Company Registration No: 02199286

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

DIRECTORS' REPORT AND FINANCIAL STATEMENTS

31 DECEMBER 2009

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

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DIRECT LINE LIFE INSURANCE COMPANY LIMITED

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DIRECT LINE LIFE INSURANCE COMPANY LIMITED

OFFICERS AND PROFESSIONAL ADVISERS

DIRECTORS	L J Bartlett D W Bradley P Cowman P R Geddes A J Grier S K Howard
SECRETARY:	P A Hutchings
REGISTERED OFFICE	3 Eridge 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 2009

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 (the Group) 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 Registrar 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

The retained profit for the period was £15m (2008 retained profit £13m) and this was transferred to reserves An interim dividend of £nil was paid in 2009 (2008 £20m) The directors recommend that a final dividend of £nil be paid (2008 £nil)

The Company's financial performance is presented in the Statement of Comprehensive Income on Page 5

Income decreased by £31m (2008 decreased by £5m) and expenses decreased by £33m (2008 decreased by £12m) After impairment provisions of £nil (2008 £nil), the profit before tax for the year was £20m (2008 £18m), an increase of 12% over 2008

At the end of the year, the financial position showed total assets of £189,652,000 (2008 £193,043,000), including income-generating assets comprising investments of £113,590,000 representing a decrease of 0 11% from 2008, and total equity of £90,637,000 (2008 £75,399,000)

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, as disclosed in note 13

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 2009 to date the following changes have taken place

Directors	Appointed	Resigned
D W Bradley	02 April 2009	
C P Sullivan		31 July 2009
P Cowman	10 August 2009	
P R Geddes	12 August 2009	
M A Hesketh		28 August 2009
A J Grier	16 September 2009	
L J Bartlett	21 October 2009	
S K Howard	21 October 2009	

DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the annual report and the financial statements in accordance with the applicable law and regulations

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

DIRECTORS' REPORT (Continued)

DIRECTORS' RESPONSIBILITIES (Continued)

Company law requires the directors to prepare a directors' report and financial statements for each financial year and the directors have elected to prepare them in accordance with the International Financial Reporting Standards as adopted by the European Union Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs at the end of the year and the profit and loss for the financial year as far as concern members of the company In preparing these financial statements, under International Accounting Standard 1, the directors are required to

- select suitable accounting policies and then apply them consistently,
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information,
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions of the entity's financial position and performance, and
- make an assessment of the company's ability to continue as a going concern

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and 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 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 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 section 418 of the Companies Act 2006

DIRECTORS' INDEMNITIES

In terms of section 236 of the Companies Act 2006, Mr L J Bartlett, Mr D W Bradley, Mr P Cowman, Mr P R Geddes, Mr A J Grier, Mr M A Hesketh, Mrs S K Howard 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

L J Bartlett

L J Bartlett
Director

Date 24 March 2010

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 2009 which comprise the Statement of Comprehensive Income, the Balance Sheet, the Cash Flow Statement, the Statement of Changes in Equity and the related Notes 1 to 29 The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 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 explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the prepartion of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error This includes an assessment of whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the company's affairs at 31 December 2009 and of its profit for the year ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit

Paul R. Stephenson

Paul Stephenson BA ACA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Auditors London, England

24 March 2010

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2009

	Notes	2009 £'000	2008 £'000
Insurance premium revenue	5	54,355	88,043
Insurance premium ceded to reinsurers	5	(24,903)	(21,212)
Net insurance premium revenue		**29,452**	**66,831**
Investment income	6	2,965	6,339
Net income		**32,417**	**73,170**
Insurance benefits	7	(8,805)	(24,191)
Insurance benefits recovered from reinsurers	7	13,290	19,025
Net insurance benefits		**4,485**	**(5,166)**
Expenses for the acquisition of insurance contracts	8	(3,136)	(26,563)
Expenses for marketing and administration	8	(13,795)	(23,613)
Expenses		**(16,931)**	**(50,176)**
Profit before tax		**19,971**	**17,828**
Tax charge	9	(4,660)	(5,040)
Profit for the year	10	**15,311**	**12,788**
Other comprehensive income			
Net fair value (loss)/gain on available-for-sale investments	20	(117)	1,656
Tax on other comprehensive income	20	44	(463)
Other comprehensive income after tax		**(73)**	**1,193**
Total comprehensive income for the year		**15,238**	**13,981**

The total comprehensive income for the year was entirely attributable to equity shareholders of the Company and is derived from continuing operations

The notes on pages 9 to 36 form part of these financial statements

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DIRECT LINE LIFE INSURANCE COMPANY LIMITED

BALANCE SHEET
AS AT 31 DECEMBER 2009

	Notes	2009 £'000	2008 £'000
ASSETS			
Property, plant and equipment	13	20	34
Investments	14	54,807	37,104
Reinsurance assets	15	62,167	63,568
Deferred tax asset	16	38	49
Loans and receivables	17	13,723	15,604
Cash and cash equivalents	18	58,897	76,684
Total assets		**189,652**	**193,043**
EQUITY			
Share capital	19	44,000	44,000
Other reserves	20	5,029	5,102
Retained earnings	20	41,608	26,297
Total equity		**90,637**	**75,399**
LIABILITIES			
Insurance contracts	21	86,671	101,643
Trade and other payables including insurance payables	22	7,750	10,280
Borrowings	23	-	61
Current tax liabilities		4,594	5,660
Total liabilities		**99,015**	**117,644**
Total equity and liabilities		**189,652**	**193,043**

The financial statements were approved by the Board of Directors and authorised for issue on 24 March 2010 They were signed on its behalf by

L J Bartlett

L J Bartlett
Director

The notes on pages 9 to 36 form part of these financial statements

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2009

	Notes	Share capital £'000	Other reserves £'000	Retained earnings £'000	Total £'000
Balance as at 1 January 2008		**44,000**	**3,909**	**33,509**	**81,418**
Profit for the year		-	-	12,788	12,788
Other comprehensive income		-	1,193	-	1,193
Total comprehensive income 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**
Profit for the year		-	-	15,311	15,311
Other comprehensive income		-	(73)	-	(73)
Total comprehensive income for the year		-	(73)	15,311	15,238
Balance as at 31 December 2009		**44,000**	**5,029**	**41,608**	**90,637**

Total changes in equity for the year was entirely attributable to the equity shareholders of the Company

The notes on pages 9 to 36 form part of these financial statements

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2009

	Notes	2009 £'000	2008 £'000
Profit for the year		15,311	12,788
Adjustments for			
Investment revenues		(2,965)	(6,339)
Tax expense		4,660	5,040
Depreciation of property, plant and equipment		14	28
Operating cash flows before movements in working capital		17,020	11,517
Net (decrease) / increase in insurance liabilities		(14,971)	968
Net decrease / (increase) in reinsurance assets		1,401	(6,010)
Net (increase) / decrease in loans and receivables		(1,944)	1,475
Net decrease / (increase) in related party balances		2,237	(210)
Net decrease in other operating liabilities		(886)	(181)
Cash generated from operations		2,857	7,559
Taxes paid		(5,366)	(3,093)
Interest paid		(34)	(31)
Other operating activities		65	(5)
Net cash (consumed by) / generated from operating activities		(2,478)	4,430
Cash flows from investing activities			
Interest received		2,911	6,568
Purchases of debt securities		(18,159)	(4,991)
Net cash (consumed by) / generated from investing activities		(15,248)	1,577
Cash flows from financing activities			
Dividends paid		-	(20,000)
Net cash consumed by financing activities		-	(20,000)
Net decrease in cash and bank overdrafts		(17,726)	(13,993)
Cash and bank overdrafts at the beginning of the year		76,623	90,616
Cash and bank overdrafts at the end of the year	18	**58,897**	**76,623**

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 36 form part of these financial statements

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009

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 The financial statements also comply with those parts of the Companies Act 2006 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 Company has considerable financial resources and as a consequence, the directors believe the company is well placed to manage its business risks successfully despite the current uncertain economic climate After making enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future Accordingly, the directors continue to adopt the going concern basis in preparing the annual report and financial statements 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 reinsures (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, designated as at fair value through profit or loss, 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 Exchange differences resulting from retranslating the amortised cost of currency monetary available-for-sale financial assets are recognised in the income statement

Changes in the fair value of available-for-sale financial assets are reported in other comprehensive income Interest calculated using the straight line method (see note 1 3 above) is recognised in the statement of comprehensive income

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

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009

ACCOUNTING POLICIES (Continued)

1 5 Financial assets (Continued)

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

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

Loans and receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method less impairment

Insurance receivables comprise outstanding insurance premiums where the policyholders have elected to pay in instalments or amounts due from brokers or third parties, where they have collected the money from the policyholder

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

Financial assets are derecognised when the rights to receive cash flows from them have expired or where they have been transferred and the company has also transferred substantially all risks and rewards of ownership

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 other comprehensive income and there is objective evidence that the asset is impaired, the cumulative loss is removed from other comprehensive income and recognised in the statement of comprehensive income 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 statement of comprenesive income, 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 recievables - if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and recievables has been incurred, the company measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and its recoverable amount Impairment losses are assesed individually where significant or collectively for assets that are not individualy significant

Impairment losses are recognised in the statement of comprehensive income and the carrying amount of the financial asset or group of financial assets is reduced by establishing an allowance for the impairment losses If in a subsequent period the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009

ACCOUNTING POLICIES (Continued)

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, except in relation to overseas earnings where remittance is controlled by the Group, and goodwill

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 shareholders' 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

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

Borrowings comprise bank overdrafts

Borrowings are measured at amortised cost using the effective interest method

1 11 Accounting Developments

The IASB issued amendments to a number of standards in April 2009 as part of its annual improvements project The amendments are effective for accounting periods beginning on or after 1 January 2010 and are not expected to have a material effect on the company

The IASB reissued IAS24, 'Related Party Disclosures', in November 2009 clarifying the existing standard and to provide certain exemptions for entities under government control The revised standard is effective for accounting periods beginning on or after 1 January 2011 and is expected generally to reduce the volume of disclosure between the Group and other parties related to the UK Government

1 12 Adoption of new and revised standards

In the current year, the following new and revised Standards and Interpretations have been adopted and have affected the amounts reported in these financial statements

IAS 1 (Revised) Presentation of Financial Statements

The IASB issued revised IAS 1 Presentation of Financial Statements in September 2007 which is effective for the financial years beginning on or after 1 January 2009 This standard requires all owner changes in equity to be presented in a statement of changes in equity, and all non-owner changes either in one statement of comprehensive income or in two separate statements which are income statement and a statement of comprehensive income The previous standard required components of comprehensive income to be presented in the statement of changes in equity The revised standard also requires that the income tax effect of each component of comprehensive income be disclosed In addition, it requires entities to present a comparative statement of financial position as at the beginning of the earliest comparative period when the entity has applied an accounting policy retrospectively, makes a retrospective restatement, or reclassifies items in the financial statements

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009

ACCOUNTING POLICIES (Continued)

1 12 Adoption of new and revised standards (Continued)

Amendment to IFRS 7 Financial Instruments Disclosures

The IASB published an amendment to IFRS 7 in March 2009 In particular, the amendment requires disclosure of the level of the fair value hierarchy into which fair value measurements are categorised based on a three level fair value hierarchy for financial instruments, a detailed reconciliation from beginning to ending balances for those instruments where significant unobservable inputs or valuation techniques have been used in their valuation, and a movement analysis between the different levels of the fair value hierarchy and the reasons for those movements In addition, the amendment provides further clarification around liquidity risk disclosures and additional quantitative disclosures based on liquidity risk of financial liabilities

The amendment applies for financial years beginning on or after 1 January 2009

Listed below are Standards and Interpretations that have been issued, which became applicable for this year, but had no impact on the reported results nor the financial position

IFRS 1 (Revised 2008) First-time adoption of International Financial Reporting Standards – Cost of an investment in a Subsidiary, Jointly Controlled Entity or Associate (Amendment),

IFRS 2 Share-Based Payment (Amendment),

IAS 27 Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity (Amendment),

IAS 39 Financial Instruments Recognition and Measurement and IFRS 7 Financial Instruments Disclosures (Amendment),

IAS 32 Financial Instruments Presentation and IAS 1 Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation,

IFRIC 13 Customer Loyalty Programmes,

IFRIC 15 Agreement for the Construction of Real Estate,

IFRIC 16 Hedges of a Net Investment in a Foreign Operation

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 2009 amounted to £23,887,000 (2008 £37,138,000)

2 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (Continued)

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 other comprehensive income 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 2009 amounted to £54,807,000 (2008 £37,104,000) and 100% were determined using observable market inputs

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009

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 (RBSG) 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 1 Risk management

The management of risk is a fundamental management activity performed throughout all the Group's operations As such it underpins the Group's reputation, performance and future success It is, therefore critically important that the adequacy and effectiveness of the Group's risk management processes are of the highest standard and subject to continuous review and enhancement

The Group has put in place a comprehensive risk management framework comprising

- Leadership, strategy and culture set by the Board and put into effect through Executive Management,
- Policies, procedures, processes and systems to execute effective risk management throughout the Group,
- A comprehensive committee structure operating at a Group level to direct, approve and review actions taken to manage risk Where appropriate this is replicated at a Divisional level,
- Risk Management functions that are independent of the business management to enforce agreed policy

A number of high-level committees support the Board in the effective measurement and management of risk

3 1 2 RBS Group Policy Framework

The RBS Group has developed, and adopted globally, one comprehensive Group Policy Framework The aim of the Group Policy Framework is to provide a simplified and effective framework to standardise presentation and control of Group policy including new policies and amendments All employees have easy access to current Group policies and policy standards through a single Group intranet site

Group Policies address the major areas of risk to the Group and the standards that must be met to enable those risks to be managed in line with Group risk appetite All Group Policies must be approved by the Executive Committee (ExCo)

3 1 3 RBS Insurance Specific Risk Management

There are significant regulatory and practical differences between the management of risk for banks and that for insurance firms RBS Insurance therefore has its own risk policies and associated minimum standards, approved by RBS Group, for the following key risk types

- Insurance Risk Policy and Minimum Standards,
- Liquidity Risk Policy and Minimum Standards,
- Credit Risk Policy,
- Market Risk Policy, and
- Operational Risk Policy

A summary of the objectives of each of the Insurance specific risks faced by the Company are described below The risks associated with market, credit and liquidity risks are described further in the Financial Risk note 3 3 below

3 1 4 Insurance Risk Policy and Minimum Standards

The primary objective of the Insurance Risk Policy is to detail the approach to ensure that all aspects of Insurance Risk are appropriately managed within the Company

The policy is also aimed at ensuring that the Company meets the relevant requirements of RBS Group Market Risk Management (who are responsible for Insurance Risk Management from a Group perspective) and the Financial Services Authority (FSA), as well as embedding best practice and facilitating as high a level of Insurance Risk Management as is

Compliance with this policy ensures that the Company stays within its stated risk appetite The policy is, therefore, kept under constant review to take into account any changes in the Company's objectives, including changes in the strategy, business plans and risk appetite

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3 1 4 Insurance Risk Policy and Minimum Standards (Continued)
The Insurance Risk Policy has associated Minimum Standards which detail how the policy requirements will be met The types of risk deemed to be covered within the scope of insurance risk minimum standards are

- **Pricing and underwriting** - how the pricing and underwriting strategy is set, controlled, monitored and modified, how breaches of risk appetite are identified and handled, how price changes are decided, implemented and the impact monitored, how policy terms and conditions are decided, applied and monitored etc ,

- **Claims management** - how the claims strategy is set, controlled, monitored and modified, how claims are assessed, how individual claims reserves are determined, reviewed and updated, how recoveries are handled, how claims inflation is set, monitored and controlled, how the claims cost is controlled, including how suppliers are controlled, how claims handling authority limits are monitored, how claims fraud and general leakage is monitored and managed,

- **Reinsurance** - how the reinsurance strategy is set, controlled, monitored and modified, how the exposure to reinsurers is assessed, controlled and monitored, how recoveries are identified and controlled, how concentration risk is managed and monitored,

- **Reserving** - how the reserving strategy is set, controlled, monitored and modified, how the technical reserves are assessed, reviewed, monitored and updated, including oversight procedures

3 1 5 Top Down Risk Management

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 Top Down Risk Management Policy, the Company 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 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 To this end the Compnay carries out detailed capital modelling of its assets, liabilities and the key risks to which it is exposed This work feeds into the company'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,
- Input to, and review and approval of stress and scenario tests, attendance at the scenario workshops as required by the facilitators,
- Sign off of the parameter setting for the DFA (Dynamic Financial Analysis) modelling,
- Review and sign off of the output from the DFA models and other quantitative modelling,
- Review, agreement and sign off of the ICA submission to the FSA, including any surrounding documentation, policies, explanations and assumptions

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3 1 5 Top Down Risk Management (Continued)

The Company 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 the Company 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 the Company to monitor, control and manage the level of risk effectively against Risk Appetite Statements a control environment has been developed 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
- 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,
- Inadequate reserves, and
- Concentration of business leading to unexpected claims from a single source

The Company 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

This risk is managed according to the following separate components

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

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3 2 1 Underwriting, pricing and reserving risk

Pricing and underwriting 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 2009	Total benefits insured			
	Before reinsurance		After reinsurance	
£'000	£m		£m	
0 - 99	5,308	29 0%	877	37 3%
100 - 199	9,104	49 7%	1,061	45 2%
200 - 299	2,875	15 7%	305	13 0%
300 +	1,036	5 6%	105	4 5%
Total	18,323		2,348	

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)

The concentration in 2009 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 (2008 2 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 4 0% (2008 3 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 (2008 4 5%), when net cash flows are negative and a lapse rate is prudent Otherwise a lapse rate of 15 5% per annum (2008 15 5%) is used For all other policies, excluding over 50's polices and creditor, the Company has used a lapse rate of 1 5% per annum (2008 3 5%), when net cash flows are negative and a low lapse rate is prudent Otherwise a lapse rate of 12 5% per annum (2008 12 5%) is used

(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 2009 £'000
Investment return	-
Mortality/Morbidity for insurance contracts	819
Expenses	(85)
Lapse rate	(507)
	227

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3 2 1 Underwriting, pricing and reserving risk (Continued)

(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	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 2009	Variability	Impact on value of investments	Impact on profit after tax	Impact on shareholders equity
		£'000	£'000	£'000
Debt securities	+20%	10,961	-	10,961
Debt securities	-20%	(10,961)	-	(10,961)
Interest rates	+1 0%	(1,999)	395	(1,044)
Interest rates	-1 0%	2,131	(849)	685
Expenses	+10 0%	-	(230)	(230)
Assurance mortality/morbidity	+5 0%	-	(429)	(429)
Increase in lapse rate	+0 5%	-	156	156

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 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 RBSG 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 Committee 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
- To maximise the portfolio's total return within the constraints of the other objectives and the limits defined by the Investment Guidelines

The portfolio is split between Operating Funds and Long-Term Funds to achieve these objectives Operating Funds which must be at least 35% of the total portfolio are required to support current business operations, identified liabilities and to provide an adequate safety margin 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

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3 3 Financial risk (Continued)

Operating Funds

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

In addition to those mentioned under Operating Funds, to achieve its investment objective, the Long-Term Funds segment of the investment portfolio may be invested in the following asset classes

- Equities,
- Property,
- Fixed Interest Debt Securities (five to fifteen years), and
- Floating Rate Debt Securities (up to forty years)

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

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

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 The Company does not hold investments for trading purposes Exposure to market risk in the investment portfolio is managed in accordance with the guidelines set out in the Company's Investment Policy as detailed above The FMC is responsible for ensuring that the Company is compliant with the standards and limits set out in the Investment Policy and Guidelines The compliance of controls in respect of market risk is reported to the FMC on at least a monthly basis

The Company assesses the financial impact from changes in market risk through DFA modelling and 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 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

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3 3 2 Credit risk (Continued)

The objective of the Credit Risk Policy and supporting Minimum Standards is to document the control processes by which the Company is able to identify, monitor, measure, manage, control and mitigate the level of credit risk effectively against the risk appetite The credit risk control environment is summarised below in the key elements of the policy

Credit Risk Governance

A Credit Risk Management Framework is in place that is appropriate for the agreed risk appetite and is established and maintained by adequately skilled credit risk professionals and supported by appropriate minimum standards, tools, techniques and credit systems and reporting

Credit Risk Assessment and Credit Limit Approvals

A credit risk assessment is used to determine the credit worthiness of a counterparty prior to entering into a transaction or contract with that counterparty A credit limit is used to define the level of credit risk that the Company is prepared to accept by a counterparty

Where appropriate, the Company assesses credit risk and sets a credit limit prior to entering into a transaction or contract with the counterparty Each assessment and credit limit is approved in accordance with Credit Authorities

Credit Authority

Credit risk assessments and limits are approved by an individual or committee that has been provided with formally documented credit approval authority Approval authorities are reviewed and renewed at least annually

Monitoring and Reporting

The level of actual credit exposure is monitored against the defined credit assessments

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 reinsurance claims, and
- Financing of premiums - loans made to customers in respect of deferred payments of their insurance premiums These amounts are managed within the Credit Risk Management Framework and benefit from The Company's ability to cancel the underlying policy in the event of non-payment

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 2009

	AAA £'000	AA+ £'000	AA £'000	AA- £'000	A+ £'000	A £'000	A- £'000
Debt securities (note 14)	54,807	-	-	-	-	-	-
Insurance contracts reinsurance asset (note 15)	-	-	-	62,167	-	-	-
Cash at bank and in hand (note 18)	-	-	14,500	5,000	29,397	10,000	
Reinsurance debtors included under loans and receivables (note 17)	-	-	-	12,080	-	-	-
Total assets bearing credit risk	54,807	-	14,500	79,247	29,397	10,000	-

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3 3 2 Credit risk (Continued)

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	-

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 measurement and management of liquidity risk within the Company is undertaken within the limits and other policy parameters of the Company's liquidity risk appetite It is included as part of the monthly Funds Management Committee pack and reviewed by the FMC The asset class and maturity parameters contained within this policy are summarised in note 3 3 above Compliance is monitored both in respect of the internal policy and the regulatory requirements of the FSA

The Company performs liquidity risk stress testing as part of its ICAS 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

In the event that one or more liquidity stress or scenario crystallises, or should any other event that may impact liquidity occur, the Company seeks to ensure that the event has rapid and controlled response A Liquidity Crisis Management Team will be formed to assess the nature and the extent of the threat and to develop an appropriate response

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

<u>Analysis of maturity of liabilities</u>

For each category of insurance and financial liabilities, the following table shows the gross liability at 31 December 2009 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 2009

	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)	86,671	7,015	16,380	6,060	39,303	17,913
Trade and other payables including insurance payables (note 22)	7,750	7,750	-	-	-	-
Total	94,421	14,765	16,380	6,060	39,303	17,913

3 MANAGEMENT OF INSURANCE AND FINANCIAL RISK (Continued)

3 3 3 Liquidity risk (Continued)

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

The concentration in 2009 has not substantially changed from the prior year

3 3 5 Operational risk

Effective operational risk management requires the Company to identify, assess, manage, monitor and report operational risk Operational risk is inherent in all of the RBS Group's business processes, systems and products Therefore, it is important to have a framework in place to ensure that operational risks are identified and managed to an acceptable level

Effective operational risk management helps the Company to achieve its objectives, including

- more focus on doing things the right way, leading to fewer surprises,
- fewer operational errors and losses, leading to increased customer satisfaction and higher quality earnings,
- achieving process efficiencies,
- better informed risk-taking, which creates greater rewards, and
- increased management attention on the risks and issues that really matter

4 CAPITAL RISK MANAGEMENT

The Company defines capital in accordance with regulations prescribed by the 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
- to provide an adequate return to its shareholders by pricing insurance and investment contracts commensurately with the level of risk

Under the rules prescribed by the FSA, 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)

4 CAPITAL RISK MANAGEMENT (Continued)

The MCR is a formulaic approach, prescribed by the EU, based on business volumes and claims reserves, whereas the ICG is specified by the FSA following the bi-annual submission of a risk based capital assessment (in accordance with the Individual Capital Adequacy Standards) by the Company to the regulator

As at 31 December 2009, the Company held a surplus of at least £80,950,000 (2008 £66,132,000), the MCR requirement was £35,765,000 (2008 £37,677,000)

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 2009 and 2008

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

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5 NET INSURANCE PREMIUM REVENUE

	2009 £'000	2008 £'000
Long-term insurance contracts		
Premium income from insurance contracts issued	54,355	88,043
Premium revenue ceded to reinsurers on insurance contracts issued	(24,903)	(21,212)
Net insurance premium revenue	**29,452**	**66,831**

6 INVESTMENT INCOME

	2009 £'000	2008 £'000
Available-for-sale financial assets		
Interest income from debt securities	2,304	1,675
Interest income		
From deposits with credit institutions	745	4,480
From related parties (note 26)	-	174
Net amortisation of premium on purchase of financial assets	(84)	10
	2,965	6,339

7 INSURANCE BENEFITS

	At 31 December 2009		
	Gross £'000	Reinsurance £'000	Net £'000
Long-term insurance contracts with fixed and guaranteed terms			
- death benefits	22,009	(13,243)	8,766
- decrease in liabilities	(13,204)	(47)	(13,251)
Total cost of policyholder benefits	**8,805**	**(13,290)**	**(4,485)**

	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**

8 EXPENSES

a) Expenses for the acquisition of insurance contracts

	2009 £'000	2008 £'000
Cost incurred for the acquisition of insurance contracts expensed in the year	3,136	26,563
	3,136	26,563

b) Expenses for marketing and administration

	2009 £'000	2008 £'000
Marketing and administrative expenses	6,674	7,359
Depreciation (note 13)	14	28
Expenses incurred under profit participation (note 26)	7,107	16,226
	13,795	23,613

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009

9 TAX CHARGE

	2009 £'000	2008 £'000
Current taxation		
Charge for the period	5,602	5,091
(Over) / Under provision in respect of prior periods	(953)	(66)
	4,649	5,025
Deferred taxation (note 16)		
Charge for the period	11	15
	11	15
Tax charge for the period	**4,660**	**5,040**

The actual tax charge differs from the expected tax charge computed by applying the standard rate of UK corporation tax of 28% (2008 28 5%) as follows

	2009 £'000	2008 £'000
Profit before tax	19,971	17,828
Expected tax charge	5,592	5,081
Effects of		
Adjustments in respect of prior periods	(953)	(66)
Other timing differences	21	25
Tax charge	4,660	5,040

10 PROFIT FOR THE YEAR

Profit for the year is stated after charging	2009 £'000	2008 £'000
Depreciation of property, plant and equipment (note 13)	14	28

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 £50,000 (2008 £51,000)

Fees in respect of the audit of the FSA Return amount to £64,000 (2008 £62,000) and fees for other services amount to £9,000 (2008 £15,000)

Directors' emoluments

	2009 £'000	2008 £'000
Other emoluments	33	159
Company pension contributions	3	9
	36	168

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 £31,453 (2008 £155,940)

A contribution of £2,768 (2008 £8,460) to a money purchase scheme was made on behalf of the highest paid director One director (2008 one director) had retirement benefits accruing under money purchase pension schemes in respect of qualifying service, five directors (2008 two directors) had benefits accruing under defined pension schemes

During the year no director exercised options (2008 no directors)

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009

11 DIVIDENDS

	2009 £'000	2008 £'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 2009

	Available for sale £'000	Loans and receivables £'000	Other (amortised costs) £'000	Non-financial assets / liabilities £'000	Total £'000
Property, plant and equipment	-	-	-	20	20
Investments	54,807	-	-	-	54,807
Reinsurance assets	-	-	-	62,167	62,167
Deferred tax asset	-	-	-	38	38
Loans and receivables	-	13,723	-	-	13,723
Cash and cash equivalents	-	58,897	-	-	58,897
	54,807	72,620	-	62,225	**189,652**
Insurance contracts	-	-	-	86,671	86,671
Trade and other payables including insurance payables	-	-	7,750	-	7,750
Current tax liabilities	-	-	-	4,594	4,594
	-	-	7,750	91,265	**99,015**
Equity					90,637
					189,652

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

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009

13 PROPERTY, PLANT AND EQUIPMENT

	Computer and other equipment £'000
Cost	
At 1 January 2008	670
At 1 January and 31 December 2009	**670**
Depreciation	
At 1 January 2008	(608)
Depreciation charge for the year	(28)
At 1 January 2009	**(636)**
Depreciation charge for the year	(14)
At 31 December 2009	**(650)**
Net book amount	
At 31 December 2009	**20**
At 31 December 2008	**34**

14 INVESTMENTS

	2009 £'000	2008 £'000
Available-for-sale investments		
Debt Securities		
Listed - fixed interest rate	**54,807**	**37,104**

Included within the debt securities balance above is £13,739,000 (2008 £nil) placed with related parties, as analysed in note 26

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy

As at 31 Dec 2009

	Notes	Level 1 (note1) £'000	Level 2 (note 2) £'000	Level 3 (note 3) £'000	Total £'000	Sensitivity Analysis Low £'000	Sensitivity Analysis High £'000
Available-for-sale financial assets							
Debt securities		**54,807**	-	-	**54,807**	-	-

As at 31 Dec 2008

	Notes	Level 1 (note1) £'000	Level 2 (note 2) £'000	Level 3 (note 3) £'000	Total £'000	Sensitivity Analysis Low £'000	Sensitivity Analysis High £'000
Available-for-sale financial assets							
Debt securities		37,104	-	-	37,104	-	-

There were no transfers between level 1 and level 2/3 during the year

Notes

1 Included in the Level 1 category are financial assets that are measured in whole or in part by reference to published quotes in an active market A financial instrument 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

2 Included in the Level 2 category are financial assets measured using a valuation technique based on assumptions that are supported by prices from observable current market transactions These are assets and liabilities for which pricing is obtained via pricing services, but where prices have not been determined in an active market, financial assets with fair values based on broker quotes, investments in private equity funds with fair values obtained via fund managers and assets that are valued using the Group's own models whereby the majority of assumptions are market observable

14 INVESTMENTS (Continued)

3 Included in the Level 3 category are financial assets measured using non market observable inputs This means that fair values are determined in whole or in part using a valuation technique (model) based on assumptions that are neither supported by prices from observable current market transactions in the same instrument nor are they based on available market data The main asset classes in this category are unlisted equity investments and limited partnerships Valuation techniques are used to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date However, the fair value measurement objective remains the same, that is, an exit price from the perspective of the Group Therefore, unobservable inputs reflect the Group's own assumptions about the assumptions that market participants would use in pricing the asset (including assumptions about risk) These inputs are developed based on the best information available, which might include the Group's own data

Reconciliation of movements in level 3 financial instruments measured at fair value
There were no level 3 financial instruments in 2008 and 2009

15 REINSURANCE ASSETS

	2009 £'000	2008 £'000
Reinsurers' share of insurance liabilities	58,313	58,266
Reinsurers' share of claims outstanding	3,854	5,302
Total assets arising from reinsurance contracts	62,167	63,568

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 2008	64
Charge to statement of comprehensive income (note 9)	(15)
At 1 January 2009	49
Charge to statement of comprehensive income (note 9)	(11)
At 31 December 2009	38

17 LOANS AND RECEIVABLES INCLUDING INSURANCE RECEIVABLES

	2009 £'000	2008 £'000
Receivables arising from insurance and reinsurance contracts		
Due from policyholders	275	334
Due from reinsurers	12,080	9,824
Other loans and receivables		
Accrued interest and rent	877	822
Receivables from related parties (note 26)	463	4,343
Other prepayments and accrued income	28	281
Total loans and receivables including insurance receivables	13,723	15,604

18 CASH AND CASH EQUIVALENTS

	2009 £'000	2008 £'000
Cash at bank and in hand		
- third parties	115	71
Short term deposits with financial institutions		
- third parties	39,500	67,500
- related parties (note 26)	19,282	9,113
	58,897	76,684

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS
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18 CASH AND CASH EQUIVALENTS (Continued)

The effective interest rate on short term deposits with credit institutions was 0 35% - 3 90% (2008 1 70% - 6 59%) and has an average maturity of 90 days (2008 90 days)

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

	2009 £'000	2008 £'000
Cash and cash equivalents	58,897	76,684
Bank overdrafts (note 23)	-	(61)
	58,897	76,623

19 SHARE CAPITAL

	2009 £'000	2008 £'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

	2009 £'000	2008 £'000
Undated loan capital	3,500	3,500
Reserve for revaluation of available-for-sale investments	1,529	1,602
Other reserves at 31 December	5,029	5,102
Retained earnings at 31 December	**41,608**	**26,297**

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

	Debt Securities	
	2009 £'000	2008 £'000
At 1 January	**1,602**	**409**
Revaluation during the period - gross	(117)	1,656
Revaluation during the period - taxation	44	(463)
At 31 December	**1,529**	**1,602**

21 INSURANCE CONTRACTS AND REINSURANCE ASSETS

	2009 £'000	2008 £'000
Gross		
Long term insurance contracts		
- with fixed and guaranteed terms	82,200	95,404
- benefits outstanding	4,471	6,239
	86,671	101,643
Recoverable from reinsurers		
Long term insurance contracts		
- with fixed and guaranteed terms	(58,313)	(58,266)
- benefits outstanding	(3,854)	(5,302)
	(62,167)	(63,568)
Net		
Long term insurance contracts		
- with fixed and guaranteed terms	23,887	37,138
- benefits outstanding	617	937
	24,504	38,075

21 INSURANCE CONTRACTS AND REINSURANCE ASSETS (Continued)

	2009 £'000	2008 £'000
Current	10,180	10,526
Non-current	14,324	27,549
	24,504	38,075

21 1 Movements in insurance liabilities and reinsurance assets

	At 31 December 2009		
	Gross £'000	Reinsurance £'000	Net £'000
At 1 January 2009	**95,404**	**(58,266)**	**37,138**
Provisions in respect of new business	51,217	(24,903)	26,314
Expected change in existing business provisions	(8,828)	13,243	4,415
Variance between actual and expected experience	(40,632)	11,613	(29,019)
Other movements	(14,961)	-	(14,961)
At 31 December 2009	**82,200**	**(58,313)**	**23,887**

	At 31 December 2008		
	Gross £'000	Reinsurance £'000	Net £'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**

22 TRADE AND OTHER PAYABLES INCLUDING INSURANCE PAYABLES

	2009 £'000	2008 £'000
Due to reinsurers	22	72
Due to related parties (note 26)	5,491	7,135
Trade creditors and accruals	2,220	3,057
Other creditors	17	16
	7,750	10,280

23 BORROWINGS

	2009 £'000	2008 £'000
Bank overdrafts with related parties (note 26)	-	61

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

DIRECT LINE LIFE INSURANCE COMPANY LIMITED

NOTES TO THE FINANCIAL STATEMENTS
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26 RELATED PARTY TRANSACTIONS

On 1 December 2008, the UK Government through HM Treasury became the ultimate controlling party of The Royal Bank of Scotland Group plc The UK Government's shareholding is managed by UK Financial Investments Limited, a company wholly owned by the UK Government As a result, the UK Government and UK Government controlled bodies became related parties of the Company

The Company's ultimate holding company is The Royal Bank of Scotland Group plc which is incorporated in Great Britain and registered in Scotland Its immediate parent company is RBS Insurance Group Limited which is incorporated in Great Britain and registered in England and Wales

As at 31 December 2009, The Royal Bank of Scotland Group plc heads the largest and smallest group in which the Company is consolidated Copies of the consolidated accounts of The Royal Bank of Scotland Group plc may be obtained from The Secretary, The Royal Bank of Scotland Group plc, Gogarburn, PO Box 1000, Edinburgh EH12 1HQ

The volume and diversity of transactions with government related entities are such that their full disclosure of their amounts during the year are impractical

The following transactions were carried out with related parties, who are all members of The Royal Bank of Scotland Group plc

i Sales of insurance contracts and other services

	2009	2008
	£'000	£'000
Sales of services		
- U K Insurance Limited	6,405	17,285
	6,405	17,285

	2009	2008
Interest received (note 6)		
- ABN AMRO Bank N V	-	174
	-	174

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 0 35% to 3 90% (2008 1 70% - 6 59%)

ii Purchases of products and services

	2009	2008
	£'000	£'000
Purchases of services		
- RBS Insurance Services Limited	2,052	2,633
- Tesco Personal Finance Limited	-	4,815
- U K Insurance Limited	2,261	11,411
	4,313	18,859

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 £2,077,000 (2008 £2,859,000)

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

	2009	2008
	£'000	£'000
Other emoluments	39	166
Company pension contributions	4	10
	43	176

Fees paid to directors and other members of key management during the year amounted to £180 (2008 £190)

26 RELATED PARTY TRANSACTIONS (Continued)

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

	2009 £'000	2008 £'000
Short term deposits held with related parties (note 18)		
- The Royal Bank of Scotland plc	19,282	9,113
	19,282	**9,113**

	2009 £'000	2008 £'000
Bank overdrafts held with related parties (note 23)		
- The Royal Bank of Scotland plc	-	(61)
	-	**(61)**

	2009 £'000	2008 £'000
Debt securities held with related parties (note 14)		
- UK Government	13,739	-
	13,739	-

	2009 £'000	2008 £'000
Receivables from related parties (note 17)		
- The Royal Bank of Scotland plc	-	1,209
- U K Insurance Limited	463	3,134
	463	**4,343**

	2009 £'000	2008 £'000
Payables to related parties (note 22)		
- RBS Insurance Services Limited	5,273	4,360
- U K Insurance Limited	193	2,749
- The One Account Limited	25	26
	5,491	**7,135**

27 EVENTS AFTER BALANCE SHEET DATE

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

28 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

	2009 £'000	2008 £'000
Total shareholders' funds as at 31 December	90,635	75,400
Adjustments to regulatory basis	(638)	(649)
Total available capital resources as at 31 December	**89,997**	**74,751**

	2009 £'000	2008 £'000
Shareholders' funds held in long term business fund	80,950	66,132
Shareholders' funds outside long term business fund	9,047	8,619
	89,997	**74,751**

28 CAPITAL RESOURCES (Continued)

Movements in the capital resources were as follows	2009 £'000	2008 £'000
Capital resources at 1 January	74,751	80,754
Changes in assumptions	227	236
New business and other factors	15,019	(6,239)
Capital resources at 31 December	**89,997**	**74,751**

29 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