

Directors' report

for the year ended 31 December 2001

Principal activities and business review

The principal activities of Royal London are the transaction of the main classes of insurance business.

The principal activities of the subsidiary undertakings are as outlined in note 26 to the financial statements.

The Chairman's statement, Group Chief Executive's and Group Finance Director's reviews on pages 2 to 21 contain a review of the Group's business.

Directors

The directors of Royal London as at the date of this report are as set out on pages 22 and 23. With the exception of Christopher Phillips, who was appointed a director on 1 April 2001, and Brian Duffin and Tom Ross, who were both appointed directors on 1 July 2001, they held office throughout the period under review. The only other directors who held office during the period were Alan Frost, who resigned on 31 March 2001, and Tony Percival and Murray Ross, who both resigned on 30 June 2001.

In accordance with the Articles of Association Brian Duffin, Tom Ross and Mike Yardley retire at the Annual General Meeting and, being eligible, offer themselves for re-election.

The details of the executive directors' service contracts are set out in the remuneration report on page 26.

None of the directors has or has had an interest in the shares of any Group undertaking.

Charitable donations

Charitable donations amounted to £34,524 (2000 £70,398).

Equal opportunities

The Group is committed to providing equal opportunities to all employees irrespective of sex, marital status, creed, colour, race, religion, ethnic origin or disability. Royal London recognises that valuing diversity brings benefits to business performance and to employee satisfaction. The Group is committed to recruiting, developing, promoting and training employees on the basis of their individual competencies and performance.

If any member of staff becomes disabled, the Group will arrange for retraining or consider an application for retirement on disability pension, as appropriate.

Employee involvement

The Group has continued to develop regular communication with employees, keeping them updated and seeking their views on specific issues. The Group's bi-monthly magazine, *Connections*, has been developed and its circulation expanded across the wider Group. A major programme of communication took place during the year to keep employees informed of progress in the integration of Scottish Life into the Group, including presentations to all Edinburgh-based employees by Mike Yardley and Brian Duffin at the time of the transfer of business. In addition, a framework for consultation with employees within the Scottish Life businesses was put in place and representatives elected to a consultative body. The Group's intranet facilities have been further developed to give employees greater access to information.

During the course of the year, extensive consultation took place on the introduction of harmonised terms and conditions for all Royal London employees. This consultation was with the trade union, MSF, and specially elected representatives of those groups not covered by trade union representation.

In addition, groups of employees have been involved in consultation on a range of other issues including standards of dress, green transport policy at our Wilmslow site and E-volution, a new computer-based performance appraisal system.

A new reward and recognition scheme has also been piloted to help celebrate the contribution of individuals to the Group's success.

A health and safety committee has operated during the year, involving employees' representatives across the Group.

Environment

The Environment Committee met twice during the year to review issues affecting the Group, including current and proposed legislation.

A major initiative at Wilmslow was the Green Commuter Policy, which provides alternatives to car travel to work to help reduce emissions and local road congestion. Bus services, car sharing and a register of car users were introduced during the year.

Approval was given for the replacement of the Wilmslow site's Halon fire suppression system with non-CFC argonite, ahead of the 2003 legislative requirement.

Environmental issues continue to be a major consideration in the acquisition and disposal of property.

The Group's policy is to dispose of plastic cups, paper, light bulbs, toner cartridges and IT equipment through specialist recycling companies.

Supplier payment policy

The Group does not follow any code or standard on payment practice with its suppliers but it is the policy of the Group to agree terms of payment when orders for goods and services are placed and to pay in accordance with those terms. The ratio of the amount owed to trade creditors at the end of the year to the amounts invoiced by suppliers during the year, equates to a 38-day average payment period.

Institutional shareholders' voting rights

As an institutional investor, Royal London uses its voting rights positively and regularly. Royal London supports the principles for good corporate governance embodied by the Association of British Insurers' guidelines for institutional investors.

The Combined Code

The Board is committed to a high standard of corporate governance and, with one exception, complies with The Combined Code (the Code) and Internal Control Guidance for Directors on the Combined Code ('the Turnbull Guidance'), published in September 1999.

The posts of chairman and chief executive are held by different persons and there is a strong and independent non-executive element on the Board. The Deputy Chairman is recognised as the senior member of the non-executive directors other than the Chairman.

The Code requires directors to submit themselves for re-election at regular intervals, and at least every three years. The current Articles of Association require one-third of the directors to retire from office at each Annual General Meeting and to seek re-election. The current Articles, however, also provide for the number of directors retiring for this reason to be reduced by the number of directors (if any) who have been appointed by the Board during the year, and, thus, who must retire and seek re-election at the next Annual General Meeting. It is, therefore, possible for the number of directors retiring by rotation not to comply strictly with the requirements of the Code.

The Board does not consider this exception to be a material departure from the principles of the Code.

Internal control

The Board is ultimately responsible for the Group's system of internal control and for reviewing its effectiveness. The system in place is designed to manage, rather than eliminate, the risk of failure to achieve business objectives, and can provide only reasonable and not absolute assurance against material misstatement or loss.

There is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group. This has been in place for the year under review and up to date. The process is regularly reviewed by the Board and accords with the Turnbull Guidance. Following the acquisition of Scottish Life, Royal London has commenced a process to introduce the same internal control management and reporting mechanisms in Scottish Life as are in place throughout the rest of the Group.

The Board has reviewed the effectiveness of the system of internal control. Management is responsible for the identification and evaluation of significant risks applicable to their areas of business, together with the design and operation of suitable internal controls. These are prepared for each functional area and provided to senior management for assessment and reporting to the Group Chief Executive and Board.

At the same time, the risks are constantly reviewed by an independent risk management function and a report is made to the Board monthly on key risks and control breakdowns and the corrective action being taken by management. This serves to provide a degree of assurance as to the operation and validity of the system of internal control.

The Compliance Risk Committee meets at least three times a year to consider the regulatory risks. Management provides updates and reports on any control weaknesses identified and corrective actions are discussed and agreed with management. The Committee is chaired by the Group Legal Director and Secretary and the other members are the Appointed Actuary, Group Financial Controller, Group Risk Manager, Group Compliance Director and the Head of Learning & Development. A report is submitted by the Group Compliance Director to the Audit Committee.

Risk Management and Group Compliance submit reports to the Audit Committee that meets at least three times a year. These reports cover significant issues facing the Group and provide an independent assessment of the management of those issues. The Audit Committee assesses the significance of the weaknesses reported and the appropriateness of management action.

Both the Audit Committee and the Compliance Risk Committee consider the authority, resources and co-ordination of those involved in the identification, assessment and management of significant risks faced by the Group. In addition, the Compliance Risk Committee will review reports submitted from Group management and consider the adequacy of the control environment directed towards the proper management of risk.

The Group Chief Executive also reports to the Board on significant changes in the business and the external environment that affect significant risks. The Group Finance Director provides the Board with monthly financial information that includes key performance indicators.

Auditors

In accordance with Section 385 of the Companies Act 1985, a resolution for the reappointment of PricewaterhouseCoopers as auditors will be proposed at the Annual General Meeting.

By order of the Board

Murray Ross

Secretary

19 March 2002

The Board's report on directors' remuneration

for the year ended 31 December 2001

The Remuneration Committee reviews executive directors' salaries annually. It considers that it is in policyholders' interests for remuneration packages to be competitive in order to attract and retain people of the required calibre. The policy aims to provide basic salaries around the median with incentive opportunities which could provide upper quartile total cash earnings for outstanding performance. The committee obtains independent advice on pay and benefits of executive directors and other senior executives.

Remuneration package

Salaries

The salary of directors is determined by considering the individual's responsibility and performance and the remuneration paid in companies of comparable size and nature.

Performance related bonus plans

• *Short-Term Incentive Plan (STIP)*

This annual plan is designed to focus participants on the results that need to be achieved to meet Royal London's strategic objectives and forms the basis of incentive arrangements introduced for all staff. The target and cap are 25% and 50% respectively of the salary at the end of the year. In line with practice in the investment field, Christopher Phillips participates in a scheme with a target and cap of 50% and 100% of salary respectively.

• *Long-Term Incentive Plan (LTIP)*

The LTIP rewards increases in Royal London's policyholder value over the longer term. The value of any award is based on Royal London's value added over each three-year period. A new plan commences annually and the 1999 – 2001 target was 20% with a cap of 40% of salary at the end of the three year period.

Benefits

Benefits are private medical insurance, medical screening, mortgage subsidy and either a company car, including all running costs, or a company car cash allowance.

Pensions

The executive directors are members of one of the Company's pension schemes, which are funded non-contributory defined benefits arrangements. Christopher Phillips and Stephen Shone are affected by the Inland Revenue earnings cap on approved pension benefits. The Company provides benefits above the cap on an unapproved basis.

Life assurance cover for death in service is four times pensionable earnings. Cover for executive directors affected by the earnings cap is increased by individual arrangements to four times final year's salary. Spouses' or dependants' pensions are payable on death based on the number of years' service.

Notice period

The period of notice required to be given to the Company by executive directors is three months in the case of Barry Fitzgerald and six months for Brian Duffin, Christopher Phillips, Stephen Shone and Mike Yardley.

Notice periods to be given by the Company to executive directors are standardised at one year except for Barry Fitzgerald who has a two-year notice period, reducing to one year at age 59.

In the event of early termination, the policy is to make payments within the contractual entitlement. Barry Fitzgerald's contract provides that, if notice is given by Royal London, he may elect for an immediate accrued pension from the scheme in lieu of any other compensation.

Non-executive directors

The remuneration of the non-executive directors is determined by the Board. The principles adopted by the Board in determining the fees are that they should be competitive, appropriate to attract and retain non-executive directors of the necessary calibre, and reflect the responsibilities and time involved in Royal London matters.

| Directors' emoluments | 2001 £000 | 2000 £000 |
|--|----------------------|--------------|
| Salaries and benefits | 1,211 | 1,023 |
| Performance related bonuses | 582 | 450 |
| Fees to the Chairman and non-executive directors | 244 | 201 |
| | 2,037 | 1,674 |

| | Salary or fees | | Performance related bonuses | | Taxable benefits | | Total | |
|---|----------------------|--------------|-----------------------------|--------------|----------------------|--------------|----------------------|--------------|
| | 2001 £000 | 2000 £000 | 2001 £000 | 2000 £000 | 2001 £000 | 2000 £000 | 2001 £000 | 2000 £000 |
| Chairman | | | | | | | | |
| Hubert Reid | 124 | 98 | - | - | - | - | 124 | 98 |
| Executive directors | | | | | | | | |
| Brian Duffin – appointed 1.7.01 | 115 | - | 23 | - | 12 | - | 150 | - |
| Barry Fitzgerald | 147 | 133 | 79 | 53 | 14 | 13 | 240 | 199 |
| Christopher Phillips – appointed 1.4.01 | 158 | - | 90 | - | 7 | - | 255 | - |
| Stephen Shone | 230 | 186 | 136 | 111 | 10 | 10 | 376 | 307 |
| Mike Yardley | 347 | 289 | 215 | 173 | 13 | 14 | 575 | 476 |
| Alan Frost – resigned 31.3.01 | 75 | 205 | - | 60 | 4 | 23 | 79 | 288 |
| Murray Ross – resigned 30.6.01 | 72 | 133 | 39 | 53 | 7 | 17 | 118 | 203 |
| Non-executive directors | | | | | | | | |
| Andrew Longhurst | 44 | 28 | - | - | - | - | 44 | 28 |
| Tim Melville-Ross | 38 | 33 | - | - | - | - | 38 | 33 |
| Tom Ross – appointed 1.7.01 | 20 | - | - | - | - | - | 20 | - |
| Tony Percival – resigned 30.6.01 | 18 | 33 | - | - | - | - | 18 | 33 |
| Barry Skipper – resigned 26.4.00 | - | 9 | - | - | - | - | - | 9 |
| | 1,388 | 1,147 | 582 | 450 | 67 | 77 | 2,037 | 1,674 |

Performance related bonuses for 2001 include amounts in respect of the 1999-2001 LTIP. The amounts included for Barry Fitzgerald, Stephen Shone, Mike Yardley and Murray Ross are £15,000, £24,000, £36,000 and £7,500 respectively.

Alan Frost's employment terminated on 31 March 2001 and he received a payment of £333,075 as compensation for loss of office and £492,680 as compensation for the loss of unfunded unapproved pension benefits. This total payment of £825,755 reflects the terms of his contract of employment with United Assurance Group plc.

| Pension entitlements | Age at 31.12.01 | Pensionable service at 31.12.01 | Additional pension earned (excluding inflation) during 2001 £000 | Pension accrued at 31.12.01 £000 | Pension accrued at 31.12.00 £000* |
|-----------------------------|----------------------------|--|---|---|--|
| Brian Duffin | 46 | 25 yrs 4 mths | 11 | 97 | 85 |
| Barry Fitzgerald | 57 | 29 yrs 8 mths | 9 | 74 | 65 |
| Christopher Phillips | 45 | 1 yr 9 mths | 3 | 8 | 5 |
| Stephen Shone | 44 | 3 yrs 0 mths | 6 | 14 | 7 |
| Mike Yardley | 45 | 23 yrs 1 mth | 28 | 146 | 117 |

*or at date of appointment

By order of the Board

Tim Melville-Ross
Chairman of the Remuneration Committee
 19 March 2002

Statement of directors' responsibilities **Membership of Board Committees**

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Parent company and Group and of the result for that period. In preparing those financial statements, the directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of Royal London and enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The maintenance and integrity of the Royal London website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Investment Committee

Brian Duffin
Andrew Longhurst (Chair)
Tim Melville-Ross
Hubert Reid
Tom Ross
Stephen Shone
Mike Yardley

Audit Committee

Andrew Longhurst
Tim Melville-Ross
Hubert Reid
Tom Ross (Chair)

Remuneration Committee

Andrew Longhurst
Tim Melville-Ross (Chair)
Hubert Reid
Tom Ross

Nomination Committee

Andrew Longhurst
Tim Melville-Ross
Hubert Reid (Chair)
Tom Ross
Mike Yardley

Independent auditors' report to the members of the Royal London Mutual Insurance Society Limited

We have audited the financial statements which comprise the consolidated profit and loss account, the balance sheets and the related notes, and the accounting policies set out in the statement of accounting policies.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board.

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

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the Chairman's statement, Group Chief Executive's review, Group Finance Director's review and the Directors' report.

We also, at the request of the directors (because the Company applies the Financial Services Authority Listing rules as if it were a listed company), review whether the corporate governance statement reflects the Company's compliance with the seven provisions of the combined codes specified by the Financial Services Authority for review by auditors of listed companies, and we report if it does not. We are not required to consider whether the Board's statement on internal control covers all risks and controls, or to form an opinion on the effectiveness of the Company's corporate governance procedures or its risks and control procedures.

Basis of audit 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 financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group at 31 December 2001 and of the result 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
London

19 March 2002

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Consolidated profit and loss account

for the year ended 31 December 2001

| | Notes | 2001 £m | 2000 Restated £m |
|---|--------|------------------|------------------------|
| Technical account – long-term business | | | |
| Earned premiums, net of reinsurance | | | |
| Gross premiums written | | | |
| – Acquisitions | | 574.9 | – |
| – Other continuing operations | | 822.3 | 884.0 |
| | | 1,397.2 | 884.0 |
| Outward reinsurance premiums | 2(i) | (5.7) | (8.1) |
| | | 1,391.5 | 875.9 |
| Investment income | | | |
| | 3(i) | 786.5 | 1,502.5 |
| Other technical income, net of reinsurance | | | |
| | 4 | | |
| – Continuing operations | | 36.8 | 31.8 |
| – Discontinued operations | | 5.4 | 8.8 |
| | | 42.2 | 40.6 |
| Total technical income | | 2,220.2 | 2,419.0 |
| Claims incurred, net of reinsurance | | | |
| Claims paid | | | |
| – Gross amount | | 1,658.1 | 978.6 |
| – Reinsurers' share | | (3.5) | (0.8) |
| | | 1,654.6 | 977.8 |
| Change in the provision for claims | | | |
| – Gross amount | | 1.7 | (0.6) |
| – Reinsurers' share | | 0.4 | – |
| | | 1,656.7 | 977.2 |
| Change in other technical provisions, net of reinsurance | | | |
| Long-term business provision, net of reinsurance | | | |
| – Gross amount | 16 | (355.2) | (497.6) |
| – Reinsurers' share | | 1.1 | (0.1) |
| | | (354.1) | (497.7) |
| Other technical provisions, net of reinsurance | | | |
| Technical provisions for linked liabilities | | | |
| – Gross amount | 16 | (158.5) | 243.3 |
| – Reinsurers' share | | (2.0) | – |
| | | (160.5) | 243.3 |
| | | (514.6) | (254.4) |
| Net operating expenses | | | |
| | 5 | | |
| – Continuing operations | | 273.9 | 205.0 |
| – Exceptional (income)/expenses | | (112.3) | 44.1 |
| | | 161.6 | 249.1 |
| Unrealised losses on investments | | | |
| | 3(ii) | 2,887.7 | 1,287.7 |
| Investment expenses and charges | | | |
| | 3(iii) | 41.6 | 22.0 |
| Other technical charges, net of reinsurance | | | |
| | 4 | 253.5 | 34.4 |
| Tax credit attributable to long-term business | | | |
| | 8 | (306.8) | (70.1) |
| Total technical charges | | 4,179.7 | 2,245.9 |
| – Acquisitions | | (371.3) | – |
| – Other continuing operations | | (1,593.6) | 164.3 |
| – Discontinued operations | | 5.4 | 8.8 |
| (Deficit)/surplus of total technical income over total technical charges | | (1,959.5) | 173.1 |
| Pension scheme (losses)/gains after tax | 29(d) | (80.0) | 27.5 |
| | | (2,039.5) | 200.6 |
| Transfer from/(to) the fund for future appropriations | 16 | 2,039.5 | (200.6) |
| Balance on the technical account – long-term business | | – | – |

The overall results of the Group are reflected in the technical account – long-term business. As a mutual company all earnings are retained for the benefit of policyholders and are carried forward within the fund for future appropriations. Accordingly, there is no balance at the foot of the technical account – long-term business. There are no gains and losses other than those included in the profit and loss account. The general business results are included in other technical income above.

Balance sheets

as at 31 December 2001

| | Notes | Group | | Parent company | |
|--|-------|-----------------|------------------------|-----------------|------------------------|
| | | 2001 £m | 2000 Restated £m | 2001 £m | 2000 Restated £m |
| Assets | | | | | |
| Intangible assets | | | | | |
| Positive goodwill | 10 | 336.8 | 26.5 | 332.1 | – |
| Negative goodwill | 10 | (49.7) | – | (49.7) | – |
| | | 287.1 | 26.5 | 282.4 | – |
| Investments | | | | | |
| Land and buildings | 11 | 2,133.0 | 1,441.0 | 1,965.6 | 825.9 |
| Investments in Group undertakings | | – | – | 282.0 | 1,604.4 |
| Other financial investments | | 14,480.3 | 11,945.4 | 14,411.3 | 4,629.8 |
| | | 16,613.3 | 13,386.4 | 16,658.9 | 7,060.1 |
| Present value of acquired in-force business | | | | | |
| | 12 | 820.8 | 523.4 | 820.8 | – |
| Assets held to cover linked liabilities | | | | | |
| | 13 | 5,004.4 | 1,542.7 | 4,020.7 | 236.7 |
| Reinsurers' share of technical provision | | | | | |
| Long-term business | | 6.8 | 2.3 | 6.8 | 1.1 |
| Technical provision for linked liabilities | | 5.4 | – | 5.4 | – |
| Claims outstanding | | 7.4 | 11.5 | 0.9 | – |
| | | 19.6 | 13.8 | 13.1 | 1.1 |
| Debtors | | | | | |
| Debtors arising out of direct insurance operations | | 41.4 | 50.2 | 41.1 | 19.1 |
| Debtors arising out of reinsurance operations | | 19.5 | 18.3 | 18.4 | – |
| Other debtors | 14 | 87.9 | 50.7 | 81.5 | 67.6 |
| | | 148.8 | 119.2 | 141.0 | 86.7 |
| Other assets | | | | | |
| Tangible assets | 15 | 19.1 | 12.7 | – | 6.0 |
| Cash at bank and in hand | | 193.0 | 33.8 | 111.1 | 7.7 |
| | | 212.1 | 46.5 | 111.1 | 13.7 |
| Prepayments and accrued income | | | | | |
| Accrued interest and rent | | 89.6 | 49.0 | 89.4 | 11.2 |
| Deferred acquisition costs – life business | | 270.5 | 180.0 | 270.5 | 48.0 |
| Other prepayments and accrued income | | 11.4 | 9.9 | 2.9 | 1.2 |
| | | 371.5 | 238.9 | 362.8 | 60.4 |
| Total assets excluding pension asset | | | | | |
| | | 23,477.6 | 15,897.4 | 22,410.8 | 7,458.7 |
| Pension asset | 29(b) | 289.1 | 212.8 | 289.1 | 46.3 |
| Total assets including pension asset | | 23,766.7 | 16,110.2 | 22,699.9 | 7,505.0 |

Assets attributable to long-term business amounted to **£23,323.6m** (2000 £15,478.3m).

Balance sheets

as at 31 December 2001

| | Notes | Group | | Parent company | |
|--|-------|-----------------|------------------------|-----------------|------------------------|
| | | 2001 £m | 2000 Restated £m | 2001 £m | 2000 Restated £m |
| Liabilities | | | | | |
| Subordinated liabilities | 19 | 125.0 | – | 125.0 | – |
| Fund for future appropriations | 16 | 3,758.9 | 4,623.0 | 3,769.8 | 2,707.2 |
| Technical provisions | | | | | |
| Long-term business | 16,22 | 14,334.6 | 9,209.5 | 14,331.2 | 4,274.3 |
| Claims outstanding | 16 | 65.4 | 60.4 | 46.7 | 17.4 |
| | | 14,400.0 | 9,269.9 | 14,377.9 | 4,291.7 |
| Technical provisions for linked liabilities | 16 | 4,965.3 | 1,533.7 | 3,969.5 | 234.8 |
| Provisions for other risks and charges | 17 | 136.8 | 466.6 | 132.0 | 174.7 |
| Creditors | | | | | |
| Creditors arising out of direct insurance operations | | 67.9 | 13.2 | 67.9 | 0.4 |
| Creditors arising out of reinsurance operations | | 6.9 | 0.3 | 0.4 | – |
| Other creditors including taxation and social security | 18 | 238.1 | 181.6 | 222.0 | 87.4 |
| | | 312.9 | 195.1 | 290.3 | 87.8 |
| Accruals and deferred income | | 46.7 | 21.9 | 14.3 | 8.8 |
| Total liabilities excluding pension liability | | 23,745.6 | 16,110.2 | 22,678.8 | 7,505.0 |
| Pension liability | 29(b) | 21.1 | – | 21.1 | – |
| Total liabilities including pension liability | | 23,766.7 | 16,110.2 | 22,699.9 | 7,505.0 |

The financial statements on pages 31 to 57 were approved by the Board of Directors and signed on its behalf on 19 March 2002.

Hubert Reid
Chairman

Mike Yardley
Group Chief Executive

Stephen Shone
Group Finance Director

Notes to the financial statements

for the year ended 31 December 2001

1. Accounting policies

a. Basis of presentation and consolidation

The Group financial statements, which consolidate the financial statements of The Royal London Mutual Insurance Society Limited (the Parent company) and its subsidiary undertakings, have been prepared in accordance with the provisions of Sections 255 and 255A of, and Schedule 9A to, the Companies Act 1985 with the exception that, in accordance with Statement of Standard Accounting Practice No. 19, no depreciation is provided in respect of freehold and leasehold investment properties as set out in note 1(e)(iii) below. The financial statements have also been prepared in accordance with applicable accounting standards and with the Association of British Insurers' Statement of Recommended Practice on Accounting for Insurance Business issued in December 1998. The financial statements have been prepared under the historical cost accounting rules, modified to include the revaluation of investments.

The results of subsidiary undertakings acquired during the period are included in the consolidated results from the date of acquisition. On acquisition of a subsidiary undertaking, all of its assets and liabilities are recorded at their fair values on the date of purchase. Costs incurred directly as a result of acquisitions are included in the cost of acquisition. Interest costs on borrowings used to fund acquisitions are written off as incurred.

The results of the Group's general insurance business, which represents a discontinued activity, are consolidated in the technical account – long-term business, under other technical income and shown separately in note 4.

All accounting policies and estimation techniques have been reviewed for appropriateness in accordance with Financial Reporting Standard 18, 'Accounting Policies'.

The Group has adopted in full the provisions of FRS 17, 'Retirement Benefits' in the current year financial statements. In prior years, the Group's contributions to its pension schemes were accounted for in accordance with Statement of Standard Accounting Practice 24, 'Accounting for Pension Costs'. FRS 17 fundamentally changes the basis upon which a sponsoring group's defined benefit pension schemes are accounted for, in that the Group is now obliged, *inter alia*, to recognise the amount recoverable out of future company contributions within its pension schemes as an asset or liability respectively on its own balance sheet. Prior year comparatives have been restated accordingly. (See notes 29 and 30).

b. Long-term business

(i) Premiums

Premiums, including reinsurance premiums, are accounted for when due for payment except for recurring single premiums and premiums in respect of unit-linked business which are accounted for on a received basis. New business premiums are accounted for when the policy liability is recognised and, in respect of regular premiums, reflect the premiums payable in a full year.

(ii) Claims

Death claims are accounted for when notified, surrenders when paid out and maturity and annuity claims when due for payment. For linked policies, claims are accounted for on cancellation of the associated units. Claims payable include related claims handling costs.

c. General business

(i) Commission

General business comprises commission income which is credited to the technical account – long-term business on an accruals basis. Additional commission is received based upon the underwriting results of the respective insurers and this is credited to the technical account – long-term business under other technical income.

(ii) Claims

Provision is made for claims admitted or intimated but not paid by the balance sheet date and for claims incurred but not reported together with related claims handling costs in claims outstanding. Anticipated reinsurance recoveries are stated separately. All claims provided for relate to discontinued general insurance business.

d. Goodwill

Goodwill, both positive and negative, arising on acquisition is capitalised in the balance sheet at cost and amortised through the profit and loss account on a straight line basis, over its useful economic life which is determined by the directors. The gain or loss on subsequent disposal of a subsidiary undertaking includes any attributable unamortised goodwill.

e. Investments

(i) Investment income

Investment income comprises interest, rents, dividends receivable and gains on the realisation of investments. Dividends are recorded net of the associated UK tax credits on the date on which the shares are quoted ex-dividend. Interest, rents and expenses are accounted for on an accruals basis.

(ii) Realised and unrealised investment gains and losses

Realised gains and losses are calculated as the difference between the net sale proceeds and the original cost. Unrealised gains and losses are calculated as the difference between the current valuation of investments and their valuation at the last balance sheet date or subsequent acquisition. The movement on unrealised gains and losses recognised in the year also includes the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

(iii) Investment valuations

All investments, including those classified as assets held to cover linked liabilities, are stated at their current value. Listed securities are valued at mid-price, with the exception of securities held by unit-linked funds and holdings in unit trusts which are valued at bid price. All freehold and leasehold properties, including those occupied by the Group, are regarded as investment properties. These are valued annually, on the basis of open market value, by independent professional valuers who are members of the Royal Institution of Chartered Surveyors.

1. Accounting policies (continued)

(iii) Investment valuations (continued)

In accordance with Statement of Standard Accounting Practice No.19, no depreciation is provided in respect of freehold investment properties and leasehold investment properties. This is a departure from the requirements of the Companies Act 1985 which requires all properties to be depreciated. As depreciation is only one of the factors reflected in the annual valuation, the relevant charge which would otherwise have been shown cannot be separately identified or quantified. The accounting policy adopted is considered necessary for the financial statements to give a true and fair view.

Other investments are valued by the directors on the basis of their estimated open market value. Investments in Group undertakings are valued annually by the directors.

Investment futures contracts are valued at market prices at the year end and, to the extent that the contracts have been entered into for specific market exposure purposes, have been reflected in the financial statements on the basis of the underlying economic exposure. All gains and losses on open contracts are treated as unrealised.

f. Present value of acquired in-force business (PVIF)

On acquisition of a portfolio of long-term insurance contracts, either directly or through the acquisition of a subsidiary undertaking, the net present value of the Group's interest in the expected after-tax cash flows of the in-force business is capitalised in the balance sheet as an asset. That part of the Group's interest which will be recognised as profit over the lifetime of the in-force policies is amortised, and the discount unwound on a systematic basis over the anticipated lives of the related contracts.

The carrying value of the asset is assessed annually using current assumptions in order to determine whether any impairment has arisen compared to the amortised acquired value based on assumptions made at the time of the acquisition.

Any amortisation or impairment charge is recorded in the technical account – long-term business, in other technical charges.

g. Tangible assets and depreciation

Tangible assets are capitalised and depreciated on a straight line basis over their estimated useful lives which range from three to eight years.

Payments in respect of operating leases are charged to the profit and loss account in the period to which they relate.

h. Deferred acquisition costs

The costs of acquiring new insurance contracts, which are incurred during a financial year but which relate to a subsequent financial year, are deferred to the extent that they are recoverable out of future revenue margins. These costs are disclosed as an explicit asset on the balance sheet.

The rates of amortisation of the deferred acquisition costs asset for each product are consistent with a prudent assessment of the expected pattern of emergence of future revenue margins over the amortisation period for the relevant contracts.

i. Fund for future appropriations

The fund for future appropriations represents all funds whose allocation between specific policyholders has not been determined at the balance sheet date. Any surplus or deficit arising in the technical account – long-term business is transferred to or from the fund on an annual basis.

j. Long-term business provisions

The long-term business provision is calculated using standard actuarial methods and having regard to the principles set out in Council Directive 92/96/EEC. For conventional non-linked business, a net premium method is used, including explicit provision for vested bonuses, including those vesting following the current valuation. Implicit provision is made for future regular bonuses by means of a reduction in the valuation rate of interest. For linked business the calculation of the provision is based upon the fund value at the valuation date. For accumulating with-profits business the calculation of the provision is in accordance with Rule 5.14 of the Interim Prudential Sourcebook for Insurers. The principal assumptions used in calculating the long-term business provision are disclosed in note 22.

k. Bonuses

New regular bonuses declared for the year are provided within the calculation of the long-term business provision. Terminal bonuses paid during the year to policyholders on maturity, death or surrender are included as part of the claims incurred in the technical account.

l. Taxation

Provision is made for taxation at current rates on the excess of investment income and realised gains over expenses and relief for overseas taxation is taken where appropriate. Deferred taxation is provided on all unrealised gains and other timing differences, between their recognition in the financial statements and their recognition in the tax computations. The value of the resultant deferred tax assets and liabilities has been calculated on a discounted basis reflecting the fact that the timing differences are projected to reverse over several years. The discount rates used are the post-tax yields to maturity that could be obtained at the balance sheet date on government bonds with maturity dates similar to those of the deferred tax assets and liabilities.

1. Accounting policies (continued)

m. Pension costs

Pension schemes are in operation for employees of the Group. The current principal schemes, to which all current employees belong, are of the funded, defined benefit type. The schemes provide benefits based on final pensionable pay. The assets of the schemes are held in separate trustee administered funds. The positions of the principal schemes are assessed annually by independent qualified actuaries.

The Group has adopted the requirements of Financial Reporting Standard 17 'Retirement Benefits'.

The aggregate pension scheme asset or liability recognised in the balance sheet is the excess, that is recoverable by the Group, of value of the assets in the schemes over the present value of the schemes' liabilities. The resulting asset is net of a provision for deferred taxation. Movements in the amount of the pension scheme assets that are recognised and which are attributable to changes in the membership of the schemes are treated as operating gains and included within net operating expenses. Deficiencies in the value of scheme assets over scheme liabilities are recognised in the balance sheet as a pension liability, net of deferred taxation. The standard requires certain items to be accounted for through the Statement of Recognised Gains and Losses, which the Group does not prepare as a mutual company. Instead, these items are shown in the technical account. Further details are contained in note 29.

The pension costs for the schemes are analysed as follows:

- *Current service costs*
Current service costs are the actuarially calculated present value of the benefits earned by the active employees in each period.
- *Past service costs*
Past service costs comprise costs relating to employee service in prior periods arising in the current period as a result of the introduction of, or improvement to, retirement benefits and are recognised in the profit and loss account on a straight line basis over the period in which the increase in benefits vest.
- *Settlements or curtailments*
Settlements or curtailments are recognised in the profit and loss account to the extent that they are not allowed for in the actuarial assumptions. Losses on settlements or curtailments are measured at the date on which the employer becomes demonstrably committed to the transaction. Gains on settlements or curtailments are measured at the date on which all parties whose consent is required are irrevocably committed.
- *Net expected return on pension assets*
Net expected return on the pension assets comprises the expected return on the pension scheme assets less interest on scheme liabilities.

The actual return less expected return on pension scheme assets and actuarial movements in pension schemes net of tax which arise from any new valuation and from updating the latest actuarial valuation to reflect conditions at the balance sheet date are shown net of tax in the technical account immediately above the transfer to or from the fund for future appropriations.

n. Foreign currency translation

Assets and liabilities denominated in foreign currencies are expressed in sterling at the exchange rates ruling on the balance sheet date. Revenue transactions and those relating to the acquisition and realisation of investments have been translated into sterling at rates of exchange ruling at the time of the respective transactions. Any exchange differences are dealt with in the technical account under the same heading as the underlying transactions are reported.

2. Analysis of premiums

It is the opinion of the Board that the Group operates in a single business segment, which is the provision of life assurance, pensions and savings products. The investment management activities of the Group are principally focused on this segment.

Gross premiums written relate to direct business from continuing operations.

| | Acquisition from 1 July 2001 £m | Existing 2001 £m | Total 2001 £m | 2000 £m |
|---|---------------------------------------|------------------------|---------------------|------------|
| (i) Gross premiums written | | | | |
| Regular premiums | 175.2 | 525.9 | 701.1 | 478.9 |
| Single premiums | 399.7 | 296.4 | 696.1 | 405.1 |
| | 574.9 | 822.3 | 1,397.2 | 884.0 |
| Individual premiums: | | | | |
| With-profits life and annuity contracts | 29.0 | 481.0 | 510.0 | 433.2 |
| With-profits individual pension contracts | 62.8 | 115.5 | 178.3 | 70.2 |
| Linked life contracts | 145.4 | 15.8 | 161.2 | 14.3 |
| Linked individual pension contracts | 196.0 | 19.2 | 215.2 | 16.4 |
| DSS rebates | 27.6 | 90.7 | 118.3 | 83.4 |
| Non-profit life and annuity contracts | 11.6 | 6.0 | 17.6 | 9.6 |
| Non-profit individual pension contracts | 15.9 | 55.4 | 71.3 | 44.8 |
| | 488.3 | 783.6 | 1,271.9 | 671.9 |
| Group premiums: | | | | |
| With-profits pension contracts | 17.1 | - | 17.1 | - |
| Linked pension contracts | 58.7 | 38.7 | 97.4 | 212.1 |
| Non-profit pension contracts | 10.8 | - | 10.8 | - |
| | 86.6 | 38.7 | 125.3 | 212.1 |
| | 574.9 | 822.3 | 1,397.2 | 884.0 |
| Premiums written in: | | | | |
| United Kingdom | 454.2 | 822.3 | 1,276.5 | 884.0 |
| Isle of Man | 120.7 | - | 120.7 | - |
| | 574.9 | 822.3 | 1,397.2 | 884.0 |

Notes to the financial statements *continued*

for the year ended 31 December 2001

2. Analysis of premiums (continued)

| | Acquisition from 1 July 2001 £m | Existing 2001 £m | Total 2001 £m | 2000 £m |
|---|---------------------------------------|------------------------|---------------------|------------|
| (ii) New business premiums | | | | |
| Insurance regular premiums: | | | | |
| With-profits life contracts | 0.7 | 16.9 | 17.6 | 14.0 |
| With-profits individual pension contracts | 4.3 | 2.7 | 7.0 | 7.9 |
| With-profits group pension contracts | 4.5 | – | 4.5 | – |
| Linked life contracts | 2.1 | 0.1 | 2.2 | – |
| Linked individual pension contracts | 20.0 | 1.7 | 21.7 | – |
| Linked group pension contracts | 5.0 | – | 5.0 | – |
| Non-profit life contracts | 0.1 | 1.5 | 1.6 | 1.4 |
| Non-profit individual pension contracts | 0.1 | – | 0.1 | 0.2 |
| Non-profit group pension contracts | 0.6 | – | 0.6 | – |
| | 37.4 | 22.9 | 60.3 | 23.5 |
| Insurance single premiums: | | | | |
| With-profits life and annuity contracts | – | 108.5 | 108.5 | 60.2 |
| With-profits individual pension contracts | 33.8 | 3.1 | 36.9 | 2.6 |
| Linked life contracts | 121.6 | – | 121.6 | 1.6 |
| Linked individual pension contracts | 142.9 | – | 142.9 | 1.6 |
| Linked group pension contracts | 46.4 | – | 46.4 | 212.1 |
| Non-profit life contracts | 7.5 | – | 7.5 | – |
| Non-profit individual pension contracts | 12.5 | 55.4 | 67.9 | 43.6 |
| Non-profit group pension contracts | 7.4 | 38.7 | 46.1 | – |
| DSS rebates | 27.6 | 90.7 | 118.3 | 83.4 |
| | 399.7 | 296.4 | 696.1 | 405.1 |
| Investment regular business: | | | | |
| Unit trust and ISA regular business | – | 14.1 | 14.1 | 8.7 |
| Investment single business: | | | | |
| Unit trust and ISA single business | – | 43.7 | 43.7 | 74.5 |
| Other investment only mandates | – | 213.7 | 213.7 | 232.0 |
| | – | 257.4 | 257.4 | 306.5 |
| Total new business premiums | 437.1 | 590.8 | 1,027.9 | 743.8 |
| New business written in: | | | | |
| United Kingdom | 316.4 | 590.8 | 907.2 | 743.8 |
| Isle of Man | 120.7 | – | 120.7 | – |
| | 437.1 | 590.8 | 1,027.9 | 743.8 |

In classifying new business premiums, the basis of recognition adopted is as follows:

- Funds at retirement under pensions contracts left with the Company are included in both claims incurred and as single premiums within gross premiums written.
- Increments under existing group pension schemes are classified as new business premiums.
- DSS rebates are accounted for on a received basis.

Funds under management in respect of the unit trust business are held in authorised unit trusts and the activities and sales of these unit trusts are not consolidated.

The linked group pension premiums includes an amount of £nil (2000 £208.0m) which represents premiums received from The Royal London Staff Pension Fund.

3. Investment return summary

| | 2001 £m | 2000 Restated £m |
|--|------------------|------------------------|
| (i) Investment income | | |
| Income from investments: | | |
| Land and buildings | 126.8 | 83.0 |
| Other financial investments | 488.8 | 338.0 |
| | 615.6 | 421.0 |
| Gains on the realisation of investments | 146.4 | 1,059.1 |
| | 762.0 | 1,480.1 |
| Net expected return on pension assets (see note 29(c)) | 24.5 | 22.4 |
| | 786.5 | 1,502.5 |
| (ii) Unrealised losses on investments | (2,887.7) | (1,287.7) |
| (iii) Investment expenses and charges | | |
| Interest payable on bank loans and overdrafts | (2.6) | (0.5) |
| Interest payable on other borrowings | (8.1) | (1.9) |
| Investment management expenses | (30.9) | (19.6) |
| | (41.6) | (22.0) |
| Net investment return | (2,142.8) | 192.8 |

4. Other technical income and charges

Other technical income includes the results of discontinued general insurance business, general insurance commission, management fees received, amortisation of acquired negative goodwill and income of non-insurance subsidiary undertakings. Other technical charges includes amortisation of present value of acquired in-force business, amortisation of acquired positive goodwill and the expenses and other outgoings of non-insurance subsidiary undertakings.

| | 2001 £m | 2000 £m |
|--|--------------|------------|
| Other technical income | | |
| Discontinued general business result | 5.4 | 8.8 |
| Amortisation of negative goodwill (see note 10) | 5.6 | 0.9 |
| Other continuing business (including general insurance commission) | 31.2 | 30.9 |
| | 42.2 | 40.6 |
| Other technical charges | | |
| PVIF realised under UAG Schedule 2C transfer (see note 12) | 164.3 | – |
| Amortisation of acquired PVIF (see note 12) | 20.8 | 20.5 |
| Amortisation of goodwill (see note 10) | 17.6 | – |
| Goodwill realised under UAG Schedule 2C transfer (see note 10) | 43.0 | – |
| Other, continuing business | 7.8 | 13.9 |
| | 253.5 | 34.4 |

The amount described as 'PVIF realised under UAG Schedule 2C transfer' of £164.3m reflects an amount transferred to the Royal London fund from the acquired United Assurance Group fund for future appropriations which had already been recognised by Royal London in the PVIF acquired. This reduces the consolidated fund for future appropriations and PVIF, (see note 12).

The amount described as 'Goodwill realised under UAG Schedule 2C transfer', of £43.0m represents an amount transferred from the long-term funds of the acquired United Assurance Group reflecting the present value of future tax savings to those funds in a mutual business. This has resulted in a realisation of goodwill in the year (see note 10).

Notes to the financial statements *continued*

for the year ended 31 December 2001

| | 2001 £m | 2000 Restated £m |
|--|----------------|------------------------|
| 5. Net operating expenses | | |
| Acquisition costs | 126.2 | 79.9 |
| Change in deferred acquisition costs | 19.9 | (14.8) |
| | 146.1 | 65.1 |
| Current service pension cost (see note 29(c)) | 27.9 | 24.1 |
| Administrative expenses | 99.9 | 115.8 |
| | 273.9 | 205.0 |
| Exceptional (income)/expenses | | |
| – impact of pension scheme reorganisation (see note 29(c)) | (112.3) | – |
| – restructuring costs | 20.8 | 41.8 |
| – utilisation of restructuring provision (see note 17(ii)) | (20.8) | – |
| – exceptional sales force training costs | – | 2.3 |
| | (112.3) | 44.1 |
| Total net operating expenses | 161.6 | 249.1 |

All of the above expenses are in respect of continuing operations. The restructuring costs incurred in 2000 relate to the integration of the United Assurance Group businesses with Royal London.

| | Group | | Parent company | |
|--|-------------|------------|-------------------|------------|
| | 2001 £m | 2000 £m | 2001 £m | 2000 £m |
| Net operating expenses include: | | | | |
| Depreciation of tangible assets | 7.7 | 13.6 | – | 10.9 |
| Operating lease rentals – land and buildings | 6.7 | 6.1 | 4.5 | 3.5 |
| | £000 | £000 | £000 | £000 |
| Auditors' remuneration (gross of VAT): | | | | |
| Audit fees | 661 | 360 | 487 | 129 |
| Audit of regulatory returns | 60 | 41 | 47 | 17 |
| Fees for other non-audit services paid to the current auditor | 371 | 250 | 209 | 250 |
| Fees for other non-audit services paid to the previous auditor | – | 800 | – | 800 |

6. Commissions

Included within acquisition costs is commission payable during the year in respect of direct insurance business of £24.3m (2000 £nil) to individuals other than employees of the Group.

7. Particulars of staff

The average number of persons (including executive directors) employed by the Group during the year was:

| | 2001 Number | 2000 Number |
|-------------------------|----------------|----------------|
| Sales and sales support | 2,925 | 3,282 |
| Administration | 1,724 | 1,422 |
| | 4,649 | 4,704 |

The aggregate remuneration payable in respect of the above employees was:

| | 2001 £m | 2000 Restated £m |
|--------------------------------------|--------------|------------------------|
| Wages and salaries | 125.0 | 111.4 |
| Social security costs | 10.5 | 9.7 |
| Other pension costs (see note 29(c)) | 27.9 | 24.1 |
| | 163.4 | 145.2 |

Full details of the directors' emoluments are included in the Board's report on directors' remuneration on pages 26 and 27. The information included therein encompasses that required by the Companies Act 1985.

8. Tax attributable to long-term business

| | 2001 £m | 2000 Restated £m |
|--|----------------|------------------------|
| Tax has been provided as follows: | | |
| UK corporation tax (credit)/charge at 30% (2000 30%) | | |
| Current year | 26.9 | 97.2 |
| Adjustment in respect of prior periods | (12.7) | 8.2 |
| | 14.2 | 105.4 |
| Foreign tax relieved against UK corporation tax | 1.5 | 2.2 |
| Deferred tax (see note 17) | (322.5) | (177.7) |
| | (306.8) | (70.1) |

Tax on realised capital gains in 2000 has been re-analysed as part of the current tax year charge.

9. Parent company profit and loss account

The Parent company has taken advantage of the exemptions under Section 230 of the Companies Act 1985 not to include a Parent company profit and loss account. The Parent company is a mutual society and consequently the result for the year is reported as nil after a transfer to or from the fund for future appropriations.

10. Goodwill

| | Group | | Parent company | |
|---|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
| | Positive goodwill 2001 £m | Negative goodwill 2001 £m | Positive goodwill 2001 £m | Negative goodwill 2001 £m |
| Cost: | | | | |
| At 1 January 2001 | 25.6 | - | - | - |
| Impact on parent of UAG Schedule 2C transfer | - | - | 26.5 | - |
| Amendment to provisional values (see note 23(iii)) | (38.8) | - | (38.8) | - |
| Realised under UAG Schedule 2C transfer | (43.0) | - | (43.0) | - |
| | (56.2) | - | (55.3) | - |
| Redesignation of positive goodwill to negative goodwill | 56.2 | (56.2) | 55.3 | (55.3) |
| Acquisitions during the year (note 23) | | | | |
| Scottish Life | 349.7 | - | 349.7 | - |
| Union Fund Management | 4.7 | - | - | - |
| At 31 December 2001 | 354.4 | (56.2) | 349.7 | (55.3) |
| Amortisation: | | | | |
| At 1 January 2001 | (0.9) | - | - | - |
| Redesignation of positive goodwill to negative goodwill | 0.9 | (0.9) | - | - |
| Amortisation for the year | 17.6 | (5.6) | 17.6 | (5.6) |
| At 31 December 2001 | 17.6 | (6.5) | 17.6 | (5.6) |
| Net book value, 31 December 2001 | 336.8 | (49.7) | 332.1 | (49.7) |
| Net book value, 31 December 2000 | 26.5 | - | - | - |

On 1 January 2001, the long-term business, including all of the assets and liabilities of certain subsidiary undertakings of the Group were transferred to the Parent company under transfers made in accordance with Schedule 2C of the Insurance Companies Act 1982. Details of these transfers are set out in note 24 and the impact on goodwill is summarised below:

- The goodwill, previously recognised as a Group consolidation adjustment, in respect of those companies referred to in note 24, is now specifically recognised in the Parent company balance sheet and;
- An amount of £43.0m has been transferred from the long-term funds of the UAG companies reflecting the present value of future tax savings to those funds in a mutual business. This has resulted in a realisation of goodwill in the year.

Following a review by the Group of all of its goodwill assets and liabilities, the directors consider a prospective amortisation period of 10 years to be appropriate. Accordingly, the goodwill asset at 1 January 2001, which previously was being amortised over 20 years will now be amortised over 10 years from that date.

Notes to the financial statements *continued*

for the year ended 31 December 2001

| | Group | | Parent company | |
|------------------------------------|----------------|----------------|----------------|--------------|
| | 2001 £m | 2000 £m | 2001 £m | 2000 £m |
| 11. Investments | | | | |
| (i) Land and buildings | | | | |
| At valuation: | | | | |
| Freehold | 1,833.2 | 1,144.4 | 1,692.6 | 735.0 |
| Long leasehold | 299.8 | 296.6 | 273.0 | 90.9 |
| | 2,133.0 | 1,441.0 | 1,965.6 | 825.9 |
| At cost: | | | | |
| | 1,834.4 | 1,123.3 | 1,655.3 | 620.6 |
| Value of owner occupied properties | 58.8 | 47.4 | - | 20.6 |

Land and buildings were valued at 31 December 2001 by a number of firms of independent chartered surveyors.

(ii) Investments in Group undertakings

| | Shares £m | Loans £m | Total £m |
|-------------------------------------|--------------|--------------|--------------|
| Parent company | | | |
| At 1 January 2001 | 932.4 | 672.0 | 1,604.4 |
| Acquired – Union Fund Management | 6.2 | - | 6.2 |
| – Scottish Life subsidiaries | 46.5 | 94.6 | 141.1 |
| Additional share capital subscribed | 3.0 | - | 3.0 |
| Effect of UAG Schedule 2C transfer | (889.7) | (576.9) | (1,466.6) |
| Impairment | (5.3) | - | (5.3) |
| Repayment of capital | (0.8) | - | (0.8) |
| As at 31 December 2001 | 92.3 | 189.7 | 282.0 |

The Schedule 2C transfer of the UAG life businesses has resulted in a reduction in carrying value of UAG and its intermediate holding companies of £1,466.6m. Assets in excess of the carrying value were transferred under the Schedule 2C agreement and this, together with the PVIF and goodwill of the acquired group, are now recognised within the Parent company.

(iii) Other financial investments

| | Group | | Parent company | |
|---|-----------------|-----------------|-----------------|----------------|
| | 2001 £m | 2000 £m | 2001 £m | 2000 £m |
| At current value: | | | | |
| Shares and other variable-yield securities and units in unit trusts | 9,061.7 | 10,012.2 | 9,039.4 | 4,066.4 |
| Debt securities and other fixed income securities | 5,089.5 | 1,710.0 | 5,058.1 | 539.2 |
| Loans secured by policies | 47.0 | 50.6 | 47.0 | 23.6 |
| Deposits with credit institutions | 246.4 | 172.0 | 231.1 | - |
| Other | 35.7 | 0.6 | 35.7 | 0.6 |
| | 14,480.3 | 11,945.4 | 14,411.3 | 4,629.8 |
| At cost: | | | | |
| Shares and other variable-yield securities and units in unit trusts | 7,014.1 | 5,956.5 | 6,991.8 | 2,458.0 |
| Debt securities and other fixed income securities | 5,072.9 | 1,631.2 | 5,041.4 | 507.1 |
| Loans secured by policies | 47.0 | 50.6 | 47.0 | 23.6 |
| Deposits with credit institutions | 246.4 | 172.0 | 231.1 | - |
| Other | 35.7 | 0.6 | 35.7 | 0.6 |
| | 12,416.1 | 7,810.9 | 12,347.0 | 2,989.3 |

Investments acquired as part of acquisitions of companies (or transferred in accordance with Schedule 2C of the Insurance Companies Act 1982), are shown at their original cost to the transferring company.

Listed investments at market value (included in the above):

| | | | | |
|---|-----------------|-----------------|-----------------|----------------|
| Shares and other variable-yield securities and units in unit trusts | 8,941.2 | 9,927.1 | 8,918.9 | 4,065.5 |
| Debt securities and other fixed income securities | 5,046.2 | 1,708.8 | 5,015.1 | 538.0 |
| | 13,987.4 | 11,635.9 | 13,934.0 | 4,603.5 |

| | Group | Parent company |
|---|--------------|----------------|
| | £m | £m |
| 12. Present value of acquired in-force business | | |
| Cost: | | |
| At 1 January 2001 | 543.9 | - |
| Reassessment of provisional values (see note 23(iii)) | 3.0 | - |
| UAG Schedule 2C transfer (see note 24) | - | 526.4 |
| PVIF realised under UAG Schedule 2C transfer (see note 4) | (164.3) | (164.3) |
| Scottish Life acquisition (see note 23) | 479.5 | 479.5 |
| At 31 December 2001 | 862.1 | 841.6 |
| Amortisation: | | |
| At 1 January 2001 | 20.5 | - |
| Amortisation for the year | 20.8 | 20.8 |
| At 31 December 2001 | 41.3 | 20.8 |
| Net book value, 31 December 2001 | 820.8 | 820.8 |
| Net book value, 31 December 2000 | 523.4 | - |

The amount described as 'PVIF realised under UAG Schedule 2C transfer' of £164.3m reflects an amount transferred to the Royal London fund from the acquired United Assurance Group fund for future appropriations which had already been recognised by Royal London in the PVIF acquired. This reduces the consolidated fund for future appropriations and PVIF.

| | Group | | Parent company | |
|--|------------|------------|----------------|------------|
| | 2001 £m | 2000 £m | 2001 £m | 2000 £m |
| 13. Assets held to cover linked liabilities | | | | |
| At valuation | 5,004.4 | 1,542.7 | 4,020.7 | 236.7 |
| At cost | 4,545.0 | 1,124.6 | 3,530.0 | 232.2 |

| | Group | | Parent company | |
|-------------------------------------|-------------|-------------|----------------|-------------|
| | 2001 £m | 2000 £m | 2001 £m | 2000 £m |
| 14. Debtors | | | | |
| Other debtors | | | | |
| Amounts due from Group undertakings | - | - | 22.3 | 39.8 |
| Tax recoverable | - | 0.7 | - | 0.7 |
| Outstanding sales of investments | 9.1 | 15.7 | 0.6 | 1.8 |
| Dividends receivable | 13.2 | 8.7 | 16.3 | 8.7 |
| Other | 65.6 | 25.6 | 42.3 | 16.6 |
| | 87.9 | 50.7 | 81.5 | 67.6 |

Notes to the financial statements *continued*

for the year ended 31 December 2001

| | Computer and office equipment £m | Motor vehicles £m | Total £m |
|---|--|-------------------------|-------------|
| 15. Tangible assets | | | |
| Group | | | |
| Cost: | | | |
| At 1 January 2001 | 27.1 | 21.3 | 48.4 |
| Acquisitions | 10.9 | 2.8 | 13.7 |
| Additions | 3.6 | 0.4 | 4.0 |
| Disposals | (1.9) | (14.6) | (16.5) |
| At 31 December 2001 | 39.7 | 9.9 | 49.6 |
| Depreciation: | | | |
| At 1 January 2001 | 22.9 | 12.8 | 35.7 |
| Charge for the year | 4.2 | 3.5 | 7.7 |
| Disposals | (0.6) | (12.3) | (12.9) |
| At 31 December 2001 | 26.5 | 4.0 | 30.5 |
| Net book value, 31 December 2001 | 13.2 | 5.9 | 19.1 |
| Net book value, 31 December 2000 | 4.2 | 8.5 | 12.7 |
| Parent company | | | |
| Cost: | | | |
| At 1 January 2001 | 25.0 | 15.2 | 40.2 |
| Acquisitions | 9.4 | 2.7 | 12.1 |
| Disposals – intra-group | (34.4) | (17.9) | (52.3) |
| At 31 December 2001 | - | - | - |
| Depreciation: | | | |
| At 1 January 2001 | 21.7 | 12.5 | 34.2 |
| Disposals – intra-group | (21.7) | (12.5) | (34.2) |
| At 31 December 2001 | - | - | - |
| Net book value, 31 December 2001 | - | - | - |
| Net book value, 31 December 2000 | 3.3 | 2.7 | 6.0 |

The Parent company transferred all tangible assets to a subsidiary, Royal London Management Services Limited, at net book value during the year ended 31 December 2001.

| | Long-term business provisions £m | Claims outstanding £m | Linked liabilities £m | Fund for future appropriations £m |
|--|---|-----------------------------|-----------------------------|--|
| 16. Technical provisions and fund for future appropriations | | | | |
| Group | | | | |
| At 1 January 2001 as previously stated | 9,209.5 | 60.4 | 1,533.7 | 4,546.4 |
| Prior year adjustment (see note 30) | - | - | - | 76.6 |
| At 1 January 2001 as restated | 9,209.5 | 60.4 | 1,533.7 | 4,623.0 |
| Scottish Life acquisition (see note 23) | 5,552.7 | 19.1 | 3,590.1 | 1,138.8 |
| Reassessment of provisional values (see note 23(iii)) | (72.4) | - | - | 36.6 |
| Change in the year | (355.2) | (14.1) | (158.5) | (2,039.5) |
| At 31 December 2001 | 14,334.6 | 65.4 | 4,965.3 | 3,758.9 |
| Parent company | | | | |
| At 1 January 2001 as previously stated | 4,274.3 | 17.4 | 234.8 | 2,660.9 |
| Prior year adjustment (see note 30) | - | - | - | 46.3 |
| At 1 January 2001 as restated | 4,274.3 | 17.4 | 234.8 | 2,707.2 |
| UAG Schedule 2C transfer (see note 24) | 4,935.2 | 8.5 | 1,298.9 | 2,623.2 |
| Reassessment of provisional values (see note 23(iii)) | (72.4) | - | - | 36.6 |
| Acquisitions | 5,549.6 | 19.1 | 2,558.8 | 1,138.8 |
| Change in the year | (355.5) | 1.7 | (123.0) | (2,736.0) |
| At 31 December 2001 | 14,331.2 | 46.7 | 3,969.5 | 3,769.8 |

The closing balance on the fund for future appropriations of the Group and Parent company includes amounts attributable to the Scottish Life and Refuge Assurance ordinary branch with-profits sub-funds, and are stated after including a net pension scheme asset of £268.0m (2000 £212.8m) – Group; £268.0m (2000 £46.3m) – Parent company.

Claims outstanding includes provisions for long-term and general insurance business.

| | Group | | | Parent company | | |
|---|--------------------|-------------|--------------|--------------------|-------------|--------------|
| | Deferred Tax £m | Other £m | Total £m | Deferred Tax £m | Other £m | Total £m |
| 17. Provisions for other risks and charges | | | | | | |
| At 1 January 2001 | 430.2 | 36.4 | 466.6 | 151.8 | 22.9 | 174.7 |
| UAG Schedule 2C transfer | - | - | - | 282.2 | 4.3 | 286.5 |
| Utilised (including unwind of discount) | - | (24.7) | (24.7) | - | (21.3) | (21.3) |
| Acquisition (see note 23) | 13.8 | - | 13.8 | 13.8 | - | 13.8 |
| (Credit)/charge for the year | (322.5) | 3.6 | (318.9) | (322.3) | 0.6 | (321.7) |
| At 31 December 2001 | 121.5 | 15.3 | 136.8 | 125.5 | 6.5 | 132.0 |

| | Group | | Parent company | |
|---|---------------|---------------|----------------|---------------|
| | 2001 £m | 2000 £m | 2001 £m | 2000 £m |
| (i) Deferred tax provided in the financial statements comprises: | | | | |
| Deferred acquisition costs | (4.6) | (3.8) | (4.6) | 1.0 |
| Capital allowances | (4.1) | - | 0.7 | - |
| UAG Schedule 2C transfer | (45.9) | - | (45.9) | - |
| Short-term timing differences | - | (7.0) | - | (11.2) |
| Revaluation of investments | 164.7 | 411.3 | 163.9 | 136.4 |
| Capital gains tax on unit trust deemed disposals | 11.4 | 29.7 | 11.4 | 25.6 |
| | 121.5 | 430.2 | 125.5 | 151.8 |
| Impact of discounting above provisions | (29.3) | (75.0) | (28.5) | (26.5) |

The impact of discounting has been calculated with reference to the historical pattern of emergence of gains from the investment funds and the likely pattern of future realisations.

The amount described as 'UAG Schedule 2C transfer' reflects the present value at end 2001 of future tax savings in the long-term funds of the United Assurance Group following the transfer of the funds to the Company under Schedule 2C of the Insurance Companies Act 1982.

| | Restructuring provision £m | Surplus offices £m | Other £m | Total £m |
|------------------------------|----------------------------------|--------------------------|-------------|-------------|
| (ii) Other provisions | | | | |
| Group | | | | |
| At 1 January 2001 | 21.8 | 10.4 | 4.2 | 36.4 |
| Utilised | (20.8) | (4.3) | (0.2) | (25.3) |
| Unwinding of discount | - | 0.6 | - | 0.6 |
| Charged in the year | - | 3.3 | 0.3 | 3.6 |
| At 31 December 2001 | 1.0 | 10.0 | 4.3 | 15.3 |
| Parent company | | | | |
| At 1 January 2001 | 20.2 | 2.7 | - | 22.9 |
| UAG Schedule 2C transfer | - | 4.3 | - | 4.3 |
| Utilised | (20.2) | (1.5) | - | (21.7) |
| Unwinding of discount | - | 0.4 | - | 0.4 |
| Charged in the year | - | 0.6 | - | 0.6 |
| At 31 December 2001 | - | 6.5 | - | 6.5 |

The provision for surplus offices is in respect of sales/administration offices which have been closed and for which the Group retains lease commitments. These commitments will not be closed out in full for a number of years and the provision, therefore, represents the discounted value of the expected future payments. The impact of the discount applied was not material.

Notes to the financial statements *continued*

for the year ended 31 December 2001

| | Group | | Parent company | |
|---|--------------|------------|----------------|------------|
| | 2001 £m | 2000 £m | 2001 £m | 2000 £m |
| 18. Other creditors including taxation and social security | | | | |
| Amounts owed to credit institutions | 90.3 | 3.8 | 50.7 | – |
| Loan stock | 11.7 | 16.8 | – | – |
| Amounts owed to subsidiary undertakings | – | – | 76.5 | 2.6 |
| Tax payable | 35.2 | 114.1 | 23.0 | 60.9 |
| Other creditors including social security | 100.9 | 46.9 | 71.8 | 23.9 |
| | 238.1 | 181.6 | 222.0 | 87.4 |

The loan stock was issued at par and is redeemable at par by the Company at any time. It is unsecured and interest is payable six monthly in arrears at a rate per annum of 0.75% below LIBOR at the start of each interest period. Loan note holders can only redeem the loan stock at the start of each six monthly interest period.

Amounts owed to credit institutions fall due for payment as follows:

| | Group | | Parent company | |
|---|-------------|------------|----------------|------------|
| | 2001 £m | 2000 £m | 2001 £m | 2000 £m |
| Less than one year | 34.0 | 3.8 | 28.4 | – |
| More than one year but less than five years | 56.3 | – | 22.3 | – |
| | 90.3 | 3.8 | 50.7 | – |

The remaining balances above are all due within one year.

19. Subordinated liabilities

On 28 November 1996 Scottish Life Finance plc, now a wholly owned subsidiary of The Royal London Mutual Insurance Society Limited, issued £125m 9% Undated Subordinated Guaranteed Bonds. Under the terms of the Schedule 2C agreement for the transfer of Scottish Life an amount equal to the value of the Bonds was transferred to The Royal London Mutual Insurance Society Limited on the same interest, repayment and subordination terms as those applicable to the Bonds. The Bonds are guaranteed by The Royal London Mutual Insurance Society Limited.

20. Stock lending

At the year end, the Parent company had entered into various contractual arrangements whereby certain of its investments with a value of £1,313.8m (2000 £775.9m) were on loan to market makers on a temporary basis in return for the payment of interest. Collateral held exceeded the value of the stocks loaned. Income arising from such activities amounted to £1.4m (2000 £1.5m).

21. Cost of bonuses

Total surplus arising in the year which has been allocated by way of regular bonuses, valued on the assumptions set out in note 22 or paid out as interim and terminal bonuses on claims amounted to £589.5m (2000 £630.4m), including a special bonus in respect of Industrial Branch business in run-off of £nil (2000 £32.6m).

22. Long-term business provision

The principal assumptions used in determining the long-term business provision for the main classes of business were as follows:

| 2001 Class of business | Mortality | Interest per annum % |
|---------------------------------------|---|----------------------------|
| Ordinary long-term, non-linked | | |
| Assurances | | |
| Royal London Mutual | AM80 minus two years and AF80 minus one year | 2.750 |
| Ex-United Assurance Group | AM80 | 2.750 |
| Ex-Scottish Life | AM80 minus one year | 2.750 |
| Pensions – deferred annuities | | |
| Ex-United Assurance Group | AM80 minus two years in deferment | 3.000 |
| | IM80C30 minus two years and IF80C30 minus three years in payment | 4.125 |
| Ex-Scottish Life – individual | AM80 minus three years in deferment | 4.000 |
| | IM80C20 minus three years and IF80C20 minus three years in payment | 4.125 |
| – group | PMA80C25 minus three years and PFA80C25 minus three years in payment | 4.125 |
| Pensions – pure endowment | | |
| Ex-United Assurance Group | Nil | 3.000 |
| Pensions – individual in payment | | |
| Royal London Mutual | IM80C20 minus two years and IF80C20 minus three years | 4.875 |
| Ex-United Assurance Group | IM80C20 minus two years and IF80C20 minus three years | 4.875 |
| Ex-Scottish Life | IM80C20 minus three years and IF80C20 minus three years | 4.875 |
| Pensions – Group in payment | | |
| Ex-Scottish Life | PMA80C25 minus three years and PFA80C25 minus three years | 4.875 |
| Industrial assurance | | |
| Royal London Mutual | ELT15 (males) minus three years | 2.750 |
| Ex-United Assurance Group | ELT15 (males) | 2.750 |

Unit-linked business provisions are calculated as the fund value. Accumulating with-profits provisions are calculated as the greater of the present value of projected future benefits and renewal expenses under the contract, determined on consistent assumptions to those shown above, and the cash value of the contract reduced by any permitted discretionary adjustments.

Assumed interest rates on Assurances and Deferred Pensions are set by reference to market yields at the balance sheet date on investments held within the Long-Term Fund. During 2001, yields on equities rose as market values fell and yields on debt securities and other fixed income securities also increased. Consequently, assumed interest rates on these classes of business have been increased by 0.5% per annum.

Mortality bases are reviewed periodically to ensure that assumptions remain appropriate, taking into account company and industry experience for each class of business. Following a review undertaken during 2001, annuitant mortality has been strengthened reflecting industry-wide expectations of further improvements in life expectancy. The Ex-United Assurance Group assurance mortality basis has also been amended to reflect improved experience for these classes of business.

The provision for Guaranteed Annuity Rates (GARs) in respect of acquired Scottish Life Business has been calculated as £474m. This has been calculated as the additional cost of converting projected fund values to annuities on guaranteed rates, for those policyholders electing to do so, over annuities purchased on the anticipated interest and mortality assumptions described in the table above. In performing this calculation, it has been assumed that 80% of projected values will be converted on GAR terms, reflecting policyholders' ability to take tax-free lump sums which can often lead to higher after tax income.

The long-term business provision includes £143m (2000 £347m) in respect of guarantees, redress payments and expenses outstanding under the Pensions Review.

Notes to the financial statements *continued*

for the year ended 31 December 2001

22. Long-term business provision (continued)

| 2000 Class of business | Mortality | Interest per annum % |
|---------------------------------------|--|----------------------------|
| Ordinary long-term, non-linked | | |
| Assurances | | |
| Royal London Mutual | AM80 minus two years and AF80 minus one year | 2.25 |
| Ex-United Assurance Group | A67-70 | 2.25 |
| Pensions – deferred annuities | A67-70 minus four years in deferment | 2.50 |
| | IM80C20 minus two years and IF80C20 minus one year in payment | 4.00 |
| Pensions – pure endowment | Nil | 2.50 |
| Pensions in payment | | |
| Royal London Mutual | IM80C10 minus two years and IF80C10 minus two years | 4.25 |
| Ex-United Assurance Group | IM80C10 minus two years and IF80C10 minus one year | 4.25 |
| Industrial assurance | | |
| Royal London Mutual | ELT15 (males) minus three years | 2.25 |
| Ex-United Assurance Group | ELT15 (males) | 2.25 |

Unit-linked business and accumulating with-profits provisions are calculated as the fund value.

23. Acquisitions

(i) Scottish Life

On 2 October 2000, Royal London and Scottish Life entered into an agreement providing the transfer of Scottish Life's business to Royal London. With effect from 1 July 2001, the Court of Session in Scotland, sanctioned a scheme, under Section 49 of, and Part 1 of Schedule 2C to, the Insurance Companies Act 1982, under which the long-term business of Scottish Life was transferred to Royal London.

As part of the transfer, a new sub-fund of the Royal London fund was formed, for the benefit of Scottish Life with-profits policyholders. The Group has used acquisition accounting to account for the transaction. The table below summarises the assets and liabilities transferred to Royal London, the fair value adjustments made at the date of the transfer and the creation of the Scottish Life sub-fund within the long-term business fund of Royal London.

As permitted under FRS 7 'Fair Values in Acquisition Accounting', the fair value of the assets acquired may be re-assessed in the instance of further information arising in the period of one year from the date of acquisition.

23. Acquisitions (continued)

Analysed as follows:

| | Book value before acquisition £m | Revaluation £m | Alignment of accounting policies £m | Other adjustments £m | Fair value to the Group £m | Scottish Life sub-fund £m | Fair value of remaining assets acquired £m |
|---|---|-------------------|--|----------------------------|--|------------------------------------|---|
| Investments | 5,885.5 | – | – | – | 5,885.5 | 4,952.0 | 933.5 |
| Present value of acquired in-force business (PVIF) (a) | – | 479.5 | – | – | 479.5 | – | 479.5 |
| Assets held to cover linked liabilities | 3,647.2 | – | – | – | 3,647.2 | 108.6 | 3,538.6 |
| Deferred acquisition costs (b) | 247.7 | (137.3) | – | – | 110.4 | 110.4 | – |
| Tangible assets | 13.3 | – | – | – | 13.3 | – | 13.3 |
| Other assets | 324.8 | – | – | – | 324.8 | 149.7 | 175.1 |
| Pension scheme surpluses (c) | – | – | 48.1 | – | 48.1 | – | 48.1 |
| Long-term business provision and claims outstanding | (5,571.8) | – | – | – | (5,571.8) | (4,705.6) | (866.2) |
| Technical provision for linked liabilities | (3,590.1) | – | – | – | (3,590.1) | (126.6) | (3,463.5) |
| Other liabilities (d) | (421.5) | – | (13.8) | – | (435.3) | (83.6) | (351.7) |
| Fund for future appropriations | (535.1) | 137.3 | 13.8 | (754.8) | (1,138.8) | (1,138.8) | – |
| Net assets | – | 479.5 | 48.1 | (754.8) | (227.2) | (733.9) | 506.7 |
| Consideration: | | | | | | | |
| Cash (including acquisition costs) | | | | | | – | (122.5) |
| Transfer of assets from the Royal London Fund to the Scottish Life sub-fund | | | | | | 733.9 | (733.9) |
| Goodwill | | | | | | – | 349.7 |

Goodwill arising on the transaction has been calculated by reference to the net assets acquired after the formation of the Scottish Life sub-fund. Although all assets and liabilities of Scottish Life are transferred to Royal London, it is a requirement of the scheme that the assets and liabilities transferred to the Scottish Life sub-fund are retained for the benefit of the Scottish Life with-profits policyholders as at the date of the transfer.

The fair value adjustments made to the book value of the assets and liabilities of Scottish Life as at the date of transfer are as follows:

- (a) The present value of in-force business (PVIF) has been provisionally valued and recognised as an asset (£479.5m) in accordance with the requirements of the Statement of Recommended Practice issued by the Association of British Insurers in December 1998. The principal assumptions underlying the calculation of the PVIF were as follows:

| | % |
|--|------|
| Future investment returns (pre-tax) | |
| – Government fixed interest securities | 5.30 |
| – Ordinary shares | 7.53 |
| – Property | 7.80 |
| Expense inflation | 3.54 |
| Discount rates | |
| – Non-linked business | 8.30 |
| – Linked business | 8.30 |

The assumed future pre-tax return on fixed interest securities is set by reference to redemption yields available in the market. The corresponding returns on ordinary shares and property are set by reference to this rate.

- (b) The value of deferred acquisition costs, held as an asset on the balance sheet of Scottish Life, has been written down by that amount which is inherent in the PVIF values (£137.3m).
- (c) The revaluation of the pension scheme surplus represents the excess of assets over pension liabilities in the Scottish Life pension schemes as at the date of the acquisition recognised in accordance with FRS 17 (see note 29).
- (d) The adjustment to other liabilities reflects the implementation of FRS 19, Deferred Tax, within Scottish Life and the consequent recognition of a deferred tax liability in respect of unrealised gains on investments.
- (e) Other adjustments comprise the transfer to the fund for future appropriations relating to the Scottish Life sub-fund arising out of the contribution required to be made from the Royal London Long-Term Business Fund. This consists of the gross contribution of £733.9m and:
- adding the excess of assets of £54.4m transferred into the Scottish Life closed fund as calculated on a regulatory basis as compared to the assets transferred on a modified statutory account basis in accordance with the scheme agreement.
 - deducting the value of net assets of Scottish Life (before fair value adjustments) acquired by Royal London of £33.5m.

Notes to the financial statements *continued*

for the year ended 31 December 2001

23. Acquisitions (continued)

In the financial year to 31 December 2000, Scottish Life transferred £359.7m from the fund for future appropriations. For the period to the acquisition, the summarised technical account for Scottish Life is set out below. Also set out below is the impact of the acquisition on the consolidated technical account of the Group for the current year.

| | Scottish Life six months to 30 June 2001 £m | Scottish Life acquisition six months to 31 Dec 2001 £m | Royal London year ended 31 Dec 2001 £m | Group Total £m |
|--|--|--|---|----------------------|
| Earned premiums, net of reinsurance | 575.2 | 571.7 | 819.8 | 1,391.5 |
| Investment income | 266.2 | 89.6 | 696.9 | 786.5 |
| Other technical income, net of reinsurance, including amortisation of negative goodwill | 1.8 | 10.7 | 31.5 | 42.2 |
| Claims incurred, net of reinsurance | (311.8) | (431.1) | (1,225.6) | (1,656.7) |
| Change in other technical provisions, net of reinsurance | 146.8 | (35.2) | 549.8 | 514.6 |
| Net operating expenses | (79.4) | (72.8) | (88.8) | (161.6) |
| Investment expenses and charges | (10.3) | (12.5) | (29.1) | (41.6) |
| Unrealised losses on investments | (795.8) | (470.5) | (2,417.2) | (2,887.7) |
| Other technical charges, including amortisation of PVIF and positive goodwill | - | - | (253.5) | (253.5) |
| Tax attributable to long-term business | 8.5 | (21.2) | 328.0 | 306.8 |
| Pension schemes losses after tax | - | - | (80.0) | (80.0) |
| Transfer from the fund for future appropriations | 198.8 | 371.3 | 1,668.2 | 2,039.5 |
| Balance on the technical account – long-term business | - | - | - | - |

There were no recognised gains or losses other than the profit for the period.

The accounts of Scottish Life can be obtained from The Royal London Mutual Insurance Society Limited's registered office at Royal London House, Middleborough, Colchester, Essex CO1 1PP.

(ii) Union Fund Management

In May 2001, the Group acquired Union Fund Management Limited for a consideration, including acquisition costs, of £6.2m, generating goodwill of £4.7m. Payment of £2.2m of the consideration is deferred until May 2002, and is contingent on the retention of certain significant clients.

(iii) Prior Year Acquisition

On 18 April 2000, the Group purchased the entire issued share capital of United Assurance Group plc. As permitted under FRS 7, 'Fair Values in Acquisition Accounting' the fair value of the net assets acquired has been reassessed and the resultant difference has been taken as an adjustment to goodwill on acquisition. Amended and provisional values of the net assets acquired are as follows and the explanations for the amendments are given in the notes below.

| | Provisional Value 2000 £m | Adjustments £m | Amended Value 2000 £m |
|--|------------------------------------|-------------------|--------------------------------|
| Investments | 7,942.2 | - | 7,942.2 |
| Present value of acquired in-force business | 543.9 | 3.0 | 546.9 |
| Assets held to cover linked liabilities | 1,263.9 | - | 1,263.9 |
| Deferred acquisition costs | 165.2 | - | 165.2 |
| Other assets | 170.0 | - | 170.0 |
| Pension scheme surpluses | 136.2 | (27.2) | 109.0 |
| Fund for future appropriations | (1,935.9) | (9.4) | (1,945.3) |
| Long-term business provisions and claims outstanding | (4,865.1) | 72.4 | (4,792.7) |
| Technical provisions for linked liabilities | (1,255.0) | - | (1,255.0) |
| Other liabilities | (633.8) | - | (633.8) |
| Net assets acquired | 1,531.6 | 38.8 | 1,570.4 |
| Goodwill | 25.6 | (38.8) | (13.2) |
| Cost of acquisition | 1,557.2 | - | 1,557.2 |

23. Acquisitions (continued)

Notes:

(a) The adjustment to the value of pension scheme surpluses arises from the recognition of the value of the surpluses, net of related deferred tax. The surpluses were provisionally valued gross of deferred tax. The pension scheme surpluses were recognised as policyholder assets and the adjustment is, therefore, also made to the fund for future appropriations.

(b) Included in the acquired long-term business provisions were amounts provided for the Pensions Review and the Historic Business Review. As a result of improved information these provisions have been reassessed and accordingly, an adjustment of £72.4m has been made. Of this amount, £36.6m is credited to the fund for future appropriations with the remaining amount of £35.8m credited to the acquired goodwill. The increase in the fund for future appropriations of £36.6m has a consequent impact on the PVIF of £3.0m.

(c) The adjustment to the fund for future appropriations is the aggregate of the adjustments outlined in notes (a) and (b) above.

(d) The goodwill adjustment is a reflection of the amended fair values detailed above.

24. Transfers under Schedule 2C Schemes

(i) United Assurance Group plc

On 1 January 2001, the long-term business and the related assets and liabilities of the life assurance companies within the United Assurance Group, were transferred to The Royal London Mutual Insurance Society Limited ('RLMISL'), under transfers made in accordance with Schedule 2C of the Insurance Companies Act 1982. There was no consideration paid in respect of these transfers. The net effect of the transfers was to increase the net assets of RLMISL by £963.6m.

(ii) The Scottish Life Assurance Company

On 1 July 2001, the long-term business and the related assets and liabilities of The Scottish Life Assurance Company were acquired by RLMISL by means of a transfer made in accordance with Schedule 2C of the Insurance Companies Act 1982. The effect of the transfer was to increase both the long-term assets and the long-term technical provisions (including the fund for future appropriations), of RLMISL by £10,118m (see note 23).

25. Commitments

(i) Capital expenditure

Capital expenditure relating to investment expenditure contracted for, but not provided for, at the balance sheet date amounted to £31.9m (2000 £107.3m).

| | Group | | Parent company | |
|--|------------|------------|----------------|------------|
| | 2001 £m | 2000 £m | 2001 £m | 2000 £m |
| (ii) Lease commitments in respect of land and buildings | | | | |
| Annual commitments which expire: | | | | |
| Up to one year | 1.1 | 0.3 | 1.0 | – |
| In the second to fifth years | 2.5 | 1.2 | 2.2 | 0.2 |
| In more than five years | 5.8 | 3.8 | 2.0 | 2.7 |
| | 9.4 | 5.3 | 5.2 | 2.9 |

Notes to the financial statements *continued*

for the year ended 31 December 2001

26. Principal subsidiary undertakings

The following represents the principal subsidiary undertakings of the Group as at 31 December 2001. All undertakings shown are wholly owned, are incorporated in Great Britain and have been included in the Group financial statements. A full list of all wholly owned subsidiaries is included in the Company's annual return to Companies' House.

| | Nature of business |
|---|---------------------------|
| Royal London Asset Management Limited | Investment management |
| The Royal London Unit Trust Managers Limited | Unit Trust management |
| Royal London Savings Limited | ISA management |
| The Royal London General Insurance Company Limited | General insurance |
| Royal London Management Services Limited | Administration services |
| Scottish Life International Insurance Company | Life assurance |
| Scottish Life Investment Management Company Limited | Unit Trust management |

Significant holdings in other companies

As at 31 December 2001 Royal London held an investment of 29.67% of the equity share capital of Leopold Joseph Holdings Public Limited Company. This company has not been treated as an associated undertaking because the Group has not exerted significant influence over the affairs of the company. This holding is the only investment that exceeds 20% of the equity share capital of a company and has been included in the investments shown in the consolidated balance sheets on pages 32 and 33.

As at 31 December 2001, Royal London held investments exceeding 10% but less than 20% of a class of equity share capital in the following companies and these too have been included in the investments shown in the consolidated balance sheets on pages 32 and 33. Britannic plc (12.27%), Invesco English and International Trust plc (14.29%), Govett High Income Investment Trust plc (11.96%), The Throgmorton Trust plc (11.33%), Finsbury Smaller Quoted Companies Trust plc (11.15%), Framlington Innovative Growth Trust plc (10.94%), The Smaller Companies Investment Trust plc (10.70%), London Scottish Bank plc (13.44%) and Personal Group Holdings plc (10.95%).

27. Contingent liabilities

(i) Exchangeable deferred shares

Under the terms of the offer to acquire the United Assurance Group, holders of convertible deferred shares (CDS) were offered exchangeable deferred shares (EDS) by RLM Finance as consideration for CDS. The terms of the EDS are the same as the CDS. In the absence of an attribution of surplus from the Refuge Assurance ordinary branch with-profits sub-fund, the EDS issued will expire on 31 December 2004 with no value. In the instance of an attribution, any amount payable would be funded from the Refuge Assurance ordinary branch with-profits sub-fund and impact accordingly the value of the fund for future appropriations. Following a Schedule 2C agreement during the year, the Refuge Assurance ordinary branch with-profits sub-fund is now a sub-fund of the Parent company fund. The nominal value of the EDS in issue at the year end 2001 was £4.8m (2000 £4.8m) and this has been included in the fund for future appropriations.

The Company has begun an investigation into the feasibility of effecting a change in the basis of its participation in the surplus retained within the Refuge Assurance ordinary branch with-profits sub-fund. Such a change, if effected, would constitute a 'Release Event' as defined under the terms of the EDS issued by RLM Finance at the time of the acquisition of the United Assurance Group. A Release Event would lead to the conversion of EDS into interest bearing loan notes, guaranteed by RLM Finance Bonds. The potential value of such loan notes cannot be estimated with any reliability at this stage.

(ii) Regulatory reviews

During the year the Group continued to address issues from past inappropriate selling practices. While incomplete, these reviews have progressed satisfactorily and appropriate provisions have been made based on the currently envisaged scope. In common with many other insurance companies, reviews of endowment sales are continuing and the Group is in the process of evaluating the results of the initial investigations which may lead to some corrective action, the cost of which is not currently capable of evaluation. Fines were levied by the Financial Services Authority on United Assurance Group companies and The Royal London Mutual Insurance Society Limited of £700,000 and £400,000 respectively during 2001.

28. Related party transactions

(i) Subsidiary undertakings' transactions with unit trust funds

The Royal London Unit Trust Managers Limited (RLUTM) and Scottish Life Investment Management Services Limited (SLIM) operate as the unit trust managers for all the unit trust business marketed by the Group. During the year RLUTM earned £17.6m (2000 £9.4m) in management fees from the unit trusts and at 31 December 2001 an amount of £1.5m (2000 £1.9m) was outstanding from the unit trusts to RLUTM. During the six month period from 1 July 2001, the date of acquisition, SLIM earned £10.6m in management fees from the unit trusts and at 31 December 2001 an amount of £1.8m was outstanding from the unit trusts to SLIM. The total value of units held by the Parent company at 31 December 2001 was £3,686.4m (2000 £791.2m).

(ii) Transactions with Royal London Growth and Income Trust

The Royal London Growth and Income Trust plc (the Trust) was created in 2000 and loan note holders of RLM Finance plc were given the option of exchanging these loan notes in favour of an investment in the Trust, which is managed by Royal London Asset Management (RLAM). During the year RLAM earned £1.5m (2000 £0.3m) in management fees from the Trust and at 31 December 2001, an amount of £0.4m (2000 £0.3m) was outstanding from the Trust.

29. Pension schemes

a) Summary

The Group operates a number of funded, defined benefit pension schemes covering the majority of its employees. There are currently four principal schemes: the Royal London Group Pension Scheme (incorporating the Refuge Assurance Superannuation Fund and the United Assurance Group Pension Scheme), The Royal London Staff Pension Fund, the United Friendly Group Pension Scheme and the Scottish Life Officers' Retirement Benefits Scheme.

From the date of acquisition of the United Assurance Group in April 2000, substantially all relevant new employees have joined the Royal London Group Pension Scheme.

On 1 December 2001, the future service benefit accrual of all existing members of The Royal London Staff Pension Fund, the United Friendly Group Pension Scheme and the Scottish Life Officers' Retirement Benefits Scheme was transferred to the Royal London Group Pension Scheme. As a result, the surpluses of £151.5m in the funds (other than that in the Royal London Group Pension Scheme), were no longer considered to be recoverable out of future contributions and have, therefore, not been recognised in the Group financial statements. However, the transfer and resulting increase in membership of the Royal London Group Pension Scheme has significantly enhanced the ability of the Group to recover the surplus previously unrecognised in that scheme, resulting in a net increase of £112.3m in the amount of the overall pension asset being recognised (see note 29(c)(ii)). In accordance with FRS 17, this increase has been recognised as an operating gain and treated as a reduction in net operating expenses and shown as an exceptional item in note 5.

Details of the latest valuation of the principal schemes are given below. All schemes were valued on 31 December 2001 using the projected unit method.

| | Royal London Group Pension Scheme | The Royal London Staff Pension Fund | United Friendly Group Pension Scheme | Scottish Life Officers' Retirement Benefits Scheme |
|---|--|--|---|---|
| Last full actuarial valuation date | 31 December 1999 | 31 March 2000 | 31 March 2000 | 31 December 1999 |
| Scheme actuary | Keith Lewis (Watson Wyatt) | David Read (Royal London) | Neil Waring (Watson Wyatt) | Peter Kilgour (Scottish Life) |
| Market value of assets at 31 December 2001 | £675.0m | £353.0m | £457.5m | £206.0m |
| Level of funding | 215% | 93% | 132% | 125% |

The major assumptions used by the scheme actuaries, which were consistently applied across the schemes, were:

| | 2001 % | 2000 % | 1999 % |
|---|-------------------|-------------------|-------------------|
| Inflation assumption | 2.5 | 2.7 | 3.2 |
| Rate of increase in salaries | 4.3 | 4.5 | 5.0 |
| Rate of increase in pensions in payment | 2.5 | 2.7 | 3.2 |
| Discount rate | 5.8 | 6.0 | 6.2 |

No contributions were made by the Group into any of these schemes during 2001 (2000 £1.6m) and it is expected that the Group will make no contributions in the foreseeable future.

Notes to the financial statements *continued*

for the year ended 31 December 2001

29. Pension schemes (continued)

b) Analysis of net pension scheme assets and liabilities

The assets in the scheme, the expected rate of return and net pension assets/(liabilities) were:

At 31 December 2001

| | <i>Expected longer term rate of return</i> | Royal London Group Pension Scheme | United Friendly Group Pension Scheme | Scottish Life Officers' Retirement Benefits Scheme | Total | The Royal London Staff Pension Fund |
|--|--|--|---|---|--------------|--|
| | % | £m | £m | £m | £m | £m |
| Fixed interest bonds | 5.00 | 62.1 | 72.3 | 12.7 | 147.1 | 3.7 |
| Index-linked bonds | 2.40 | 0.4 | 27.8 | 2.0 | 30.2 | - |
| Equities | 7.80 | 592.7 | 318.2 | 166.6 | 1,077.5 | 324.2 |
| Property | 6.50 | - | 28.9 | 18.5 | 47.4 | 24.4 |
| Cash | 4.00 | 19.8 | 10.3 | 6.2 | 36.3 | 0.7 |
| Total market value of assets | | 675.0 | 457.5 | 206.0 | 1,338.5 | 353.0 |
| Present value of scheme liabilities | | 313.6 | 347.0 | 165.0 | 825.6 | 379.4 |
| Surplus/(deficit) in the scheme | | 361.4 | 110.5 | 41.0 | 512.9 | (26.4) |
| Restriction on recoverability of surplus | | - | (110.5) | (41.0) | (151.5) | - |
| Recognised surplus/(deficit) | | 361.4 | - | - | 361.4 | (26.4) |
| Related deferred tax liability | | (72.3) | - | - | (72.3) | 5.3 |
| Net pension scheme asset/(liability) | | 289.1 | - | - | 289.1 | (21.1) |

At 31 December 2000

| | <i>Expected longer term rate of return</i> | The Royal London Staff Pension Fund | Royal London Group Pension Scheme | United Friendly Group Pension Scheme | Total |
|--|--|--|--|---|--------------|
| | % | £m | £m | £m | £m |
| Fixed interest bonds | 4.70 | 12.0 | 64.0 | 88.0 | 164.0 |
| Index-linked bonds | 2.00 | - | - | 28.0 | 28.0 |
| Equities | 7.10 | 404.0 | 715.0 | 381.0 | 1,500.0 |
| Property | 6.50 | 25.7 | 3.0 | 34.0 | 62.7 |
| Cash | 4.00 | (0.8) | 22.5 | 13.0 | 34.7 |
| Total market value of assets | | 440.9 | 804.5 | 544.0 | 1,789.4 |
| Present value of scheme liabilities | | 383.0 | 300.7 | 352.0 | 1,035.7 |
| Surplus in the scheme | | 57.9 | 503.8 | 192.0 | 753.7 |
| Restriction on recoverability of surplus | | - | (350.7) | (137.0) | (487.7) |
| Recognised surplus | | 57.9 | 153.1 | 55.0 | 266.0 |
| Related deferred tax liability | | (11.6) | (30.6) | (11.0) | (53.2) |
| Net pension scheme asset | | 46.3 | 122.5 | 44.0 | 212.8 |

(Included within the heading 'Royal London Group Pension Scheme' are the United Assurance Group Pension Scheme and Refuge Assurance Superannuation Fund.)

In arriving at the restriction on the recoverability of the surplus, management has taken into account the inherent uncertainties in the business environment in which the Group operates and, as a result, have restricted the average period over which they anticipate being able to recover surpluses out of reduced future contributions to the schemes to 20 years.

29. Pension schemes (continued)

At 31 December 1999

| | <i>Expected longer term rate of return %</i> | The Royal London Staff Pension Fund £m |
|-------------------------------------|--|---|
| Fixed interest bonds | 5.10 | 27.6 |
| Index-linked bonds | 1.90 | 1.2 |
| Equities | 7.70 | 420.3 |
| Property | 6.50 | 37.8 |
| Cash | 4.00 | 4.1 |
| Total market value of assets | | 491.0 |
| Present value of scheme liabilities | | 395.5 |
| Surplus in the scheme | | 95.5 |
| Related deferred tax liability | | (19.1) |
| Net pension scheme asset | | 76.4 |

c) Analysis in movements in consolidated profit and loss account

| | 2001 £m | 2000 £m |
|--|--------------------|------------|
| <i>i) Analysis of the amount charged to net operating expenses</i> | | |
| Current service cost | (27.9) | (24.1) |
| Past service cost | - | - |
| Total operating charge | (27.9) | (24.1) |

Past service cost for 2001 has been reduced by £5.0m (2000 £nil) as a result of the use of the unrecognised surplus brought forward in the Royal London Group Pension Scheme.

| | 2001 £m | 2000 £m |
|---|--------------------|------------|
| <i>ii) Analysis of the amount credited to net operating expenses – exceptional item</i> | | |
| Loss arising on non-recognition of surpluses in the United Friendly Group Pension Scheme and Scottish Life Officers' Retirement Benefits Scheme | (151.5) | - |
| Less: previously unrecognised surpluses | 55.5 | - |
| Actual loss arising | (96.0) | - |
| Profit arising on transfer of active service to the Royal London Group Pension Scheme | 208.3 | - |
| Total exceptional items | 112.3 | - |

| | 2001 £m | 2000 £m |
|---|--------------------|------------|
| <i>iii) Analysis of the net expected return on pension assets</i> | | |
| Expected return on pension scheme assets | 136.4 | 120.0 |
| Less: restriction due to unrecognised surpluses | (45.0) | (41.8) |
| | 91.4 | 78.2 |
| Less: interest on pension scheme liabilities | (66.9) | (55.8) |
| Net expected return on pension assets | 24.5 | 22.4 |

The expected return on pension scheme assets is calculated using the investment return assumptions applied to the market value of pension scheme assets as stated in the tables above for the preceding year end. The expected return has been restricted as a result of the existence of unrecognised surpluses in the Royal London Group Pension Scheme and the United Friendly Group Pension Scheme.

Notes to the financial statements *continued*

for the year ended 31 December 2001

29. Pension schemes (continued)

d) Analysis of pension scheme gains and losses after tax

| | 2001 £m | 2000 £m |
|---|----------------|------------|
| <i>i) Summary of experience gains and losses</i> | | |
| Actual return less expected return on pension scheme assets | (414.8) | (226.5) |
| Less: absorbed within unrecognised surpluses brought forward | 263.9 | 125.5 |
| | (150.9) | (101.0) |
| Experience gains arising on the scheme liabilities | 50.9 | 15.1 |
| Changes in assumptions underlying the present value of the scheme liabilities | - | 47.8 |
| Actuarial losses before tax | (100.0) | (38.1) |
| Deferred tax on actuarial gains and losses | 20.0 | 7.6 |
| Actuarial gains and losses after tax | (80.0) | (30.5) |
| Other movements (see below) | - | 58.0 |
| Pension scheme (losses)/gains after tax | (80.0) | 27.5 |

The actual return less expected return on pension scheme assets has been reduced as a result of the use of unrecognised surpluses brought forward in the Royal London Group Pension Scheme and the United Friendly Group Pension Scheme.

| | 2001 £m | 2000 £m |
|---|------------|------------|
| <i>ii) Analysis of other movements</i> | | |
| Increase in amount of recoverable surplus | - | 72.5 |
| Less: deferred tax | - | (14.5) |
| Net effect of changes in recoverability assumptions | - | 58.0 |

The increase in the amount of recoverable surplus arises from a change from 13 to 20 years in the assumption of the average period over which management anticipate being able to recover the pension scheme surplus out of reduced future contributions to the Royal London Group Pension Scheme. This resulted from actions taken after the acquisition of United Assurance Group plc to open up the membership of that scheme to all relevant Group employees. It had previously been assumed that there would be no new members of the scheme and the surplus was restricted to the expected average period of the future service lives of the members of the scheme as at the date of acquisition of the United Assurance Group.

| | Notes | Group | | Parent company | |
|--|------------|----------------|------------|----------------|------------|
| | | 2001 £m | 2000 £m | 2001 £m | 2000 £m |
| e) Movement in surplus during the year before tax | | | | | |
| Recoverable surplus in schemes at beginning of the year | | 266.0 | 95.5 | 57.9 | 95.5 |
| Acquisition of Scottish Life (2000 United Assurance Group plc) | 23 | 60.1 | 136.2 | 60.1 | - |
| Effect of Schedule 2C transfer on 1 January 2001 | | - | - | 208.1 | - |
| Movement in year: | | | | | |
| Total operating charge | 29(c)(i) | (27.9) | (24.1) | (27.9) | (15.0) |
| Exceptional credit | 29(c)(ii) | 112.3 | - | 112.3 | - |
| Contributions | | - | 1.6 | - | 1.6 |
| Net expected return on pension scheme asset | 29(c)(iii) | 24.5 | 22.4 | 24.5 | 13.3 |
| Actuarial losses | 29(d)(i) | (100.0) | (38.1) | (100.0) | (37.5) |
| Other movements | 29(d)(ii) | - | 72.5 | - | - |
| Recoverable surplus in schemes at end of year | | 335.0 | 266.0 | 335.0 | 57.9 |
| Analysed as follows: | | | | | |
| Royal London Group Pension Scheme | | 361.4 | 153.1 | 361.4 | - |
| The Royal London Staff Pension Fund | | (26.4) | 57.9 | (26.4) | 57.9 |
| United Friendly Group Pension Scheme | | - | 55.0 | - | - |
| | | 335.0 | 266.0 | 335.0 | 57.9 |

29. Pension schemes (continued)

| f) History of experience gains and losses (Group) | Notes | 2001 £m | 2001 % | 2000 £m | 2000 % |
|---|----------|--------------------|-------------------|------------|-----------|
| Difference between the expected and actual return on scheme assets as a percentage of scheme assets | 29(d)(i) | (414.8) | (26.0) | (226.5) | (15.8) |
| Experience gains on scheme liabilities | 29(d)(i) | 50.9 | 4.2 | 15.1 | 1.5 |
| Total amount recognised as part of actuarial losses as a percentage of scheme liabilities | 29(d)(i) | (100.0) | (8.3) | (38.1) | (3.7) |

The calculation of the differences between the expected and actual return on scheme assets as a percentage of closing scheme assets has been adjusted to take account of the fact that the acquisitions of the United Assurance Group and Scottish Life took place part way during 2000 and 2001 respectively.

30. Prior year adjustment

As a result of implementing FRS 17, 'Retirement Benefits' early, prior year figures have been restated as follows:

Restatement of 2000 technical account – long-term business (Group)

| | As previously reported £m | Prior year adjustment £m | As restated £m |
|---|------------------------------|-----------------------------|-------------------|
| Net operating expenses – continuing operations | 184.7 | 20.3 | 205.0 |
| Net return on pension scheme assets | – | 22.4 | 22.4 |
| Tax attributable to long-term business | (70.6) | 0.5 | (70.1) |
| Excess of total technical income over technical charges | 171.5 | 1.6 | 173.1 |
| Pension scheme gains and losses after tax | – | 27.5 | 27.5 |
| Transfer to the fund for future appropriations | (171.5) | (29.1) | (200.6) |

Restatement of balances at 1 January 2001

| | Group | | Parent company | |
|---------------------------------|----------------------------|--------------------------------------|----------------------------|--------------------------------------|
| | Pension scheme asset £m | Fund for future appropriations £m | Pension scheme asset £m | Fund for future appropriations £m |
| Balances as previously reported | 136.2 | 4,546.4 | – | 2,660.9 |
| Prior year adjustment | 76.6 | 76.6 | 46.3 | 46.3 |
| Balances as restated | 212.8 | 4,623.0 | 46.3 | 2,707.2 |

The effect of the change in accounting policy has been to decrease the deficit of technical income over technical charges (after tax) for the year ended 31 December 2001 by £87.1m and to decrease the transfer from the fund for future appropriations by £7.1m.

Additional information

for the year ended 31 December 2001

Declared bonuses – Royal London Mutual

The directors have declared annual bonuses for 2001 in respect of with-profits contracts. Examples of the bonuses are set out below together with terminal bonus rates effective from the dates shown.

| | Regular bonus rate | Terminal bonus rate |
|---------------------------|---------------------|---------------------|
| Industrial Branch | 1.0% to 2.0% simple | up to 424.5% |
| Ordinary Branch | | |
| Traditional life business | | |
| – regular premium | 2.5% to 9.0% simple | up to 545.0% |
| – single premium | 1.5% to 5.0% simple | up to 613.2% |
| Personal pensions | | |
| – regular premium | 3.25% compound | up to 156.8% |
| – single premium | 3.25% compound | up to 296.5% |
| ISA business | | |
| – regular premium | 3.0% compound | nil |
| – single premium | 3.0% compound | nil |

The rate for Table 95 personal pensions policies issued before 1 July 1988 is 0.5% compound higher.

Interim bonus for personal pension policies is 2.75% per annum, (3.25% per annum for pre-1 July 1988 Table 95 policies) and for ISA business is 3.0% per annum compound. The directors reserve the right to review interim and final bonus rates at any time.

Terminal bonuses are based on sum assured for Industrial Branch and Ordinary Branch traditional life business, notional fund inclusive of annual bonuses for Ordinary Branch personal pensions and ISAs. These rates apply to policies becoming claims by maturity and death with effect from 1 January 2002.

Declared Bonuses – Ex-Refuge Assurance business

The directors have declared regular bonuses for 2001 in respect of traditional with-profits contracts and for 2002 in respect of unitised with-profits contracts. These are set out below together with terminal bonus rates effective from the dates shown:

| | Regular bonus rate | Terminal bonus rate |
|---|--------------------|--|
| Industrial Branch | 1.0% compound | up to 655.50% |
| Ordinary Branch | | |
| – traditional life regular premium business | 1.0% compound | up to 147.85% |
| – traditional life single premium business | 1.0% compound | up to 87.74% |
| – traditional pensions business | 1.75% compound | up to 404.6% |
| – unitised life business | 4.0% unit value | up to 10.0% unit value (from 13/2/02) |
| – unitised pensions business series 1 | 5.0% unit value | nil |
| – unitised pensions business series 2 | 5.0% unit value | nil |

Interim regular bonuses for OB traditional business are equal to the last declared rate. The directors reserve the right to review them and terminal bonus rates at any time. Terminal bonuses are based on sum assured and attaching regular bonuses for Ordinary Branch traditional life business, sum assured (with-profits annuity for pre-October 1992 pensions contracts) otherwise. These rates apply to policies becoming claims by maturity and death (excluding OB traditional pension business) with effect from 1 January 2002.

Declared Bonuses – Ex-United Friendly Insurance business

The directors have declared regular bonuses for 2001 in respect of traditional with-profits contracts. These are set out below for the major classes of business together with terminal bonus rates effective from the dates shown:

| | Regular bonus rate | Terminal bonus rate |
|---|---|---------------------|
| Industrial Branch | | |
| – whole life policies pre-1979 (weekly paid) | 7.5% simple | up to 45.0% |
| – whole life policies post-1979 (weekly paid) | 5.0% simple | up to 33.0% |
| – endowments post-1979 (weekly paid) | 2.5% simple | up to 65.0% |
| – endowments post-1988 (lunar paid) | 1.0% approx simple (depends upon entry year) | up to 20.0% |
| Ordinary Branch | | |
| Traditional life business | | |
| – endowments (simple bonus series) | 1.5%* | up to 275.0% |
| – endowments (compound series) | 1.0% | up to 22.0% |
| – whole life (simple bonus series) | 2.5%* | up to 165.0% |
| Traditional pensions business (issued from 1988) | | |
| – single premium personal pension | 1.5% compound | up to 14.6% |
| – regular premium personal pension | 1.0% compound | up to 20.2% |

*Including guaranteed bonus rate where applicable.

There are no interim bonuses. The directors reserve the right to review the terminal bonus rates at any time.

Terminal bonuses are based on sum assured for Ordinary Branch traditional life business, sum assured and attaching regular bonuses otherwise. These rates apply to policies becoming claims by maturity and death (excluding OB traditional pension business) with effect from 1 January 2002.

Declared Bonuses – Ex-Scottish Life

The directors have declared regular bonuses for 2001 in respect of with-profits contracts. Examples of the bonuses are set out below together with terminal bonus rates effective from the dates shown.

Individual life policies

| | Regular bonus rate on basic benefit | Bonus rate on declared bonus additions | Regular Terminal bonus rate* |
|--------------------------------|-------------------------------------|--|------------------------------|
| Life Fund policies: | | | |
| – annual premium compound | 1.5% | 2.25% | up to 315% |
| – annual premium simple | 8.75% | | up to 315% |
| – single premium compound | 1.75% | 2.25% | up to 315% |
| – single premium simple | 10.75% | | up to 315% |
| Annuity and Pension | | | |
| Business Fund policies: | | | |
| – annual premium compound | 1.25% | 2.25% | up to 320% |
| – annual premium simple | 11.75% | | up to 320% |
| – single premium compound | 1.5% | 2.25% | up to 390% |
| – single premium simple | 13.25% | | up to 390% |

*Terminal bonus is calculated as a percentage of the basic benefit plus attaching regular bonuses, rates depending on the number of years of participation completed. The maximum rates shown apply after the completion of 40 years of participation, although special rates apply at longer terms.

| Unitised with profits | Regular bonus rate on basic units | Regular bonus rate on declared bonus units | Terminal bonus rate |
|------------------------------|-----------------------------------|--|---------------------|
| Profitbuilder | 2.5% | 3.5% | up to 17.0% |
| Talisman | 3.0% | 4.5% | up to 26.5% |

Until further notice interim bonuses will be payable at the regular bonus rates in 2002.

Stockholders' endowment assurance

For claims arising in 2002 a bonus will be paid at the rate of 1.375% of the basic sum assured for each year of participation from commencement.

An additional bonus is calculated on the net value of the units plus the bonus referred to above, rates depending on the number of years of participation completed. The rates range from 7% at term 10 to 42% at term 40, with special rates applying at terms less than 10 and more than 40 years.

Additional information

for the year ended 31 December 2001

Declared Bonuses – Ex-Scottish Life (continued)

Group with-profits plan

The compound regular bonus rate for the 2001/02 scheme year is 4.375% plus a special addition of 5%. Until further notice interim bonuses at 4.25% per annum will be paid on benefits vesting during the 2002/03 scheme year.

Crest Growth plan – with-profits fund

From 1 January 2002 and until further notice the bonus rate will be 3.5% per annum. In addition, in money purchase schemes, a terminal bonus will be paid, calculated as a percentage of the amount of the with-profits unit account in respect of each year's premium payments, the percentage depending upon the number of years of participation completed. The maximum terminal bonus rate is 29.5%.

Deposit Administration contracts

Crest Secure Plan, Protected Growth Retirement Benefit Plan, Sovereign Plan and the capital account under Talisman Personal Pension Plan and Talisman Executive Pension Plan (including Talisman Buyout and Talisman FSAVC) are all contracts of this type.

For Crest Secure Plan, the declared rate of growth for the 2001/02 scheme year is 4.5% and the guaranteed minimum growth rate for the 2002/03 scheme year is 2.25%. Until further notice the interim growth rate on movements in the 2002/03 scheme year will be 4.0% per annum.

For the other plans, the declared rate of growth for the 2001/02 scheme year is 5.25% and the guaranteed minimum growth rate for the 2002/03 scheme year is 3.0%. Until further notice the interim growth rate on policies becoming claims in the 2002/03 scheme year will be 4.75% per annum.

| | 2001 | 2000 | 1999 | 1998 | 1997 |
|--|-----------------|----------------|---------|---------|---------|
| | £m | Restated £m | £m | £m | £m |
| Five year review | | | | | |
| Group | | | | | |
| Investments at market value at 31 December | 21,617.7 | 14,929.1 | 7,506.0 | 6,868.4 | 6,363.7 |
| Long-term business provision (gross) including unit-linked liabilities | 19,299.9 | 10,743.2 | 4,894.8 | 4,859.7 | 3,987.2 |
| Fund for future appropriations | 3,758.9 | 4,623.0 | 2,439.0 | 1,656.0 | 1,951.2 |
| New life, pensions and unit trusts – annual | 74.4 | 32.2 | 14.6 | 43.1 | 42.5 |
| – single | 739.8 | 479.6 | 118.1 | 201.2 | 172.9 |
| New investment business | 213.7 | 232.0 | 46.1 | 42.3 | – |
| Annualised new business | 169.8 | 103.4 | 31.0 | 67.5 | 59.8 |
| Earned premiums, net of reinsurance | 1,391.5 | 875.9 | 386.2 | 481.3 | 446.1 |
| Claims incurred | 1,656.7 | 977.2 | 521.9 | 529.6 | 443.3 |

As required by FRS 17 the figures for 2000 have been restated. There is no requirement to restate earlier years and accordingly the figures for 1997 to 1999 have not been restated.

Notice of Annual General Meeting

The Annual General Meeting of The Royal London Mutual Insurance Society Limited will be held at Royal London House, Middleborough, Colchester, Essex CO1 1PP (see below) on Tuesday 30 April 2002, at 5 pm for the following purposes:

- 1 To receive the directors' report and audited accounts for the year ended 31 December 2001
- 2 By separate resolutions, to re-elect as directors
 - a) Brian Duffin
 - b) Tom Ross
 - c) Mike Yardleywho are retiring as directors in accordance with the Articles of Association and who, being eligible, offer themselves for re-election
- 3 To reappoint PricewaterhouseCoopers as auditors to hold office from the conclusion of the meeting until the conclusion of the next general meeting at which accounts are laid at a remuneration to be fixed by the directors.

The Articles of Association provide for the Annual General Meeting to take place at the registered office. They continue that the meeting 'may at the discretion of the Chairman thereof if he so deems necessary or convenient be forthwith adjourned by him to larger premises'. The registered office is the new Royal London House (formerly Royal London Court), Middleborough, Colchester, Essex CO1 1PP. There is no area in this building that is large enough to accommodate a general meeting.

In accordance with the Articles, the meeting on 30 April 2002 will be formally opened in the Board Room at the new Royal London House but the Chairman will adjourn the meeting immediately, and without transacting any business, to the Staff Restaurant at the old Royal London House (also at Middleborough, Colchester), that has been the venue for general meetings for many years. The meeting will be re-opened there at 5.10 pm. It is suggested that members attending the meeting go directly to the old Royal London House.

The Royal London Mutual
Insurance Society Limited

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