

**ROYAL SCOTTISH ASSURANCE PLC**  
**REPORT AND ACCOUNTS 1998**

V



## **REPORT AND ACCOUNTS 1998**

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**STATEMENT BY THE CHAIRMAN**

*Royal Scottish Assurance provides life assurance, pensions and investment products primarily to the customers of The Royal Bank of Scotland plc. This report covers the Company's eighth full year of trading since its inception in 1990.*

I am delighted to report that this has been another record year for sales. Total new annual premium increased by 52% and although single premium business fell by 4%, overall sales performance was outstanding. The regulated sales force based in the Bank branches has again exceeded its previous record of sales of Royal Scottish Assurance and other products, this year by 12%.

The relationship with Scottish Widows, who become a shareholder of the company in 1997, continues to provide significant benefits. In the year under review our range of life and pension products has been completely updated with new products mainly administered by Scottish Widows, our investments are now largely managed by Scottish Widows, service standards to our customers have been improved, and the migration of existing business and support services to Scottish Widows is nearing completion.

I would like to thank Tony Schofield, my predecessor as Chairman, for his strong contribution to the success of the company over the years and wish him a happy retirement. I would also like to thank David Finlayson who retired from the Board on 1 October and welcome Bill Main who joined the Board as Deputy Chairman on that date.

On behalf of the Board I would also like to thank the staff of the company, its shareholders and other partners for their efforts in helping to achieve the success of this year.

The year under review has been one of significant progress. Industry issues such as the pension review and wider concerns such as the expected economic slowdown and recent turmoil in global equity markets will all give rise to challenges, and opportunities, in the year ahead, and beyond. However I am confident that the company is well placed to deal with these as we go forward.



**B HIGGINS**

**23 November 1998**

## **ROYAL SCOTTISH ASSURANCE PLC**

### **CHIEF EXECUTIVE's REVIEW**

#### **Overview**

I am pleased to report real success in migrating new business to Scottish Widows via a totally new range of products and another record year for new premium income. Unfortunately the migration of existing business has proved extremely testing, but we are still confident of meeting our 31st December 1998 deadline.

A key element of our sales success has been the ever improving relationship between consultants and Royal Bank branch staff. We shall continue to build on this going forward. Meantime thanks are due to branch network staff for helping generate this year's record performance.

#### **Critical Success Factors**

In addressing the year's challenges we have focused on four Critical Success Factors (CSFs).

- Customer Confidence
- Our People
- Risk Control
- Organisational Flexibility

As a way of developing staff understanding and contribution to promoting these CSFs, 'CSF Boards' have been set up for each Factor. Staff from all parts of the company sat on each board and contributed significantly to maintaining our focus during a year of substantial change

#### **Customer Confidence**

Customer confidence can be measured in a number of ways:-

- Sales; our 198 consultants added around 55,000 new customers and generated another record year for premium income.
- Industry Recognition - Financial Adviser's Mystery Shopper Tied Agent of the Year, plus commendations in the Best In-House Training Programme and Company Representative of the year categories.
- A top consumer magazine placed our new personal pensions policy in its top 10 best buys
- Complaints were well down
- Our telephone unit contacted the majority of our new policyholders with excellent feedback regarding service received.
- Service turnaround standards improved.

All evidence that progress is being made, but we still need to do better. During the coming year we shall continue to search for new ways of improving our performance.

#### **Our People**

During its relatively short history Royal Scottish staff have coped with substantial change. However, this year has probably been the most stretching yet. Staff have shown real commitment and tenacity in delivering remarkable results and my huge appreciation and thanks are added to those of our Chairman. During the year we have had our Investor In People status reviewed and re-affirmed and we have elected for annual assessment to ensure we maintain clear focus on the development of our staff.

Field staff have taken on the challenge of completing the 'Advanced' Financial Planning Certificate within three years and the whole company is going through a 'Values' programme designed to understand how we can link the Royal Bank's core values into our day to day working practices. A training needs analysis programme has been established, with each member of staff having a personal development 'Account'. All of this is geared to help deliver our commitment to:

- improved customer service & advice
- better risk management
- corporate flexibility in exploiting available opportunity
- improving the skill and hence C.V. of each member of staff
- ultimately improving shareholder value

## ROYAL SCOTTISH ASSURANCE PLC

### Risk Control

Risks have been categorised as falling into the areas of finance, operation, regulation and resource. The key to risk management is staff awareness and skill in identifying and dealing with risk. The risk management CSF board has done an excellent job in creating an operational 'risk map' which is being permeated throughout the organisation. This is heightening awareness of risk issues.

External reviews have been conducted on our pensions review work, sales process and quality of advice. Generally the company is in good shape but we shall continue to develop our attention to detail in this area. Our partnership with Scottish Widows will undoubtedly help in this regard.

### Organisational Flexibility

Organisational flexibility is a balance between skill, attitude and resource. With this year's substantial investment in migration we have had to depend mainly on the skill and attitude of our staff to deal with the challenges and opportunities presented. The loss of High Income Bond following a Treasury ruling, the shift toward pensions, changes within the Royal Bank of Scotland branch network, the introduction of Phase 2 of the pensions review and numerous other issues alongside migration and record new business have tested our ability to respond quickly and effectively. In the main staff have met the challenge well. Going forward, we shall be examining how we can work with our new partners at Scottish Widows to utilise effectively mutual skill and expertise to improve continually our ability to respond even more effectively. Skill development and the continued attention to attitude via our values programme have a major part to play in this area.

### Board and Management

I would echo our Chairman's thanks to Tony Schofield and David Finalyson and look forward to working with Bill Main.

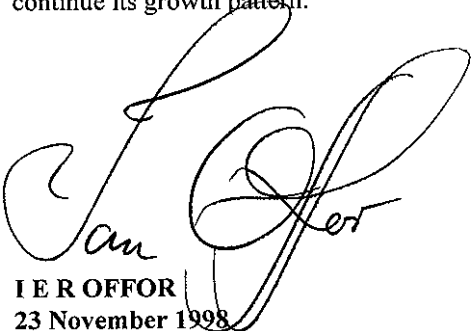
At management board level Mike Smith has joined the company as Chief Operations Manager. Mike will provide an important link with Scottish Widows and help the understanding of how we can best work together.

Neil Pettie, Personal Development Director, retires in December. Neil has been with the company since inception and contributed significantly to its growth and development. Thanks and best wishes for the future Neil.

### Summary

The generation of record sales combined with the complexity of migration has meant this has been a testing year for the company. Staff and colleagues in the branch network have combined at the front to create the most effective bancassurance sales operation in the UK. Behind the scenes Scottish Widows, Scottish Equitable, IBM, New Direction Finance and our own head office team have worked well together to keep new business and ongoing service at more than acceptable levels whilst dealing with migration.

The coming year has new challenges; an uncertain economic environment, phase 2 of the pensions review, and the introduction of ISAs to name but a few. However, the foundations laid this year stand the company in good stead to continue its growth pattern.



IAN ROFFOR  
23 November 1998

**ROYAL SCOTTISH ASSURANCE PLC**  
**DIRECTORS AND OFFICERS**

**CHAIRMAN**

Bernard Higgins

**DEPUTY CHAIRMAN**

William Hill Main

**DIRECTORS**

Alistair Robert Borthwick  
Michael John Patrick Hutchins  
Douglas George Johnson  
Desmond John Le Grys  
Ian Eric Richard Offor

**SECRETARY**

Alan E Mills

Registered Office:-  
42 St Andrew Square, Edinburgh EH2 2YE  
Royal Scottish Assurance plc is registered in Scotland No. 119820  
Telephone No: 0131-557-9696

Member of the Personal Investment Authority  
Authorised by DTI to carry on insurance business

## ROYAL SCOTTISH ASSURANCE PLC

### DIRECTORS' REPORT

The Directors have pleasure in submitting their report and audited accounts for the year ended 30 September 1998.

#### ACTIVITIES

The principal activity of Royal Scottish Assurance plc ("the Company") is the transaction of life assurance and pension business in the United Kingdom. It is intended that the Company continues to participate in these markets and it is expected that a good level of new business will be achieved in future.

#### NEW BUSINESS

The new business in the year, on an annualised basis, was

		1998 £000	1997 £000
<b>Annual Premiums</b>			
Life	- Non-Linked	3,013	2,237
	- Linked	8,120	4,684
Pension	- Linked	10,586	7,407
<b>Total Annual Premiums</b>		<u>21,719</u>	<u>14,328</u>
<b>Single Premiums</b>			
Life	- Linked	275,728	287,104
Pension	- Linked	3,575	4,205
<b>Total Single Premiums</b>		<u>279,303</u>	<u>291,309</u>

*The above figures are gross of reinsurance.*

#### FINANCIAL MATTERS

The results for the period are given in the profit and loss account on pages 14 and 15.

The directors do not recommend the payment of a dividend.

Movements in Shareholders' Funds are given in Note 15 to the accounts.

#### DIRECTORS

The present members of the Board of Directors are named on page 6 and except as noted below, all the named directors were directors for the whole of the year ended 30 September 1998.

On 31 March 1998, George Anthony Schofield, Chairman, resigned and Bernard Higgins was appointed as director and chairman on 19 May 1998. On 1 October 1998 David John Finlayson resigned as director and Mr William Hill Main was appointed as a director.

# ROYAL SCOTTISH ASSURANCE PLC

## DIRECTORS' REPORT (continued)

### DIRECTORS' INTERESTS

No director had an interest in the shares of the Company.

The following directors were beneficially interested in the 25p ordinary shares of The Royal Bank of Scotland Group plc, the ultimate holding company.

	At 30 September 1998	At 30 September 1997 or date of appointment if later
I E R Offor	4,406	2,136
D J M Finlayson	22,885	21,297
M J P Hutchins	23,614	17,732

Options to subscribe for ordinary shares of 25p each in The Royal Bank of Scotland Group plc at 30 September 1998 and those granted and exercised during the year to 30 September 1998 are included in the table below:-

	<u>Options Granted</u>			<u>Options Exercised</u>		At 30 September 1998
	At 1 October 1997 (or date of appointment if later)	Number	Price £	Number	Price £	
B Higgins	-	28,300	10.065	-	-	28,300
I E R Offor	46,470	19,800	10.065	-	-	66,270
D J M Finlayson	66,725	97	7.99	23,000 488	2.12 2.12	43,334
M J P Hutchins	128,305	37,100 341	10.065 7.99	2,278 66,000	2.12 4.29	97,468

No director had an interest in any of the preference shares of The Royal Bank of Scotland Group plc during the year to 30 September 1998.

In addition, during that period, none of the directors held a beneficial interest in the loan capital of The Royal Bank of Scotland Group plc or in the share or loan capital of any of the other subsidiaries of The Royal Bank of Scotland Group plc, including the Company.

### STAFF

The weekly average number of persons employed by the Company was 16 (1997 - 15) and the aggregate remuneration for the year for all staff amounted to £854,000 (1997 - £627,000).

### POLITICAL AND CHARITABLE CONTRIBUTIONS

The Company made charitable contributions of £259 (1997 - £1,935) during the year. The Company made no political contributions.



**DIRECTORS' REPORT** (continued)

**POLICY AND PRACTICE ON PAYMENT OF CREDITORS**

In the year ending 30 September 1999, the Company will adhere to the following payment policy in respect of all suppliers. The Company is committed to maintaining a sound commercial relationship with its suppliers. Consequently, it is the Company's policy to negotiate and agree terms and conditions with its suppliers, which includes the giving of an undertaking by the company to pay suppliers within 30 days of receipt of a correctly prepared invoice submitted in accordance with the terms of the contract.

The proportion which the amount owed to trade creditors at 30 September 1998 bears to the amounts invoiced by suppliers during the year then ended equated to a 68 days proportion of 365 days. This ratio is distorted by large balances outstanding to our two shareholders at the end of the year.

**YEAR 2000**

The directors have assessed the risks and uncertainties surrounding the Year 2000 issue and the consequences it may have for the Company and its suppliers and customers. The Company relies on the systems of its two shareholders both of whom have Year 2000 project plans in place. These project plans have been taken into account by the Company as part of its overall Year 2000 project.

The Company has a continuous programme of systems of maintenance and development which includes addressing the problems posed by Year 2000. The costs of addressing the Year 2000 issue are therefore absorbed in the ongoing IT development expenditure of the Company and ongoing service charges from its Shareholders.

**AUDITORS**

Our auditors, Coopers & Lybrand, merged with Price Waterhouse on 1 July, following which Coopers & Lybrand resigned and the directors appointed the new firm, PricewaterhouseCoopers, as auditors. A resolution to reappoint PricewaterhouseCoopers as auditors to the company will be proposed at the annual general meeting.

By order of the Board



**A E MILLS**

Secretary

23 November 1998

## ROYAL SCOTTISH ASSURANCE PLC

### STATEMENT OF DIRECTORS' RESPONSIBILITIES

Company law requires the directors to prepare accounts for each financial year which give a true and fair view of the state of affairs of the Company and the Group and the profit or loss for that year. In preparing those accounts, the directors are required to:

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

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and to enable them to ensure that the accounts comply with the provisions of the Companies Act 1985. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors confirm that these statements comply with the aforementioned requirements.

By order of the Board



**A E MILLS**  
Secretary

23 November 1998

## ROYAL SCOTTISH ASSURANCE PLC

### REPORT OF THE AUDITORS TO THE MEMBERS OF ROYAL SCOTTISH ASSURANCE PLC

We have audited the accounts on pages 12 to 27 which have been prepared in accordance with the accounting policies set out on pages 12 and 13.

#### Respective responsibilities of directors and auditors

As described on page 10 the Company's directors are responsible for the preparation of accounts. It is our responsibility to form an independent opinion, based on our audit, on those accounts and to report our opinion to you.

#### Basis of opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

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

#### Opinion

In our opinion the accounts give a true and fair view of the state of affairs of the Company and Group as at 30 September 1998 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



**PricewaterhouseCoopers**  
**Chartered Accountants and Registered Auditors**  
**Edinburgh**

**23 November 1998**

**ACCOUNTING POLICIES**

**1. Accounting convention**

The accounts have been prepared under the historical cost convention as modified by the revaluation of investments and in accordance with Section 255(a) and Schedule 9A to the Companies Act 1985 as amended by the Companies Act 1985 (Insurance Companies Accounts) Regulations 1993 and in accordance with applicable Accounting Standards in the United Kingdom. The Company has one subsidiary, RSA (Services) Limited, which has been consolidated into the Group accounts. All intercompany balances and transactions are eliminated from the Group Accounts.

**2. Premiums**

Premiums are included net of reinsurance. Non-linked business premiums are accounted for in the year in which they fall due. Linked business premiums are accounted for when the actuarial liability is established. Reinsurance premiums are charged when they become payable.

**3. Investment income, expenses and charges**

Investment income includes dividends, interest and realised gains and losses calculated by reference to cost on the realisation of investments and related expenses. Dividends are recorded on the date on which shares are quoted ex dividend and include the imputed tax credits where relevant.

Policyholder fund investment income and expenses are dealt with through the technical account. Shareholder fund investment income and expenses are dealt with through the non-technical account.

**4. Unrealised gains and losses on investments**

Unrealised gains and losses on shareholder fund investments are dealt with in the non-technical account. All other unrealised gains and losses are dealt with through the technical account.

Unrealised gains and losses recorded in the profit and loss account represent the changes in value during the year of investments held at the balance sheet date adjusted for realised gains or losses recognised during the year.

**5. Claims**

Claims and surrenders paid to policyholders are included net of reinsurance but include costs of settlement. Claims and surrenders intimated by the end of the financial year are provided for in the accounts. Maturity claims are recognised in the technical account when due for payment.

**6. Premises and equipment**

Depreciation is provided by the Company to write off the cost of tangible fixed assets over their estimated useful economic lives as follows:-

Short term leasehold premises are amortised by equal annual instalments over the unexpired term of the lease or estimated useful life if shorter.

Computers and motor vehicles are depreciated on a straight-line basis over three to five years and other equipment over periods between five and ten years.

**7. Investments**

Stock Exchange investments are included at middle market value.

Holdings in authorised unit trusts are valued at the bid price ruling at the year end.

Financial futures, including structured instruments, are included at market value.

**ACCOUNTING POLICIES** (continued)

**8. Leases**

Where the Company enters into a lease which entails taking substantially all the risks and rewards of ownership of an asset, the lease is treated as a finance lease. All other leases are operating leases and the rental charges are taken to the profit and loss account: technical account.

**9. Pensions costs**

In arriving at the operating result, the costs of providing pensions are assessed and charged on a regular basis in accordance with the advice of professionally qualified actuaries.

Pensions costs are recognised on a systematic basis so that the costs of providing retirement benefits to employees are matched evenly, so far as possible, to the estimated service life of the employees concerned.

**10. Taxation**

Provision is made for taxation at current rates on taxable profits. The balance on the long term business technical account transferred to the non technical account is grossed up at the relevant effective UK corporation tax rate. Deferred taxation is provided on the liability method in respect of timing differences to the extent that they are likely to crystallise in the foreseeable future.

**11. Foreign currencies**

Assets and liabilities denominated in foreign currencies are valued at rates ruling at the balance sheet date. Any changes in value arising are dealt with in the profit and loss account: technical account as investment gains or losses or other income as appropriate.

Forward foreign exchange contracts are valued at the market rates ruling at the balance sheet date and the difference between those values and the contract prices are dealt with in the profit and loss account as unrealised gains or losses on investments.

**12. Long term business provision and technical provision for linked liabilities**

The long term business provision is determined on the basis of recognised actuarial methods. A prospective net premium valuation method is used for all non-linked business. For unit-linked business the provisions are based on the market value of the related assets. The long term business provision includes a non-unit liability in respect of unit-linked business.

**13. Acquisition costs and deferred acquisition costs**

Acquisition costs comprise all direct and indirect costs arising from the conclusion of insurance contracts. Deferred acquisition costs are costs of acquiring insurance policies which are incurred during a financial year but relate to subsequent financial years. They are deferred in the expectation that they will be recoverable out of future margins and the rate of amortisation for the deferred acquisition costs is consistent with a prudent assessment of the expected pattern of earned profits of the relevant contracts over the period that they are expected to remain in force. For both linked and non-linked business an explicit deferred acquisition cost asset has been established in the balance sheet.

At the end of each accounting period, deferred acquisition costs are reviewed for recoverability against future margins from the related policies in force at the balance sheet date.

ROYAL SCOTTISH ASSURANCE PLC

**CONSOLIDATED PROFIT AND LOSS ACCOUNT : TECHNICAL ACCOUNT - LONG TERM BUSINESS**

**for the year ended 30 September 1998**

	Notes	1998 £000	1998 £000	1997 £000	1997 £000
<b>Earned premiums, net of reinsurance</b>					
Gross premiums written	1	351,151		352,147	
Outward reinsurance premiums		<u>(2,685)</u>		<u>(2,287)</u>	
			348,466		349,860
<b>Investment income</b>	2		174,710		60,129
<b>Unrealised (losses)/gains on investments</b>	2		(106,483)		154,598
<b>Other technical income, net of reinsurance</b>	21(a)		11,400		-
<b>Claims incurred, net of reinsurance</b>					
Claims paid					
Gross amount		(106,062)		(76,638)	
Reinsurers' share		<u>9,395</u>		<u>5,212</u>	
			(96,667)		(71,426)
Change in the provision for claims	16				
Gross amount		(272)		(1,443)	
Reinsurers' share		<u>2,785</u>		<u>636</u>	
			2,513		(807)
<b>Change in other technical provisions, net of reinsurance,</b>					
Long term business provision, net of reinsurance	16				
Gross amount		(18,654)		(3,540)	
Reinsurers' share		<u>4,456</u>		<u>(1,493)</u>	
			(14,198)		(5,033)
Technical provisions for linked liabilities, net of reinsurance	16				
Gross amount		(203,961)		(436,205)	
Reinsurers' share		<u>(5,076)</u>		<u>20,087</u>	
			(209,037)		(416,118)
<b>Net operating expenses</b>	3		(29,725)		(36,282)
<b>Investment expenses and charges</b>	2		(51,657)		(22,833)
<b>Tax attributable to long term business</b>	6		<u>(11,719)</u>		<u>(4,391)</u>
<b>Balance on the long term business technical account</b>			<u>17,603</u>		<u>7,697</u>

**CONSOLIDATED PROFIT AND LOSS ACCOUNT : NON TECHNICAL ACCOUNT**

**for the year ended 30 September 1998**

	Notes	1998 £000	1997 £000
<b>Balance on the long term business technical account</b>		17,603	7,697
Tax attributable to shareholders' profits arising from long term business	6	<u>7,909</u>	<u>3,622</u>
Shareholders' pre tax profit arising from long term business		25,512	11,319
Investment income	2	<u>97</u>	<u>80</u>
<b>Profit on ordinary activities before tax</b>	4	25,609	11,399
<b>Tax on profit on ordinary activities</b>	6	<u>(7,909)</u>	<u>(3,648)</u>
<b>Retained profit for the financial year</b>	15	<u><u>17,700</u></u>	<u><u>7,751</u></u>

These results relate to continuing operations, owned throughout the year.

There are no recognised gains or losses for 1998 or 1997 other than the balance on the technical account shown above.

There have been no material gains or losses during the year other than as reported in the results above.

**Note of historical cost profit and losses**

		1998 £000	1997 £000
Reported profit on ordinary activities before taxation		25,609	11,399
Unrealised losses/(gains) for year included in the long term business technical account	2	<u>106,483</u>	<u>(154,598)</u>
Historical cost profit on ordinary activities before taxation		<u>132,092</u>	<u>(143,199)</u>
Historical cost profit for the year retained after taxation		<u><u>124,183</u></u>	<u><u>(146,847)</u></u>

ROYAL SCOTTISH ASSURANCE PLC

**BALANCE SHEET - GROUP AND COMPANY**

**As at 30 September 1998**

	Notes	1998		1997	
		£000	£000	£000	£000
<b>ASSETS</b>					
<b>Investments</b>					
Other financial investments	7		206,263		169,282
Assets held to cover linked liabilities	8		1,370,702		1,157,542
<b>Reinsurers' share of technical provisions</b>					
Long term business provisions	16	54,867		50,411	
Claims outstanding	16	5,135		2,350	
Technical provision for linked liabilities	16	91,091		96,167	
			151,093		148,928
<b>Debtors</b>					
Debtors arising out of direct insurance operations	9	475		727	
Other debtors	10	9,288		2,821	
			9,763		3,548
<b>Other assets</b>					
Tangible assets	11	4,765		4,601	
Cash at bank and in hand		1,637		1,540	
			6,402		6,141
<b>Prepayments and accrued income</b>					
Deferred acquisition costs		46,857		44,770	
Other prepayments and accrued income		200		7,969	
			47,057		52,739
<b>Total assets</b>			<b><u>1,791,280</u></b>		<b><u>1,538,180</u></b>



**ROYAL SCOTTISH ASSURANCE PLC**  
**BALANCE SHEET - GROUP AND COMPANY** (continued)

**As at 30 September 1998**

	Notes	1998		1997	
		£000	£000	£000	£000
<b>LIABILITIES</b>					
<b>Capital and reserves</b>					
Called up share capital	13	49,000		49,000	
Profit and loss account	15	<u>41,216</u>		<u>23,516</u>	
Shareholders' funds - equity interests	15		90,216		72,516
<b>Technical provisions</b>					
Long term business provision	16	96,970		78,316	
Claims outstanding	16	<u>3,287</u>		<u>3,015</u>	
			100,257		81,331
<b>Technical provisions for linked liabilities</b>	16		1,461,793		1,257,832
<b>Provisions for other risks and charges</b>	17		20,000		22,000
<b>Deposits received from reinsurers</b>	18		91,091		88,300
<b>Creditors</b>					
Creditors arising out of direct insurance operations	19	2,653		2,028	
Other creditors including taxation and social security	20	<u>21,411</u>		<u>9,966</u>	
			24,064		11,994
<b>Accruals and deferred income</b>			<u>3,859</u>		<u>4,207</u>
<b>Total liabilities</b>			<u><b>1,791,280</b></u>		<u><b>1,538,180</b></u>



**B HIGGINS** Director



**D G JOHNSON** Director

23 November 1998

**ROYAL SCOTTISH ASSURANCE PLC**

**SHAREHOLDERS' FUNDS CASH FLOW STATEMENT**

**For the year ended 30 September 1998**

	Notes	1998 £000	1997 £000
Net cashflow from operating activities	24(a)	-	-
<b>RETURNS ON INVESTMENTS</b>			
Interest received		<u>97</u>	<u>80</u>
Net cash inflow from returns on investments		<u>97</u>	<u>80</u>
Net cash inflow before financing		<u>97</u>	<u>80</u>
Increase in cash and cash equivalents	24(b)	<u>97</u>	<u>80</u>

**ROYAL SCOTTISH ASSURANCE PLC**

**NOTES TO THE ACCOUNTS**

**1. Gross premiums written**

Gross written premiums, all of which relate to direct insurance, can be analysed as follows:-

	1998 £000	1997 £000
Premiums written:-		
<b>Life assurance business</b>		
Non-participating contracts - periodic premium	14,142	11,298
Non-participating contracts - single premium	3,956	2,574
Linked contracts - periodic premium	27,283	23,645
Linked contracts - single premium	<u>271,650</u>	<u>283,495</u>
	<u>317,031</u>	<u>321,012</u>
<b>Pension business</b>		
Linked contracts - periodic premiums	28,386	25,491
Linked contracts - single premiums	<u>5,734</u>	<u>5,644</u>
	<u>34,120</u>	<u>31,135</u>
Gross premiums written	351,151	352,147
Outward reinsurance premiums	<u>(2,685)</u>	<u>(2,287)</u>
Net premiums written	<u><u>348,466</u></u>	<u><u>349,860</u></u>

All business is written in the United Kingdom.

**2. Investment activity account**

	<b>Technical Account</b>		<b>Non-technical Account</b>	
	1998 £000	1997 £000	1998 £000	1997 £000
Income from listed investments	26,150	28,228	-	-
Income from other investments	59,336	28,998	97	80
Gain on the realisation of investments	89,224	2,903	-	-
<b>Investment income</b>	<u>174,710</u>	<u>60,129</u>	<u>97</u>	<u>80</u>
Investment management expenses	(1,423)	(675)	-	-
Interest payable	<u>(50,234)</u>	<u>(22,158)</u>	<u>-</u>	<u>-</u>
<b>Investment expenses and charges</b>	<u>(51,657)</u>	<u>(22,833)</u>	<u>-</u>	<u>-</u>
Unrealised gains on investments	(106,483)	154,598	-	-
<b>Net investment return</b>	<u><u>16,570</u></u>	<u><u>191,894</u></u>	<u><u>97</u></u>	<u><u>80</u></u>

**ROYAL SCOTTISH ASSURANCE PLC**  
**NOTES TO THE ACCOUNTS (continued)**

<b>3. Net operating expenses</b>	<b>1998 £000</b>	<b>1997 £000</b>
Acquisition costs	32,629	29,022
Change in deferred acquisition costs	(2,087)	(3,653)
Administration expenses	6,059	14,490
Other commission received	(6,876)	(3,577)
	<u>29,725</u>	<u>36,282</u>

Administration expenses include the reversal of a provision of £10 million originally made in 1997 relating to the costs of transferring the main administration services to the Company from Scottish Equitable to Scottish Widows. These costs will now be borne by The Royal Bank of Scotland plc.

<b>4. Profit on ordinary activities before tax</b>	<b>1998 £000</b>	<b>1997 £000</b>
<i>Profit on ordinary activities before tax is stated after charging /(crediting)</i>		
Depreciation	1,506	1,354
Loss/(profit) on disposal of tangible fixed assets	161	(21)
Auditors' remuneration:		
Audit	200	60
Other services	27	8
Commissions payable in respect of direct business	1,089	1,414
Land & buildings operating lease rentals	266	209

<b>5a Staff costs</b>	<b>1998 No</b>	<b>1997 No</b>
The average number of persons (including executive directors) employed by the Company during the year was:-	16	15
<b>Employee costs (excluding directors):-</b>	<b>£000</b>	<b>£000</b>
Wages and salaries	703	485
Social security costs	66	48
Other pension costs	85	94
	<u>854</u>	<u>627</u>
Recharge from The Royal Bank of Scotland plc for services of sales force and related staff	14,841	13,035
	<u>15,695</u>	<u>13,662</u>

<b>5b Directors' emoluments</b>	<b>1998 £000</b>	<b>1997 £000</b>
Aggregate emoluments	<u>167</u>	<u>154</u>

Retirement benefits are accruing to one director under a defined benefit scheme.

# ROYAL SCOTTISH ASSURANCE PLC

## NOTES TO THE ACCOUNTS (continued)

6. Taxation	Technical Account		Non-technical Account	
	1998 £000	1997 £000	1998 £000	1997 £000
UK Corporation tax: at rates between 20% and 31% (1997 - 20% and 33%)				
Current	13,590	3,929	-	26
Irrecoverable overseas tax	499	462	-	-
Credit in respect of group/consortium relief in respect of prior year losses	(2,370)	-	-	-
Tax attributable to the balance on the technical account at 31% (1997 - 32%)	-	-	7,909	3,622
	<u>11,719</u>	<u>4,391</u>	<u>7,909</u>	<u>3,648</u>
7 Other financial investments			1998 £000	1997 £000
Debt securities and other fixed income securities			101,880	113,611
Deposits with credit institutions			116,053	69,681
Structured instruments issued by a group undertaking			91,091	88,300
Less amounts payable to a group undertaking under margining agreements			(102,761)	(102,310)
			<u>206,263</u>	<u>169,282</u>
The historical cost of investments held by the Company at the year end was £184,727,000 (1997 - £133,417,000)				
8. Assets held to cover linked liabilities:-			1998 £000	1997 £000
Assets held to cover property linked liabilities:-				
Structured instruments issued by a group undertaking			523,347	354,598
Less amounts payable to a group undertaking under margining agreements			(502,898)	(303,876)
Other assets held to cover property linked liabilities			<u>1,297,767</u>	<u>1,056,398</u>
			<u>1,318,216</u>	<u>1,107,120</u>
Assets held to cover index linked liabilities:-				
Structured instruments issued by a group undertaking			52,486	50,473
Less amounts payable to a group undertaking under margining agreements			(54,258)	(49,132)
Other assets held to cover index linked liabilities			<u>54,258</u>	<u>49,081</u>
			<u>52,486</u>	<u>50,422</u>
Total			<u>1,370,702</u>	<u>1,157,542</u>

The value of listed investments held by the Company at the year end was £1,487,045,000 (1997-£1,153,502,000) and the historical cost of investments held by the Company at the year end was £1,274,635,000 (1997-£903,580,000). In 1997, assets held to cover linked liabilities differ from technical provisions for linked liabilities as some assets and liabilities related to linked business are included elsewhere in the accounts.

**ROYAL SCOTTISH ASSURANCE PLC**

**NOTES TO THE ACCOUNTS (continued)**

<b>9. Debtors arising out of direct insurance operations</b>	<b>1998</b>	<b>1997</b>
	<b>£000</b>	<b>£000</b>

Amounts owed by policyholders	<u>475</u>	<u>727</u>
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<b>10. Other debtors</b>	<b>1998</b>	<b>1997</b>
	<b>£000</b>	<b>£000</b>

Investments sold for subsequent settlement	-	1,152
Other debtors	881	1,423
Amounts due by property linked funds	<u>8,407</u>	<u>246</u>
	<u>9,288</u>	<u>2,821</u>

**11. Tangible fixed assets**

	<b>Short term leasehold buildings</b>	<b>Motor vehicles computers and other equipment</b>	<b>Total</b>
<b>Cost</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
At 30 September 1997	379	8,560	8,939
Additions	-	2,325	2,325
Disposals	(5)	(2,950)	(2,955)
At 30 September 1998	<u>374</u>	<u>7,935</u>	<u>8,309</u>
<b>Depreciation</b>			
At 30 September 1997	310	4,028	4,338
Charge for year	-	1,506	1,506
Disposals	(5)	(2,295)	(2,300)
At 30 September 1998	<u>305</u>	<u>3,239</u>	<u>3,544</u>
<b>Net book value</b>			
At 30 September 1997	<u>69</u>	<u>4,532</u>	<u>4,601</u>
At 30 September 1998	<u>69</u>	<u>4,696</u>	<u>4,765</u>

Included in the total net book value of tangible fixed assets is £240,208 (1997, £240,208) less accumulated depreciation of £227,732 (1997 - £215,251) in respect of assets acquired under finance leases. Depreciation for the period on these assets was £12,481 (1997 - £12,798).

**NOTES TO THE ACCOUNTS (continued)**

**12 Subsidiary Company**

At 30 September 1998 the Company held shares in the following subsidiary company, which is incorporated in Great Britain, registered in Scotland. The subsidiary has only one class of ordinary share, and has issued share capital of £100:-

Name	Principal Activity	% held
RSA (Services) Limited	Financial Investment Consultancy	100%

13.	<b>Called up share capital</b>	<b>1998</b>	<b>1997</b>	
		<b>£000</b>	<b>£000</b>	
	<i>Authorised</i>			
	Ordinary shares of £1 each	<u>100,000</u>	<u>100,000</u>	
	<i>Allotted, called up and fully paid</i>			
	Ordinary share of £1 each	<u>49,000</u>	<u>49,000</u>	
14.	<b>Realised and unrealised reserves</b>	<b>1998</b>	<b>1997</b>	
		<b>£000</b>	<b>£000</b>	
	Realised reserves	1,585	1,488	
	Unrealised reserves	<u>39,631</u>	<u>22,028</u>	
	Total reserves	<u>41,216</u>	<u>23,516</u>	
15.	<b>Reconciliation of movements in shareholders' funds</b>	<b>Share capital</b>	<b>Profit &amp; loss account</b>	<b>Total</b>
		<b>£000</b>	<b>£000</b>	<b>£000</b>
	At beginning of year	49,000	23,516	72,516
	Retained profit for the financial year	-	<u>17,700</u>	<u>17,700</u>
	Closing shareholders' funds	<u>49,000</u>	<u>41,216</u>	<u>90,216</u>

**ROYAL SCOTTISH ASSURANCE PLC**  
**NOTES TO THE ACCOUNTS (continued)**

16. Technical provisions	Long term business provision	Technical provisions for linked liabilities	Claims outstanding	Total
	£000	£000	£000	£000
<b>Gross amount</b>				
Balance at beginning of year	78,316	1,257,832	3,015	1,339,163
Transfer to the long term business technical account	18,654	203,961	272	222,887
Balance at end of year	96,970	1,461,793	3,287	1,562,050
<b>Reinsurers' share</b>				
Balance at beginning of year	50,411	96,167	2,350	148,928
Transfer (from)/to the long term business technical account	4,456	(5,076)	2,785	2,165
Balance at end of year	54,867	91,091	5,135	151,093
<b>Net technical provisions</b>				
At 30 September 1997	27,905	1,161,665	665	1,190,235
At 30 September 1998	42,103	1,370,702	(1,848)	1,410,957

Included within the technical provision for linked liabilities is £29,279,000 (1997- £26,944,000) in respect of deferred taxation on unrealised capital gains.

The principal assumptions underlying the calculation of the long term business provision are set out below:-

	1998 Rate of Interest %	1997 Rate of Interest %	
Life policies	4	4.7	
Pension policies	5	6.5	
<b>17. Provision for other risks and charges</b>			
	<b>Mortgage Endowment Provision £'000</b>	<b>Other (See below) £'000</b>	<b>Total £'000</b>
At 1 October 1997	12,000	10,000	22,000
Movement in year	8,000	(10,000)	(2,000)
At 30 September 1998	20,000	0	20,000

As stated in Note 3, the £10 million provision for migration made in the year to 1997 was reversed during the year.

Provisions for other risks and charges include a provision in relation to the Mortgage Endowment policies described in Note 21b, the costs in respect of which have been fully borne and funded by the Company's immediate holding company.

The amounts of deferred tax (not recognised)/provided are as follows, in respect of:-	1998 £000	1997 £000
Deferred acquisition costs	(919)	250



**NOTES TO THE ACCOUNTS (continued)**

<b>18</b>	<b>Deposits received from reinsurers</b>	<b>1998</b>	<b>1997</b>
		<b>£000</b>	<b>£000</b>
	Other deposits received from reinsurers	91,091	88,300
<b>19.</b>	<b>Creditors arising out of direct insurance operations</b>	<b>1998</b>	<b>1997</b>
		<b>£000</b>	<b>£000</b>
	Premiums received in advance	783	1,478
	Reinsurance premiums payable	16	227
	Commission payable to parent undertaking	1,854	323
		2,653	2,028
<b>20.</b>	<b>Other creditors including taxation and social security</b>	<b>1998</b>	<b>1997</b>
		<b>£000</b>	<b>£000</b>
	<b>Amounts falling due within one year</b>		
	Bank overdraft due to parent undertaking	828	4,618
	Amounts due to parent undertaking	495	-
	Corporation tax payable	14,813	4,443
	Investments purchased for subsequent settlement	-	368
	Other creditors	5,275	537
		21,411	9,966

**21. Contingent liabilities**

**a) *Review of Pension Transfers and Opt Outs - Phase 1 and 2***

The Company is following guidance from the Personal Investment Authority to review its business of pension transfers and opt-outs and is working towards achieving the deadlines given. This review and its associated administration has led to the Company making payments and having further future liabilities in relation to business written. Although provision has been made on the basis of the best information available to the industry, the effect on the Company cannot yet be determined with certainty.

The Royal Bank of Scotland plc has provided funding to the company of £11.4 million to cover certain costs and/or liabilities which may be incurred by the Company in relation to pension mis-selling.

**b) *Mortgage Endowment***

The Company is in discussion with the Personal Investment Authority regarding its mortgage endowment policies sold prior to 1995. These discussions may give rise to the Company having liabilities in relation to business written. Although provision has been made on the basis of the best information available, the effect on the Company cannot yet be determined with certainty.

**c) *Reinsurance Transactions***

The Company has received correspondence from the Inland Revenue questioning its treatment of certain reinsurance transactions prior to the legislation changes announced at the November 1994 budget. Correspondence is at an early stage. It is not yet clear whether any liability will arise nor can the directors estimate with any degree of certainty the amount of any liability that might arise.

**NOTES TO THE ACCOUNTS (continued)**

**22. Pensions commitments**

The Company operates a pension scheme providing benefits based on final pensionable pay. The assets of the scheme are held separately from those of the Company, being invested with insurance companies. Contributions to the scheme are charged to the revenue account so as to spread the cost of pensions over employees' working lives with the Company. The contributions are determined by a qualified actuary on the basis of triennial valuations using the projected unit method with a 20 year control period. The assumptions which will have the most significant effect on the results of the valuation are those relating to the rate of return on investments and the rates of increase in salaries and pensions. It is assumed that the investment returns will be 8½% per annum, that salary increases will average 7½% per annum and that present and future pensions will increase at the rate of 3% per annum on GMP and 5% on non GMP. An actuarial valuation of the Scheme was carried out as at 31 December 1997 which demonstrated that on these assumptions the value of the assets of the scheme which had a market value of £7,386,000 at the date of the valuation, exceeds 120% of the amount of the liabilities of the scheme. As a result of this valuation, the contributions of both the Company and the employee are 0% of pensionable earnings with effect from 15 September 1998 (1997 - 22% and 0%).

The pension charge relating to the scheme for the period was £27,073 (1997 - £84,996).

In addition to contributions to the above scheme, the Company made pension contributions totalling £10,831 (1997 - £9,006) in respect of employees who are members of other schemes. The Company has reimbursed The Royal Bank of Scotland plc for amounts of pension contributions paid on behalf of former employees and these are included as part of the recharge shown in Note 5(a).

**23. Operating lease commitments**

	1998 £000	1997 £000
Operating lease commitments in respect of land and buildings are as follows:-		
Expiring within one year	72	78
Expiring outwith one year but within five years	164	82
	<u>236</u>	<u>160</u>

**24. Notes to cash flow statement**

<b>a) Reconciliation of operating loss to net cash outflow from operating activities</b>	<b>1998 £000</b>	<b>1997 £000</b>
Operating profit	97	80
Interest and dividends received	(97)	(80)
Net cashflow from operating activities	<u>-</u>	<u>-</u>
<b>b) Analysis of changes in cash and cash equivalents during year</b>	<b>1998 £000</b>	<b>1997 £000</b>
Balance at 1 October 1997	1,540	1,460
Net cash inflow	97	80
Balance at 30 September 1998	<u>1,637</u>	<u>1,540</u>
<b>c) Analysis of shareholders' cash and cash equivalents</b>	<b>1998 £000</b>	<b>1997 £000</b>
Deposits with a credit institution (the parent undertaking)	<u>1,637</u>	<u>1,540</u>

## ROYAL SCOTTISH ASSURANCE PLC

### NOTES TO THE ACCOUNTS (continued)

#### 25. Holding companies

The ultimate holding company is The Royal Bank of Scotland Group plc. The immediate holding company is The Royal Bank of Scotland plc. Both companies are registered in Scotland and incorporated in Great Britain and accounts can be obtained from The Company Secretary, The Royal Bank of Scotland plc, 42 St Andrew Square, Edinburgh.

#### 26. Related party transactions

Royal Scottish Assurance plc is a related party of The Royal Bank of Scotland Group plc ("RBSG"), its ultimate holding company. In the course of its business as a provider of finance RBSG and its subsidiaries have undertaken transactions with Royal Scottish Assurance plc. The Royal Bank of Scotland also provides services in relation to the Company's business, primarily the Company's salesforce and some of its head office personnel. The total costs in relation to these services reimbursed by Royal Scottish Assurance during the year was £29.7million (1997 - £19.6 million). In addition Royal Scottish Assurance pays commission to the Royal Bank of Scotland. Commission payable during the year totalled £8,394,000 of which £1,854,000 was outstanding at the year end. The Company has also received funding from The Royal Bank of Scotland as described in note 21(a).

Scottish Widows' Fund and Life Assurance Society is a related party of the Company and provides insurance services to the Company. Fees payable during the year totalled £12,696,000 of which a balance of £4,048,064 was outstanding at the year end.

In addition two directors have insurance policies with the company. The policies have been issued on the same basis as for all staff. Details of the policies have not been disclosed as they are considered to be immaterial.

#### 27. Approval of accounts

The accounts were approved by the Board of Directors on 23 November 1998.