Legal & General Group Plc Preliminary Results

For the year ended 31 December 2006

Stock Exchange Release – Part 1
14 March 2007

Excellent results

Good progress on capital review

- **EEV[1] operating profit of £1,233m** **+ 13%**
- **UK new business contribution of £380m** **+ 24%**
- **IFRS[2] operating profit of £752m** **+ 16%**
- **EEV ordinary shareholders' equity of £7.9bn** **+ 14%**
- **IFRS ordinary shareholders' equity of £5.4bn** **+ 27%**
- **Recommended full year dividend of 5.55p** **+ 5%**

NEWS

Group Chief Executive, Tim Breedon, said:

"Legal & General has delivered an excellent set of results, with record new business and record profits. Strong underlying performance has been enhanced by the first actions arising from the Group's capital review.

The UK life and pensions market expanded strongly in 2006 due primarily to the pensions A-day effect and demand for individual savings products. Legal & General, however, strengthened its position across its annuities, protection, savings and investments businesses. This contributed to a significant rise in UK new business profits - up 24% to £380m on an EEV basis.

In December, we implemented the first structural change arising from our capital review when we reinsured all of the Group's UK non profit pensions and annuity business to a new subsidiary. In doing so, we believe we will increase the transparency and flexibility for the whole of our non profit business. We will report further on our capital review at the time of our Interim results in July.

Today's results demonstrate the energy and momentum of Legal & General's balanced yet flexible business model – a model which continues to deliver profitable growth. We also continue to invest in the expansion of our business, notably through the recent agreement to distribute our products through the Nationwide – the UK's largest building society with over 11m customers – and the further development of our open architecture bond and pension products.

With continued investment in our business, strong UK economic fundamentals and a positive environment for long term savings and investment, Legal & General is well positioned to make further progress in 2007."

(1) EEV: European Embedded Value
(2) IFRS: International Financial Reporting Standards

Legal & General

Legal & General Group Plc Preliminary Results

For the year ended 31 December 2006

Financial highlights	2006	% change
EEV basis:		
UK new business contribution	**£380m**	+24%
Worldwide life and pensions new business contribution	**£418m**	+26%
Worldwide life and pensions operating profit	**£1,030m**	+14%
Worldwide operating profit	**£1,233m**	+13%
Profit from continuing operations after tax	**£1,446m**	+19%
Ordinary shareholders' equity per share	**121p**	+13%
IFRS basis:		
UK life and pensions operating profit	**£517m**	+25%
Worldwide operating profit	**£752m**	+16%
Profit from continuing operations after tax	**£1,631m**	+61%
Recommended full year dividend per share	**5.55p**	+5%

Overview of results

Legal & General's 2006 preliminary results demonstrated the continued strength of our core business and also reflected the first benefits of our wide-ranging capital review. Profit from continuing operations after tax increased by 19% to £1,446m (2005: £1,212m) on an EEV basis and by 61% to £1,631m (2005: £1,012m) on an IFRS basis.

Our worldwide operating profit on an EEV basis grew by 13% to £1,233m (2005: £1,092m). Worldwide contribution from new life and pensions business increased by 26% to £418m (2005: £331m) and total experience and operating assumption changes were positive at £82m. UK life and pensions operating profit grew by 9% to £874m (2005: £801m), primarily reflecting increased new business contribution. Operating profit from our international businesses grew by 56% to £156m (2005: £100m), due principally to higher new business contribution and the benefits of our second successful Triple X securitisation in the USA.

On an IFRS basis, worldwide operating profit increased by 16% to £752m (2005: £647m), benefiting from higher contributions from both the UK non profit and with-profits life and pensions businesses. With a record £21bn increase in new institutional funds under management in 2006 and a highly scalable platform, our investment management business grew operating profits by 29% to £133m (2005: £103m).

The benefits of the first phase of work carried out under our capital review were also shown in the results. In accordance with the timetable laid out in our Capital and Cash Flow presentation in November 2006:

- We created a new, wholly owned subsidiary, Legal & General Pensions Limited (LGP), to reinsure the Group's UK non linked non profit pensions and annuity business;
- We implemented more realistic reserving for individual protection business, following the introduction of the FSA's Policy Statement (PS) 06/14; and
- We enhanced asset liability matching for annuities.

These developments together resulted in an increase in profit after tax on an EEV basis of £233m and, on an IFRS basis, of £1,089m. The full financial effects of these actions are detailed in the "Significant impacts" sections in the notes to these results.

Also as indicated in November 2006, we have provided an update to the balanced scorecard of measures used to assess our capital position, and we will continue to do so on a regular basis. This can be found in the "Capital review" section below.

Legal & General strengthened its position across its strategic markets in 2006, growing scale in bonds and pensions, extending its market leading position in protection, and delivering record new bulk annuity and institutional fund management volumes. Combining strong financial management with a flexible, resilient business model, we believe Legal & General is well placed for further success in 2007.

UK distribution and product developments

We believe open architecture technology will play an increasingly important role in the evolution of the savings market. Legal & General has established a strong proposition through its alliance with the market leading Cofunds fund platform. We see it as strategically important to continue developing a coherent, comprehensive savings product offering based on open architecture and to accelerate adoption of Cofunds platform technology among IFAs. We successfully launched our on-platform Portfolio Plus SIPP in April and added 40 new funds to our Portfolio Bond during the year. We believe Legal & General's competitive products combined with an established fund platform create a powerful foundation for further profitable growth in sales of savings products. Cofunds reached £10bn of assets on its platform in 2006, with Legal & General products accounting for a substantial and growing share of new asset flows.

Our many bank and building society relationships form further key components of our balanced distribution strategy. The relationships we have established are varied, ranging from the provision of single products, to fully integrated multi-product propositions. We have the capabilities to flex our broad product range, technology and administrative infrastructure to meet the differing needs of our partners.

We continue to develop both existing and new relationships. In February 2007, we were pleased to enter into a strategic alliance with Nationwide Building Society to supply life insurance, investment and pension products to their customers. This agreement builds further on our position as a partner provider of choice to many of the UK's leading banks and building societies.

Outlook

We remain confident in the fundamentals of the UK economy for 2007 and in the outlook for the UK's savings, protection and investment markets.

We expect the effects of A-day to continue to support the pensions market into 2007. In addition, the increasing acceptance of open architecture, greater flexibility for larger single premium contributions and more flexibility on charging are improving the economics of this business. We see opportunities to build scale profitably by continuing to target the most attractive segments.

In the bond market, we were pleased with the success of our efforts to promote platform usage among IFAs. We will continue to do so in 2007 and intend to extend our range of product wrappers, including the addition of an International bond. Our additional unit allocation offer for customers is continuing in 2007, albeit currently at a lower level than the previous year.

Whilst our competitive position in individual annuities remains strong, we will continue to focus on profitability rather than volumes and will only compete where the required returns can be achieved. We expect to continue to win significant volumes of bulk annuity business in the coming year, although quarterly sales will fluctuate depending on the timing and size of business received. We have seen new entrants to the bulk annuities market in the latter stages of 2006, with competition increasing especially for larger schemes, and we expect this will continue in 2007. Legal & General's reputation and extensive risk pricing and administrative skills, developed over more than 20 years, are widely recognised in the industry and provide significant competitive advantages.

The housing market appears to remain robust, despite the increase in interest rates at the beginning of 2007. However the removal of Pensions Term Assurance at the end of 2006 may dampen growth prospects in the protection market. We expect to strengthen our already market leading position in individual protection during 2007, as we continue to develop distribution relationships - most recently with Nationwide Building Society – and to enhance our systems, processes and expertise. Protection new business margins in 2006 benefited from the implementation of lower regulatory reserving requirements. Although we have not yet seen a substantial change in market pricing to reflect this, we would expect margins to moderate from 2006 levels.

Our capital review programme is progressing well and in line with the timetable detailed in our presentation on Capital and Cash Flow in November 2006. An update in respect of our capital position will be given with our Interim results in July.

Legal & General Group Plc Preliminary Results

For the year ended 31 December 2006

Enquiries:

Investors:

Andrew Palmer	Group Director (Finance)	020 7528 6286
Jonathan Maddock	Head of Investor Relations	020 7528 6298
Nicola Marshall	Investor Relations Manager	020 7528 6263

Media:

John Morgan	Media Relations Director	020 7528 6213
Anthony Carlisle	Citigate Dewe Rogerson	07973 611888

Notes:

- Issued share capital at 31 December 2006 was 6,532,261,961 shares of 2.5p.
- A copy of this announcement can be found in "Results", under the "Financial information" section of our shareholder website at http://investor.legalandgeneral.com/results.cfm.
- A presentation to analysts and fund managers will take place at 09.30 GMT today at Temple Court, 11 Queen Victoria Street, London EC4N 4TP. There will be a live audiocast of the presentation which can be accessed at http://investor.legalandgeneral.com/results.cfm. A replay will be available on this website later today. The presentation slides will be available after 09.20 GMT, also at http://investor.legalandgeneral.com/results.cfm.
- There will be a live listen only teleconference link to the presentation. UK investors should dial 0800 6942 586 and overseas investors should dial +44 (0)1452 567 098. The conference ID number is 1956301.

The European Union requires all listed companies to prepare their consolidated financial statements using standards issued by the International Accounting Standards Board. The Group's statutory results have therefore been reported on an International Financial Reporting Standards basis. The Group's directors continue to believe that the supplementary accounts prepared using European Embedded Value principles provide a more accurate and meaningful reflection of the Group's long term operations and their value to shareholders.

The following financial statements were approved by a sub-committee of the Board on 13 March 2007 and constitute non statutory accounts within the meaning of Section 240 of the Companies Act 1985. The Group's financial statements for 2006 include the auditors' unqualified report and do not contain a statement under either Sections 237(2) or 237(3) of the Companies Act 1985.

Financial calendar 2007:

Event	Date
Ex-dividend date for 2006 final dividend	18 April 2007
Record date for 2006 final dividend	20 April 2007
Q1 2007 New business results	26 April 2007
Annual General Meeting	16 May 2007
Payment date of 2006 final dividend	21 May 2007
2007 Interim results and Q2 2007 New business results	26 July 2007
Ex-dividend date for 2007 interim dividend	5 September 2007
Record date for 2007 interim dividend	7 September 2007
Payment date for 2007 interim dividend	1 October 2007
Q3 2007 New business results	17 October 2007

A Dividend Re-investment Plan is available to shareholders.

Forward-looking statements:

This document may contain certain forward-looking statements with respect to certain of Legal & General Group Plc's plans and its current goals and expectations relating to future financial condition, performance and results. By their nature, forward-looking statements involve risk and uncertainty because they relate to future events and circumstances which are beyond Legal & General Group Plc's control, including, among others, UK domestic and global economic and business conditions, market related risks such as fluctuations in interest rates and exchange rates, the policies and actions of regulatory authorities, the impact of competition and the policies and actions of governmental and regulatory authorities and the timing impact and other uncertainties of future acquisition or combinations within relevant industries. As a result, Legal & General Group Plc's actual future condition, performance and results may differ materially from the plans, goals and expectations set out in Legal & General Group Plc's forward-looking statements. Legal & General Group Plc does not undertake to update forward-looking statements contained in this document or any other forward-looking statement it may make.

Legal & General Group Plc Preliminary Results

For the year ended 31 December 2006

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2006 Business Review

Consolidated Income Statements

£m	EEV		IFRS	
	2006	2005	**2006**	2005
Operating profit from:				
- Life and pensions	**1,030**	901	**592**	489
- Investment management	**181**	136	**133**	103
- General insurance	**9**	14	**9**	14
- Other operational income[1]	**13**	41	**18**	41
Total operating profit	**1,233**	1,092	**752**	647
Variation from longer term investment return	**460**	870	**63**	139
Effect of economic assumption changes	**2**	8	**N/A**	N/A
Contribution from UK non profit business	**N/A**	N/A	**1,136**	516
Property income attributable to minority interests	**67**	81	**67**	81
Corporate restructure	**(216)**	-	**N/A**	N/A
Profit from continuing operations before tax attributable to equity holders	**1,546**	2,051	**2,018**	1,383
Tax charge on profit from ordinary activities	**(422)**	(563)	**(387)**	(371)
Effect of UK tax changes	**-**	(276)	**N/A**	N/A
EEV tax impact of Corporate restructure	**322**	-	**N/A**	N/A
Profit from continuing operations after tax	**1,446**	1,212	**1,631**	1,012
Profit from discontinued operations	**-**	13	**-**	13
Profit from ordinary activities after tax	**1,446**	1,225	**1,631**	1,025
Profit attributable to minority interests	**(67)**	(81)	**(67)**	(81)
Profit attributable to equity holders of the Company	**1,379**	1,144	**1,564**	944

Life and pensions operating profit – EEV basis

UK life and pensions - Contribution from new business

	PVNBP (£m)		Contribution (£m)		Margin (%)	
	2006	2005	**2006**	2005	**2006**	2005
Protection	**1,201**	1,051	**131**	82	**10.9**	7.8
Annuities	**1,735**	1,539	**191**	177	**11.0**	11.5
Savings:						
- Unit linked bonds	**2,612**	2,082	**51**	49	**2.0**	2.3
- Pensions – Stakeholder and other non profit[2]	**1,326**	935	**(10)**	(18)	**(0.7)**	(1.9)
With-profits	**1,232**	1,014	**17**	16	**1.4**	1.6
Contribution from new UK life and pensions business	**8,106**	6,621	**380**	306	**4.7**	4.6

[1] On an IFRS basis, 2006 Other operational income included the element relating to Legal & General Pensions Limited, which is included in the covered business

[2] Includes the re-categorisation of £18m APE (£3m annual premiums and £149m single premiums) previously reported in with-profits individual pensions in the 2006 Full Year New Business Results announcement of 25 January 2007.

The total contribution from UK life and pensions new business was £380m, a 24% increase on 2005, with an aggregate margin of 4.7%.

Protection margins grew by 3.1 percentage points to 10.9% in 2006. The new business contribution included a net benefit of £33m in respect of our implementation of PS 06/14 and the lower resulting cost of financing. We also saw the benefits of increasing scale in reduced unit costs of business acquisition. Our market share of individual protection business grew to over 20% during the year (2005: 17%), extending our already market-leading position.

The **annuity** business margin was 11.0% (2005: 11.5%). A higher proportion of individual annuity business was written in the second half of the year, leading to a lower margin mix than that reported at Interims 2006. Individual annuities represented 41% of non profit annuity sales over the full year 2006 (H1 2006: 30%, H2 2006: 49%; 2005: 43%). The cost of solvency capital on this business increased as a result of the creation of the new pensions and annuity reinsurance company, Legal & General Pensions Limited. This is explained in further detail in the "Significant impacts" sections in the notes to these results.

Unit linked bond margins decreased from 2.3% in 2005 to 2.0% in 2006. We took the strategic decision to compete to build scale and further enhance our on-platform presence, particularly in the second half of the year. This included an additional unit allocation promotion for customers, aimed at encouraging bond applications processed on-platform. We estimate that we are now the second largest provider of unit linked bonds through the IFA channel in the UK. In the fourth quarter, 75% of our sales through IFAs were written on-platform.

The margin on **stakeholder and other non profit pensions** improved to negative 0.7% in 2006 (2005: negative 1.9%), supported by strong volume growth in a buoyant post A-Day market. The successful introduction of our SIPP product, much of which is written on the Cofunds platform, contributed to this improvement, together with increased volumes of revised stakeholder business, pension increments and reduced acquisition expenses.

The **with-profits** new business margin decreased from 1.6% in 2005 to 1.4% in 2006, mainly due to changes in business mix.

UK life and pensions - Operating profit

£m	2006	2005
Contribution from new business (after cost of capital)	**380**	306
Contribution from in-force business:		
- Expected return	**323**	294
- Experience variances	**41**	89
- Operating assumption changes	**5**	(14)
Development costs	**(21)**	(20)
Contribution from shareholder net worth	**146**	146
Operating profit	**874**	801

The expected contribution from UK life and pensions in-force business increased to £323m in 2006 (2005: £294m), reflecting the unwinding of a higher in-force value at a lower opening risk discount rate of 7.1% (2005: 7.5%).

The overall impact of experience variances and operating assumption changes was positive at £46m (2005: positive £75m), which included the effect of releases from reserves on protection business as a result of the adoption of PS 06/14.

- **Persistency:** Total experience and operating assumption changes relating to persistency were negative £27m (2005: positive £32m). We experienced adverse persistency on with-profits bonds - mainly on those reaching their fifth anniversary. We strengthened our future assumptions as a result and have put in place a number of client retention initiatives. Pensions persistency was marginally negative. We saw a small increase in early retirements, although the impact of other pensions persistency effects was broadly neutral. There was a positive assumption change on protection business, reflecting improved persistency experience on certain segments of the book.

- **Mortality/morbidity**: Total mortality/morbidity experience and operating assumption changes amounted to positive £5m in 2006 (2005: positive £25m). Positive experience on group risk and individual protection was the main contributor to a favourable £10m mortality/morbidity variance. Operating assumption changes were net negative £5m. This included a strengthening in future longevity assumptions on deferred annuities, partially offset by positive variances on individual protection and group income protection. Here we saw the benefit of our focus on active claims management feed through to improved claims experience.
- **Expenses:** Total expense experience variances and operating assumption changes amounted to negative £78m in 2006 (2005: negative £30m), with assumption changes of negative £80m.

  In our individual protection business, we are investing further in systems and processes to ensure we continue to deliver a high quality of service to our growing customer base, and to improve claims and persistency experience over the long term. We have allowed for higher in-force costs as a result, giving rise to an assumption change of negative £33m.

  We have assumed a rise in investment management costs, leading to an assumption change of negative £40m. This reflects increased location expenses relating to the move to new City premises in 2007 and further business investment, such as the development of our structured solutions and US based fixed income teams. These latter are contributing to enhancements we are making to the management of our substantial fixed income portfolios.
- **Other:** Other experience and operating assumption changes totalled positive £146m (2005: positive £48m). The net in-force effect of the implementation of PS 06/14 and the termination of related financial reinsurance was positive £64m. Improved data management in the loading of bulk annuity liabilities onto our administration system led to further current and expected releases of margins for prudence. The EEV benefit of these releases was £56m. There was a positive assumption change of £34m, primarily relating to a reassessment of prior and future tax. This adjustment had a broadly neutral effect on the embedded value with the positive here being offset by a similar negative variance in the contribution from shareholder net worth.

Development costs for 2006 of £21m (2005: £20m) related primarily to the ongoing development of the platform proposition, as we continued to expand the products and services available.

The contribution from shareholder net worth was unchanged at £146m (2005: £146m), after adjusting for the reassessment of prior and future tax mentioned above. This reflected the unwinding at a lower discount rate of 7.1% (2005: 7.5%) of a higher opening shareholder net worth. In addition, the contribution in respect of SRC and sub-fund was grossed up using a notional tax rate of 30% in 2006, compared with the 20% rate used historically, providing greater consistency.

International life and pensions - Operating profit

£m	2006	2005
Contribution from new business (after cost of capital)	**38**	25
Contribution from in-force business:		
- Expected return	**70**	62
- Experience variances	**19**	-
- Operating assumption changes	**17**	(5)
Contribution from shareholder net worth	**12**	18
Operating profit	**156**	100

Operating profit from our international life and pensions businesses grew to £156m in 2006 (2005: £100m), as a result of increased contribution from new business, together with positive experience and operating assumption changes totalling £36m (2005: negative £5m).

In the USA, new business and in-force results benefited from the effects of a Triple X securitisation, which was completed in the second half of 2006, leading to an operating profit of £89m (2005: £24m). Operating profit in France of £22m (2005: £33m) reflected favourable net operating assumption changes, although these were lower than in 2005. Adverse morbidity experience and assumption changes on protection products were more than offset by favourable persistency assumption changes on savings business. In the Netherlands, increased contribution from new business and favourable persistency assumption changes on unit-linked products contributed to an operating profit of £45m (2005: £43m).

Life and pensions operating profit – IFRS basis

£m	2006	2005
UK life and pensions operating profit:		
- Distribution relating to non profit and shareholder net worth	**388**	312
- Subordinated debt interest	**34**	37
- With-profits business	**95**	66
	517	415
USA	**58**	52
Netherlands	**7**	18
France	**10**	4
Life and pensions operating profit	**592**	489

UK life and pensions - Operating profit

UK life and pensions operating profit before tax increased by 25% to £517m in 2006 (2005: £415m). Within this, the distribution in respect of the non profit business and shareholder net worth increased to £388m (2005: £312m). The distribution is calculated by reference to the formula agreed with our regulators in 1996. It reflected 7% of the increased adjusted shareholder net worth embedded value, together with 5% of the lower adjusted non profit business embedded value, as detailed in note 5.05. The movements in these embedded values included the effects of the capital review, which are summarised below and are detailed in the “Significant impacts” sections in the notes to these results.

Interest on the intra-group subordinated debt capital attributed to the SRC amounted to £34m in 2006, marginally down from £37m in 2005. The small decrease was due to the early repayment of this subordinated debt to Legal & General Group Plc in December 2006, carried out as part of the Corporate restructuring. The external servicing cost of the related debt is reflected in interest expense reported within other operational income.

The profit contribution from the with-profits business increased by 44% to £95m (2005: £66m), in line with increased with-profits bonuses announced in February 2006. These were supported by strong gross investment returns of over 11% on assets backing with-profits policies (pre-tax and pre-charges) - the fourth consecutive year of double digit returns.

International life and pensions - Operating profit

The IFRS operating profit from our international life and pensions businesses remained broadly stable at £75m (2005: £74m). In the USA, profits rose from £52m in 2005 to £58m, mainly as a result of growth in the in-force book. Operating profit from our business in France benefited from a one-off realised gain on the sale of property, partially offset by increased morbidity claims on the protection book. Higher interest rates resulted in higher unrealised losses and lower operating profit in the Netherlands, where operating profit declined from £18m in 2005 to £7m in 2006. Under IFRS, all assets but not all liabilities are valued at fair value, leading to ongoing volatility in this line.

Investment management operating profit – IFRS basis

£m	2006	2005
Investment management new business:		
- Institutional funds	**20,650**	17,134
- Retail funds APE	**664**	315
Operating profit:		
- Managed pension funds	**96**	74
- Ventures	**4**	4
- Property	**6**	4
- Retail investments	**11**	7
- Other external income	**6**	5
- Other operational income	**10**	9
Operating profit	**133**	103
Cost/income ratio (institutional business)	**37%**	36%

Following another outstanding year for new business generation, operating profit from our investment management business grew by 29% to £133m in 2006 (2005: £103m). We saw flat or increased contributions from every business line. Our institutional business once again delivered strong new business growth while continuing to operate at a low cost income ratio on external business of 37% (2005: 36%). This supported a 30% increase in profits from our managed pension fund business to £96m (2005: £74m). Our retail investment business also saw the benefits of growth on our scalable platform, increasing operating profit by 57% to £11m (2005: £7m).

In 2006, among other initiatives, we opened a Chicago office to provide US fixed income expertise in support of our UK products and expanded our team delivering structured solutions to customers, including liability driven investments. We expect to continue to invest in expanding our product range and expertise in 2007.

Funds under management grew by 14% to £233bn during 2006 (31 December 2005: £204bn), reflecting rising market values, strong new business flows and favourable persistency. Business outflows, including benefits paid to pension schemes, remained lower than the assumptions made in our EEV reporting, which can be found in our supplementary notes.

General insurance operating profit – IFRS basis

	2006		2005	
£m	**Operating profit/(loss)**	**Underwriting result**	Operating Profit	Underwriting result
Household	**(9)**	**(21)**	7	(6)
Other	**18**	**13**	7	1
Operating profit	**9**	**(8)**	14	(5)

Gross written premiums declined by 3% in 2006 to £323m (2005: £334m). We continued to increase our focus on the core household market, which offers greater synergies with our existing protection franchise. We ceased writing motor insurance business in 2006, resulting in £3m of closure costs and, in early 2007, we decided to withdraw from the healthcare market. In both cases, we made arrangements with other insurers to offer our customers continuing cover from the next renewal date.

Operating profit fell to £9m (2005: £14m) for the year and the combined operating ratio increased to 105% (2005: 101%). The household account reported an operating loss of £9m (2005: £7m profit) as a result of deteriorating claims experience in the second half of the year, on-going competition in the broker channel and additional business development expenditure. The cost of household claims arising as a result of the January 2007 storms is currently estimated at £8m.

Other operational income – IFRS basis

£m	2006	2005
Shareholders' other income:		
- Investment return on ordinary shareholders' equity	**139**	127
- Interest expense	**(106)**	(75)
	33	52
Other operations	**(2)**	(5)
Unallocated corporate and development expenses	**(13)**	(6)
Other operational income	**18**	41

Other operational income decreased to £18m (2005: £41m). This was mainly as a result of increased interest expense following the issuance of €600m of subordinated debt in June 2005 and the reclassification of £400m undated subordinated notes as debt in March 2006. The notes were required to be treated as equity at the end of 2005 but were reclassified as debt following the modification of terms. Unallocated corporate and development expenses grew to £13m in 2006 (2005: £6m) largely relating to the implementation of the first actions of the capital review and other corporate projects.

Profit attributable to equity holders

	EEV		IFRS	
£m	2006	2005	2006	2005
Operating profit	**1,233**	1,092	**752**	647
Variation from longer term investment return	**460**	870	**63**	139
Effect of economic assumption changes	**2**	8	**N/A**	N/A
Contribution from UK non profit business	**N/A**	N/A	**1,136**	516
Property income attributable to minority interests	**67**	81	**67**	81
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EEV tax impact of Corporate restructure	**322**	-	**N/A**	N/A
Profit from continuing operations after tax	**1,446**	1,212	**1,631**	1,012
Profit from discontinued operations	**-**	13	**-**	13
Profit from ordinary activities after tax	**1,446**	1,225	**1,631**	1,025
Profit attributable to minority interests	**(67)**	(81)	**(67)**	(81)
Profit attributable to equity holders of the Company	**1,379**	1,144	**1,564**	944

EEV basis

Profit attributable to equity holders of the company on an EEV basis increased by 21% during the year to £1,379m (2005: £1,144m). The variation from longer term investment return was £460m in 2006 (2005: £870m), reflecting strong equity and property investment performance, albeit below that seen in 2005.

The financial effects of the capital review on an EEV basis are summarised in the "Capital review" section below and further detail is provided in the "Significant impacts" sections in the notes to these results.

IFRS basis

Profit attributable to equity holders on an IFRS basis increased by 66% to £1,564m (2005: £944m). The main movement in the year related to the contribution from UK non profit business which, after tax, increased from £368m in 2005 to £972m in 2006. This included the effects of the implementation of PS 06/14 and other actions carried out as part of the capital review.

Capital review

In November 2006, as part of a broad programme of communications to the market, we presented our capital management framework and our progress in conducting a wide-ranging review of our capital structure. We have advanced according to the timetable laid out at that presentation and provide an update on three key developments below. The financial effects of these actions are summarised in the table below and further detail is provided in the "Significant impacts" sections in the notes to these results.

1. Corporate restructuring - creation of pensions and annuity reinsurance company

On 31 December 2006, the non linked non profit pensions and annuity business of Legal & General Assurance Society Limited (Society) was ceded to a new, wholly owned, reinsurance subsidiary - Legal & General Pensions Limited (LGP). We believe this will provide greater capital transparency and flexibility, enhance Legal & General's ability to compete in the annuity markets and ensure that both our non profit life and pensions businesses are taxed appropriately. Legal & General Investment Management Limited provides investment services to LGP on a market-related fee basis.

2. Implementation of changes to FSA reporting

In 2006, the FSA introduced a more realistic reserving framework for certain non profit business, as detailed in PS 06/14. This framework was implemented for all our UK individual protection business.

3. Review of annuity investment policy

During 2006, Legal & General undertook a review of its asset liability matching policy for annuity business. Property assets backing annuity liabilities were replaced with corporate bonds and we entered into inflation swaps to mitigate negative inflation risk more effectively. As a result of these actions, we achieved a closer match between assets and liabilities, together with a lower capital requirement and a higher valuation discount rate. Additionally, the margin within the reserves to cover an interest rate mismatch was reviewed and reduced.

Summary of principal capital review developments

	Corporate restructuring	Changes to FSA reporting	Annuity investment policy
IFRS			
Increase in SRC	£502m[1]	£496m	£422m
Profit after tax	£171m	£496m	£422m
EEV			
Operating profit	-	£97m	£18m
Profit before tax	(£216m)	£97m	(£9m)
Profit after tax	£171m	£68m	(£6m)
Capital[2]			
IGD surplus capital	(£0.5bn)	-	-
Society surplus capital	(£0.5bn)	£0.1bn	£0.4bn

[1] There was an offsetting negative in LGP

[2] Management estimates based on draft regulatory returns

Capital balanced scorecard measures

At our Capital and Cash Flow presentation in November 2006, we indicated our intention to update the market regularly on our balanced scorecard measures for capital management. These are detailed in the following table:

	Range	**2006**	2005
IGD surplus capital	£1-2bn	**£2.1bn**	£2.4bn
Society surplus capital	£2.5-3.5bn	**£4.9bn**	£4.4bn
Economic Capital	Strong AA	**Very strong AA**	Very strong AA
Return on Embedded Value	Increase over medium term	**12.5%**	12.6%

New Business

2.01 New business summary

	Notes	APE[1] 2006 £m	PVNBP[2] 2006 £m	Margin[3] 2006 %	APE 2005 £m	PVNBP 2005 £m	Margin 2005 %
UK life and pensions	2.02	**1,073**	**8,106**	**4.7**	872	6,621	4.6
International life and pensions	2.05	**103**	**824**	**4.6**	107	873	2.9
Total life and pensions		**1,176**	**8,930**	**4.7**	979	7,494	4.4
UK retail investments	2.08	**664**			315		
International retail investments	2.08	**2**			2		
Total retail investments		**666**			317		
		1,842			1,296		
Institutional fund management	2.11	**20,650**			17,134		

2.02 Analysis of UK life and pensions new business by product

For the year ended 31 December 2006	**APE £m**	**Contri-bution from new business[4] £m**	**PVNBP £m**	**Margin %**
Protection	**231**	**131**	**1,201**	**10.9**
Annuities	**174**	**191**	**1,735**	**11.0**
Savings				
- Unit linked bonds	**261**	**51**	**2,612**	**2.0**
- Pensions, stakeholder and other non profit[5]	**208**	**(10)**	**1,326**	**(0.7)**
With-profits	**199**	**17**	**1,232**	**1.4**
Total	**1,073**	**380**	**8,106**	**4.7**
Cost of capital		**27**		
Contribution from new business before cost of capital		**407**		

For the year ended 31 December 2005				
Protection	208	82	1,051	7.8
Annuities	154	177	1,539	11.5
Savings				
- Unit linked bonds	208	49	2,082	2.3
- Pensions, stakeholder and other non profit	152	(18)	935	(1.9)
With-profits	150	16	1,014	1.6
Total	872	306	6,621	4.6
Cost of capital		8		
Contribution from new business before cost of capital		314		

2.03 Internal rate of return on non profit business

	2006 %	2005 %
Non profit internal rate of return (including solvency margin)	**16**	15

1. Annual Premium Equivalent (APE) is calculated for total new business, including unit trusts and ISAs but excluding institutional fund management, and comprises the new annual premiums together with 10% of single premiums.
2. The present value of new business premiums (PVNBP) on the EEV basis is defined as the present value of annual premiums plus single premiums for any given period. It is calculated using the same assumptions as for the contribution from new business but determined as at the point of sale.
3. The new business margin is defined as the contribution from new business (including the cost of solvency capital) divided by the PVNBP.
4. The contribution from new business is defined as the present value at point of sale of assumed profits from new business written in the period and then rolled forward to the end of the financial period using the risk discount rate applicable at the end of the reporting period.
5. Includes the re-categorisation of £18m APE (£3m annual premiums and £149m single premiums) previously reported in with-profits individual pensions in the '2006 full year new business results' Stock Exchange Release announcement on 25 January 2007.

2.04 Analysis of UK life and pensions PVNBP

	Annual premiums 2006 £m	Present value of annual premiums 2006 £m	Capital-isation factor[1] 2006	Single premiums 2006 £m	PVNBP 2006 £m	PVNBP 2005 £m
Protection	**231**	**1,201**	**5.2**	**-**	**1,201**	1,051
Annuities	**-**	**-**	**-**	**1,735**	**1,735**	1,539
Savings						
- Unit linked bonds	**-**	**-**	**-**	**2,612**	**2,612**	2,082
- Pensions, stakeholder and other non profit[2]	**126**	**509**	**4.0**	**817**	**1,326**	935
With-profits	**117**	**405**	**3.5**	**827**	**1,232**	1,014
Total	**474**	**2,115**	**4.5**	**5,991**	**8,106**	6,621

2.05 Analysis of international life and pensions new business

For the year ended 31 December 2006	APE £m	Contri-bution from new business[3] £m	Cost of capital £m	PVNBP £m	Margin %
USA	**42**	**10**	**6**	**286**	**3.5**
Netherlands	**29**	**21**	**3**	**258**	**8.3**
France	**32**	**7**	**6**	**280**	**2.4**
Total	**103**	**38**	**15**	**824**	**4.6**
For the year ended 31 December 2005					
USA	42	2	6	295	0.8
Netherlands	29	16	5	258	6.1
France	36	7	6	320	2.1
Total	107	25	17	873	2.9

2.06 Analysis of international life and pensions new business in local currency

For the year ended 31 December 2006	APE m	Contri-bution from new business m	Cost of capital m	PVNBP m	Margin %
USA	**$77**	**$19**	**$11**	**$528**	**3.5**
Netherlands	**€43**	**€32**	**€5**	**€379**	**8.3**
France	**€46**	**€10**	**€9**	**€411**	**2.4**
For the year ended 31 December 2005					
USA	$75	$4	$10	$507	0.8
Netherlands	€42	€23	€7	€377	6.1
France	€57	€10	€8	€467	2.1

2.07 Analysis of international life and pensions PVNBP

	Annual premiums 2006 m	Present value of annual premiums 2006 m	Capital-isation factor 2006	Single premiums 2006 m	PVNBP 2006 m	PVNBP 2005 m
USA	**$77**	**$528**	**6.8**	**-**	**$528**	$507
Netherlands	**€18**	**€130**	**7.2**	**€249**	**€379**	€377
France	**€17**	**€123**	**7.4**	**€288**	**€411**	€467

1. The capitalisation factor is the present value of annual premiums divided by the amount of new annual premiums.
2. Includes the re-categorisation of £18m APE (£3m annual premiums and £149m single premiums) previously reported in with-profits individual pensions in the '2006 full year new business results' Stock Exchange Release announcement on 25 January 2007.
3. Contribution from new business is reported after the cost of capital.

2.08 Analysis of retail investments new business

	Annual premiums 2006 £m	Single premiums 2006 £m	APE 2006 £m	Annual premiums 2005 £m	Single premiums 2005 £m	APE 2005 £m
UK	**20**	**6,443**	**664**	15	2,999	315
France	**-**	**25**	**2**	-	25	2
Total	**20**	**6,468**	**666**	15	3,024	317

2.09 Analysis of UK APE new business premiums

	Annual Premiums 2006 £m	Single Premiums 2006 £m	APE 2006 £m	Annual Premiums 2005 £m	Single Premiums 2005 £m	APE 2005 £m
Protection						
- Individual protection	**167**	**-**	**167**	137	-	137
- Group risk	**64**	**-**	**64**	71	-	71
Annuities						
- Individual	**-**	**702**	**71**	-	662	66
- Bulk purchase	**-**	**1,033**	**103**	-	877	88
Savings						
- Unit linked bonds	**-**	**2,612**	**261**	-	2,082	208
- Individual pensions[1]	**126**	**812**	**207**	97	547	152
- DWP rebates	**-**	**5**	**1**	-	2	-
With-profits						
- Annuities	**-**	**83**	**8**	-	60	6
- Individual pensions	**115**	**502**	**165**	73	379	110
- DWP rebates	**-**	**155**	**16**	-	116	12
- Group pensions	**2**	**4**	**2**	4	5	5
- Bonds	**-**	**83**	**8**	-	169	17
Total UK life and pensions business	**474**	**5,991**	**1,073**	382	4,899	872
- Unit trusts	**2**	**5,945**	**596**	1	2,577	259
- ISAs	**18**	**498**	**68**	14	422	56
Total UK retail investment business	**20**	**6,443**	**664**	15	2,999	315
Total UK new business	**494**	**12,434**	**1,737**	397	7,898	1,187

1. Includes the re-categorisation of £18m APE (£3m annual premiums and £149m single premiums) previously reported in with-profits individual pensions in the '2006 full year new business results' Stock Exchange Release announcement on 25 January 2007.

2.10 Analysis of total UK APE

	APE 2006 £m	APE 2005 £m
Independent financial advisers	**926**	667
Tied	**603**	327
Direct	**39**	31
Total UK individual	**1,568**	1,025
Individual life and pensions	**904**	710
Retail investments	**664**	315
Total UK individual	**1,568**	1,025
Group life and pensions	**169**	162
Total UK	**1,737**	1,187

2.11 Analysis of institutional fund management new business

	2006 £m	2005 £m
Managed pension funds[1]		
Pooled funds	**17,878**	14,778
Segregated funds	**608**	240
Total managed funds	**18,486**	15,018
Other funds[2]	**2,164**	2,116
Total	**20,650**	17,134

2.12 Institutional fund management new business by investment approach

	2006 %	2005 %
Indexed equities	**46.3**	50.6
Indexed bonds (including indexed linked funds and cash)	**39.1**	37.6
Active bonds (including indexed linked funds and cash)	**9.6**	10.3
Property	**0.7**	0.7
Private equity	**0.1**	0.3
Active equities	**0.3**	0.2
Structured solutions	**3.9**	0.3
Total	**100.0**	100.0

1. New monies from pension fund clients of Legal & General Assurance (Pensions Management) Limited exclude £4.4bn (2005: £4.1bn) held through the year on a temporary basis, generally as part of portfolio reconstructions.
2. Includes segregated property, property partnerships, ventures and institutional clients excluding institutional trusts.

Consolidated income statement

For the year ended 31 December 2006

	Notes	**2006 £m**	2005 £m
From continuing operations			
Life and pensions	3.02/3.03	**1,030**	901
Investment management	3.08	**181**	136
General insurance	4.04	**9**	14
Other operational income	3.09	**13**	41
Operating profit		**1,233**	1,092
Variation from longer term investment return	3.06	**460**	870
Effect of economic assumption changes	3.02	**2**	8
Property income attributable to minority interests		**67**	81
Corporate restructure	3.01	**(216)**	-
Profit from continuing operations before tax attributable to equity holders		**1,546**	2,051
Tax charge on operating profit		**(361)**	(314)
Tax charge on other profits and losses		**(61)**	(249)
Tax charge on profit from ordinary activities	3.10	**(422)**	(563)
Effect of UK tax changes	3.11	**-**	(276)
Tax impact of Corporate restructure	3.01/3.11	**322**	-
Profit from continuing operations after tax		**1,446**	1,212
Profit from discontinued operations	4.09	**-**	13
Profit from ordinary activities after tax		**1,446**	1,225
Profit attributable to minority interests	4.17	**(67)**	(81)
Profit attributable to equity holders of the Company		**1,379**	1,144

		p	p
Earnings per share	3.12		
Based on operating profit from continuing operations after tax		**13.45**	12.02
Based on profit attributable to ordinary equity holders of the Company		**21.27**	17.42
Diluted earnings per share	3.12		
Based on operating profit from continuing operations after tax		**13.36**	11.74
Based on profit attributable to ordinary equity holders of the Company		**21.12**	16.89

Consolidated balance sheet

As at 31 December 2006

	Notes	2006 £m	2005 £m
Assets			
Investments		**213,228**	186,413
Long term in-force business asset		**2,529**	2,738
Other assets		**4,614**	5,427
		220,371	194,578
Equity and liabilities			
Ordinary shareholders' equity	3.14/3.15	**7,931**	6,970
Subordinated borrowings designated as equity	4.16	**-**	394
Minority interests	4.17	**414**	285
Total equity		**8,345**	7,649
Subordinated borrowings	4.16	**818**	415
Unallocated divisible surplus		**2,178**	1,894
Participating contract liabilities		**19,770**	20,277
Non-participating contract liabilities		**183,618**	158,956
Senior borrowings	4.16	**1,607**	1,634
Other creditors and provisions		**4,035**	3,753
		220,371	194,578

Consolidated statement of recognised income and expense

For the year ended 31 December 2006

	2006 £m	2005 £m
Fair value losses on cash flow hedges	**(3)**	-
Exchange differences on translation of overseas operations	**(41)**	22
Actuarial gains/(losses) on defined benefit pension schemes	**3**	(55)
Actuarial (gains)/losses on defined benefit pension schemes transferred to unallocated divisible surplus	**(1)**	22
Expense recognised directly in equity, net of tax	**(42)**	(11)
Profit from ordinary activities after tax	**1,446**	1,225
Total recognised income and expense	**1,404**	1,214
Attributable to:		
Minority interests	**67**	81
Equity holders of the Company	**1,337**	1,133

Notes to the Financial Statements

3.01 Significant impacts

The capital review update within the 2006 Review identifies three key initiatives implemented during the year. The financial impact on EEV reporting is set out below.

Corporate restructuring

On 31 December 2006, the non-linked non profit pensions and annuity business of Legal & General Assurance Society Limited (Society) was ceded to a new, wholly owned, reinsurance company, Legal & General Pensions Limited (LGP). The required capital and free surplus of LGP is included in the covered business. LGP has been capitalised using £1.3bn of Society shareholder capital, £400m of which is represented by subordinated debt (£200m upper tier II, £200m lower tier II) and £900m by equity. The reinsurance was effected on arm's length terms resulting in an initial regulatory loss in LGP. Further funds of £571m have been injected from Society's LTF into LGP's LTF by means of a contingent loan to cover this loss.

Prior to the capitalisation of LGP, the intra-group subordinated debt capital of £602m attributed to SRC was repaid to Group Plc and an equivalent amount was lent to Society shareholder capital on a subordinated basis (£301m upper tier II, £301m lower tier II).

Overall, the corporate restructuring has increased the embedded value by £171m. This arises from tax benefits totalling £322m, which include a partial reversal of the adverse impact of the 2005 UK tax changes. This is offset by an additional cost of solvency capital of £119m in LGP and other impacts of £32m which together total £151m. The EEV impact of the net tax benefits is reported within the tax section of the income statement. The impact of the higher cost of solvency capital and other impacts is reported below operating profit and grossed up for tax at 30%. The tax gross up of £65m is included in the tax charge. The additional cost of solvency capital in respect of new business transferred to LGP has reduced the contribution from new business by £19m.

Implementation of changes to FSA reporting and capital rules (Policy Statement 06/14)

In 2006, the FSA introduced a more realistic reserving framework for certain non profit business. As a result, there has been a reduction in the regulatory reserves required for term assurance business of £641m (see note 5.03(c)). The associated financial reinsurance previously in place to finance these reserves was terminated.

The impact of these changes has been to increase the EEV operating assumption changes by £64m, and contribution from new business by £33m, due to the resulting lower capital requirements.

Review of annuity investment policy

During 2006, Society undertook a review of its asset liability matching policy for annuity business. Property assets backing annuity liabilities were replaced with corporate bonds and Society entered into inflation swaps to mitigate negative inflation risk. As a result, a closer match between assets and liabilities was achieved. Additionally, the margin within the reserves to cover an interest rate mismatch was reviewed and reduced.

EEV operating profit has increased by £18m due to the reduction in the capital requirement. However, the EEV variation from longer term investment return is reduced by £27m due to the change in asset mix.

3.02 Profit from continuing operations after tax from covered business

For the year ended 31 December 2006	Notes	UK £m	International £m	Life and pensions total £m	Investment management[1] £m	Total £m
Contribution from new business after cost of capital		**380**	**38**	**418**	**61**	**479**
Contribution from in-force business:						
- expected return		**323**	**70**	**393**	**24**	**417**
- experience variances	3.04	**41**	**19**	**60**	**34**	**94**
- operating assumption changes	3.05	**5**	**17**	**22**	**26**	**48**
Development costs		**(21)**	**-**	**(21)**	**(1)**	**(22)**
Contribution from shareholder net worth[2]		**146**	**12**	**158**	**7**	**165**
Operating profit		**874**	**156**	**1,030**	**151**	**1,181**
Variation from longer term investment return[3]		**387**	**(21)**	**366**	**13**	**379**
Effect of economic assumption changes		**(5)**	**7**	**2**	**-**	**2**
Corporate restructure		**(216)**	**-**	**(216)**	**-**	**(216)**
Profit from continuing operations before tax		**1,040**	**142**	**1,182**	**164**	**1,346**
Tax[2]		**(337)**	**(45)**	**(382)**	**(49)**	**(431)**
Tax impact of Corporate restructure		**322**	**-**	**322**	**-**	**322**
Profit from continuing operations after tax		**1,025**	**97**	**1,122**	**115**	**1,237**
For the year ended 31 December 2005						
Contribution from new business after cost of capital		306	25	331	49	380
Contribution from in-force business:						
- expected return		294	62	356	21	377
- experience variances	3.04	89	-	89	25	114
- operating assumption changes	3.05	(14)	(5)	(19)	14	(5)
Development costs		(20)	-	(20)	(1)	(21)
Contribution from shareholder net worth		146	18	164	6	170
Operating profit		801	100	901	114	1,015
Variation from longer term investment return[3]		653	53	706	35	741
Effect of economic assumption changes		3	5	8	-	8
Profit from continuing operations before tax		1,457	158	1,615	149	1,764
Tax		(421)	(51)	(472)	(45)	(517)
Effect of UK tax changes		(276)	-	(276)	-	(276)
Profit from continuing operations after tax		760	107	867	104	971

1. For covered business, Investment management comprises managed pension funds and is included in the total Investment management result of £181m (2005: £136m). See note 3.08.
2. In 2006, the contribution from shareholder net worth has been grossed up using a notional attributed tax rate of 30%. The 2006 impact of changing the notional attributed tax rate on the shareholder net worth to 30% is to increase operating profit by £12m and decrease profit before tax, and tax, by £3m. The contribution from shareholder net worth in 2005 has not been restated for this change in estimation technique. If the notional attributed tax rate had been 30% in 2005, the impact would have been to increase operating profit by £14m and profit before tax, and tax, by £23m.
3. UK life and pensions variation from longer term investment return comprises £185m (2005: £357m) relating to the value of in-force business and £202m (2005: £296m) relating to shareholder net worth.

Notes to the Financial Statements

3.03 Life and pensions operating profit

	2006 £m	2005 £m
UK	**874**	801
USA	**89**	24
Netherlands	**45**	43
France	**22**	33
	1,030	901

3.04 Analysis of experience variances

For the year ended 31 December 2006	UK £m	International £m	Life and pensions total £m	Investment management £m	Total £m
Persistency	**(15)**	**2**	**(13)**	**12**	**(1)**
Mortality / morbidity	**10**	**(9)**	**1**	**-**	**1**
Expenses	**2**	**-**	**2**	**-**	**2**
Other	**44**	**26**	**70**	**22**	**92**
	41	**19**	**60**	**34**	**94**

2006 UK other experience variances of £44m principally comprise the impact of the release of prudent margins as more data is loaded onto the BPA administration system (£33m) and opening adjustments (£34m) primarily to reflect a revision of assessments of prior and future tax. These opening adjustments had a broadly neutral effect on the embedded value, with the positive variance here being offset by a negative variance in the contribution from shareholder net worth. This is partially offset by differences between actual and modelled tax and an increase in deferred tax provisions (-£21m).

2006 International other experience variances relates primarily to the impact of Triple X financing.

2006 Investment management other experience variances of £22m includes the effect of higher average fee rates than assumed (£17m).

For the year ended 31 December 2005	UK £m	International £m	Life and pensions total £m	Investment management £m	Total £m
Persistency	2	2	4	15	19
Mortality / morbidity	14	(7)	7	-	7
Expenses	(6)	1	(5)	2	(3)
Other	79	4	83	8	91
	89	-	89	25	114

2005 UK other experience variances of £79m principally comprise the impact of the release of prudent margins as more data is loaded onto the BPA administration system (£73m).

2005 Investment management other experience variances of £8m include the effect of higher average fee rates than assumed.

Notes to the Financial Statements

3.05 Analysis of operating assumption changes

For the year ended 31 December 2006	UK £m	International £m	Life and pensions total £m	Investment management £m	Total £m
Persistency	**(12)**	**21**	**9**	**-**	**9**
Mortality / morbidity	**(5)**	**(7)**	**(12)**	**-**	**(12)**
Expenses	**(80)**	**4**	**(76)**	**(1)**	**(77)**
Other	**102**	**(1)**	**101**	**27**	**128**
	5	**17**	**22**	**26**	**48**

2006 UK expenses of -£80m relate to an assumed increase in future expenses in relation to the management of existing protection policies (-£33m) and an anticipated rise in investment management costs (-£40m). The latter relates to the move to new City premises in 2007 and the development of our structured solutions and US based fixed income teams.

2006 UK other operating assumption changes of £102m primarily relate to the impact of PS 06/14 on realistic protection reserving after the recapture of financial reinsurance (£64m) and changes to annuity investment policy (£19m), together with a reassessment of future reserve releases as data is loaded onto the BPA administration system (£23m).

2006 Investment management other operating assumption changes of £27m arise from the continuation of the ten year lapse assumption for all contracts through the extension of the modelling period (£15m) coupled with higher fee and income assumptions (£12m).

For the year ended 31 December 2005	UK £m	International £m	Life and pensions total £m	Investment management £m	Total £m
Persistency	30	(12)	18	-	18
Mortality / morbidity	11	(11)	-	-	-
Expenses	(24)	4	(20)	-	(20)
Other	(31)	14	(17)	14	(3)
	(14)	(5)	(19)	14	(5)

2005 UK other operating assumption changes of -£31m relate mainly to -£24m of reserve strengthening in respect of endowment compensation.

2005 Investment management other operating assumption changes of £14m arise from the continuation of the ten year lapse assumption for all contracts through the extension of the modelling period.

3.06 Variation from longer term investment return

	2006 £m	2005 £m
Total covered business	**379**	741
Investment management[1]	**(1)**	-
General insurance	**(7)**	8
Other operational income	**89**	121
	460	870

1. Non-covered Investment management business.

3.07 Time value of options and guarantees

	2006 £m	2005 £m
Life and pensions		
UK non profit	**4**	21
UK with-profits	**2**	2
International	**12**	5
	18	28

For UK non profit, the reduction in 2006 is primarily due to the purchase of negative inflation hedges coupled with higher inflation expectations resulting in a reduction in inflation guarantees.

For International, the increase in 2006 arises primarily from the rise in US interest rates on universal life contracts which have a guaranteed minimum crediting rate and a guaranteed surrender value.

Notes to the Financial Statements

3.08 Investment management income statement

	2006 £m	2005 £m
From continuing operations		
Managed pension funds	**151**	114
Ventures	**4**	4
Property	**6**	4
Retail investments	**11**	7
Other external income	**6**	5
Other income[1]	**3**	2
Operating profit from investment management	**181**	136
Variation from longer term investment return	**13**	35
Profit on ordinary activities before tax	**194**	171
Tax	**(58)**	(52)
Profit on ordinary activities after tax	**136**	119

Investment management comprises the managed pensions fund business on an EEV basis and other investment management business on an IFRS basis.

1. Other income excludes the element relating to managed pension funds on the IFRS basis.

3.09 Other operational income

	2006 £m	2005 £m
Shareholders' other income		
Investment return on ordinary shareholders' equity[1]	**134**	127
Interest expense	**(106)**	(75)
	28	52
Other operations[2]	**(2)**	(5)
Unallocated corporate and development expenses	**(13)**	(6)
	13	41

1. Investment return on ordinary shareholders' equity excludes the element relating to LGP on the IFRS basis.
2. Principally the Regulated mortgage network and Cofunds.

3.10 Analysis of tax

	Profit/(loss) before tax 2006 £m	Tax (charge)/ credit 2006 £m	Profit before tax 2005 £m	Tax charge 2005 £m
From continuing operations				
UK life and pensions	**874**	**(262)**	801	(230)
International life and pensions	**156**	**(51)**	100	(33)
	1,030	**(313)**	901	(263)
Investment management	**181**	**(54)**	136	(42)
General insurance	**9**	**(2)**	14	(4)
Other operational income	**13**	**8**	41	(5)
Operating profit	**1,233**	**(361)**	1,092	(314)
Variation from longer term investment return	**460**	**(128)**	870	(246)
Effect of economic assumption changes	**2**	**2**	8	(3)
Property income attributable to minority interests	**67**	**-**	81	-
Corporate restructure	**(216)**	**65**	-	-
Profit from continuing operations before tax / Tax	**1,546**	**(422)**	2,051	(563)

3.11 Tax impact of Corporate restructure

The tax benefit from the Corporate restructure arose primarily from the reversal of the effect of the UK tax changes reported in 2005.

Notes to the Financial Statements

3.12 Earnings per share

(a) Earnings per share

	Profit/(loss) before tax 2006 £m	Tax (charge)/ credit 2006 £m	Profit/(loss) after tax 2006 £m	Per share 2006 p	Profit before tax 2005 £m	Tax (charge)/ credit 2005 £m	Profit/(loss) after tax 2005 £m	Per share 2005 p
Operating profit from continuing operations	**1,233**	**(361)**	**872**	**13.45**	1,092	(314)	778	12.02
Variation from longer term investment return	**460**	**(128)**	**332**	**5.12**	870	(246)	624	9.64
Effect of economic assumption changes	**2**	**2**	**4**	**0.06**	8	(3)	5	0.08
Profit from discontinued operations	**-**	**-**	**-**	**-**	12	1	13	0.20
Corporate restructure	**(216)**	**65**	**(151)**	**(2.33)**	-	-	-	-
Tax impact of Corporate restructure	**-**	**322**	**322**	**4.97**	-	-	-	-
Effect of UK tax changes	**-**	**-**	**-**	**-**	-	(276)	(276)	(4.27)
Distributions on subordinated borrowings designated as equity			**-**	**-**			(16)	(0.25)
Earnings per share based on profit attributable to equity holders	**1,479**	**(100)**	**1,379**	**21.27**	1,982	(838)	1,128	17.42

(b) Diluted earnings per share

(i) Based on operating profit from continuing operations after tax

	Profit after tax 2006 £m	Number of shares[1] 2006 m	Per share 2006 p	Profit after tax 2005 £m	Number of shares[1] 2005 m	Per share 2005 p
Operating profit from continuing operations after tax	**872**	**6,483**	**13.45**	778	6,474	12.02
Net shares under options allocable for no further consideration	**-**	**46**	**(0.09)**	-	38	(0.07)
Convertible bonds outstanding	**-**	**-**	**-**	20	285	(0.21)
Diluted earnings per share	**872**	**6,529**	**13.36**	798	6,797	11.74

(ii) Based on profit attributable to ordinary equity holders of the Company

	Profit after tax 2006 £m	Number of shares[1] 2006 m	Per share 2006 p	Profit after tax 2005 £m	Number of shares[1] 2005 m	Per share 2005 p
Profit attributable to ordinary equity holders of the Company	**1,379**	**6,483**	**21.27**	1,128	6,474	17.42
Net shares under options allocable for no further consideration	**-**	**46**	**(0.15)**	-	38	(0.09)
Convertible bonds outstanding	**-**	**-**	**-**	20	285	(0.44)
Diluted earnings per share	**1,379**	**6,529**	**21.12**	1,148	6,797	16.89

The number of shares in issue at 31 December 2006 was 6,532,261,961 (2005: 6,507,421,932).

1. Weighted average number of shares.

Notes to the Financial Statements

3.13 Embedded value reconciliation

As at 31 December 2006	Notes	UK value of in-force £m	UK shareholder net worth[1] £m	UK life and pensions £m	International life and pensions £m	Life and pensions total £m	Investment management[2] £m	Total £m
At 1 January								
Value of in-force business (VIF)		3,142	-	3,142	570	3,712	238	3,950
Shareholder net worth (SNW)		-	1,762	1,762	298	2,060	184	2,244
		3,142	1,762	4,904	868	5,772	422	6,194
Exchange rate movements		-	-	-	(78)	(78)	-	(78)
		3,142	1,762	4,904	790	5,694	422	6,116
Profit for the period:								
- New business contribution		485	(219)	266				
- Expected return on VIF		226	-	226				
- Expected return - transfer to SNW		(293)	293	-				
- Experience variances		(160)	161	1				
- Operating assumption changes		(284)	286	2				
- Development costs		-	(14)	(14)				
- Expected return on SNW		-	112	112				
- Investment variances		(56)	320	264				
- Economic assumption changes		(5)	2	(3)				
- Corporate restructure		(561)	410	(151)				
- Tax impact of Corporate restructure		-	322	322				
Profit for the period[3]		(648)	1,673	1,025	97	1,122	115	1,237
Capital movements[4]		-	698	698	31	729	-	729
Distributions relating to:								
- Non profit	5.05 (a)		(110)	(110)				
- With-profits		(66)		(66)				
- Shareholder net worth	5.05 (a)		(162)	(162)				
- Subordinated debt			(24)	(24)				
Distributions		(66)	(296)	(362)	(5)	(367)	(62)	(429)
Movement in pension deficit		-	(9)	(9)	-	(9)	-	(9)
Embedded value	3.14/3.15	2,428	3,828	6,256	913	7,169	475	7,644
Represented by:								
Non profit		1,643		1,643				
With-profits		785		785				
Value of in-force business		2,428	-	2,428	652	3,080	281	3,361
Shareholder net worth		-	3,828	3,828	261	4,089	194	4,283

1. UK shareholder net worth (SNW) represents the amounts in the Society long term fund and LGP shareholder capital which are regarded as either required capital or free surplus held within the covered business.
2. For covered business, Investment management comprises managed pension funds and is included in the total Investment management shareholders' equity of £592m.
3. Included in the profit for the period is an inter-fund transfer from non profit (included in VIF) to SRC (included in SNW) of £1,222m.
4. Capital movements comprise £300m equity capital, £600m capital contribution and £400m of intra-group subordinated debt attributed to LGP, less the repayment of £602m of intra-group subordinated debt previously attributed to the SRC.

Notes to the Financial Statements

3.13 Embedded value reconciliation (continued)

As at 31 December 2005	Notes	UK value of in-force £m	UK shareholder net worth £m	UK life and pensions £m	International life and pensions £m	Life and pensions total £m	Investment management[1] £m	Total £m
At 1 January								
Value of in-force business (VIF)		2,885	-	2,885	431	3,316	191	3,507
Shareholder net worth (SNW)		-	1,560	1,560	276	1,836	162	1,998
		2,885	1,560	4,445	707	5,152	353	5,505
Exchange rate movements		-	-	-	51	51	-	51
		2,885	1,560	4,445	758	5,203	353	5,556
Profit for the period:								
- New business contribution		447	(232)	215				
- Expected return on VIF		206	-	206				
- Expected return - transfer to SNW		(340)	340	-				
- Experience variances		(151)	145	(6)				
- Operating assumption changes		14	(23)	(9)				
- Development costs		-	(14)	(14)				
- Expected return on SNW		-	96	96				
- Investment variances		250	296	546				
- Economic assumption changes		2	-	2				
- Effect of UK tax changes		(125)	(151)	(276)				
Profit for the period[2]		303	457	760	107	867	104	971
Capital movements		-	-	-	5	5	-	5
Distributions relating to:								
- Non profit	5.05 (a)		(119)	(119)				
- With-profits		(46)		(46)				
- Shareholder net worth	5.05 (a)		(100)	(100)				
- Subordinated debt			(26)	(26)				
Distributions		(46)	(245)	(291)	(2)	(293)	(35)	(328)
Movement in pension deficit		-	(10)	(10)	-	(10)	-	(10)
Embedded value	3.14/3.15	3,142	1,762	4,904	868	5,772	422	6,194
Represented by:								
Non profit		2,387		2,387				
With-profits		755		755				
Value of in-force business		3,142	-	3,142	570	3,712	238	3,950
Shareholder net worth		-	1,762	1,762	298	2,060	184	2,244

1. For covered business, Investment management comprises managed pension funds and is included in the total Investment management shareholders' equity of £506m.
2. Included in the profit for the period is an inter-fund transfer from non profit (included in VIF) to SRC (included in SNW) of £282m.

Notes to the Financial Statements

3.14 Analysis of ordinary shareholders' equity

As at 31 December 2006	UK £m	International £m	Life and pensions total £m	Investment management[1] £m	Other operations[2] £m	Total £m
Analysed as:						
IFRS basis ordinary shareholders' equity	**4,213**	**731**	**4,944**	**194**	**287**	**5,425**
Additional retained profit on an EEV basis	**2,043**	**182**	**2,225**	**281**	**-**	**2,506**
Ordinary shareholders' equity on an EEV basis	**6,256**	**913**	**7,169**	**475**	**287**	**7,931**
Comprising:						
Shareholder net worth						
- Free surplus	**652**	**110**	**762**	**176**		
- Required capital to cover solvency margin	**1,362**	**151**	**1,513**	**18**		
- Other required capital	**1,814**	**-**	**1,814**	**-**		
Value of in-force						
- Value of in-force business	**2,572**	**703**	**3,275**	**286**		
- Cost of capital	**(144)**	**(51)**	**(195)**	**(5)**		
As at 31 December 2005						
Analysed as:						
IFRS basis ordinary shareholders' equity	2,560	737	3,297	184	776	4,257
Additional retained profit on an EEV basis	2,344	131	2,475	238	-	2,713
Ordinary shareholders' equity on an EEV basis	4,904	868	5,772	422	776	6,970
Comprising:						
Shareholder net worth						
- Free surplus	-	148	148	166		
- Required capital to cover solvency margin	689	150	839	18		
- Other required capital	1,073	-	1,073	-		
Value of in-force						
- Value of in-force business	3,148	618	3,766	243		
- Cost of capital	(6)	(48)	(54)	(5)		

Free surplus is the market value of any capital and surplus allocated to, but not required to support, the in-force covered business at the valuation date.

Total required capital includes any amount of assets attributed to the covered business, over and above that required to back liabilities, the distribution of which to shareholders is restricted.

1. Investment management comprises managed pension funds and is included in the total Investment management shareholders' equity of £592m (2005: £506m).
2. Other Investment management businesses included on an IFRS basis of £117m (2005: £84m) are included in other operations.

Notes to the Financial Statements

3.15 Segmental analysis of ordinary shareholders' equity

	Covered business EEV basis 2006 £m	Other business IFRS basis 2006 £m	Total 2006 £m	Covered business EEV basis 2005 £m	Other business IFRS basis 2005 £m	Total 2005 £m
UK [1]	**6,256**	**-**	**6,256**	4,904	-	4,904
Society shareholder capital (excluding LGP) [2]	**-**	**1,307**	**1,307**	-	1,896	1,896
	6,256	**1,307**	**7,563**	4,904	1,896	6,800
Embedded value of international life and pensions business						
- USA	**552**	**-**	**552**	566	-	566
- Netherlands	**228**	**-**	**228**	192	-	192
- France	**133**	**-**	**133**	110	-	110
	7,169	**1,307**	**8,476**	5,772	1,896	7,668
Investment management	**475**	**117**	**592**	422	84	506
	7,644	**1,424**	**9,068**	6,194	1,980	8,174
General insurance	**-**	**169**	**169**	-	167	167
Corporate funds [3]	**-**	**(1,306)**	**(1,306)**	-	(1,371)	(1,371)
	7,644	**287**	**7,931**	6,194	776	6,970

Further analysis of the covered business is included in note 3.13.

	2006 £m	2005 £m
Movement		
At 1 January	**6,970**	6,186
Total recognised income and expense	**1,337**	1,133
Issue of ordinary share capital	**15**	1
Net movements in employee share schemes and treasury shares	**(5)**	7
Dividend distributions to ordinary equity holders of the Company during the year	**(349)**	(331)
Distributions during the year on subordinated borrowings designated as equity	**-**	(16)
Movements in pension deficit	**(9)**	(10)
Fair value loss after tax on reclassification of subordinated borrowings as debt	**(28)**	-
At 31 December	**7,931**	6,970

1. 2005 included £602m of intra-group subordinated debt capital attributed to the SRC, which was repaid in 2006. An equivalent amount (£602m) was then lent to Society shareholder capital on a subordinated basis, £400m of this was lent to LGP on similar terms.
2. Represents surplus capital held outside Society's LTF, including the rights issue proceeds, but excluding LGP shareholder capital which is regarded as either required capital or free surplus held within the covered business.
3. Includes the convertible debt of £nil (2005: £509m), subordinated borrowings of £818m (2005: £809m) and senior debt of £602m, which has been lent to Society shareholder capital on a subordinated basis (2005: £602m lent to the SRC on a subordinated basis).

Notes to the Financial Statements

3.16 Sensitivities

In accordance with the guidance issued by the CFO Forum in October 2005 the table below shows the effect of alternative assumptions on the long term embedded value and new business contribution.

Effect on embedded value as at 31 December 2006

	As published £m	1% lower risk discount rate £m	1% higher risk discount rate £m	1% lower interest rate £m	1% higher equity/ property yields £m	10% lower equity/ property values £m
Life and pensions						
- UK	6,256	431	(376)	138	275	(290)
- International	913	61	(54)	(8)	5	(6)
Total life and pensions	7,169	492	(430)	130	280	(296)
Investment management	475	12	(11)	(3)	9	(18)
Total covered business	7,644	504	(441)	127	289	(314)

	As published £m	10% lower maintenance expenses £m	10% lower lapse rates £m	5% lower mortality (UK annuities) £m	5% lower mortality (other business) £m
Life and pensions					
- UK	6,256	59	71	(104)	33
- International	913	10	34	n/a	67
Total life and pensions	7,169	69	105	(104)	100
Investment management	475	15	17	n/a	n/a
Total covered business	7,644	84	122	(104)	100

Effect on new business contribution for the year

	As published £m	1% lower risk discount rate £m	1% higher risk discount rate £m	1% lower interest rate £m	1% higher equity/ property yields £m	10% lower equity/ property values £m
Life and pensions						
- UK	380	74	(65)	10	37	(32)
- International	38	16	(14)	(3)	1	-
Total life and pensions	418	90	(79)	7	38	(32)
Investment management	61	3	(3)	(1)	1	-
Total covered business	479	93	(82)	6	39	(32)

	As published £m	10% lower maintenance expenses £m	10% lower lapse rates £m	5% lower mortality (UK annuities) £m	5% lower mortality (other business) £m
Life and pensions					
- UK	380	15	26	(11)	9
- International	38	2	6	n/a	10
Total life and pensions	418	17	32	(11)	19
Investment management	61	-	3	n/a	n/a
Total covered business	479	17	35	(11)	19

Opposite sensitivities are broadly symmetrical.

3.17 Assumptions

UK assumptions

The assumed future pre-tax returns on fixed interest and RPI linked securities are set by reference to redemption yields available in the market at the end of the reporting period. The corresponding return on equities and property is equal to the fixed interest gilt assumption plus the appropriate risk premium. An asset mix consistent with the current investment policy and future management intentions has been assumed within the projections.

Economic assumptions

	31.12.06 % p.a.	31.12.05 % p.a.	31.12.04 % p.a.
Equity risk premium	**3.0**	3.0	3.0
Property risk premium	**2.0**	2.0	2.0
Investment return			
- Gilts:			
- Fixed interest	**4.6**	4.1	4.5
- RPI linked	**4.7**	4.2	4.5
- Non gilts:			
- Fixed interest	**4.9 – 5.3**	4.4 – 4.8	4.9 – 5.3
- RPI linked	**4.6 – 5.1**	4.2 – 4.6	4.7 – 5.1
- Equities	**7.6**	7.1	7.5
- Property	**6.6**	6.1	6.5
Risk margin	**3.0**	3.0	3.0
Risk discount rate (net of tax)	**7.6**	7.1	7.5
Inflation			
- Expenses/earnings	**4.2**	3.9	3.8
- Indexation	**3.2**	2.9	2.8

The assumed returns on non gilt securities are net of an allowance for default risk of 0.2% p.a. (2005: 0.2% p.a.), other than for certain government-supported securities where no such allowance is made.

UK life and pensions

i. The value of the Sub-fund is the discounted value of total projected investment returns over its lifetime.

ii. Assets are valued at market value. For the projection of fixed interest and RPI linked investment returns, asset values are adjusted to reflect the assumed interest and inflation rates.

iii. Future bonus rates have been set at levels which would fully utilise the assets supporting the policyholders' portion of the with-profits business. The proportion of profits derived from with-profits business allocated to shareholders has been assumed to be 10% throughout.

iv. The value of in-force business reflects the cost, including administration expenses, of providing for benefit enhancement or compensation in relation to certain products.

v. Other actuarial assumptions have been set at levels commensurate with recent operating experience, including those for mortality, morbidity, persistency and maintenance expenses (excluding the development costs referred to below). These are reviewed annually. An allowance is made for future improvements in annuitant mortality based on experience and externally published data. Male annuitant mortality is assumed to improve in accordance with CMI Working Paper 1, projection MC for future experience with a minimum annual improvement of 0.6%, and the average of projections MC and LC for statutory reserving with a minimum annual improvement of 0.8%. Female annuitant mortality is assumed to improve in accordance with the MC projection from CMI Working Paper 1 for statutory reserving and at 70% of this rate for future experience, with the same underpinning minima as for males.

vi. The subordinated debt capital was repaid in 2006 but was included in the embedded value in 2005 at the face value of £602m (estimated market value of £699m at 31 December 2005). If the market value of the subordinated debt capital was used, total embedded value in 2005 would have increased by £31m. £400m of subordinated debt attributed to Legal & General Pensions Limited (LGP) in 2006 has been included at face value. The estimated market value was not materially different to the face value.

vii. Development costs relate to strategic systems.

3.17 Assumptions (continued)

UK managed pension funds

viii. All contracts are assumed to lapse over a 10 year period. Fees are projected on a basis which reflects current charges or, if less, anticipated charges. New business consists of monies received from new clients and incremental receipts from existing clients, and excludes the roll-up of the investment returns. Development costs relate to strategic systems.

International

ix. Key assumptions:

	31.12.06 % p.a.	31.12.05 % p.a.	31.12.04 % p.a.
USA			
Reinvestment rate	**5.4**	5.1	4.9
Risk margin	**3.0**	3.0	3.0
Risk discount rate (net of tax)	**7.8**	7.4	7.3
Europe			
Government bond return	**4.0**	3.3	3.8
Risk margin	**3.0**	3.0	3.0
Risk discount rate (net of tax)	**7.0**	6.3	6.8

x. Other actuarial assumptions have been set at levels commensurate with recent operating experience, including those for mortality, morbidity, persistency and maintenance expenses.

Tax

xi. EEV results are computed on an after tax basis and are grossed up by notional attributed tax for presentation in the income statement. The tax rate used for grossing up is the corporate tax rate in the territory concerned which for the UK was 30% (2005: 30%).

Stochastic calculations

xii. The time value of options and guarantees is calculated using economic and non-economic assumptions consistent with those used for the deterministic embedded value calculations.

This section describes the models used to generate future investment simulations, and gives some sample statistics for the simulations used. A single model has been used for UK and international business, with different economic assumptions for each territory.

Government nominal interest rates are generated using a LIBOR Money Market Model projecting full yield curves at annual intervals. The model provides a good fit to the initial yield curve.

The total annual returns on equities and property are calculated as the return on 1 year bonds plus an excess return. The excess return is assumed to have a lognormal distribution. Corporate bonds are modelled separately by credit rating using stochastic credit spreads over the risk-free rates, transition matrices and default recovery rates. The real yield curve model assumes that the real short rate follows a mean-reverting process subject to two normally distributed random shocks.

Asset classes

The significant asset classes are for:
- UK with-profits business – equities, property and fixed rate bonds of various durations;
- UK annuity business – fixed rate and index-linked bonds of various durations; and
- International business – fixed rate bonds of various durations.

3.17 Assumptions (continued)

Summary statistics

The following table sets out means and standard deviations (StDev) of future returns as at 31 December 2006 for the most significant asset classes. Correlations between asset classes have been set based on an internal assessment of historical data.

	10-year return		20-year return	
	Mean[1]	StDev[2]	Mean[1]	StDev[2]
UK Business (Sterling)				
Government bonds	4.8%	2.7%	4.5%	3.0%
Corporate bonds	5.3%	3.1%	5.1%	3.3%
Property (excess returns)	2.0%	15.1%	2.0%	14.8%
Equities (excess returns)	3.0%	20.1%	3.0%	20.3%
European Business (Euro)				
Long Government bonds[3]	4.0%	5.0%	4.4%	5.1%
Short Government bonds[4]	4.0%	3.7%	4.4%	7.1%
US Business (US Dollar)				
Long Government bonds[3]	4.9%	5.9%	5.3%	5.8%

1. Other than for equities and property, means are calculated as the excess of 1 year bond asset return means plus 1 year bond means. Means for the equities and property excess returns are calculated as the excess of 1 year bond asset return means. Each mean is derived by calculating the accumulated value of a unit asset invested to time n years for each simulation, averaging the resultant values across all simulations, then calculating the equivalent annual return required to give this average accumulation (by taking the nth root of the average accumulation and deducting 1).
2. Standard deviations are calculated by accumulating a unit investment for n years in each simulation, taking the natural logarithm of the result, calculating the variance of this statistic, dividing by n and taking the square root. Equities and property values use excess returns. The results are comparable to implied volatilities quoted in investment markets.
3. Long term bonds are defined to be 10-year par-coupon bonds.
4. Short term bonds are defined to be 1 year duration bonds.

Risk discount rate

The risk discount rate is scenario-dependent within the stochastic projection. It is calculated by applying the deterministic risk margin to the risk free rate in each stochastic projection.

Sensitivity calculations

xiii. A number of sensitivities have been produced on alternative assumption sets to reflect the sensitivity of the embedded value and the new business contribution to changes in key assumptions. Relevant details relating to each sensitivity are:

- 1% variation in discount rate - a one percentage point increase/decrease in the risk margin has been assumed in each case (for example a 1% increase in the risk margin would result in a 4.0% risk margin).
- 1% lower interest rate environment – a one percentage point decrease in all investment assumptions and the risk discount rate, including consequential changes to valuation bases.
- 1% higher equity/property yields - a one percentage point increase in the assumed equity/property investment returns, excluding any consequential changes, for example, to risk discount rates or valuation bases, has been assumed in each case (for example a 1% increase in equity returns would increase assumed total equity returns from 7.6% to 8.6%).
- 10% lower equity/property market values - an immediate 10% reduction in equity and property asset values.
- 10% lower maintenance expenses, excluding any consequential changes, for example, to valuation expense bases or potentially reviewable policy fees (a 10% decrease on a base assumption of £10 per annum would result in an £9 per annum expense assumption).
- 10% lower assumed persistency experience rates, excluding any consequential changes to valuation bases, incorporating a 10% decrease in lapse, surrender and premium cessation assumptions (a 10% decrease on a base assumption of 7% would result in a 6.3% lapse assumption).
- 5% lower mortality and morbidity rates, excluding any consequential changes to valuation bases but including assumed product repricing action where appropriate (for example if base experienced mortality is 90% of a standard mortality table then, for this sensitivity, the assumption is set to 85.5% of the standard table).

The sensitivities for life and pensions business allow for any material changes to the cost of financial options and guarantees but do not allow for any changes to reserving bases or capital requirements within the sensitivity calculation, unless indicated otherwise above.

Operating profit income statement

For the year ended 31 December 2006

	Notes	2006 £m	2005 £m
From continuing operations			
Life and pensions	4.02	**592**	489
Investment management	4.03	**133**	103
General insurance	4.04	**9**	14
Other operational income	4.05	**18**	41
Operating profit		**752**	647
Variation from longer term investment return	4.06	**63**	139
Contribution from UK non profit business	4.07	**1,136**	516
Property income attributable to minority interests		**67**	81
Profit from continuing operations before tax attributable to equity holders		**2,018**	1,383
Tax attributable to equity holders	4.08	**(387)**	(371)
Profit from continuing operations after tax		**1,631**	1,012
Profit from discontinued operations	4.09	**-**	13
Profit from ordinary activities after tax		**1,631**	1,025
Profit attributable to minority interests	4.17	**(67)**	(81)
Profit attributable to equity holders		**1,564**	944

		p	p
Earnings per share	4.10		
Based on operating profit from continuing operations after tax		**8.33**	7.04
Based on profit attributable to ordinary equity holders of the Company		**24.12**	14.33
Diluted earnings per share	4.10		
Based on operating profit from continuing operations after tax		**8.27**	7.00
Based on profit attributable to ordinary equity holders of the Company		**23.95**	13.95

This supplementary information provides further analysis of the results reported under IFRS and we believe gives shareholders a better understanding of the underlying performance of the business.

For UK life and pensions business, operating profit represents:

- the distribution of profit relating to non profit and shareholder net worth, grossed up for tax. The current distribution comprises;
  - 7% of the embedded value of the SRC and Sub-fund (shareholder net worth - SNW) adjusted to remove the impact from the contingent loan between SRC and LGP and the SNW of LGP; and
  - 5% of the embedded value of the non profit business adjusted to remove the impact from the contingent loan between SRC and LGP;
- the subordinated debt interest on the intra group subordinated debt included within the SRC, until it was repaid in December 2006;
- the shareholders' share of the with-profits surplus recognised in the year, grossed up for tax.

An analysis of the distribution of profit relating to non profit and shareholder net worth is included in Note 5.05(a).

Operating profit includes a longer term investment return on shareholders', General insurance's and Netherlands' funds held outside a LTF. It excludes investment variances and the contribution from UK non profit business. The income statement comprises returns to shareholders and excludes policyholders' returns.

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Consolidated income statement

For the year ended 31 December 2006

	Notes	2006 £m	2005 £m
Revenue			
Gross written premiums	4.11	**4,286**	4,084
Outward reinsurance premiums		**(518)**	(406)
Net change in provision for unearned premiums		**7**	(6)
Net premiums earned		**3,775**	3,672
Fees from fund management and investment contracts		**535**	348
Investment return		**16,572**	26,931
Operational income		**84**	38
Total revenue		**20,966**	30,989
Expenses			
Claims and change in insurance liabilities		**1,938**	6,367
Reinsurance recoveries		**1,123**	19
Net claims and change in insurance liabilities		**3,061**	6,386
Change in provisions for investment contract liabilities		**13,878**	21,369
Acquisition costs		**987**	550
Finance costs		**153**	116
Other expenses		**674**	619
Transfers to unallocated divisible surplus		**284**	360
Total expenses		**19,037**	29,400
Profit before income tax		**1,929**	1,589
Income tax attributable to policyholder returns		**89**	(206)
Profit from continuing operations before income tax attributable to equity holders		**2,018**	1,383
Total income tax expense		**(298)**	(577)
Income tax attributable to policyholder returns		**(89)**	206
Income tax attributable to equity holders		**(387)**	(371)
Profit from continuing operations after income tax		**1,631**	1,012
Profit from discontinued operations		**-**	13
Profit from ordinary activities after income tax		**1,631**	1,025
Attributable to:			
Minority interests		**67**	81
Equity holders of the Company		**1,564**	944
Dividend distributions to ordinary equity holders of the Company during the year		**349**	331
Distributions during the year on subordinated borrowings designated as equity		**-**	16
Dividend distributions to ordinary equity holders of the Company proposed after the year end		**248**	236
		p	p
Earnings per share			
Based on profit from continuing operations after income tax attributable to ordinary equity holders		**24.12**	14.13
Diluted earnings per share			
Based on profit from continuing operations after income tax attributable to ordinary equity holders		**23.95**	13.76

Consolidated balance sheet

As at 31 December 2006

	Notes	2006 £m	2005 £m
Assets			
Investment in associates		**16**	16
Plant and equipment		**43**	32
Investment property		**6,852**	5,774
Financial investments	4.14	**201,430**	176,622
Reinsurers' share of contract liabilities		**1,481**	2,779
Purchased interest in long term businesses		**23**	25
Deferred acquisition costs		**1,456**	1,375
Income tax recoverable		**12**	79
Other assets		**1,622**	1,162
Cash and cash equivalents		**4,930**	4,001
Total assets		**217,865**	191,865
Equity			
Share capital		**163**	163
Share premium account		**923**	908
Treasury shares		**(45)**	(36)
Other reserves		**49**	34
Retained earnings		**4,335**	3,188
Capital and reserves attributable to ordinary equity holders of the Company	4.15	**5,425**	4,257
Subordinated borrowings designated as equity	4.16	**-**	394
Capital and reserves attributable to equity holders of the Company		**5,425**	4,651
Minority interests	4.17	**414**	285
Total equity	4.18	**5,839**	4,936
Liabilities			
Subordinated borrowings	4.16	**818**	415
Participating insurance contracts	4.19	**12,660**	13,180
Participating investment contracts	4.20	**7,501**	7,476
Unallocated divisible surplus		**2,178**	1,894
Value of in-force non-participating contracts		**(391)**	(379)
Participating contract liabilities		**21,948**	22,171
Non-participating insurance contracts	4.19	**21,602**	23,152
Non-participating investment contracts	4.20	**162,016**	135,804
Non-participating contract liabilities		**183,618**	158,956
Senior borrowings	4.16	**1,607**	1,634
Provisions		**568**	582
Deferred income liabilities		**422**	351
Deferred tax liabilities		**472**	492
Income tax liabilities		**106**	197
Other liabilities		**1,663**	1,303
Net asset value attributable to unitholders		**804**	828
Total liabilities		**212,026**	186,929
Total equity and liabilities		**217,865**	191,865

Consolidated statement of recognised income and expense

For the year ended 31 December 2006

	2006 £m	2005 £m
Fair value losses on cash flow hedges	**(3)**	-
Exchange differences on translation of overseas operations	**(35)**	20
Actuarial gains/(losses) on defined benefit pension schemes	**3**	(55)
Actuarial (gains)/losses on defined benefit pension schemes transferred to unallocated divisible surplus	**(1)**	22
Net change in financial investments designated as available-for-sale	**7**	(10)
Expense recognised directly in equity, net of tax	**(29)**	(23)
Profit from ordinary activities after income tax	**1,631**	1,025
Total recognised income and expense	**1,602**	1,002
Attributable to:		
Minority interests	**67**	81
Equity holders of the company	**1,535**	921

Consolidated cash flow statement

For the year ended 31 December 2006

	2006 £m	2005 £m
Cash flows from operating activities		
Profit from ordinary activities after income tax	**1,631**	1,025
Adjustments for non cash movements in net profit for the period		
Realised and unrealised gains on financial investments and investment properties	**(9,505)**	(20,962)
Investment income	**(6,630)**	(5,646)
Interest expense	**153**	116
Income tax payable	**298**	577
Other adjustments	**46**	40
Net (increase)/decrease in operational assets		
Investments designated as held for trading or fair value through profit or loss	**(9,599)**	(16,519)
Investments designated as available-for-sale	**(251)**	86
Other assets	**557**	(294)
Net increase/(decrease) in operational liabilities		
Insurance contracts	**(1,893)**	3,071
Transfer to unallocated divisible surplus	**285**	338
Investment contracts	**19,527**	33,173
Value of in-force non-participating contracts	**(12)**	55
Other liabilities	**596**	536
Cash used in operations	**(4,797)**	(4,404)
Interest paid	**(146)**	(96)
Interest received	**3,478**	2,967
Income tax paid	**(315)**	(240)
Dividends received	**3,095**	2,576
Net cash flows from operating activities	**1,315**	803
Cash flows from investing activities		
Net acquisition of plant and equipment	**(24)**	(22)
Net proceeds from disposal of Ventures' investments	**10**	23
Net proceeds from disposal of Gresham	**-**	73
Non-financial investments purchased	**(3)**	(19)
Net cash flows from investing activities	**(17)**	55
Cash flows from financing activities		
Dividend distributions to ordinary equity holders of the Company during the year	**(349)**	(331)
Distributions during the year on subordinated borrowings designated as equity	**-**	(16)
Proceeds from issue of ordinary share capital	**15**	1
Purchase of treasury shares	**(11)**	(15)
Proceeds from borrowings	**1,062**	764
Repayment of borrowings	**(1,051)**	(257)
Other	**-**	(1)
Net cash flows from financing activities	**(334)**	145
Net increase in cash and cash equivalents	**964**	1,003
Exchange (losses)/gains on cash and cash equivalents	**(35)**	6
Cash and cash equivalents at 1 January	**4,001**	2,992
Cash and cash equivalents at 31 December	**4,930**	4,001

The Group's consolidated cash flow statement includes all cash and cash equivalent flows, including those relating to the UK Long Term Funds.

Notes to the Financial Statements

4.01 Significant impacts

The capital review update within the 2006 Review identifies three key initiatives implemented during the year. The financial impact on IFRS reporting is set out below.

Corporate restructuring

On 31 December 2006, the non-linked non profit pensions and annuity business of Legal & General Assurance Society Limited (Society) was ceded to a new, wholly owned, reinsurance company, Legal & General Pensions Limited (LGP). LGP has been capitalised using £1.3bn of Society shareholder capital, £400m of which is represented by subordinated debt (£200m upper tier II, £200m lower tier II) and £900m by equity. The reinsurance was effected on arm's length terms resulting in an initial regulatory loss in LGP. Further funds of £571m have been injected from Society's LTF into LGP's LTF by means of a contingent loan to cover this loss. On an IFRS basis, after adjusting for certain prudent reserves, the transaction creates a pre-tax profit in SRC of £502m (see note 5.03(c)). The corresponding IFRS loss in LGP has given rise to a deferred tax asset of £171m, resulting in a retained loss of £331m.

Prior to the capitalisation of LGP, the intra-group subordinated debt capital of £602m attributed to SRC was repaid to Group Plc and an equivalent amount was lent to Society shareholder capital on a subordinated basis (£301m upper tier II, £301m lower tier II).

The corporate restructuring has had no impact on the pre-tax IFRS result for the year. The movement in liabilities and assets between Society and LGP is eliminated in the Group consolidation, but the initial loss in LGP has given rise to a deferred tax asset of £171m in LGP.

Implementation of changes to FSA reporting and capital rules (Policy Statement 06/14)

In 2006, the FSA introduced a more realistic reserving framework for certain non profit business. As a result, there has been a reduction in the regulatory reserves required for term assurance business of £641m (see note 5.03(c)). The associated financial reinsurance previously in place to finance these reserves was terminated.

As a consequence of these changes, the deferred acquisition cost asset relating to term assurance business amounting to £145m has been eliminated. The net impact on the IFRS income statement has been to increase profit after tax by £496m.

Review of annuity investment policy

During 2006 Society undertook a review of its asset liability matching policy for annuity business. Property assets backing annuity liabilities were replaced with corporate bonds and Society entered into inflation swaps to mitigate negative inflation risk. As a result, a closer match between assets and liabilities was achieved. Additionally, the margin within the reserves to cover an interest rate mismatch was reviewed and reduced. These actions increased the IFRS profit after tax for Society by £422m (see note 5.03(c)).

4.02 Life and pensions operating profit

	Notes	**2006 £m**	2005 £m
Distribution relating to non profit and shareholder net worth	5.05(a)	**388**	312
Subordinated debt interest		**34**	37
Non profit business		**422**	349
With-profits business		**95**	66
UK		**517**	415
USA		**58**	52
Netherlands		**7**	18
France		**10**	4
		592	489

4.03 Investment management operating profit

	2006 £m	2005 £m
Managed pension funds	**96**	74
Ventures	**4**	4
Property	**6**	4
Retail investments	**11**	7
Other external income	**6**	5
Other income	**10**	9
	133	103

Notes to the Financial Statements

4.04 General insurance operating profit, underwriting result and combined operating ratios

	Operating profit/ (loss) 2006 £m	Under-writing result 2006 £m	Combined operating ratio 2006 %	Operating profit 2005 £m	Under-writing result 2005 £m	Combined operating ratio 2005 %
From continuing operations						
Household	**(9)**	**(21)**	**111%**	7	(6)	101%
Other business	**18**	**13**	**89%**	7	1	101%
	9	**(8)**	**105%**	14	(5)	101%

The combined operating ratio is:

$$\left[\frac{\text{Net incurred claims}}{\text{Net earned premiums}} + \frac{\text{Expenses} + \text{Net commission}}{\text{Net written premiums}}\right] x\,100$$

4.05 Other operational income

	2006 £m	2005 £m
Shareholders' other income		
Investment return on ordinary shareholders' equity	**139**	127
Interest expense	**(106)**	(75)
	33	52
Other operations[1]	**(2)**	(5)
Unallocated corporate and development expenses	**(13)**	(6)
	18	41

1. Principally the Regulated mortgage network and Cofunds.

4.06 Variation from longer term investment return

	2006 £m	2005 £m
Netherlands	**(18)**	10
Investment management	**(1)**	-
General insurance	**(7)**	8
Other operational income	**89**	121
	63	139

Investment return is allocated to operating profit by reference to a longer term rate of investment return for the respective invested funds. The difference between the amount allocated to operating profit and actual investment return is the variation from longer term investment return analysed above.

4.07 Contribution from UK non profit business

	Notes	2006 £m	2005 £m
Investment income		**75**	67
Interest expense and charges		**(3)**	(3)
Realised investment gains		**215**	191
Unrealised investment gains		**16**	132
Investment return on SRC		**303**	387
Net capital released from non profit business	5.03	**1,255**	478
Distribution of operating profit from non profit business		**(422)**	(349)
Contribution from UK non profit business before tax		**1,136**	516

Notes to the Financial Statements

4.08 Analysis of tax

	Profit before tax 2006 £m	**Tax 2006 £m**	Profit before tax 2005 £m	Tax 2005 £m
From continuing operations				
UK life and pensions	**517**	**(154)**	415	(125)
International life and pensions	**75**	**(24)**	74	(25)
	592	**(178)**	489	(150)
Investment management	**133**	**(40)**	103	(32)
General insurance	**9**	**(2)**	14	(4)
Other operational income	**18**	**8**	41	(5)
Operating profit	**752**	**(212)**	647	(191)
Variation from longer term investment return	**63**	**(11)**	139	(32)
Contribution from UK non profit business	**1,136**	**(164)**	516	(148)
Property income attributable to minority interests	**67**	**-**	81	-
Profit from continuing operations before tax / Tax	**2,018**	**(387)**	1,383	(371)

Only the element of total tax attributable to equity holders' profit is shown explicitly in the analysis above; the tax attributable to policyholder returns is included within expenses in the operating profit income statement.

In accordance with the Group's policy for attributing tax to equity holders and policyholders, the IFRS profit before equity holder tax from the net capital released from UK non profit business is determined by grossing up after tax amounts at the standard rate of UK corporation tax (30%). In 2006, there was no current or deferred tax charge on these profits.

No deferred tax is provided at the incremental rate on the undeclared surplus in the Society LTF represented by the SRC on the grounds that, at the balance sheet date, no obligation to make a declaration of surplus actually exists and there is no expectation that such a declaration will occur. The maximum amount of incremental tax which would crystallise on such a declaration of surplus is estimated to be £717m (2005: £509m).

4.09 Profit from discontinued operations

Gresham Insurance Company Limited

On 31 March 2005, the Group sold its 90% stake in its subsidiary Gresham to Barclays Bank PLC for a consideration of £85m, of which £4m was paid in dividends by Gresham and the remainder in cash by Barclays. The transaction resulted in an exceptional profit before tax of £15m (£15m after tax).

	2006 £m	2005 £m
Post tax result from discontinued operations to 31 March 2005	**-**	(2)
Gain on disposal	**-**	15
	-	13

Notes to the Financial Statements

4.10 Earnings per share

(a) Earnings per share

	Profit before tax 2006 £m	Tax charge 2006 £m	Profit after tax 2006 £m	Earnings per share 2006 p	Profit before tax 2005 £m	Tax (charge)/ credit 2005 £m	Profit/ (loss) after tax 2005 £m	Earnings per share 2005 p
Operating profit from continuing operations	**752**	**(212)**	**540**	**8.33**	647	(191)	456	7.04
Variation from longer term investment return	**63**	**(11)**	**52**	**0.80**	139	(32)	107	1.66
Contribution from UK non profit business	**1,136**	**(164)**	**972**	**14.99**	516	(148)	368	5.68
Profit from discontinued operations	**-**	**-**	**-**	**-**	12	1	13	0.20
Distributions on subordinated borrowings designated as equity			**-**	**-**			(16)	(0.25)
Earnings per share based on profit attributable to equity holders	**1,951**	**(387)**	**1,564**	**24.12**	1,314	(370)	928	14.33

(b) Diluted earnings per share

(i) Based on operating profit from continuing operations after tax

	Profit after tax 2006 £m	Number of shares[1] 2006 m	Earnings per share 2006 p	Profit after tax 2005 £m	Number of shares[1] 2005 m	Earnings per share 2005 p
Operating profit from continuing operations after tax	**540**	**6,483**	**8.33**	456	6,474	7.04
Net shares under options allocable for no further consideration	**-**	**46**	**(0.06)**	-	38	(0.04)
Convertible bonds outstanding	**-**	**-**	**-**	20	285	-
Diluted earnings per share	**540**	**6,529**	**8.27**	476	6,797	7.00

(ii) Based on profit attributable to ordinary equity holders

	Profit after tax 2006 £m	Number of shares[1] 2006 m	Earnings per share 2006 p	Profit after tax 2005 £m	Number of shares[1] 2005 m	Earnings per share 2005 p
Profit attributable to ordinary equity holders of the company	**1,564**	**6,483**	**24.12**	928	6,474	14.33
Net shares under options allocable for no further consideration	**-**	**46**	**(0.17)**	-	38	(0.08)
Convertible bonds outstanding	**-**	**-**	**-**	20	285	(0.30)
Diluted earnings per share	**1,564**	**6,529**	**23.95**	948	6,797	13.95

The number of shares in issue at 31 December 2006 was 6,532,261,961 (2005: 6,507,421,932).

1. Weighted average number of shares.

Notes to the Financial Statements

4.11 Gross written premiums

	2006 £m	2005 £m
From continuing operations		
UK Life and pensions participating business	**376**	485
UK Life and pensions non-participating business	**2,691**	2,428
Total UK life and pensions	**3,067**	2,913
USA	**347**	329
Netherlands	**266**	243
France	**283**	265
Total life and pensions	**3,963**	3,750
General insurance		
Household	**240**	234
Other business	**83**	100
Total General insurance	**323**	334
Total gross written premiums	**4,286**	4,084

4.12 Segmental analysis

The Group is organised into three main business segments:
- Long term business (includes insurance and investment business)
- Investment management
- General insurance

Other operations comprise Shareholders' assets, Regulated mortgage network, Estate agencies and Corporate expenses, none of which constitute a separately reportable segment.

(i) Income statement analysed by business segments (primary disclosures)

For the year ended 31 December 2006	Long term business[1] £m	Investment manage-ment £m	General insurance £m	Other operations £m	Elimination of inter segment amounts £m	Total £m
Total revenue from continuing operations	**8,355**	**12,013**	**315**	**526**	**(243)**	**20,966**
Total expenses from continuing operations	**6,802**	**11,849**	**314**	**315**	**(243)**	**19,037**
Profit from continuing operations after income tax	**1,344**	**93**	**1**	**193**	**-**	**1,631**
Profit from discontinued operations	**-**	**-**	**-**	**-**	**-**	**-**
Inter segment revenue	**(26)**	**(40)**	**(2)**	**(175)**	**243**	**-**
For the year ended 31 December 2005						
Total revenue from continuing operations	11,512	18,833	328	559	(243)	30,989
Total expenses from continuing operations	10,373	18,724	311	235	(243)	29,400
Profit from continuing operations after income tax	650	71	13	278	-	1,012
Profit from discontinued operations	-	-	13	-	-	13
Inter segment revenue	-	(59)	(2)	(182)	243	-

1. The long term business segment for 2006 has been impacted by the matters discussed in Note 4.01.

(ii) Balance sheet analysed by business segments (primary disclosures)

As at 31 December 2006	Long term business £m	Investment manage-ment £m	General insurance £m	Other operations £m	Elimination of inter segment amounts £m	Total £m
Total assets	**69,729**	**144,725**	**534**	**4,519**	**(1,642)**	**217,865**
Total liabilities	**66,053**	**144,000**	**365**	**3,250**	**(1,642)**	**212,026**
Total equity	**3,676**	**725**	**169**	**1,269**	**-**	**5,839**
As at 31 December 2005						
Total assets	65,146	123,304	516	4,676	(1,777)	191,865
Total liabilities	62,901	122,622	351	2,832	(1,777)	186,929
Total equity	2,245	682	165	1,844	-	4,936

Notes to the Financial Statements

4.12 Segmental analysis (continued)

(iii) Revenue and assets by geographic segments (secondary disclosures)

31 December 2006	UK £m	USA £m	Netherlands £m	France £m	Elimination of inter segment amounts £m	Total £m
Total revenue from continuing operations	**20,020**	**329**	**300**	**319**	**(2)**	**20,966**
Total assets	**212,185**	**2,478**	**1,415**	**1,807**	**(20)**	**217,865**
31 December 2005						
Total revenue from continuing operations	29,918	321	362	388	-	30,989
Total assets	186,936	2,016	1,269	1,663	(19)	191,865

4.13 Pension cost

The Legal & General Group UK Pension and Assurance Fund and the Legal & General Group UK Senior Pension Scheme are defined benefit pension arrangements and account for all UK and the majority of worldwide assets of, and contributions to, such arrangements. At 31 December 2006, the combined after tax deficit arising from these arrangements (net of annuity obligations insured by Society) has been estimated at £122m (2005: £148m). These amounts have been recognised in the financial statements with £72m charged against shareholder equity (2005: £88m) and £50m against the unallocated divisible surplus (2005: £60m).

4.14 Financial investments

	2006 £m	2005 £m
Equities	**112,589**	99,277
Unit trusts	**4,190**	2,941
Debt securities	**82,685**	72,941
Accrued interest	**1,079**	887
Derivative assets	**77**	30
Loans and receivables	**810**	546
	201,430	176,622

4.15 Segmental analysis of ordinary shareholders' equity

	2006 £m	2005 £m
SRC [1]	**3,263**	2,560
Society shareholder capital (excluding LGP)	**1,307**	1,896
LGP shareholder capital	**950**	-
Society shareholder capital [2]	**2,257**	1,896
	5,520	4,456
General insurance	**169**	167
Netherlands	**97**	103
France	**82**	64
Total Society shareholders' equity	**5,868**	4,790
USA	**552**	570
Investment management	**311**	268
Corporate funds [3]	**(1,306)**	(1,371)
Ordinary shareholders' equity	**5,425**	4,257

1. 2005 included £602m of intra-group subordinated debt capital attributed to the SRC, which was repaid in 2006. An equivalent amount (£602m) was then lent to Society shareholder capital on a subordinated basis, £400m of this was lent to LGP on similar terms.
2. Represents capital held outside Society's Long Term Fund, including the rights issue proceeds and LGP shareholder capital.
3. Includes the convertible debt of £nil (2005: £509m), subordinated borrowings of £818m (2005: £809m) and senior debt of £602m, which has been lent to Society shareholder capital on a subordinated basis (2005: £602m lent to the SRC on a subordinated basis).

Notes to the Financial Statements

4.16 Borrowings

	2006 £m	2005 £m
Subordinated borrowings designated as equity		
5.875% Sterling undated subordinated notes	**-**	394
Subordinated borrowings		
5.875% Sterling undated subordinated notes	**429**	-
4.0% Euro subordinated notes 2025	**389**	415
Total subordinated borrowings	**818**	809
Senior borrowings		
2.75% Sterling convertible bond 2006	**-**	509
Sterling medium term notes 2031-2041	**608**	608
Euro commercial paper 2007	**370**	110
Bank loans 2007	**3**	6
Non recourse financing		
- US Dollar Triple X securitisation 2025	**270**	308
- US Dollar Triple X securitisation 2037	**226**	-
- Sterling property partnership loans 2011	**130**	93
Total senior borrowings	**1,607**	1,634
Total borrowings	**2,425**	2,443
Total borrowings (excluding non recourse financing)	**1,799**	2,042

During 2006 £602m of borrowings which were previously attributed to the SRC were attributed to Society shareholders. £106m of interest expense was incurred during the period (2005: £75m) on borrowings (excluding non recourse financing).

Subordinated borrowings
The Sterling undated subordinated notes are treated as upper tier II capital for regulatory purposes and the Euro dated subordinated notes as lower tier II capital.

5.875% Sterling undated subordinated notes
Legal & General Group Plc has issued £400m of 5.875% undated subordinated notes. These notes are callable in 1 April 2019 and every five years thereafter. If not called, the coupon from 1 April 2019 will be reset to the prevailing five year benchmark gilt yield plus 2.33% per annum. As at 31 December 2005 the undated subordinated notes were classified as equity because their perpetual nature meant that in certain circumstances interest could be deferred indefinitely. On 13 March 2006 the Group entered into a supplementary deed to remove the discretionary nature of the interest in certain circumstances. This had the effect of reclassifying the notes from equity to liability and coupon payments from distributions to interest. Upon reclassification the debt was recognised at fair value.

4.0% Euro subordinated notes 2025
Legal & General Group Plc has also issued €600m of 4.0% Euro dated subordinated notes. The proceeds were swapped into sterling. The notes are callable on 8 June 2015 and each year thereafter. If not called, the coupon from 8 June 2015 will reset to a floating rate of interest based on prevailing three month Euribor plus 1.7% per annum.

Non recourse financing
US Dollar Triple X securitisation 2025
A subsidiary of Legal & General America has issued US$550m of non recourse debt in the US capital markets to meet the Triple X reserve requirements on the US term insurance business. It is secured on the cash flows related to this business.

US Dollar Triple X securitisation 2037
In 2006, a subsidiary of Legal & General America issued US$450m of non recourse debt in the US capital markets to meet the Triple X reserve requirements on the US term insurance business. It is secured on the cash flows related to this business.

Sterling property partnership loans 2011
The property partnership loans are secured on specific properties.

Convertible bond
The convertible bond matured in 2006 and was redeemed at par without being converted into ordinary shares.

4.17 Minority interests

Minority interests represent third party interests in property investment vehicles which are consolidated in the Group's results.

Notes to the Financial Statements

4.18 Total equity

	2006 £m	2005 £m
At 1 January	**4,936**	4,283
Total recognised income and expense	**1,602**	1,002
Issue of ordinary share capital	**15**	1
Net movements in employee share schemes and treasury shares	**(5)**	7
Dividend distributions to ordinary equity holders of the Company during the year	**(349)**	(331)
Distributions during the year on subordinated borrowings designated as equity	**-**	(16)
Movements in minority interests including disposals	**62**	(10)
Reclassification of subordinated borrowings from equity to debt	**(394)**	-
Fair value loss after tax on reclassification of subordinated borrowings as debt (Note 4.16)	**(28)**	-
At 31 December	**5,839**	4,936

4.19 Insurance contract liabilities

(a) Analysis of insurance contract liabilities

	Gross 2006 £m	Reinsurance 2006 £m	Gross 2005 £m	Reinsurance 2005 £m
Life and pensions participating insurance contracts	**12,660**	**(1)**	13,180	(1)
Life and pensions non-participating insurance contracts	**21,321**	**(1,237)**	22,860	(2,649)
General insurance contracts	**281**	**(16)**	292	(14)
Insurance contract liabilities	**34,262**	**(1,254)**	36,332	(2,664)

(b) Movement in participating insurance contract liabilities

	Gross 2006 £m	Reinsurance 2006 £m	Gross 2005 £m	Reinsurance 2005 £m
At 1 January	**13,180**	**(1)**	12,388	(1)
New liabilities in the year	**240**	**-**	224	-
Liabilities discharged in the year	**(1,671)**	**-**	(1,142)	-
Unwinding of discount rates	**432**	**-**	402	-
Effect of change in non-economic assumptions	**29**	**-**	305	-
Effect of change in economic assumptions	**487**	**-**	1,148	-
Other	**(37)**	**-**	(145)	-
At 31 December	**12,660**	**(1)**	13,180	(1)

In 2005, the largest impact of changes to non-economic assumptions was from the strengthening of the provision for claims on the endowment book (£240m).

(c) Movement in non-participating insurance contract liabilities

	Gross 2006 £m	Reinsurance 2006 £m	Gross 2005 £m	Reinsurance 2005 £m
At 1 January	**22,860**	**(2,649)**	20,509	(2,887)
New liabilities in the year	**1,995**	**(287)**	2,370	(457)
Liabilities discharged in the year	**(1,630)**	**75**	(1,350)	215
Unwinding of discount rates	**958**	**(134)**	926	(225)
Effect of change in non-economic assumptions	**90**	**(33)**	(709)	706
Effect of change in economic assumptions	**(417)**	**9**	899	(1)
Foreign exchange adjustments	**(176)**	**26**	95	(19)
Other	**(2,359)**	**1,756**	120	19
At 31 December	**21,321**	**(1,237)**	22,860	(2,649)

Included within Effect of economic assumption changes is the impact of Society's review of its annuity investment policy as described in Note 4.01.

In 2006, Other includes £2,248m gross (£1,756m reinsurance) relating to the impact of applying PS06/14. The implementation of PS06/14 is described in Note 4.01.

Notes to the Financial Statements

4.19 Insurance contract liabilities (continued)

(d) Analysis of General insurance contract liabilities

	Gross 2006 £m	**Reinsurance 2006 £m**	Gross 2005 £m	Reinsurance 2005 £m
Outstanding claims	**101**	**(4)**	97	(5)
Claims incurred but not reported	**36**	**(1)**	45	-
Unearned premiums	**144**	**(11)**	150	(9)
General insurance contract liabilities	**281**	**(16)**	292	(14)

(e) Movement in General insurance claim liabilities

	Gross 2006 £m	**Reinsurance 2006 £m**	Gross 2005 £m	Reinsurance 2005 £m
At 1 January	**142**	**(5)**	180	(6)
Claims arising	**247**	**(3)**	272	(6)
Claims paid	**(206)**	**2**	(219)	6
Adjustments to prior year liabilities	**(46)**	**1**	(38)	1
	137	**(5)**	195	(5)
Disposal of Gresham	**-**	**-**	(53)	-
At 31 December	**137**	**(5)**	142	(5)

4.20 Investment contract liabilities

(a) Analysis of investment contract liabilities

	Gross 2006 £m	**Reinsurance 2006 £m**	Gross 2005 £m	Reinsurance 2005 £m
Participating investment contracts	**7,501**	**(88)**	7,476	(64)
Non-participating investment contracts	**162,016**	**(139)**	135,804	(51)
Investment contract liabilities	**169,517**	**(227)**	143,280	(115)

The UK participating liabilities are valued under the requirements of FRS 27.

(b) Movement in investment contract liabilities

	Gross 2006 £m	**Reinsurance 2006 £m**	Gross 2006 £m	Reinsurance 2006 £m
At 1 January	**143,280**	**(115)**	110,144	(67)
Reserves in respect of new business	**28,423**	**(93)**	24,542	(31)
Amounts paid on surrenders and maturities during the year	**(15,633)**	**3**	(12,389)	1
Investment return and related benefits	**13,804**	**(22)**	21,289	(18)
Management charges	**(339)**	**-**	(269)	-
Foreign exchange adjustments	**(18)**	**-**	(37)	-
At 31 December	**169,517**	**(227)**	143,280	(115)

Notes to the Financial Statements
4.21 Value of assets in the UK Long Term Funds

	2006 £bn	2005 £bn
With-profits business	**30.1**	29.7
Non profit business	**26.6**	22.7
Sub-fund	**0.3**	0.3
SRC	**3.3**	2.6
	60.3	55.3

4.22 Non-linked invested asset mix and investment return

At 31 December 2006	Investment Return 2006 %	With-profits Asset share %	With-profits Non Par %	With-profits Other %	Non profit %	SRC %	Sub-fund %	SSC %
Equities	**14**	**50**	**4**	**(35)**	**1**	**74**	**83**	**53**
Bonds	**1**	**28**	**82**	**125**	**96**	**-**	**-**	**45**
Property	**20**	**19**	**2**	**-**	**2**	**25**	**15**	**-**
Cash	**5**	**3**	**12**	**10**	**1**	**1**	**2**	**2**
		100	**100**	**100**	**100**	**100**	**100**	**100**
Investment return (%)	**6**	**11**	**2**	**(5)**	**2**	**15**	**15**	**7**
Invested assets (£bn)		**18.7**	**2.5**	**1.7**	**16.1**	**1.7**	**0.3**	**2.6**

4.23 Sensitivities
(a) UK non profit life and pensions sensitivity analysis

	Impact on pre-tax profit net of reinsurance 2006 £m	Impact on equity net of reinsurance 2006 £m
Sensitivity test		
Market interest rate increase of 1%	**(139)**	**(98)**
Market interest rate decrease of 1%	**237**	**166**
Reduction in the mortality rates for annuitants of 5%	**(234)**	**(164)**
Protection claims increasing by 5%	**(73)**	**(51)**
Increase in expenses of 10%	**(59)**	**(41)**
Increase in lapse rates of 10%	**(25)**	**(18)**
Decrease in lapse rates of 10%	**27**	**19**

(b) General insurance sensitivity analysis

	Impact on pre-tax profit net of reinsurance 2006 £m	Impact on equity net of reinsurance 2006 £m
Sensitivity test		
Single storm event with 1 in 200 year probability	**(30)**	**(21)**
Subsidence event – worst claims ratio in last 30 years	**(37)**	**(26)**
Repeat of 1990 recession on ASU/DMI[1]/Household accounts	**(52)**	**(36)**
5% decrease in overall claims ratio	**15**	**11**
5% surplus over claims liabilities	**7**	**5**

1. Accident, sickness and unemployment (ASU)/Domestic mortgage indemnity (DMI)

Notes to the Financial Statements

4.24 Contingent liabilities, guarantees and indemnities

Provision for the liabilities arising under contracts with policyholders is based on certain assumptions. The variance of actual experience from that assumed may result in such liabilities differing from the provisions made for them. Liabilities may also arise in respect of claims relating to the interpretation of such contracts, or the circumstances in which policyholders have entered into them (together in this paragraph "liabilities"). The extent of such liabilities is influenced by a number of factors including the actions and requirements of the FSA, by ombudsman rulings, by industry compensation schemes and by court judgements. The continuing general profile and emphasis being given by the FSA and other bodies to the suitability of the past sales of endowment policies in the context of some mortgage transactions has led to the continuing receipt of claims from holders of endowment policies.

Various Group companies receive claims and become involved in actual or threatened litigation and regulatory issues from time to time. Provision for liabilities continues to be made and is regularly reviewed. However, it is not possible to predict, with certainty, the extent and the timing of the financial impact to which these claims, litigation or issues may give rise. The relevant members of the Group nevertheless consider that each makes prudent provision, as and when circumstances calling for such provision become clear, and that each has adequate capital and reserves to meet all reasonably foreseeable eventualities.

In 1975 the Society was required by the Institute of London Underwriters (ILU) to execute the ILU form of guarantee in respect of policies issued through the ILU's Policy Signing Office on behalf of NRG Victory Reinsurance Company Ltd (Victory), a company which was then a subsidiary of the Society. In 1990, Nederlandse Reassurantie Groep Holding NV (the assets and liabilities of which have since been assumed by Nederlandse Reassurantie Groep NV under a statutory merger in the Netherlands) acquired Victory and provided an indemnity to the Society against any liability the Society may have as a result of the ILU's requirement, and the ILU agreed that its requirement of the Society would not apply to policies written or renewed after the acquisition. Whether the Society has any liability as a result of the ILU's requirement and, if so, the amount of its potential liability is uncertain. The Society has made no payment or provision in respect of this matter.

Group companies have given indemnities and guarantees, including interest rate guarantees, as a normal part of their operating activities or in relation to capital market transactions.

4.25 Events after the balance sheet date

On 7 February 2007, the Group entered into an agreement with the Nationwide Building Society to purchase Nationwide Life Limited and Nationwide Unit Trust Managers Limited for a consideration estimated at £285m. Consideration will be set by reference to the financial position of the two companies at the date of completion using an agreed basis of valuation. In addition, the arrangement provides access to Nationwide's distribution network, through which it is anticipated that a wide range of the Group's investment, pensions and life insurance products will be sold. The sale is conditional on the consent of the Financial Services Authority to the change of control of the companies, and other customary conditions, and is expected to complete in the summer of 2007, when the distribution arrangements are expected to be launched.

4.26 Foreign exchange rates

Principal rates of exchange used for translation are:

	01.01.06-31.12.06 Average	**2006 Year end**	01.01.05-30.06.05 Average	01.07.05-31.12.05 Average	2005 Year end
United States Dollar	**1.84**	**1.96**	1.87	1.77	1.72
Euro	**1.47**	**1.48**	1.46	1.47	1.46

Capital and Cash Flow

5.01 Significant impacts

The capital review update within the 2006 Review identifies three key initiatives implemented during the year. The financial impact on capital and cash flow is set out below.

Corporate restructuring

On 31 December 2006, the non-linked non profit pensions and annuity business of Legal & General Assurance Society Limited (Society) was ceded to a new, wholly owned, reinsurance company, Legal & General Pensions Limited (LGP). LGP has been capitalised using £1.3bn of Society shareholder capital, £400m of which is represented by subordinated debt (£200m upper tier II, £200m lower tier II) and £900m by equity. The reinsurance was effected on arm's length terms resulting in an initial regulatory loss in LGP. Further funds of £571m have been injected from Society's LTF into LGP's LTF by means of a contingent loan to cover this loss. On an IFRS basis, after adjusting for certain prudent reserves, the transaction creates a pre-tax profit in SRC of £502m (see note 5.03(c)). The corresponding IFRS loss in LGP has given rise to a deferred tax asset of £171m, resulting in a retained loss of £331m.

Prior to the capitalisation of LGP, the intra-group subordinated debt capital of £602m attributed to SRC was repaid to Group Plc and an equivalent amount was lent to Society shareholder capital on a subordinated basis (£301m upper tier II, £301m lower tier II).

The corporate restructuring has reduced Society's regulatory surplus capital by £0.5bn (2006 total surplus: £4.9bn) and the IGD regulatory surplus by £0.5bn (2006 total surplus: £2.1bn), primarily due to the requirement to hold solvency margins in both Society and LGP for the reinsured business.

Implementation of changes to FSA reporting and capital rules (Policy Statement 06/14)

In 2006, the FSA introduced a more realistic reserving framework for certain non profit business. As a result, there has been a reduction in the regulatory reserves required for term assurance business of £641m (see note 5.03(c)), and a consequent small reduction in the long term insurance capital requirement. The associated financial reinsurance previously in place to finance these reserves was terminated and no credit has been taken for implicit items in the regulatory balance sheet, of which approximately £240m related to term assurance. The net impact on Society's regulatory capital surplus of the changes to reserving has been an increase of approximately £125m.

In addition, the FSA removed the requirement for Society to calculate a resilience capital requirement and changed the calculation of the With-Profits Insurance Capital Component which has resulted in a decrease in Society's capital resources requirement of £432m (see note 5.02(b)).

Review of annuity investment policy

During 2006 Society undertook a review of its asset liability matching policy for annuity business. Property assets backing annuity liabilities were replaced with corporate bonds and Society entered into inflation swaps to mitigate negative inflation risk. As a result, a closer match between assets and liabilities was achieved. Additionally, the margin within the reserves to cover an interest rate mismatch was reviewed and reduced. These actions reduced the regulatory reserves for Society by £422m (see note 5.03(c)).

Capital and Cash Flow

5.02 Regulatory capital resources

(a) Insurance Groups Directive

The Group is required to measure and monitor its capital resources on a regulatory basis and to comply with the minimum capital requirements of regulators in each territory in which it operates. At Group level, Legal & General must comply with the requirements of the Insurance Groups Directive (IGD). This is a very prudent measure of capital resources as it excludes any amount of surplus capital within a Long Term Fund (£2.9bn for Society). The table below shows the estimated unaudited total Group capital resources, Group capital resources requirement and the surplus.

	2006 £bn	2005 £bn
Tier I	**6.0**	6.1
Upper tier II	**0.4**	0.4
Lower tier II	**0.4**	0.4
Deductions	**(0.1)**	(0.1)
Group capital resources	**6.7**	6.8
Group capital resources requirement	**4.6**	4.4
Insurance Groups Directive surplus	**2.1**	2.4

A segmental analysis is given below.

	2006 £bn	2005 £bn
Society Long Term Fund	**3.7**	4.1
Society Shareholder Capital	**1.3**	1.9
L&G Pensions	**1.4**	-
L&G Insurance	**0.1**	0.1
L&G France	**0.1**	0.1
L&G Netherlands	**0.1**	0.1
L&G America	**0.2**	0.2
Investment Management	**0.3**	0.3
Other	**0.5**	1.2
Tier II capital	**0.8**	0.8
Debt	**(1.8)**	(2.0)
Group capital resources	**6.7**	6.8
Society Long Term Fund	**3.7**	4.1
L&G Pensions	**0.6**	-
Other	**0.3**	0.3
Group capital resources requirement	**4.6**	4.4

A reconciliation of the Group capital resources on an IGD basis to the capital and reserves attributable to the equity holders of the company on an IFRS basis is given below.

	2006 £bn	2005 £bn
Capital and reserves attributable to equity holders on an IFRS basis	**5.4**	4.7
Tier II capital	**0.8**	0.4
Additional capital available from Society	**0.9**	2.1
Adjustment to reflect regulatory value of L&G America	**(0.4)**	(0.4)
Group capital resources	**6.7**	6.8

5.02 Regulatory capital resources (continued)

(b) Society capital surplus

Society is required to measure and monitor its capital resources on a regulatory basis. The figures in the table below are unaudited.

	2006 Long term business £bn	**2006 General insurance £bn**	2005 Long term business £bn	2005 General insurance £bn
Tier I	**8.7**	**0.1**	7.9	0.1
Upper tier II	**0.3**	**-**	0.6	-
Lower tier II	**0.3**	**-**	-	-
Available capital resources	**9.3**	**0.1**	8.5	0.1
Insurance capital requirement	**1.7**	**-**	1.8	-
Resilience capital requirement	**-**	**-**	0.7	-
With-Profits Insurance Capital Component	**2.0**	**-**	1.5	-
Capital requirements of regulated related undertakings	**0.7**	**0.1**	0.1	0.1
Capital resources requirement	**4.4**	**0.1**	4.1	0.1
Regulatory capital surplus	**4.9**	**-**	4.4	-

In 2005, tier I resources included an implicit item relating to non profit business of £540m and financial reinsurance relating to term assurance. There is no implicit item or financial reinsurance in 2006.

The table below summarises the realistic position of the with-profits part of Society's LTF:

	2006 £m	2005 £m
With-profits surplus	**1,128**	842
Risk capital margin	**465**	327
Surplus	**663**	515

Society is required to maintain a surplus in the with-profits part of the fund on a realistic basis (Peak 2). If the surplus on a realistic basis is lower than the surplus using Peak 1 solvency rules, then a further capital requirement, the With-Profits Insurance Capital Component (WPICC) is required. In 2006, the WPICC was reduced to reflect the value of shareholder transfers of £432m within the risk capital margin calculation.

(c) LGP capital surplus

	2006 Long term business £bn	2005 Long term business £bn
Tier I	**1.0**	-
Upper tier II	**0.2**	-
Lower tier II	**0.2**	-
Available capital resources	**1.4**	-
Insurance capital requirement	**0.6**	-
Capital resources requirement	**0.6**	-
Regulatory capital surplus	**0.8**	-

The regulatory capital surplus in LGP of £0.8bn is included within the IGD calculation (see note 5.02(a)). For Society's regulatory capital calculation (on the adjusted solo basis), the regulatory capital surplus of LGP is reduced by £0.3bn to reflect ineligible surplus capital. As a result, LGP is included at a regulatory value of £0.5bn in Society's regulatory capital surplus. The figures in the table above are unaudited.

5.03 IFRS capital resources

(a) Group capital resources

The Group's total capital resources of £8.4bn on an IFRS basis, comprise ordinary equity holders' capital (£5.4bn) (see note 4.15), subordinated debt (£0.8bn), and unallocated divisible surplus (£2.2bn, including £0.3bn of Sub-fund).

(b) Society capital resources

Society has been allocated capital of £5.5bn, reflecting the significance of this operation and the importance of ensuring financial strength to support long term growth of the business. Of this total, £2.2bn is held outside any Long Term Fund as Society shareholder capital (SSC) of which approximately £1.0bn is within LGP; the remainder of £3.3bn is held within Society's LTF as Shareholder Retained Capital (SRC). An analysis of the movement in total Society capital on the IFRS basis is provided in the table below:

	Notes	**2006 SSC £m**	**2006 SRC £m**	2005 SSC £m	2005 SRC £m
SSC/SRC as at 1 January		**1,896**	**2,560**	1,973	2,196
Investment return		**186**		250	
Transfer from Society Long Term Fund		**338**		265	
Dividends from subsidiaries		**2**		105	
Capital invested in subsidiaries		**(13)**		-	
Net capital contributed to LGP non profit business	5.01	**(502)**		-	
Distribution to shareholders		**(380)**		(638)	
Issue of subordinated loan capital		**602**		-	
Tax		**140**		(57)	
Other		**(12)**		(2)	
SSC at 31 December		**2,257**		1,896	
Held within:					
LGP		**950**		-	
Society		**1,307**		1,896	
Investment return			**303**		387
Net capital released from Society non profit business	5.03(c)		**1,972**		478
Distribution of operating profit from Society non profit business			**(422)**		(349)
Repayment of subordinated loan capital			**(602)**		-
Tax			**(550)**		(148)
SRC movement included in the statement of recognised income and expense			**2**		(4)
SRC at 31 December			**3,263**		2,560
Society capital at 31 December		**2,257**	**3,263**	1,896	2,560

The total net capital released from the non profit business is £1,255m (2005: £478m) (see note 4.07), consisting of the net capital contributed to LGP non profit business of £502m (gross of tax £717m) and the net capital released from Society of £1,972m.

(c) Analysis of net capital released from Society non profit business

		2006 £m	2005 £m
Net capital released from Society non profit business comprises:			
New business			
- Strain, before financing arrangements		**(546)**	(466)
- Changes to FSA reporting and capital rules	5.01	**278**	-
- Financing arrangements		**-**	125
Existing business			
- Expected capital release, before financing arrangements		**555**	499
Termination of financing arrangements		**(125)**	-
Experience variances		**90**	274
Changes to non-economic assumptions		**(90)**	(35)
Effect of corporate restructuring	5.01	**502**	-
Annuity investment policy	5.01	**422**	-
Changes to FSA reporting and capital rules	5.01	**363**	-
Movements in non-cash items		**(96)**	(67)
Other		**27**	5
		1,380	335
Tax gross-up		**592**	143
		1,972	478

5.03 IFRS capital resources (continued)

Financing arrangements represent the impact on new business strain and expected capital released from financial reinsurance. As a result of PS 06/14, the financial reinsurance has been terminated.

Expected capital release represents the capital and profit generated in the period from the in-force non profit business if the embedded value assumptions are borne out in practice. The experience variances are calculated with reference to embedded value assumptions, including the apportionment of investment return and tax in the EEV model.

Both new business strain and expected capital release exclude required solvency margin, as this is not accounted for under IFRS. On average, the capital invested in new non profit business, including solvency margin, is repaid from product cash flows in approximately six years.

An analysis of the experience variances, non-economic assumption changes and non-cash items, all net of tax, is provided below:

Experience variances	**2006 £m**	2005 £m
Persistency	**4**	13
Mortality / morbidity	**-**	15
Expenses	**(28)**	(8)
Bulk Purchase Annuity data loading	**157**	78
Investment	**27**	121
Other	**(70)**	55
	90	274

Changes to non-economic assumptions	**2006 £m**	2005 £m
Mortality / morbidity	**(27)**	33
Expenses	**(50)**	(19)
Negative inflation	**-**	(33)
Other	**(13)**	(16)
	(90)	(35)

Movements in non-cash items	**2006 £m**	2005 £m
Deferred tax	**(123)**	34
Deferred acquisition costs	**(21)**	160
Deferred income liabilities	**(78)**	(110)
IFRS adjustment for financial reinsurance	**125**	(125)
Other	**1**	(26)
	(96)	(67)

5.04 Group credit ratings

Society continues to be one of the two highest rated European life assurers. As at March 2007, our financial strength ratings from Standard & Poor's, Moody's and A.M.Best were maintained at AA+, Aa1 and A+ respectively, all with a stable outlook.

The Group's current long term and short term debt ratings are, from Standard & Poor's, AA- and A1+ and, from Moody's A1 and P1.

5.05 Distributions to shareholders from Society's Long Term Fund

(a) Calculation of distribution relating to non profit and shareholder net worth

The transfer to shareholders from Society's Long Term Fund is limited by a formula agreed with our regulator. The formula is the aggregate of the shareholders' share of the with-profits surplus, a smoothed investment return of 7% on the embedded value of the SRC and Sub-fund and 5% on the embedded value of the non profit business of Society and LGP, adjusted to remove the impact of the contingent loan between SRC and LGP and the SNW of LGP.

	2006 Non profit £m	**2006 SNW £m**	2005 Non profit £m	2005 SNW £m
Embedded value at end of period	**1,643**	**3,828**	2,387	1,762
Less: subordinated debt	**-**	**-**	-	(602)
Less: LGP shareholders fund	**-**	**(1,280)**	-	-
Contingent loan	**571**	**(571)**	-	-
Add back: pension deficit attributable to SNW	**(5)**	**60**	-	51
Add back: distributions	**-**	**272**	-	219
	2,209	**2,309**	2,387	1,430
Distribution formula - full year	**5.0%**	**7.0%**	5.0%	7.0%
Distribution after tax	**110**	**162**	119	100
Tax gross up @ 30%	**47**	**69**	51	42
Distribution before tax	**157**	**231**	170	142

(b) Analysis of distribution to shareholders

	2006 £m	2005 £m
Non profit transfer	**272**	219
With-profits transfer	**66**	46
Transfer from Society's Long Term Fund	**338**	265
Subordinated debt interest	**24**	26
Distribution to shareholders after tax	**362**	291
Tax gross up @ 30%	**155**	124
Distribution to shareholders before tax	**517**	415

5.06 Group cash flow statement

The table below shows the cash flows in the year relating to the Group's parent company.

	2006 £m	2005 £m
Dividends received:		
UK life and pensions	**380**	533
General insurance	**-**	105
Investment management	**50**	69
Other	**3**	2
	433	709
Dividend distributions to ordinary equity holders of the Company during the year	**(349)**	(331)
Distributions during the year on subordinated borrowings designated as equity	**-**	(16)
Proceeds from issue of equity	**15**	1
Proceeds from issue of subordinated borrowings	**-**	397
Repayment of convertible bond	**(525)**	-
Working capital movements	**(52)**	(136)
Net cash (outflow)/inflow	**(478)**	624

Appendices

I UK funds under management

	2006 £m	2005 £m
Total investments	**232,969**	204,328
Represented by		
Index tracking funds:		
- UK equities	**68,531**	58,739
- Overseas equities	**42,114**	36,468
- Fixed interest	**29,076**	23,364
- Index linked	**21,594**	18,906
- Cash/deposits	**652**	170
Total index tracking funds	**161,967**	137,647
Actively managed funds	**66,503**	63,659
Structured solutions	**4,499**	3,022
	232,969	204,328
By investment approach		
Indexed equities	**110,644**	95,207
Active bonds (including index linked funds and cash)	**44,713**	43,397
Indexed bonds (including index linked funds and cash)	**51,322**	42,440
Active equities	**10,966**	11,542
Property	**10,444**	8,388
Private equity	**381**	332
Structured solutions	**4,499**	3,022
	232,969	204,328
By source of business		
Institutional funds under management [1]:		
- Managed pension funds pooled	**142,716**	122,067
- Managed pension funds segregated	**4,101**	5,948
- Managed pension funds structured solutions	**4,499**	3,022
- Other	**6,217**	4,069
Total institutional funds under management	**157,533**	135,106
UK Operations (unit trusts - excluding life fund investment)	**11,759**	10,378
UK Operations (life and general insurance funds)	**63,677**	58,844
	232,969	204,328

1. Excludes institutional investments in unit trust funds.

II Capital

II a Group capital resources

As at 31 December 2006	UK with-profits £m	UK non profit, SRC and Sub-fund £m	LGP £m	Overseas and PMC £m	Total life £m	Shareholders' equity and other activities[1] £m	Total £m
Ordinary shareholders' equity outside the LTF	-	-	550	906	1,456	706	2,162
Ordinary shareholders' equity held in the LTF	-	3,263	-	-	3,263	-	3,263
Capital and reserves attributable to ordinary equity holders of the company	-	3,263	550	906	4,719	706	5,425
Adjustments onto regulatory basis[2]:							
Unallocated divisible surplus	1,862	302	-	14	2,178	-	2,178
Other[3]	(734)	(242)	(70)	(428)	(1,474)	(29)	(1,503)
Other qualifying capital:							
Subordinated borrowings[4]	-	-		-	-	797	797
Internal loans[5]	-	(571)	971	12	412	(412)	-
Implicit item[6]	-	-	-	-	-	-	-
Total available capital resources	1,128	2,752	1,451	504	5,835	1,062	6,897
IFRS liability analysis:							
UK participating liabilities on realistic basis:							
- Options and guarantees	520	-	-	-	520	-	520
- Other policyholder obligations	18,117	37	-	-	18,154	-	18,154
Overseas participating liabilities	-	-	-	1,487	1,487	-	1,487
Unallocated divisible surplus	1,862	302	-	14	2,178	-	2,178
Value of in-force non-participating contracts	(391)	-	-	-	(391)	-	(391)
Participating contract liabilities	20,108	339	-	1,501	21,948	-	21,948
Unit linked non-participating life assurance liabilities	678	4,307	-	971	5,956	-	5,956
Non-linked non-participating life assurance liabilities	1,996	11,847	-	1,522	15,365	-	15,365
Unit linked non-participating investment contract liabilities	7,468	11,069	-	143,479	162,016	-	162,016
General insurance liabilities	-	-	-	-	-	281	281
Non-participating contract liabilities	10,142	27,223	-	145,972	183,337	281	183,618

1. Society shareholder capital of £1,307m (2005: £1,896m) is included within Shareholders' equity and other activities.
2. Figures extracted from draft regulatory returns.
3. Shareholders' share in realistic liabilities of £749m (2005: £690m) and changes to the value of assets and liabilities on a regulated basis of £754m (2005: £638m) are included within Other.
4. Group has issued €600m of subordinated lower tier II borrowings and £400m of subordinated upper tier II borrowings both of which are treated as capital on a regulatory basis.
5. In 2006, LGP issued £200m of subordinated upper tier II and £200m of subordinated lower tier II borrowings to Society. In addition, £571m has been injected from Society's LTF into LGP's LTF by means of a contingent loan to cover the initial regulatory loss in LGP. These loans qualify as capital for regulatory purposes in LGP. Legal & General Overseas Holdings Limited has subscribed for a total of €18m of perpetual subordinated loan stock issued by Legal & General Holdings (France) S.A.. This loan qualifies as hybrid capital for L&G Holdings (France) S.A..
6. The implicit item recognises profits in relation to in-force business written in the non profit part of Society's LTF which are expected on a prudent assessment to emerge over the next five years. The maximum amount permitted is determined by the FSA. In 2005, there was an implicit item of £540m. There is no implicit item in 2006.

II Capital (continued)

II b Movements in life business capital resources

	UK with-profits 2006 £m	UK non profit, SRC and Sub-fund 2006 £m	LGP 2006 £m	Overseas and PMC 2006 £m	Total life 2006 £m
At 1 January	**842**	**3,173**	**-**	**592**	**4,607**
Effect of investment variations	**127**	**862**	**-**	**(42)**	**947**
Effect of changes in non-economic assumptions	**72**	**(75)**	**-**	**-**	**(3)**
Changes in management policy	**(4)**	**(1,297)**	**-**	**-**	**(1,301)**
Changes in regulatory requirements	**2**	**363**	**-**	**3**	**368**
New business	**16**	**(236)**	**-**	**(89)**	**(309)**
Cash distributions	**-**	**(272)**	**-**	**(68)**	**(340)**
Other factors	**73**	**234**	**1,451**	**108**	**1,866**
At 31 December	**1,128**	**2,752**	**1,451**	**504**	**5,835**

Other factors within LGP represent the available capital resources of that company on a regulatory basis (see Note 5.02(c)).

III Reconciliations

III a Reconciliation of shareholder net worth (SNW)

	UK life and pensions 2006 £m	Total 2006 £m	UK life and pensions 2005 £m	Total 2005 £m
SNW of long term operations (IFRS basis)	**3,263**	**5,138**	2,560	3,481
Other assets (IFRS basis)	**950**	**287**	-	776
Ordinary shareholders' equity on the IFRS basis	**4,213**	**5,425**	2,560	4,257
Purchased interests in long term business	**(7)**	**(25)**	(10)	(25)
Sub-fund	**313**	**313**	287	287
Deferred acquisition costs/deferred income liabilities	**(115)**	**(677)**	(216)	(790)
Deferred tax [1]	**(693)**	**(520)**	(810)	(646)
Other [2]	**117**	**54**	(49)	(63)
Shareholder net worth on the EEV basis	**3,828**	**4,570**	1,762	3,020
Represented by:				
SNW of long term operations (EEV basis)	**2,878**	**4,283**	1,762	2,244
LGP shareholder capital (EEV basis)	**950**	**-**	-	-
Other assets (IFRS basis)	**-**	**287**	-	776

1. Deferred tax represents all tax which is expected to be paid under current legislation, including tax which would arise if shareholders' assets were distributed.
2. Other relates primarily to the different treatment of sterling reserves, other long term reserves and the non profit result of LGP under EEV compared with IFRS.

Appendices

IV New business

a) UK life and pensions new business APE by quarter

	3 months 31.12.06 £m	3 months 30.09.06 £m	3 months 30.06.06 £m	3 months 31.03.06 £m	3 months 31.12.05 £m	3 months 30.09.05 £m	3 months 30.06.05 £m	3 months 31.03.05 £m
Protection	59	61	55	56	46	54	54	54
Annuities	53	50	38	33	40	35	35	44
Savings								
- Unit linked bonds	80	60	60	61	60	54	51	43
- Pensions, stakeholder and other non profit[1]	60	55	52	41	39	41	41	31
With-profits	41	58	52	48	40	38	37	35
Total	**293**	**284**	**257**	**239**	225	222	218	207

b) UK life and pensions new business annual premiums by quarter

	3 months 31.12.06 £m	3 months 30.09.06 £m	3 months 30.06.06 £m	3 months 31.03.06 £m	3 months 31.12.05 £m	3 months 30.09.05 £m	3 months 30.06.05 £m	3 months 31.03.05 £m
Protection	59	61	55	56	46	54	54	54
Annuities	-	-	-	-	-	-	-	-
Savings								
- Unit linked bonds	-	-	-	-	-	-	-	-
- Pensions, stakeholder and other non profit[1]	31	31	37	27	26	26	26	19
With-profits	25	30	33	29	18	19	21	19
Total	**115**	**122**	**125**	**112**	90	99	101	92

c) UK life and pensions new business single premiums by quarter

	3 months 31.12.06 £m	3 months 30.09.06 £m	3 months 30.06.06 £m	3 months 31.03.06 £m	3 months 31.12.05 £m	3 months 30.09.05 £m	3 months 30.06.05 £m	3 months 31.03.05 £m
Protection	-	-	-	-	-	-	-	-
Annuities	520	507	375	333	401	352	348	438
Savings								
- Unit linked bonds	799	600	608	605	599	544	505	434
- Pensions, stakeholder and other non profit[1]	278	245	152	142	128	146	151	124
With-profits	179	273	185	190	217	192	161	159
Total	**1,776**	**1,625**	**1,320**	**1,270**	1,345	1,234	1,165	1,155

d) International life and pensions new business APE by quarter

	3 months 31.12.06 £m	3 months 30.09.06 £m	3 months 30.06.06 £m	3 months 31.03.06 £m	3 months 31.12.05 £m	3 months 30.09.05 £m	3 months 30.06.05 £m	3 months 31.03.05 £m
USA	10	11	10	11	12	11	9	10
Netherlands	7	6	7	9	7	8	6	8
France	7	5	13	7	6	8	17	5
Total	**24**	**22**	**30**	**27**	25	27	32	23

1. Includes the re-categorisation of £18m APE (£3m annual premiums and £149m single premiums) previously reported in with-profits individual pensions in the '2006 full year new business results' Stock Exchange Release announcement on 25 January 2007.

IV New Business (continued)

e) International life and pensions new business annual premiums by quarter

	3 months 31.12.06 £m	3 months 30.09.06 £m	3 months 30.06.06 £m	3 months 31.03.06 £m	3 months 31.12.05 £m	3 months 30.09.05 £m	3 months 30.06.05 £m	3 months 31.03.05 £m
USA	**10**	**11**	**10**	**11**	12	11	9	10
Netherlands	**3**	**2**	**4**	**3**	3	4	3	3
France	**1**	**2**	**8**	**1**	1	3	12	1
Total	**14**	**15**	**22**	**15**	16	18	24	14

f) International life and pensions new business single premiums by quarter

	3 months 31.12.06 £m	3 months 30.09.06 £m	3 months 30.06.06 £m	3 months 31.03.06 £m	3 months 31.12.05 £m	3 months 30.09.05 £m	3 months 30.06.05 £m	3 months 31.03.05 £m
USA	**-**	**-**	**-**	**-**	-	-	-	-
Netherlands	**40**	**34**	**37**	**59**	41	39	32	46
France	**50**	**38**	**48**	**59**	50	49	48	44
Total	**90**	**72**	**85**	**118**	91	88	80	90

g) Retail investments new business APE by quarter

	3 months 31.12.06 £m	3 months 30.09.06 £m	3 months 30.06.06 £m	3 months 31.03.06 £m	3 months 31.12.05 £m	3 months 30.09.05 £m	3 months 30.06.05 £m	3 months 31.03.05 £m
UK	**231**	**91**	**218**	**124**	67	79	94	75
France	**-**	**1**	**1**	**-**	-	1	1	-
Total	**231**	**92**	**219**	**124**	67	80	95	75

h) Retail investments new business annual premiums by quarter

	3 months 31.12.06 £m	3 months 30.09.06 £m	3 months 30.06.06 £m	3 months 31.03.06 £m	3 months 31.12.05 £m	3 months 30.09.05 £m	3 months 30.06.05 £m	3 months 31.03.05 £m
UK	**4**	**6**	**6**	**4**	3	2	7	3
France	**-**	**-**	**-**	**-**	-	-	-	-
Total	**4**	**6**	**6**	**4**	3	2	7	3

i) Retail investments new business single premiums by quarter

	3 months 31.12.06 £m	3 months 30.09.06 £m	3 months 30.06.06 £m	3 months 31.03.06 £m	3 months 31.12.05 £m	3 months 30.09.05 £m	3 months 30.06.05 £m	3 months 31.03.05 £m
UK	**2,275**	**853**	**2,120**	**1,195**	642	765	874	718
France	**8**	**7**	**5**	**5**	4	11	5	5
Total	**2,283**	**860**	**2,125**	**1,200**	646	776	879	723

IV New Business (continued)

j) Analysis of total UK APE

	3 months 31.12.06 £m	3 months 30.09.06 £m	3 months 30.06.06 £m	3 months 31.03.06 £m	3 months 31.12.05 £m	3 months 30.09.05 £m	3 months 30.06.05 £m	3 months 31.03.05 £m
Independent financial advisers	**265**	**243**	**196**	**222**	165	185	180	137
Tied	**209**	**83**	**226**	**85**	76	69	95	87
Direct	**7**	**7**	**15**	**10**	7	5	10	9
Total UK individual	**481**	**333**	**437**	**317**	248	259	285	233
Individual life and pensions	**250**	**242**	**219**	**193**	181	180	191	158
Retail investments	**231**	**91**	**218**	**124**	67	79	94	75
Total UK individual	**481**	**333**	**437**	**317**	248	259	285	233
Group life and pensions	**43**	**42**	**38**	**46**	44	42	27	49
Total UK	**524**	**375**	**475**	**363**	292	301	312	282

k) Institutional fund management new business by quarter

	3 months 31.12.06 £m	3 months 30.09.06 £m	3 months 30.06.06 £m	3 months 31.03.06 £m	3 months 31.12.05 £m	3 months 30.09.05 £m	3 months 30.06.05 £m	3 months 31.03.05 £m
Managed pension funds[1]								
Pooled funds	**5,801**	**3,814**	**4,500**	**3,763**	5,129	2,939	3,396	3,314
Segregated funds	**1**	**8**	**538**	**61**	94	41	63	42
Total managed funds	**5,802**	**3,822**	**5,038**	**3,824**	5,223	2,980	3,459	3,356
Other funds[2]	**159**	**109**	**157**	**1,739**	1,705	351	3	57
Total	**5,961**	**3,931**	**5,195**	**5,563**	6,928	3,331	3,462	3,413

1. New monies from pension fund clients of Legal & General Assurance (Pensions Management) Limited exclude £4.4bn (2005: £4.1bn) held through the year on a temporary basis, generally as part of a portfolio reconstruction.
2. Includes segregated property, property partnerships, ventures, alternative investments and institutional clients excluding institutional trusts.

V European Embedded Value Methodology

Basis of preparation

The supplementary financial statements have been prepared in accordance with the European Embedded Value (EEV) Principles issued in May 2004 by the European CFO Forum.

Covered business

The Group uses EEV methodology to value Individual and Group life assurance, pensions and annuity business written in the UK, Continental Europe and the US and within our UK managed pension funds company.

All other businesses are accounted for on the IFRS basis adopted in the primary financial statements.

There is no distinction made between insurance and investment contracts in our life and pensions businesses as there is under IFRS.

Description of methodology

The objective of EEV is to provide shareholders with more realistic information on the financial position and current performance of the Group than is provided within the primary financial statements.

The methodology requires assets of an insurance company, as reported in the primary financial statements, to be attributed between those supporting the covered business and the remainder. The method accounts for assets in the covered business on an EEV basis and the remainder of the Group's assets on the IFRS basis adopted in the primary financial statements.

The EEV methodology recognises as profit from the covered business the total of:

i. cash transfers during the relevant period from the covered business to the remainder of the Group's assets; and

ii. the movement in the present value of future distributable profits to shareholders arising from the covered business over the relevant reporting period.

Embedded value

Shareholders' equity on the EEV basis comprises the embedded value of the covered business plus the shareholders' equity on other businesses, less the value included for purchased interests in long term business.

The embedded value is the sum of the shareholder net worth (SNW) and the value of the in-force business (VIF). SNW is defined as those amounts, within covered business (both within the long term fund and held outside the long term fund but used to support long term business), which are regarded either as required capital or which represent free surplus.

The VIF is the present value of future shareholder profits arising from the covered business, projected using best estimate assumptions, less an appropriate deduction for the cost of holding the required level of capital and the time value of financial options and guarantees.

Service companies

All services relating to the UK life and pensions business are charged on a cost recovery basis, with the exception of investment management services provided to Legal & General Pensions Limited (LGP), which are charged on an arm's length fee basis. Profits arising on the provision of these services are valued on a "look through" basis.

New business

New business premiums reflect income arising from the sale of new contracts during the reporting period and any changes to existing contracts, which were not anticipated at the outset of the contract.

In-force business comprises previously written single premium, regular premium and recurrent single premium contracts.

DWP rebates have not been treated as recurrent and are included in single premium new business when received.

New business contribution arising from the new business premiums written during the reporting period has been calculated on the same economic and operating assumptions used in the embedded value at the end of the financial period. This has then been rolled forward to the end of the financial period using the risk discount rate applicable at the end of the reporting period.

The present value of future new business premiums (PVNBP) has been calculated and expressed at the point of sale. The PVNBP is equivalent to the total single premiums plus the discounted value of regular premiums expected to be received over the term of the contracts using the same economic and operating assumptions used for the embedded value at the end of the financial period. The new business margin is defined as new business contribution at the end of the reporting period divided by the PVNBP. The premium volumes and projection assumptions used to calculate the PVNBP are the same as those used to calculate new business contribution.

V European Embedded Value Methodology (continued)

Projection assumptions

Cash flow projections are determined using realistic assumptions for each component of cash flow and for each policy group. Future economic and investment return assumptions are based on conditions at the end of the financial year. Future investment returns are projected by one of two methods. The first method is based on an assumed investment return attributed to assets at their market value. The second, which is used in the US, where the investments of that subsidiary are substantially all fixed interest, projects the cash flows from the current portfolio of assets and assumes an investment return on reinvestment of surplus cash flows. The assumed discount and inflation rates are consistent with the investment return assumptions.

Detailed projection assumptions including mortality, persistency, morbidity and expenses reflect recent operating experience and are reviewed annually. Allowance is made for future improvements in annuitant mortality based on experience and externally published data. Favourable changes in operating experience are not anticipated until the improvement in experience has been observed.

All costs relating to the covered business, whether incurred in the covered business or elsewhere in the Group, are allocated to that business. The expense assumptions used for the cashflow projections therefore include the full cost of servicing this business.

Tax

The projections take into account all tax which is expected to be paid, based on best estimate assumptions, applying current legislation and practice together with known or expected future changes. This includes tax which would arise if surplus assets within the covered business were eventually to be distributed. The future benefit of certain current UK tax rules on the apportionment of income has not been reflected. It is expected that these rules will be amended as part of the current consultation on life assurance taxation, such that the benefit is not expected to be realised.

Allowance for risk

Aggregate risks within the covered business are allowed for through the following principal mechanisms:

i. setting required capital levels with reference to both the Group's internal risk based capital models, and an assessment of the strength of regulatory reserves in the covered business;

ii. allowing explicitly for the time value of financial options and guarantees within the Group's products; and

iii. setting risk discount rates by deriving a Group level risk margin to be applied consistently to local risk free rates.

Required capital and free surplus

Regulatory capital for UK life and pensions business is provided by assets backing the with-profits business or by the SNW. The SNW comprises the sum of the values of the Shareholder Retained Capital (SRC), the Sub-fund and the shareholder capital within LGP.

For UK with-profits business, the required capital is covered by the surplus within the with-profits part of the fund and no effect is attributed to shareholders except for the burn-through cost, which is described later. This treatment is consistent with the Principles and Practices of Financial Management for this part of the fund.

For UK non profit business, the required capital will be maintained at no less than the level of the EU minimum solvency requirement. This level, together with the margins for adverse deviation in the regulatory reserves, is, in aggregate, in excess of internal capital targets assessed in conjunction with the Individual Capital Adequacy (ICA) assessment.

In Society the SRC is either required to cover EU solvency margin or is encumbered because its distribution to shareholders is restricted due to previous understandings with the Financial Services Authority. It is therefore classified as required capital and not as free surplus for the purposes of EEV reporting. SRC is valued by assuming it is distributed from the LTF over a 20 year period with allowance for tax payable on distribution. For this purpose, distribution of the SRC is restricted such that there is always sufficient SRC left to cover the EU solvency margin for in-force non profit business in Society.

In LGP, the shareholder capital covers the EU minimum solvency margin for the business.

The initial strains relating to new non profit business, together with the related EU solvency margin, are supported by releases from existing non profit business, the SRC and LGP shareholder capital. As a consequence, the writing of new business defers the release of capital from the SRC and LGP shareholder capital to free surplus. Any assets in LGP shareholder capital in excess of those required to cover the EU minimum solvency margin are treated as free surplus. Cost of holding required capital is defined as the difference between the value of the required capital and the present value of future releases of that capital. For new business, the cost of capital is taken as the difference in the value of that capital assuming it was available for release immediately and the present value of the future releases of that capital. As the investment return, net of tax, on that capital is less than the risk discount rate, there is a resulting cost of capital which is reflected in the value of new business.

The Sub-fund is also treated as required capital, because its distribution to shareholders is restricted by Society's Articles of Association.

For our UK managed pension funds business, management's capital policy has been used to set the level of required capital. The balance of net assets within the UK Managed Funds business is treated as free surplus.

V European Embedded Value Methodology (continued)

For Legal & General America, the Company Action Level (CAL) of capital has been treated as required capital for modelling purposes. The CAL is the regulatory capital level at which the company would have to take prescribed action, such as submission of plans to the State insurance regulator, but would be able to continue operating on the existing basis. The CAL is currently twice the level of capital at which the regulator is permitted to take control of the business.

For Legal & General Netherlands (LGN), required capital has been set at 100% of EU minimum solvency for all products which do not have any related financial options and guarantees (FOGs). For those products with FOGs, capital of between 112.5% and 130% of the EU minimum solvency margin has been used. The level of capital has been determined using risk based capital techniques.

For Legal & General France (LGF), 100% of EU minimum solvency margin has been used for EV modelling purposes for all products both with and without FOGs. The level of capital has been determined using risk based capital techniques.

The contribution from new business for our Overseas businesses reflects an appropriate allowance for the cost of holding the required capital.

Financial options and guarantees

In the UK, all financial options and guarantees (FOGs) are within the UK life and pensions business.

Under the EEV Principles an allowance for time value of FOGs is required where a financial option exists which is exercisable at the discretion of the policyholder. These types of option principally arise within the with-profits part of the fund and their time value is recognised within the with-profits burn-through cost described below. Additional financial options for non profit business exist only for a small amount of deferred annuity business where guaranteed early retirement and cash commutation terms apply when the policyholders choose their actual retirement date.

Further financial guarantees exist for non profit business, in relation to index-linked annuities where capped or collared restrictions apply. Due to the nature of these restrictions and the manner in which they vary depending on the prevailing inflation conditions, they are also treated as FOGs and a time value cost recognised accordingly.

The time value of FOGs has been calculated stochastically using a large number of real world economic scenarios derived from assumptions consistent with the deterministic EEV assumptions and allowing for appropriate management actions where applicable. The management action primarily relates to the setting of bonus rates. Future regular and terminal bonuses on participating business within the projections are set in a manner consistent with expected future returns available on assets deemed to back the policies within the stochastic scenarios.

In recognising the residual value of any projected surplus assets within the with-profits part of the fund in the deterministic projection, it is assumed that terminal bonuses are increased to exhaust all of the assets in the part of the fund over the future lifetime of the in-force with-profits policies. However, under stochastic modelling, there may be some extreme economic scenarios when the total projected assets within the with-profits part of the fund are insufficient to pay all projected policyholder claims and associated costs. The average additional shareholder cost arising from this shortfall has been included in the time value cost of options and guarantees and is referred to as the with-profits burn-through cost.

The same economic scenarios have been used to assess the time value of the financial guarantees for non profit business by using the inflation rate generated in each scenario. The inflation rate used to project index-linked annuities will be constrained in certain real world scenarios, for example, where negative inflation occurs but the annuity payments do not reduce below pre-existing levels. The time value cost of FOGs allows for the projected average cost of these constrained payments for the index-linked annuities. It also allows for the small additional cost of the guaranteed early retirement and cash commutation terms for the minority of deferred annuity business where such guarantees have been written.

In the US, FOGs relate to guaranteed minimum crediting rates and surrender values on a range of contracts. The guaranteed surrender value of the contract is based on the accumulated value of the contract including accrued interest. The crediting rates are discretionary but related to the accounting income for the amortising bond portfolio. The majority of the guaranteed minimum crediting rates are between 4% and 5%. The assets backing these contracts are invested in US dollar denominated fixed interest securities.

In the Netherlands, there are two types of guarantees which have been separately provided for: interest rate guarantees and maturity guarantees. Certain contracts provide an interest rate guarantee where there is a minimum crediting rate based on the higher of 1-year Euribor and the policy guarantee rate. This guarantee applies on a monthly basis. Certain unit linked contracts provide a guaranteed minimum value at maturity where the maturity amount is the higher of the fund value and a guarantee amount. The fund values for both these contracts are invested in Euro denominated fixed interest securities.

In France, FOGs which have been separately provided for relate to guaranteed minimum crediting rates and surrender values on a range of contracts. The guaranteed surrender value of the contract is the accumulated value of the contract including accrued bonuses. The bonuses are based on the accounting income for the amortising bond portfolios plus income and releases from realised gains on any equity type investments. Policy liabilities equal guaranteed surrender values. Local statutory accounting rules require the establishment of a specific liability when the accounting income for a company is less than 125% of the guaranteed minimum credited returns, although this has never been required. In general, the guaranteed annual bonus rates are between 1.5% and 4.5%.

V European Embedded Value Methodology (continued)

Risk discount rate

The risk discount rate (RDR) is a combination of the risk free rate and a risk margin, which reflects the residual risks inherent in the Group's covered businesses, after taking account of prudential margins in the statutory provisions, the required capital and the specific allowance for financial options and guarantees.

The risk margin has been determined based on an assessment of the Group's weighted average cost of capital (WACC). This assessment incorporates a beta for the Group, which measures the correlation of movements in the Group's share price to movements in a relevant index. Beta values therefore allow for the market's assessment of the risks inherent in the business relative to other companies in the chosen index.

The WACC is derived from the Group's cost of equity and debt, and the proportion of equity to debt in the Group's capital structure measured using market values. Each of these three parameters should be forward looking, although informed by historic information. The cost of equity is calculated as the risk free rate plus the equity risk premium for the chosen index multiplied by the company's beta. Forward-looking or adjusted betas make allowance for the observed tendency for betas to revert to 1 and therefore a weighted average of the historic beta and 1 tends to be a better estimate of the company's beta for the future period. We have computed the WACC using an arithmetical average of forward-looking betas against the FTSE 100 index.

The cost of debt used in the WACC calculations takes account of the actual locked-in rates for our senior and subordinated long term debt. All debt interest attracts tax relief at a rate of 30%.

Whilst the WACC approach is a relatively simple and transparent calculation to apply, subjectivity remains within a number of the assumptions. Management believes that the chosen margin, together with the levels of required capital, the inherent strength of the Group's regulatory reserves and the explicit deduction for the cost of options and guarantees, is appropriate to reflect the risks within the covered business. For these results the risk margin has been maintained at 3.0%.

A similar approach will be adopted when risk margins are reassessed in future periods.

Key assumptions are summarised below:

Risk free rate:	Derived from gross redemption yields on relevant gilt portfolio
Equity risk premium	3.0% (UK only)
Property risk premium	2.0% (UK only)
Risk margin	3.0%

Analysis of profit

Operating profit is identified at a level which reflects an assumed longer term level of investment return.

The contribution to operating profit in a period is attributed to four sources:

i. new business;

ii. the management of in-force business;

iii. development costs; and

iv. return on shareholder net worth.

Further profit contributions arise from actual investment return differing from the assumed long term investment return (investment return variances), and from the effect of economic assumption changes.

The contribution from new business represents the value recognised at the end of each period from new business written in that period, after allowing for the actual cost of acquiring the business and of establishing the required technical provisions and reserves and after making allowance for the cost of capital. New business contributions are calculated using closing assumptions.

The contribution from in-force business is calculated using opening assumptions and comprises:

i. expected return - the discount earned from the value of business in-force at the start of the year;

ii. experience variances - the variance in the actual experience over the reporting period from that assumed in the value of business in-force as at the start of the year; and

iii. operating assumption changes - the effects of changes in future assumptions, other than changes in economic assumptions from those used in valuing the business at the start of the year. These changes are made prospectively from the end of the year.

Development costs are associated with investment in building a new enterprise or exceptional development activity over a defined period.

V European Embedded Value Methodology (continued)

The contribution from shareholder net worth comprises the increase in embedded value based on assumptions at the start of the year in respect of:

i. encumbered assets within the covered business – principally the unwind of the discount rate;

ii. LGP shareholder capital – the expected investment return; and

iii. residual assets - the expected investment return.

Further profit contributions arise from actual investment returns differing from the assumed long-term investment returns (investment return variances) and from the effect of economic assumption changes.

Investment return variances represent the effect of actual investment performance and changes to investment policy on shareholder net worth and in-force business from that assumed at the beginning of the period.

Economic assumption changes comprise the effect of changes in economic variables, beyond the control of management, including associated changes to valuation bases to the extent that they are reflected in revised assumptions.

VI IFRS basis of preparation

Basis of preparation
The Group's financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) and as adopted by the European Commission (EC) for use in the European Union. The Group's financial statements also comply with IFRS as issued by the IASB.

The Group presents its balance sheet broadly in order of liquidity. This is considered to be more relevant than a before or after twelve months presentation, given the long term nature of the Group's core business. However, for each asset and liability line item which combines amounts expected to be recovered or settled before and after twelve months from the balance sheet date, disclosure of the split is made by way of note.

Financial assets and financial liabilities are disclosed gross in the balance sheet unless a legally enforceable right of offset exists and there is an intention to settle recognised amounts on a net basis. Income and expenses are not offset in the income statement unless required or permitted by any accounting standard or International Financial Reporting Interpretations Committee (IFRIC) interpretation, as detailed in the applicable accounting policies of the Group.

Use of estimates
The preparation of the financial statements includes the use of estimates and assumptions that affect items reported in the consolidated balance sheet and income statement and the disclosure of contingent assets and liabilities at the date of the financial statements. 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.

Summary of significant accounting policies
The Group has selected accounting policies that fairly state its financial position and financial performance for a reporting period. These accounting policies are applied after an assessment of complex issues, and may require subjective judgments to be made. Such judgements relate to insurance and investment contract liabilities, deferred acquisition costs, pension schemes and the determination of fair values of unquoted financial investments.

The accounting policies have been consistently applied to all years presented, unless otherwise stated.