

**Paternoster UK Limited**

**Registered Number 5656083**

**Paternoster UK Limited**

**Annual Report And Financial Statements  
For the year ended 31 December 2010**

**Paternoster UK Limited**

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## **Paternoster UK Limited**

### **Directors and Officers**

#### Directors

G.P.J. Earle  
D.M. Jackson  
E.J. Jervis  
A. Loudiadis  
D.W. McDonogh  
D. Paterson  
K. Satchell

#### Company Secretary

H. Wilby

#### Registered Office

Fleet Place House  
2 Fleet Place  
London  
EC4M 7RF

#### Auditors

PricewaterhouseCoopers LLP  
Hay's Galleria  
1 Hay's Lane  
London  
SE1 2RD

**Directors' Report For The Year Ended 31 December 2010**

The Directors present their report and the audited financial statements for the year ended 31 December 2010.

**Principal Activity**

The principal activity of the Company is the provision of long-term insurance business, in particular for pension schemes. On 29 April 2009 the Company varied its permissions with the Financial Services Authority such that the Company will not effect new contracts of insurance. Where premiums are due on existing contracts they will continue to be collected.

**Business Review, Results And Performance**

The position of the Company at 31 December 2010 is shown in the Balance Sheet on page 8. The Income Statement for the year appears on page 7. The loss after tax for the year is £40,762,000 (2009: Profit of £3,021,000). The Shareholders' funds at the Balance Sheet date were £196,915,000 (2009: £229,552,000). No dividend for the year is proposed.

The result for the year reflected the impact of changes in economic conditions, specifically in respect of illiquidity in the inflation market for Limited Price Indexation (LPI).

The credit risk default reserve at 31 December 2010 was equivalent to holding 64bps (2009: 79bps) reduction in yield for every year. Expressed as a percentage of spread over the risk free rate (i.e. gilt yields), this equates to 40% (2009: 38%) of the spread on the investment portfolio held against default risk.

The Company's main focus for the year continued to be on management of its existing contractual commitments, improving the efficiency of its operations and delivering high quality service to its policyholders. During the year 27 schemes were wound-up with issuance of individual policies to members or otherwise transitioned into a steady state. Costs continue to be closely monitored. During the year the Board began a process designed to provide long term capital stability for the Paternoster Group and the Company. The Board and management team engaged with the Group's shareholders to raise capital through a sale process.

On 10 December 2010 the ultimate parent company, Paternoster Limited announced that, following that sale process, shareholders holding a majority of its shares entered into an agreement pursuant to which they intend to sell their shares to Rothesay Life (Cayman) Limited ("Rothesay Life"), a wholly owned subsidiary of The Goldman Sachs Group Inc. ("Goldman Sachs")

This ultimately resulted in the sale of the Paternoster Group by all shareholders to Rothesay Life on 11 January 2011.

The Company monitored its solvency position throughout the year using various estimation techniques, supported by full valuations as required. The Company has complied with the regulatory capital requirements under Pillar 1 as set out in Note 3. In addition, based on the 2009 Individual Capital Assessment, it is management's view that the Company has held capital in excess of its Pillar 2 assessment throughout 2010.

**Future Developments**

The sale of the Paternoster Group on 11 January 2011 enhance the long term security of its policyholders. The integration of the Paternoster and Rothesay Life businesses will provide an excellent platform to exploit the opportunities in the growing bulk annuity market.

Following conclusion of the sale, with agreement from the Financial Services Authority, £160,000,000 of additional capital was injected into the Company in the form of equity and a long-term subordinated loan agreement. The investment portfolio has been significantly de-risked with the sale of approximately 50% of the corporate bond portfolio, the proceeds of which are held in cash. The investment performance of the portfolio is delivered through a secured financing arrangement covering the long-term business fund assets supporting the insurance contract liabilities.

The changes outlined above are part of the strategy of merging the Paternoster and Rothesay Life businesses with the intention to undertake a Part VII transfer of Paternoster's in-force book into Rothesay Life Limited within the next twelve months.

Directors' Report For The Year Ended 31 December 2010 (continued)

**Principal Risks And Uncertainty**

Details of the Company's financial risk management during the year are disclosed in Note 2.

Following the sale of the Paternoster Group to Rothesay Life in January 2011, the Company's risk appetite, particularly in respect of credit risk, has changed. The risk framework is being aligned with that applied throughout Goldman Sachs which will include an update to Paternoster's individual capital assessment to a consistent basis with that applied by Rothesay Life Limited. The statements with regard to risk management and control (Note 2) and management of capital resources (Note 3) reflect the position for the Company at the balance sheet date.

The process of risk management was addressed through a framework of policies, procedures and internal controls. All policies were subject to Board approval and review by management, risk management and compliance. Compliance with regulations, legal and ethical standards was a high priority for the Company and the finance department played an important oversight role in this regard.

The Company developed a framework for identifying the risks that the Company was exposed to and their impact on capital resources. The process used individual capital assessment principles to manage the Company's capital requirements and to ensure that it had the financial strength and capital adequacy to support the business and to meet the requirements of policyholders and regulators.

The principal risk for a life insurance business is being unable to pay obligations to policyholders as they fall due. Market and other risks relating to the performance of those financial assets supporting policyholders' liabilities were monitored by the Company's investment department on a continuous basis.

Additionally, longevity is a significant risk to the Company and this was closely monitored through the analysis of actual to expected deaths and through the calibration of models to historic scheme experience.

**Key Performance Indicators**

During the year, the Board monitored progress of the Company by reference to the following key performance indicators:

	2010	2009
	£'000	£'000
Gross Premium revenue	1,819	20,779
(Loss)/Profit before tax	(49,833)	7,269
Financial assets	3,054,829	2,880,270
Cash and cash equivalents	230,572	293,270
Excess Pillar 1 Regulatory Capital (refer Note 3)	133,414	165,456
Embedded Value	287,442	323,100

**Directors**

The names of the Directors are set out on page 1. The details of the Directors appointed and resigned are as follows.

Name	Appointed on	Resigned on
N.J. Campsie	-	11-Jan-11
J. Goford	-	11-Jan-11
R.A. Sandler	-	11-Jan-11
N.S. Sangha	-	06-Jan-11
A.J. Smith	-	11-Jan-11
G.M. Wood	-	11-Jan-11
Sir Howard Davis	-	31-Oct-10
Lord Lietch of Oakley	-	31-Oct-10
J. Chakraverty	01-Jul-10	11-Jan-11
J. J. Yates	01-Jul-10	11-Jan-11
G.P. Earle	18-Jan-11	-
D.M. Jackson	18-Jan-11	-
A. Loudiadis	18-Jan-11	-
D.W. McDonogh	18-Jan-11	-
D.G. Paterson	18-Jan-11	-
K. Satchell	18-Jan-11	-

Paternoster UK Limited

**Directors' Report For The Year Ended 31 December 2010 (continued)**

**Statement Of Disclosure Of Information To The Auditors**

Each of the persons who is a director at the date of this report confirms that:

- 1) so far as each of them is aware, there is no information relevant to the audit of the Company's financial statements for the year ended 31 December 2010 of which the auditors are unaware; and
- 2) the director has taken all steps that he ought to have taken in his duty as a director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

**Auditors**

An elective resolution has been passed by the Company dispensing with the need to appoint auditors annually. Accordingly, PricewaterhouseCoopers LLP will be deemed to be re-appointed auditors of the Company for the current financial year.

**Qualifying Third Party Indemnities**

The Articles of Association of the Company provide for the directors and officers of the Company to be indemnified in respect of liabilities incurred as a result of their office. Paternoster Limited, the parent company of the Paternoster group at the balance sheet date, also provided certain protections for the Paternoster Group directors and senior managers against personal financial exposure that they may have incurred in their capacity as such. These include qualifying third party indemnity provisions (as defined under section 234 of the Companies Act 2006) in force for the benefit of the directors of Paternoster UK Limited during the year. This policy ceased upon change of control to Goldman Sachs. The directors and officers are thereafter covered by a policy for Goldman Sachs which, at the time this directors' report, was approved under section 419(1) of the Companies Act 2006.


**Going Concern**

In preparing the financial statements the directors have given full consideration to the uncertainties and principal risks as set out in Note 1.11 and Note 2. The directors consider that the Company has adequate resources to continue in operational existence for the foreseeable future. They have therefore adopted the going concern basis in preparing the financial statements.

**Date of authorisation of issue**

The financial statements were authorised for issue by the Board of Directors on 30 March 2011.

On behalf of the board of directors

  
Hannah Wilby  
Company Secretary  
30 March 2011

## **Paternoster UK Limited**

### **Statement of Directors' Responsibility in respect of the Financial Statements**

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union. Under Company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the directors are required to:

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

**Paternoster UK Limited**

**Independent Auditors' Report**

To the member of Paternoster UK Limited

We have audited the financial statements of Paternoster UK Limited for the year ended 31 December 2010 which comprise the Income Statement, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

**Respective Responsibilities Of Directors And Auditors**

As explained more fully in the Directors' Responsibilities Statement on page 5, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's member in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

**Scope of the audit of the financial statements**

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

**Opinion on financial statements**

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2010 and of its loss and cash flows for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

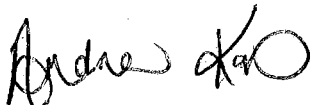
**Opinion on other matter prescribed by the Companies Act 2006**

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

**Matters on which we are required to report by exception**

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

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



Andrew Kail (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London  
30 March 2011

Paternoster UK Limited

Income Statement

For the year ended 31 December 2010

	Notes	2010 £'000	2009 £'000
<b>Revenue</b>			
Net Premium revenue	6	1,203	20,160
Investment return	7	314,348	375,213
<b>Total revenue</b>		<b>315,551</b>	<b>395,373</b>
<b>Expenses</b>			
Claims and change in insurance contract liabilities	8	340,173	360,898
Administration costs	11	20,299	20,519
Finance costs	10	4,912	6,687
<b>Total expenses</b>		<b>365,384</b>	<b>388,104</b>
<b>(Loss)/Profit before tax</b>		<b>(49,833)</b>	<b>7,269</b>
Income tax benefit/(expense)	13	9,071	(4,248)
<b>(Loss)/Profit for the year attributable to equityholders</b>		<b>(40,762)</b>	<b>3,021</b>

Statement of Comprehensive Income

For the year ended 31 December 2010

	2010 £000	2009 £000
<b>(Loss)/Profit for the year attributable to equityholders</b>	<b>(40,762)</b>	<b>3,021</b>
<b>Total comprehensive income for the year</b>	<b>(40,762)</b>	<b>3,021</b>

The accounting policies and notes to the financial statements on pages 11 to 46 form an integral part of these financial statements.

The amounts shown above are all in respect of continuing operations.

Paternoster UK Limited

Balance Sheet

As at 31 December 2010

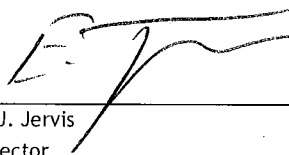
	Notes	2010 £'000	2009 £'000
<b>Assets</b>			
Deferred tax asset	15	62,602	53,531
Financial assets	16	3,054,829	2,880,270
Reinsurers' share of insurance contract liabilities	4	7,600	6,237
Trade and other receivables	18	71,399	71,082
Cash and cash equivalents	19	230,572	293,270
<b>Total assets</b>		<b>3,427,002</b>	<b>3,304,390</b>
<b>Equity</b>			
Share capital	20	4	4
Share premium account	20	372,338	372,338
Retained earnings	21	(220,410)	(179,648)
Share based payment reserves	22	44,983	36,858
<b>Total equity</b>		<b>196,915</b>	<b>229,552</b>
<b>Liabilities</b>			
Insurance contract liabilities	4	2,910,295	2,731,644
Derivative financial liabilities	17	109,026	123,584
Borrowings	23	120,379	115,467
Trade and other payables	24	90,387	104,143
<b>Total liabilities</b>		<b>3,230,087</b>	<b>3,074,838</b>
<b>Total equity and liabilities</b>		<b>3,427,002</b>	<b>3,304,390</b>

The accounting policies and notes to the financial statements on pages 11 to 46 form an integral part of these financial statements.

The financial statements on pages 7 to 46 were approved by the directors on 30 March 2011 and were signed on their behalf by:



K. Satchell  
Director



E.J. Jervis  
Director

Paternoster UK Limited  
Registered Number: 5656083

Paternoster UK Limited

Statement of Changes in Equity  
For the year ended 31 December 2010

	Notes	Share capital	Share premium	Retained earnings	Share based payment reserves	Total
		£'000	£'000	£'000	£'000	£'000
<b>Year ended 31 December 2010</b>						
Balance at 1 January		4	372,338	(179,648)	36,858	229,552
Loss for the year		-	-	(40,762)	-	(40,762)
Share based payment charge recognised directly in equity	22	-	-	-	8,125	8,125
<b>At 31 December 2010</b>		<b>4</b>	<b>372,338</b>	<b>(220,410)</b>	<b>44,983</b>	<b>196,915</b>
<b>Year ended 31 December 2009</b>						
Balance at 1 January		4	361,338	(182,669)	28,955	207,628
Profit for the year		-	-	3,021	-	3,021
Proceeds from shares issued	20	-	11,000	-	-	11,000
Share based payment charge recognised directly in equity	22	-	-	-	7,903	7,903
<b>At 31 December 2009</b>		<b>4</b>	<b>372,338</b>	<b>(179,648)</b>	<b>36,858</b>	<b>229,552</b>

The accounting policies and notes to the financial statements on pages 11 to 46 form an integral part of these financial statements.

**Paternoster UK Limited**

**Cash Flow Statement**

**For the year ended 31 December 2010**

	Notes	2010 £'000	2009 £'000
<b>Cash flows from operating activities</b>			
(Loss)/Profit before tax		(49,833)	7,269
Adjustments for non cash movements in loss for the year			
Share based payment expense	12	8,125	7,903
Net purchase of operational assets			
Financial assets		(165,767)	(218,994)
Derivative financial assets and liabilities		(23,350)	41,484
Net movement in other operational assets and liabilities			
(Increase)/Decrease in Trade and other receivables		(317)	2,999
Increase in reinsurer's share of Insurance contract liabilities		(1,363)	(6,237)
Increase in Insurance contract liabilities		178,651	197,540
Increase in Borrowings for interest on contingent loan		4,912	6,548
(Decrease)/Increase in Trade and other payables		(13,756)	48,183
<b>Net cash (outflow)/inflow from operating activities</b>		<b>(62,698)</b>	<b>86,695</b>
<b>Cash flows from financing activities</b>			
Proceeds from issue of ordinary share capital (including share premium)	20	-	11,000
<b>Net cash inflow from financing activities</b>		<b>-</b>	<b>11,000</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>		<b>(62,698)</b>	<b>97,695</b>
Cash and cash equivalents at 1 January		293,270	195,575
<b>Cash and cash equivalents at 31 December</b>	<b>19</b>	<b>230,572</b>	<b>293,270</b>

Cash and cash equivalents of £111,053,000 (2009: £162,610,000) are held within the long term business fund and are not available to settle obligations outside the fund.

The accounting policies and notes to the financial statements on pages 11 to 46 form an integral part of these financial statements.

**Paternoster UK Limited**

**Notes to the Financial Statements  
For the year ended 31 December 2010**

- Note 1: Accounting policies
- Note 2: Risk management and control
- Note 3: Management of capital resources
- Note 4: Insurance contract liabilities
- Note 5: Segmental information
- Note 6: Net Premium revenue
- Note 7: Investment return
- Note 8: Claims and change in insurance contract liabilities
- Note 9: Acquisition costs
- Note 10: Finance costs
- Note 11: Expenses by nature
- Note 12: Share based payments expense
- Note 13: Taxation
- Note 14: Dividends
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- Note 18: Trade and other receivables
- Note 19: Cash and cash equivalents
- Note 20: Share capital and share premium
- Note 21: Retained earnings
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- Note 23: Borrowings
- Note 24: Trade and other payables
- Note 25: Related party transactions
- Note 26: Commitments and contingent liabilities
- Note 27: Events after the Balance Sheet date

## Paternoster UK Limited

### Notes to the Financial Statements For the year ended 31 December 2010

#### 1: Accounting policies

##### 1.1 General information

Paternoster UK Limited (the Company) has as its principal activity the management of long-term insurance business in the UK. The Company specialises in providing insurance to pension schemes and manages the risk of its existing pensioners.

Paternoster UK Limited is a registered company incorporated within the UK. The Company's registered office and principal place of business is Fleet Place House, 2 Fleet Place, London, EC4M 7RF.

##### 1.2 Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs), IFRIC interpretations and the Companies Act 2006 applicable to companies reporting under IFRS.

The financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets and financial liabilities (including derivative instruments) at fair value through the Income Statement.

The directors consider that the Company has adequate resources to continue in operational existence for the foreseeable future. They have therefore used the going concern basis in preparing the financial statements.

The Company presents its Balance Sheet broadly in order of liquidity. This is considered to be more relevant than a current / non-current presentation, given the long term nature of the Company's insurance business. For each asset and liability line item which combines amounts expected to be recovered or settled before and after 12 months from the Balance Sheet date, disclosure of the split is included within the notes to the financial statements.

Financial assets and financial liabilities are shown gross, such that they are not offset unless there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously. Income and expenses are not offset in the Income Statement unless required or permitted by an accounting standard or interpretation, as specifically disclosed in the accounting policies of the Company.

##### *Use of estimates, assumptions and judgements*

The preparation of the financial statements requires management to exercise its judgement in the process of applying the Company's accounting policies to complex issues. The major areas of judgement on policy application are considered to be the valuation of insurance contract liabilities (refer Note 1.4 and Note 4), impairment of financial assets (refer Note 1.5 and Note 16) and the recoverability of the deferred tax asset (refer Note 1.7 and Note 15).

The preparation of the financial statements will involve the use of certain critical estimates and assumptions which affect items reported in the Balance Sheet and Income Statement. Although these estimates are based on management's best knowledge of current circumstances and future events and actions, actual results may differ from those estimates, possibly significantly. The estimates and assumptions used are disclosed in the relevant notes to these financial statements.

Critical accounting estimates are applied in the valuation of insurance contract liabilities, notably the assumptions for longevity and the assessment of an appropriate adjustment for default risk on the discount rate (refer Note 4), valuation of financial assets and liabilities (refer Note 16) and the determination of share based payment expenses (refer Note 12).

Management have undertaken a detailed review of the fair value of financial assets (refer Note 16) to ensure the valuation used at year end fully reflects current market conditions. This has involved some judgement in the application of the Company's accounting policies as set out in the application of the fair value hierarchy. No significant adjustments to the market derived fair values were deemed necessary. Estimation techniques are applied in the valuation of unlisted investments.

Notes to the Financial Statements  
For the year ended 31 December 2010

1: Accounting policies (continued)

**Summary of significant accounting policies**

The accounting policies selected, fairly state the financial position of the Company and its financial performance for the reporting period. The accounting policies have been consistently applied to all periods presented, unless otherwise stated. The principal accounting policies adopted in preparing these financial statements are set out below.

**(a) Standards, amendments and interpretations to existing standards effective in 2010**

The following standards effective in 2010 have been considered in the financial statements. There is no major impact of these standards on the results of current year or prior year.

- IAS 39 (amendment), 'Financial instruments: Recognition and measurement - Eligible hedged items'.

The amendment was issued in July 2008. It provides guidance in two situations: on the designation of a one-sided risk in a hedged item, IAS 39 concludes that a purchased option designated in its entirety as the hedging instrument of a one-sided risk will not be perfectly effective. The designation of inflation as a hedged risk or portion is not permitted unless in particular situations. It is not expected to have a material impact on the Company's financial statements.

- IFRS 9, 'Financial instruments'.

IFRS 9 addresses classification and measurement of financial assets and is available for early adoption immediately. The new standard replaces the multiple classification and measurement models in IAS 39 with a single model that has only two classification categories: amortised cost and fair value. The Company's financial assets will continue to be valued at fair value to minimise the profit and loss mismatch and therefore there is no significant impact.

The management has reviewed and concluded that the other standards effective in 2010 have been considered and there is no impact of these standards on the results.

**(b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Company**

The management has reviewed and concluded that the other standards, amendments and interpretations to published standards are not relevant to the Company's operations.

**1.3 Foreign currency translation**

Foreign currency transactions are translated into the functional currency, being the currency of the primary economic environment in which the entity operates, using the exchange rate prevailing at the date of the transactions. The functional currency of the Company is British Pounds Sterling.

Monetary assets and liabilities denominated in foreign currencies are translated at the year end exchange rates into the functional currency.

Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the Income Statement for the period.

The financial statements are presented in thousands of Pounds Sterling, which is the Company's presentation currency. The Company does not hold any non-monetary assets or liabilities in currencies other than Sterling.

**1.4 Insurance contracts and investment contracts**

**Product classification**

IFRS4 requires policyholder contracts written by insurers to be classified as either 'insurance contracts' or 'investment contracts' depending on the level of insurance risk transferred.

Insurance contracts are those policyholder contracts that, at the inception of the contract, transfer significant insurance risk. As a general guideline, the Company defines as significant insurance risk the possibility of having to pay benefits on the occurrence of an insured event that are at least 10% more than the benefits payable if the insured event did not occur. Once a policyholder contract has been classified as an insurance contract, it remains an insurance contract throughout the life of the policy, even if the insurance risk reduces during this period.

Policyholder contracts which do not transfer significant insurance risk to the insurer are classified as investment contracts. The Company has classified all its policyholder contracts as insurance contracts.

Notes to the Financial Statements  
For the year ended 31 December 2010

1: Accounting policies (continued)

1.4 Insurance contracts and investment contracts (continued)

**Premium revenue**

Premiums are received in consideration for taking on pension scheme liabilities. Premiums are recognised when due, being the date from which the policy becomes effective. Upon recognition of premiums for policyholder contracts, a liability for future contractual benefits that are expected to be incurred is recorded within insurance contract liabilities in the Balance Sheet.

**Reinsurance contracts held**

The reinsurance premium payable represents the management fee payable under longevity swap contracts. Premiums payable for reinsurance contracts are recognised as an expense when due.

The benefits to which the Company is entitled under its reinsurance contracts held are recognised as reinsurance assets. These assets consist of the longer term receivables that are dependent on the expected claims and benefits arising under the related reinsured insurance contracts. The reinsurance assets are assessed for impairment on an annual basis. If there is objective evidence that the reinsurance asset is impaired, the Company reduces the carrying amount of the reinsurance asset to its recoverable amount and recognises that impairment loss in the income statement.

**Claims expense**

Claims and benefits payable consist of regular annuities paid to pension scheme members and surrenders, which consist of full settlements of transfers out and partial settlements of tax-free cash components of pension benefits. Annuities are recognised when due for payment. Surrenders are accounted for when paid. Death claims are accounted for when notified at which time the policy ceases to be included within the calculation of the insurance contract liabilities. Claims expense includes claims handling costs, being the internal and external costs incurred in connection with the settlement of claims. Claims expense includes movements in the value of insurance contract liabilities.

Claims recoveries in respect of reinsurance contracts represents the net amounts due under longevity swap contracts as a result of comparing the actual payments made to policyholders with the fixed contractual payments.

**Acquisition costs**

Acquisition costs comprise direct costs such as initial commission and the indirect costs of obtaining and processing new business. The indirect costs consist primarily of internally generated expenses such as salaries and share based payment remuneration. It is not considered appropriate to defer these costs and they are charged to the Income Statement when incurred.

**Insurance contract liabilities**

As IFRS4 permits continued usage of previously applied GAAP, insurance contract liabilities are measured using UK Generally Accepted Accounting Principles (UK GAAP). The modified statutory basis of reporting has been applied as set out in the Association of British Insurers' Statement of Recommended Practice on Accounting for Insurance Business (ABI SORP) dated December 2005 and revised in December 2006. The statutory basis is modified for IFRS reporting purposes by removing contingency reserves from the valuation.

The initial policyholder contract liability set up within the long-term business fund is calculated in accordance with the relevant Financial Services Authority (FSA) rules contained in the Prudential Sourcebook for Insurers. The calculation is initially based on available pension scheme data obtained during the quotation exercise and is updated when subsequent information is obtained which clarifies the original information. The gross premium valuation method is used and explicit allowance for future expenses is included.

Long-term business liabilities can never be definite as to their timing or the amount of claims and are therefore subject to subsequent reassessment on a regular basis. The long-term business fund is subject to an annual investigation at 31 December to ensure that the carrying value of the liabilities is maintained in accordance with the FSA rules. The valuation of the liabilities is a critical accounting estimate, which represents a determination within a range of possible outcomes, where the assumptions used in the calculation depend on the circumstances prevailing in each policy. Details of the principal assumptions used are set out in Note 4.

Notes to the Financial Statements  
For the year ended 31 December 2010

1: Accounting policies (continued)

1.4 Insurance contracts and investment contracts (continued)

*Liability adequacy test*

At each reporting date, an assessment is made of whether the recognised insurance contract liabilities are adequate, using current estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from the assets backing such liabilities, known as the liability adequacy test. If that assessment shows that the carrying amount of the liabilities is insufficient in the light of the estimated future cash flows, the deficiency is recognised immediately in the Income Statement by setting up an additional provision in the Balance Sheet.

*Trade receivables and payables*

Trade receivables are recognised when due and measured on initial recognition at the fair value of the amount receivable. In addition, trade receivables include annuity payments made to pension schemes in advance of the balance sheet date to ensure settlement to scheme members on a timely basis.

Trade payables are recognised when due and measured on initial recognition at the fair value of the consideration paid. Trade receivables and payables are subsequently carried at amortised cost.

1.5 Financial assets

*Recognition and Measurement*

The Company has determined that all financial assets (excluding derivative financial instruments) are accounted for at fair value through the income statement to minimise any measurement or recognition inconsistency with the associated liabilities. Management determines the classification of its financial assets at initial recognition.

Financial assets designated as fair value through the income statement include those that are held in the Company's long-term fund matching insurance contract liabilities (refer Note 4). The designation of these assets to be at fair value through income statement eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on a different basis.

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

The fair values of quoted investments are based on bid market prices. For unlisted securities and all other financial assets for which there is no active market, the Company establishes fair value using valuation techniques, where necessary. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, counter party/ broker valuations, and option pricing models. These assessments are based largely on observable market data. Further details on application of fair values is set out in the fair value hierarchy disclosures in Note 16.

Purchases and sales of financial investments are accounted for as at trade date.

Net gains or losses arising from changes in the fair value of financial investments at fair value through the income statement are presented in the Income Statement within investment return in the period in which they arise.

*Investment Return*

Investment return comprises all investment income, realised investment gains and losses and net movements in fair value. Interest income is recognised as it accrues, taking into account the effective yield on the investment.

Realised gains and losses on investments carried at fair value are calculated as the difference between net sale proceeds and purchase price. Net movements in fair value on investments represent the difference between the fair value at the balance sheet date and their purchase price or their fair value at the last balance sheet date, together with the reversal of the net movement in fair value recognised in earlier accounting periods in respect of investment disposals in the current period.

*Derivative Financial Instruments*

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are calculated using discounted cash flow techniques based on adjusted market data. All derivatives are carried as assets when the fair value is positive and as liabilities when the fair values are negative. Net gains or losses arising from changes in the fair value of the derivative financial instruments are recognised immediately in the income statement within the investment return.

**Notes to the Financial Statements  
For the year ended 31 December 2010**

**1: Accounting policies (continued)**

**1.5 Financial assets (continued)**

***Securities lending***

The Company is party to various securities lending agreements under which securities are loaned to third parties on a short-term basis. The loaned securities are not derecognised; rather, they continue to be recognised within the appropriate investment classification. Income from securities lending is recognised as it accrues and has been classified as investment income.

***Collateral***

The Company receives and pledges collateral in the form of cash or debt securities in respect of stock lending transactions and certain derivative financial instruments. The amount and type of collateral required depends on the contractual arrangements and the credit risk of the counterparty.

Collateral received in the form of cash, which is not legally segregated from the Company, is recognised as an asset on the Balance Sheet with a corresponding liability for the repayment included within trade and other payables. Non-cash collateral received is not recognised on the Balance Sheet unless the Company either sells or repledges these assets in the case of default, at which point the obligation to return this collateral is recognised as a liability.

Collateral payable in respect of derivative financial instruments, where required, is primarily provided in the form of debt securities. Non-cash collateral pledged is not derecognised from the Balance Sheet unless the Company defaults on its obligations under the relevant agreement, and therefore continues to be recognised on the Balance Sheet within financial investments.

**1.6 Financial Liabilities**

Derivative financial liabilities are initially recognised at fair value on the date on which they are entered into and are subsequently re-measured at their fair value, which is determined as per Note 1.5.

Borrowings are recognised initially at fair value, net of transaction costs. Borrowings classified as liabilities are subsequently stated at amortised cost, any difference between the proceeds and the redemption value is recognised in the Income Statement over the period of the borrowings using the effective interest rate method.

**1.7 Taxation**

Tax expense disclosed on the face of the Income Statement represents the sum of current year corporation tax, the movement in deferred income tax and adjustments to prior periods' tax.

The current income tax charge is calculated in accordance with the relevant tax legislation. Tax payable is calculated using tax rates that have been enacted or substantially enacted by the balance sheet date.

Provision is made for deferred tax liabilities, or credit taken for deferred tax assets, using the balance sheet liability method, on all material temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

Deferred tax is recognised in the Income Statement for the period, except to the extent that it is attributable to a gain or loss that is recognised directly in equity. In this case the gain or loss is shown net of the charge or credit in respect of deferred tax.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient future taxable profit will be available to allow all or part of the asset to be recovered.

**Notes to the Financial Statements**  
**For the year ended 31 December 2010**

**1: Accounting policies (continued)**

**1.8 Cash And Cash Equivalents**

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less.

**1.9 Share Capital**

Shares are classified as equity when there is no obligation to transfer cash or other assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

**1.10 Employee benefits: Share based payment scheme**

Paternoster Limited operates equity-settled share based compensation plans for the Paternoster Group. The Company recognises the fair value of the services received in exchange for the grant of options and warrants to the Group's employees and other providers as an expense with a corresponding share based payment equity reserve on the Company's Balance Sheet. The Black-Scholes method has been used to value the options and warrants granted.

The total amount to be expensed is determined by reference to the fair value of the options and warrants granted, excluding the impact of any non-market vesting conditions, at the grant date. The valuation is based on an estimate of the number of options and warrants that are expected to become exercisable. The expense is recognised over the vesting period taking into account the terms and conditions of the plans.

At each balance sheet date, the Company revises its estimate of the number of options and warrants that are expected to become exercisable. The Company recognises the impact of the revisions of original estimates, if any, in the income statement, along with a corresponding adjustment to the share based payment reserve, over the remaining vesting period.

A liability is recognised and a charge taken to the Income Statement for employer National Insurance contributions arising in respect of share based payments over the vesting period in accordance with the recognition of the share based payment charge as modified for the fair valuing of share options and warrants at the reporting date which are based on latest available company valuation for taxation purposes.

**1.11 Uncertainties**

At the balance sheet date, there were a number of risks and uncertainties that could have had a material impact on the Company's future financial position. The Company's view of the principal risks are detailed in the Directors' Report on pages 2 and 3. The current economic environment could have given rise to particular uncertainty as to the future level of defaults on corporate bonds and other economic factors. Furthermore the Company faces exposure to the risk of increased life expectancy in policyholders. The exposure of the Company to changes in credit default rates and longevity are detailed in Note 2. It should however be noted that each of the disclosed sensitivities is calculated independently of the others and that it is inappropriate to assume these could not be concurrent i.e. it could be possible for the risks to impact the financial position additively.

At the balance sheet date, corporate bond defaults would have had a substantial and immediate impact on the Company's capital resources and if such default occurred it could increase the risk of the Company being unable to maintain its status as a going concern and in particular reduce the Company's available capital. Details of credit defaults during the year are set out in the credit risk disclosures in Note 2. Allowance has been made for a limited number of defaults within the allowance for credit default risk in valuing the insurance contract liabilities. This is reflected in both the Company's Balance Sheet and in its Regulatory capital position as measured by its Pillar 2 capital under the Company's Individual Capital Assessment ("ICA").

Notes to the Financial Statements  
For the year ended 31 December 2010

1: Accounting policies (continued)

1.11 Uncertainties (continued)

In the event of significant defaults occurring or changes being necessary to reflect significant revised assumptions regarding longevity the assumption that it is appropriate to continue to use the going concern basis of preparation for the accounts could be questioned. The Board has carefully considered the impact of these uncertainties by reference to plausible economic scenarios and believes that the Company would continue to hold capital resources in excess of its Pillar 1 capital requirements.

Subsequent to the balance sheet date, additional capital has been injected into the Company following the sale of the Paternoster Group to Goldman Sachs. In addition, the investment portfolio has been significantly de-risked with the sale of approximately 50% of the corporate bond portfolio. Further details of the events after the balance sheet date which have reduced the uncertainties facing the Company are set out in Note 27.

The Board has the expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly they adopt the going concern basis in preparing these financial statements.

Notes to the Financial Statements  
For the year ended 31 December 2010

**2: Risk Management and Control**

**Financial Risk Management Objectives**

The Company's business involves the acceptance and management of risk in order to achieve its strategic objectives. The significant risks which the Company manages include insurance, market, credit, liquidity and operational risks. Insurance risk is implicit in the Company's business and principally arises from differences in longevity in respect of annuity payments to pension scheme members. Market risk is the risk arising from fluctuations in interest rates, inflation rates and currency exchange rates. Credit risk is the risk of counterparty defaults on financial assets. Liquidity risk is the risk that the Group, although solvent, either does not have sufficient financial resources available to fund the obligations arising from contracts with policyholders, or can secure them only at excessive cost. Liquidity risk also impacts the overall credit markets, such that the ability to trade at or near market price may be adversely impacted if illiquid market conditions prevail. Operational risk arises as a result of failures in internal control due to systems, people and processes.

The corporate governance structure overseeing risk management during the year was as follows:

The Board had overall responsibility for the management of the exposure to these risks. The Board was supported through formal sub-Committees of the Board, being the Audit Risk & Compliance Committee and Investment Supervision Committee. The membership of these Committees included non-executive directors, executive directors and relevant senior managers. These Committees and their related Management Committees, specifically the Executive Committee, Risk Committee, Marketing Committee, Investment Committee, Treating Pensioners Fairly Committee, Actuarial Committee and Implementation Committee, ensured that the management of the business was conducted within the delegated risk framework from the main Board.

Following the sale of the Paternoster group to Rothesay Life on 11 January 2011 new corporate governance structures are being put in place in accordance with Goldman Sachs requirements.

**Market Risk**

The Company is exposed to market risk as a consequence of fluctuations in values or returns on assets and liabilities which are influenced by one or more external factor. The external factors that impact the assets and liabilities of the insurance business include changes in interest rates, inflation indices (such as the Retail Price Index and Limited Price Index) and currency exchange rates.

During the year, the Company managed market risk through an asset liability management (ALM) framework that was developed to closely match the investment portfolio income to its obligations under insurance contracts. Payments under the insurance contracts in the form of regular annuities to pension scheme members are sensitive to interest rate risk, such that the principal technique of the ALM was to match assets to the liabilities arising from insurance contracts by reference to the type of benefits payable to contract holders. This resulted in a portfolio of assets which, when interest rates changed, moved broadly in line with the change in the value of the liabilities.

Within the context of the ALM framework, the Company used derivative financial instruments to reduce market risk. Interest rate and inflation swaps were entered into to improve the matching of asset and liability cash flows. The Company also invested in Floating Rate Notes (FRNs) to back these derivative financial instruments. Currency swaps have been entered into to eliminate the majority of the currency risk on financial assets invested in non-Sterling based debt securities where liabilities are denominated in Sterling.

Management monitored market risk by examining the sensitivity of earnings to changes in underlying risk factors. In completing this sensitivity analysis, interest rate and inflation risks are measured as an impact on excess value (assets minus liabilities) for a one basis point change in values of market instruments used to construct interest and inflation curves. The interest rate curve is constructed using Sterling LIBOR rates and interest rate futures for the short end of the curve and Sterling interest swap rates for terms of two years or longer. Linear interpolation was used for unknown maturities. The inflation curve was constructed using break-even UK RPI inflation swap rates. Again linear interpolation was used for unknown maturities and a seasonality adjustment was applied based on a three year rolling average.

**Interest Rate Risk**

Interest rate risk arises primarily from the Company's investment portfolio of debt securities and valuation of liabilities, which are exposed to fluctuations in interest rates. As stated above, the composition of the investment portfolio was structured so as to generate cash flows of such amount at the appropriate time to meet the Company's obligation and commitments under its insurance contracts. The ALM framework significantly reduced the Company's exposure to interest rate risk. However, under this methodology interest rate risk could not be completely eliminated due to the nature and uncertainty of the timing of the cash flows arising under the insurance contracts.

Notes to the Financial Statements  
For the year ended 31 December 2010

**2: Risk Management and Control (Continued)**

The Company monitored interest rate risk by calculating the exposure of the investment portfolio and the liabilities to a one basis point move in interest rates known as PV01. The PV01 of the liabilities was determined by projecting prudent cash flows from the contracts using a prudent estimate of mortality and best estimate inflation and then discounting using the valuation rate of interest (VROI) and the VROI stressed by one basis point to determine the sensitivity to a one basis point movement and then taking the difference between these values. In projecting expected cash flows, no future discretionary benefits are assumed to accrue. The PV01 of the assets was calculated in a consistent manner.

The cash flow of assets that are being used for PV01 includes an allowance for defaults which was consistent with the Company's Pillar 1 assumptions. Any gap between the PV01 of the assets and the PV01 of the liabilities was minimised by means of buying and selling fixed interest securities and the use of interest rate swaps. On this basis, an increase of one basis point interest yields would have resulted in a PV01 movement of £144,000 at the year end (2009: £13,000). In addition, it is estimated that a change of 40 basis points in the market interest rate would have resulted in a change of £5,771,000 (2009: £511,000) in the results for the year and £4,155,000 (2009: £368,000) impact on shareholders' equity.

**Inflation Rate Risk**

Inflation rate risk was monitored on a comparable basis to interest rate risk. The change in sensitivity of the Company's assets to a one basis point move in inflation expectation was calculated and would have resulted in a movement of £3,000 at the year end (2009: £4,000). In addition, it is estimated that a 10% adverse movement in inflation would have resulted in a change of 35 (2009: 35) basis points, a change of £118,000 (2009: £153,000) in the results for the year and £85,000 (2009: £110,000) impact on shareholders' equity.

**Currency Exchange Risk**

The Company was exposed to currency exchange risk through its investment in non-Sterling based debt securities backing the insurance business. It was the Company's policy to hedge significant foreign currency exposure on debt securities through the use of derivatives which were designed to secure the Sterling equivalents over the remaining life of the securities.

As at the balance sheet date, bonds denominated in Euro of £3,920,000 were held to cover liabilities in Euro and these bonds amounted to 96% of the total non-Sterling denominated assets of £4,078,000, thus significantly covering currency risk. In 2009, bonds denominated in currencies other than sterling amounting to £33,246,000 were paired with currency swap contracts in order to hedge economically currency risk, which amounted to 87% of total non-Sterling denominated assets of £38,201,000. Thus given that there was no large exposure to non-sterling denominated assets or liabilities and that a significant portion of it was hedged, no sensitivity analysis for currency movement has been performed.

**Credit Risk**

Credit risk is the risk of loss due to the default of a counterparty in performing its financial obligations to the Company. The Company was primarily exposed to credit risk through its investment in debt securities and cash deposits within both the long-term business fund and the shareholder fund of the Company. Credit risk also arises in respect of derivative contracts to the extent that there is potential default on the part of the counterparties. To a lesser extent, counterparty risk potentially exists in respect of amounts owed from pension schemes in respect of insurance contracts, although in the majority of cases this risk is limited as the amount of insured member benefits may be varied in the event of default.

For debt securities and derivative financial assets, exposure to loss can result from default on payment of principal or interest amounts due or any changes in the value of an investment due to a rating downgrade. For cash deposits and derivative contracts, exposure to loss arises from a deposit institution's or counterparty's default or deterioration of their financial position.

An analysis of Balance Sheet assets subject to credit risk is summarised as follows:

	2010	2009
	£'000	£'000
Financial assets (Note 16)	3,054,829	2,880,270
Accrued interest (Note 18)	62,300	56,810
Cash and cash equivalents (Note 19)	230,572	293,270
<b>Total assets bearing credit risk</b>	<b>3,347,701</b>	<b>3,230,350</b>

The above analysis represents the maximum credit exposure without taking into account any non-cash collateral held. Corporate bonds and gilts under Financial Assets amounting to £2,902,781,000 (2009: £2,751,142,000) are being held with one custodian having 'A' rating.

Notes to the Financial Statements  
For the year ended 31 December 2010

2: Risk Management and Control (Continued)

The Company's management of credit risk was achieved through credit worthiness assessments for new and existing investments and the application of Board approved concentration limits. The Company monitored its exposure to a single counterparty or group of counterparty and industry segments. The amount of derivative assets subject to credit risk was controlled through collateralisation of the value of the instrument. To further minimise credit risk, the financial condition of counterparties was monitored on a regular basis. Allowance for possible defaults was made in the actuarial valuation of insurance contract liabilities as set out in Note 4.

The estimate of the levels of defaults is inherently uncertain. Whilst the Company believes that it has made an appropriate allowance for future defaults, based on current credit spreads, a requirement to materially increase the allowance would lead to a reduction in the available capital resources. A change in the default allowance by 10bps would change the mathematical reserves by £39,000,000 (2009: £34,000,000). The actual level of defaults experienced during the year was £Nil (2009: £284,000). In addition, certain financial institutions have deferred or missed coupon payments, the impact of which is not significant on the returns from the portfolio.

When monitoring the Company's credit risk concentration, debt securities were graded according to an average of current credit ratings issued by Moody's, Standard & Poor's and Fitch rating agencies. These ratings were further adjusted in accordance with Paternoster's credit rating model, where debt securities trade at prices indicative of lower ratings. Where there is no external agency rating, the Company reviewed the investment against available comparable bonds and other external views and then assigned a rating. The total value of bonds to which the Company's own credit rating has been applied at 31 December 2010 was £402,651,000 (2009: £275,562,000). This represents a more conservative rating compared to the rating agencies which resulted in higher default reserve in valuation of insurance contract liabilities. Credit limits for each counterparty were set based on the credit rating assigned which, therefore, reflects the perceived default probabilities.

In accordance with Board approved guidelines, the Company invested predominantly in investment grade corporate bonds which had BBB to AAA rating, with AAA being the highest possible rating. The target investment portfolio rating for the assets supporting the insurance liabilities within the long-term business fund was broadly 'AA'. The Company holds a diverse portfolio of bonds, at the balance sheet date the average credit rating was calculated to be 'AA-' (2009: 'AA-') after allowing for the longer duration of higher rated bonds. The Company did not have any exposure to unrated assets.

To reflect the fact that longer dated debt securities have generally a higher probability of default over the life of the instrument, risk was further minimised by investing in higher grade credit at longer durations.

The Company's exposure to credit risk can be analysed by credit rating as follows:

	2010	2009
	£'000	£'000
UK Government gilts	61,891	52,490
AAA rated	586,942	500,079
AA rated	759,320	750,166
A rated	1,196,853	1,219,209
BBB rated	549,365	542,456
BB rated	161,138	115,101
B rated	16,944	18,686
CCC rated	15,248	31,612
C rated	-	551
<b>Total assets bearing credit risk</b>	<b>3,347,701</b>	<b>3,230,350</b>

At 31 December 2010, total financial assets include overdue accrued interest of £30,000 (2009: £6,000) which is not more than one year old. As the financial assets are predominantly measured at fair value (refer Note 1.5), there was no specific impairment charge or impaired assets.

Notes to the Financial Statements  
For the year ended 31 December 2010

2: Risk Management and Control (Continued)

Liquidity Risk

Liquidity risk is the risk that the Company, although solvent, either does not have sufficient financial resources available to it in order to meet its obligations when they fall due, or can secure them only at excessive cost. The Company's ALM framework was designed to ensure that cash is available from the investment portfolio of sufficient amount and on a timely basis to support the anticipated pension annuity payments. In addition to holding significant liquid financial assets within the long-term business fund, liquidity risk was managed through forecasting of annuity payments, ensuring highly rated counterparties for cash deposits and application of limits on investments that cannot be readily realisable.

At the balance sheet date, the Company's principal funding had been provided through equity capital participation and contingent loan funding from a fellow group undertaking. As such the Company did not have any borrowings external to the Group or any committed third party funding facilities available. Details of funding provided by way of a contingent loan from a fellow group undertaking are set out in Note 23. Repayment of the related party borrowings are contingent upon sufficient regulatory surplus being available in the Company's regulatory return filed with the FSA and written approval from the FSA and therefore is not considered in the liabilities cash flows below.

Financial liabilities consist of trade and other payables, being derivative liabilities, creditors arising out of direct insurance operations, accruals, investment settlements, collateral repayment liabilities, amount due to group undertaking and other payables. With the exception of derivative financial liabilities, all financial liabilities mature within 1 year (2009: 1 year).

The maturity analysis of derivative cash flows in respect of all derivative assets and liabilities in absolute amounts are shown below. Derivative assets of £92,309,000 (2009: £83,517,000) and derivative liabilities of £109,026,000 (2009: £123,584,000) are shown at the net present value of future outflows and inflows, being the fair value as shown in the Balance Sheet.

The table below presents the cash flows payable by the Company for managing liquidity risk by remaining contractual maturities at the balance sheet date.

The following table also provides an aggregation of the liquidity analysis for liabilities. The maturity analysis of the assets is illustrated below. All liabilities are presented on a contractual cash flow basis except for the insurance liabilities, which are presented with their expected cash flows.

	Contractual cash flows (undiscounted)				Total £'000
	0-1 yrs £'000	1-2 yrs £'000	2-5 yrs £'000	> 5 yrs £'000	
<b>As at 31 December 2010</b>					
<b>Assets</b>					
Cash flows arising from:					
Debt securities	237,177	229,801	563,127	5,202,283	6,232,388
Derivative financial instruments, net	1,674	(2,645)	(6,057)	26,517	19,489
Reinsurer's share of insurance liabilities	12	51	363	21,880	22,306
Cash and cash equivalents	230,572	-	-	-	230,572
<b>Total</b>	<b>469,435</b>	<b>227,207</b>	<b>557,433</b>	<b>5,250,680</b>	<b>6,504,755</b>
<b>Liabilities</b>					
Expected cash flows (undiscounted)					
Insurance liabilities	154,219	162,536	494,281	5,838,826	6,649,862
Trade and other payables	90,387	-	-	-	90,387
<b>Total</b>	<b>244,606</b>	<b>162,536</b>	<b>494,281</b>	<b>5,838,826</b>	<b>6,740,249</b>

2: Risk Management and Control (Continued)

Liquidity Risk (Continued)

	Contractual cash flows (undiscounted)				Total £'000
	0-1 yrs £'000	1-2 yrs £'000	2-5 yrs £'000	> 5 yrs £'000	
<b>As at 31 December 2009</b>					
<b>Assets</b>					
Cash flows arising from:					
Debt securities	166,351	219,717	582,035	5,474,816	6,442,919
Derivative financial instruments, net	1,628	(795)	(9,705)	(28,829)	(37,701)
Reinsurer's share of insurance liabilities	(64)	(21)	168	22,921	23,004
Cash and cash equivalents	293,270	-	-	-	293,270
<b>Total</b>	<b>461,185</b>	<b>218,901</b>	<b>572,498</b>	<b>5,468,908</b>	<b>6,721,492</b>
<b>Liabilities</b>					
Expected cash flows (undiscounted)					
Insurance liabilities	153,808	166,783	491,681	5,791,084	6,603,356
Trade and other payables	104,143	-	-	-	104,143
<b>Total</b>	<b>257,951</b>	<b>166,783</b>	<b>491,681</b>	<b>5,791,084</b>	<b>6,707,499</b>

The cash flows arising from foreign currency denominated debt securities are included net of the impact of foreign currency swaps.

Cash flow mismatches shown above will be offset by future returns (not included above) to be earned following reinvestment of maturing assets (including cash and cash equivalent balance). Consequently, the Company is exposed to a re-investment risk. This is monitored on an ongoing basis and is taken into account in the Company's valuation of insurance contract liabilities.

## 2: Risk Management and Control (Continued)

### Insurance risk

The Company actively pursues insurance risk in support of the Company's strategic objectives. Note 4 describes the insurance contracts written and the basis of setting assumptions in measuring insurance liabilities.

Insurance contracts written are single premium bulk or individual annuity contracts which provide for regular payments to policyholders whilst the pension scheme members and/or their spouse or dependants are still alive. Payments under the policies reflect the member entitlements which vary from scheme to scheme. Payments to individual members are generally either fixed, increase in line with standard inflation indices (e.g. Retail Price Index) or are subject to specified minimum and maximum increases.

Insurance risk in respect of annuity business primarily consists of longevity risk and expense risk and was managed through implementation of the Company's underwriting manual and reserving policy.

The underwriting manual set out strict underwriting criteria to be applied in pricing quotations to pension scheme trustees and reflected Board approved limits. The pricing was subject to review by the Marketing Committee which monitored compliance with the underwriting manual and approved the pricing of pension scheme features. The reserving policy was reviewed annually and documented within the Valuation Basis Note prepared by the Actuarial Function Holder and approved by the Board.

The underwriting and reserving policies of the Company were established in line with established actuarial techniques, relevant regulation and legislation.

### Longevity risk

Insurance of pension scheme obligations exposes the Company to the risk that mortality experience is lower than assumed. Lower than expected mortality would require payments to be made for longer and increases the cost of benefits provided.

Current mortality rates for pensioners were derived from a model which allowed for gender, age, annuity amount, geographical location and other indicators of socio-economic class. In order to minimise the risk that the model mis-estimates mortality rates it was tested and calibrated against mortality experience data from as wide a range of pension schemes as possible. Scheme experience data was requested for all quotations relating to large schemes with more than 500 current pensioners.

An experience analysis showing actual versus expected numbers of deaths for in-force business was provided to management on a monthly basis. Appropriate adjustments to the mortality model were made to reflect emerging experience. The model was continually refined and recalibrated to reflect experience data received from pension schemes and formed an integral part of the Company's asset liability management.

Future longevity improvement risk was monitored through regular review of the factors driving mortality change and methods for projecting future improvements. The Company's exposure to future improvements had been managed by ensuring that the mix of business was suitably weighted towards current pensioners who are less exposed to long-term improvements in mortality rates than younger deferred pensioners.

This risk is primarily at the time of writing new business. As the Company has not effected new contracts of insurance, management of risk was limited to monitoring of experience and where economically viable, entering into reinsurance to mitigate potential future longevity improvement risk.

## 2: Risk Management and Control (Continued)

### Reinsurance risk

The Company is able to manage the risk that pensioners will live longer than expected through use of suitable reinsurance. The Company has entered into a longevity swap contract in which the Company has swapped actual payments made to pensioners contingent upon their survival into fixed annuity payments agreed with the reinsurer. The value of such reinsurance contracts will increase if pensioners live for longer than expected. They therefore provide a potential hedge for the longevity risk assumed by the Company and allow capital held to cover this risk to be reduced. The reinsurance treaty in-force at the balance sheet date represents a quota share treaty with Hannover Ruckversicherung AG covering pension payments to members of various insured pension schemes. The treaty offsets around 10% of the longevity risk inherent in the Company's gross insurance contract liabilities.

### Expense risk

Higher expenses will tend to increase the value of insurance contract liabilities. The Company is exposed to the risk that the return on its assets are not sufficient to cover future expenses. At the balance sheet date, the Company held prudent reserves against this risk. Monthly monitoring of expenses occurred at Board level.

The Company held a closure provision to ensure that it had sufficient funding to reduce its cost base below the prudent level assumed in the reserving, should it move into run off. This expense reserve has been utilised from July 2009 following the decision by the Company to vary its permission with the FSA such that the Company will not effect new contracts of insurance.

### Sensitivity to insurance risk

The amount, timing and uncertainty of future insurance contract cash flows are most sensitive to the extent to which the duration of the assets held closely match the expected duration of the liabilities under the contracts. However, given that the Company's ALM methodology was to match the duration of assets and liabilities within the long-term business fund, the impact of short-term asset value movements as a result of interest rate movements was expected to broadly offset changes in the value of the liabilities caused by movements in the valuation rate of interest.

In addition, the cash flows were sensitive in respect of the variance between actual and expected mortality experience and the extent to which future mortality experience would give rise to changes in the measurement of liabilities, known as improvement risk.

The impact of a one year increase in life expectancy would be an increase in reserves of approximately 3% (2009: 3%) resulting in an increase in the loss for the year of £87,100,000 (2009: £81,949,000) and an impact on shareholders' equity of £62,700,000 (2009: £59,003,000).

An increase in maintenance expenses of 10% (2009: 10%) would increase reserves by 0.35% (2009: 0.34%) and would impact the result for the year by £10,300,000 (2009: £9,000,000) and impact on shareholders' equity of £7,400,000 (2009: £6,672,000).

### Concentrations of insurance risk

All insurance contracts are written in the UK and are in respect of pension schemes. As such, the results are sensitive to changes in the pensions and insurance market, regulatory and tax regimes within the UK. Concentrations of insurance risk are formally considered in the annual ICA review.

### Operational Risk

Operational risk is the potential for loss resulting from inadequate or failed internal processes, people and systems, or from external events. The Company's internal control processes were supported by maintenance of department risk registers and an independent internal audit review. The risk of internal fraud was managed through a number of processes including the screening of staff at recruitment, segregation of duties and whistle-blowing policies.

The Company has significant outsourcing arrangements for administration of pension payrolls and investment custody and administration functions. These arrangements were subject to agreements with formal service level requirements, operated within agreed authority limits and were subject to extensive review by senior management.

External events which may have an impact on the level of operational risk within the Company include risks relating to regulation, legal, financial processes and taxation. The Executive Committee were responsible for compliance and were supported through active engagement with regulatory authorities and regular involvement of sector specialists as required.

**3: Management of capital resources**

**Capital structure**

The Company writes long-term insurance business through the long-term business fund. This fund is segregated from the Company's other assets which are held within the shareholder's fund. The Company specialises in the insurance of pension scheme liabilities through non-participating contracts which are accounted for in accordance with the policy on product classification set out in Note 1.4. The Company does not write any with-profits or unit-linked insurance business. Shareholders' are entitled to all the profits, although capital in excess of the regulatory minimum required to cover the insurance contract liabilities is maintained to support existing business.

At the balance sheet date, the primary sources of capital used by the Company were equity shareholders' funds, a contingent loan from a fellow group company and a longevity swap arrangement with Hannover Ruckversicherung AG for a quota share covering pension payments to members of various insured pension schemes. The Company did not utilise external debt capital or securitisation.

**Capital management policies and objectives**

Capital was managed within the Company to maintain financial strength sufficient to satisfy the requirements of regulators to support in-force business. Any capital in excess of the regulator's requirements and the Company's extraction of value policy would have been made available initially to pay the Company's contingent loan and then any dividend recommended by the Board.

Shareholder targets were determined firstly by reference to appropriate capital adequacy and then by reference to growth in embedded value.

**Capital measures**

In recognition of the requirements of different stakeholders, the Company measured its capital on various accounting and regulatory bases.

**Accounting bases**

Management had regard to the primary financial statements prepared under IFRS, in order to manage capital and cash flow usage. Embedded value reporting, which measures the long-term underlying value of the capital employed, was widely used internally and in discussions with former investors.

**Regulatory bases**

When monitoring the capital position of the Company, consideration was always given to the regulatory bases in accordance with the FSA rules which incorporate the requirements of European Union directives.

The FSA rules which govern the regulation of insurance form part of the Prudential Sourcebook for Insurers, the General Prudential Sourcebook and Interim Prudential Sourcebook for Insurers. These rules require an insurer to hold capital resources equal at least to the Minimum Capital Requirement, known as Pillar 1. The Prudential Sourcebook for Insurers also contains ICA rules whereby an insurer must make their own assessment of the amount of capital needed to back their business, known as Pillar 2.

The Pillar 1 calculation consists of two parts. Firstly, the long-term insurance capital requirement (LTICR) which is calculated by applying fixed percentages to mathematical reserves and sums assured at risk. Secondly, the resilience capital requirement (RCR) is based on the most onerous of a number of stress tests which are applied to both assets and insurance contract liabilities. Details of the Pillar 1 requirements are publicly available from the FSA annual return. The regulatory requirements under Pillar 1 were fully complied with during the year.

The Pillar 2 calculation is an internal assessment of the capital required to withstand severe financial and operational shocks and is derived through a combination of stochastic modelling and scenario testing. In the opinion of the Company it had complied with these requirements during the year.

Notes to the Financial Statements  
For the year ended 31 December 2010

3: Management of capital resources (continued)

Available regulatory capital resources

The analysis of the available capital resources of the Company at balance sheet date, calculated in accordance with the Pillar 1 regulatory basis set out above, is as follows:

	UK Non participating £'000	Shareholder's funds £'000	Total £'000
<b>At 31 December 2010</b>			
Shareholder's equity held outside the long-term business fund	-	74,413	74,413
Shareholder's equity held inside the long-term business fund	122,502	-	122,502
<b>Total shareholders' equity</b>	<b>122,502</b>	<b>74,413</b>	<b>196,915</b>
Regulatory adjustments			
Assets	(62,602)	120,379	57,777
Liabilities	(2,950)		(2,950)
<b>Total available capital resources</b>	<b>56,950</b>	<b>194,792</b>	<b>251,742</b>
Capital resource requirement			(118,328)
<b>Excess regulatory capital</b>			<b>133,414</b>
<b>At 31 December 2009</b>			
Shareholder's equity held outside the long-term business fund	-	73,956	73,956
Shareholder's equity held inside the long-term business fund	155,596	-	155,596
<b>Total shareholder's equity</b>	<b>155,596</b>	<b>73,956</b>	<b>229,552</b>
Regulatory adjustments			
Assets	(53,531)	115,467	61,936
Liabilities	(2,900)		(2,900)
<b>Total available capital resources</b>	<b>99,165</b>	<b>189,423</b>	<b>288,588</b>
Capital resource requirement			(123,132)
<b>Excess regulatory capital</b>			<b>165,456</b>

The amount of policyholder liabilities is set out in Note 4. There were no investment contract liabilities at the balance sheet date.

Regulatory adjustments arise as a result of excluding the deferred tax asset, as it is an inadmissible asset for regulatory reporting purposes, inclusion of additional prudence within the valuation of insurance contract liabilities for regulatory reporting purposes and inclusion of the contingent loan as available capital resources.

Notes to the Financial Statements  
For the year ended 31 December 2010

3: Management of capital resources (continued)

Restrictions on available capital resources

The established surplus, being the excess of assets over liabilities in the long-term fund determined through a formal actuarial valuation, is generally available for distribution to the shareholder. In establishing whether the surplus under a Pillar 1 is to be available for distribution to the shareholder, consideration would be required to be given to the payment of interest on the contingent loan, capital position under the Pillar 2 assessment and any further capital requirements of the Company. Any transfer of surplus would give rise to a tax charge. However, it is management's intention to ensure that capital is retained within the Company to support policyholder in-force business with appropriate cover for risk.

Movement in capital resources

	2010	2009
	£'000	£'000
Balance at 1 January	288,588	239,968
Issue of share capital (Note 20)	-	11,000
Capital injection - share based payments charge (Note 21)	8,125	7,903
Changes in economic assumptions	15,307	5,720
Changes in non-economic assumptions	(13,006)	(2,696)
Disallowability of deferred tax asset	(9,071)	13,469
Other factors	(38,201)	13,224
Balance at 31 December	251,742	288,588

Other factors represents changes in market conditions such as illiquidity premium in LPI cover and downgrades and data modelling changes.

**Notes to the Financial Statements**  
**For the year ended 31 December 2010**

**4: Insurance contract liabilities**

**Valuation assumptions**

In accordance with the accounting policy on product classification, all policyholder contracts since the Company commenced trading in June 2006 have been classified as insurance contracts.

The liability for insurance contract liabilities contained within the long-term business fund is calculated on the basis of recognised actuarial methods having due regard to actuarial principles and best practice. The methods and assumptions are determined by the directors after considering the advice of the Actuarial Function Holder. Material judgement is applied in setting the assumptions and implementation of the accounting policy in this area.

The Company accepts the liabilities of pension schemes where the trustees wish to insure pension benefits. In certain situations, this is done with the intention to wind up the pension scheme and transfer its members to individual policies on the same terms and conditions agreed with the trustees of the pension scheme at commencement of the insurance policy. As such, the valuation of the liability is determined by reference to the contractual arrangements of the insured schemes at the individual member level.

The assumptions are initially based on those used to comply with the FSA statutory solvency basis. The valuation is then modified for IFRS reporting purposes to remove contingency reserves. Whilst allowances for these are required under the solvency basis applied for regulatory purposes, they are not required for financial accounting. The assumptions are initially applied at the individual member level with additional allowance for specific policy features at a scheme level. The Company seeks to make prudent assumptions about its future experience based on current market conditions and recent experience. The assumptions used incorporate margins to allow for the inherent uncertainty that actual experience may be less favourable than would otherwise be assumed.

The valuation of the insurance contract liabilities represents the present value of obligations to policyholders and related cash flows. This is calculated as the discounted value of future cash flows using the gross premium method. The projected cash flows represent those benefits, principally annuity payments, contractually payable to pension scheme members in accordance with the terms of the policy contract, after appropriate allowance for future mortality experience. Annuities in payment and in deferment may be level, subject to fixed increases or have increases linked to either the Retail Price Index (RPI) or National Average Earnings Index (NAEI). In certain cases, annuities in deferment may be subject to increase through Social Security Revaluation of Earnings Factors Orders. The Company is reviewing the UK government's changes to link pension payments to Consumer Price Index (CPI) rather than RPI in consultation with the insured pension scheme trustees to assess the impact on the inforce policies.

The cash flows used in the valuation include the expected future administration expenses. The cash flows are discounted at the valuation interest rate on those assets determined as covering the liabilities. For those contracts where the policyholder does not have the right to vary the amount of the premium to be paid, full credit is taken for the premiums contractually due at the valuation date.

The principal economic and non-economic assumptions for the valuation of insurance contract liabilities are set out below.

***Economic assumptions***

**Valuation interest rate :**

The valuation interest rate is based on the FSA regulatory requirements and is set with regard to the yields on the supporting assets within the long-term business fund. An explicit deduction from the yields on corporate bonds is made within the valuation interest rate to reflect the risk of default on these assets. The default assumption is based on an analysis of historical market rates of default (based on experience since 1920) and takes into account financial conditions at the valuation date. This analysis takes into account credit rating, term to redemption and security. The rating category will usually be its published rating but this may be adjusted downwards in accordance with the Company's credit rating model if the yield on the bond is higher than would be commensurate with a bond with that published rating. Using this information, default rates are derived appropriate to the assets within the portfolio.

The valuation interest rate applied at the balance sheet date was 4.791% (2009: 5.276%). The impact of the allowance for asset defaults was a reduction in the valuation interest rate of 64 bps (2009: 73 bps).

Paternoster UK Limited

Notes to the Financial Statements  
For the year ended 31 December 2010

4: Insurance contract liabilities

Valuation assumptions (continued)

*Non-economic assumptions*

Mortality:

The base mortality assumptions inherent in the projected cash flows used in the valuation of insurance contract liabilities are derived from an analysis of recent population and internal mortality experience obtained from the pension scheme administrators and make allowance for improvements in longevity in the future.

The mortality assumptions are set with reference to the standard tables drawn up by the Continuous Mortality Investigation Bureau (CMIB) of the Institute and Faculty of Actuaries. These tables are based on industry-wide experience. Internal statistical investigations are carried out on an on-going basis to determine the extent to which the Company's experience and mortality improvement expectations differ from that of the industry and suggest appropriate adjustments which need to be made to the standard tables for the purpose of the valuation assumptions. The adjustments applied to these tables vary according to gender, age, geo-graphical location and other indicators of socio-economic class.

An allowance for future mortality improvements has been made using sets of reduction factors derived using the mortality projection model published by the CMIB in November 2010. Specifically the projections used were CMI\_2010\_M [1.8%] and CMI\_2010\_F [1.6%] for males and females respectively. For comparative purposes, similar mathematical reserves would result from CMI\_2009\_M [1.85%] and CMI\_2009\_F [1.7%] for males and females respectively.

Expenses:

An allowance is made for expenses, including investment management expenses, following a review of the Company's costs.

Taxation:

No assumptions are made for taxation as it's incidence is contingent on future surplus.

The analysis of the insurance contract liabilities at the balance sheet date is as follows:

	2010	2009
	£'000	£'000
Insurance contract liabilities	2,910,295	2,731,644
Reinsurer's share of insurance contract liabilities	(7,600)	(6,237)
<b>Net insurance contract liabilities</b>	<b>2,902,695</b>	<b>2,725,407</b>

Reinsurer's share of insurance liabilities consists of the reinsurer's share in respect of the mortality risk associated with certain annuity payments to scheme members. The reinsurance asset's recoverability has been assessed and there is no requirement for impairment at balance sheet date.

The Company does not hold any collateral as security against potential default by the reinsurer.

Notes to the Financial Statements  
For the year ended 31 December 2010

4: Insurance contract liabilities

Valuation assumptions (continued)

Changes in insurance contract liabilities

At 31 December 2010	£'000	£'000	£'000
Movements in the insurance contracts liabilities during the year were as follows:	Gross	Reinsurance	Net
Balance at 1 January	2,731,644	(6,237)	2,725,407
New liabilities on recognition of premiums	765	-	765
Liabilities discharged in the year through annuitant payments and benefit transfers	(162,783)	(102)	(162,885)
Investment income attributed to liabilities	137,739	-	137,739
Change due to market movements (net of impact of trading)	203,049	-	203,049
Effect of change in economic assumptions	(19,624)	-	(19,624)
Effect of change in non-economic assumptions	16,674	-	16,674
Other changes to reserves including reinsurance, data and methodologies	2,831	(1,261)	1,570
<b>Balance at 31 December</b>	<b>2,910,295</b>	<b>(7,600)</b>	<b>2,902,695</b>
Expected to be settled within twelve months	150,801	(12)	150,789
Expected to be settled within more than twelve months	2,759,494	(7,588)	2,751,906
<b>Total insurance contract liabilities</b>	<b>2,910,295</b>	<b>(7,600)</b>	<b>2,902,695</b>

Changes in insurance contract liabilities

At 31 December 2009	£'000	£'000	£'000
Movements in the insurance contracts liabilities during the year were as follows:	Gross	Reinsurance	Net
Balance at 1 January	2,534,104	-	2,534,104
New liabilities on recognition of premiums	18,840	-	18,840
Liabilities discharged in the year through annuitant payments and benefit transfers	(169,505)	(90)	(169,595)
Investment income attributed to liabilities	140,480	-	140,480
Change due to market movements	202,523	-	202,523
Effect of change in economic assumptions	(7,945)	-	(7,945)
Effect of change in non-economic assumptions	3,744	-	3,744
Other changes to reserves including reinsurance, data and methodologies	9,403	(6,147)	3,256
<b>Balance at 31 December</b>	<b>2,731,644</b>	<b>(6,237)</b>	<b>2,725,407</b>
Expected to be settled within twelve months	150,078	63	150,141
Expected to be settled within more than twelve months	2,581,566	(6,300)	2,575,266
<b>Total insurance contract liabilities</b>	<b>2,731,644</b>	<b>(6,237)</b>	<b>2,725,407</b>

As part of the annual valuation of the insurance contract liabilities, a liability adequacy test has been carried out at the policy level. There is no additional provision to be recognised for 2010 or 2009.

Notes to the Financial Statements  
For the year ended 31 December 2010

4: Insurance contract liabilities (continued)

There were minor changes to economic assumptions during the year and the credit default assumptions continue to be refined in response to recent market condition. This led to a £5,300,000 release in reserves. The reinvestment rates assumed in the cashflow mismatch reserve was increased to be in line with the reinvestment assumption used for swap coverage releasing £14,300,000 of reserves.

Non economic changes in 2010 related predominantly to a strengthening in the mortality improvement factors. This resulted in an increase in the valuation of the insurance contract liabilities of £13,100,000.

Expected insurance contract liability cash flows

An analysis of the undiscounted expected contract cash flows in respect of insurance contract liabilities is as follows:

	2010 £'000	2009 £'000
Less than 5 years	811,036	812,272
Within 5-10 years	839,172	835,052
Within 10-15 years	849,195	861,071
Within 15-20 years	830,767	829,054
Within 20-25 years	772,662	769,765
Greater than 25 years	2,547,030	2,496,142
<b>Total undiscounted expected cash flows</b>	<b>6,649,862</b>	<b>6,603,356</b>

5: Segmental information

The Company operates in a single business segment, being long-term insurance business in the UK.

During 2009, the Company varied its permission with the FSA such that the Company will not effect new contracts of insurance. Premiums will be accepted but only to the extent that these are already subject to a pre-existing contractual commitment. This results in premium adjustment which can be additional premium receipt or refund of premium. Pursuant to this, the Company has earned gross premium revenue of £1,819,000 (2009: £20,779,000) due to premium adjustments, out of which £2,104,000 (2009: £17,740,000) is generated from three (2009: two) of its existing pension schemes.

Notes to the Financial Statements  
For the year ended 31 December 2010

**6: Net Premium revenue**

Gross premium revenue is derived from single premium business, being insurance of pension scheme obligations. Premiums are received in consideration for taking on pension scheme liabilities. Premiums are recognised when due for payment. Premium revenue can be analysed according to pension payment types, at inception, as follows:

	2010	2009
	£'000	£'000
Immediate annuitants	943	20,574
Deferred annuitants	876	205
Gross premium revenue	1,819	20,779
Less: Reinsurance premium expenses	(616)	(619)
<b>Net premium revenue</b>	<b>1,203</b>	<b>20,160</b>

In accordance with the accounting policy on product classification, all policyholder contracts written during the year and in prior periods have been classified as insurance contracts. All premiums are single premium business. All business is written in the United Kingdom and relates to group pension buyouts.

On 20 March 2009 the Company entered into a longevity swap arrangement with a third party reinsurer in respect of the mortality risk associated with certain annuity payments to scheme members from 1 December 2008. This reinsurance transaction is a cash flow swap for current pensioners only wherein a fixed leg of cash flows is paid by the Company and the floating leg will be paid by the reinsurer. Reinsurance premium expenses represents swap management fees (refer Note 1.4).

**7: Investment return**

	2010	2009
	£'000	£'000
<b>Interest income</b>		
Interest received on investments held at fair value through the Income Statement	155,696	150,360
Interest received on cash and cash equivalents	1,506	2,551
<b>Total interest income</b>	<b>157,202</b>	<b>152,911</b>
Net gain/(loss) on the realisation of investments held at fair value through the Income Statement	11,748	(8,420)
Net fair value gain on financial assets and liabilities	144,545	229,840
Stock lending income, fund distribution and other income	853	882
<b>Total investment return</b>	<b>314,348</b>	<b>375,213</b>

Net fair value gains or losses includes gains and losses on financial assets designated at fair value through the Income Statement and derivative financial assets and liabilities that have been classified as held for trading. The net fair value gain on derivative financial assets and liabilities is £24,911,000 ( 2009: loss £41,080,000).

**Paternoster UK Limited**

**Notes to the Financial Statements  
For the year ended 31 December 2010**

**8: Claims and change in insurance contract liabilities**

	2010	2009
	£'000	£'000
Gross claims and benefits paid	162,783	169,505
Reinsurer's share of claims paid	102	90
<b>Total claims and benefits paid, net</b>	<b>162,885</b>	<b>169,595</b>
Change in insurance contract liabilities	178,651	197,540
Reinsurer's share of insurance contract liabilities	(1,363)	(6,237)
<b>Net change in insurance contract liabilities</b>	<b>177,288</b>	<b>191,303</b>
<b>Total claims and change in liabilities</b>	<b>340,173</b>	<b>360,898</b>

Reinsurer's share of claims paid represents the net payment to the reinsurer under longevity swap contract as a result of comparing the actual payments to policyholders with the fixed contractual payments.

**9: Acquisition costs**

Since the Company is not affecting any new business contracts, all costs are deemed in respect of maintenance of existing in-force and there are no acquisition costs. As a result, all costs have been included in administration costs within the income statement.

**10: Finance costs**

	2010	2009
	£'000	£'000
Interest payable - related party contingent loan	4,912	6,547
Interest Income on amounts due from/to policyholders	-	140
<b>Total finance costs</b>	<b>4,912</b>	<b>6,687</b>

**11: Expenses by nature**

	2010	2009
	£'000	£'000
The following items have been included in arriving at loss before tax:		
Investment expenses and charges	178	441

**Auditors' remuneration**

Fees paid to the Company's auditors in respect of :

Audit of the financial statements pursuant to legislation	110	163
Other services pursuant to such legislation	30	30
Other services relating to taxation	-	-
<b>Total auditors' remuneration</b>	<b>140</b>	<b>193</b>

**Paternoster UK Limited**

**Notes to the Financial Statements  
For the year ended 31 December 2010**

**11: Expenses by nature (continued)**

**Directors' emoluments**

The directors of the Company were remunerated by Paternoster Services Limited, a fellow subsidiary of Paternoster Limited, which employs the directors. These costs are recharged to Paternoster UK Limited under the service agreement between the two companies.

	2010	2009
	£'000	£'000
Aggregate emoluments:	1,240	1,158

There were no amounts payable to any director (including the highest paid director) relating to compensation for loss of office, long-term incentive schemes (excluding shares), defined benefit pension schemes nor sums paid to third parties for directors' services.

During the year, six directors (2009: four) of the Company (including the highest paid director) exercised share options and warrants in the parent company, Paternoster Limited. Two directors (including the highest paid director) received additional grants during the year.

**Highest Paid Director:**

	2010	2009
	£'000	£'000
Aggregate emoluments and amounts (excluding shares) receivable under long-term incentive schemes	436	551

**Employee remuneration**

Staff costs incurred during the period can be analysed as follows:

Share based payments expense - equity settled schemes	8,394	4,802
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Staff costs in respect of share based payment incentives are recognised directly by the Company for employees of other group companies. Salaries and related costs are incurred by Paternoster Services Limited and Paternoster India Private Limited, both fellow group companies. These costs are recharged to the Company under the service agreements between the these companies; details of which are below:

	2010	2009
	£'000	£'000
Wages and salaries	5,097	7,079
Social security costs	495	765
<b>Total employee remuneration</b>	<b>5,592</b>	<b>7,844</b>

The average monthly number of staff including executive and non-executive directors employed during the year by the Group was 107 (2009: 133). The number of staff, including executive and non-executive directors, employed at the end of the year is 36 (2009: 34) in UK and 67 (2009:73) in India.

Notes to the Financial Statements  
For the year ended 31 December 2010

12: Share based payments expense

Options and warrants are equity settled arrangements, whereby the fair value of services received from employees and others, is measured by reference to the fair value of the equity instruments granted.

Options and warrants have been granted over the shares of the ultimate parent company to certain directors and employees of the Group. The purpose of the schemes is to incentivise and remunerate employees of the Group.

The valuation of the options and warrants is a calculated estimate based on future uncertain events. The salient features of the plans and the methods and assumptions used in the valuation are as follows:

- Options and warrants were granted in five tranches on 26 April 2006, 26 June 2006, 12 December 2007, 31 March 2008 and 24 July 2008;
- Prior to the implementation of the sale of the Paternoster Group (refer below), options and warrants vested with individuals in four equal annual instalments beginning on the first anniversary of the grant date and were conditional upon employees remaining in service at the exercise date;
- Weighted average share price at grant dates £0.65 (2009: £0.65);
- A risk-free interest rate of 1.38% (2009: 1.64%) p.a;
- Share volatility of 55% (2009: 55%), based on a comparison with similar companies;
- No expected dividends;
- No time limit is set within which the options and warrants expire, with an expected period of exercise for options and warrants within one year from the Balance Sheet date; and
- The fair value of the options is estimated on the date of grant using a Black-Scholes option valuation model.

A reconciliation of the movement in options and warrants is as follows:

	Options	Special Warrants	A Warrants	B Warrants	C Warrants
<b>Year ended 31 December 2010</b>					
Fair value of grants	£0.649	£0.649	£0.075	£0.011-£0.028	£0.001-£0.010
	Nos.	Nos.	Nos.	Nos.	Nos.
Outstanding at 1 January	3,490,001	18,462,348	30,708,979	30,708,979	30,708,979
Granted during the year	293,099	1,527,273	270,984	270,984	270,984
Forfeited during the year	(182,471)	(395,247)	(1,820,007)	(1,820,007)	(1,820,007)
Exercised during the year	(1,685,373)	(10,565,975)	-	-	-
Outstanding at 31 December	1,915,256	9,028,399	29,159,956	29,159,956	29,159,956
Of which, the total number exercisable at end of the year were:	1,915,256	9,028,399	29,159,956	29,159,956	29,159,956
<b>Year ended 31 December 2009</b>					
Fair value of grants	£0.649	£0.649	£0.075	£0.017-£0.041	£Nil-£0.022
	Nos.	Nos.	Nos.	Nos.	Nos.
Outstanding at 1 January	4,164,831	21,439,938	33,885,483	33,885,483	33,885,483
Granted during the year	16,227	84,558	140,410	140,410	140,410
Forfeited during the year	(470,943)	(2,007,947)	(3,316,914)	(3,316,914)	(3,316,914)
Exercised during the year	(220,114)	(1,054,201)	-	-	-
Outstanding at 31 December	3,490,001	18,462,348	30,708,979	30,708,979	30,708,979
Of which, the total number exercisable at end of the year were:	1,681,112	8,622,413	18,559,511	18,559,511	18,559,511

The options and special warrants have a fixed exercise price of £0.001 per share. The A Warrants have a fixed exercise price of £1.079 per share with B and C Warrants subject to a 15% and 30% per annum uplift respectively from the date of grant to exercise date. The range of exercise prices of the B Warrants as at 31 December 2010 was £1.627-£2.227 (2009: £1.627-£2.227). The range of exercise prices of the C Warrants as at 31 December 2010 was £2.333-£4.206 (2009: £2.333-£4.206).

Included within the grants outstanding at the Balance Sheet date are 2,207,681 special warrants (2009: 4,415,366) issued to an existing investor in Paternoster Limited to compensate them for services in connection with the establishment and funding activities of the Group. All other options and warrants were issued to employees, including executive and non-executive directors.

**Paternoster UK Limited**

**Notes to the Financial Statements**

**For the year ended 31 December 2010**

**12: Share based payments expense (continued)**

The fair value of the options and warrants granted during the year was £1,212,000 (2009: £145,000). The net total charge for the year relating to equity-settled share based payment plans (including National Insurance costs) was £8,394,000 (2009: £4,802,000), being £7,177,000 (2009: £3,727,000) in respect of employees and £1,217,000 (2009: £1,075,000) for other services. The total charges excluding National Insurance costs recognised directly in equity was £8,125,000 (2009: £7,903,000). The weighted average share price during the year for options and warrants exercised was £0.65 (2009: £0.65).

On 16 December 2010 the then ultimate Parent Company, Paternoster Limited, implemented the sale of the entire issued and to-be-issued ordinary share capital of Paternoster Limited to Rothesay Life, a wholly owned subsidiary of Goldman Sachs.

Under the rules of the Paternoster Limited Share Option Plan and under the terms of the Warrant Instrument, all outstanding options and warrants granted became exercisable in full at this time. All outstanding options and warrants (excluding A, B & C warrants which were out-of-the-money) were exercised. The share based payment charge for the current year recognises the full remaining cost of the grants on the basis that unconditional vesting occurred prior to the balance sheet date.

There are no further costs to be allocated to future accounting periods in respect of share based payment schemes.

Based on the exit value achieved on sale of Paternoster Group in January 2011, the value of the options and warrants granted during 2010 was £859,000.

**13: Taxation**

	2010	2009
	£'000	£'000
<b>Current tax</b>		
UK corporation tax for the current year	-	-
<b>Total current tax</b>	<b>-</b>	<b>-</b>
<b>Deferred tax</b>		
Origination and reversal of temporary differences		
Prior year adjustments	(1,085)	-
Current year	(10,305)	4,248
Reduction in deferred tax due to change in tax rates	2,319	-
<b>Total deferred tax</b>	<b>(9,071)</b>	<b>4,248</b>
<b>Total income tax (benefit)/expense</b>	<b>(9,071)</b>	<b>4,248</b>

Income tax (benefit) calculated at the standard UK corporation tax rate of 28% (2009: 28%):

	2010	2009
	£'000	£'000
(Loss)/Profit before tax	(49,833)	7,269
Tax on (Loss)/Profit	(13,953)	2,035
Effects of:		
Disallowable expenditure	2,275	2,213
Reduction in deferred tax due to change in tax rates	2,319	-
Prior year adjustments	(1,085)	-
Group relief surrendered to a related company at no cost	1,373	-
<b>Total income tax (benefit)/expense</b>	<b>(9,071)</b>	<b>4,248</b>

Notes to the Financial Statements  
For the year ended 31 December 2010

14: Dividends

No dividends have been declared during the year or prior year and no dividends are proposed at the Balance Sheet date.

15: Deferred tax

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

Deferred tax assets are recognised to the extent that they are regarded as recoverable and it can be regarded, as more likely than not, that there will be suitable taxable profits from which the future reversal of the temporary differences can be deducted.

Deferred tax assets and liabilities are attributable to the following:

	Balance at 1 January	Recognised in income	Balance at 31 December
<b>Year ended 31 December 2010</b>			
Temporary differences between the financial statements and the tax deduction for insurance contract liabilities.	(17,386)	(2,248)	(19,634)
Tax losses carried forward	70,917	11,319	82,236
<b>Net deferred tax asset</b>	<b>53,531</b>	<b>9,071</b>	<b>62,602</b>
<b>Year ended 31 December 2009</b>			
Temporary differences between the financial statements and the tax deduction for insurance contract liabilities.	(21,838)	4,452	(17,386)
Tax losses carried forward	79,617	(8,700)	70,917
<b>Net deferred tax asset</b>	<b>57,779</b>	<b>(4,248)</b>	<b>53,531</b>

The deferred tax asset expected to be settled within twelve months is £9,200,000 (2009:£2,700,000) and the balance is expected to be settled within more than twelve months.

The deferred tax assets are recognised only to the extent that, based on management's assessment, they are regarded as recoverable. On the basis of all available evidence, management regard as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying temporary differences, including unrecovered tax losses, can be deducted. Future taxable profits are expected to emerge from the release of profits from the in-force policyholders business.

There are no unrecognised deferred tax assets or deferred tax liabilities at 31 December 2010 or 31 December 2009.

In accordance with IAS12, deferred tax assets are recognised on an undiscounted basis. By applying a discount basis consistent with that used in the derivation of the Company's embedded value, the deferred tax asset on a discounted basis would be £47,818,000 (2009: £39,000,000).

**Paternoster UK Limited**

**Notes to the Financial Statements  
For the year ended 31 December 2010**

**16: Financial assets**

The Company has determined that all financial assets are accounted for at fair value through the Income Statement, designated as such upon initial recognition. Derivative financial assets and liabilities have been classified as held for trading.

	2010 £'000	2009 £'000
Fixed income deposits with banks (original maturities in excess of three months)	24,500	10,005
Debt securities and others		
Government - UK Gilts	45,687	35,041
Government - UK Indexed linked bonds	15,732	17,135
Corporate - UK	2,381,843	2,272,198
Corporate - UK Indexed linked bonds	328,528	279,887
Corporate - UK Asset backed/ Mortgaged securities	148,912	133,553
Corporate - Foreign currency bonds	3,782	33,779
Private Placement Fund	13,536	15,155
<b>Total debt securities</b>	<b>2,938,020</b>	<b>2,786,748</b>
Derivative financial assets (Note 17)	92,309	83,517
<b>Total financial assets</b>	<b>3,054,829</b>	<b>2,880,270</b>

Debt securities can be further analysed as follows:

Expected to be settled within twelve months	39,159	15,155
Expected to be settled within more than twelve months	2,898,861	2,771,593
<b>Total debt securities</b>	<b>2,938,020</b>	<b>2,786,748</b>

Listed	2,879,943	2,717,119
Unlisted	58,077	69,629
<b>Total debt securities</b>	<b>2,938,020</b>	<b>2,786,748</b>

Fixed rate	2,491,259	2,381,411
Floating rate	446,761	405,337
<b>Total debt securities</b>	<b>2,938,020</b>	<b>2,786,748</b>

All fixed income deposits are expected to be settled within twelve months. Corporate - UK Asset backed/ Mortgaged securities includes UK Indexed Linked bonds of £6,412,000 (2009: £5,488,000).

The following is a summary of the cost, gross unrealised gains and losses and fair value of financial investments:

	Cost £'000	Unrealised Gains £'000	Unrealised Losses £'000	Fair Value £'000
<b>Year ended 31 December 2010</b>				
Debt securities	2,843,945	157,786	(63,711)	2,938,020
Derivative financial assets	1,173	91,136	-	92,309
Fixed income deposits with banks	24,500	-	-	24,500
<b>Total financial investments</b>	<b>2,869,618</b>	<b>248,922</b>	<b>(63,711)</b>	<b>3,054,829</b>
<b>Year ended 31 December 2009</b>				
Debt securities	2,812,272	107,402	(132,926)	2,786,748
Derivative financial assets	2,429	81,088	-	83,517
Fixed income deposits with banks	10,005	-	-	10,005
<b>Total financial investments</b>	<b>2,824,706</b>	<b>188,490</b>	<b>(132,926)</b>	<b>2,880,270</b>

Notes to the Financial Statements  
For the year ended 31 December 2010

16: Financial assets (continued)

Fair Value Hierarchy

Fair value measurements for each class of financial instruments have been classified into fair value hierarchy per IFRS 7 as below. For the accounting policies regarding the determination of the fair values of financial assets and financial liabilities refer Note 1.5 and Note 1.6.

At 31 December 2010, investments classified as Level 1 comprise approximately 2.81% (2009: 2.16%) of financial assets measured at fair value on a recurring basis. Fair value measurements classified as Level 1 include UK Gilts using prices from active market source readily available and fixed income deposits with banks.

At 31 December 2010, investments classified as Level 2 comprise approximately 92.86% (2009: 90.48%) of financial assets measured at fair value on a recurring basis. They primarily include agency securities and corporate debt securities and derivative financial instruments. Derivative financial instruments were reclassified from Level 3 to Level 2 during the year to reflect the ongoing development of internal pricing models based on observable market inputs.

Fair value of securities is measured using various broker (market participants) quotes, iboxx prices (closing bid price) etc. readily and regularly available on Bloomberg. The price selection process involved review of various above mentioned quotes and selecting the one which is the most representative quote from various contributors.

As disclosed in Note 17, the fair value of derivative financial assets and liabilities is £92,309,000 and £109,026,000 respectively at 31 December 2010 (2009: £83,517,000 and £123,584,000 respectively). All of these derivative contracts have been executed in the over-the-counter (OTC) derivative market and are classified as Level 2 (from Level 3 in 2009) within the fair value hierarchy. The fair values of derivative assets and liabilities were determined by an internal system using quantitative models that required use of the contractual terms of the derivative instruments and multiple market inputs (significantly observable), including interest rates, inflation rate, foreign exchange rates, prices and indices to generate continuous yield or pricing curves and volatility factors, if any, which were then applied to value the positions. Further, their reasonableness was assessed by comparison to separately determined valuations from the counterparty.

At 31 December 2010, investments classified as Level 3 comprise approximately 4.33% (2009: 7.36%) of financial assets measured at fair value on a recurring basis. They primarily include illiquid corporate debt securities, and privately placed fund investments. Determinations to classify fair value measures within Level 3 of the valuation hierarchy are generally based on the significance of the unobservable factors to the overall fair value measurement. Included in the Level 3 classification at 31 December 2010 were approximately £132,146,000 (2009: £128,627,000) of illiquid corporate debt securities and privately placed fund investments. Pricing of corporate debt securities/privately placed fund Investments was as per indicative pricing or unit prices obtained from specific brokers/counterparties or based on an internal pricing model that otherwise could not be completely corroborated to market observable data. The company applied various due diligence procedures, as considered appropriate, to validate these valuations for reasonableness, based on its understanding of the markets, including use of internally-developed assumptions about the inputs a market participant would use to price the security.

The following table presents the Company's assets and liabilities measured at fair value at 31 December 2010:

	Level 1	Level 2	Level 3	Total balance
	£'000	£'000	£'000	£'000
<b>Assets</b>				
Fixed Income deposits	24,500	-	-	24,500
Financial assets at fair value through income				
- Government - UK Gilts & Indexed linked bonds	61,419	-	-	61,419
- Debt securities	-	2,744,455	118,610	2,863,065
- Private placement fund	-	-	13,536	13,536
Derivative financial instruments (Note 17)	-	92,309	-	92,309
<b>Total assets</b>	<b>85,919</b>	<b>2,836,764</b>	<b>132,146</b>	<b>3,054,829</b>
<b>Liabilities</b>				
Derivative financial instruments (Note 17)	-	(109,026)	-	(109,026)
<b>Total liabilities</b>	<b>-</b>	<b>(109,026)</b>	<b>-</b>	<b>(109,026)</b>

Notes to the Financial Statements  
For the year ended 31 December 2010

16: Financial assets (continued)

The following table presents the Company's assets and liabilities measured at fair value at 31 December 2009:

	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total balance £'000
<b>Assets</b>				
Fixed Income deposits	10,005	-	-	10,005
Financial assets at fair value through income				
- Government - UK Gilts & Indexed linked bonds	52,176	-	-	52,176
- Debt securities	-	2,605,945	113,472	2,719,417
- Private placement fund	-	-	15,155	15,155
Derivative financial instruments	-	-	83,517	83,517
<b>Total assets</b>	<b>62,181</b>	<b>2,605,945</b>	<b>212,144</b>	<b>2,880,270</b>
<b>Liabilities</b>				
Derivative financial instruments	-	-	(123,584)	(123,584)
<b>Total liabilities</b>	<b>-</b>	<b>-</b>	<b>(123,584)</b>	<b>(123,584)</b>

The following table presents the changes in Level 3 instruments:

	2010 Debt securities £'000	2010 Derivative financial instruments £'000	2009 Debt securities £'000	2009 Derivative financial instruments £'000
<b>Balance at 1 January</b>				
- Assets	128,627	83,517	118,161	233,115
- Liabilities	-	(123,584)	-	(231,697)
	128,627	(40,067)	118,161	1,418
<b>Movements during the period:</b>				
Income statement:				
- Unrealised gain/(loss)	17,629	-	26,852	(41,080)
- Realised gain/(loss)	-	-	-	(168)
- Accrued Interest	-	-	-	(329)
Transfer out to Level 2	-	40,067	(23,258)	-
Purchases	8,525	-	6,930	(76)
Sales	(22,570)	-	-	168
Settlements at maturity of investment	(65)	-	(58)	-
<b>Total movements during the period</b>	<b>3,519</b>	<b>40,067</b>	<b>10,466</b>	<b>(41,485)</b>
<b>Balance at 31 December</b>	<b>132,146</b>	<b>-</b>	<b>128,627</b>	<b>(40,067)</b>
- Assets	132,146	-	128,627	83,517
- Liabilities	-	-	-	(123,584)
<b>Total</b>	<b>132,146</b>	<b>-</b>	<b>128,627</b>	<b>(40,067)</b>

The total fair value gain for the period included in investment return for assets and liabilities held at the end of the reporting period were £3,742,000 (2009: £24,060,000) for debt securities and £Nil (2009: loss of £56,084,000) for derivative financial instruments.

Derivative financial instruments have been transferred out to Level 2 as significant inputs used for their fair valuation are market observable as at year end. Derivative financial assets and liabilities have been shown together under derivative financial instruments above as this reflects the basis on which they are managed.

There are no significant transfers between Level 1 and Level 2 classifications.

Notes to the Financial Statements  
For the year ended 31 December 2010

16: Financial assets (continued)

Securities Lending

At the balance sheet date, the Company had securities lending arrangements in the UK with its custodian acting as its agent and in accordance with established market conventions. Investments were lent to locally domiciled counterparties, primarily major brokerage firms, and governed by agreements written under English law.

The Company's policy was that collateral in excess of 100 per cent of the fair value of securities loaned was required from all securities borrowers and typically consists of cash or debt securities.

Included within financial investments are £85,948,000 (2009: £143,064,000) of debt securities which the Company had lent under securities lending arrangements at the balance sheet date. The collateral held (including guarantees) under such agreements was £89,712,000 (2009: £146,634,000), of which £82,020,000 (2009: £96,163,000) was held in cash, with an off-setting payable recognised within trade and other payables. No amounts receivable or payable have been recognised in respect of non-cash collateral. Investment income in respect of securities lending during the year was £327,000 (2009: £468,000).

Collateral on Derivative Financial Instruments

Included within financial investments are £30,276,000 (2009: £49,007,000) of debt securities which the Company had provided as collateral in respect of derivative financial instruments. Further, the Company had also received collateral in the form of debt securities of £7,103,000 (2009: £3,868,000) in respect of derivative financial instruments. No amounts receivable or payable have been recognised in respect of the non-cash collateral held.

17: Derivative financial assets and liabilities

The Company entered into various inflation, interest rate and currency swap agreements in accordance with the financial risk management approach set out in Note 2.

Derivative financial assets and liabilities are accounted for at fair value.

	Contract / Notional Value £'000	Fair value Assets £'000	Fair value Liabilities £'000
<b>Year ended 31 December 2010</b>			
Interest rate swaps	1,097,199	67,577	51,768
Inflation swaps	1,668,594	21,526	48,324
Currency swaps	6,498	3,206	8,934
<b>Total derivative financial assets and liabilities</b>	<b>2,772,291</b>	<b>92,309</b>	<b>109,026</b>
<b>Year ended 31 December 2009</b>			
Interest rate swaps	1,401,972	54,268	68,881
Inflation swaps	1,641,256	22,685	35,631
Currency swaps	31,961	6,564	19,072
<b>Total derivative financial assets and liabilities</b>	<b>3,075,189</b>	<b>83,517</b>	<b>123,584</b>

All derivative financial assets and liabilities are classified as held for trading and are expected to be settled within twelve months.

The amount of change during the period and cumulatively in the fair value of the derivative financial liabilities at the year end is attributable to market risk and there is no significant amount attributable to the change in the credit risk. All derivative financial instruments were subject to collateralisation which was reviewed on a daily basis.

**Paternoster UK Limited**

**Notes to the Financial Statements  
For the year ended 31 December 2010**

**18: Trade and other receivables**

	2010	2009
	£'000	£'000
Amounts due from policyholders	8,549	8,737
Accrued interest	62,300	56,810
Amounts due from group undertakings	-	53
Other debtors	550	5,482
<b>Total trade and other receivables</b>	<b>71,399</b>	<b>71,082</b>

Other debtors include £NIL (2009: £4,986,000) towards unsettled investment sale transactions. Trade and other receivables are expected to be settled within twelve months.

**19: Cash and cash equivalents**

	2010	2009
	£'000	£'000
Cash at bank	176,615	183,969
Cash equivalents	53,957	109,301
<b>Total cash and cash equivalents</b>	<b>230,572</b>	<b>293,270</b>

Cash and cash equivalents of £111,053,000 (2009: £162,610,000) are held within the long term business fund and are not available to settle obligations outside the fund.

The effective interest rate on cash at bank and cash equivalents was 0.49% (2009: 0.54%) and has an average maturity of 4 days (2009: 17 days).

Cash at bank includes £82,020,000 (2009: £96,163,000) held as a result of the receipt of collateral on lending of securities.

**20: Share capital and share premium**

	Number of shares	Share capital £'000	Share premium £'000
<b>Issued share capital, fully paid</b>			
Balance at 1 January 2009	3,830	4	361,338
Issue of shares to investors	110	-	11,000
<b>Balance at 31 December 2009</b>	<b>3,940</b>	<b>4</b>	<b>372,338</b>
Issue of shares to investors	-	-	-
<b>Balance at 31 December 2010</b>	<b>3,940</b>	<b>4</b>	<b>372,338</b>

The amounts recognised in the share premium reserve represent the proceeds received in excess of the nominal value of the shares issued.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company.

Paternoster UK Limited

Notes to the Financial Statements  
For the year ended 31 December 2010

21: Retained earnings

	2010	2009
	£'000	£'000
Balance at 1 January	(179,648)	(182,669)
(Loss)/Profit for the year	(40,762)	3,021
Balance at 31 December	(220,410)	(179,648)

22: Share based payment reserve

	2010	2009
	£'000	£'000
Balance at 1 January	36,858	28,955
Share based payments expense for the year (Note 12)	8,125	7,903
Balance at 31 December	44,983	36,858

23: Borrowings

The Company has a contingent loan from Paternoster Financial Services Limited, a fellow group company, to support the capital surplus in the Company. The rate of interest on the contingent loan is fixed on 1 January each year at 1 year LIBOR + 3.0% per annum. The effective interest rate for the year was 4.25% (2009: 6.01%). The repayment of the loan and interest accrued thereon is subject to approval from the FSA and when the Company has regulatory surplus in its regulatory return filed with FSA. The Company may repay or defer the payment of the whole or part of the above loan along with all the interest accrued thereon at any time at its option, subject to necessary approvals.

The carrying value of borrowings include the principal loan amount of £105,000,000 (2009: £105,000,000) and the interest accrued of £15,379,000 (2009: £10,467,000). Both the principal loan amount and the interest accrued are expected to be settled within more than twelve months.

There were no borrowing costs incurred in connection with the establishment of this loan facility.

There are no undrawn facilities associated with the contingent loan borrowings at the balance sheet date.

The carrying value of borrowings approximates fair value.

24: Trade and other payables

	2010	2009
	£'000	£'000
Creditors arising out of direct insurance operations	4,062	2,067
Accruals	161	191
Investment settlements and collateral repayment liabilities	82,272	101,207
Amount due to group undertakings	3,038	-
Other payables	854	678
Total trade and other payables	90,387	104,143

Trade and other payables are expected to be settled within twelve months.

**Paternoster UK Limited**

**Notes to the Financial Statements**

For the year ended 31 December 2010

**25: Related party transactions**

**Key management personnel compensation**

The key management personnel of the Company were remunerated by Paternoster Services Limited and Paternoster India Private Limited, fellow subsidiaries of Paternoster Limited, which employed the key management personnel. These costs were recharged to the Company under the service agreements between the companies. Compensation to those employees classified as key management, being those having authority and responsibility for planning, directing and controlling the activities of the Company, including the executive and non-executive directors, is as follows:

	2010	2009
	£'000	£'000
Salary and other short-term benefits	3,181	2,123
Share based payment benefits	9,859	7,611
<b>Total key management personnel compensation</b>	<b>13,040</b>	<b>9,734</b>

There were no post-employment benefits or termination benefits paid to key management personnel. No consideration is payable to the third parties for making their services available as a director.

**Other related party transactions**

The Company entered into various investment transactions with Deutsche Bank AG, formerly a significant shareholder of the Parent company at the balance sheet date, and other group subsidiary companies. All transactions were on a commercial, arms-length basis. Details of transactions and balances in respect of these transactions are as follows:

	2010	2009
	£'000	£'000
<b>Revenue earned</b>		
- Deutsche Bank AG:		
Net swap payments on derivative financial assets and liabilities	(10,160)	(1,957)
Net fair value gain/(loss) on financial assets held at fair value through the Income Statement	23,110	(8,455)
<b>Total revenue earned</b>	<b>12,950</b>	<b>(10,412)</b>
<b>Expenses incurred</b>		
- Fellow Group Undertakings		
Services received	11,719	15,197
Finance costs	4,912	6,547
<b>Total expenses incurred</b>	<b>16,631</b>	<b>21,744</b>
<b>Balances receivable</b>		
- Fellow Group Undertakings		
Trade and other receivables	-	53
- Deutsche Bank AG:		
Derivative financial assets	65,957	65,134
<b>Total balances receivable</b>	<b>65,957</b>	<b>65,187</b>
<b>Balances payable</b>		
- Fellow Group Undertakings		
Borrowings	120,379	115,467
Trade and other payables	3,038	
- Deutsche Bank AG:		
Derivative financial liabilities	56,764	79,051
<b>Total balances payable</b>	<b>180,181</b>	<b>194,518</b>

The nominal value of derivative contracts outstanding with Deutsche Bank AG at 31 December 2010 was £2,151,699,000 (2009: £2,389,568,000).

**Paternoster UK Limited**

**Notes to the Financial Statements  
For the year ended 31 December 2010**

**25: Related party transactions (Continued)**

**Parent company**

At the balance sheet date, the immediate parent company was Paternoster Holdings Limited and the ultimate parent company was Paternoster Limited, both of which are incorporated in the Isle Of Man. Group accounts are prepared for Paternoster Limited, copies of which can be obtained from the Company Secretary, Fleet Place House, 2 Fleet Place, London EC4M 7RF.

**26: Commitments and contingent liabilities**

The Company has no contingent liabilities other than those relating to normal insurance risks.

**27: Events after the Balance Sheet date**

The sale of the Paternoster Group to Rothesay Life (Cayman) Limited concluded on 11 January 2011 and the Paternoster Group of companies became wholly owned subsidiaries of The Goldman Sachs Group Inc., as the ultimate parent company, from that date.

On 12 January 2011, the Company allotted 600 ordinary shares to its parent, Paternoster Holdings Limited of £1.00 per share for a total consideration of £60,000,000 to strengthen the capital position of the Company, with agreement of FSA.

Following the acquisition of the Paternoster group, the investment portfolio has been significantly de-risked with sale of approximately 50% of the bond portfolio and the proceeds being retained in cash. The investment performance of the portfolio is delivered through a secured financing arrangement covering the long-term business fund assets supporting the insurance contract liabilities.

On 13 January 2011 the Company entered into a long-term subordinated loan agreement with a fellow subsidiary of Goldman Sachs. The agreement provides the Company with financing facility of up to £100,000,000 on arm length commercial terms. This facility was immediately drawn down in full.