.

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.

1. ACCOUNTING POLICIES (Continued)

1.2 Life assurance (Continued)

d) Reinsurance (Continued)

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.

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

On initial recognition 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.

A financial asset is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The appropriate quoted market price for an asset held is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction. If conditions have changed since the time of the transaction (e.g. a change in the risk-free interest rate following the most recent price quote for a corporate bond), the fair value reflects the change in conditions by reference to current prices or rates for similar financial instruments, as appropriate.

1. **ACCOUNTING POLICIES (Continued)**

1.5 Financial assets (Continued)

The valuation methodology described above uses observable market data.

If the market for a financial asset is not active, the Company establishes fair value by using a valuation technique. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the Company uses that technique.

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.

Other loans and receivables principally comprise loans to related parties and other debtors.

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.

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. **ACCOUNTING POLICIES (Continued)**

1.10 Borrowings

Borrowings comprise bank overdrafts.

The Company classifies a financial instrument that it issues as a financial liability or an equity instrument in accordance with the substance of the contractual arrangement. An instrument is classified as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms. An instrument is classified as equity if it evidences a residual interest in the assets of the Company after the deduction of liabilities.

1.11 Accounting Developments

The IASB reissued IAS 23 'Borrowing Costs' in March 2007. Entities are required to capitalise borrowing costs attributable to the development or construction of intangible assets or property, plant or equipment. The standard is effective for accounting periods beginning on or after 1 January 2009 and is not expected to have a material effect on the Company.

The IASB revised IAS 1 'Presentation of Financial Statements' in September 2007. The amendments to the presentation requirements for financial statements are not expected to have a material effect on the Company. The standard is effective for accounting periods beginning on or after 1 January 2009.

In addition to the above, the Company has considered the reissued IFRS 3 'Business Combinations' and IAS 27 'Consolidated and Separate Financial Statements' by the IASB following the completion in January 2008 of its project on the acquisition and disposal of subsidiaries. The Company has concluded that these will not apply.

The IASB issued amendments to a number of standards in May 2008 as part of its annual improvements project. The amendments are effective for accounting periods beginning on or after 1 January 2009. Based on the current activities of the Company it is not expected that adoption of these amendments will have a significant impact on the Company's financial statements.

The IASB also issued an amendment to IAS 39 "Financial Instruments: Recognition and Measurement" and IFRS 7 "Financial Instruments: Disclosure" - Reclassification of Financial Assets. The amendment, issued in October 2008, permits an entity to reclassify non – derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the fair value through profit or loss category in particular circumstances. The amendment also permits an entity to transfer from the available-for-sale category to the loans and receivables category (if the financial asset had been designated as available-for-sale), if the entity has the intention and ability to hold that financial asset for the foreseeable future. The Company has elected not to reclassify such financial assets; as such this amendment has no impact on the Company's financial statements.

In addition to the above, the following standards and amendments to published standards are mandatory for accounting periods beginning on or after 1 January 2009 or later periods and they have been considered not relevant to the Company's operations or not applicable:

- IFRS 8 "Operating Segments";
- IFRS 2 "Share – based Payments"; Vesting conditions and cancellation;
- IAS 32 "Financial Instruments: Presentation" and IAS 1 "Presentation of Financial Statements" – Puttable Financial Instruments and Obligations Arising on Liquidations";
- IFRS 1 "First time adoption of International Financial Reporting Standards" and IAS 27 "Consolidated and Separate Financial Statements"- Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate; and
- IAS 39 "Financial Instruments: Recognition and Measurement" - Eligible Hedged Items

The Company has considered IFRIC 12 "Service Concession Arrangements" applicable for accounting period beginning on or after 1 January 2008 (IFRIC 12 has not yet been endorsed by EU) and concluded it will not apply to the Company.

The Company has considered IFRIC 13 "Customer Loyalty Programmes" issued in June 2007. The interpretation is effective for annual periods beginning on or after 1 July 2008 and it is not expected to have a material impact on the Company's financial statements.

The Company has considered new interpretations (IFRIC 15 to 17) issued during the year and has concluded that these will not apply.

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 9 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 2008 amounted to £37,138,000 (2007: £41,916,000).

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 available-for-sale 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 Company closely monitors the valuation of assets in markets that have become less liquid. Determining whether a market is active requires the exercise of judgement and is determined based upon the facts and circumstances of the market for the instrument being measured. Where it is determined that there is no active market, fair value is established using a valuation technique as described in the note above. The techniques applied incorporate relevant information available and reflect appropriate adjustments for credit and liquidity risks. The relative weightings given to differing sources of information and the determination of non-observable inputs to valuation models can require the exercise of significant judgement. Where possible, the Company seeks at least external quotations for each bond and considers whether these are representative of fair value in the light of current traded levels, and in comparison to the internal group valuation models. Where this information is not available or where it is considered to be not representative of fair value, fair value has been estimated using quoted market prices for securities with similar credit, maturity and yield characteristics.

The fair value of available-for-sale financial assets at 31 December 2008 amounted to £37,104,000 (2007: £30,448,000) and 100% were determined using observable market inputs.

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 an entity within RBS Insurance which constitutes the Insurance Division of The Royal Bank of Scotland Group plc (the RBS Group) and benefits from services provided by specialist teams and risk management procedures and controls which are applied across the Division. Within RBS Insurance, risk is managed both by individual entity and on a combined basis.

The Company is regulated by the Financial Services Authority.

3.1 Risk management

The RBS Group has developed, and adopted globally, one comprehensive Risk Management Framework to ensure that a consistent risk philosophy is communicated and enacted throughout the Group's operations. This risk framework defines the risk organisation, risk approach, risk people and risk infrastructure. It sets out the framework that is required to:

- Execute the Group's risk appetite objectives;
- Support the governance and internal control of the businesses;
- Communicate risk appetite with both internal and external stakeholders;
- Ensure compliance with regulatory requirements;
- Ensure that all risks are identified in a timely manner, and subsequently properly assessed and managed and/or mitigated in accordance with the relevant risk policy, appetite and tolerances; and
- Monitor and report on risks and issues across the businesses and RBS Insurance as a whole to facilitate management information for decision making, strategy setting and best practice internal control.

The management of risk is a fundamental management activity performed throughout all of RBS Insurance's operations. The primary role of RBS Insurance's Risk Management function is to provide the framework and support to the relevant Senior Management (including the Approved Persons) of RBS Insurance to manage the risks faced across the Division.

In order to consider the key risks which pose a material threat to the Company's strategic objectives or to the Company's profit and capital, a 'top down' risk policy and process has been developed and approved.

In accordance with the RBS Insurance Top Down Risk Management Policy, RBS Insurance uses a high-level risk register (HLRR) to record the major risks faced by the business. This register has been used to determine risks which have been subjected to stress and scenario analysis in the quantitative modelling. The potential profit variance arising from these stress and scenario tests is used to assess the Company's exposure to each of these risks.

'Business as usual' risks and their mitigating controls for each category and the Central Functions are recorded within each area's Risk and Control Register. These risks are reviewed at least monthly by the area/register owner, and by the central RBS Insurance Risk Team (Divisional Risk) on a quarterly basis. The Risk and Control Registers focus on business facing risks and predominantly comprise operational risks. Although other risk types such as insurance and credit risk are not specifically excluded, the key requirement is the documentation of operational risks which threaten business processing. Risks contained in the Risk and Control Registers are subject to ongoing review and control testing to ensure that risks are managed within operational risk appetite. A materialised risk identification, reporting and resolution process takes place to ensure that corrective actions are taken in response to any unacceptable operational weakness.

The responsibility for ensuring that each legal entity within RBS Insurance has sufficient capital to meet its liabilities rests with the Board of each legal entity. To this end RBS Insurance carries out detailed capital modelling of its assets, liabilities and the key risks to which it is exposed. This work feeds into each entity's own assessment of its capital requirements for solvency purposes in the submission of its Individual Capital Assessment (ICA) to the FSA quantifying the following categories of risk: insurance risk, market risk, credit risk, liquidity risk, operational risk, and group risk.

The Board of each regulated entity is closely involved in the ICA process and signs off on its assumptions and results. Specifically the following are fundamental areas that the Board has key involvement in:

- Completion of a HLRR for each Business Category or Central Function, input to the aggregated HLRR for RBS Insurance as a whole, sign-off of the final HLRR and regular review (at least quarterly) of the HLRR;
- Assessment of the risk appetite in relation to strategy and business plans;

3. MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3.1 Risk management (Continued)

- Input to, and review and approval of stress and scenario tests; attendance at the scenario workshops as required by the facilitators; and
- Review, agree and sign off of the ICA submission to the FSA including any surrounding documentation, policies, explanations and assumptions.

RBS Insurance seeks to engender awareness and a shared responsibility for risk management at all levels of the organisation. The Company's Insurance Risk Appetite Policy supports this. Risk Appetite can be described as the willingness of RBS Insurance to tolerate risk related to the pursuit of its approved business activities and objectives. Risk Appetite is restricted to, and limits are set for, approved lines of business. Insurance Risk can be measured as follows:

- Level one - Individual limits

This is expressed in terms of the type of business transacted, (e.g. product types that are underwritten) and the maximum limits per individual risk by these product types. This is captured in a risk appetite matrix of underwriting limits expressed as a function of products and limits.

- Level two - Aggregate limits

This can be expressed in terms of the aggregate volume of business for a particular class (exposure and premium as recorded in business plans, business category budget plans and subsequent quarterly re-forecast plans of each business unit).

- Level three - Mitigated risk

This can be expressed in terms of the potential profit variance which could result from the risks accepted; this will include the quantification of major risks to the business as outlined in the HLRR scenario analysis, based on modelling of these risks on a 1:200 year event as defined in FSA ICA submission.

To enable RBS Insurance to monitor, control and manage the level of risk effectively against Risk Appetite Statements a control environment has been developed within RBS Insurance which consists of the following components:

- Clearly defined management responsibilities and organisational structures;
- A process for delegated limits of authority;
- Appropriate policies and procedures (in line with FSA Senior Management Arrangements Systems and Controls rules (SYSC));
- Accounting controls and reconciliations;
- Management reporting systems comprising information of Key Performance Indicators and Key Risk Indicators;
- A structured budget and reforecast process;
- Personnel requirements for key positions (FSA controlled functions rules);
- Segregation of duties; and
- Regular internal review and audit mechanisms.

3.2 Insurance risk

Insurance risk can arise from:

- Fluctuations in the timing, frequency and severity of insured events, relative to the expectations of the Company at the time of underwriting;
- Inaccurate pricing at underwriting;
- Inadequate reinsurance protection; and
- Inadequate reserves.

Direct Line Life Insurance Company Limited underwrites 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, fixed term life cover with critical illness and over 50's life cover. Contracts are issued typically on a long-term basis, which means that the Company's liability can extend for a period ranging from five years up to fifty-two years. For creditor insurance, contracts are issued either on a monthly renewable basis (regular premium) and can be amended or cancelled by either party at any point during the contract, or for the full term of the loan (single premium). In the latter case, (these policies were withdrawn from sale in December 2008) the customer has the option to cancel the contract at any point but generally the Company is obligated for the full term of up to a maximum of 10 years but typically 3 to 5 years.

3. MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3.2 Insurance risk (Continued)

This risk is managed according to the following separate components:

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

3.2.1 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 this risk 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 internal quality review audit programmes;
- Pricing policies which are set by management and implemented through pricing committees by product line and by brand;
- Central control, within underwriting, of policy wordings and any subsequent changes;
- Insurance risk framework that involves, among other things, regular minuted meetings where all aspects of insurance risk are discussed, and additional meetings where detailed claims data are examined and discussed;
- Weekly monitoring within the business of key performance indicators by product and brand;
- Formal monthly monitoring and reporting to the Executive, by product and brand;
- Annual budgeting and quarterly re-forecasting, signed off by the Company Executive; and
- Reserves are calculated by an independent consulting firm of actuaries.

(a) 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.

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 2008	Total benefits insured			
	Before reinsurance		After reinsurance	
£'000	£m		£m	
0 - 99	5,397	29.7%	909	38.2%
100 - 199	9,010	49.6%	1,072	45.1%
200 - 299	2,771	15.3%	297	12.5%
300 +	977	5.4%	99	4.2%
Total	18,155		2,377	

3. MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3.2.1 Underwriting, pricing and reserving risk (Continued)

Benefits assured per life assured at the end of 2007	Total benefits insured			
	Before reinsurance		After reinsurance	
£'000	£m		£m	
0 - 99	5,402	31.7%	948	40.6%
100 - 199	8,356	49.0%	1,030	44.2%
200 - 299	2,429	14.2%	267	11.4%
300 +	862	5.1%	88	3.8%
Total	17,049		2,333	

The concentration in 2008 has not substantially changed from the prior year.

(b) 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.

(c) 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 2.5% net of tax (2007: 3.5%).

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 3.0% (2007: 4.0%) 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.

Lapses

For critical illness policies the Company has used a lapse rate of 4.5% per annum (2007: 3.5%), when net cash flows are negative and a lapse rate is prudent. Otherwise a lapse rate of 15.5% per annum (2007: 12.5%) is used. For all other policies, excluding over 50's polices and creditor, the Company has used a lapse rate of 3.5% per annum (2007: 3.5%), when net cash flows are negative and a low lapse rate is prudent. Otherwise a lapse rate of 12.5% per annum (2007: 12.5%) is used.

3. MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3.2.1 Underwriting, pricing and reserving risk (Continued)

(d) 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 2008 £'000
Investment return	(314)
Mortality/Morbidity for insurance contracts	416
Expenses	105
Lapse rate	29
	236

(e) 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 analysis
Debt Securities	This sensitivity factor is a new analysis this year. It has been selected due to the the financial turbulence in the economic environment. The method used in calculating this sensitivity is to apply a 20% change to market values to the debt securities portfolio.
Interest rate and 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% or 6%)
Expenses	The impact of an increase in ongoing administrative expenses and the claims handling expenses provision by 10%
Assurance mortality/morbidity	The impact of an increase in mortality/morbidity rates for assurance contracts by 5%.
Lapse rates	The impact of an increase in lapse rates by 0.5%

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.

Sensitivity at 31 December 2008	Variability	Impact on value of investments	Impact on profit after tax	Impact on shareholders equity
		£'000	£'000	£'000
Debt securities	+20%	7,421	-	7,421
Debt securities	-20%	(7,421)	-	(7,421)
Interest rates	+1.0%	(1,130)	305	(503)
Interest rates	-1.0%	1,176	(467)	373
Expenses	+10.0%	-	(188)	(188)
Assurance mortality/morbidity	+5.0%	-	(399)	(399)
Increase in lapse rate	+0.5%	-	157	157

3. MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3.2.1 Underwriting, pricing and reserving risk (Continued)

Sensitivity at 31 December 2007	Variability	Impact on value of investments £'000	Impact on profit after tax £'000	Impact on shareholders equity £'000
Debt securities	+20%	6,090	-	6,090
Debt securities	-20%	(6,090)	-	(6,090)
Interest rates	+1.0%	(1,152)	268	(539)
Interest rates	-1.0%	1,217	(315)	537
Expenses	+10.0%	-	(187)	(187)
Assurance mortality/morbidity	+5.0%	-	(433)	(433)
Increase in lapse rate	+0.5%	-	139	139

3.2.2 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 an appropriate, 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.

3.2.3 Reinsurance risk

Reinsurance risk arises from a failure of reinsurance to control exposure to losses, to reduce volatility or to protect capital.

RBS Insurance uses reinsurance:

- To save capital;
- 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 retention strategy.

RBS Insurance reviews its reinsurance purchases at least annually to ensure that the levels of protection being bought reflect any changes in exposure and risk appetite of the Group.

Reinsurance is only effective when the counterparty is financially secure. Before entering into a contract with a new reinsurer, it must satisfy the Credit Risk Approval process that uses information derived internally and from security ratings agencies. Acceptable reinsurers are rated at A- or better by Standard and Poors ratings agency unless specifically authorised by the RBS Insurance Board.

3.3 Financial risk

The Company is exposed to financial risk through its financial assets and financial liabilities. The Company's financial risk is concentrated within its investment portfolio. This 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 Committee, which is made up of Senior Executives of both the Insurance Division and the Company, and executed on their behalf by the Funds Management Committee (FMC).

The Investment Company determines high level policy and controls, covering such areas as safety, liquidity and performance. It meets at least 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 FMC and the Company's Investment Policy and Guidelines are updated to reflect the changes.

The objectives set out in the Investment Policy are:

- To maintain safety of the portfolio's principal both in economic terms and from an accounting and reporting perspective;
- To maintain sufficient liquidity to provide cash requirements for operations; and

3. **MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)**

3.3 Financial risk (Continued)

- 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 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. The Investment Guidelines set out asset allocation rules and controls for each component part of the portfolio as follows:

Operating Funds

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); and
- 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.

Long Term Funds

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;
- Fixed Interest Debt Securities (five to fifteen years); and
- Floating Rate Debt Securities (up to forty years).

Opportunistic investments in individual equity stocks will also be allowed up to a maximum of £100m and will be held as an Individual Equity Fund. This type of investment purchased for this portfolio would typically be those which are of undoubted credit quality and offer a good dividend yield. It is likely that such stocks would be liquid and traded on one of the major world stock exchanges.

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.

3.3.1 Market 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 in both the value of its liabilities and the value of assets held. Exposure to market risk in the investment portfolio is managed in accordance with the guidelines set out in the RBS Insurance Investment Policy as detailed above.

The Company assesses the financial impact from changes in market risk through stress testing adopted as part of the Individual Capital Assessment (ICA) process. These tests are designed to consider the impact on capital arising from various scenarios based on changes in the financial circumstances and budget assumptions.

Interest rate risk

Interest rate risk arises primarily from the Company's investments in long term debt and fixed income securities, which are exposed to fluctuations in interest rates.

A table showing the sensitivity of profits to changes in interest rates is included at note 3.2.1 above.

3. MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3.3.2 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; and
- 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 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 has established its own CRMF consistent with The Royal Bank of Scotland Group plc CRMF. The RBS Insurance 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 tables analyse the credit quality of financial and insurance assets by type of asset. The tables include reinsurance exposure, after provision. Note 3.2.3 details the Company's approach to reinsurance credit risk management.

At 31 December 2008

	AAA £'000	AA+ £'000	AA £'000	AA- £'000	A+ £'000	A £'000	A- £'000
Debt securities (note 14)	37,104	-	-	-	-	-	-
Insurance contracts: reinsurance asset (note 15)	-	-	-	63,568	-	-	-
Cash at bank and in hand (note 18)	-	3,000	29,500	15,000	19,184	10,000	-
Reinsurance debtors included under loans and receivables (note 17)	-	-	-	9,824	-	-	-
Total assets bearing credit risk	37,104	3,000	29,500	88,392	19,184	10,000	-

At 31 December 2007

	AAA £'000	AA+ £'000	AA £'000	AA- £'000	A+ £'000	A £'000	A- £'000
Debt securities (note 14)	30,448	-	-	-	-	-	-
Insurance contracts: reinsurance asset (note 15)	-	-	-	57,558	-	-	-
Cash at bank and in hand (note 18)	5,000	6,183	38,500	21,290	15,000	5,000	-
Reinsurance debtors included under loans and receivables (note 17)	-	-	-	11,493	-	-	-
Total assets bearing credit risk	35,448	6,183	38,500	90,341	15,000	5,000	-

3.3.3 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 Royal Bank of Scotland Group plc Insurance Division is undertaken within the limits and other policy parameters set out in the Liquidity Risk Policy. The asset class and maturity parameters contained within this policy are summarised in 3.3 above. Compliance is monitored both in respect of the internal policy and the regulatory requirements

3. MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3.3.3 Liquidity risk (Continued)

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.

The Company performs liquidity risk stress testing as part of its Individual Capital Assessment (ICA) process. These tests are designed to assess the Company's liquidity requirement in order to meet claims and other liabilities in a number of different extreme event scenarios and compare this requirement against the liquidity available from its investment portfolio and other assets. In all of the events considered the Company is comfortably able to meet its liabilities as they fall due.

Analysis of maturity of liabilities

For each category of insurance and financial liabilities, the following table shows the gross liability at 31 December 2008 analysed by remaining duration. The total liability is split by remaining duration in proportion to the cashflows expected to arise during that period.

At 31 December 2008

	Total £'000	Within one year £'000	After one but not more than three years £'000	After three but not more than five years £'000	After five but not more than ten years £'000	Over ten years £'000
Insurance liabilities (note 21)	101,643	8,707	24,020	12,288	37,630	18,998
Borrowings (note 23)	61	61	-	-	-	-
Trade and other payables including insurance payables (note 22)	10,280	10,280	-	-	-	-
Total	111,984	19,048	24,020	12,288	37,630	18,998

At 31 December 2007*

	Total £'000	Within one year £'000	After one but not more than three years £'000	After three but not more than five years £'000	After five but not more than ten years £'000	Over ten years £'000
Insurance liabilities (note 21)	100,675	8,919	26,678	14,280	31,103	19,695
Borrowings (note 23)	357	357	-	-	-	-
Trade and other payables including insurance payables (note 22)	8,999	8,999	-	-	-	-
Total	110,031	18,275	26,678	14,280	31,103	19,695

The concentration in 2008 has not substantially changed from the prior year.

*The comparative disclosure has been restated. The splits between remaining duration have been reallocated to enhance comparison with current year analysis.

4. CAPITAL RISK MANAGEMENT

The Company defines capital in accordance with regulations prescribed by the Financial Services Authority (FSA) and manages it in accordance with the RBS Insurance Capital Management Policy. Its objectives when managing capital are:

- to comply with legal and regulatory obligations and maintain capital resources commensurate with the nature, scale and risk profile of its business;
- to provide a framework for monitoring the capital position of the Company, including the procedures to be followed during periods of general financial stress, either due to internal or external events;
- to safeguard its ability to continue as a going concern; and
- provide an adequate return to its shareholders by pricing insurance and investment contracts commensurately with the level of risk.

The principle underlying the rules prescribed by the FSA is that the Company must at all times maintain assets of a value sufficient to cover its liabilities, including liabilities arising under or in connection with contracts of insurance, and that there is a suitable matching of assets and liabilities. The FSA rules require the Company to maintain a surplus of admissible assets over its liabilities which is at all times at least equal to the higher of its Minimum Capital Requirement (MCR) or its Individual Capital Guidance (ICG).

As at 31 December 2008, the Company held a surplus of at least £66,132,000 (2007: £53,019,000), the MCR requirement was £37,677,000 (2007: £36,468,000)

Management information to monitor the Company's capital position is produced and presented to The RBS Insurance Capital Committee and the RBS Insurance board on a regular basis ensuring that the Company meets its capital requirements at all times.

The Company has complied with the FSA imposed rules and guidance in respect of capital in both 2008 and 2007.

5. NET INSURANCE PREMIUM REVENUE

	2008 £'000	2007 £'000
Long-term insurance contracts:		
Premium income from insurance contracts issued	88,043	94,081
Premium revenue ceded to reinsurers on insurance contracts issued	(21,212)	(17,922)
Net insurance premium revenue	**66,831**	**76,159**

6. INVESTMENT INCOME

	2008 £'000	2007 £'000
Available-for-sale financial assets:		
Interest income from debt securities	1,675	1,586
Interest income:		
From deposits with credit institutions	4,480	5,203
From related parties (note 27)	174	50
Net amortisation of premium on purchase of financial assets	10	9
	6,339	6,848

7. INSURANCE BENEFITS

	At 31 December 2008		
	Gross £'000	Reinsurance £'000	Net £'000
Long-term insurance contracts with fixed and guaranteed terms:			
- death benefits	22,860	(12,916)	9,944
- increase in liabilities	1,331	(6,109)	(4,778)
Total cost of policyholder benefits	**24,191**	**(19,025)**	**5,166**

	At 31 December 2007		
	Gross £'000	Reinsurance £'000	Net £'000
Long-term insurance contracts with fixed and guaranteed terms:			
- death benefits	22,779	(11,757)	11,022
- increase in liabilities	(3,312)	2,162	(1,150)
Total cost of policyholder benefits	**19,467**	**(9,595)**	**9,872**

8. EXPENSES

a) Expenses for the acquisition of insurance contracts

	2008 £'000	2007 £'000
Cost incurred for the acquisition of insurance contracts expensed in the year	26,563	32,625
	26,563	32,625

b) Expenses for marketing and administration

	2008 £'000	2007 £'000
Marketing and administrative expenses	7,359	12,158
Depreciation (note 13)	28	64
Expenses incurred under profit participation (note 27)	16,226	17,727
	23,613	29,949

9. TAX CHARGE

	2008 £'000	2007 £'000
Current taxation:		
Charge for the period	5,091	3,172
(Over) / Under provision in respect of prior periods	(66)	55
	5,025	3,227
Deferred taxation (note 16):		
Charge for the period	15	8
	15	8
Tax charge for the period	**5,040**	**3,235**

The actual tax charge differs from the expected tax charge computed by applying the standard rate of UK corporation tax of 28.5% (2007: 30%) as follows:

	2008 £'000	2007 £'000
Profit before tax	17,828	10,561
Expected tax charge	5,081	3,168
Effects of:		
Adjustments in respect of prior periods	(66)	55
Other timing differences	25	12
Tax charge	5,040	3,235

10. PROFIT FOR THE YEAR

	2008 £'000	2007 £'000
Profit for the year is stated after charging:		
Depreciation of property, plant and equipment (note 13)	28	64

Auditors' remuneration

Fees for audit and non-audit services, included within marketing and administration expenses, are borne and recharged by a related party, RBS Insurance Services Limited.

Fees paid to the auditors with respect to the statutory audit of the Company amount to £51,000 (2007: £48,000).

Fees in respect of the audit of the FSA Return amount to £62,000 (2007: £59,000) and fees for other services amount to £15,000 (2007: £15,000)

Directors' emoluments

	2008 £'000	2007 £'000
Other emoluments	159	233
Company pension contributions	9	30
	168	263

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 £155,940 (2007: £228,782).

A contribution of £8,460 (2007: £30,173) to a money purchase scheme was made on behalf of the highest paid director. One other director (2007: two directors) had retirement benefits accruing under money purchase pension schemes in respect of qualifying service, two directors (2007: four directors) had benefits accruing under defined pension schemes.

During the year no director exercised options (2007: six directors).

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008

11. DIVIDENDS

	2008 £'000	2007 £'000
Equity dividends on ordinary shares:		
Interim dividend paid	20,000	-
	20,000	-

12. CLASSIFICATION OF FINANCIAL INSTRUMENTS

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The summary of significant accounting policies in note 1 describes how the classes of financial instruments are measured and how income and expenses of the financial assets and liabilities by category are defined in IAS39 and by the balance sheet heading.

At 31 December 2008

	Available for sale £'000	Loans and receivables £'000	Other (amortised costs) £'000	Non-financial assets / liabilities £'000	Total £'000
Property, plant and equipment	-	-	-	34	34
Investments	37,104	-	-	-	37,104
Reinsurance assets	-	-	-	63,568	63,568
Deferred tax asset	-	-	-	49	49
Loans and receivables	-	15,604	-	-	15,604
Cash and cash equivalents	-	76,684	-	-	76,684
	37,104	92,288	-	63,651	**193,043**
Insurance contracts	-	-	-	101,643	101,643
Trade and other payables including insurance payables	-	-	10,280	-	10,280
Borrowings	-	-	61	-	61
Current tax liabilities	-	-	-	5,660	5,660
	-	-	10,341	107,303	**117,644**
Equity					75,399
					193,043

At 31 December 2007

	Available for sale £'000	Loans and receivables £'000	Other (amortised costs) £'000	Non-financial assets / liabilities £'000	Total £'000
Property, plant and equipment	-	-	-	62	62
Investments	30,448	-	-	-	30,448
Reinsurance assets	-	-	-	57,558	57,558
Deferred tax asset	-	-	-	64	64
Loans and receivables	-	15,636	-	-	15,636
Cash and cash equivalents	-	90,973	-	-	90,973
	30,448	106,609	-	57,684	**194,741**
Insurance contracts	-	-	-	100,675	100,675
Trade and other payables including insurance payables	-	-	8,999	-	8,999
Borrowings	-	-	357	-	357
Current tax liabilities	-	-	-	3,292	3,292
	-	-	9,356	103,967	**113,323**
Equity					81,418
					194,741

13. PROPERTY, PLANT AND EQUIPMENT

	Computer and other equipment £'000
Cost	
At 1 January 2007	670
At 1 January and 31 December 2008	**670**
Depreciation	
At 1 January 2007	(544)
Depreciation charge for the year	(64)
At 1 January 2008	**(608)**
Depreciation charge for the year	(28)
At 31 December 2008	**(636)**
Net book amount	
At 31 December 2008	34
At 31 December 2007	62

14. INVESTMENTS

	2008 £'000	2007 £'000
Available-for-sale investments		
Debt Securities:		
Listed - fixed interest rate	37,104	30,448

15. REINSURANCE ASSETS

	2008 £'000	2007 £'000
Reinsurers' share of insurance liabilities	58,266	52,157
Reinsurers' share of claims outstanding	5,302	5,401
Total assets arising from reinsurance contracts	63,568	57,558

16. DEFERRED TAXATION

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

	Accelerated capital allowances £'000
At 1 January 2007	72
Charge to income statement (note 9)	(8)
At 1 January 2008	64
Charge to income statement (note 9)	(15)
At 31 December 2008	49

17. LOANS AND RECEIVABLES INCLUDING INSURANCE RECEIVABLES

	2008 £'000	2007 £'000
Receivables arising from insurance and reinsurance contracts:		
Due from policyholders	334	373
Due from reinsurers	9,824	11,493
Other loans and receivables:		
Accrued interest and rent	822	1,051
Receivables from related parties (note 27)	4,343	2,671
Other prepayments and accrued income	281	48
Total loans and receivables including insurance receivables	**15,604**	**15,636**

18. CASH AND CASH EQUIVALENTS

	2008 £'000	2007 £'000
Cash at bank and in hand		
- third parties	71	3,183
Short term deposits with financial institutions		
- third parties	67,500	81,500
- related parties (note 27)	9,113	6,290
	76,684	**90,973**

The effective interest rate on short term deposits with credit institutions was 1.70% - 6.59% (2007: 5.45% - 6.59%) and has an average maturity of 90 days (2007: 90 days).

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

	2008 £'000	2007 £'000
Cash and cash equivalents	76,684	90,973
Bank overdrafts (note 23)	(61)	(357)
	76,623	**90,616**

19. SHARE CAPITAL

	2008 £'000	2007 £'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

20. OTHER RESERVES AND RETAINED EARNINGS

	2008 £'000	2007 £'000
Undated loan capital	3,500	3,500
Reserve for revaluation of available-for-sale investments	1,602	409
Other reserves at 31 December	**5,102**	**3,909**
Retained earnings at 31 December	**26,297**	**33,509**

20. OTHER RESERVES AND RETAINED EARNINGS (Continued)

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

	Debt Securities	
	2008	2007
	£'000	£'000
At 1 January	**409**	**128**
Revaluation during the period - gross	1,656	401
Revaluation during the period - taxation	(463)	(120)
At 31 December	**1,602**	**409**

21. INSURANCE CONTRACTS AND REINSURANCE ASSETS

	2008	2007
	£'000	£'000
Gross		
Long term insurance contracts:		
- with fixed and guaranteed terms	95,404	94,073
- benefits outstanding	6,239	6,602
	101,643	100,675
Recoverable from reinsurers		
Long term insurance contracts		
- with fixed and guaranteed terms	(58,266)	(52,157)
- benefits outstanding	(5,302)	(5,401)
	(63,568)	(57,558)
Net		
Long term insurance contracts		
- with fixed and guaranteed terms	37,138	41,916
- benefits outstanding	937	1,201
	38,075	**43,117**
Current	10,526	11,899
Non-current	27,549	31,218
	38,075	**43,117**

21.1 Movements in insurance liabilities and reinsurance assets

	At 31 December 2008		
	Gross	Reinsurance	Net
	£'000	£'000	£'000
At 1 January 2008	**94,073**	**(52,157)**	**41,916**
Provisions in respect of new business	61,481	(21,213)	40,268
Expected change in existing business provisions	(18,253)	12,916	(5,337)
Variance between actual and expected experience	(20,491)	2,188	(18,303)
Other movements	(21,406)	-	(21,406)
At 31 December 2008	**95,404**	**(58,266)**	**37,138**

	At 31 December 2007		
	Gross	Reinsurance	Net
	£'000	£'000	£'000
At 1 January 2007	**97,385**	**(54,319)**	**43,066**
Provisions in respect of new business	61,456	(17,922)	43,534
Expected change in existing business provisions	(21,629)	11,757	(9,872)
Variance between actual and expected experience	(15,470)	8,327	(7,143)
Other movements	(27,669)	-	(27,669)
At 31 December 2007	**94,073**	**(52,157)**	**41,916**

22. TRADE AND OTHER PAYABLES INCLUDING INSURANCE PAYABLES

	2008 £'000	2007 £'000
Due to reinsurers	72	27
Due to related parties (note 27)	7,135	5,673
Trade creditors and accruals	3,057	3,227
Other creditors	16	72
	10,280	8,999

23. BORROWINGS

	2008 £'000	2007 £'000
Bank overdrafts with related parties (note 27)	61	357

The borrowings are repayable on demand.

24. CONTINGENT LIABILITIES

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

25. COMMITMENTS

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

26. PARENT COMPANIES

The Company's immediate parent company is RBS Insurance Group 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. Copies of the 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.

On 1 December 2008, the UK Government through HM Treasury acquired a controlling shareholding in The Royal Bank of Scotland Group plc. The UK Government has announced that its shareholdings in banks will be managed by UK Financial Investments Limited, a company wholly-owned by the UK Government.

27. RELATED PARTY TRANSACTIONS

The following transactions were carried out with related parties.

i. Sales of insurance contracts and other services

	2008 £'000	2007 £'000
Sales of services:		
- U K Insurance Limited	17,285	20,134
	17,285	20,134

	2008 £'000	2007 £'000
Interest received: (note 6)		
- ABN AMRO Bank N.V.	174	50
	174	50

Sales of services are provided between related parties on an arms length basis.

Interest income received from deposits held with related parties were at rates ranging from 1.70% to 6.59% (2007: 5.45% - 6.59%).

27. RELATED PARTY TRANSACTIONS (Continued)

ii. Purchases of products and services

	2008 £'000	2007 £'000
Purchases of services:		
- RBS Insurance Services Limited	2,633	3,168
- Tesco Personal Finance Limited	4,815	4,745
- U K Insurance Limited	11,411	12,982
	18,859	20,895

Purchases of services also includes payments made between companies determined by the levels of business generated and as agreed between the parties, on an arms length basis.

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 £2,859,000 (2007: £3,193,000).

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.

iii. Compensation of key management

The aggregate remuneration of directors and other members of key management during the year was as follows:

	2008 £'000	2007 £'000
Other emoluments	166	237
Company pension contributions	10	31
	176	268

Fees paid to directors and other members of key management during the year amounted to £190 (2007: £80).

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

	2008 £'000	2007 £'000
Short term deposits held with related parties (note 18)		
- ABN AMRO Bank N.V.	-	4,000
- The Royal Bank of Scotland plc	9,113	2,290
	9,113	6,290

	2008 £'000	2007 £'000
Bank overdrafts held with related parties (note 23)		
- The Royal Bank of Scotland plc	(61)	(357)
	(61)	(357)

	2008 £'000	2007 £'000
Receivables from related parties (note 17)		
- Direct Line Unit Trusts Limited	-	86
- The Royal Bank of Scotland plc	1,209	211
- U K Insurance Limited	3,134	2,374
	4,343	2,671

	2008 £'000	2007 £'000
Payables to related parties (note 22)		
- Direct Line Insurance plc	-	1
- RBS Insurance Services Limited	4,360	3,643
- Tesco Personal Finance Limited	-	746
- U K Insurance Limited	2,749	1,254
- The One Account Limited	26	29
	7,135	5,673

28. EVENTS AFTER BALANCE SHEET DATE

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

29. 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.

	2008 £'000	2007 £'000
Total shareholders' funds as at 31 December	75,400	81,418
Adjustments to regulatory basis	(649)	(664)
Total available capital resources as at 31 December	74,751	80,754

	2008 £'000	2007 £'000
Shareholders' funds held in long term business fund	66,132	53,019
Shareholders' funds outside long term business fund	8,619	27,735
	74,751	80,754

Movements in the capital resources were as follows:

	2008 £'000	2007 £'000
Capital resources at 1 January	80,754	73,139
Changes in assumptions	236	504
New business and other factors	(6,239)	7,111
Capital resources at 31 December	74,751	80,754

30. 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.