

Box Hill Life Finance plc

(Incorporated in England and Wales with limited liability under registered number 5259209)

£280,000,000 Class A-1 Floating Rate Secured Notes due 2016

£100,000,000 Class A-2 Floating Rate Secured Notes due 2019

Issue Price of the Notes: 100 per cent.

**Unconditionally and irrevocably guaranteed in relation to Scheduled Interest and Ultimate Principal
by Ambac Assurance UK Limited**



Ambac Assurance UK Limited

(Incorporated with limited liability in England and Wales under company number 3248674)

Box Hill Life Finance plc (the "Issuer") will issue on or about 16 December 2004 (or such later date as the Lead Manager and the Issuer may agree) (the "Closing Date") the £280,000,000 Class A-1 Floating Rate Secured Notes due 2016 (the "Class A-1 Notes") and the £100,000,000 Class A-2 Floating Rate Secured Notes due 2019 (the "Class A-2 Notes" and, together with the Class A-1 Notes, the "Notes" and each a "Class of Notes"). The Notes will have the following basic characteristics:

Class of Notes	Aggregate Nominal Amount	Interest Rate	Interest Payment Date	Issue Price	Expected Ratings (S&P/Moody's)	Final Maturity Date
Class A-1 Notes	£280,000,000	3 month LIBOR plus 0.20 per cent. per annum	15 January, 15 April, 15 July and 15 October in each year (or, if such day is not a Business Day, the immediately succeeding Business Day)	100 per cent.	AAA/Aaa	15 April 2016
Class A-2 Notes	£100,000,000	3 month LIBOR plus 0.23 per cent. per annum	15 January, 15 April, 15 July and 15 October in each year (or, if such day is not a Business Day, the immediately succeeding Business Day)	100 per cent.	AAA/Aaa	15 April 2019

The Notes will be constituted by a single trust deed to be dated on or about the Closing Date and made between the Issuer, The Bank of New York, London Branch, as trustee (the "Note Trustee"), and Ambac Assurance UK Limited ("Ambac") (the "Trust Deed"). Application has been made to the Financial Services Authority in its capacity as competent authority for the purposes of Part VI of the Financial Services and Markets Act 2000 (the "FSMA") (the "UK Listing Authority") for the Notes to be admitted to the Official List maintained by the UK Listing Authority (the "Official List") and application will be made to the London Stock Exchange PLC (the "Stock Exchange") for the Notes to be admitted to trading by the Stock Exchange. Copies of this offering document (including the Appendices hereto), which comprises listing particulars with regard to the Issuer and the Notes approved in accordance with the listing rules (the "Listing Rules") made under Section 74 of FSMA, have been delivered to the Registrar of Companies in England and Wales for registration in accordance with Section 83 of FSMA.

The Notes will be unconditionally and irrevocably guaranteed in relation to Scheduled Interest and Ultimate Principal (each as defined in the Ambac Note Financial Guarantee) pursuant to a financial guarantee and the endorsement thereto (the "Ambac Note Financial Guarantee") to be issued by Ambac as set out in "Form of Ambac Note Financial Guarantee" below.

The Class A-1 Notes and the Class A-2 Notes will each initially be represented by a temporary global note in bearer form (respectively, the "Class A-1 Temporary Global Note" and the "Class A-2 Temporary Global Note" and, together, the "Temporary Global Notes") without coupons or talons attached and which will represent the aggregate principal amount outstanding of, respectively, the Class A-1 Notes and the Class A-2 Notes. The Temporary Global Notes will be deposited on behalf of the subscribers of the Notes with The Bank of New York, London Branch, as common depositary (the "Common Depositary") for Clearstream Banking, société anonyme ("Clearstream, Luxembourg") and Euroclear Bank S.A./N.V., as operator of the Euroclear System ("Euroclear") on or about the Closing Date. Interests in the Temporary Global Notes will be exchangeable on and after the date which is 40 days after the Closing Date (the "Exchange Date"), upon certification of non-U.S. beneficial ownership, for interests in, in the case of the Class A-1 Temporary Global Note, a permanent global note (the "Class A-1 Permanent Global Note") representing the Class A-1 Notes and, in the case of the Class A-2 Temporary Global Note, a permanent global note (the "Class A-2 Permanent Global Note", together with the Class A-1 Permanent Global Note, the "Permanent Global Notes" and each a "Permanent Global Note") representing the Class A-2 Notes, each in bearer form without coupons or talons, which will also be deposited with the Common Depositary. The Class A-1 Permanent Global Note will be exchangeable for definitive Class A-1 Notes (the "Definitive Class A-1 Notes") and the Class A-2 Permanent Global Note will be exchangeable for definitive Class A-2 Notes (the "Definitive Class A-2 Notes", together with the Definitive Class A-1 Notes, the "Definitive Notes" and each a "Definitive Class of Notes") issued in bearer form in the limited circumstances described in Condition 2 of the Terms and Conditions of the Notes.

Interest on the Notes is payable by reference to successive interest periods (each, an "Interest Period"). Interest will be payable quarterly in arrear in Pounds Sterling on 15 January, 15 April, 15 July and 15 October in each year (subject to adjustment as specified herein for non-business days) (each, an "Interest Payment Date") commencing on the Interest Payment Date falling in April 2005.

The Class A-1 Notes will mature on the Interest Payment Date falling in April 2016 and the Class A-2 Notes will mature on the Interest Payment Date falling in April 2019, in each case unless previously redeemed in full. The Notes will be subject to mandatory partial redemption and/or optional redemption in whole or in part before such date in the specific circumstances and subject to the conditions summarised under "Transaction Summary – Description of the Notes" and more fully set out in the Terms and Conditions of the Notes.

If any withholding or deduction for or on account of tax is applicable to the Notes, payment of interest on, and principal and premium (if any) in respect of, the Notes will be made subject to such withholding or deduction. In such circumstances, neither the Issuer, Ambac nor any other party will be obliged to pay any additional amounts as a consequence. (But see "Form of Ambac Note Financial Guarantee" below as regards payments made by Ambac under the Ambac Note Financial Guarantee.)

The Notes will be obligations of the Issuer only. The Notes will not be obligations or responsibilities of, or guaranteed by, any other person other than Ambac in respect of Scheduled Interest and Ultimate Principal. In particular, the Notes will not be obligations or responsibilities of, nor will they be guaranteed by, the officers, directors or incorporators of the Issuer, the holders of the Notes, the Note Trustee, the Issuer Security Trustee, the Issuer Swap Provider, the Principal Paying Agent, the Agent Bank, the Issuer Cash Manager, the Issuer Account Bank, the Issuer Administrator, InterCo, the InterCo Security Trustee, the InterCo Swap Provider, the Liquidity Facility Provider, the InterCo Investment Manager, the InterCo Custodian, the InterCo Cash Manager, the InterCo Account Bank, the InterCo Administrator, the Reinsurer, the Reinsurer Security Trustee, the Reinsurer Swap Provider, the Reinsurer Investment Manager, the Reinsurer Custodian, the Reinsurer Cash Manager, the Reinsurer Account Bank, the Reinsurer Administrator, Ambac (save in relation to the payment of Scheduled Interest and Ultimate Principal), Friends Provident Life and Pensions Limited ("FPLP"), its holding company, any of its affiliates or any other company in the same group of companies as, or affiliated to, FPLP, or any other company in the same group of companies as, or affiliated to, the Issuer.

It is expected that each Class of Notes will, when issued, be assigned an "AAA" rating by Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc. ("S&P") and an "Aaa" rating by Moody's Investors Service Limited ("Moody's" and, together with S&P, the "Rating Agencies"). The ratings of the Notes are based on, *inter alia*, the financial strength and claims paying ability of Ambac. A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.

For a description of certain risks associated with an investment in the Notes, see the section herein entitled "Investment Considerations".

Lead Manager

Barclays Capital

The date of this Offering Circular is 13 December 2004.

The Issuer accepts responsibility for all the information contained in this Offering Circular. To the best of the knowledge and belief of the Issuer (having taken all reasonable care to ensure that such is the case), the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information. The Issuer accepts responsibility accordingly.

Ambac accepts responsibility for the information contained in the sections entitled “*Ambac Assurance UK Limited*”, “*Ambac Assurance Corporation*”, “*Relationship between Ambac Assurance UK Limited and Ambac Assurance Corporation*”, “*Form of Ambac Note Financial Guarantee*”, paragraphs 2, 5(a), 6(a), 8 and 9(a) under “*General Information*” below and in Appendix 2 entitled “*Financial Statements of Ambac Assurance UK Limited*” (together, the “**Ambac Information**”). To the best of the knowledge and belief of Ambac (having taken all reasonable care to ensure that such is the case), the Ambac Information is in accordance with the facts and does not omit anything likely to affect the import of such information. No representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by Ambac as to the accuracy or completeness of any information contained in this Offering Circular (other than the Ambac Information) or any other information supplied in connection with the Notes or their distribution. Other than in respect of the Ambac Information, Ambac has not separately verified the information contained herein and no representation, warranty or undertaking, express or implied, is made and no liability accepted by Ambac as to the accuracy or completeness of such information. Each person receiving this Offering Circular acknowledges that such person has not relied on Ambac or any of its affiliates in connection with its investigation of the information contained herein (other than the Ambac Information).

Friends Provident Life and Pensions Limited (“**FPLP**”) accepts responsibility for the information contained in the sections entitled “*Defined Book Surplus*”, “*The Base Case*”, “*Sensitivity Analysis*”, “*Reinsurer Regulatory Surplus*”, “*FPLP*”, “*Reinsurer*”, paragraphs 5(c), (d) and (e), 6(c), (d) and (e), 9(c), (d) and (e) under “*General Information*” below, Appendix 1 entitled “*Investment Performance and Strategy*”, Appendix 3 entitled “*Financial Statements of FPLP*”, Appendix 4 entitled “*Base Case and Sensitivity Analysis Tables*”, Appendix 5 entitled “*Defined Book Policy Descriptions*” and Appendix 7 entitled “*Base Case Assumptions Tables*” (together, the “**FPLP Information**”). To the best of the knowledge and belief of FPLP (having taken all reasonable care to ensure that such is the case), the FPLP Information is in accordance with the facts and does not omit anything likely to affect the import of such information. No representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by FPLP as to the accuracy or completeness of any information contained in this Offering Circular (other than the FPLP Information) or any other information supplied in connection with the Notes or their distribution. Other than in respect of the FPLP Information, FPLP has not separately verified the information contained herein and no representation, warranty or undertaking, express or implied, is made and no liability accepted by FPLP as to the accuracy or completeness of such information. Each person receiving this Offering Circular acknowledges that such person has not relied on FPLP or any of its affiliates in connection with its investigation of the information contained herein (other than the FPLP Information).

Barclays Bank PLC (“**Barclays**”) accepts responsibility for information contained in the section entitled “*Barclays*” (the “**Barclays Information**”). To the best of the knowledge and belief of Barclays (having taken all reasonable care to ensure that such is the case), the Barclays Information is in accordance with the facts and does not omit anything likely to affect the import of such information. No representation, warranty or undertaking, express or implied is made and no responsibility or liability is accepted by Barclays as to the accuracy or completeness of any information contained in this Offering Circular (other than the Barclays Information) or any other information supplied in connection with the Notes or their distribution. Other than in respect of the Barclays Information, Barclays has not separately verified the information contained herein and no representation, warranty or undertaking, express or implied, is made and no liability accepted by Barclays as to the accuracy or completeness of such information. Each person receiving this Offering Circular acknowledges that such person has not relied on Barclays or any of its affiliates in connection with its investigation of the information contained herein (other than the Barclays Information).

No person is authorised to give any information or to make any representation in connection with the offering or sale of the Notes other than those contained in this Offering Circular and, if given or made, such information or representation must not be relied upon as having been authorised by

the Note Trustee, the Issuer Security Trustee, the Issuer Swap Provider, the Principal Paying Agent, the Agent Bank, the Issuer Cash Manager, the Issuer Account Bank, the Issuer Administrator, InterCo, the InterCo Security Trustee, the InterCo Swap Provider, the Liquidity Facility Provider, the InterCo Investment Manager, the InterCo Custodian, the InterCo Cash Manager, the InterCo Account Bank, the InterCo Administrator, the Reinsurer, the Reinsurer Security Trustee, the Reinsurer Swap Provider, the Reinsurer Investment Manager, the Reinsurer Custodian, the Reinsurer Cash Manager, the Reinsurer Account Bank, the Reinsurer Administrator, Ambac (save in relation to the payment of Scheduled Interest and Ultimate Principal), FPLP, its holding company, any of its affiliates or any other company in the same group of companies as, or affiliated to, FPLP, or any other company in the same group of companies as, or affiliated to, the Issuer. Neither the delivery of this Offering Circular nor any sale, allotment or solicitation made in connection with the offering of the Notes shall, under any circumstances, create any implication or constitute a representation that there has been no change in the affairs of the Issuer, InterCo, the Reinsurer, FPLP or Ambac or in the other information contained herein since the date hereof or that the information contained herein is correct at any time subsequent to the date hereof.

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended (the “**Securities Act**”) or any State securities laws, and include Notes in bearer form which are subject to U.S. tax law requirements. The Notes may not be offered or sold within the United States or for the benefit or account of, or to, any U.S. persons (as defined in Regulation S under the Securities Act), except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable State securities laws.

Other than the approval of this document as listing particulars in accordance with the listing rules made under Part VI of FSMA and the delivery of copies of this document to the Registrar of Companies in England and Wales for registration in accordance with Section 83 of FSMA, no action has been or will be taken to permit a public offering of the Notes or the distribution of this Offering Circular in any jurisdiction. The distribution of this Offering Circular and the offering of the Notes in certain jurisdictions may be restricted by law. Persons into whose possession this Offering Circular (or any part thereof) comes are required by the Issuer and the Lead Manager to inform themselves about and to observe any such restrictions. For a description of certain further restrictions on offers and sales of the Notes and the distribution of this Offering Circular, see “*Subscription and Sale*” below.

Particular attention is drawn to the sections herein entitled “*Investment Considerations*” and “*Summary of the Transaction Documents – Trust Deed*”.

The Base Case (as defined below) projections included under “*The Base Case*” below and in Appendix 4 may be ‘forward looking statements’ within the meaning of applicable securities laws. These projections and statements may relate to matters such as assumptions about future experience, including tax, early termination rates, paid up rates, mortality, morbidity, expenses, reinsurance and legislation as well as other factors beyond FPLP’s control. Projections and forward-looking statements are subject to inherent uncertainties and risk. In light of these risks and uncertainties, actual events and results may vary significantly from those included in, or contemplated or implied by, such projections and forward looking statements. Prospective investors are cautioned not to place undue reliance on such statements.

The projections under “*The Base Case*” below and in Appendix 4 (and such projections as referred to elsewhere in this document) set out (or refer to) (i) a base case (the “**Base Case**”) and (ii) certain scenarios included under “*Sensitivity Analysis*”.

The Base Case is based on the Base Case Assumptions (as defined below). The Base Case Assumptions relating to mortality, morbidity and discontinuance (being those relating to persistency rates and paid-up rates) (all as described below) represented an estimate, as at 31 May 2004 (the “**Base Case Assumptions Date**”) (adjusted, in the case of longevity, to reflect an increase in allowance for improvements in mortality to mid-way between the medium and long cohort set out in working paper 1 – “A proposed interim basis for adjusting the “92” series mortality projections for cohort effects” published by the Mortality sub-committee of the Continuous Mortality Investigation in December 2002 (the “**CMI Longevity Paper**”) in setting the statutory valuation basis applicable from 31 December 2004 and, in the case of persistency, to reflect recent experience), of FPLP or Defined Book Policies (to the extent FPLP has recorded experience in relation to these separately) made in accordance with actuarial practice which takes account of the historic experience of FPLP, and, in the case of mortality and morbidity, of information relating to

the life assurance industry in respect of comparable business to the Defined Book generally available to FPLP as at the Base Case Assumptions Date; the Base Case Assumptions relating to other matters have been determined in relation thereto on the basis as described in “*The Base Case – Base Case Assumptions used in projecting Defined Book Surplus*” below.

In (and subject to the terms of) the Actuary’s Report, KPMG LLP (“KPMG”) considers the Base Case Assumptions to be reasonable at the date as at which they were made (see “*Actuary’s Report*” below).

The Base Case Assumptions (which are long term assumptions) are considered by KPMG in its Actuary’s Report (subject to the terms set out therein) to be reasonable at the date of this Offering Circular, taken as a whole over the period over which Defined Book Surplus is projected to arise; to the extent that changes in investment returns generally have occurred since 31 May 2004, FPLP and KPMG consider that such changes are not likely to result in a material reduction in the amount of Aggregate Defined Book Surplus projected in the Base Case.

The scenarios set out under “*Sensitivity Analysis*” and in Appendix 4 are designed to illustrate the effects of the variability of certain specific Base Case Assumptions on the Base Case projections, and are not intended to be projections, estimates, forecasts or forward looking statements or indications of the likelihood that these scenarios may occur or that other scenarios may not occur. These scenarios do not purport to be comprehensive, are not based on any view of FPLP, KPMG, the Reinsurer, InterCo, the Issuer, Ambac, the Lead Manager or any of their respective affiliates or any other person as to the likelihood of their occurrence, are not the worst case scenarios which could prevail and do not reflect variations in anything other than the relevant Base Case Assumptions; other scenarios may show different effects on the Base Case projections (and, accordingly, the ability of the Issuer to pay interest on and to redeem the Notes may differ from the scenarios illustrated and may be worse).

Actual future experience is likely to differ from that assumed in the calculation of the Base Case, and such variations may be material. Consequently, the inclusion of the Base Case projections herein should not be regarded as a representation by FPLP, KPMG, the Reinsurer, InterCo, the Issuer, Ambac, the Lead Manager or any of their respective affiliates or any other person that the projections of the Defined Book Surplus over this period, or the projection of any Defined Book Surplus in respect of any particular Calculation Period, will be achieved.

None of FPLP, KPMG, the Reinsurer, InterCo, the Issuer, Ambac, the Lead Manager or any of their respective affiliates or any other person undertakes any obligation to update any forward looking statement contained herein.

This Offering Circular does not constitute an offer of, or an invitation by or on behalf of, the Issuer or the Lead Manager to subscribe or purchase any of the Notes.

In this Offering Circular all references to *Pounds Sterling* or £ are references to the lawful currency for the time being of the United Kingdom of Great Britain and Northern Ireland, all references to *U.S. dollars* or \$ are to the lawful currency for the time being of the United States of America, and references to *Euro* and € are to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended by the Treaty on European Union.

IN CONNECTION WITH THIS ISSUE OF NOTES, BARCLAYS BANK PLC AS THE STABILISING INSTITUTION (THE “STABILISING MANAGER”) (OR ANY PERSON ACTING FOR THE STABILISING MANAGER) MAY OVER-ALLOT OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF A PARTICULAR CLASS OF THE NOTES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL FOR A LIMITED PERIOD FROM THE CLOSING DATE. HOWEVER, THERE MAY BE NO OBLIGATION ON THE STABILISING MANAGER (OR THE AGENT OF THE STABILISING MANAGER) TO DO THIS. SUCH STABILISING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME, AND MUST BE BROUGHT TO AN END AFTER A LIMITED PERIOD. SUCH STABILISING SHALL BE IN COMPLIANCE WITH ALL APPLICABLE LAWS, REGULATIONS AND RULES. SEE “SUBSCRIPTION AND SALE” BELOW.

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EXECUTIVE OVERVIEW

This section contains a brief overview of the transactions described elsewhere in this Offering Circular and an overview of their economic effect. It is not complete and omits significant detail and is therefore qualified in its entirety by reference to other information appearing elsewhere in this Offering Circular. It should be read with caution and attention is drawn in particular to the section in this Offering Circular entitled "Investment Considerations" commencing on page 45. Defined terms used in this section have the meaning given to them elsewhere in this Offering Circular; an index of defined terms appears at the end of this Offering Circular.

Purpose of the financing

The purpose of the issue of the Notes is to raise finance to enable Friends Provident Reinsurance Services Limited (the "**Reinsurer**") to provide reinsurance to FPLP of certain liabilities of the Defined Book. The reinsurance so provided is expected to provide regulatory capital to FPLP and enables funds to be released to finance new business growth.

Background to the financing

The demutualisation of Friends' Provident Life Office ("**FPLO**") was effected by obtaining court and members' approval in June 2001 for the scheme of transfer by which FPLO transferred its policyholder and other liabilities to FPLP in accordance with Schedule 2C to the Insurance Companies Act 1982 (the scheme of transfer, as amended from time to time, is referred to as the "**Scheme**").

Under the terms of the Scheme, FPLP was established with a long-term business fund (the "**FPLP Long Term Business Fund**") and a shareholder fund (the "**FPLP Shareholder Fund**"). Within the FPLP Long Term Business Fund, two sub-funds, the with profits fund (the "**With Profits Fund**") and the non profit fund (the "**Non Profit Fund**"), were established.

In addition, the Scheme implicitly required two further sub-funds within the With Profits Fund which are referred to, for the purpose of this Offering Circular, as, respectively, the "**Defined Book**" and the "**With Profits/With Profits Fund**":

- **The Defined Book:** The Defined Book contains all of the policies transferred from FPLO at the time of demutualisation, excluding permanent health insurance ("**PHI**") policies (which were transferred to the Non Profit Fund) and conventional with profits policies. The Defined Book comprises conventional non-profit life and pensions policies, unit linked life and pensions policies and unitised with profits life and pensions policies, excluding the investment element thereon (see below). The Defined Book will be the subject of the Reinsurance Agreement.
- **The With Profits/With Profits Fund:** This sub-fund contains conventional with profits policies transferred from FPLO at the time of demutualisation and the investment element (including guarantees in respect of bonuses declared) of unitised with profits life and pensions policies in the Defined Book. This fund also contains the investment element (including guarantees in respect of bonuses declared) of post-demutualisation unitised with profits business that was written in both the Non Profit Fund and FPLP's subsidiaries and reassured to the With Profits Fund under internal reinsurance arrangements.

From 9 July 2001 to 31 December 2003, new non profit and unit linked life and PHI business was written in the Non Profit Fund of FPLP. From 1 January 2003, most new non profit life and PHI business was reassured to the Other Business Fund ("**OBF**") of Friends Provident Life Assurance Limited (a wholly-owned subsidiary of FPLP) ("**FPLA**") and, from 1 January 2004, most of this business was progressively written directly in the OBF of FPLA, although some overseas life business will continue to be written in FPLP's Non Profit Fund. From 9 July 2001 to 31 December 2001, new non-profit and unit linked pensions business was written in the Non Profit Fund and reassured to Friends Provident Pensions Limited (also a wholly-owned subsidiary of FPLP) ("**FPP**"). From 1 January 2002, new non-profit and unit linked pension business has been written in FPP. The investment element of post demutualisation new unitised with profits life and pensions business is reassured to FPLP's With Profits Fund.

Under the terms of the Scheme, which were approved by a court process at the time of demutualisation and which were amended by the court on 29 July 2004, surplus arising from the Defined Book is attributable as follows:

- 60 per cent. is attributable to the Non Profit Fund for the benefit of shareholders; and

- 40 per cent. is attributable to (i.e. retained in) the With Profits/With Profits Fund for the benefit of the With Profits policyholders.

As the Defined Book policies were written prior to demutualisation, the Scheme requires that the calculation of surplus (the “**Schedule 3 Amount**”) arising on the Defined Book policies is to be undertaken on an annual basis for the year ending 31 December (the “**Calculation Period**”) in accordance with the formula set out in Schedule 3 to the Scheme.

Minor changes were made to Schedule 3 to the Scheme by a court order dated 29 July 2004 enabling, *inter alia*, the Schedule 3 Amount to be calculated taking into account the effects of transactions designated by the Board of Directors of FPLP with the Financial Services Authority having confirmed it does not object to such designation (a “**Designated Transaction**”); the Reinsurance Agreement is a Designated Transaction.

Surplus for the purposes of the Reinsurance Agreement (“**Defined Book Surplus**”) is based on that calculated for the purpose of the Scheme, but ignoring the effects of entry into the Reinsurance Agreement.

The principal parties

Box Hill Life Finance plc (the “**Issuer**”) is a special purpose public company limited by shares which is newly incorporated in England and Wales and was established for the purpose of providing finance to Box Hill Loan Finance Limited (“**InterCo**”).

InterCo is a special purpose private company limited by shares which is newly incorporated in England and Wales and was established for the purpose of providing finance to the Reinsurer in order to enable the Reinsurer to fund its obligations under the Reinsurance Agreement as described in this Offering Circular.

The Reinsurer is a special purpose private company limited by shares which is newly incorporated in England and Wales and was established for the purpose of entering into the Reinsurance Agreement and other transactions described in this Offering Circular. The Reinsurer is a wholly owned subsidiary of FPLP and is regulated by the Financial Services Authority, having permission to carry on long-term insurance business. The Reinsurer will be capitalised by FPLP subscribing £30 million of share capital on or before the Closing Date of which £20 million will be transferred into the Reinsurer’s Long Term Business Fund as surplus.

Application of principal funds raised by the Issuer

Under the proposed principal financing transactions, the proceeds raised from issuing the Notes will be applied as follows:

- (a) The Issuer will raise £380,000,000 of finance by issuing £280,000,000 in aggregate principal amount of Class A-1 Notes and £100,000,000 of Class A-2 Notes.
- (b) The Issuer will on-lend the £380,000,000 so raised to InterCo under the InterCo Loan Agreement.
- (c) InterCo will on-lend the £380,000,000 so raised to the Reinsurer under the Reinsurer Loan Agreement.
- (d) The Reinsurer will use the proceeds of the Reinsurer Loan (and the available funds from the capital it has issued) to purchase Reinsurer Eligible Investments, *inter alia*, to comprise the reserves required in respect of its obligations to FPLP under the Reinsurance Agreement.

In very broad terms (and ignoring the swaps, reserve account and effects of breaches of representation, warranty or covenant) if Defined Book Surplus arises in FPLP, it will be applied in paying an Annual Premium and recapturing all or part of the Assumed Liabilities (that is, in reducing the liability of the Reinsurer to FPLP under the Reinsurance Agreement with FPLP thereby reassuming the risk previously reinsured by the Reinsurer). The Annual Premium and recapture of Assumed Liabilities will contribute to Reinsurer Regulatory Surplus in the Reinsurer, enabling the Reinsurer to pay (in accordance with the Reinsurer Priorities of Payments) an equivalent amount as interest and ongoing commitment fees (Reinsurer Ongoing Commitment Fees) and then, on and following the Interest Payment Date falling in April 2006, principal on the Reinsurer Loan to InterCo. InterCo will apply the amount so received in paying (in accordance with the InterCo Priorities of Payments) its costs, expenses and in paying interest and ongoing commitment fees (InterCo Ongoing Commitment Fees) and then, on and following the Interest Payment Date falling in April 2006, principal of the InterCo Loan to the Issuer. The Issuer will apply the amount so

received in paying (in accordance with the Issuer Priorities of Payments) its costs and expenses and in paying interest and then, on and following the Interest Payment Date falling in April 2006, principal on the Notes.

Payments of interest and principal on the Notes

Interest on the Notes is payable quarterly in arrears. No principal will be paid on the Notes until the Interest Payment Date falling in April 2006. Thereafter, and prior to the service of a Note Acceleration Notice following the occurrence of an Issuer Event of Default, principal will be repaid first on the Class A-1 Notes and, once the Class A-1 Notes have been redeemed in full, then on the Class A-2 Notes. Interest and then principal payable on the Notes will be paid out of Issuer Available Funds after paying or providing for amounts ranking higher in the Issuer Priorities of Payment set out in the Issuer Deed of Charge. Issuer Available Funds consist, broadly, of interest, ongoing commitment fees and principal and other amounts received from InterCo on the InterCo Loan together with amounts payable by the Issuer Swap Provider to the Issuer under the Issuer Swap Agreement and, on the Class A-2 Notes Final Maturity Date in April 2019, the amount repayable under the InterCo Deposit Agreement made by the Issuer on the Closing Date.

The Notes will benefit from a financial guarantee provided by Ambac of Scheduled Interest and Ultimate Principal. At the date of this Offering Circular, Ambac's financial strength is rated AAA by S&P and Aaa by Moody's.

Payments of interest, InterCo Ongoing Commitment Fees and principal on the InterCo Loan

InterCo's ability to pay interest and the InterCo Ongoing Commitment Fee and repay principal under the InterCo Loan depends on it having InterCo Available Funds (see "*Summary of the Transaction Documents – InterCo Loan Agreement – InterCo Available Funds*") at the relevant time. Prior to the Class A-2 Notes Final Maturity Date or the service of an InterCo Enforcement Notice, InterCo Available Funds will, broadly, consist of interest, the Reinsurer Ongoing Commitment Fee and principal received from the Reinsurer under the Reinsurer Loan Agreement.

In addition, in the event that the Reinsurer pays an amount on the Reinsurer Loan insufficient to enable InterCo to pay interest and the InterCo Ongoing Commitment Fees (and expenses (other than item (a)) ranking senior to interest and to InterCo Ongoing Commitment Fees in the InterCo Pre-Enforcement Priority of Payment) under the InterCo Loan, InterCo may draw on the Liquidity Facility to fund interest and the InterCo Ongoing Commitment Fees (and expenses ranking senior to interest and to InterCo Ongoing Commitment Fees in the InterCo Pre-Enforcement Priority of Payment (other than item (a) thereof)) up to an amount outstanding of £100,000.

Amounts standing to the credit of the InterCo General Reserve Account will be invested in InterCo Eligible Investments. InterCo Eligible Investments will be realised prior to the Class A-2 Notes Final Maturity Date and the amount standing to the credit of the InterCo General Reserve Account will normally be available as part of the InterCo Available Funds only on the Class A-2 Notes Final Maturity Date.

Payments of interest, Reinsurer Ongoing Commitment Fees and principal on the Reinsurer Loan

In order to achieve the required capital treatment of the Reinsurer Loan, payments under the Reinsurer Loan are required to be linked to the emergence of surplus in the Reinsurer. The Reinsurer's ability to pay interest, the Reinsurer Ongoing Commitment Fees and principal to InterCo on the Reinsurer Loan on the Interest Payment Date in April each year depends on (i) the amount of the Available Reinsurer Surplus at the end of the immediately preceding Calculation Period (which is described further below) and (ii) the Reinsurer having Reinsurer Available Funds (see "*Summary of the Transaction Documents – Reinsurer Loan Agreement – Reinsurer Available Funds*") at the relevant time.

With regard to the Reinsurer having Reinsurer Available Funds, the Reinsurer will be required to realise sufficient assets and transfer the proceeds of such realisations and its other available cash (including the Annual Premium) to the Reinsurer Transaction Account so that the amount standing to the credit of the Reinsurer Transaction Account at the relevant time (which amount will be the Reinsurer Available Funds at that time) equals the amount of the Available Reinsurer Surplus at the end of the last Calculation Period (which may be used to pay interest, the Reinsurer Ongoing Commitment Fees and principal on the Reinsurer Loan) plus the amounts required to pay the Reinsurer's other obligations. Accordingly, so long as the Reinsurer is able to realise sufficient assets (which should comprise cash and Reinsurer Eligible Investments) it would be able to pay,

subject to the Reinsurer Priorities of Payments, interest, the Reinsurer Ongoing Commitment Fees and principal on the Reinsurer Loan (the Reinsurer Ongoing Commitment Fees being paid before interest, which is paid before principal) in an amount equal to Available Reinsurer Surplus.

In broad terms, the Reinsurer will be required to manage its financial position so that an amount equal to the Defined Book Surplus of FPLP (and any Breach Adjustments (essentially, compensation payable by FPLP for breaches of warranties or covenants) less any Recapture Reduction (essentially repayment by the Reinsurer of over compensation for breaches of warranties or covenants)) is available, as surplus in the Reinsurer, to be paid out as interest, Reinsurer Ongoing Commitment Fees and, on and following the Interest Payment Date falling in April 2006, then principal on the Reinsurer Loan.

Accordingly, the ability of the Reinsurer to pay interest, Reinsurer Ongoing Commitment Fees and principal in respect of the Reinsurer Loan, and therefore the ability of InterCo to pay interest, InterCo Ongoing Commitment Fees (and its own costs and expenses) and to repay principal in respect of the InterCo Loan and ultimately the ability of the Issuer to pay interest and principal on the Notes, effectively depends on Defined Book Surplus arising in FPLP (ignoring any hedging or liquidity arrangements).

Ancillary financing agreements of the Issuer, InterCo and the Reinsurer

Certain ancillary arrangements with the Issuer, InterCo and the Reinsurer relating to the hedging of interest rate risk, the provision of liquidity and the funding of certain miscellaneous expenses will be entered into.

The Reinsurer needs to hold effective fixed rate investments as appropriate assets to match the fixed rate increase in the amount of the potential claim of FPLP under the Reinsurance Agreement (see below). The Reinsurer is required to invest in Reinsurer Eligible Investments with a view to meeting its investment objective of yielding a rate of return exceeding 3-month LIBOR, returning the principal invested and managing its liquidity appropriately; accordingly, the Reinsurer is expected to receive a return based on floating rates. To hedge the floating rate into a fixed rate, the Reinsurer has entered into the Reinsurer Swap Agreement with the Reinsurer Swap Provider under which the Reinsurer will receive the fixed rate under the Reinsurer Swap Agreement and pay a floating rate equal to 3-month LIBOR. The combined effect of the Reinsurer's investments and the Reinsurer Swap is that the Reinsurer has effective fixed rate investments. Interest on the Reinsurer Loan Agreement will be at a fixed rate (unless the Reinsurer Swap Agreement is terminated in whole or, if FPLP makes a Claim under the Reinsurance Agreement, in part, when an equivalent amount of the Reinsurer Loan will start to accrue interest at LIBOR).

As interest on the Reinsurer Loan is normally a fixed rate, interest payable to the Issuer on the InterCo Loan will also normally be at a fixed rate. (To the extent the Reinsurer Loan interest becomes payable at a floating rate, as described above, the InterCo Loan will similarly become payable at a floating rate on a corresponding principal amount). However, the Issuer's obligations under the Notes are floating rate (based on 3-month LIBOR plus a margin). The Issuer will enter into the Issuer Swap Agreement with the Issuer Swap Provider to hedge its fixed rate based interest receivable from InterCo into its 3-month LIBOR floating rate obligations under the Notes (under the Issuer Fixed/Floating Swap) and to fund the margin over 3-month LIBOR payable on the Notes on each quarterly Interest Payment Date which is not the annual Loan Interest Payment Date under the InterCo Loan (under the Issuer Funding Swap, which amounts the Issuer repays, with interest compounding quarterly, on the following Loan Interest Payment Date). Ambac is guaranteeing the fixed rate payment of the Issuer to the Issuer Swap Provider under the Issuer Fixed/Floating Swap and the payment of the Margin plus interest by the Issuer to the Issuer Swap Provider under the Issuer Funding Swap on the Loan Interest Payment Date.

In addition to the Issuer Swap Agreement, the Issuer will, *inter alia*:

- borrow £14,000,000 under a non-interest bearing subordinated loan agreement from InterCo (the "**Issuer Subordinated Loan Agreement**") to bear any first loss in connection with the transaction;
- make a non-interest bearing deposit of £14,000,000 with InterCo pursuant to a deposit agreement (the "**InterCo Deposit Agreement**") under which the Issuer will deposit with InterCo the proceeds of the Issuer Subordinated Loan;

- borrow £100,000 from FPLP under an expenses loan agreement (the “**Expenses Loan Agreement**”) to enable the Issuer to pay expenses (other than Note interest which will be funded out of receipts on the Issuer Swap) which fall due other than on the Interest Payment Date falling in April each year;
- enter into a guarantee and reimbursement agreement with Ambac (which deals with Ambac’s rights with respect to the Issuer in respect of the Ambac Note Financial Guarantee and the Ambac Issuer Swap Financial Guarantee) (the “**Issuer Guarantee and Reimbursement Agreement**”); and
- enter into certain administration and other agreements related to the financing and its administration, as described in this Offering Circular.

InterCo will, *inter alia*:

- enter into a liquidity facility agreement (“the “**Liquidity Facility Agreement**”) with the Liquidity Facility Provider to fund payments of interest and InterCo Ongoing Commitment Fees and expenses ranking senior to these items in the InterCo Pre-Enforcement Priority of Payments (other than item (a) thereof)) due and payable by InterCo to the Issuer under the InterCo Loan, in the event that InterCo would otherwise have insufficient funds available to meet such payment obligations. The maximum aggregate amount available to be drawn is £42,180,000;
- enter into a subordinated loan agreement (the “**InterCo Subordinated Loan Agreement**”) with FPLP under which FPLP will advance money to InterCo to enable InterCo to fund the Issuer Subordinated Loan Agreement on the Closing Date (to the extent not funded out of share capital). The amount so advanced to the Issuer will be deposited back by the Issuer with InterCo under the InterCo Deposit Agreement and credited to a reserve account (the “**InterCo General Reserve Account**”). In addition certain further advances may be required to be made by FPLP in limited circumstances described in this document (see further “*Summary of Transaction Documents – InterCo Loan Agreement*”);
- invest amounts received under the InterCo Deposit Agreement and deposited in the InterCo General Reserve Account in InterCo Eligible Investments. Interest on these amounts will roll up in InterCo on, in effect, a pre-tax basis (interest will accrue on the InterCo Subordinated Loan but is deferred until the InterCo Loan has been paid in full). To the extent that InterCo is required to pay tax on, broadly, an amount in excess of 0.01 per cent. per annum of the principal amount outstanding of the Reinsurer Loan, including in respect of profits, income or gains on the InterCo Eligible Investments which are not matched by deductible interest accruing on the InterCo Subordinated Loan, that excess tax will be funded by a further loan advanced from FPLP under the InterCo Subordinated Loan Agreement;
- enter into the InterCo Swap Agreement which enables InterCo to hedge interest accruing at a fixed rate on fixed rate interest deferred under the Reinsurer Loan into three month LIBOR, on which interest on amounts drawn under the Liquidity Facility will be based;
- enter into a guarantee and reimbursement agreement with Ambac (which deals with Ambac’s rights with respect to InterCo in respect of Ambac’s guarantee of certain amounts payable under the Liquidity Facility Agreement and the InterCo Swap Agreement) (the “**InterCo Guarantee and Reimbursement Agreement**”); and
- enter into certain administration and other agreements related to the financing and its administration, as described in this Offering Circular.

Optional Termination of the Reinsurance Agreement for Regulatory or Tax Events

FPLP will have the right under the Reinsurance Agreement to terminate the Reinsurance Agreement at any time if there is a Regulatory Event or Tax Event (as defined in the Reinsurance Agreement), subject to certain conditions being met.

Reinsurer funding of Reinsurer Loan obligations

The effect of the Reinsurer having Reinsurer Regulatory Surplus is that assets with a value equal to such Reinsurer Regulatory Surplus cease to be required to be held by the Reinsurer as assets backing its Mathematical Reserves in respect of the Adjusted Sum Reinsured. Accordingly, the Reinsurer could pay an amount up to the surplus as interest, Reinsurer Ongoing Commitment Fees and, on and following the Interest Payment Date falling in April 2006, then principal to InterCo on

the Reinsurer Loan. The Reinsurer Loan requires the Reinsurer to pay the lower of Available Defined Book Surplus (being the Defined Book Surplus plus Breach Adjustments and less Recapture Reductions) plus any Regulatory Surplus Deficiency (being certain deficiencies in respect of prior years adjusted for certain disputes) and Adjusted Regulatory Surplus (being, broadly, surplus of the Reinsurer (the “**Reinsurer Regulatory Surplus**”) adjusted for certain deficiencies in respect of prior years) as interest, Reinsurer Ongoing Commitment Fees and, on and following the Interest Payment Date falling in April 2006, then principal.

To the extent the Reinsurer needs cash in excess of its available cash resources to pay such amount to InterCo under the Reinsurer Loan (after paying other amounts ranking higher in the Reinsurer Order of Priorities of Payments), the Reinsurer Investment Manager will be required to sell Reinsurer Eligible Investments of a sufficient value to achieve this.

Ensuring Reinsurer Regulatory Surplus at least equals Available Defined Book Surplus

The surplus of the Reinsurer arises in the Reinsurer Long Term Business Fund. In addition to the cash and Reinsurer Eligible Investments held in the Reinsurer’s Long Term Business Fund to back the Mathematical Reserves of the Reinsurer in respect of its obligations under the Reinsurance Agreement, the Reinsurer holds additional assets (which are required to be Reinsurer Eligible Investments when acquired) in its Long Term Business Fund and shareholder fund. The Reinsurer is expected to manage the holding of assets so that, if it appears that there will be insufficient surplus in the Reinsurer’s Long Term Business Fund, assets sufficient in value to cover the deficit are transferred from the Reinsurer’s Shareholder Fund to the Reinsurer’s Long Term Business Fund. In addition, FPLP covenants to (i) ensure that the Reinsurer will be adequately capitalised under applicable laws and regulations and (ii) ensure that in relation to each Calculation Period during the term of the Reinsurance Agreement the Reinsurer Regulatory Surplus is no less than the Available Defined Book Surplus (adjusted for Capital Injections made by FPLP to the Reinsurer and taken into account in that Calculation Period and for certain deficiencies in respect of prior years) (item (ii) being referred to as the Conduit Covenant).

The Reinsurance Agreement and Defined Book Surplus

The Reinsurance Agreement, under which the reinsurance is provided, will be entered into between, *inter alios*, the Reinsurer and FPLP on or about the Closing Date.

Under the Reinsurance Agreement, the Reinsurer provides reinsurance of certain liabilities and risks of FPLP. The sum reinsured by the Reinsurer to FPLP under the Reinsurance Agreement will initially be equal to £723,939,156 (the “**Sum Reinsured**”) (being £380,000,000 compounded annually at 4.6 per cent. per annum (the “**Benefit Increase Rate**”) to 15 April 2019). The aggregate maximum liability of the Reinsurer at any date on or after the Closing Date will be the Sum Reinsured discounted at the Benefit Increase Rate to such date as reduced by any Recapture Amount and any Claim (in each case grossed up at the Benefit Increase Rate for the period from the date the obligation arose to such date) (the “**Adjusted Sum Reinsured**”). The net economic effect is that the initial maximum liability of the Reinsurer under the Reinsurance Agreement is £380,000,000 which increases each Calculation Period by the Benefit Increase Rate and is reduced by each Recapture Amount and any Claim (increased at the Benefit Increase Rate to the date of calculation). The Recapture Amount is a function of the Available Defined Book Surplus and is described in more detail below.

Each year FPLP will determine the Defined Book Surplus, as described in more detail in this Offering Circular, see “*Defined Book Surplus*” and “*Summary of the Transaction Documents – Reinsurance Agreement*” for a description of Defined Book Surplus and “*Surplus Calculation Process and Interaction – Process for Determining Defined Book Surplus*” for the process for agreeing Defined Book Surplus. For an overview of the Defined Book Surplus, see “*The Defined Book Surplus*” and “*Principal factors affecting the Defined Book Surplus*” below in this section. In summary, the Defined Book Surplus is the amount of surplus which would be attributable to the With Profits Fund and the Non Profit Fund as calculated under Schedule 3 to the Scheme in each year starting in the year commencing 1 January 2004 in respect of the Defined Book and ignoring the effect of the Reinsurance Agreement.

The Available Defined Book Surplus will, during the life of the Notes, generally be allocated to two components:

- (a) first, an Annual Premium which FPLP will be required to pay, in cash, to the Reinsurer out of the Available Defined Book Surplus and which is calculated on the basis set out in the Reinsurance Agreement. The Annual Premium is intended to ensure that FPLP funds the Reinsurer Ongoing Commitment Fees (and, (i) in April 2005 only, interest accruing to the Interest Payment Date in April 2005 to the extent it exceeds the amount of the recapture of the increase in the Adjusted Sum Reinsured and (ii) if the interest on the Reinsurer Loan is accruing at a floating rate due to partial termination of the Reinsurer Swap following a Claim having been made by FPLP under the Reinsurance Agreement, such floating amount of interest); and
- (b) second, an amount equal to the Available Defined Book Surplus less the Annual Premium, which balance will be grossed up to 15 April 2019 at FPLP's valuation rate of interest relating to the value of the Reinsurance Agreement and then discounted back at the Benefit Increase Rate (being the Reinsurer's initial valuation rate of interest) to determine the Recapture Amount, which will be applied in recapturing the liability of the Reinsurer to FPLP under the Reinsurance Agreement in the manner set out in "*Summary of the Transaction Documents – Reinsurance Agreement*".

The effect of grossing up the balance of the Available Defined Book Surplus at FPLP's valuation rate of interest and discounting the amount so calculated at the Benefit Increase Rate is that the aggregate of the Annual Premium and the value of the Recapture Amount in the Reinsurer will exceed the Available Defined Book Surplus (as FPLP's valuation rate of interest will be higher than the Reinsurer's valuation rate of interest). However, the amount payable as interest, Reinsurer Ongoing Commitment Fees and principal is the lower of (i) the Available Defined Book Surplus plus any Regulatory Surplus Deficiency (being certain deficiencies in respect of prior years) and (ii) the Adjusted Regulatory Surplus (being Reinsurer Regulatory Surplus adjusted for certain deficiencies in prior years) and accordingly the principal effect is that retained surplus is likely to accumulate in the Reinsurer reflecting the difference. This retained surplus will be used by the Reinsurer to reduce the likelihood of other factors affecting the Reinsurer resulting in the Reinsurer Regulatory Surplus being less than the Available Defined Book Surplus and any Regulatory Surplus Deficiency and accordingly reduce the likelihood of FPLP having to fund the Conduit Covenant. These amounts are not expected to be significant in any Calculation Period and simply reflect the strain between the valuation rate used by FPLP and that used by the Reinsurer at the outset being released as the Sum Reinsured is recaptured.

The whole of the Available Defined Book Surplus (reduced, in the case of the Calculation Period ending on 31 December 2004 by an amount equal to the advance premium which is to be pre-paid on the Closing Date to fund the initial costs and expenses of the transaction (the "**FPLP Initial Commitment Fee**")) less the Annual Premium will be used in calculating the value of the Recapture Amount in the Reinsurer; the whole of the Recapture Amount will be used to recapture liabilities under the Reinsurance Agreement with respect to Calculation Periods ending after 31 December 2004. On the Interest Payment Date falling in April 2005, only that part of the Available Defined Book Surplus (after deduction of the FPLP Initial Commitment Fee) required to pay the Annual Premium and recapture the increase in the Reinsurance Liability from the Closing Date to 31 December 2004 will be applied in determining the Recapture Amount (the balance being retained by FPLP).

At any time after the Interest Payment Date in April 2005, the Recapture Amount shall be an amount equal to the Available Defined Book Surplus in respect of the preceding Calculation Period, less the Annual Premium in respect of such Calculation Period grossed up to 15 April 2019 at FPLP's valuation rate of interest relating to the value of the Reinsurance Agreement and then discounted back at the Benefit Increase Rate (being the Reinsurer's initial valuation rate of interest). The Recapture Amount will be applied in recapturing the liability of the Reinsurer to FPLP under the Reinsurance Agreement.

The effect of the Adjusted Sum Reinsured being reduced by the Recapture Amount is that the reserves required to be held by the Reinsurer to back the Adjusted Sum Reinsured are reduced and an amount corresponding to the value to the Reinsurer of the Recapture Amount, together with the amount received as the Annual Premium, will contribute to the surplus of the Reinsurer. The Reinsurer will be able to add such contribution to its existing retained surplus in determining the Reinsurer Regulatory Surplus for the Calculation Period. The amount payable as interest, Reinsurer Ongoing Commitment Fees and principal on a Loan Interest Payment Date is limited (assuming there are sufficient Reinsurer Available Funds) to the Available Reinsurer Surplus at the end of the

preceding Calculation Period; the Available Reinsurer Surplus is the lower of (i) Available Defined Book Surplus and any Regulatory Surplus Deficiency and (ii) the Adjusted Regulatory Surplus.

In broad terms, the economic flows for the Reinsurer (prior to any Claim) could be looked at as follows (though no cash in-flow or asset is legally hypothecated to any particular cash outflow or liability): (i) interest earned on the Reinsurer Eligible Investments held by the Reinsurer funds the floating rate payable on the Reinsurer Swap and the Reinsurer's other costs and expenses (excluding amounts of interest, Reinsurer Ongoing Commitment Fees and principal on the Reinsurer Loan), (ii) the Annual Premium and the fixed rate receivable on the Reinsurer Swap fund, respectively, the Reinsurer Ongoing Commitment Fees and interest on the Reinsurer Loan and (iii) Reinsurer Eligible Investments will be realised (in an amount equal to the lower of the Recapture Amount and the excess of Available Defined Book Surplus over the Annual Premium) to repay the principal under the Reinsurer Loan. The obligation to pay (ii) and (iii) (interest on, the Reinsurer Ongoing Commitment Fees in respect of, and principal on the Reinsurer Loan) is contingent on there being a corresponding amount of Available Reinsurer Surplus; in the absence of Available Reinsurer Surplus, even if the Reinsurer has funds available, interest, the Reinsurer Ongoing Commitment Fees and principal will not be payable.

If a Claim is made on the Reinsurer by FPLP under the terms of the Reinsurance Agreement, the Reinsurer will realise Reinsurer Eligible Investments which, together with its other cash resources, will enable it to pay such Claim to FPLP. The resultant reduction in Reinsurer Eligible Investments will be matched by a decrease in the Adjusted Sum Reinsured of the Reinsurer as a result of the payment of the Claim.

If FPLP makes a Claim and the Adjusted Sum Reinsured is reduced, but not to zero, the notional principal of the Reinsurer Swap (and, in an aggregate principal amount, the InterCo Swap and the Issuer Fixed/Floating Swap) will be reduced by a corresponding amount. If the effect is that the aggregate Principal Amount Outstanding on all the Notes exceeds the Adjusted Sum Reinsured, the Reinsurer Loan will accrue interest at LIBOR on such excess (the "**Reinsurer Floating Principal Amount**", the amount corresponding to the lower of the aggregate Principal Amount Outstanding on all the Notes and the Adjusted Sum Reinsured being the "**Reinsurer Fixed Principal Amount**"). The Reinsurer Floating Principal Amount will accrue (and compound) interest at LIBOR quarterly on each Interest Payment Date but be payable annually on the relevant Loan Interest Payment Date. A corresponding amount of principal on the InterCo Loan (the "**InterCo Floating Principal Amount**") will accrue interest at LIBOR quarterly, which will be paid quarterly on each Interest Payment Date by InterCo drawing (to the extent it is available to be drawn) on the Liquidity Facility and recovering such amount out of InterCo Available Funds on the next Loan Interest Payment Date. As principal of the Reinsurer Loan (and InterCo Loan) is repaid, it will repay the Reinsurer Floating Principal Amount (or, as applicable, the InterCo Floating Principal Amount) before the Reinsurer Fixed Principal Amount (or, as applicable, the InterCo Fixed Principal Amount). The Annual Premium will increase to include the amount of floating rate interest payable by the Reinsurer (reducing the Available Defined Book Surplus taken into account in determining the Recapture Amount).

If Claims or recapture of liabilities by FPLP have resulted in the Adjusted Sum Reinsured being reduced to zero, FPLP will be required to pay, as a premium (an "**Ongoing Premium**") to the Reinsurer, the whole of the Defined Book Surplus thereafter in cash, until such time as no amounts remain outstanding (including any contingent liabilities) under any Transaction Documents; such amounts will be paid directly to the Reinsurer Transaction Account. The Reinsurer Transaction Account is secured in favour of, *inter alios*, InterCo.

The liability of the Reinsurer to FPLP under the Reinsurance Agreement, to InterCo under the Reinsurer Loan and to the other Reinsurer Secured Creditors is limited recourse to the assets held by it and in respect of which it has granted fixed and floating charges in favour of the Reinsurer Security Trustee, all as described in more detail in this Offering Circular (see "*Summary of the Transaction Documents – Reinsurer Deed of Charge*").

The obligation of FPLP to pay the Annual Premium is an unsecured obligation of FPLP which ranks *pari passu* with other unsecured and unsubordinated creditors other than creditors, including the insurance debts to policyholders, which are preferred by law (including under The Insurers (Reorganisation and Winding Up) Regulations 2004 (S.I. 2004 No. 353)).

The obligation of the Reinsurer to pay claims to FPLP under the Reinsurance Agreement and to pay InterCo under the Reinsurer Loan are secured obligations of the Reinsurer with the effect that

the obligations to InterCo rank, subject to the Reinsurer Priorities of Payments, *pari passu* with other secured creditors.

Under the Reinsurance Agreement, if certain representations, warranties and covenants in relation to FPLP or the Reinsurer are incorrect or breached, (i) in the case of certain representations and the covenant not to transfer Defined Book Policies, the Reinsurance Agreement may be terminated, (ii) it may give rise to an obligation on FPLP to compensate the Reinsurer for the breach through a Breach Adjustment or Capital Injection, (iii) it may result in an increase in the premium payable by the Issuer to Ambac or (iv) it may result in other remedies available being used (depending on a matrix of remedies set out in the Reinsurance Agreement). Breach Adjustments will increase the Available Defined Book Surplus, giving rise to an increase in the Annual Premium and/or Recapture Amount (and will therefore increase the Reinsurer Regulatory Surplus). A Capital Injection to the Reinsurer compensates the Reinsurer by enabling it to transfer the capital injected to the Reinsurer's Long Term Business Fund (thereby increasing Reinsurer Regulatory Surplus).

FPLP covenants, *inter alia*, to ensure that the Reinsurer is capitalised in accordance with applicable laws and to provide additional capital if this is not the case and also covenants to ensure that, in each Calculation Period, Reinsurer Regulatory Surplus in such Calculation Period is not less than the Available Defined Book Surplus plus any Regulatory Surplus Deficiency and Capital Injections accounted for in such Calculation Period (this latter covenant is referred to as the "Conduit Covenant"). A detailed description of certain of the representations, warranties and covenants is set out in "*Summary of the Transaction Documents – Reinsurance Agreement – Part A Warranties*" and "*– Funded Covenants*" and includes a requirement that FPLP acts as a prudent insurer in addition to dealing with specific matters such as mis-selling, persistency and lapse. Whether liability arises in relation to a breach is in certain cases subject to materiality thresholds in such Calculation Period (though this is not the case for the Conduit Covenant) and the timing of payments in respect of any breach, as well as how reductions in the Defined Book Surplus are dealt with, depends on the nature and consequence of the breach. The provisions are summarised under "*Summary of the Transaction Documents – Reinsurance Agreement – Funding of Breaches*". Certain misrepresentations and a breach of the covenant not to transfer the Defined Book Policies may result in the Reinsurance Agreement being terminated, which will result in surplus in the Reinsurer arising due to it no longer needing to retain reserves in respect of its liability under the Reinsurance Agreement and, to that extent, in the Reinsurer Loan becoming repayable and the Notes being redeemed.

The Defined Book Surplus

The calculation of the Defined Book Surplus for each Calculation Period will be made by FPLP. A description of the process is set out under "*Surplus Calculation Process and Interaction – Process for determining Defined Book Surplus*".

The principal items contributing to the Defined Book Surplus emerging in a period are summarised under "*Defined Book Surplus – Principal Factors Contributing to the Emergence of Defined Book Surplus*". The principal risks in relation to Defined Book Surplus emerging are then dealt with in the section headed "*Defined Book Surplus – Principal Risks to the Emergence of Defined Book Surplus*". The following is a very brief overview of the projected Base Case and the principal factors likely materially to affect the Defined Book Surplus.

The Base Case

The Base Case is a projection of the Defined Book Surplus based on assumptions and other factors described in more detail under "*The Base Case*". The purpose of the Base Case is to indicate, based on the assumptions and other factors described in this Offering Circular, the cash flow projected to be available to FPLP to recapture liabilities undertaken by the Reinsurer under the Reinsurance Agreement and to pay the premiums payable under the Reinsurance Agreement.

The basis for the assumptions and the other significant relevant factors used in determining the Base Case are set out under "*The Base Case – Base Case Assumptions used in projecting Defined Book Surplus Amounts*". Actual future experience is, however, likely to differ from that projected under the Base Case for the reasons set out in this Offering Circular.

The section entitled "*Sensitivity Analysis*" and Appendix 4 outline the effect on the projected Base Case if the Base Case Assumptions are subjected to certain variations as described therein.

The following table sets out the Base Case for this Offering Circular projected for the period to December 2043:

The Base Case

Calculation Period ending 31 December all figures in £,000,000	Aggregate Defined Book Surplus ¹	Defined Book Surplus ²	Financing Costs ³	Class A-1 Base Case Amortisation Profile ⁴	Class A-2 Base Case Amortisation Profile ⁴
2004	857	87	7	280	100
2005	786	96	21	205	100
2006	733	85	17	137	100
2007	688	80	12	69	100
2008	645	76	10	3	100
2009	605	72	6	0	37
2010	566	68	2	0	0
2011	529	64	0	0	0
2012	494	61	0	0	0
2013	461	58	0	0	0
2014	428	54	0	0	0
2015	397	51	0	0	0
2016	368	48	0	0	0
2017	339	46	0	0	0
2018	313	43	0	0	0
2019 onward ⁵	287	427			

The Base Case has been calculated on the basis of data as at 31 May 2004 and the Base Case Assumptions. With respect to the projected Defined Book Surplus for the period to 31 December 2004, this has been calculated as the aggregate of (i) the Defined Book Surplus calculated as at 31 May 2004 on the basis set out in Schedule 3 to the Scheme and (ii) the amount projected as the Defined Book Surplus from 31 May 2004 to 31 December 2004 on the basis of the data and Base Case Assumptions as at 31 May 2004. (see *“The Base Case – Base Case Assumptions used in projecting Defined Book Surplus Amounts”*.)

- 1 Aggregate Defined Book Surplus is the present value of all Defined Book Surplus cash flows projected (under the Base Case Assumptions) to arise in the future, in respect of all policies in force as at 31 May 2004 discounted a rate of 5.47 per cent. per annum, being equal to the aggregate of (i) the fixed rate of the Reinsurer Loan plus (ii) the premium payable to Ambac (expressed as a rate per cent. per annum and assuming no step ups) plus (iii) a spread of 0.21 per cent. per annum reflecting the initial weighted average spread of the Notes over LIBOR (the *“Financing Rate”*) (the other ancillary costs of the Issuer and InterCo have not been included in the costs). The Aggregate Defined Book Surplus has been calculated assuming that cash flows are available on 15 April of each year following the Calculation Period, discounted to 15 April of the year in which the Calculation Period ends (i.e. the 2005 value is discounted to 15 April 2005). The 2004 value is the present value of all future surplus payable from April 2005 and onwards, discounted to 16 December 2004.
- 2 The Defined Book Surplus is the non-discounted amount projected under the Base Case Assumptions to be the Defined Book Surplus in respect of each future Calculation Period on the basis such period ends on 31 December in each year.
- 3 Financing Costs are the amount projected under the Base Case Assumptions to be the aggregate of (i) the fixed rate of interest under the Reinsurer Loan plus (ii) the premiums payable to Ambac (expressed as a rate per cent. per annum and assuming no step ups) plus (iii) a spread of 0.21 per cent. per annum reflecting the initial weighted average spread of the Notes over LIBOR (the other ancillary costs of the Issuer and InterCo have not been included in the costs).
- 4 The Base Case Amortisation Profile is the then projected Principal Amount Outstanding of the Notes following the April Interest Payment Date following each Calculation Period less the Available Defined Book Surplus after deducting from the Available Defined Book Surplus the aggregate of the Financing Costs. It assumes that the Reinsurer Regulatory Surplus in respect of the corresponding Reinsurer Calculation Period is at least equal to the Available Defined Book Surplus.
- 5 The table excludes any Defined Book Surplus emerging after the Calculation Period ending in December 2043.
- 6 Under Schedule 3 of the Scheme, increments to Defined Book Policies after the demutualisation are not part of the Schedule 3 Amount and therefore not included in Defined Book Surplus. For practical reasons, they are processed together on an original policy records basis. In order efficiently to return value to FPLP’s Shareholder Fund the increments so written have been valued and the value fixed, £51 million, has been deducted from the amount determined for the Base Case and the amounts determined for the Sensitivity Analysis after the relevant assumption has been varied. The effect of this methodology, however, is that the variations in the relevant assumption may have a *“geared”* effect on the result, increasing the effect of the relevant change by up to 3 per cent.

Overview of the policy types in the Defined Book

The underlying policies of the Defined Book can be divided into the following categories:

- unit linked and unitised with profits investment products (such as endowment policies, single premium savings policies and universal whole of life policies);
- unit linked and unitised with profits pension products (such as personal pension plans and group personal pension plans);
- conventional non profit life products (such as life insurance and critical illness); and
- conventional non profit pension products (such as disability premium waiver and annuities).

The Defined Book does not include profit participating conventional (“with profits”) contracts other than unitised with profits products.

Save as described below, none of the policies comprised within the Defined Book offers any guarantees regarding investment performance. This risk has been excluded from Schedule 3 Amounts (and therefore Defined Book Surplus) under the Scheme. There is a small liability in respect of business originally written in Friends Provident (London and Manchester) Assurance Limited for which a reserve of £7,000,000 is maintained, where the level of reserves are considered sufficient to cover these liabilities.

The Defined Book does not include liabilities for onerous annuity rate guarantee options; to the extent there are annuity rate guarantee options the cost resides in the With Profits/With Profits Fund. Nor does the Defined Book include any “high income” (precipice) bonds.

The following table summarises certain statistics relating to the above categories, including the value of the Aggregate Defined Book Surplus allocated to such categories of policies.

Summary of Defined Book Policies at 31 May 2004

Policy Category	Contracts in force ¹	In-force premium (£m)	Non-unit reserves (£m)	Unit reserves (£m)	Total NPV ² (£m)	NPV per cent.
Conventional non-profit life	233,436	27	113	—	96	11
Conventional non-profit pensions	138,157	7	2,492	—	266	31
Unit linked life	294,253	107	2	1,680	85	10
Unit linked pensions	505,330	116	26	2,732	145	17
Unitised with profit life	370,965	145	—	2,835	168	20
Unitised with profit pensions	413,814	79	—	2,702	97	11
Total	1,955,955	481	2,633	9,949	857	100

Notes:

- 1 Number of policies, in-force premium and reserves amounts are as at 31 May 2004.
- 2 Net Present Value (“NPV”) is the aggregate value of all Defined Book Surplus cash flows projected (under the Base Case Assumptions) to arise in the future, in respect of all policies in force as at 31 May 2004, discounted to 16 December 2004, assuming that cash flows are available on 15 April of each year following the Calculation Period. The discount rate is 5.47 per cent. per annum.

Principal factors affecting the Defined Book Surplus

The Defined Book Surplus for each Calculation Period is intended to be the surplus emerging on all pre-demutualisation policies transferred by the Scheme which were in force at any time during the Calculation Period other than conventional with profits policies and PHI policies (i.e. the Defined Book). For each Calculation Period, the Defined Book Surplus is computed as the aggregate of the following, with each item being computed on the same basis as the corresponding item in Schedule 3 to the Scheme as it exists as at the Closing Date (noting that (i) certain items will be calculated net of amounts attributable to reinsurances as described in (C) below, (ii) policyholder tax shall be as described in paragraph (D) below and (iii) Defined Book Policies shall be treated in the same manner as Schedule 3 Policies) (and, for the avoidance of doubt, disregarding the effect on surplus (if any) of any Designated Transaction as defined in the Scheme):

premiums less, in the case of linked policies or unitised with profits policies, the investment element of those premiums plus any emerging annual management charges due from the linked funds including, in respect of unitised with profits policies, notional annual management charges equal to the annual management charge which is applicable to the corresponding Linked Policy at the effective date of the Scheme

plus

investment income and gains received or accrued which are attributable to the statutory reserves of Defined Book Policies excluding any unit linked reserves

plus

risk premiums charged to unitised with profits policy or linked policy units

less (or plus) as the case may be

increase (or reduction) in non linked reserves in respect of Defined Book Policies arising from any factor other than a Designated Transaction

less

claims less, in the case of linked policies or unitised with profits policies, the investment element of those claims

less

expenses determined in accordance with Schedule 2 to the Scheme attributable to the Defined Book Policies

less

amount (if any) by which the Defined Book Surplus in respect of the previous Calculation Period was negative.

For the purposes of the above, the Reinsurance Agreement will be a Designated Transaction.

In calculating the Defined Book Surplus pursuant to the Reinsurance Agreement:

- (A) Mis-Selling Liabilities, and levies imposed by, *inter alia*, the Financial Services Compensation Scheme, will be ignored;
- (B) new annuities arising from vested deferred annuity contracts within the With Profits Fund (as defined in the Scheme) are not Defined Book Policies and will not affect the calculation of Defined Book Surplus;
- (C) premiums, claims, non linked reserves, expenses and attributed investment income and gains taken into account in determining the Defined Book Surplus shall be calculated net of amounts attributable to reinsurances other than the Reinsurance Agreement;
- (D) investment income and gains and expenses taken into account in this calculation shall be adjusted for policyholder tax attributable thereto;
- (E) adjustments to charges which may be made pursuant to the Scheme by the FPLP With Profits Actuary shall not apply unless:
 - (i) such adjustments are notified in advance to the Relevant Person; and
 - (ii) the reasonable comments of the Relevant Person are fairly reflected in the adjustments made;
- (F) for the avoidance of doubt, as the Inflation Hedge (or any replacement thereof) will be allocated to the assets backing the liabilities of the Defined Book, income and expenses associated therewith, and the regulatory value of any asset or liability which it represents, shall be reflected in items in the second and/or fourth indent above,
- (G) for the avoidance of doubt, references to “investment income and gains” in the item in the second indent of the Defined Book Surplus calculation above and in paragraph (D) above shall include a reference to losses.
- (H) Linked Policies include, for the avoidance of doubt, hybrid policies (as such terms are defined in the Scheme).

The principal risks to surplus (which are described in more detail below under “*Defined Book Surplus – Principal Factors Contributing to the Emergence of Defined Book Surplus*” and “*– Principal risks to the Emergence of Defined Book Surplus*”) include:

- Investment performance: In the case of the unit linked products, the annual management charge is calculated as a percentage of the value of units allocated to policies on a daily basis; accordingly the amount of the annual management charge will be affected by, *inter alia*, investment performance, including daily volatility in investment performance. The main investment return risks in respect of conventional non-participating (that is, non-unit linked) business (life and pensions, including annuities), are the risks that interest rates move unfavourably to the rates assumed for the policy, or that assets are not sufficiently well matched to liabilities or that assets default, in each case resulting in a corresponding reduction in surplus.

- Adverse persistency (early termination): Persistency is a term used to describe the situation whereby policies terminate (whether lapsing or becoming paid-up) earlier than expected, otherwise than due to death or critical illness or through the retirement of the insured. For unit linked and unitised with profits policies, the principal effect is to reduce the assets allocated to policies and accordingly the annual management charge for those assets. For conventional non-profit policies (other than annuities) (e.g. term assurance policies), the effect may give rise to a short-term increase in surplus arising from a release of expense and mortality/morbidity reserves but the longer-term reduction in surplus is commonly greater.
- Mortality and morbidity risks: Mortality risk (other than in respect of annuities, which is dealt with under “– Longevity” below) is the risk of the insured dying; morbidity risk is the risk of the insured suffering a critical illness or disability. In relation to conventional non-profit products and the risk benefit component of unit linked and unitised with profits products (such as life insurance, critical illness and disability), the greatest risk is that mortality and/or morbidity levels are higher than assumed at the time of setting the reserves (or the last review of premiums or charges, where this is permitted) leaving underwriting profits lower than projected or reserves prove to be insufficient with the result that additional reserves need to be set aside and surplus is reduced.
- Longevity: For annuity business, surplus emerges as the difference between reserves established based on interest rate, expenses and longevity assumptions set when the annuity is granted and actual experience. In particular, if annuitants live longer than assumed in the assumptions, reserves may need to be strengthened and surplus would thereby be reduced. The life expectancy of annuitants has been increasing and this may be expected to continue; existing reserves make an allowance for a level of improvement in life expectancy of annuitants. The risk remains, however, that actual improvement is greater than that currently reserved for and to mitigate this, FPLP has, in calculating the Base Case, reflected an increase in allowance for improvements in mortality to mid-way between the medium and long cohorts (as set out in the CMI Longevity Paper) in setting the statutory valuation basis applicable from 31 December 2004, as reflected in the Permitted Reserving Basis.
- Change of reserving basis: FPLP has to calculate and hold reserves appropriate for each policy. There are two types of reserve – unit reserves and non-unit reserves. Unit reserves show the value of assets allocated to a policy and increases or decreases in the value of those assets are reflected in the value of the unit reserves; non-unit reserves are the other reserves set aside for the business. It is unlikely that the valuation basis for determining the unit reserves will be altered. If the valuation basis for determining non-unit reserves is altered, the change may lead to an increase or fall in the amount of reserves and this will reduce or increase surplus. The timing of the emergence of surplus will therefore be affected by any changes to the valuation basis for determining non-unit reserves. Changes to such basis may occur in response to changing past or future expected experience or changes to requirements arising from regulation or practice or changes in the tax regime. Actual future experience will determine the extent to which any strengthening of reserves represents an actual reduction in surplus rather than a deferral of surplus.

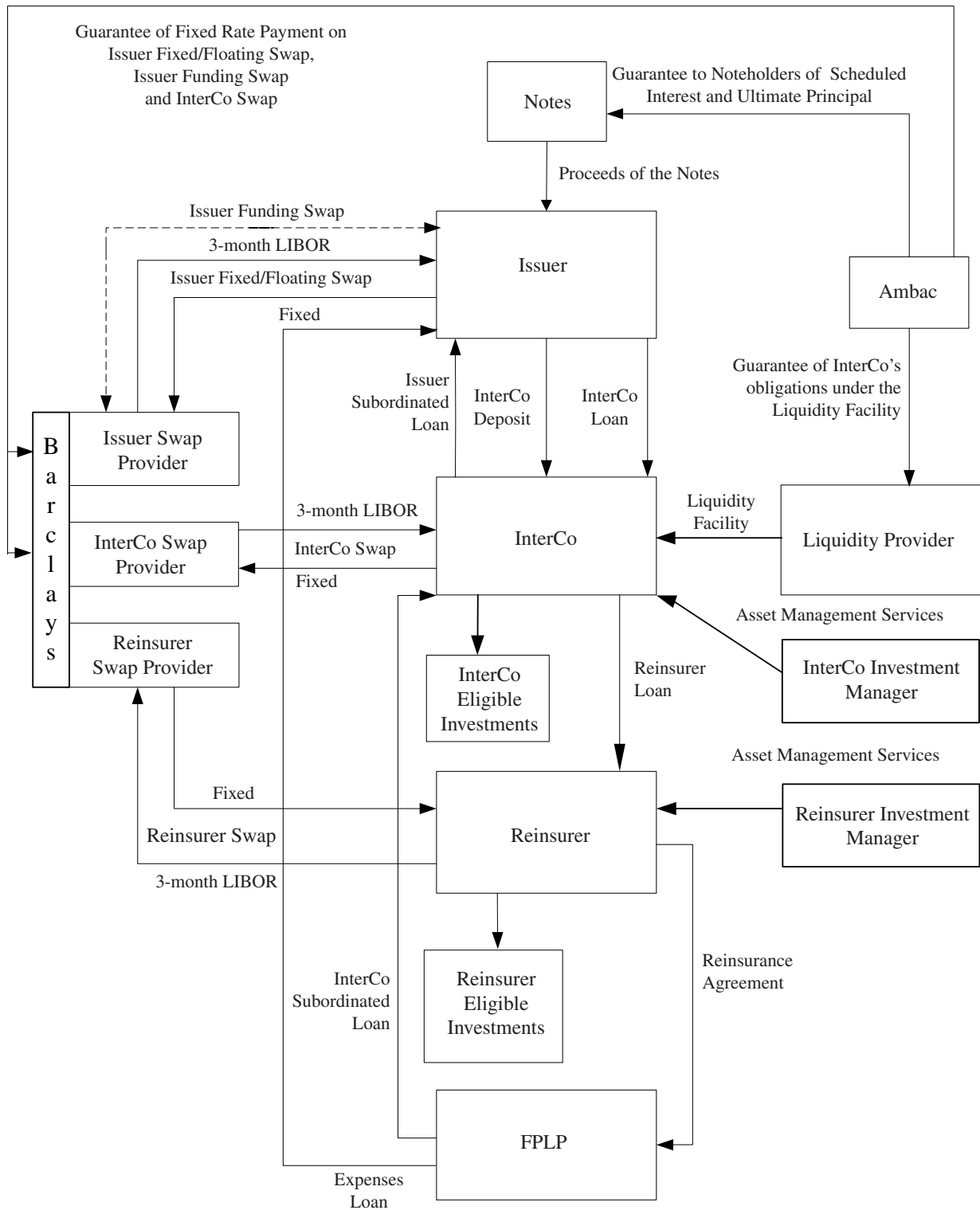
Some protection against changes in the valuation basis for determining reserves is provided by regulation, which provides that the method of calculation of the amount of the liabilities and the assumptions used must not be subject to discontinuities from year to year arising from arbitrary changes. In addition, the procedure under which the Defined Book Surplus is determined provides for the Relevant Person (which will be Ambac (for so long as Ambac is the Reinsurer Controlling Creditor)) to be able to consider changes to the reserving basis and where it considers a change is not a Permitted Change, to require any dispute to be resolved by reference to an independent expert (see “*Surplus Calculation Process and Interaction*”).

- Expenses: The amount of surplus determined for a life insurance company will depend on the level of expenses. Expense inflation greater than that assumed will result in surplus emerging being lower than would otherwise have been the case. However the following points should be noted:
 - (A) the calculation of the Defined Book Surplus pursuant to the Reinsurance Agreement is based on Mis-Selling Liabilities being ignored;

- (B) certain expenses under the Scheme are determined at fixed rates (adjusted for inflation (subject to (C) below)) to 31 December 2009 and thereafter at a rate determined by FPLP which may at no time exceed the charges for similar services made by third party companies and may at no time significantly exceed the costs the With Profits Fund would incur if FPLP were to undertake such services itself and the only business of FPLP were that comprised in the With Profits Fund; and
- (C) certain expenses under the Scheme will be increased by reference to increases in the retail prices index (“RPI”) (generally RPI plus 1 per cent. per annum); however, FPLP has entered into a hedge transaction (the “Inflation Hedge”) with Barclays Bank PLC in respect of the expenses projected to arise under the assumption for lapse set out in Scenario 3 under “*Sensitivity Analysis*” under which the Defined Book will receive RPI on the notional principal of the hedge and will pay 3.1 per cent. per annum on the notional principal of the Inflation Hedge, thereby hedging the inflation risk to the extent the expenses correspond to that notional amount. The notional principal of the Inflation Hedge in each period from 1 January 2005 to (and including) 31 December 2019 (being the end of the Calculation Period immediately following the Class A-2 Notes Final Maturity Date) is the amount of expenses for that period which are projected to be adjusted by RPI (or RPI plus one per cent.) and are projected to be payable in respect of such Calculation Period under the assumption for lapse set out in Scenario 3 under “*Sensitivity Analysis*” together, in 2019, with the present value of the projected expense base to 2043. As the expenses subject to inflation are determined by the Scheme, the accuracy of the Inflation Hedge is primarily a function of lapse of Defined Book Policies being different from that assumed for the purposes of the Base Case, resulting in under or over-hedging depending on the circumstances; while using Scenario 3 will result in the Inflation Hedge being an under-hedge (compared with the Base Case Assumptions relating to lapse), this is considered preferable to the expenses being over-hedged in a more stressed lapse situation when the effect of overhedging and adverse inflation could be to reduce Defined Book Surplus further at a time when the Defined Book Surplus can least afford to be further reduced. FPLP has covenanted in the Reinsurance Agreement (i) not to terminate the Inflation Hedge except in the circumstances permitted in the Reinsurance Agreement without Ambac’s consent and (ii) to allocate the Inflation Hedge to the Defined Book (and breach of such covenant will result in a Breach Adjustment or Capital Injection).
- Taxation: In principle, tax on investment income and realised capital gains for life products reduces surplus while relief for the annual administration expenses of life products increases surplus by reducing the effective amount of such expenses. Provision is also made for tax on unrealised capital gains attributable to life policies within unit linked funds. Any variation between the actual and assumed provision is a cost/release to that fund. Rates of taxation on life business, and the basis for taxation may change in the future; accordingly, the amount of surplus could be reduced (or increased) as a result of changes in tax law (including rates of tax).
 - Mis-selling: Under the Scheme, any pensions or endowment mis-selling liabilities are not liabilities which reduce the Defined Book Surplus. Any such liabilities will be met out of other resources available to FPLP. The exception is in respect of some 200 cases where guarantees were given rather than redress; the reserves of £7,000,000 for such guarantees which are already set up within the Defined Book are considered sufficient to cover these liabilities.

Structure Diagram

The following diagram summarises the above financing arrangements at the Closing Date following the issue of the Notes:



TRANSACTION SUMMARY

The information in this section is a summary of the principal features of the issue of the Notes and certain other related transactions. This summary is not complete and should be read in conjunction with, and is qualified in its entirety by reference to, the more detailed information appearing elsewhere in this Offering Circular. Defined terms used in this section have the meaning given to them elsewhere in this Offering Circular; an index of defined terms appears at the end of this Offering Circular.

KEY TRANSACTION PARTIES

- Ambac:** Ambac Assurance UK Limited, a company incorporated in England and Wales with registered number 3248674, which is authorised to issue, *inter alia*, financial guarantees, and is licensed to offer insurance services in the United Kingdom. At the date of this Offering Circular, Ambac's financial strength rating is rated AAA by S&P and Aaa by Moody's. Ambac will guarantee in favour of the Noteholders the payment by the Issuer of Scheduled Interest and Ultimate Principal. Ambac will guarantee in favour of the Issuer Swap Provider and the InterCo Swap Provider the payment by the Issuer and InterCo of the fixed rate payments under the Issuer Swap Agreement and the InterCo Swap Agreement. Ambac will also provide a separate guarantee in favour of the Liquidity Facility Provider in respect of certain of InterCo's obligations under the Liquidity Facility Agreement.
- Issuer:** Box Hill Life Finance plc is a public company limited by shares incorporated in England and Wales under the Companies Act 1985 with registered number 5259209. The Issuer is a special purpose company whose primary purpose is to issue the Notes and enter into the Issuer Swap Agreement, the InterCo Loan Agreement and ancillary agreements. The Issuer will use the proceeds of the Notes to make the InterCo Loan to InterCo. The shares in the Issuer are held by its holding company, Box Hill Holdings Limited ("**HoldCo**"), whose shares are held by a share trustee on trust for certain charitable purposes.
- InterCo:** Box Hill Loan Finance Limited is a private company limited by shares incorporated in England and Wales under the Companies Act 1985 with registered number 5294776. InterCo is a special purpose company whose primary purpose is to enter into the InterCo Loan Agreement, the Reinsurer Loan Agreement, the Liquidity Facility Agreement and ancillary agreements. InterCo is established as an orphan company, the shares in which are held by a share trustee on trust for certain charitable purposes.
- Reinsurer:** Friends Provident Reinsurance Services Limited is a private company limited by shares incorporated in England and Wales under the Companies Act 1985 with registered number 05165822. The Reinsurer is a special purpose company whose primary purpose is to enter into the Reinsurance Agreement, the Reinsurer Loan Agreement and the Reinsurer Swap Agreement and ancillary agreements in order to fund itself to enable it to provide the reinsurance to FPLP under the Reinsurance Agreement. The Reinsurer is a wholly owned subsidiary of FPLP.
- FPLP:** Friends Provident Life and Pensions Limited is a private company limited by shares incorporated in England and Wales under the Companies Act 1985 with registered number 4096141. FPLP is a wholly owned subsidiary of Friends Provident plc, the holding company of the Friends Provident group, whose ordinary shares are listed on the London Stock Exchange PLC.

Issuer Swap Provider, InterCo Swap Provider and Reinsurer Swap Provider:

A financial institution which, as at the Closing Date, has, or is guaranteed by a person which has, a rating assigned to its (a) long-term unsecured, unsubordinated and unguaranteed debt obligations of AA- or higher by S&P or short-term unsecured, unsubordinated and unguaranteed debt obligations of A-1+ by S&P and (b) long-term unsecured, unsubordinated and unguaranteed debt obligations of A-1 or higher by Moody's or its short-term unsecured, unsubordinated and unguaranteed debt obligations of P-1 or higher by Moody's (the "**Swap Requisite Rating**"). It is anticipated that Barclays will, as at the Closing Date, be appointed as the initial Issuer Swap Provider, the initial InterCo Swap Provider and the initial Reinsurer Swap Provider.

Liquidity Facility Provider:

A financial institution which, as at the Closing Date, has, or is guaranteed by a person which has, a rating assigned to its unsecured, unsubordinated and unguaranteed debt obligations which meets the criteria published by S&P and Moody's. It is anticipated that Barclays will, as at the Closing Date, be appointed as the initial Liquidity Facility Provider.

Reinsurer Investment Manager:

The Reinsurer Investment Manager will, as at the Closing Date, be F&C Asset Managers Limited.

InterCo Investment Manager:

The InterCo Investment Manager will, as at the Closing Date, be F&C Asset Managers Limited.

Reinsurer Custodian and InterCo Custodian:

The Reinsurer Custodian and the InterCo Custodian (acting in separate capacities) will, as at the Closing Date, be The Bank of New York, London Branch.

The Note Trustee, Issuer Security Trustee, InterCo Security Trustee and Reinsurer Security Trustee:

The Note Trustee and the Issuer Security Trustee (acting in separate capacities) will, as at the Closing Date, be The Bank of New York, London Branch.

The Note Trustee (which expression includes its successors or any further or other trustee appointed pursuant to the Trust Deed) will be appointed to represent the Noteholders pursuant to the Trust Deed.

The Issuer Security Trustee (which expression includes its successors or any further or other trustee appointed pursuant to the Issuer Deed of Charge) will hold the security granted under the Issuer Deed of Charge on behalf of the Issuer Secured Creditors and will be entitled (following the service of an Issuer Enforcement Notice and (for so long as Ambac is the Issuer Controlling Creditor) with the prior written consent of Ambac) to enforce such security and rights.

The Bank of New York, London Branch will also act as security trustee under the InterCo Deed of Charge on behalf of the InterCo Secured Creditors (in such capacity, the "**InterCo Security Trustee**" (which expression includes its successors or any further or other trustee appointed pursuant to the InterCo Deed of Charge)) and will be entitled (following the service of an InterCo Enforcement Notice as directed by the InterCo Controlling Creditor) to enforce such security and rights.

The Bank of New York, London Branch will also act as security trustee under the Reinsurer Deed of Charge on behalf of the Reinsurer Secured Creditors (in such capacity, the "**Reinsurer Security Trustee**" (which expression includes its successors or any further or other trustee appointed pursuant to the Reinsurer Deed of Charge)) and will be entitled (following the service of a Reinsurer Enforcement Notice as directed by the Reinsurer Controlling Creditor) to enforce such security and rights.

The Principal Paying Agent and Agent Bank:	The Principal Paying Agent and the Agent Bank will be The Bank of New York, London Branch. The Principal Paying Agent will provide paying agency services in respect of the Notes to the Issuer pursuant to an agency agreement (the “ Agency Agreement ”) to be entered into on or about the Closing Date between, <i>inter alios</i> , the Issuer, the Note Trustee, the Issuer Security Trustee and the Agents. The Agent Bank will provide calculation services in respect of the Notes to the Issuer pursuant to the Agency Agreement.
The Issuer Administrator:	The Issuer Administrator will be Law Debenture Corporate Services Limited. The Issuer Administrator will provide corporate administration services to the Issuer pursuant to a corporate administration agreement entered into on or about the Closing Date with the Issuer (the “ Issuer Administration Agreement ”).
The InterCo Administrator:	The InterCo Administrator will be Structured Finance Management Limited. The InterCo Administrator will provide corporate administration services to InterCo pursuant to a corporate administration agreement entered into on or about the Closing Date with InterCo (the “ InterCo Administration Agreement ”).
The Reinsurer Administrator:	The Reinsurer Administrator will be Friends Provident Management Services Limited, a wholly owned subsidiary of Friends Provident plc. The Reinsurer Administrator will provide corporate administration services to the Reinsurer pursuant to a corporate administration agreement (the “ Reinsurer Administration Agreement ”).
The Issuer Account Bank:	The Issuer Account Bank will be a bank which, as at the Closing Date, is required to have a short-term credit rating of at least A-1 from S&P and P-1 from Moody’s. The Issuer Account Bank will be appointed by the Issuer to open and maintain bank accounts in the name of the Issuer and to provide banking services pursuant to a bank account agreement entered into on or about the Closing Date with, <i>inter alios</i> , the Issuer (the “ Issuer Account Bank Agreement ”). The initial Issuer Account Bank is expected to be The Bank of New York, London Branch.
The InterCo Account Bank:	The InterCo Account Bank will be a bank which, as at the Closing Date, is required to have a short-term credit rating of at least A-1 from S&P and P-1 from Moody’s. The InterCo Account Bank will be appointed by InterCo to open and maintain bank accounts in the name of InterCo and to provide banking services pursuant to a bank account agreement entered into on or about the Closing Date with, <i>inter alios</i> , InterCo (the “ InterCo Account Bank Agreement ”). The initial InterCo Account Bank is expected to be The Bank of New York, London Branch.
The Reinsurer Account Bank:	The Reinsurer Account Bank will be a bank which, as at the Closing Date, is required to have a short-term credit rating of at least A-1 from S&P and P-1 from Moody’s. The Reinsurer Account Bank will be appointed by the Reinsurer to open and maintain bank accounts in the name of the Reinsurer and to provide banking services pursuant to a bank account agreement entered into on or about the Closing Date with, <i>inter alios</i> , the Reinsurer (the “ Reinsurer Account Bank Agreement ”). The initial Reinsurer Account Bank is expected to be The Bank of New York, London Branch.

Issuer Cash Manager, InterCo Cash Manager and the Reinsurer Cash Manager:

The Issuer Cash Manager will be The Bank of New York, London Branch. The Issuer Cash Manager will provide cash management services pursuant to the Issuer Cash Management Agreement.

The InterCo Cash Manager will be The Bank of New York, London Branch. The InterCo Cash Manager will provide cash management services pursuant to the InterCo Cash Management Agreement.

The Reinsurer Cash Manager will be The Bank of New York, London Branch. The Reinsurer Cash Manager will provide cash management services pursuant to the Reinsurer Cash Management Agreement.

Successors:

References to any person shall include any successor thereto appointed from time to time.

KEY CHARACTERISTICS OF THE NOTES:

	Class A-1 Notes	Class A-2 Notes
Nominal Amount per Note	£100,000	£100,000
Total Nominal Amount	£280,000,000	£100,000,000
Issue Price	100 per cent.	100 per cent.
Interest Rate ¹	LIBOR plus 0.20 per cent. per annum	LIBOR plus 0.23 per cent. per annum
Frequency of Payments of Interest	Quarterly	Quarterly
Frequency of Amortisation of Principal ¹	Annually, commencing in April 2006, in the amount determined to be available to be paid in or towards redeeming the Class A-1 Notes in accordance with the Issuer Pre-Acceleration Priority of Payments, until all the Class A-1 Notes have been redeemed or provided for in full	On and following redemption in full of the Class A-1 Notes, annually in the amount determined to be available to be paid in or towards redeeming the Class A-2 Notes in accordance with the Issuer Pre-Acceleration Priority of Payments, until all the Class A-2 Notes have been redeemed or provided for in full
Payment Dates for Interest Payments	15 January, 15 April, 15 July and 15 October of each year (or, if any such day is not a Business Day, the next succeeding Business Day), the first Interest Payment Date being 15 April, 2005	15 January, 15 April, 15 July and 15 October of each year (or, if any such day is not a Business Day, the next succeeding Business Day), the first Interest Payment Date being 15 April, 2005
Payment Dates for Principal Payments	15 April of each year, commencing with the Interest Payment Date falling in April, 2006 (or, if any such day is not a Business Day, the next succeeding Business Day)	15 April of each year, commencing with the Interest Payment Date falling in April, 2006 (or, if any such day is not a Business Day, the next succeeding Business Day)
Expected Average Life ²	2.8 years	5.7 years
Expected Maturity Date	15 April 2010	15 April 2011
Final Maturity Date	15 April 2016	15 April 2019
Moody's Rating	Aaa	Aaa
S&P Rating	AAA	AAA
Form at Issue	Bearer form	Bearer form
Listing	Application for the Notes to be admitted to the Official List maintained by the UK Listing Authority has been made	Application for the Notes to be admitted to the Official List maintained by the UK Listing Authority has been made
Clearing	Euroclear and Clearstream, Luxembourg	Euroclear and Clearstream, Luxembourg
Common Code	020587075	020587091
ISIN	XS0205870750	XS0205870917

1 The Notes have the benefit of a financial guarantee from Ambac as to Scheduled Interest and Ultimate Principal.

2 See Estimated Average Life table in section headed "Investment Considerations – Average Life and Duration of the Notes".

DESCRIPTION OF THE NOTES

Amount and title of the Notes:

On the Closing Date the Issuer will issue:

- (c) the £280,000,000 Class A-1 Floating Rate Secured Notes due 2016 (the “**Class A-1 Notes**”); and
- (d) the £100,000,000 Class A-2 Floating Rate Secured Notes due 2019 (the “**Class A-2 Notes**”).

Any reference in this Offering Circular to a “**Class of Notes**” or to a “**Class of Noteholders**” shall be a reference to the Class A-1 Notes or the Class A-2 Notes, as the case may be, or to the respective holders thereof.

Any reference to the “**Notes**” shall be a reference to the Class A-1 Notes and the Class A-2 Notes or to any Class of them as the context may require.

Form, status and denomination of the Notes:

The Notes will constitute secured, direct and unconditional obligations of the Issuer. The Notes will not be obligations or responsibilities of, or guaranteed by, any person other than the Issuer (other than, in respect of the Ultimate Principal and Scheduled Interest, by Ambac). The Notes will be constituted by a trust deed (the “**Trust Deed**”) to be entered into between the Issuer, Ambac and the Note Trustee on the Closing Date. The Notes will all have the benefit of the same security and will rank *pari passu* and rateably without preference or priority among themselves.

If certain amounts due from the Issuer are outstanding to Ambac pursuant to the Issuer Guarantee and Reimbursement Agreement, the Issuer’s obligations in respect thereof will rank in priority to certain of its obligations in respect of the Notes (see “*Terms and Conditions of the Notes – Status, Priority and Security*” below).

The Class A-1 Notes and the Class A-2 Notes will each initially be represented by a temporary global note in bearer form (respectively, the “**Class A-1 Temporary Global Note**” and the “**Class A-2 Temporary Global Note**” and, together, the “**Temporary Global Notes**”) without coupons or talons attached and which will represent the aggregate principal amount outstanding of, respectively, the Class A-1 Notes and the Class A-2 Notes. The Temporary Global Notes will be deposited on behalf of the subscribers of the Notes with The Bank of New York, London Branch, as common depositary (the “**Common Depositary**”) for Clearstream Banking, société anonyme (“**Clearstream, Luxembourg**”) and Euroclear Bank S.A./N.V., as operator of the Euroclear System (“**Euroclear**”) on or about the Closing Date. Interests in the Temporary Global Notes will be exchangeable on and after the date which is 40 days after the Closing Date (the “**Exchange Date**”), upon certification of non-U.S. beneficial ownership, for interests in, in the case of the Class A-1 Temporary Global Note, a permanent global note (the “**Class A-1 Permanent Global Note**”) representing the Class A-1 Notes and, in the case of the Class A-2 Temporary Global Note, a permanent global note (the “**Class A-2 Permanent Global Note**”, together with the Class A-1 Permanent Global Note, the “**Permanent Global Notes**” and each a “**Permanent Global Note**”) representing the Class A-2 Notes, each in bearer form without coupons or talons, which will also be deposited with the Common Depositary. The Class A-1 Permanent Global Note will be exchangeable for definitive Class A-1 Notes (the “**Definitive Class A-1 Notes**”) and the Class A-2 Permanent Global Note will be exchangeable for definitive Class A-2 Notes (the “**Definitive**”).

Class A-2 Notes”, together with the Definitive Class A-1 Notes, the “**Definitive Notes**” and each a “**Definitive Class of Notes**”) issued in bearer form in the limited circumstances described in Condition 2 of the Terms and Conditions of the Notes.

The Issuer Deed of Charge contains provisions requiring the Issuer Security Trustee (except where expressly provided otherwise) to have regard to the interests of the Issuer Secured Creditors as a whole as regards all powers, trusts, authorities, duties and discretions of the Issuer Security Trustee but requiring the Issuer Security Trustee to have regard only to the interests of Ambac (for so long as Ambac is the Issuer Controlling Creditor) (other than in respect of Reserved Matters or any Basic Terms Modification) if, in the Issuer Security Trustee’s opinion, there is a conflict between the interests of (A) Ambac and (B) any other Issuer Secured Creditor, and in all other cases while there are any Notes outstanding, to have regard only to the interests of the Noteholders if, in the opinion of the Issuer Security Trustee, there is a conflict between the interests of the Noteholders and the other Issuer Secured Creditors. In determining the interests of the Noteholders, the Security Trustee shall be entitled to treat the Class A-1 Notes and the Class A-2 Notes as a single class.

Recourse:

The obligations of the Issuer under the Transaction Documents, other than in respect of the Notes, will be limited to the assets of the Issuer. The obligations of the Issuer under the Notes will be full recourse. The obligations of the Issuer under the Transaction Documents will be secured pursuant to the security created by the Issuer Deed of Charge.

Security for the Notes:

The Issuer’s obligations under the Notes (together with its obligations to certain of its other creditors, including Ambac under the Issuer Guarantee and Reimbursement Agreement, InterCo under the Issuer Subordinated Loan Agreement and the Issuer Swap Provider under the Issuer Swap Agreement) will be secured by a deed of charge (the “**Issuer Deed of Charge**”) which will create first priority fixed charges and a first priority floating charge over substantially all of the assets of the Issuer (the “**Issuer Security**”) in favour of the Issuer Security Trustee for, *inter alios*, the Noteholders, the Note Trustee, Ambac, InterCo and the Issuer Swap Provider. The security created by the Issuer Deed of Charge will include:

- (1) an assignment, by way of first fixed security for the payment or discharge of the Issuer Secured Obligations, to and in favour of the Issuer Security Trustee of all of its right, title, interest and benefit, existing at the date of the Issuer Deed of Charge or in the future, in, to, under or in respect of the InterCo Loan Agreement, the Issuer Subordinated Loan Agreement, the Issuer Swap Agreement, the InterCo Deposit Agreement, the Agency Agreement, the Issuer Account Bank Agreement, the Issuer Guarantee and Reimbursement Agreement, the Issuer Administration Agreement, the Issuer Cash Management Agreement and the InterCo Deed of Charge (together, the “**Issuer Assigned Agreements**”) and any other agreement, instrument or notice to which the Issuer becomes a party or in respect of which it has or may have any right, interest, title or benefit, either existing now or at any time in the future (the “**Issuer Other Secured Contractual Rights**”) including without limitation:

- (i) the benefit of all representations, warranties, covenants, undertakings and indemnities under or in respect of the Issuer Assigned Agreements and the Issuer Other Secured Contractual Rights;
 - (ii) all of its rights to receive payment of any amounts which may become payable to it pursuant or with respect to such Issuer Assigned Agreements and Issuer Other Secured Contractual Rights;
 - (iii) all payments received by it pursuant to, or with respect to, such Issuer Assigned Agreements and Issuer Other Secured Contractual Rights;
 - (iv) all its rights to serve notices and/or make demands pursuant to such Issuer Assigned Agreements and Issuer Other Secured Contractual Rights and/or to take such steps as are required to cause payments to become due and payable thereunder or with respect to such Issuer Assigned Agreements and Issuer Other Secured Contractual Rights;
 - (v) all of its rights of action in respect of any breach of such Issuer Assigned Agreements and Issuer Other Secured Contractual Rights; and
 - (vi) all of its rights to receive damages, compensation or obtain other relief in respect of, including in respect of any breach of or default in respect of such Issuer Assigned Agreements and Issuer Other Secured Contractual Rights;
- (2) a charge, by way of first fixed security for the payment or discharge of the Issuer Secured Obligations, to and in favour of the Issuer Security Trustee of all of its right, title, interest and benefit, existing at the date of the Issuer Deed of Charge or in the future, in and to the Issuer Bank Accounts and all sums of moneys which may be at or are after the date of the Issuer Deed of Charge from time to time standing to the credit of the Issuer Bank Accounts and any other bank account or book debt in which the Issuer may at any time acquire any right, title, interest or benefit and each debt represented by these, including all interest accrued and other moneys received in respect thereof; and
- (3) a charge by way of first fixed security for the payment or discharge of the Issuer Secured Obligations, to and in favour of the Issuer Security Trustee of all of its right, title, interest and benefit, existing at the date of the Issuer Deed of Charge or in the future, in and to the Issuer Eligible Investments and other securities and investments which the Issuer may at any time acquire, make or otherwise obtain an interest or benefit in, together with all moneys received in respect thereof and all interest accruing on them from time to time, all dividends and distributions paid or payable thereon, all property paid, distributed, accruing or offered at any time on, to or in respect of or in substitution therefor and the proceeds of sale, redemption or discharge thereof and the benefit of all covenants relating to such Issuer Eligible Investments and other Securities and all rights and remedies for enforcing the same.
- (4) a charge to and in favour of the Issuer Security Trustee, by way of first floating charge for the payment or discharge of the Issuer Secured Obligations, of the whole of its

undertaking and all of its property and assets whatsoever and wheresoever situate, present and future, other than any property or assets from time to time or for the time being effectively charged by way of fixed charge, or otherwise assigned as security, pursuant to the Issuer Deed of Charge.

The security constituted by the Issuer Deed of Charge will be enforceable after the expiry of appropriate grace periods in circumstances (each, an “**Issuer Event of Default**”) which include non-payment of amounts due on the Notes, certain breaches of the Issuer’s covenants set out in the Conditions, certain events related to the solvency of the Issuer and an Ambac Event of Default occurring.

Certain other obligations of the Issuer (including, *inter alia*, the amounts owing to (i) the Note Trustee under the Trust Deed, (ii) the Issuer Security Trustee and any Receiver under the Issuer Deed of Charge, (iii) the Issuer Account Bank under the Issuer Account Bank Agreement (iv) the Issuer Administrator under the Issuer Administration Agreement, (v) the Paying Agents and Agent Bank under the Agency Agreement) and (vi) the Issuer Swap Provider under the Issuer Swap Agreement will also be secured by the security referred to above.

For a more detailed description of the provisions of the Issuer Deed of Charge, see “*Summary of Transaction Documents – Issuer Deed of Charge*” below.

Use of proceeds:

The Issuer will apply the gross proceeds of the issue of the Notes in making the InterCo Loan to InterCo under the InterCo Loan Agreement on the terms set out therein. No fees and expenses of the Issuer will be deducted from the gross proceeds of the issue of the Notes. For further details, see “*Use of Proceeds*” below.

Mandatory redemption by payment of Note Principal Payments:

Under Condition 6(b), to the extent that the Issuer has sufficient funds available from Issuer Available Funds, after paying higher ranking amounts in the Issuer Pre-Acceleration Priority of Payments, the Issuer will apply such excess funds in redeeming the Notes, redeeming the Class A-1 Notes prior to redeeming the Class A-2 Notes prior to acceleration of the Notes.

Redemption for Taxation or other reasons and Substitution for Taxation:

If a Tax Event (as defined in the Terms and Conditions of the Notes) occurs and if requested by FPLP, then the Issuer shall, if to do so would avoid the relevant event, use all reasonable endeavours to arrange a substitution of another company (including, if necessary, incorporated in another jurisdiction) as principal debtor under the Notes, which substitution is approved in writing by the Note Trustee and subject to (i) obtaining the consent of Ambac (for so long as Ambac is the Issuer Controlling Creditor) and (ii) the Rating Agencies having confirmed that the ratings of the Notes (including the Unguaranteed Rating) in effect immediately prior to substitution would not be adversely affected by such substitution. If the Issuer is unable to arrange a substitution which would have the result of avoiding the relevant event, then the Issuer may, on any Interest Payment Date following its having satisfied the Note Trustee and Ambac (for so long as Ambac is the Issuer Controlling Creditor) that such event has occurred, redeem all, but not some only, of the Notes at their Principal Amount Outstanding together with accrued but unpaid interest to (but excluding) the date of redemption subject to certain conditions, including as to its ability to fund the redemption of the Notes.

Redemption upon enforcement:	Following service of a Note Acceleration Notice, the Notes will become redeemable in accordance with the Issuer Post-Acceleration Priority of Payments.
Withholding tax:	Payments of interest and principal in respect of the Notes will be made subject to any applicable withholding or deduction for or on account of any tax and none of the Issuer, Ambac, the Paying Agents or any other entity will be obliged to pay any additional amounts as a consequence thereof (but see, as regards payments made by Ambac under the Ambac Note Financial Guarantee, “ <i>Form of Ambac Note Financial Guarantee</i> ”).
Final redemption:	Unless previously redeemed in full, the Notes will be redeemed, at their then respective Principal Amounts Outstanding as follows: <ul style="list-style-type: none"> (a) the Class A-1 Notes on the Interest Payment Date falling in April 2016; and (b) the Class A-2 Notes on the Interest Payment Date falling in April 2019.
Purchase of Notes:	The Issuer will not be permitted to purchase any of the Notes.
Interest:	<p>Interest will be payable on the Notes quarterly in arrear on 15 January, 15 April, 15 July and 15 October in each year (or if any such day is not a Business Day, the next succeeding Business Day) (each, an “Interest Payment Date”), commencing on the Interest Payment Date falling in April, 2005. Interest will be payable on the Notes by reference to successive interest periods (each, an “Interest Period”). The first Interest Period will commence on (and include) the Closing Date and will end on (but exclude) the Interest Payment Date falling in April, 2005. Each successive Interest Period will commence on (and include) an Interest Payment Date and end on (but exclude) the next succeeding Interest Payment Date, subject in all cases to the detailed provisions of the Conditions in relation to Interest Periods.</p> <p>The interest rates applicable to the Notes from time to time will be determined by reference to LIBOR for three-month sterling deposits (other than, in each case, in respect of the first Interest Period in respect of which it will be determined by reference to a linear interpolation of three and four-month LIBOR) plus, in each case, the applicable Margin.</p> <p>Interest on the Notes will be calculated for any period (including any Interest Period), on the basis of actual days elapsed and a 365-day year (or, if any portion of that Interest Period falls in a leap year, the sum of (x) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366 and (y) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365).</p>
Listing:	Application has been made to admit the Notes to the Official List of the UK Listing Authority.
Transfer restrictions:	Subject to applicable laws and regulations, there are no transfer restrictions in respect of the Notes.
Governing law:	The Notes will be governed by English law.

OUTLINE OF OTHER TRANSACTION DOCUMENTS

All Transaction Documents are governed by English Law.

- Trust Deed: The Issuer, The Note Trustee and Ambac will enter into the Trust Deed on or about the Closing Date. The Trust Deed will contain the form of the Notes and will contain covenants from the Issuer to the Note Trustee and Ambac (i) to pay interest, principal and other amounts (if any) on the Notes and (ii) so long as any Note remains outstanding, to comply with, perform and observe the terms of the Trust Deed, the Notes, the Conditions and the other Transaction Documents to which it is a party. The Note Trustee will hold the benefit of those covenants on trust for the benefit of itself, the Noteholders, the Couponholders, the Talonholders and Ambac (for so long as Ambac is the Issuer Controlling Creditor).
- Ambac Note Financial Guarantee: On or about the Closing Date, Ambac will provide an unconditional and irrevocable financial guarantee (the “**Ambac Note Financial Guarantee**”) in favour of the Note Trustee on behalf of the Noteholders from time to time pursuant to which Ambac will guarantee the payment of Scheduled Interest and Ultimate Principal in respect of the Notes. (See “*Form of Ambac Note Financial Guarantee*”).
- Issuer Swap Agreement: In order to exchange the interest receivable under the InterCo Loan, which is based on a fixed rate, for the rate related to three month Sterling LIBOR payable under the Notes, the Issuer and the Issuer Swap Provider will, on or before the Closing Date, enter into a 1992 ISDA Master Agreement (Cross Border – Multicurrency) (the “**Issuer ISDA Master**”) together with a schedule thereto (the “**Issuer Schedule**”) and confirmations thereunder with respect to, respectively, the Notes and the margin on the Notes (the “**Issuer Confirmations**”, and together with the Issuer Schedule and the Issuer ISDA Master, the “**Issuer Swap Agreement**”, and the transactions thereunder being, the “**Issuer Swaps**”) with the Issuer and the Issuer Security Trustee pursuant to which:
- (I) under the Issuer Fixed/Floating Swap the Issuer will receive 3-month LIBOR (excluding the margin on the Notes) in exchange for the fixed rate under the InterCo Loan on a notional principal equal to the lower of the Adjusted Sum Reinsured and the aggregate Principal Amount Outstanding on all the Notes; and
 - (II) under the Issuer Funding Swap the Issuer will receive the margin over LIBOR on the Notes other than on each Loan Interest Payment Date, on which date it will repay the amount received to fund the margin over LIBOR on the Interest Payment Dates which are not Loan Interest Payment Dates together with interest thereon compounded quarterly at 3-month LIBOR plus 0.40 per cent. per annum.
- If Notes are redeemed in whole or part or the Reinsurer Swap Agreement is subject to Partial Early Termination as a result of a Claim being made under the Reinsurance Agreement, the notional principal of the Issuer Fixed/Floating Swap will be reduced by an amount equal to the principal redeemed on the Notes less the InterCo Floating Principal Amount immediately prior to the relevant Loan Interest Payment Date and break costs will be payable by or to the Issuer in respect of such partial termination. (Break costs payable to the Issuer by the Issuer Swap Provider will reflect a corresponding amount of break costs payable by the Issuer to InterCo for the fixed rate loan being prepaid or converted to a floating rate; InterCo will have a

corresponding obligation to pay break costs to the Reinsurer under the Reinsurer Loan Agreement for the fixed rate Reinsurer Loan being prepaid or converted to a floating rate (and will receive break costs from the InterCo Swap Provider in respect of the partial termination of the InterCo Swap); and the Reinsurer will have a corresponding obligation to pay break costs to the Reinsurer Swap Provider arising from a partial termination of the Reinsurer Swap. Conversely, if break costs are payable by the Issuer to the Issuer Swap Provider this will reflect a corresponding break cost amount payable by InterCo to the Issuer for the fixed rate InterCo Loan being prepaid or converted to a floating rate; InterCo will have a corresponding right to receive break costs from the Reinsurer under the Reinsurer Loan Agreement (and will pay additional break costs reflecting those payable by InterCo for partial termination of the InterCo Swap); the Reinsurer will have a corresponding right to receive break costs from the Reinsurer Swap Provider for partial termination of the Reinsurer Swap.

Ambac Issuer Swap Financial Guarantee:

The obligations of the Issuer to pay the Issuer Swap Fixed Amount payable by the Issuer under the Issuer Fixed/Floating Swap and the repayment of amounts funded in advance by the Issuer Swap Provider under the Issuer Funding Swap will be guaranteed unconditionally and irrevocably by Ambac under a separate financial guarantee (the “**Ambac Issuer Swap Financial Guarantee**”).

Issuer Ambac Fee Letter:

On or before the Closing Date, the Issuer and Ambac will enter into the Issuer Ambac Fee Letter pursuant to which the Issuer will pay to Ambac the fees under the Issuer Ambac Fee Letter, on the terms as set out therein, in consideration for the provision by Ambac of the Ambac Note Financial Guarantee and the Ambac Issuer Swap Financial Guarantee.

Issuer Guarantee and Reimbursement Agreement:

The Issuer and Ambac will enter into the Issuer Guarantee and Reimbursement Agreement under which the Issuer will be obliged, *inter alia*, to reimburse Ambac in respect of any payments made by Ambac under the Ambac Note Financial Guarantee and/or the Ambac Issuer Swap Financial Guarantee and will be obliged to pay any fees and expenses of Ambac in respect of the provision of the Ambac Note Financial Guarantee and/or the Ambac Issuer Swap Financial Guarantee.

In so far as Ambac makes payments under the Ambac Note Financial Guarantee and/or the Ambac Issuer Swap Financial Guarantee, it shall be subrogated to the rights of the Noteholders against the Issuer or the Issuer Swap Provider against the Issuer (as applicable) in respect of any payments so made. Payments due to Ambac pursuant to the Issuer Guarantee and Reimbursement Agreement will be paid in accordance with the terms (including the Issuer Priorities of Payments) of the Issuer Deed of Charge and such payment obligations will be limited recourse obligations of the Issuer.

Notwithstanding that the Notes are not subject to the provisions limiting recourse to the Issuer, Ambac agrees with the Issuer that its rights in respect of subrogation and reimbursement will be limited recourse obligations of the Issuer.

Issuer Subordinated Loan Agreement:

On or before the Closing Date, InterCo will enter into a subordinated loan agreement with, *inter alios*, the Issuer (the “**Issuer Subordinated Loan Agreement**”) under which InterCo will advance to the Issuer a limited recourse non-interest bearing loan

of £14,000,000 (“**Issuer Subordinated Loan**”). The Issuer Subordinated Loan will be applied by the Issuer in funding the InterCo Deposit.

The Issuer Subordinated Loan will be repayable on the earlier of (i) all Notes being redeemed in full and no amounts remain outstanding to Ambac under the Issuer Guarantee and Reimbursement Agreement or the InterCo Guarantee and Reimbursement Agreement and (ii) the Final Maturity Date of the Class A-2 Notes and to the extent of the Issuer Available Funds remaining after paying or providing for payments with a higher ranking priority in the Issuer Priorities of Payments applicable on such date.

Expenses Loan Agreement:

On or before the Closing Date, FPLP will lend £100,000 to the Issuer to fund certain ongoing expenses of the transaction (the “**Expenses Loan**”). Under the Issuer Deed of Charge, interest and principal on the Expenses Loan will be subordinated to interest and principal on the Notes.

Interest will accrue annually in arrears at LIBOR plus one per cent. per annum (see “*Summary of Transaction Documents – Expenses Loan Agreement*”).

Interest will be payable subject to applicable withholding or deduction for or on account of United Kingdom tax, provided always that if there is any such withholding or deduction, no additional amount will be payable in respect thereof.

Interest will be payable and principal will be repayable on the Expenses Loan on the earlier of (i) all Notes being redeemed in full and (ii) the Final Maturity Date of the Class A-2 Notes, to the extent of the Issuer Available Funds remaining after paying or providing for payments with a higher ranking priority in the Issuer Priorities of Payments applicable on such date.

Issuer Administration Agreement:

On or before the Closing Date, the Issuer, the Issuer Administrator and the Issuer Security Trustee will enter into the Issuer Administration Agreement.

Issuer Account Bank Agreement:

On or before the Closing Date, *inter alios* the Issuer and the Issuer Account Bank will enter into the Issuer Account Bank Agreement pursuant to which the Issuer will establish the Issuer Bank Accounts.

Issuer Cash Management Agreement:

On or before the Closing Date, *inter alios*, the Issuer, the Issuer Cash Manager and the Issuer Security Trustee will enter into the Issuer Cash Management Agreement pursuant to which the Issuer Cash Manager will manage the cash of the Issuer.

InterCo Loan Agreement:

On the Closing Date, the Issuer will lend £380,000,000 to InterCo under the InterCo Loan Agreement. Under the InterCo Loan Agreement, InterCo will pay interest and repay principal to the Issuer.

Interest will be payable annually in arrear on each Loan Interest Payment Date at 4.906 per cent. per annum on the InterCo Fixed Principal Amount and quarterly in arrear at a rate equal to LIBOR for each Interest Period on the InterCo Floating Principal Amount (and, if the Issuer Swaps are terminated and not replaced, in which event interest will be payable quarterly and the rate will be equal to LIBOR for each Interest Period) calculated in accordance with the InterCo Loan Agreement on each Interest Payment Date out of InterCo Available Funds (see “*Summary of Transaction Documents – InterCo Loan Agreement*”).

An initial commitment fee will be payable to the Issuer on the Closing Date (the “**InterCo Initial Commitment Fee**”). An ongoing commitment fee (the “**InterCo Ongoing Commitment Fee**”), will be payable by InterCo on each Loan Interest Payment Date; this is calculated so as to (i) fund the Issuer’s costs and expenses other than principal and interest (excluding the margin over LIBOR) on the Notes and the fixed rate payable by the Issuer under the Issuer Fixed/Floating Swap and (ii) provide a return to the Issuer.

On each Loan Interest Payment Date falling in or after April 2006, InterCo will repay an amount of the principal amount outstanding of the InterCo Loan to the extent that InterCo Available Funds remain available on such Loan Interest Payment Date after having paid or made provision for the payment of all amounts ranking higher in the InterCo Priorities of Payments.

InterCo or the Issuer (as applicable) will be required to pay break costs for (i) the InterCo Loan being prepaid (in whole or in part) prior to the Loan Interest Payment Date falling in April 2019 (the “**Loan Maturity Date**”) and (ii) the interest rate on the InterCo Loan becoming based in whole or part on a floating rate. (See the description of break costs opposite “*Issuer Swap Agreement*” above.)

All payments under the InterCo Loan Agreement will be made without set off, deduction or withholding for or on account of tax unless the deduction or withholding is required by law in which event the payor will (subject to, as relevant, the Issuer Deed of Charge and the InterCo Deed of Charge (including there being Issuer Available Funds or, as applicable, InterCo Available Funds and payment being subject to the Issuer Priorities of Payments or, as applicable, the InterCo Priorities of Payments)) (a) pay such additional amount as will result in the recipient receiving the amount it would have received had no such withholding or deduction been required or (b) lend to the recipient such additional amount as will result in the recipient receiving the amount it would have received had no such withholding or deduction been required. Repayment of such loan will be made out of InterCo Available Funds in accordance with the InterCo Priorities of Payment or out of Issuer Available Funds in accordance with the Issuer Priorities of Payments (as applicable) and only if, and to the extent that, the borrower recovers or obtains credit for the tax withheld.

InterCo Swap Agreement:

If interest on the Reinsurer Fixed Principal Amount is unpaid it will roll up and accrue interest at the then applicable rate under the Reinsurer Loan, which will be a fixed rate while the Reinsurer Swap is outstanding. InterCo will fund its obligation to pay interest on the InterCo Loan by drawing on the Liquidity Facility.

Amounts drawn under the Liquidity Facility carry interest based on three-month Sterling LIBOR. In order to exchange the fixed rate interest accruing on interest which is unpaid under the Reinsurer Fixed Principal Amount of the Reinsurer Loan for a rate related to three month Sterling LIBOR, InterCo and the InterCo Swap Provider will, on or about the Closing Date, enter into a 1992 ISDA Master Agreement (Cross Border – Multicurrency) (the “**InterCo ISDA Master**”) together with a schedule thereto (the “**InterCo Schedule**”) and a confirmation thereunder (the “**InterCo Confirmation**”), and together with the InterCo Schedule and the InterCo ISDA Master, the “**InterCo Swap Agreement**”, the transaction described thereunder being, the “**InterCo Swap**”) with InterCo and the InterCo Security Trustee pursuant to which:

- (a) the notional amount of the InterCo Swap will initially be zero and thereafter will, in effect, be the difference between the notional amount of the Reinsurer Swap (which will fluctuate from time to time, as more particularly described under “*Summary of the Transaction Documents – Reinsurer Swap Agreement*”) and the notional amount of the Issuer Fixed/Floating Swap (before any partial termination in any given year);
- (b) InterCo will pay annually a fixed rate of 4.906 per cent. per annum on the notional amount on each Loan Interest Payment Date and receive quarterly three-month Sterling LIBOR from the InterCo Swap Provider on the then notional amount of the InterCo Swap.

If there is any partial termination of the Reinsurer Swap in respect of the amount by which the notional amount of the Reinsurer Swap exceeds the notional amount of the Issuer Fixed/Floating Swap, the InterCo Swap will be subject to automatic partial termination in respect of which InterCo may be required to pay or may receive an amount in respect of break costs depending on whether the notional swap used for determining the break costs in relation to the InterCo Swap is out-of-the-money to InterCo (which it will pay) or in-the-money to InterCo (which it will receive). (See the description in parentheses opposite “*Issuer Swap Agreement*” above summarising the flow of funds in relation to break costs.)

Ambac InterCo Swap Financial Guarantee:

On or about the Closing Date, Ambac will issue in favour of the InterCo Swap Provider, an unconditional and irrevocable financial guarantee (the “**Ambac InterCo Swap Financial Guarantee**”) in respect of InterCo’s obligations to pay the InterCo Swap Fixed Amounts payable under the InterCo Swap Agreement.

Liquidity Facility Agreement:

On or before the Closing Date, the Liquidity Facility Provider will enter into the Liquidity Facility Agreement with, *inter alios*, InterCo pursuant to which the Liquidity Facility Provider will provide a floating rate 364-day, renewable, liquidity facility under which InterCo (or the InterCo Cash Manager acting on behalf of InterCo) may draw under the Liquidity Facility to the extent that InterCo has insufficient InterCo Available Funds on (i) the Interest Payment Date falling in April within such 364 day period to pay in full any of the items specified in (b) to (m) (inclusive) in the InterCo Pre-Enforcement Priority of Payments (see “*Summary of the Transaction Documents – InterCo Deed of Charge – Pre-Enforcement Priority of Payments*”) or (ii) any other Interest Payment Date falling within such 364 day period to pay interest on the InterCo Floating Principal Amount.

Ambac Liquidity Financial Guarantee:

Certain obligations of InterCo under the Liquidity Facility will be guaranteed by Ambac under a separate financial guarantee (the “**Ambac Liquidity Financial Guarantee**”). Ambac will unconditionally and irrevocably guarantee the payment of interest (other than Liquidity Gross-up Amounts) on a current basis and, to the extent that the Liquidity Facility has been drawn and not repaid, the payment of principal on the earlier of the Class A-2 Note Final Maturity Date and the date on which the Notes are redeemed in full.

InterCo Ambac Fee Letter:

On or before the Closing Date, InterCo and Ambac will enter into the InterCo Ambac Fee Letter pursuant to which InterCo will pay to Ambac a fee, on the terms as set out therein, in consideration for the provision by Ambac of the Ambac Liquidity Financial Guarantee and the Ambac InterCo Swap Financial Guarantee.

InterCo Guarantee and Reimbursement Agreement:

InterCo and Ambac will enter into the InterCo Guarantee and Reimbursement Agreement under which InterCo will be obliged, *inter alia*, to reimburse Ambac in respect of any payments made by Ambac under the Ambac InterCo Swap Financial Guarantee and the Ambac Liquidity Financial Guarantee and will be obliged to pay any fees and expenses of Ambac in respect of the provision of the Ambac InterCo Swap Financial Guarantee and the Ambac Liquidity Financial Guarantee.

In so far as Ambac makes payments under the Ambac InterCo Swap Financial Guarantee or the Ambac Liquidity Financial Guarantee, it shall be subrogated to the rights of, respectively, the InterCo Swap Provider and the Liquidity Facility Provider against InterCo. Payments due to Ambac pursuant to the InterCo Guarantee and Reimbursement Agreement will be paid in accordance with the terms (including the InterCo Priorities of Payments) of the InterCo Deed of Charge and such payment obligations will be limited recourse obligations of InterCo.

InterCo Subordinated Loan Agreement:

On or before the Closing Date FPLP will enter into a subordinated loan agreement with, *inter alios*, InterCo under which FPLP will agree to advance £14,000,000 to InterCo on the Closing Date to enable InterCo to advance to the Issuer on the Closing Date the Issuer Subordinated Loan.

In addition:

- (a) to the extent that InterCo is required to pay tax on an amount of profits in excess of 0.01 per cent. per annum of the principal amount outstanding of the Reinsurer Loan, a further advance will be required to be made by FPLP under the InterCo Subordinated Loan Agreement to fund such excess tax; and
- (b) FPLP shall, upon request by the InterCo Cash Manager, make a further advance to InterCo to cover transaction costs and expenses including, but not limited to, the costs, charges, liabilities and expenses of the InterCo Security Trustee (other than interest, InterCo Ongoing Commitment Fees and principal on the InterCo Loan) provided that the aggregate amount of such advances which are outstanding may not exceed £100,000 at any time.

Interest will roll up and compound annually in arrears on each Loan Interest Payment Date at the rate per cent. per annum determined as the yield on the InterCo Eligible Investments in the corresponding period.

Interest will be payable subject to applicable withholding or deduction for or on account of UK tax, provided always that if there is any such withholding or deduction, no additional amount will be payable in respect thereof.

InterCo shall pay the accrued interest and, subject as follows, repay the InterCo Subordinated Loan following repayment in full of the InterCo Loan out of InterCo Available Funds remaining after paying or providing for payments with a higher ranking in the InterCo Priorities of Payments. Amounts of principal drawn under (b) above will be repayable out of InterCo Available Funds

in accordance with the InterCo Priorities of Payments prior to interest, InterCo Ongoing Commitment Fees or Principal on the InterCo Loan and will be available to be redrawn. (See “*Summary of the Transaction Documents – InterCo Subordinated Loan Agreement*”).)

InterCo Deposit Agreement: On or about the Closing Date the Issuer will enter into a deposit agreement (the “**InterCo Deposit Agreement**”) with, *inter alios*, InterCo under which the Issuer will deposit with InterCo the sum of £14,000,000 (the “**InterCo Deposit**”). The InterCo Deposit is a non-interest bearing obligation of InterCo.

The Issuer shall not be entitled to withdraw or claim repayment of the Deposit or any part thereof until the earlier of (i) the Loan Interest Payment Date falling in 2019 and (ii) the date on which no Notes remain outstanding and no amounts remain outstanding to Ambac under the Issuer Guarantee and Reimbursement Agreement or the InterCo Guarantee and Reimbursement Agreement.

InterCo Administration Agreement: On or before the Closing Date, *inter alios*, InterCo and the InterCo Administrator will enter into the InterCo Administration Agreement under which the InterCo Administrator will agree to provide corporate administration services to InterCo.

InterCo Account Bank Agreement: On or before the Closing Date, *inter alios*, InterCo and the InterCo Account Bank will enter into the InterCo Account Bank Agreement pursuant to which InterCo will establish the InterCo Bank Accounts.

InterCo Cash Management Agreement: On or before the Closing Date InterCo, the InterCo Cash Manager and the InterCo Security Trustee will enter into the InterCo Cash Management Agreement pursuant to which the InterCo Cash Manager will manage the cash of InterCo.

InterCo Investment Management Agreement: On or before the Closing Date InterCo, the InterCo Custodian, the InterCo Security Trustee and the InterCo Investment Manager will enter into the InterCo Investment Management Agreement pursuant to which the InterCo Investment Manager will agree to act as investment manager on behalf of the InterCo Security Trustee to invest InterCo’s Funds in InterCo Eligible Investments.

InterCo Custody Agreement: On or before the Closing Date InterCo, the InterCo Security Trustee and the InterCo Custodian will enter into the InterCo Custody Agreement pursuant to which the InterCo Custodian, as custodian of the InterCo Security Trustee, will agree to hold the InterCo Eligible Investments (and any other investments of InterCo) and the cash derived from them on behalf of the InterCo Security Trustee.

Reinsurance Agreement: Under the Reinsurance Agreement, the Reinsurer provides reinsurance of certain liabilities and risks of FPLP. The sum reinsured by the Reinsurer from FPLP under the Reinsurance Agreement will initially be equal to £723,939,156 (the “**Sum Reinsured**”) (being £380,000,000 compounded annually at 4.6 per cent. per annum (the “**Benefit Increase Rate**”) to 15 April 2019). The aggregate maximum liability of the Reinsurer as at any date on or after the Closing Date will be the Sum Reinsured discounted at the Benefit Increase Rate to such date as reduced by any Recapture Amount and any Claim (in each case grossed up at the Benefit Increase Rate for the period from the date the obligation arose to such date) (the “**Adjusted Sum Reinsured**”). The net economic effect is that the initial maximum liability of the Reinsurer under the Reinsurance Agreement is £380,000,000 which increases each Calculation Period by the Benefit Increase

Rate and is reduced by each Recapture Amount and any Claim (increased at the Benefit Increase Rate to the date of calculation). The Recapture Amount is a function of the Available Defined Book Surplus and is described in more detail below. If and to the extent any part of the Sum Reinsured has not been paid by way of a Claim at 15 April 2019, the remaining Sum Reinsured will be payable as a prepayment of Claims on that date in 2019. FPLP will continue to be required to pay premiums equal to the Available Defined Book Surplus until, *inter alia*, no amounts remain outstanding or payable under the Transaction Documents.

Each year FPLP will determine the Defined Book Surplus, as described in more detail in this Offering Circular, see “*Summary of the Transaction Documents – Reinsurance Agreement*” for a description of Defined Book Surplus. For an overview of the Defined Book Surplus, see “*Defined Book Surplus*”. FPLP will determine the Defined Book Surplus in respect of each Calculation Period (being, each calendar year unless the Relevant Person otherwise agrees) in accordance with the procedures set out in the Reinsurance Agreement which require the Relevant Person (which will principally be Ambac (for so long as Ambac is the Reinsurer Controlling Creditor)) to be consulted in connection with the determination of the Defined Book Surplus (and to be able to dispute FPLP’s determination).

The Available Defined Book Surplus (being the Defined Book Surplus plus Breach Adjustments and less Recapture Reduction) will, during the life of the Notes, generally be allocated to two components:

- (a) first, an Annual Premium which FPLP will be required to pay, in cash, to the Reinsurer out of the Available Defined Book Surplus and which is calculated on the basis set out in the Reinsurance Agreement. The Annual Premium is intended to ensure that FPLP funds the Reinsurer Ongoing Commitment Fees (and, (i) in April 2005 only, interest accruing to the Interest Payment Date in April 2005 to the extent it exceeds the amount of the recapture of the increase in the Adjusted Sum Reinsured and (ii) if the interest on the Reinsurer Loan is accruing at a floating rate due to partial termination of the Reinsurer Swap following a Claim having been made by FPLP under the Reinsurance Agreement, such floating amount of interest); and
- (b) second, an amount equal to the Available Defined Book Surplus less the Annual Premium, which amount will be grossed up to 15 April 2019 at FPLP’s valuation rate of interest relating to the value of the Reinsurance Agreement and then discounted back at the Benefit Increase Rate (being the Reinsurer’s initial valuation rate of interest) to determine the Recapture Amount, which will be applied in recapturing the liability of the Reinsurer to FPLP under the Reinsurance Agreement.

The effect of grossing up the balance of the Available Defined Book Surplus at FPLP’s valuation rate of interest and discounting the amount so calculated at the Benefit Increase Rate is that the aggregate of the Annual Premium and the value of the Recapture Amount in the Reinsurer will exceed the Available Defined Book Surplus (as FPLP’s valuation rate of interest will be higher than the Reinsurer’s valuation rate of interest). However, the amount payable as interest, Reinsurer Ongoing Commitment Fees and principal is the lower of (i) the Available Defined Book Surplus and

Regulatory Surplus Deficiency and (ii) the Reinsurer Regulatory Surplus plus any Unfunded Regulatory Surplus Deficiency (the “**Adjusted Regulatory Surplus**”) and accordingly the principal effect is that retained surplus is likely to accumulate in the Reinsurer reflecting the difference. This retained surplus will be used by the Reinsurer to reduce the likelihood of other factors affecting the Reinsurer resulting in the Reinsurer Regulatory Surplus being less than the Available Defined Book Surplus and any Regulatory Surplus Deficiency and accordingly reduce the likelihood of FPLP having to fund the Conduit Covenant. These amounts are not expected to be significant in any Calculation Period and simply reflect the strain between the valuation rate used by FPLP and that used by the Reinsurer at the outset being released as the Sum Reinsured is recaptured.

The whole of the Available Defined Book Surplus (reduced, in the case of the Calculation Period ending on 31 December 2004 by an amount equal to the FPLP Initial Commitment Fee which was pre-paid on the Closing Date to fund the initial costs and expenses of the transaction) less the Annual Premium will be used in calculating the value of the Recapture Amount in the Reinsurer; the whole of the Recapture Amount will be used to recapture liabilities under the Reinsurance Agreement with respect to Calculation Periods ending after 31 December 2004. On the Interest Payment Date falling in April 2005 only that part of the Available Defined Book Surplus (after deduction of the FPLP Initial Commitment Fee) required to pay the Annual Premium and recapture the increase in the Reinsurance Liability from the Closing Date to 31 December 2004 will be applied in determining the Recapture Amount (the balance being retained by FPLP).

At any time after the Interest Payment Date in April 2005, the Recapture Amount shall be an amount equal to the Available Defined Book Surplus in respect of the preceding Calculation Period, less the Annual Premium in respect of such Calculation Period grossed up to 15 April 2019 at FPLP’s valuation rate of interest relating to the value of the Reinsurance Agreement and then discounted back at the Benefit Increase Rate (being the Reinsurer’s initial valuation rate of interest) to determine the application of the Recapture Amount, which will be applied in recapturing the liability of the Reinsurer to FPLP under the Reinsurance Agreement.

The effect of the Adjusted Sum Reinsured being reduced by the Recapture Amount is that the reserves required to be held by the Reinsurer to back the Adjusted Sum Reinsured are reduced and an amount corresponding to the value to the Reinsurer of the Recapture Amount, together with the amount received as the Annual Premium, will contribute to the surplus of the Reinsurer. The Reinsurer will be able to add such contribution to its existing retained surplus in determining the Reinsurer Regulatory Surplus for the Calculation Period. The amount payable as interest, Reinsurer Ongoing Commitment Fees and principal on a Loan Interest Payment Date is limited (assuming there are sufficient Reinsurer Available Funds) to the Available Reinsurer Surplus at the end of the preceding Calculation Period; the Available Reinsurer Surplus is the lower of (i) the Available Defined Book Surplus and Regulatory Surplus Deficiency and (ii) the Adjusted Regulatory Surplus (being the Reinsurer Regulatory Surplus plus any Unfunded Regulatory Surplus Deficiency).

If a Claim is made on the Reinsurer by FPLP under the terms of the Reinsurance Agreement, the Reinsurer will realise Reinsurer Eligible Investments which, together with its other cash resources, will enable it to pay such Claim to FPLP. The resultant reduction in Reinsurer Eligible Investments will be matched by a decrease in the value of Adjusted Sum Reinsured in the Reinsurer as a result of the payment of the Claim.

If Claims or recapture of liabilities by FPLP have resulted in the Adjusted Sum Reinsured being reduced to zero, FPLP will be required to pay, as a premium, to the Reinsurer the whole of the Defined Book Surplus thereafter, in cash, until such time as the Reinsurer, InterCo and the Issuer have no liabilities outstanding (including any contingent liabilities) under any Transaction Documents; such amounts will be paid directly to the Reinsurer Transaction Account. The Reinsurer Transaction Account is secured in favour of, *inter alios*, InterCo.

The liability of the Reinsurer to FPLP under the Reinsurance Agreement, to InterCo under the Reinsurer Loan and to the other Reinsurer Secured Creditors is limited recourse to the assets held by it and in respect of which it has granted fixed and floating charges in favour of the Reinsurer Security Trustee, all as described in more detail in this Offering Circular (see “*Summary of the Transaction Documents – Reinsurer Deed of Charge*”).

The obligation of FPLP to pay the Annual Premium is an unsecured obligation of FPLP which ranks *pari passu* with other unsecured and unsubordinated creditors other than creditors, including policyholders, which are preferred by law. However, as described in the section “*Summary of the Transaction Documents – Reinsurance Agreement*”, if FPLP fails to pay the Annual Premium within the specified time, the Reinsurer may give notice to terminate the Reinsurance Agreement.

The Reinsurance Agreement contains representations, warranties and covenants given by FPLP in relation to itself and the Reinsurer (see “*Summary of Transaction Documents – Reinsurance Agreement – Part A Warranties*” “*– Funded Covenants*” and “*– Part B Warranties*”). The remedy for breach depends on the event and the circumstances. Certain breaches of representation and covenant may result in the Reinsurance Agreement being terminated. In addition, compensation for breach may be made by way of a Breach Adjustment (which increases the amount available to recapture liabilities) or, in certain cases, by way of a Capital Injection (resulting in FPLP paying an amount to the Reinsurer to remedy the effect of the relevant breach). In addition, in certain cases it may result in a step up in the premium payable by the Issuer to Ambac. (See “*Summary of Transaction Documents – Reinsurance Agreement – Funding of Part A Breaches*” and “*– Funding of Part B Breaches and Breach Determinations*”).

Reinsurer Loan Agreement:

On the Closing Date, InterCo will lend £380,000,000 to the Reinsurer under the Reinsurer Loan Agreement. Under the Reinsurer Loan Agreement, the Reinsurer will pay interest and the Reinsurer Ongoing Commitment Fees and repay principal to InterCo; the amount payable is, however, contingent on the emergence of surplus in the Reinsurer and will, subject as follows, be payable on each Loan Interest Payment Date in an amount equal to the lower of (a) the Available Defined Book Surplus, plus any Regulatory Surplus Deficiency and (b) the Adjusted Regulatory

Surplus in each case, as at the end of the Calculation Period immediately preceding the relevant Loan Interest Payment Date (the “**Available Reinsurer Surplus**”).

If the Reinsurance Agreement is terminated, the amount payable is contingent only on the Adjusted Regulatory Surplus determined following such termination and, to the extent any amounts remain outstanding, the previous paragraph will apply subsequently.

Interest will be payable on each Loan Interest Payment Date annually in arrear at 4.906 per cent. per annum on the Reinsurer Fixed Principal Amount and annually in arrear at a rate equal to LIBOR for each Interest Period falling in such Loan Interest Period on the Reinsurer Floating Principal Amount (and if the Reinsurer Swap is terminated and not replaced, in which event the rate will be equal to LIBOR compounded in relation to each quarter in the relevant Loan Interest Period for each Interest Period commencing in the corresponding Loan Interest Period on each Loan Interest Payment Date out of Reinsurer Available Funds) (see “*Summary of Transaction Documents – Reinsurer Loan Agreement*”).

An initial commitment fee will be payable to InterCo on the Closing Date (the “**Reinsurer Initial Commitment Fee**”). An annual commitment fee (the “**Reinsurer Ongoing Commitment Fee**”) will be payable by the Reinsurer on each Loan Interest Payment Date; this is calculated so as to (i) fund InterCo’s costs and expenses and the InterCo Ongoing Commitment Fee, but excluding interest and principal on the InterCo Loan, the fixed rate payable by InterCo under the InterCo Swap and interest on the InterCo Subordinated Loan and (ii) provide a return to InterCo.

On each Loan Interest Payment Date, the Reinsurer will repay, to the extent there are Reinsurer Available Funds and in accordance with the Reinsurer Priorities of Payment then applicable, an amount equal to the lower of (a) the principal amount outstanding on the Reinsurer Loan and (b) the Available Reinsurer Surplus (or, following termination of the Reinsurance Agreement, Adjusted Regulatory Surplus) less the amounts paid in respect of Reinsurer Ongoing Commitment Fees, interest, deferred interest, Deferred Reinsurer Ongoing Commitment Fees and withholdings under the provisions of the Reinsurer Loan Agreement.

The Reinsurer and InterCo (as applicable) will be required to pay break costs for (i) the Reinsurer Loan being prepaid (in whole or in part) prior to the Loan Maturity Date and (ii) the interest rate on the Reinsurer Loan becoming based, in whole or in part, on a floating rate. (See the description in parentheses opposite “*Issuer Swap Agreement*” above summarising the flow of funds in relation to break costs.)

All payments under the Reinsurer Loan Agreement will be made without set off, deduction or withholding for or on account of tax unless the deduction or withholding is required by law in which event the payor will (subject to as relevant, the Reinsurer Deed of Charge and the InterCo Deed of Charge (including there being Reinsurer Available Funds and Available Reinsurer Surplus in respect of that amount or, as applicable, InterCo Available Funds and payment being subject to the Reinsurer Priorities of Payments or, as applicable, the InterCo Priorities of Payments)):

(a) pay such additional amount as will result in the recipient receiving the amount it would have received had no such withholding or deduction been required; or (b) lend to the recipient such additional amount as will result in the recipient receiving the amount it would have received had no such withholding or deduction been required. Repayment of such loan will be made out of Reinsurer Available Funds in accordance with the Reinsurer Priorities of Payment or out of InterCo Available Funds in accordance with the InterCo Priorities of Payment (as applicable) and only if, and to the extent that, the borrower recovers or obtains credit for the tax withheld.

Reinsurer Swap Agreement:

In order to value the Sum Reinsured at an appropriate amount, the Reinsurer needs its net economic return on its investments to be at a fixed rate in excess of the Benefit Increase Rate.

The Reinsurer Eligible Investments are short-term or floating rate and are to be managed with a view to obtaining a return of principal and a yield in excess of three-month LIBOR. The Reinsurer therefore needs to hedge the investments into a fixed rate in excess of the Benefit Increase Rate. In order to exchange the expected floating rate yield on the Reinsurer Eligible Investments for a fixed rate in excess of the Benefit Increase Rate, the Reinsurer Swap Provider will, on or about the Closing Date, enter into a 1992 ISDA Master Agreement (Cross Border – Multicurrency) (the “**Reinsurer ISDA Master**”) together with a schedule thereto (the “**Reinsurer Schedule**”), a confirmation thereunder with respect to the Notes (the “**Reinsurer Confirmation**”) and a credit support deed (the “**Reinsurer Credit Support Deed**”) together with the Reinsurer ISDA Master, the Reinsurer Schedule, the Reinsurer Confirmation and the Reinsurer Credit Support Deed, the “**Reinsurer Swap Agreement**”, and the transactions described thereunder being, the “**Reinsurer Swap**”) with the Reinsurer and the Reinsurer Security Trustee pursuant to which:

- (a) the notional amount of the Reinsurer Swap will initially be £380,000,000 and will increase thereafter at 4.906 per cent. per annum (on a compounding basis) (subject to partial termination as described below);
- (b) the Reinsurer will pay quarterly a floating rate equal to three-month LIBOR (or interpolated three-month and four month LIBOR in the case of the Interest Payment Date falling in April 2005) on the then notional amount on each Interest Payment Date and will receive annually 4.906 per cent. per annum on the notional amount at the beginning of a Loan Interest Period on the Loan Interest Payment Date falling at the end of such Loan Interest Period.

If the value of the Reinsurer Swap exceeds 10 per cent. of the value of the Reinsurer’s long-term business fund the Reinsurer Swap Provider is required to post collateral having a value equal to the excess which meets the criteria set out in the Reinsurer Credit Support Deed.

If FPLP recaptures Assumed Liabilities (or the Adjusted Sum Reinsured is otherwise reduced as a result, for example, of a Claim) the Reinsurer will not require the Reinsurer Swap in respect of the amount of the reduction. Accordingly the Reinsurer Swap will be terminated in part to reflect the reduction in the Adjusted Sum Reinsured. Where the notional amount of the Reinsurer Swap is reduced by virtue of partial termination, the

Reinsurer may be required to pay or receive an amount in respect of break costs, depending on whether the notional swap used for determining the break costs is out-of-the-money to the Reinsurer (when it will pay such break costs to the Reinsurer Swap Provider) or in-the-money to the Reinsurer (when it will receive break costs from the Reinsurer Swap Provider). (See the description in parentheses opposite “*Issuer Swap Agreement*” above summarising the flow of funds in relation to break costs under each of the swap transactions involved in the transaction.)

Reinsurer Administration Agreement:

On or before the Closing Date, *inter alios*, the Reinsurer and the Reinsurer Administrator will enter into the Reinsurer Administration Agreement, under which the Reinsurer Administrator will provide corporate administration services to the Reinsurer.

Reinsurer Account Bank Agreement:

On or before the Closing Date, *inter alios*, the Reinsurer and the Reinsurer Account Bank will enter into the Reinsurer Account Bank Agreement pursuant to which the Reinsurer will establish the Reinsurer Bank Accounts.

Reinsurer Cash Management Agreement:

On or before the Closing Date, the Reinsurer, the Reinsurer Cash Manager, the Reinsurer Account Bank and the Reinsurer Security Trustee will enter into the Reinsurer Cash Management Agreement pursuant to which the Reinsurer Cash Manager will manage the cash of the Reinsurer.

Reinsurer Investment Management Agreement:

On or before the Closing Date, the Reinsurer will enter into a Reinsurer Investment Management Agreement with the Reinsurer Investment Manager, the Reinsurer Custodian and the Reinsurer Security Trustee. Under the Reinsurer Investment Management Agreement, the Reinsurer Investment Manager agrees to act as investment manager on behalf of the Reinsurer Security Trustee to invest the Reinsurer’s funds in Reinsurer Eligible Investments.

Reinsurer Custody Agreement:

On or before the Closing Date, the Reinsurer will enter into a custody agreement with the Reinsurer Custodian and the Reinsurer Security Trustee pursuant to which the Reinsurer Custodian, as custodian of the Reinsurer Security Trustee, will agree to hold the Reinsurer Eligible Investments (and any other investments of the Reinsurer) and the cash derived from these on behalf of the Reinsurer Security Trustee.

Issuer Deed of Charge:

The Issuer’s obligations under the Notes (together with its obligations to certain of its other creditors, including, *inter alios*, InterCo under the InterCo Loan Agreement and the Issuer Subordinated Loan Agreement, the Issuer Swap Provider under the Issuer Swap Agreement and Ambac under the Issuer Guarantee and Reimbursement Agreement) will be secured by a deed of charge (the “**Issuer Deed of Charge**”) which will create first priority fixed charges and a first priority floating charge over substantially all of the assets of the Issuer in favour of the Issuer Security Trustee.

InterCo Deed of Charge

InterCo’s obligations under the InterCo Loan Agreement (together with its obligations to certain of its other creditors, including, *inter alios*, the Reinsurer under the Reinsurer Loan Agreement, and the Issuer under the InterCo Deposit Agreement, the Liquidity Facility Provider under the Liquidity Facility Agreement, Ambac under the InterCo Guarantee and Reimbursement Agreement and FPLP under the InterCo Subordinated Loan) will be secured by a deed of charge (the

“**InterCo Deed of Charge**”) which will create first priority fixed charges and a first priority floating charge over substantially all of the assets of InterCo in favour of the InterCo Security Trustee.

Reinsurer Deed of Charge:

The Reinsurer’s obligations under the Reinsurer Loan Agreement (together with its obligations to certain of its other creditors, including, *inter alios*, FPLP under the Reinsurance Agreement and the Reinsurer Swap Provider under the Reinsurer Swap Agreement) will be secured by a deed of charge (the “**Reinsurer Deed of Charge**”) which will create first priority fixed charges and a first priority floating charge over substantially all of the assets of the Reinsurer in favour of the Reinsurer Security Trustee.

INVESTMENT CONSIDERATIONS

The following is a summary of certain aspects of the Notes and the transaction about which prospective Noteholders should be aware. This summary is not intended to be exhaustive and prospective Noteholders should also read the detailed information set out in this Offering Circular and reach their own views prior to making any investment decision.

Transaction Risks

Reliance on Ambac

To the extent that the Issuer fails to make payments of Scheduled Interest and Ultimate Principal due under the Notes, the payment of the Guaranteed Amounts will be dependent on, *inter alia*, Ambac performing its obligations under the Ambac Note Financial Guarantee. The Ambac Note Financial Guarantee will not guarantee any amount becoming payable for any other reason, including the early redemption of the Notes or an accelerated payment after the occurrence of an Issuer Event of Default. In these circumstances, Ambac's obligations will be to continue to pay the Guaranteed Amounts as they fall Due for Payment (as defined in the Ambac Note Financial Guarantee) on each Interest Payment Date (see further "*Form of Ambac Note Financial Guarantee*") and to that extent the Noteholders will not be affected by the risks related to the negative performance of the Issuer. In the absence of payment under the Ambac Note Financial Guarantee, the Noteholders will directly bear the risks associated with the negative performance of the Issuer. Ambac will also provide the Ambac Liquidity Financial Guarantee, the Ambac Issuer Swap Financial Guarantee and the Ambac InterCo Swap Financial Guarantee.

Reliance on the Issuer, the Issuer Swap Provider, InterCo, the InterCo Swap Provider, the Liquidity Facility Provider, the Reinsurer, the Reinsurer Swap Provider and FPLP

The ability of the Issuer to pay interest and principal in respect of the Notes depends on the ability of InterCo to pay interest, InterCo Ongoing Commitment Fees and principal in respect of the InterCo Loan, InterCo to pay amounts due under the InterCo Deposit Agreement and the Issuer Swap Provider to pay amounts due under the Issuer Swap Agreement.

The ability of InterCo to pay interest, InterCo Ongoing Commitment Fees and principal on the InterCo Loan depends on the ability of the Reinsurer to pay interest, Reinsurer Ongoing Commitment Fees and principal in respect of the Reinsurer Loan, the InterCo Swap Provider to pay amounts due under the InterCo Swap Agreement, the Liquidity Facility Provider to pay amounts due under the Liquidity Facility Agreement and FPLP to pay amounts due under the InterCo Subordinated Loan Agreement.

The ability of the Reinsurer to pay interest, the Reinsurer Ongoing Commitment Fees and principal in respect of the Reinsurer Loan depends primarily on the Defined Book Surplus arising, FPLP paying any Annual Premium and Ongoing Premiums and other amounts payable to the Reinsurer under the Reinsurance Agreement, the Reinsurer Swap Provider paying amounts due under the Reinsurer Swap Agreement and providing, if required, collateral under the Reinsurer Credit Support Deed and the ability of the Reinsurer to realise its Reinsurer Eligible Investments at an amount equal to their acquisition cost (ignoring purchased and sold accrued interest). The ability of the Reinsurer to pay interest, Reinsurer Ongoing Commitment Fees and principal in respect of the Reinsurer Loan depends on there being Available Defined Book Surplus; the ability of the Reinsurer to pay interest, Reinsurer Ongoing Commitment Fees and principal on the Reinsurer Loan equal to the aggregate of the Available Defined Book Surplus plus any Regulatory Surplus Deficiency in respect of the immediately preceding Calculation Period depends on Adjusted Regulatory Surplus being at least equal to such amounts, which depends on the Reinsurer ensuring there are sufficient assets in the Reinsurer's Long Term Business Fund, which may depend on FPLP's performance of certain covenants under the Reinsurance Agreement.

Full Recourse Obligations of the Issuer

The Notes are full recourse obligations of the Issuer; however, the Issuer will not have any assets or funds other than those described in this Offering Circular and, accordingly, in practice the Notes are funded solely from, and holders of the Notes must rely solely on, amounts received by the Issuer in respect of the InterCo Loan, repayment of the InterCo Deposit Agreement and the payments under the Issuer Swap Agreement (except that the holders of the Notes are also entitled to the benefit of the Ambac Note Financial Guarantee with respect to Scheduled Interest and

Ultimate Principal – see “*Form of Ambac Note Financial Guarantee*” below). The Notes will not be obligations of or responsibilities of, or guaranteed by, any other person (other than Ambac in relation to Scheduled Interest and Ultimate Principal). In particular, none of the Note Trustee, the Issuer Security Trustee, the Issuer Swap Provider, the Principal Paying Agent, the Agent Bank, the Issuer Cash Manager, the Issuer Account Bank, the Issuer Administrator, InterCo, the InterCo Security Trustee, the InterCo Swap Provider, the Liquidity Facility Provider, the InterCo Investment Manager, the InterCo Custodian, the InterCo Cash Manager, the InterCo Account Bank, the InterCo Administrator, the Reinsurer, the Reinsurer Security Trustee, the Reinsurer Swap Provider, the Reinsurer Investment Manager, the Reinsurer Custodian, the Reinsurer Cash Manager, the Reinsurer Account Bank, the Reinsurer Administrator, Ambac (save in relation to the payment of Scheduled Interest and Ultimate Principal), FPLP or any of its affiliates or any other company in the same group of companies as, or affiliated to, the Issuer, or any of the officers, directors or incorporators of any of the aforementioned parties, including the Issuer, will be obliged to make payments on the Notes.

There can be no assurance that the amounts received by the Issuer in respect of the InterCo Loan Agreement, the InterCo Deposit Agreement or the Issuer Swap Agreement will be sufficient to make payments on the Notes after making payments of amounts required to be paid to other creditors ranking senior to or *pari passu* with such Notes.

The Issuer’s ability to make payments in respect of the Notes will be subject to the terms of the Trust Deed and the Issuer Deed of Charge. If amounts received under the InterCo Loan Agreement, the InterCo Deposit Agreement and the Issuer Swap Agreement are insufficient to make payments on the Notes in accordance with the Issuer Priorities of Payments, the Issuer is not expected to have any other assets available for payment of the shortfall (except that the holders of the Notes are also entitled to the benefit of the Ambac Note Financial Guarantee with respect to Scheduled Interest and Ultimate Principal – see “*Form of Ambac Note Financial Guarantee*” below).

In addition, none of the Noteholders or any other Issuer Secured Creditor, except Ambac (for so long as it is the Issuer Controlling Creditor), may take any steps to direct the Issuer Security Trustee to enforce the Issuer Security or any part of it nor take any steps or pursue any action whatsoever for the purpose of recovering any debts due or owing to it by the Issuer or in respect of insolvency proceedings in respect of the Issuer unless the Issuer Security Trustee having become bound to take any steps or proceedings to enforce the Issuer Security fails to do so within a reasonable period of becoming so bound and such failure is continuing (in which case each Issuer Secured Creditor shall be entitled to take any such steps and proceedings as it shall deem necessary provided that an Issuer Secured Creditor (other than Ambac for so long as Ambac is the Issuer Controlling Creditor and the Note Trustee (acting on behalf of the Noteholders)) shall not take any corporate action or other steps or legal proceedings seeking the commencement of insolvency proceedings in respect of the Issuer.

For the avoidance of doubt, the above provision does not prevent Ambac (for so long as Ambac is the Issuer Controlling Creditor or, thereafter, the Noteholders) from directing the Issuer Security Trustee to take steps to obtain payment of amounts payable under the Transaction Documents upon the Issuer Security becoming enforceable, in accordance with the Issuer Deed of Charge.

Other than the foregoing and any interest on the Issuer Accounts, the Issuer will not have any other funds available to it to meet its obligations under the Notes and/or any other payment obligation ranking in priority to, or *pari passu* with, the Notes.

Reliance of InterCo on Reinsurer InterCo Swap Provider, the Liquidity Facility Provider, FPLP and Ambac

The obligation of InterCo to pay interest, InterCo Ongoing Commitment Fees and principal in respect of the InterCo Loan is limited recourse. However, InterCo will not have any assets or funds other than those described in this Offering Circular and, accordingly, in practice the amounts payable on the InterCo Loan are funded solely from, and the Issuer must rely solely on, amounts received by InterCo in respect of the Reinsurer Loan, payments under the Liquidity Facility Agreement, the payments under the InterCo Swap Agreement, the realisation shortly prior to the Class A-2 Notes Final Maturity Date of InterCo Eligible Investments and certain limited further advances from FPLP (to fund expenses (in respect of which the maximum outstanding drawn amount may not exceed £100,000) and certain tax costs and losses arising from default on InterCo Eligible Investments). None of the officers, directors or incorporators of InterCo, the Note Trustee, the Issuer Security Trustee, the Issuer Swap Provider, the Principal Paying Agent, the Agent Bank,

the Issuer Cash Manager, the Issuer Account Bank, the Issuer Administrator, the InterCo Security Trustee, the InterCo Swap Provider, the Liquidity Facility Provider, the InterCo Investment Manager, the InterCo Custodian, the InterCo Cash Manager, the InterCo Account Bank, the InterCo Administrator, the Reinsurer, the Reinsurer Security Trustee, the Reinsurer Swap Provider, the Reinsurer Investment Manager, the Reinsurer Custodian, the Reinsurer Cash Manager, the Reinsurer Account Bank, the Reinsurer Administrator, Ambac, FPLP or any of its affiliates (other than InterCo), or any other company in the same group of companies as, or affiliated to, InterCo will be obliged to make payments on the InterCo Loan.

There can be no assurance that the amounts received under the Reinsurer Loan Agreement, the Liquidity Facility Agreement, the InterCo Swap Agreement, the InterCo Subordinated Loan Agreement or from InterCo Eligible Investments will be sufficient to make payments on the InterCo Loan Agreement after making payments of amounts required to be paid to other creditors ranking senior to or *pari passu* with the obligations under the InterCo Loan Agreement.

InterCo's ability to make payments in respect of the InterCo Loan Agreement will be subject to the terms of the InterCo Deed of Charge. If amounts received under the Reinsurer Loan Agreement, the Liquidity Facility Agreement, the InterCo Swap Agreement, the InterCo Subordinated Loan Agreement and the InterCo Eligible Investments are insufficient to make payments on the InterCo Loan Agreement in accordance with the InterCo Priorities of Payments, InterCo is not expected to have any other assets available for payment of the shortfall.

In addition, none of the Issuer or any other InterCo Secured Creditor, except Ambac (for so long as it is the InterCo Controlling Creditor), may take any steps to direct the InterCo Security Trustee to enforce the InterCo Security or any part of it nor take any steps or pursue any action whatsoever for the purpose of recovering any debts due or owing to it by InterCo or in respect of insolvency proceedings in respect of InterCo unless the InterCo Security Trustee having become bound to take any steps or proceedings to enforce the InterCo Security fails to do so within a reasonable period of becoming so bound and such failure is continuing (in which case each InterCo Secured Creditor shall be entitled to take any such steps and proceedings as it shall deem necessary provided that an InterCo Secured Creditor (other than Ambac for so long as Ambac is the InterCo Controlling Creditor) shall not take any corporate action or other steps or legal proceedings seeking the commencement of insolvency proceedings in respect of InterCo).

For the avoidance of doubt, the above provision does not prevent Ambac (for so long as Ambac is the InterCo Controlling Creditor) directing the InterCo Security Trustee to take steps to obtain payment of amounts payable under the Transaction Documents, upon the InterCo Security becoming enforceable, in accordance with the InterCo Deed of Charge.

Other than the foregoing and any interest on the InterCo Bank Accounts, InterCo will not have any other funds available to it to meet its obligations under the InterCo Loan and/or any other payment obligation ranking in priority to, or *pari passu* with, interest, InterCo Ongoing Commitment Fees and principal of the InterCo Loan.

Reliance of Reinsurer on FPLP, the Reinsurer Swap Provider and Reinsurer Eligible Investments

The obligation of the Reinsurer to pay interest, Reinsurer Ongoing Commitment Fees and principal on the Reinsurer Loan on a Loan Interest Payment Date is contingent on Available Reinsurer Surplus available at the end of the Calculation Period immediately preceding that Loan Interest Payment Date. Available Reinsurer Surplus is based on Reinsurer Regulatory Surplus which will be determined in accordance with regulations from time to time. FPLP has covenanted that it will pay to the Reinsurer additional amounts (including as an addition to the Reinsurer's regulatory capital) so that the Reinsurer Regulatory Surplus plus any Unfunded Regulatory Surplus Deficiency is at least equal to the Available Defined Book Surplus (together with Capital Injections) and Regulatory Surplus Deficiency in respect of the corresponding Calculation Period. The Reinsurer will not have assets other than those described in this Offering Circular and, accordingly, in practice the amounts payable on the Reinsurer Loan are funded solely from, and InterCo must rely solely on, amounts received by the Reinsurer in respect of the Reinsurance Agreement, payments under the Reinsurer Swap Agreement and the income, principal and proceeds of realisation of the Reinsurer Eligible Investments and other investments of the Reinsurer and are subject to there being Available Reinsurer Surplus. None of the officers, directors or incorporators of the Reinsurer, the Note Trustee, the Issuer Security Trustee, the Issuer Swap Provider, the Principal Paying Agent, the Agent Bank, the Issuer Cash Manager, the Issuer Account Bank the Issuer Administrator, InterCo, the InterCo Security Trustee, the InterCo Swap Provider, the Liquidity Facility Provider, the InterCo

Investment Manager, the InterCo Custodian, the InterCo Cash Manager, the InterCo Account Bank, the InterCo Administrator, the Reinsurer Security Trustee, the Reinsurer Swap Provider, the Reinsurer Investment Manager, the Reinsurer Custodian, the Reinsurer Cash Manager, the Reinsurer Account Bank, the Reinsurer Administrator, Ambac, FPLP or any of its affiliates (other than the Reinsurer), will be obliged to make payments on the Reinsurer Loan.

There can be no assurance that there will be Available Reinsurer Surplus or that the amounts realised by the Reinsurer on its Reinsurer Eligible Investments (or any other investments), received from FPLP under the Reinsurance Agreement and from the Reinsurer Swap Provider under the Reinsurer Swap Agreement will be sufficient to give rise to sufficient Reinsurer Available Funds to enable the Reinsurer to make payments of interest, Reinsurer Ongoing Commitment Fees and principal under the Reinsurer Loan Agreement or that the amounts realised on its Reinsurer Eligible Investments (or other investments), received from FPLP under the Reinsurance Agreement and from the Reinsurer Swap Provider under the Reinsurer Swap Agreement will be sufficient to make payments under the Reinsurer Loan Agreement after making payments of amounts required to be paid to other creditors ranking senior to or *pari passu* with obligations under the Reinsurer Loan Agreement.

In addition, the Reinsurer's ability to make payments under the Reinsurer Loan Agreement will be adversely affected if a Claim becomes payable by the Reinsurer to FPLP under the Reinsurance Agreement. Notwithstanding that the Claim ranks below the Reinsurer Loan interest, Reinsurer Ongoing Commitment Fees and principal under the Reinsurer Priorities of Payments, the priority of interest, Reinsurer Ongoing Commitment Fees and principal relates only to amounts of interest, Reinsurer Ongoing Commitment Fees and principal which have become due and which have ceased to be contingent as a result of there having been Available Reinsurer Surplus out of which such amounts are available to be paid.

A Claim will become payable by the Reinsurer to FPLP if any of the Assumed Liabilities under the policies written by FPLP are to be paid by FPLP to its policyholders at a time when FPLP's Long Term Business Reserves in respect of Defined Book Policies are less than or equal to the Adjusted Sum Reinsured. The Assumed Liabilities are the last amounts contractually required to be paid by FPLP to holders of Defined Book Policies, together with associated expenses, but excluding the investment element of linked policies, the investment element of and Mathematical Reserves in respect of unitised with profits policies and the investment element of hybrid policies (to the extent not excluded as part of the investment element of linked policies or unitised with profits policies) which relates to with profits units or unit-linked units. In addition, a Claim will be payable on the Class A-2 Notes Final Maturity Date to the extent that the Adjusted Sum Reinsured remains outstanding. FPLP will, following the Adjusted Sum Reinsured being reduced to zero, be liable to pay Defined Book Surplus to the Reinsurer as an Ongoing Premium to the extent amounts remain payable under the Transaction Documents. In addition, if the Reinsurer commences winding up an amount in respect of the Claim, calculated in accordance with the Insurers (Winding Up) Rules 2001 (see "*-Reinsurer winding up*" below) will become payable (but the payment of, *inter alia*, interest, Reinsurer Ongoing Commitment Fees and principal under the Reinsurer Loan Agreement will remain contingent and therefore will not become due). Accordingly, following payment of, or in respect of, a Claim, the Reinsurer Eligible Investments may no longer be available as collateral for the Reinsurer's obligations under the Reinsurer Loan Agreement (and payment will, accordingly, be subject to credit exposure to FPLP); in addition, as the Reinsurer Swap, InterCo Swap and Issuer Swap will have terminated in whole or part, depending on the circumstances, interest on the Reinsurer Loan and InterCo Loan may be, in whole or in part, depending on the circumstances, at a floating rate; investors will be exposed to the risk that greater Defined Book Surplus will be required to finance interest if such floating rates exceed the fixed rate under the Reinsurer Swap prior to it becoming floating rate, and therefore that the amount of Defined Book Surplus required to pay interest, principal and other fees, costs and expenses is higher than would have been the case if the swaps had not terminated in whole or part.

In addition, none of InterCo or any other Reinsurer Secured Creditor, except Ambac (for so long as it is the Reinsurer Controlling Creditor), may take any steps to direct the Reinsurer Security Trustee to enforce the Reinsurer Security or any part of it nor take any steps or pursue any action whatsoever for the purpose of recovering any debts due or owing to it by the Reinsurer or in respect of insolvency proceedings in respect of the Reinsurer unless the Reinsurer Security Trustee having become bound to take any steps or proceedings to enforce the Reinsurer Security fails to do so within a reasonable period of becoming so bound and such failure is continuing (in which

case each Reinsurer Secured Creditor shall be entitled to take any such steps and proceedings as it shall deem necessary provided that a Reinsurer Secured Creditor (other than Ambac for so long as Ambac is the Reinsurer Controlling Creditor) shall not take any corporate action or other steps or legal proceedings seeking the commencement of insolvency proceedings in respect of the Reinsurer.

For the avoidance of doubt, the above provision does not prevent Ambac (for so long as Ambac is the Reinsurer Controlling Creditor) directing the Reinsurer Security Trustee to take steps to obtain payment of amounts payable under the Transaction Documents upon the Reinsurer Security becoming enforceable, in accordance with the Reinsurer Deed of Charge.

Other than the foregoing and any interest on the Reinsurer Bank Accounts, the Reinsurer will not have any other funds available to it to meet its obligations under the Reinsurer Loan and/or any other payment obligation ranking in priority to, or *pari passu* with, the payment of interest, Reinsurer Ongoing Commitment Fees and principal of the Reinsurer Loan.

Available Defined Book Surplus and Available Reinsurer Surplus

The ability of the Issuer to pay interest and principal on the Notes depends primarily on the receipt of interest, InterCo Ongoing Commitment Fees and principal from InterCo; the ability of InterCo to pay interest, InterCo Ongoing Commitment Fees and principal on the InterCo Loan depends primarily on the receipt of interest, Reinsurer Ongoing Commitment Fees and principal from the Reinsurer. The obligation of the Reinsurer to pay, on a Loan Interest Payment Date, interest, Reinsurer Ongoing Commitment Fees and principal on the Reinsurer Loan is contingent on Available Reinsurer Surplus (being the lower of (a) the Adjusted Regulatory Surplus and (b) Available Defined Book Surplus plus any Regulatory Surplus Deficiency) arising in the Calculation Period ending immediately prior to such Loan Interest Payment Date.

Accordingly, the amount of the interest, Reinsurer Ongoing Commitment Fees and principal on the Reinsurer Loan is dependent first on the amount of Defined Book Surplus, Breach Adjustments, Recapture Reductions and Regulatory Surplus Deficiency (in each case, if any) in a Calculation Period and secondly the Adjusted Regulatory Surplus not being lower than the aggregate of the Available Defined Book Surplus plus any Regulatory Surplus Deficiency.

The determination of Defined Book Surplus and issues relating thereto, including a summary of the principal risks in respect thereof, is described under “*Defined Book Surplus*” below (in particular under “– *Principal Factors Contributing to Defined Book Surplus emerging*” and “– *Principal Risks to the Emergence of Defined Book Surplus*”).

The treatment of Breach Adjustments is described under “*Summary of Transaction Documents – Reinsurance Agreement – Funding of Breaches*” and “– *Breach Adjustments*” below.

The determination of Available Reinsurer Surplus, Adjusted Regulatory Surplus, Reinsurer Regulatory Surplus and Regulatory Surplus Deficiency is described under “*Reinsurer Regulatory Surplus*” below. Very broadly, the surplus of the Reinsurer will increase to the extent that (i) it becomes entitled to the Annual Premiums or Ongoing Premiums or (ii) its obligations under the Reinsurance Agreement are reduced by the recapture of the Assumed Liabilities or (iii) by FPLP making a Capital Injection. It is expected that, under current laws and regulation, the Reinsurer Regulatory Surplus will exceed the Available Defined Book Surplus. To the extent that there are defaults on Reinsurer Eligible Investments, the Reinsurer Eligible Investments yield a return less than the amount payable by the Reinsurer to the Reinsurer Swap Provider under the Reinsurer Swap Agreement, that the Reinsurer Swap Provider does not perform its obligations under the Reinsurer Swap Agreement or there is a change in law which produces a different result the retained surplus may be eroded causing Reinsurer Regulatory Surplus to be less than the Available Defined Book Surplus plus any Regulatory Surplus Deficiency. FPLP has covenanted with, *inter alia*, the Reinsurer and Ambac that, to the extent that the Reinsurer Regulatory Surplus is less than the aggregate of Available Defined Book Surplus plus any Regulatory Surplus Deficiency, FPLP will make Capital Injections into the Reinsurer. This will enable the amounts so injected to be transferred to the Reinsurer’s Long Term Business Fund to remove the deficiency in Reinsurer Regulatory Surplus such that it is not lower than the aggregate of Available Defined Book Surplus and Regulatory Surplus Deficiency.

Risk of default on Reinsurer’s investments: The Reinsurer is required to invest only in Reinsurer Eligible Investments which are required to meet, *inter alia*, certain rating criteria. It is therefore expected that the risk of default on Reinsurer Eligible Investments should be low. The Reinsurer

has, in addition to the £380,000,000 advanced under the Reinsurer Loan and invested in Reinsurer Eligible Investments, an additional £30,000,000 of capital (of which £20 million will be transferred into the Reinsurer's Long Term Business Fund as surplus) subscribed on or before the Closing Date which has been sized to take account of the probability of losses on Reinsurer Eligible Investments. It remains possible that losses may arise, *inter alios* as a result of a default. However, FPLP will bear the risk through a combination of agreeing that the Reinsurer will have sufficient capital to comply with applicable laws and regulations and that the Reinsurer Regulatory Surplus will not be less than the aggregate of the Available Defined Book Surplus together with Capital Injections plus any Regulatory Surplus Deficiency.

Risk of insufficient return on Reinsurer's investments: The notional amount of the Reinsurer Swap will initially be £380,000,000 in respect of which the Reinsurer is required to pay, quarterly, to the Reinsurer Swap Provider three-month LIBOR on such notional amount. The Reinsurer will obtain a return on the Reinsurer Eligible Investments; while this may be at a rate which is below the rate payable on the Reinsurer Swap Agreement, the amount of the Reinsurer Eligible Investments and cash will reflect the proceeds of the Reinsurer Loan and the Reinsurer's capital (which is initially expected to be, in aggregate, £410,000,000), which has been sized to take account of, *inter alia* this risk. It remains possible that insufficient income and gains may arise as a result of the investment management of the Reinsurer. FPLP has agreed that it will bear the risk of an insufficiency of income and gains through a combination of agreeing that the Reinsurer will have sufficient capital to comply with applicable laws and regulations and that the Adjusted Regulatory Surplus will not be less than the Available Defined Book Surplus together with Capital Injections plus any Regulatory Surplus Deficiency.

Risk of Reinsurer Swap Provider default: The Reinsurer Swap Agreement contains provisions which require the Reinsurer Swap Provider at its own cost to transfer its obligations to another person (and, in certain circumstances, to transfer its obligations to Ambac (or such other third party replacement nominated by Ambac), if Ambac exercises its step-in right under the Reinsurer Swap Agreement) or take other action as described in "*Summary of the Transaction Documents – Reinsurer Swap Agreement – Termination Provisions*" in situations which comply with the criteria set by the Rating Agencies for swaps in structured finance transactions (however, there is no requirement to collateralise in such circumstances in view of the interaction of the Reinsurer Swap Agreement, the InterCo Swap Agreement and the Issuer Swap Agreement on termination). The Reinsurer Swap Provider, the InterCo Swap Provider and/or the Issuer Swap Provider, as applicable, will always pay (i) the first leg of the break costs due on partial termination of the swaps and (ii) its scheduled payments under the swap agreements (whether floating or fixed) before receiving the corresponding payment from the Reinsurer, InterCo or Issuer.

Change in law risk: No assurance can be given that the law will not change which could have the result that Reinsurer Regulatory Surplus will be of greater difference to Available Defined Book Surplus plus any Regulatory Surplus Deficiency than would have been the case in the absence of a change in law. As FPLP will retain the benefits of any additional amount paid into the Reinsurer to reflect such risk which remains after the transactions have terminated, FPLP has agreed to bear this risk through a combination of agreeing that the Reinsurer will have sufficient capital to comply with applicable laws and regulations and that the Reinsurer Regulatory Surplus will not be less than the aggregate of the Available Defined Book Surplus together with Capital Injections plus any Regulatory Surplus Deficiency.

In addition to the obligation of the Reinsurer to pay interest, Reinsurer Ongoing Commitment Fees and principal on the Reinsurer Loan being contingent on the lower of (a) the Adjusted Regulatory Surplus and (b) the Available Defined Book Surplus plus any Regulatory Surplus Deficiency arising in the Calculation Period ending immediately prior to such Loan Interest Payment Date, the ability of the Reinsurer to pay its obligations (including the interest, Reinsurer Ongoing Commitment Fees and principal on the Reinsurer Loan) is subject to the Reinsurer having sufficient Reinsurer Available Funds (after paying or providing for amounts ranking higher in the Reinsurer Priorities of Payments) to pay such interest, Reinsurer Ongoing Commitment Fees and principal on the Reinsurer Loan. The amount of the Reinsurer Available Funds is dependent on the ability of the Reinsurer Investment Manager to realise sufficient Reinsurer Eligible Investments so that cash equal to the amount of the obligations of the Reinsurer to the Reinsurer Secured Creditors (and those other amounts payable in accordance with the Reinsurer Priorities of Payments) can be transferred to the Reinsurer Transaction Account for payment to the Reinsurer Secured Creditors. There can

be no assurance that the Reinsurer Investment Manager will be able to realise such assets so as to achieve such objective.

Breach Adjustments and Capital Injections

FPLP gives certain representations and covenants in respect of itself and the Reinsurer under the Reinsurance Agreement. Certain representations (and the covenants not to transfer the Defined Book Policies) may result in the Reinsurance Agreement being terminated by the Reinsurer (acting at the direction of the Reinsurer Controlling Creditor). Where a breach of representation or covenant does not give rise to termination of the Reinsurance Agreement, FPLP will be required to make a payment in respect of such breach as determined in accordance with the provisions of the Reinsurance Agreement and in some cases the Issuer may be required to increase the premium payable to Ambac.

Where FPLP is required to make a payment in respect of a breach, there are two types of payments – Breach Adjustment and Capital Injections. A “**Breach Adjustment**” means together: (A) FPLP shall owe such amount as would, upon being received by the Reinsurer, have the effect of reversing the effect on the Reinsurer Regulatory Surplus of (i) the relevant Part A Breach or Part B Breach or (ii) in the case of the Base Case Warranty, the Aggregate Base Case Breach Amount or (iii) or, in the case of a Part B Breach, if higher, the amount of damages (plus costs and interest) awarded in respect of the relevant Part B Breach (each such amount a “**Repurchase Amount**”); and (B) to the extent that FPLP has not paid the Repurchase Amount to the Reinsurer by the Payment Date immediately following the end of the relevant Calculation Period, the Reinsurer’s reinsurance obligations shall be reduced by an amount equal thereto, by way of reduction in the Adjusted Sum Reinsured (but not so as to reduce the Adjusted Sum Reinsured to less than zero). Whether liability arises in relation to a breach in certain cases is subject to materiality thresholds. However liability to remedy a Conduit Breach is not subject to such thresholds and any Capital Injection in respect thereof must be made on a pound for pound basis; likewise, the covenant given by FPLP that its group reinsurers will perform their obligations is not subject to any threshold.

A Breach Adjustment will be added to the amount of Defined Book Surplus and is taken into account in calculating the Recapture Amount under the Reinsurance Agreement which shall be used to recapture Assumed Liabilities.

A Capital Injection will result in additional funds being paid to the Reinsurer’s Shareholder Fund. FPLP undertakes to ensure that the Reinsurer Regulatory Surplus is not lower than the Available Defined Book Surplus plus any Regulatory Surplus Deficiency and any Capital Injection taken into account in the relevant Calculation Period and accordingly to the extent required the amount may be transferred to the Reinsurer’s Long Term Business Fund (where it will be included in the computation of surplus). To the extent this occurs following the end of the Calculation Period in respect of which the amount should have been paid by FPLP, there may be a delay in the related surplus arising until the end of the Calculation Period in which it is done, in which event the deficiency will increase the amount of Regulatory Surplus Deficiency at the end of the next Calculation Period.

Expense inflation

The principal risks to which the Defined Book Surplus is exposed are summarised in “*Defined Book Surplus – Principal risks to the Emergence of Defined Book Surplus*”. One of these risks is that expenses are higher than those projected in the Base Case. This could be due to inflation being higher than projected. Certain expenses under the Defined Book Surplus are increased at a rate linked to RPI (or RPI plus one per cent. per annum). To mitigate the risk that expense inflation may be higher than projected, resulting in lower Defined Book Surplus, on 10 December 2004 FPLP entered into the Inflation Hedge (which is an asset of the Defined Book) with Barclays Bank PLC to hedge some of the inflation risk relating to the expenses determined for the purpose of calculating the Defined Book Surplus. The Inflation Hedge is designed to hedge expenses projected to arise under the assumption for lapse set out in Scenario 3 under “*Sensitivity Analysis*”; the notional principal of the Inflation Hedge is, therefore, set at the expenses projected for each Calculation Period to be the expenses using Scenario 3 under the “*Sensitivity Analysis*” under which the Defined Book will receive RPI on the notional principal of the Inflation Hedge and will pay 3.1 per cent. per annum on the notional principal of the Inflation Hedge, thereby hedging the inflation risk to the extent the expenses correspond to that notional amount. As the expenses subject to inflation are determined by the Scheme, the accuracy of the Inflation Hedge is primarily a function of lapse

of Defined Book Policies being different from that assumed for the purposes of the Base Case, resulting in under or over hedging depending on the circumstances; while using Scenario 3 under the “*Sensitivity Analysis*” will result in the inflation hedge being, initially, an under-hedge (compared with the Base Case Assumptions relating to lapse), this is considered preferable to the expenses being over-hedged in a more stressed lapse situation when the effect of over-hedging adverse inflation could be to further reduce Defined Book Surplus at a time when the Defined Book Surplus can least afford to be further reduced. There can be no assurance that the Inflation Hedge will not adversely affect the amount of Defined Book Surplus compared to what it would have been in the absence of an Inflation Hedge (for example, where inflation is lower than 3.1 per cent. per annum).

FPLP has covenanted in the Reinsurance Agreement, *inter alia*, (i) not to terminate the Inflation Hedge without Ambac’s consent and (ii) to allocate the Inflation Hedge to the Defined Book (breach of which will result in a Breach Adjustment or a Capital Injection).

Under the Scheme certain expenses are fixed to 31 December 2009 (subject to inflation described elsewhere in this Offering Circular). There can be no assurance that when this period expires expenses will not increase above the level prevailing prior to that date. However, under the Scheme (and the Defined Book Surplus calculation) such expenses must following 31 December 2009 be set at a rate determined by FPLP which may at no time exceed the charges for similar services made by third party companies and may at no time significantly exceed the costs the With Profits Fund would incur if FPLP were to undertake such services itself and the only business of FPLP were that comprised in the With Profits Fund.

Limited Liquidity of Notes and Restrictions on Transfer

There is currently no market for the Notes and there can be no assurance that such a market will develop. In addition, there can be no assurance that any secondary market will provide the holders of Notes with liquidity of investment or will continue for the life of such Notes. Consequently, a purchaser must be prepared to hold such Notes for an indefinite period of time and potentially until their Maturity Date. In addition, such Notes are subject to certain transfer restrictions. Such restrictions on the transfer of such Notes may further limit their liquidity. See “*Subscription and Sale*”.

Suitability

Prospective purchasers of Notes should ensure that they understand the nature of such Notes and the extent of their exposure to risk, that they have sufficient knowledge and experience, and access to professional advisers to assist them, to make their own legal, tax, accounting, regulatory and financial evaluation of the merits and risks of investment in such Notes and that they consider the suitability of such Notes as an investment in the light of their own circumstances and financial condition.

Ratings of the Notes

The ratings assigned to the Notes by the Rating Agencies are based on the value of the Defined Book Surplus and other relevant structural features of the transaction, including, *inter alia*, the long-term, unsecured, unsubordinated and unguaranteed debt ratings of FPLP and the rating of Ambac’s financial strength, in respect of Scheduled Interest and Ultimate Principal due on the Notes, and reflect only the views of the Rating Agencies. The ratings of the Notes address (i) the full and timely payment to the Noteholders of all payments of interest on the Notes on each Interest Payment Date, and (ii) the full and ultimate repayment to the Noteholders of all principal on the Notes on the Final Maturity Date.

There can be no assurance that any such ratings will continue for any period of time or that they will not be reviewed, revised, suspended or withdrawn entirely by the Rating Agencies as a result of changes in or unavailability of information or if, in the Rating Agencies’ judgment, circumstances so warrant. Future events, including events affecting FPLP, the Reinsurer or Ambac, or circumstances relating to the policies, the Defined Book Surplus or the life assurance and pensions industry generally, could also have an adverse impact on the ratings of the Notes. **A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation.**

Ranking of the Notes

The terms on which the security for the Notes will be held will provide that, upon acceleration of amounts owing under the Notes, payments will rank in the order set out in the Issuer Post-

Acceleration under Condition 3(h) below. There is no assurance that these subordination provisions will protect the holders of the Notes from risk of loss.

Subordination

Payment of interest and principal on the Notes is subordinate to certain fees, costs and expenses, to payments to the Issuer Swap Provider under the Issuer Swap Agreement, to certain payments in respect of break costs to InterCo, to certain payments to Ambac under the Issuer Guarantee and Reimbursement Agreement and to payments to FPLP in respect of interest on the Expenses Loan.

Certain payments by InterCo to the Issuer under the InterCo Loan are also subject to subordination under the terms thereof and the InterCo Deed of Charge.

Relationship between Noteholders

Interest on the Class A-1 Notes and the Class A-2 Notes ranks rateably and *pari passu*. Prior to the service of a Note Acceleration Notice no payment of principal on the Class A-2 Notes will be made until the Class A-1 Notes have been redeemed in full. On and following the service of a Note Acceleration Notice, interest and principal of the Class A-1 Notes and the Class A-2 Notes ranks rateably and *pari passu* amongst themselves.

Following service of a Note Acceleration Notice all interest, principal and other amounts due to the Class A-1 Noteholders and the Class A-2 Noteholders will be paid to them *pro rata* to the Principal Amount Outstanding irrespective of whether they hold Class A-1 Notes or Class A-2 Notes. Circumstances could potentially arise in which the interests of the holders of the Class A-1 Notes and the Class A-2 Notes could differ (for example, as to whether the Issuer Security should be enforced, or whether the Note Trustee should take or refrain from taking any other action). The Trust Deed will provide that the Note Trustee will (except as expressly provided otherwise) at all times have regard to the Class A-1 Notes and the Class A-2 Notes as a single class. The Trust Deed and the terms and conditions of the Notes will also provide that any direction given to the Note Trustee shall be given by the requisite number of Noteholders without differentiating between the Class A-1 Notes and Class A-2 Notes. The Trust Deed will also provide that, except in the case of an Extraordinary Resolution which in the opinion of the Note Trustee affects the interests of the Class A-1 Noteholders and the Class A-2 Noteholders and gives or may give rise to a conflict of interest between the Class A-1 Noteholders and the Class A-2 Noteholders, any matter to be considered by or resolved at any meeting of the Noteholders will not be required to be passed at separate meetings of the holders of the Class A-1 Notes and the Class A-2 Notes and that at any meeting of the Noteholders the same voting rights will attach to the Class A-1 Notes and the Class A-2 Notes. The Note Trustee will not be required to consider the consequences of any action taken or refrained from being taken by it on any single class of Notes.

Mandatory Redemption

The Issuer is required, prior to the service of a Note Acceleration Notice, on each Interest Payment Date to apply the Issuer Available Funds, after paying or providing for higher ranking amounts in the Issuer Pre-Acceleration Priority of Payments, in redeeming the Notes, the Class A-1 Notes being redeemed before principal on the Class A-2 Notes is payable.

The time at which principal will be repaid, and the amount of principal which will be repaid, will depend to a large extent on the speed at which Defined Book Surplus emerges under the Reinsurance Agreement. The amount of the Defined Book Surplus, and the time at which it emerges depends on a number of factors (see "*Defined Book Surplus*" below).

Optional Redemption for tax and change in law

If FPLP so requests and if the Issuer at any time satisfies the Note Trustee and (for so long as Ambac is the Issuer Controlling Creditor) Ambac that:

- (i) (I) FPLP under the Reinsurance Agreement, the InterCo Subordinated Loan Agreement or the Expenses Loan Agreement, (II) the Reinsurer under the Reinsurance Agreement, the Reinsurer Loan Agreement or the Reinsurer Swap Agreement, (III) InterCo under the Reinsurer Loan Agreement, the InterCo Subordinated Loan Agreement, the InterCo Swap Agreement, the InterCo Loan Agreement, the Issuer Subordinated Loan Agreement, the InterCo Deposit Agreement, the Liquidity Facility Agreement, the InterCo Ambac Fee Letter or the InterCo Guarantee and Reimbursement Agreement, (IV) the Issuer under the Notes, the InterCo Loan

Agreement, the Issuer Subordinated Loan Agreement, the InterCo Deposit Agreement, the Issuer Swap Agreement, the Issuer Ambac Fee Letter or the Issuer Guarantee and Reimbursement Agreement, (V) the Reinsurer Swap Provider under the Reinsurer Swap Agreement, (VI) the Issuer Swap Provider under the Issuer Swap Agreement, (VII) the InterCo Swap Provider under the InterCo Swap Agreement, (VIII) the Liquidity Facility Provider under the Liquidity Facility Agreement, (IX) Ambac under the Ambac Note Financial Guarantee, the Ambac Liquidity Financial Guarantee, the Ambac Issuer Swap Financial Guarantee or the Ambac InterCo Swap Financial Guarantee, in each case would be required to withhold or deduct any amount for or on account of any present or future taxes, duties, assessments or governmental charges of any nature imposed, levied, collected, withheld or assessed by the United Kingdom or any political sub-division of it or any authority of it or in it; or

- (ii) the Issuer, InterCo or the Reinsurer, by reason of a change in tax law (or in the application or official interpretation of any tax law), would not be entitled to relief for tax purposes in the United Kingdom for any amount which it is obliged to pay and which is treated as an expense in its profit and loss account, or would be treated as receiving for tax purposes in the jurisdiction of tax residency of the Issuer, InterCo or the Reinsurer as applicable, an amount which it was not entitled to receive, under the Issuer Swap Agreement, the InterCo Swap Agreement or the Reinsurer Swap Agreement as applicable; or
- (iii) by reason of a change in law (or the application or official interpretation thereof), it has become or will become unlawful in the United Kingdom for (I) the Issuer to make, fund or allow to remain outstanding all or any advances made or to be made by it under the InterCo Loan Agreement, (II) InterCo to make, fund or allow to remain outstanding all or any advances made or to be made by it under the Reinsurer Loan Agreement or the Issuer Subordinated Loan Agreement, (III) the Liquidity Facility Provider to make, fund or allow to remain outstanding all or any advances made or to be made by it under the Liquidity Facility Agreement or (IV) FPLP to make, fund or allow to remain outstanding all or any advances made or to be made by it under the InterCo Subordinated Loan Agreement,

then the Issuer shall, if to do so would avoid the relevant event described in (i), (ii) or (iii) above, use all reasonable endeavours to arrange a substitution of another company (including, if necessary a company incorporated in another jurisdiction) as principal debtor under the Notes, which substitution is approved in writing by the Note Trustee and subject to obtaining (i) the consent of Ambac (for so long as Ambac is the Issuer Controlling Creditor) and (ii) confirmation from the Rating Agencies that the ratings of the Notes (including the Unguaranteed Rating) in effect immediately prior to substitution would not be adversely affected by such substitution.

The Issuer may only redeem the Notes in such circumstances if it has given not less than 30 nor more than 60 days notice (or in the case of an event described in (iii) above, such shorter period expiring on or before the latest date permitted by relevant law) to the Note Trustee and Noteholders in accordance with Condition 17, on the next following Interest Payment Date and conditional on the Issuer having satisfied the Note Trustee and Ambac (for so long as Ambac is the Issuer Controlling Creditor) that such event has occurred. There can be no assurance that the Issuer would be able to obtain the funds to redeem the Notes other than if the Reinsurance Agreement had also terminated (see below).

A redemption of the Notes may not occur unless two directors of the Issuer certify to the Note Trustee and Ambac (for so long as Ambac is the Issuer Controlling Creditor) that it will have sufficient funds on the proposed redemption date to redeem all the Notes and to pay all amounts in the Issuer Post-Acceleration Priority of Payments required to be paid in priority to, or *pari passu* with, and including the Notes.

The Notes shall be redeemed at par together with accrued unpaid interest.

Redemption following termination of the Reinsurance Agreement

Under the Reinsurance Agreement, FPLP may give notice in writing to the Reinsurer to terminate the Reinsurance Agreement with immediate effect following the occurrence of a Regulatory Event or a Tax Event. “**Regulatory Event**” means (a) FPLP ceasing to be able, under PRU 7.3, to disregard some or all of the cash outflows deriving from surplus which are to be applied under the Reinsurance Agreement; (b) the Reinsurance Agreement ceasing to be treated, in whole or in part, as counting towards FPLP’s Regulatory Capital Requirement; (c) the Reinsurer Loan ceasing to be treated, in whole or in part, as counting towards the Reinsurer’s Regulatory Capital Requirement; or

(d) any change in Applicable Law (or the application or official interpretation thereof) occurring which leads to the transaction contemplated by the Transaction Documents becoming, in the reasonable opinion of the board of FPLP, inefficient or uneconomic, or which in the reasonable opinion of the FPLP board of directors results in such transaction no longer achieving its intended purpose.

Termination may only occur if (i) FPLP satisfies the Solvency Condition both at the time of and immediately after such termination; and (ii) sufficient funds will be received by (a) the Issuer (through InterCo) to enable it to redeem the Notes at their Principal Amount Outstanding together with all accrued unpaid interest and to pay its other obligations under the Transaction Documents in full; and (b) the Reinsurer and InterCo to enable them to pay all their obligations under the Transaction Documents (other than the Reinsurance Agreement) in full.

The Reinsurance Agreement may not be terminated other than as described above and except for certain misrepresentations, breach of the covenant not to transfer the Defined Book Policies and failure to Calculate Defined Book Surplus and/or pay Premiums. If the Reinsurance Agreement is terminated, the Reinsurer will cease to be required to hold assets backing the reserves maintained in respect of the Reinsurance Agreement, the Calculation Period will terminate and, in respect of such Calculation Period, the Reinsurer is required to pay interest, Reinsurer Ongoing Commitment Fees and principal equal to the lower of such amount accrued and outstanding and the Adjusted Regulatory Surplus. To the extent any interest, Reinsurer Ongoing Commitment Fees and principal remain outstanding, FPLP will be required to pay an ongoing premium to the Reinsurer equal to Available Defined Book Surplus which will give rise to Reinsurer Regulatory Surplus enabling the Reinsurer, to the extent of such amounts, to discharge all of its remaining obligations (including any contingent obligations).

Redemption upon enforcement

Following service of an Issuer Enforcement Notice, the Notes will be redeemable in accordance with the Issuer Post-Acceleration Priorities of Payments set out in Condition 3(k). Acceleration of the Notes does not of itself accelerate the InterCo Loan or the Reinsurer Loan and accordingly it is likely that the Issuer will be unable to redeem the Notes (unless Ambac exercises its right to make payments in respect of acceleration of the Notes, which is at Ambac's sole discretion).

Withholding Tax

Under current law all payments in respect of the Notes will be made free from any withholding or deduction for or on account of any tax imposed in the United Kingdom subject as provided in "*Taxation – Interest on the Notes*".

However, there can be no assurance that the law or practice will not change. In the event that withholding of any tax from any payment by the Issuer in respect of the Notes is required by law or practice in any jurisdiction, neither the Issuer nor Ambac will be obliged to pay any additional amount to Noteholders in respect of such imposition or withholding.

Under current law and practice, payments under the Transaction Documents may be made without withholding or deduction for or on account of tax of the United Kingdom (or any political subdivision thereof). There can be no assurance that this will remain the case.

If such tax is required to be withheld or deducted no party shall be liable to pay any additional amounts in respect thereof save that if the withholding or deduction is required in respect of amounts paid by:

- (i) the Reinsurer under the Reinsurer Loan Agreement, the Reinsurer Deed of Charge, the Reinsurer Account Bank Agreement and the Reinsurer Cash Management Agreement;
- (ii) InterCo under the Reinsurer Loan Agreement, the InterCo Loan Agreement, the Liquidity Facility Agreement, the InterCo Guarantee and Reimbursement Agreement, the InterCo Deed of Charge, the InterCo Account Bank Agreement and the InterCo Cash Management Agreement;
- (iii) the Issuer under the InterCo Loan Agreement, the Issuer Guarantee and Reimbursement Agreement, the Issuer Deed of Charge, the Agency Agreement, the Issuer Account Bank Agreement and the Issuer Cash Management Agreement;
- (iv) Ambac to Noteholders under the Ambac Note Financial Guarantee (but see "*Form of Ambac Note Financial Guarantee*" below),

then, subject to the qualifications described in this Offering Circular, the party making the payment shall pay such additional amount (or, in the case of the InterCo Loan Agreement and the Reinsurer Loan Agreement make a loan equal to the tax withheld) as will result in the recipient receiving the amount it would have received had no such withholding or deduction been required. Such additional payments, in the case of (i), (ii) and (iii), may in some cases directly or indirectly affect the amount of Issuer Available Funds, which may adversely affect the ability of the Issuer to pay interest and principal under the Notes.

Rights of Ambac

Under the Issuer Priorities of Payments, any Issuer Financial Guarantee Fees due and payable to Ambac under the Issuer Ambac Fee Letter are senior in right of payment to any payment of interest on or principal of the Notes. Ambac is required to make payments of Scheduled Interest and Ultimate Principal on the Notes and the Issuer Swap Fixed Amounts under the Issuer Swap Agreement. To the extent that Ambac makes a payment of a claim under the Ambac Note Financial Guarantee or the Ambac Issuer Swap Financial Guarantee, the Issuer's reimbursement obligation for such payment will be immediately due and payable, together with interest thereon.

In certain circumstances arising from breach of representation or covenant, the premium payable by the Issuer to Ambac will double to reflect the additional risk. The increase in the premium will reduce the amount available to be paid to creditors ranking lower in the Issuer Priorities of Payment (which includes payments of principal on the Notes, though the Notes remain guaranteed for Scheduled Interest and Ultimate Principal by Ambac).

Under the InterCo Priorities of Payments, any guarantee fees due and payable by InterCo to Ambac under the InterCo Ambac Fee Letter are senior in right of payment to any payment of interest and InterCo Ongoing Commitment Fees on or principal of the InterCo Loan. Ambac is required to make payments of the InterCo Swap Fixed Amounts under the InterCo Swap Agreement and certain payments under the Liquidity Facility Agreement under, respectively, the Ambac InterCo Swap Financial Guarantee and the Ambac Liquidity Financial Guarantee. To the extent that Ambac makes a payment of a claim under either of the Ambac InterCo Swap Financial Guarantee or the Ambac Liquidity Financial Guarantee, InterCo's reimbursement obligation for such payment will be immediately due and payable, together with interest thereon. Such reimbursement obligations will reduce the amount of InterCo Available Funds available to pay amounts ranking *pari passu* with or junior to such reimbursement obligations and accordingly could adversely affect the amount of principal paid on the InterCo Loan and may, therefore, adversely affect the interest and principal payable on the Notes.

Under the Trust Deed Ambac has certain rights to require the Note Trustee to act as directed (other than with respect to any Issuer Basic Terms Modification or Issuer Reserved Matters). When acting at the direction of Ambac (if Ambac is then, or the Note Trustee is entitled to assume that Ambac is then, the Issuer Controlling Creditor), the Note Trustee shall have no duty to take into account the interest of Noteholders and no liability for acting in accordance with such directions.

In addition, Ambac will generally be the Issuer Controlling Creditor, the InterCo Controlling Creditor and the Reinsurer Controlling Creditor under the Issuer Deed of Charge, the InterCo Deed of Charge and the Reinsurer Deed of Charge, respectively, as to which see below under “– *Rights of the Issuer Controlling Creditor, the InterCo Controlling Creditor and the Reinsurer Controlling Creditor*” below.

Rights of the Issuer Controlling Creditor, the InterCo Controlling Creditor and the Reinsurer Controlling Creditor

The right to direct the Issuer Security Trustee, the InterCo Security Trustee and the Reinsurer Security Trustee to take certain action, including, *inter alia*, to enforce the security created under the Issuer Deed of Charge, the InterCo Deed of Charge and the Reinsurer Deed of Charge, respectively, is given to, in the case of the Issuer Deed of Charge, the Issuer Controlling Creditor, in the case of the InterCo Deed of Charge, the InterCo Controlling Creditor and in the case of the Reinsurer Deed of Charge, the Reinsurer Controlling Creditor. So long as no Ambac Termination Event has occurred, Ambac will be (i) the Issuer Controlling Creditor (other than in respect of any Issuer Basic Terms Modifications and Issuer Reserved Rights, in respect of which the Note Trustee will be the Issuer Controlling Creditor), (ii) the InterCo Controlling Creditor (other than in respect of InterCo Basic Terms Modifications and InterCo Reserved Rights in respect of which the InterCo Controlling Creditor will be the Noteholders (insofar as it relates to the InterCo Loan Agreement),

the Liquidity Provider (insofar as it relates to the Liquidity Facility Agreement or the Ambac Liquidity Financial Guarantee), the InterCo Swap Provider (insofar as it relates to the InterCo Swap Agreement or the Ambac InterCo Swap Financial Guarantee) and FPLP (insofar as it relates to the InterCo Subordinated Loan Agreement) and (iii) the Reinsurer Controlling Creditor (except in certain circumstances relating to the failure by the Reinsurer to pay a Claim under the Reinsurance Agreement to FPLP). Ambac, as the Issuer Controlling Creditor, the InterCo Controlling Creditor and the Reinsurer Controlling Creditor has no obligation to have regard to the interests of the Noteholders or any of the Issuer Secured Creditors, the InterCo Secured Creditors or the Reinsurer Secured Creditors; and the Note Trustee will not have regard to the interests of any Noteholders or any other Issuer Secured Creditor when acting on the instructions of Ambac.

Consents to variations of Transaction Documents and other matters

In relation to certain matters and the variation of the terms of the Transaction Documents the consent of the Consenting Parties (or, in the case of the Reinsurance Agreement, the parties to that agreement) is required. The consent of the Noteholders is not required in respect of all such matters. In certain circumstances the Issuer Security Trustee, the InterCo Security Trustee, the Reinsurer Security Trustee and the Note Trustee (as applicable) will be obliged to give such consent if certain conditions are met. In certain circumstances, Ambac will have the right to direct the Note Trustee as to how it exercises its rights under the Transaction Documents (other than in respect of Reserved Matters or Basic Terms Modifications). Ambac as the Issuer Controlling Creditor has no obligation to have regard to the interests of the Noteholders or any of the Issuer Secured Creditors and the Note Trustee will not have regard to the interests of any Noteholders or any other Issuer Secured Creditor when acting on the instructions of Ambac.

Where a particular matter (including the determination of material prejudice by the Issuer Security Trustee, the InterCo Security Trustee, the Reinsurer Security Trustee or the Note Trustee and changes to certain of the operational covenants) involves the Rating Agencies being requested to confirm the then current ratings of the Notes or the Unguaranteed Rating, such confirmation may or may not be given by the Rating Agencies. Any such confirmation, if given, will be given on the basis of the facts and circumstances prevailing at the relevant time, and in the context of cumulative changes to the transaction since the Closing Date. A confirmation of ratings represents only a restatement of the ratings given at the Closing Date and should not be construed as advice for the benefit of any parties to the transaction. No assurance can be given that a requirement to seek ratings confirmation will not have a subsequent impact upon the business of the Issuer.

Projections, Forecasts and Estimates

Any projections, forecasts and estimates contained herein (including those in relation to the Base Case) are forward looking statements and are based upon certain assumptions. Projections are necessarily speculative in nature, and it can be expected that some or all of the assumptions underlying the projections will not materialise or will vary significantly from actual results. Accordingly, the projections are only an estimate. Actual results are likely to vary from the projections, and the variations may be material.

Interest Rate Risk

On the Closing Date, the Issuer will enter into the Issuer Swap Agreement to hedge the fixed rate amounts receivable by it under the InterCo Loan for floating amounts payable under the Notes. If at any time the Issuer Swap becomes subject to early termination, the Issuer will seek to obtain a replacement swap on substantially similar terms, or on such other terms as would not adversely affect the ratings of the Notes with, in each case, the prior written consent of Ambac (for so long as Ambac is the Issuer Controlling Creditor). There can be no certainty that a replacement would be found.

On the Closing Date, InterCo will enter into the InterCo Swap Agreement to hedge the fixed rate interest accruing on unpaid interest on the Reinsurer Loan for three month LIBOR (ignoring any margin) payable on drawings under the Liquidity Facility (or on any claims paid by Ambac under the Ambac Liquidity Financial Guarantee). If at any time the InterCo Swap Agreement becomes subject to early termination, InterCo will seek to obtain a replacement swap on substantially similar terms, or on such other terms as would not adversely affect the ratings of the Notes with, in each case, the prior written consent of Ambac (for so long as Ambac is the InterCo Controlling Creditor). There can be no certainty that a replacement would be found.

On the Closing Date, the Reinsurer will enter into the Reinsurer Swap to hedge three month LIBOR into the fixed rate amounts payable by it under the Reinsurer Loan. If at any time the Reinsurer Swap becomes subject to early termination, the Reinsurer will seek to obtain a replacement swap on substantially similar terms, or on such other terms as would not adversely affect the ratings of the Notes with, in each case, the prior written consent of Ambac (for so long as Ambac is the Reinsurer Controlling Creditor). There can be no certainty that a replacement would be found.

Each of the Issuer Swap Agreement, the InterCo Swap Agreement and the Reinsurer Swap Agreement contains an additional termination event which will result in all such agreements being subject to early termination if one of them is terminated. In such a case interest on the Reinsurer Loan and the InterCo Loan will become payable at a rate equal to LIBOR, which is included in the calculation of, respectively, the Reinsurer Ongoing Commitment Fee and the InterCo Ongoing Commitment Fee). As interest and Reinsurer Ongoing Commitment Fees on the Reinsurer Loan are payable only annually, the interest determined for each Interest Period will be compounded at the applicable LIBOR rate until it is paid. Interest and Reinsurer Ongoing Commitment Fees will remain payable only out of Reinsurer Available Funds, in accordance with the Reinsurer Priorities of Payment and only to the extent of Available Reinsurer Surplus (in the case of the Reinsurer Loan) and interest and InterCo Ongoing Commitment Fees will only be payable out of InterCo Available Funds, in accordance with the InterCo Priorities of Payments (in the case of the InterCo Loan). Interest, expenses and InterCo Ongoing Commitment Fees payable by InterCo on each quarterly Interest Payment Date which is not also the annual Loan Interest Payment Date will be funded out of drawings on the Liquidity Facility until the Liquidity Facility is fully drawn.

If a Claim is made by FPLP which reduces the Adjusted Sum Reinsured below the aggregate Principal Amount Outstanding on the Notes, the notional amount of the Issuer Fixed/Floating Swap will be terminated in part (and a corresponding termination of part of the Reinsurer Swap will occur). Interest will accrue at LIBOR on the principal amount of the Reinsurer Loan equal to the Reinsurer Floating Principal Amount and will be payable annually (subject to there being Available Reinsurer Surplus and Reinsurer Available Funds after paying amounts ranking higher in the Reinsurer Priorities of Payments). In such a case a corresponding amount of principal on the InterCo Loan (the InterCo Floating Principal Amount) will accrue interest at LIBOR, payable quarterly to the extent it can be funded out of drawing on the Liquidity Facility. If interest accrues on the Reinsurer Loan or InterCo Loan at a floating rate, then if the floating rate of interest exceeds the fixed rate which would otherwise have been payable, it will be necessary for a greater amount of Available Defined Book Surplus to arise to repay the same amount of principal on the Notes than would have been the case had the Reinsurer Loan and InterCo Loan continued to accrue interest at a fixed rate. This may adversely affect the time and amount of interest and ongoing commitment fees paid and principal repaid on the Reinsurer Loan and the InterCo Loan and, accordingly, interest paid and principal repaid on the Notes.

Hedge Accounting for the Issuer Swaps and the InterCo Swap

The question whether a transaction qualifies for hedge accounting under the provisions of International Accounting Standard 39 ("IAS 39") needs to be determined each year by reference to a number of factors.

The Issuer expects to be able to account for each of the Issuer Fixed/Floating Swap and the Issuer Funding Swap as a cash flow hedge or as a fair value hedge under IAS 39. If, however, such treatment ceases to be appropriate for these swap transactions, the relevant transactions would need to be accounted for on a fair value basis (in accordance with applicable financial reporting standards). This may result in the swaps being required to be brought into the income statement at their fair value. This could have adverse consequences depending on the circumstances at the time.

InterCo expects to be able to account for the InterCo Swap as a cash flow hedge or as a fair value hedge under IAS 39. If, however, such treatment ceases to be appropriate for the swap transaction, the relevant transaction would need to be accounted for on a fair value basis (in accordance with applicable financial reporting standards). This may result in the swap being required to be brought into the income statement at its fair value. This could have adverse consequences depending on the circumstances at the time.

Average Life and Duration of the Notes

The Final Maturity Date of the Class A-1 Notes is 15 April 2016 and of the Class A-2 Notes is 15 April 2019; however, the average life of each Class of Notes is expected to be shorter than the number of years until their respective Final Maturity Date. Average life refers to the average amount of time that will elapse from the date of delivery of a debt obligation until each Pound Sterling of the principal of such debt obligation will be paid to the Noteholder. The average lives of each Class of Notes will be determined by the amount and frequency of principal payments in respect of such Notes, which are dependent upon, among other things, the speed at which the Defined Book Surplus emerges (as to which see "*Defined Book Surplus*" below).

Based on the Base Case, the average life of the Class A-1 Notes issued on the Closing Date would be expected to be 2.8 years and the average life of the Class A-2 Notes issued on the Closing Date would be expected to be 5.7 years.

The approximations in the preceding paragraph are not predictive; in fact, the actual average lives of the Notes will be affected by various factors as referred to above. See "*Defined Book Surplus*" below.

In addition, the Notes may also mature earlier than expected in the event of a mandatory redemption (as described in Condition 6(b)) or an optional redemption (as described in Condition 6(c)). See "*Mandatory Redemption*", "*Optional Redemption by FPLP*" and "*Optional Redemption*" above.

Investment management risk of Reinsurer and InterCo

The Reinsurer Investment Manager is required in the Reinsurer Investment Management Agreement to invest the assets of the Reinsurer in Reinsurer Eligible Investments, which (i) meet certain ratings and other criteria designed to reduce the risk of default of the obligor in respect of such Reinsurer Eligible Investments (see the definition of Reinsurer Investment Criteria), (ii) yield a rate of return based on 3 month GBP-LIBOR-BBA (as such term is defined in the ISDA 2002 Definitions) as set on each Note Interest Payment Date and to return the principal so invested and (iii) manage its liquidity with a view to ensuring that it has sufficient cash available to pay its obligations as they fall due (ignoring any limit on recourse and assuming sufficiency of Reinsurer Available Funds to pay such obligations) (see the definition of Reinsurer Investment Criteria). There can be no assurance that the Reinsurer Investment Manager will be able to achieve this or that the Reinsurer Eligible Investments will either not default or be realisable at an amount corresponding to their acquisition cost (excluding any purchased or sold accrued interest). In any such cases, the Reinsurer may not have sufficient funds available to it to fund its obligations without using its capital unless FPLP performs in accordance with its obligations under certain covenants in the Reinsurance Agreement.

The InterCo Investment Manager is required in the InterCo Investment Management Agreement to invest in InterCo Eligible Investments, which are sterling denominated debt securities carrying (generally) a fixed rate of interest and redeemable no earlier than October 2018. There can be no assurance as to what rate such securities will yield and accordingly no assurances as to what value the InterCo Reserve Account will contribute to the InterCo Available Funds.

Forthcoming changes to the United Kingdom Regulatory Regime

FPLP and Reinsurer are insurance companies and subject to regulation under FSMA and subordinate legislation. The regulatory regime applicable to insurance companies, including that for determining the solvency margin required for insurance companies, is subject to change from time to time.

Introduction

The current regulatory capital regime for UK authorised insurance companies is derived from various EU directives, and has been in place for many years. In the UK the detailed rules implementing the EU regime are found in the FSA's Interim Prudential Sourcebook for Insurers ("*IPRU(INS)*"). This basically reproduces the rules that were previously contained in the Insurance Companies Act 1982, the Insurance Companies Regulations 1994 and other secondary legislation, which were repealed when FSMA came into force in December 2001.

As its name suggests, IPRU(INS) is an interim measure; the FSA is drawing together the capital rules for insurers, banks and investments firms into an Integrated Prudential Sourcebook ("*IPS*").

The IPS will not just replicate the existing rules, it will introduce significant changes to the current regime (see below). The FSA has announced that the IPS will come into effect for insurers at the end of 2004. The final form rules in the IPS as it applies to insurers were considered by the FSA Board on 18 November 2004 and published on 22 November 2004.

The current regulatory capital regime

Under the current rules set out in IPRU(INS) an insurer must maintain a margin of regulatory capital – the required minimum margin (“RMM”). In simple terms the RMM is a specified surplus of assets over the insurer’s liabilities. One third of the RMM, or the fixed amount specified in the rules, whichever is higher, is the guarantee fund. This is the absolute minimum level of surplus required by the regulatory capital regime. The RMM, assets covering the RMM and liabilities are all calculated according to the rules laid down in IPRU(INS).

The formula for the RMM differs depending upon whether the insurer is writing life or non-life insurance business. The precise formula also varies for different classes of business. For class 1 life insurance, for example, the RMM is broadly a fixed percentage of the mathematical reserves added to a fixed percentage of the capital at risk. Mathematical reserves are, in effect, the insurer’s provisions for its life insurance liabilities. For with-profits, for example, these will include the benefits guaranteed to policyholders and an implicit allowance for future bonuses. The manner in which these liabilities must be calculated is specified in IPRU(INS). The general principle is that long term liabilities must be determined on actuarial principles and with due regard for the reasonable expectations of policyholders.

Mathematical Reserves are based on a calculation of expected future cash flows from in-force business. Cash flows comprise anticipated future premiums and anticipated benefit payments payable by the insurer to policyholders. Using a discount rate derived from a rate of return on assets, future cash flows are discounted back to a net present value to give the mathematical reserves. The future cash flows and discount rates are adjusted to cater for possible adverse deviations.

An insurer has to hold sufficient assets to cover its Mathematical Reserves and RMM. However, not all assets are admissible for this purpose. Assets have to be valued in accordance with valuation rules contained in IPRU(INS). Any asset that does not have a corresponding valuation rule is inadmissible. In addition, even assets that have a valuation rule are limited in the extent to which they are admissible. Exposures to asset categories in excess of the limits set out in IPRU(INS) are inadmissible for regulatory capital purposes.

There are certain other types of asset which, with the consent of the FSA, an insurer can use to cover its reserves and RMM. In particular, implicit items, such as expected future profits, can be used if the FSA grants the insurer a waiver from the rule which requires implicit items to be left out of account.

At the beginning of 2004 the basic EU regulatory capital regime was modified by two EU directives, known as Solvency 1 (one directive amends the life requirements, the other the non-life requirements). The Solvency 1 Directive made relatively minor adjustments to the existing regime, for example, increasing the fixed euro amount of the minimum guarantee fund.

The Integrated Prudential Sourcebook – the future capital regime

The FSA has been concerned that the existing insurance regulatory capital regime does not adequately reflect the various risks to which insurers are subject, and it has announced changes to the requirements for both life and non-life insurers. These will be contained in the IPS, which will replace IPRU(INS) for insurers with effect from the end of 2004. The final form rules in the Integrated Prudential Sourcebook as it applies to insurers were considered by the FSA Board on 18 November 2004 and published on 22 November 2004 in Policy Statement 04/24.

The approach of the IPS is to identify the various risks to which insurers are subject, such as credit risk, market risk, operational risk and insurance risk. Some of these risks, such as operational risk, are addressed in the IPS by way of guidance on the systems and controls which insurers should put in place to mitigate the risk. Other risks, in particular insurance risk, have an explicit capital requirement. The IPS requirements will supplement, rather than replace, the EU regime. The FSA cannot allow a UK authorised insurer which is covered by the EU directive to hold less capital than would be required under the directives. The directive-based regulatory capital regime will, therefore, continue to set the minimum capital requirement.

The FSA will require companies to carry out an Individual Capital Assessment (“ICA”), based on which the FSA will be able to vary each insurer’s regulatory capital requirements. This will assist the FSA to provide Individual Capital Guidance (“ICG”) to firms on a confidential basis. ICG will be set with reference to the specific business and control risks faced by each company and will take account of each company’s ICA and any margins elsewhere in the business. Companies that can demonstrate that they have identified and have assessed their risk and have appropriate controls to mitigate those risks are expected to receive a lower ICG.

Twin Peaks

For life insurers with with-profits business the IPS will contain some significant changes to the current regulatory capital regime. These changes focus on the calculation of reserves. They require a comparison of the reserves calculated using a modified version of the current rules against a calculation based on a new realistic basis. The FSA has termed this the “twin peaks” approach.

Under the realistic peak, a with-profits insurer must calculate a realistic present value of its expected future contractual liabilities together with projected “fair” discretionary bonus payments to policyholders. The assessment of what is a “fair” discretionary bonus payment will depend upon what the policyholders’ reasonable expectations are. These in turn are linked to the FSA’s new requirements on with-profits governance and, in particular, the requirement that as from 30 April 2004 with-profits insurers have had to publish a document called the Principles and Practices of Financial Management setting out how the insurer intends to exercise its discretion under with-profits policies.

The FSA will also require an additional margin or buffer to be added to the realistic reserve calculation to cater for risk. Called the risk capital margin (“RCM”), this will address risk factors, such as market, credit and persistency risks, the effect of which could render the realistic calculation insufficient.

Under the FSA’s proposals the resilience test, which is currently an adjustment to the mathematical reserves, will become an explicit capital requirement, which will apply to all long term insurance business, not just with-profits business. If the calculation of the realistic peak, including the RCM, produces a reserving requirement in excess of the Mathematical Reserve peak including the Long Term Insurance Capital Requirement (“LTICR”) and the resilience capital requirement then the difference will give rise to a further capital requirement, the with profits insurance capital component (“WPICC”) to cover the difference.

The capital requirements

Under the IPS, the capital resources requirements (“CRR”) for insurers will consist of the sum of the various different capital components. For insurers with with-profits liabilities the CRR will comprise: the LTICR (an adjusted version of the current RMM); the resilience capital requirement; and the with-profits insurance capital component. For long term insurers with non-profit liabilities the capital requirement will consist of the LTICR and the resilience capital requirement, in each case, subject to the minimum capital requirements set by the EU directives.

Friends Provident plc will be categorised as an insurance holding company. The Insurance Groups Directive (“IGD”) introduced new supervisory arrangements for insurance companies falling within a group, including a supplementary capital calculation to be performed at parent company level. Analogous to the solvency test applied to individual insurers, this calculation takes into account net assets of the parent and its share of surplus assets of its related insurers, reinsurers and intermediate holding companies. The IGD does not impose any capital requirement on the parent undertaking itself, but merely requires the calculation to be performed. Any regulatory response must then be directed at the level of the regulated insurance subsidiary. This approach was adopted by the FSA on implementation of the directive in IPRU(INS).

In October 2003, the FSA published a consultation paper on implementation of the Financial Groups Directive (CP204), in which it proposed that the parent company solvency calculation for EEA insurance groups become a “hard” capital requirement, rather than a reporting obligation. However, in PS04/20, containing feedback on CP204, the FSA indicated that it was considering this issue further and would publish a supplementary policy statement in due course. This statement was issued on 22 November 2004 in PS 04/24 and confirms that the “hard” capital requirement at parent company level will come into effect on 31 December 2006. The parent company solvency calculation will be a public reporting requirement from 31 December 2005.

The IGD contains further provisions for monitoring intra-group transactions, including at least annual reporting of significant transactions. Insurers must also be required to have appropriate internal control mechanisms to allow the production of data/information relevant to supervision under the IGD.

In the case of FPLP, see “*FPLP – Financial position of FPLP and its subsidiaries*” below.

The amount of capital of the Reinsurer will, on the Closing Date, be £30 million, which is in excess of the capital expected to be required for the Reinsurer under the existing and new regimes.

Group capital: Policy Statement 04/24 (Insurance Groups) sets out the new regulatory capital test that will be applied at the level of the holding company of an insurance group from January 2005. Its purpose is to ensure that Friends Provident Group has sufficient capital to support all its operations. The test will be applied at the level of Friends Provident plc. PS 04/24 also modifies the regulatory capital test in respect of FPLP by modifying the capital treatment of its insurance subsidiaries. It is expected that FPLP will comply comfortably with the requirement.

Solvency II: There are additional EU proposals relating to capital adequacy, commonly referred to as “*Solvency II*”; however, few details have been published and they are not expected to be required to be implemented until 2009 at the earliest. Accordingly it is not possible to determine whether they may have any effect on FPLP or the Reinsurer.

Products, sales and changes to pensions regime: The precise nature and extent of any impact on FPLP of changes to the regimes for sales, lower charging products and the pension regime cannot at this stage be determined. Alternative products, in particular those with lower fees, or changes to the regime for the tax treatment of pensions or changes to the state pensions regime may result in lapse rates being higher than would otherwise be the case or, possibly, in FPLP reducing fees with a view to managing the lapse position. Either of these may reduce the Defined Book Surplus below the levels they would otherwise have been.

Changes to the regulation of the Reinsurer

The Insurance Committee of the European Union has set up a reinsurance sub-group to investigate how reinsurance supervision is performed in the EU and whether harmonised rules are necessary in this area. Under the current draft Reinsurance Directive, solvency requirements for life reinsurance are identical to those for direct life business. This aspect of the directive has been particularly controversial as it is expected to have a significant impact on the capital requirements of pure reinsurers. Pure reinsurers falling within a group will also be subject to group capital requirements. It is currently expected that the directive is likely to be adopted by the European Commission by the end of 2005 and implemented in the UK from 2007 at the earliest.

If there is a change in the regulation of reinsurance business in the United Kingdom, there could be no assurance that the Reinsurer would be able to comply with the then applicable regulatory requirements, including authorisation requirements or any associated capitalisation requirements that could be attached to an authorisation. Additionally, even if the Reinsurer were to comply with such additional regulatory requirements, any increased costs of regulatory compliance could adversely affect the Reinsurer and could consequently affect Noteholders. However, FPLP has covenanted to ensure that capital resources of the Reinsurer at all times meet the applicable regulatory capital or capital ratios required by the FSA and to ensure that Reinsurer Regulatory Surplus in respect of a Calculation Period is not less than the Available Defined Book Surplus together with Capital Injection plus any Regulatory Surplus Deficiency.

Changes to insurance accounting regime

Following a recent EU directive it will be mandatory for all UK listed companies to prepare consolidated financial statements which comply with International Financial Reporting Standards in relation to accounting periods beginning on or after 1 January 2005. This will apply to reported financial results rather than surplus and accordingly would not, under current law, affect the determination of the Defined Book Surplus. (See under “*Hedge accounting for the Issuer Swap and the InterCo Swap*” for matters relating to accounting for such transactions under IAS 39).

In addition, in November 2003 an Association of British Insurers’ Statement of Recommended Accounting Practice (“*SORP*”) was issued, replacing an earlier statement of recommended practice for insurers. It no longer allows insurers/reinsurers to hold as an asset the present value of in-force

business (“PVIF”) (that is, Defined Book Surplus). This will result in the PVIF of the Reinsurer not being recognised as an asset, creating a deficit in the Reinsurers accounts.

European Monetary Union

It is possible that prior to the maturity of the Notes, the United Kingdom may become a participating member state in the European Economic and Monetary Union and that the Euro may become the lawful currency of the United Kingdom. Adoption of the Euro by the United Kingdom may have the following consequences: (a) all amounts payable in respect of the Notes may become payable in Euro; (b) the published or displayed rates for deposits in Sterling used to determine the rates of Interest on the Notes may disappear or the way those rates are calculated, quoted, published or displayed may change and (c) applicable provisions of law may allow the Issuer to redenominate the Notes into Euro and take additional measures in respect of the Notes. It cannot be said with certainty what effect, if any, adoption of the Euro by the United Kingdom would have on investors in the Notes.

The adoption of the Euro would result in additional costs for FPLP to convert its systems to operate with the Euro. Such costs have not been quantified but would not be included in the calculation of the Defined Book Surplus.

Security

- (a) **Fixed Charge:** Although the security constituted by the Issuer Deed of Charge, the InterCo Deed of Charge and Reinsurer Deed of Charge over the assets of, respectively, the Issuer, InterCo and the Reinsurer held from time to time, including the security over their respective bank accounts, is expressed to take effect as fixed security, it may (as a result, *inter alia*, of the payments to be made from their respective bank accounts in accordance with the Conditions and the Issuer Deed of Charge, the InterCo Deed of Charge and the Reinsurer Deed of Charge, respectively) take effect as a floating charge which, in particular, would rank after a subsequently created fixed security interest. However, each of the Issuer, InterCo and the Reinsurer has covenanted not to create any such subsequent security interests without the consent of Ambac (for so long as Ambac is, as relevant, the Issuer Controlling Creditor, the InterCo Controlling Creditor or the Reinsurer Controlling Creditor) and unless the Rating Agencies have confirmed that such actions would not adversely affect the then current ratings of any of the Notes (ignoring the Ambac Note Financial Guarantee).
- (b) **Governing Law of the Security:** The Issuer Deed of Charge, the InterCo Deed of Charge, the Reinsurer Deed of Charge and security interests created pursuant to each of them are governed by English law. Some of the obligations subject to such security may be governed by the laws of jurisdictions other than England and which require different and/or additional procedures and/or documentation to create or perfect any security interest. The Issuer Deed of Charge, the InterCo Deed of Charge and the Reinsurer Deed of Charge contain a further assurance clause under which the Issuer, InterCo or the Reinsurer, as applicable, agrees to take such further action as the Issuer Security Trustee, the InterCo Security Trustee or Reinsurer Security Trustee may require to ensure that it creates valid security over its assets in favour of the Issuer Security Trustee, the InterCo Security Trustee or Reinsurer Security Trustee.

Insolvency Act 2000

Significant changes to the English insolvency regime have recently been enacted. These include the Insolvency Act 2000 (the “**Insolvency Act**”) the majority of which came into force in April 2001, other than the moratorium provision (as described below), which came into force on 1 January 2003. The Insolvency Act allows certain “small” companies (which are currently defined by reference to certain tests relating to a company’s balance sheet, turnover and average number of employees) to seek protection from their creditors for a period of 28 days with the option for creditors to extend the moratorium for a further two months. The position as to whether or not a company is a “small” company may change and consequently no assurance can be given that the Issuer will not, at any given time, be determined to be a “small” company.

The Secretary of State for Trade and Industry may modify the eligibility requirements for “small” companies by regulation and can make different provisions for different cases. Under that power the Secretary of State passed the Insolvency Act 1986 (Amendment) (No 3) Regulations 2002 (SI 2002 No 1990), which introduced three new eligibility criteria which make a company ineligible to

obtain a moratorium if (i) it is a party to a capital markets arrangement (as therein defined); (ii) it is a project company of a public private partnership (PPP) project which includes step-in rights (as therein defined); or (iii) it has incurred a liability of £10,000,000 under an agreement. These regulations came into force on 1 January 2003. None of the Issuer, InterCo or the Reinsurer is a “small company” within the current definition. However, as the Secretary of State has the power to make further modifications to the eligibility requirements of “small” companies, no assurance can be given that any such modification or different provisions will not be detrimental to the interests of Noteholders.

Enterprise Act 2002

The provisions of the Enterprise Act 2002 (the “**Enterprise Act**”) amending the corporate insolvency provisions of the Insolvency Act 1986 came into force on 15 September 2003. As a result of these amendments, the holder of a qualifying floating charge created on or after 15 September 2003 will be prohibited from appointing an administrative receiver (and consequently will be unable to prevent the chargee entering into administration) unless the qualifying floating charge falls within certain exceptions. As the Reinsurer Deed of Charge, the InterCo Deed of Charge and the Issuer Deed of Charge are being entered into after 15 September 2003, the Reinsurer Security Trustee, the InterCo Security Trustee and the Issuer Security Trustee will not be entitled to appoint an administrative receiver over the assets of, respectively, the Reinsurer, InterCo or the Issuer unless the relevant floating charge falls within one of the exceptions.

One such exception is in respect of, in certain circumstances, the appointment of an administrative receiver pursuant to an agreement which is or forms part of a “capital markets arrangement” (which is broadly defined in the Insolvency Act 1986). This exception will apply if a party incurs or, when the agreement in question was entered into was expected to incur, a debt of at least £50,000,000 and if the arrangement involves the issue of a “capital market investment” (also defined in the Insolvency Act 1986 but generally a rated, listed or traded bond). Although there is as yet no case law on how this exception will be interpreted, the Reinsurer, InterCo and the Issuer each consider that the exception will be applicable to the transactions described in this Offering Circular. However, the Secretary of State for Trade and Industry may, by secondary legislation, modify the exceptions to the prohibition on appointing an administrative receiver and/or provide that the exception shall cease to have effect. No assurance can be made that any such modification or provisions in respect of the capital market exception will not be detrimental to the interests of the Noteholders.

Other amendments made to the corporate insolvency provisions of the Insolvency Act 1986 by virtue of the Enterprise Act include (a) the ring fencing, on the commencement of insolvency proceedings in respect of a company, of a certain percentage of the realisations from assets secured by a floating charge (after the payment of preferential creditors), such realisations to be used to satisfy unsecured debts; (b) the abolition of the categories of preferential debt payable to the Crown, including debts due to the Inland Revenue in respect of PAYE, debts due to H.M. Customs and Excise in respect of VAT and social security contributions; and (c) the replacement of the existing administration regime in its entirety with a new, streamlined administration procedure.

By virtue of the relevant prescribing order, the ring fencing of a percentage of certain floating charge realisations for the benefit of unsecured creditors applies to floating charges which are created on or after 15 September 2003. The amount available for unsecured creditors will depend upon the value of the chargor’s “net property”, being the amount of the chargor’s property which would be available for satisfaction of debts due to the holder(s) of any debentures secured by a floating charge. The prescribing order provides for 50 per cent. of the net property under £10,000 and 20 per cent. of net property over £10,000 to be made available for the satisfaction of the chargor’s unsecured debts, subject to an overall cap on the ring fenced fund of £600,000. However, the relevant provisions do not apply to any charge created or otherwise arising under a financial collateral arrangement within the Financial Collateral Arrangements (No. 2) Regulations 2003 (the “**Financial Collateral Regulations**”).

Accordingly, with respect to the floating charge granted under each of the Reinsurer Deed of Charge, the InterCo Deed of Charge and the Issuer Deed of Charge respectively, floating charge realisations upon the enforcement of the security created under the Deed of Charge will be reduced by the operation of the ring fencing provisions, to the extent the relevant charge is created or otherwise arises under a financial collateral arrangement within the Financial Collateral Regulations.

Insolvency of FPLP and the Reinsurer

The general insolvency laws of the United Kingdom applicable to companies are modified in certain respects in relation to insurance companies. An insurer effecting or carrying out contracts of long-term insurance may not be wound up voluntarily without the consent of the Financial Services Authority. Unless a court otherwise orders (a stop order), a liquidator must carry on the insurer's business so far as it consists of carrying out the insurer's contracts of long-term insurance with a view to its being transferred as a going concern to a person who may lawfully carry out those contracts. A court may, in place of making a winding up order where an insurance company has been proved unable to pay its debts, reduce the amount payable under the contracts of the insurance company on such terms and subject to such conditions as it thinks just. In addition, where an insurance company is in financial difficulties including liquidation, the Board of the Financial Services Compensation Scheme has certain powers, including the duty to take measures for securing the transfer of all or part of the business to another insurance company provided it is reasonably practicable to do so.

FPLP being in financial difficulties or insolvent is likely to affect adversely the amount of the Defined Book Surplus and may affect the ability to recover amounts owed by FPLP to the Reinsurer (including by way of Annual Premium). The Reinsurer has no security over any assets of FPLP and would therefore be an unsecured creditor. As the obligations of FPLP to the Reinsurer do not constitute an insurance debt of a direct insurer, if there were any Annual Premium or other amounts payable by FPLP to the Reinsurer not subject to security (or arrangements which have the effect of providing security), preferred creditors and creditors in respect of insurance debts (broadly, obligations under a direct contract of insurance to the policyholder of such contract) would rank in priority thereto. The impact of the insolvency of FPLP on the timing of emergence or amount of the Defined Book Surplus is difficult to determine and will depend on the circumstances at the time. In principle, the policies would be valued in accordance with the Insurers (Winding Up) Rules 2001 and to the extent that FPLP's obligations as valued by those Rules to Defined Book Policyholders fall to be reinsured by the Reinsurer under the Reinsurance Agreement, FPLP would be able to claim in accordance with the terms of the Reinsurance Agreement (subject to any set off).

The Reinsurer being in financial difficulties or insolvent at a time when FPLP is not is considered to be an unlikely event. First, the Reinsurer's obligations to the Reinsurer Secured Creditors is subject to provisions limiting recourse to the assets of the Reinsurer; secondly, the Reinsurer Secured Creditors have agreed with the Reinsurer, *inter alia*, not to commence winding up proceedings against the Reinsurer; thirdly, the Reinsurer has agreed not to enter into any transactions or agreements not contemplated by the Transaction Documents to which it is a party; and fourthly, FPLP has covenanted to ensure that the Reinsurer complies with applicable laws, which includes maintaining capital at at least the minimum level required by laws and regulation. However, in the event that the Reinsurer were to go into winding up, FPLP would be entitled to prove in the winding up for the value of its claim under the Reinsurance Agreement; such amount would be a secured obligation of the Reinsurer under the Reinsurer Deed of Charge and, accordingly, the assets which may otherwise have been available to be realised to pay interest, Reinsurer Ongoing Commitment Fees and principal to InterCo may have been realised and paid to FPLP. FPLP will, however, remain under an obligation under the Reinsurance Agreement to continue to pay Defined Book Surplus to the Reinsurer, though such amounts will be unsecured claims of the Reinsurer against FPLP (however, if FPLP fails to pay the Annual Premium within the specified time, the Reinsurer may give notice to terminate the Reinsurance Agreement). The Reinsurer's obligations to the Reinsurer Secured Creditors will, however, remain subject to the Reinsurer Deed of Charge.

Change of Law

The structure of the issue of the Notes and the ratings which are to be assigned to them are based on English law in effect as at the date of this document. No assurance can be given as to the impact of any possible change to English law or administrative practice in the United Kingdom after the date of this document.

Investors to consider laws and regulations applicable to an acquisition of Notes

Prospective purchasers should consult their own advisers as to the consequences to and effect on them of the acquisition of the Notes under all applicable taxation, accounting, legal and regulatory provisions, including the potential application of the new Basel Capital Accord proposals.

Taxation

Tax payable by the Issuer, InterCo and the Reinsurer

The level of taxable profit arising in the Reinsurer, in InterCo and the Issuer assumed in the projections on which the Class A-1 Base Case Amortisation Profile and the Class A-2 Base Case Amortisation Profile have been based may in practice prove to be incorrect. In particular, where a company fails to discharge certain taxes due and payable by it within a specified time period, UK tax law imposes in certain circumstances (including where that company has been sold so that it becomes controlled by another person) a secondary liability for those overdue taxes on other companies which have controlled or have been under common control with the company that has not discharged its primary liability to pay that tax. Such a secondary liability could arise in the Reinsurer, InterCo and the Issuer.

FPLP has given certain covenants, including a covenant to ensure that Reinsurer Regulatory Surplus is not less than the Available Defined Book Surplus (together with Capital Injections) plus any Regulatory Surplus Deficiency in the corresponding Calculation Period and a covenant to ensure that, at all times, the Reinsurer's capital resources are sufficient to meet the applicable regulatory capital or capital ratios required by the FSA. Unexpected tax charges in the Reinsurer may affect Reinsurer Regulatory Surplus. If FPLP fails to comply with such covenants the amount of Reinsurer Regulatory Surplus and/or capital resources will be lower than would otherwise have been the case, which may result in less Reinsurer Ongoing Commitment Fees and principal being paid at such time on the Reinsurer Loan. This could adversely affect Noteholders.

Under the InterCo Subordinated Loan Agreement, FPLP will make an advance to InterCo of an amount equal to any payment for or on account of tax which it is required to pay in respect of an accounting period which is in excess of the daily weighted average standard rate of corporation tax in the accounting period in respect of which the tax is payable on an amount equal to 0.01 per cent. per annum of the principal amount outstanding of the Reinsurer Loan (the "excess"). To the extent that advances equal to the excess are not made to InterCo pursuant to the InterCo Subordinated Loan Agreement this would adversely affect InterCo Available Funds available to be paid to those ranking *pari passu* with or lower than the obligation to pay tax in the InterCo Priorities of Payments and could consequently adversely affect Noteholders.

Interco Ongoing Commitment Fees payable by Interco to the Issuer under the Interco Loan Agreement (and Reinsurer Ongoing Commitment Fees payable by the Reinsurer to Interco under the Reinsurer Loan Agreement) will be increased for an amount equal to any payment for or on account of tax payable by the Issuer to the extent that tax payable by the Issuer exceeds corporation tax at the appropriate rate on annual profits equal to the higher of 0.75 basis points of the principal amount outstanding under the Notes and £7,000 (plus an amount equal to VAT which would be payable at the then current standard rate on an amount of £7,000). To the extent that Interco Ongoing Commitment Fees payable by Interco to the Issuer are not paid this would adversely affect Issuer Available Funds available to be paid to those ranking *pari passu* with or lower than the obligation to pay tax in the Issuer Priorities of Payments and could consequently affect Noteholders.

The directors of the Issuer consider that, taking account of the circumstances in which any such secondary liability as is mentioned above could arise and the features of the Transaction Documents referred to above, adequate protection is provided for Noteholders in relation to these and other unexpected tax charges.

2004 Pre-Budget Report

On 2 December 2004 the Inland Revenue published a draft statutory instrument, intended to be effective from 1 January 2005 and draft legislation for inclusion in the Finance Bill next year. These set out changes to the life insurance tax legislation. Two of the proposed changes may have a significant effect for some life insurance companies: these are the proposals relating to the taxation of the investment return from realistic excess capital in with-profit funds and the proposals relating to the recognition for tax purposes of revenue accounts (Forms 40). These proposals have resulted in representations from the life insurance industry and the final form of any changes to the legislation is uncertain.

Nevertheless, on the basis of the published proposals, the directors of the Issuer and the Reinsurer consider that the Available Reinsurer Surplus will be unaffected by the proposals noted above as the Reinsurer does not conduct with-profits business and it has a single Form 40.

In addition, the directors of FPLP consider that the Defined Book Surplus will be unaffected by the proposed changes to life insurance tax legislation.

DEFINED BOOK SURPLUS

Introduction

The principal source of funds available to the Issuer for it to fund payment of interest and principal on the Notes each year (after taking account of payments and receipts under the Issuer Swap) is the amount paid by InterCo under the InterCo Loan on the Loan Payment Date in such year. The principal source of funds available to InterCo is the amount paid by the Reinsurer under the Reinsurer Loan on the Loan Payment Date in such year. The ability of the Reinsurer to pay interest and Reinsurer Ongoing Commitment Fees on and principal of the Reinsurer Loan is primarily determined by reference to the amount by which its reserves are reduced as a result of Available Defined Book Surplus emerging in FPLP (being Defined Book Surplus plus any Breach Adjustments less any Recapture Reduction) in respect of the immediately preceding Calculation Period.

This section first gives an overview of Defined Book Surplus (see “– *Overview of Defined Book Surplus*”) and then a summary of how the Defined Book Surplus is determined (see “– *Calculation of Defined Book Surplus for the purpose of the Reinsurance Agreement*”). It then summarises the principal categories of policy which were in-force at 31 May 2004 and comprised within the Defined Book (being Conventional Non Profit Life Business, Conventional Non Profit Pensions Business, Unit Linked Business and Unitised With Profits Business) (see “– *Policy Categories*” below). A summary of certain features of the principal policies within each category from which Defined Book Surplus is projected to arise is contained in Appendix 5.

Following the overview and summary of Defined Book Surplus and summary of policy categories is a summary of the principal ways in which Defined Book Surplus arises on the different categories of policy.

The contribution of the principal items contributing to surplus emerging in a Calculation Period is summarised below under “– *Principal Factors Contributing to the Emergence of Defined Book Surplus*”. The principal risks in relation to surplus emerging are then dealt with in the sub-section below headed “– *Principal Risks to the Emergence of Defined Book Surplus*”.

Overview of Defined Book Surplus

The demutualisation of FPLO was effected by obtaining court and members’ approval in June 2001 for the scheme of transfer by which FPLO transferred its policyholder and other liabilities to FPLP in accordance with Schedule 2C to the Insurance Companies Act 1982 (the “**Scheme**”).

Under the terms of the Scheme, FPLP was established with a long-term business fund (the “**FPLP Long Term Business Fund**”) and a shareholder fund (the “**FPLP Shareholder Fund**”). Within the FPLP Long Term Business Fund, two sub-funds, the With Profits Fund and the Non Profit Fund, were established.

In addition, the Scheme implicitly required two further sub-funds within the With Profits Fund, referred to, for the purpose of this Offering Circular, as the “**Defined Book**” and “**The With Profits/With Profits Fund**”:

- **The Defined Book:** The Defined Book contains all of the policies transferred from FPLO at the time of demutualisation, excluding permanent health (“**PHI**”) insurance policies (which were transferred to the Non Profit Fund) and conventional with profits policies. The Defined Book comprises conventional non profit life and pensions policies, unit linked life and pensions policies and unitised with profits life and pensions policies, excluding the investment element thereon (see below). The Defined Book will be the subject of the Reinsurance Agreement.
- **The With Profits/With Profits Fund:** This sub-fund contains conventional with profits policies transferred from FPLO at the time of demutualisation and the investment element (including guarantees in respect of bonuses declared) of unitised with profits life and pensions policies in the Defined Book. This fund also contains the investment element (including guarantees in respect of bonuses declared) of post-demutualisation unitised with profits business that was written in both the Non Profit Fund and FPLP’s subsidiaries and reassured to the With Profits Fund under internal reinsurance arrangements.

Under the terms of the Scheme, which were approved by the court at demutualisation and which were amended by the court on 29 July 2004, a formula (set out in Schedule 3 to the Scheme, see “– *Summary of Defined Book Surplus*” below) was established for determining surplus from the

Defined Book, where assets of a value equal to the surplus arising from the Defined Book are attributable as follows:

- 60 per cent. is attributable to the Non Profit Fund for the benefit of shareholders;
- 40 per cent. is attributable to (i.e. retained in) the With Profits/With Profits Fund for the benefit of the With Profits policyholders.

As the Defined Book Policies were written prior to demutualisation, the determination of the amount of the surplus arising from the Defined Book is calculated in accordance with the rules governing the demutualisation.

The Scheme requires that the calculation of surplus amounts arising on the Defined Book policies is to be undertaken on an annual basis (the “**Calculation Period**”) in accordance with the formula set out in Schedule 3 to the Scheme (the “**Schedule 3 Surplus**”) (see below).

Minor changes were made to the Scheme by a court order dated 29 July 2004 enabling, *inter alia*, the Schedule 3 Surplus to be calculated taking into account the Reinsurance Agreement.

Summary of Schedule 3 Surplus

Each year FPLP determines the Schedule 3 Surplus.

The Schedule 3 Surplus for each Calculation Period is intended to be the surplus emerging on all pre-demutualisation policies transferred by the Scheme which were in force at any time during the Calculation Period (other than conventional with profits policies and PHI policies), i.e. the Defined Book. For each Calculation Period, the Schedule 3 Surplus is computed as the aggregate of the following:

premiums less, in the case of linked policies or unitised with profits policies, the investment element of those premiums plus any emerging annual management charges due from the linked funds including, in respect of unitised with profits policies, notional annual management charges equal to the annual management charge which is applicable to the corresponding linked policy at the date the Scheme became effective (the “**Effective Date**”)

plus

investment income and gains received or accrued which are attributable to the statutory reserves of policies excluding any unit linked reserves

plus

risk premiums charged to unitised with profits policy or linked policy units

plus

any amount received in respect of, or reduction in non linked reserves resulting from, a reinsurance or other transaction in respect of, or relating to, all or any category of Schedule 3 policies, being a transaction:

- (1) of which notice has been given to the Financial Services Authority and either the Financial Services Authority has, before the expiration of the period of one month beginning with the date on which it received such notice, notified FPLP that it does not object to the transaction being designated for the purposes of Schedule 3 to the Scheme, or that period has elapsed without the Financial Services Authority having served on FPLP written notice of objection to such designation; and
- (2) which has been designated for the purposes of Schedule 3 to the Scheme by the FPLP Board (a “**Designated Transaction**”)

less

aggregate of any amounts paid or repaid to a reinsurer or other party pursuant to a Designated Transaction and any increase in non linked reserves resulting from recapture of liabilities under a Designated Transaction

less (or plus) as the case may be

increase (or reduction) in non linked reserves in respect of Schedule 3 policies arising from any factor other than a Designated Transaction

less

claims less, in the case of linked policies or unitised with profits policies, the investment element of those claims

less

expenses determined in accordance with Schedule 2 to the Scheme attributable to the Schedule 3 Policies

less

amount (if any) by which the Schedule 3 Surplus in respect of the previous year was negative.

The Reinsurance Agreement is a Designated Transaction for the purposes of the Scheme.

Premiums, claims, non linked reserves, expenses and attributed investment income and gains taken into account in determining the Schedule 3 Surplus shall be calculated net of amounts attributable to reinsurances (other than any Designated Transaction, unless the FPLP Board specifies otherwise at the time it designates the relevant transaction) on the basis which the FPLP Board regards as appropriate.

Investment income, gains and expenses taken into account in this calculation shall be adjusted for policyholder tax attributable thereto on the basis which the FPLP Board regards as appropriate.

Broadly, there are two types of reserves: unit reserves for the unit linked component of the unit linked policies and non-unit (or sterling) reserves.

Unit reserves for unit linked policies are determined by reference to the unit pricing policy of the life assurance company. An essential feature of unit linked policies and unitised with profits policies is that policyholders' investment benefits are determined solely by the performance of the funds whose units are allocated to the relevant unit linked policy or unitised with profits policy. Accordingly, as changes in unit reserves and unitised with profits investment element reserves do not affect surplus directly, as any increase or decrease effectively accrues to the benefit of the policyholders, they are excluded from the calculation. The performance of those funds effectively contributes to surplus only to the extent of charges (such as the actual or (in the case of unitised with profits policies) notional annual management charge) levied on those funds.

Non-unit (or sterling) reserves are reserves for expected future claims and expenses to the extent not covered by expected future premiums and policy charges, taxes due and tax reliefs, and investment income on assets backing such reserves and are calculated as the discounted value of a forward projection on a policy-by-policy basis. No allowance is currently made for the possibility that a policy will discontinue early unless such a calculation would result in an increase in reserves. Non-unit reserves are calculated on a prudent basis using prudent parameters.

The Schedule 3 Surplus calculation was devised to reflect the statutory basis for surplus calculation. However, Schedule 3 Surplus may differ from the equivalent surplus arising on a statutory basis in the ways described below. This is because part of the impact on statutory reserves is reflected in results outside the Defined Book due to implicit reinsurance or expense agreements in respect of:

- determination of attributable expenses;
- the cost of unitised with profits investment guarantees in respect of previous bonus declarations.

Determination of Attributable Expenses

Expenses will be allocated to the Defined Book in accordance with formulae stipulated in the Scheme. The Scheme contains detailed recharging provisions regarding the maintenance, termination, and investment management expenses which will be allocated to the With Profits Fund in respect of the Defined Book Policies.

Under the Scheme, until 31 December 2009, maintenance and termination expenses will be based on those incurred by FPLO in 2000, increased each year by the change in the Retail Prices Index (the "RPI") plus 1 per cent. per annum or, in certain specified instances, by RPI only. After 31 December 2009, the Scheme dictates that these expenses will not exceed the market rate charges for similar services.

In effect, this meant that the Schedule 3 Surplus would not be subject to variance in expenses (other than that associated with changes in the RPI) before 2010. From 2010, expenses under the Scheme will be charged to the Defined Book at a rate determined by FPLP which may at no time exceed the charges for similar services made by third party companies and may at no time significantly exceed the costs the With Profits Fund would incur if FPLP were to undertake such services itself and the only business of FPLP were that comprised in the With Profits Fund. If in

2010 the expenses are set at a rate which exceeds those in 2009 (adjusted for inflation), the premium payable by the Issuer to Ambac will step up.

However, FLP has entered into a hedge transaction (the “**Inflation Hedge**”) with Barclays Bank PLC in respect of the expenses projected to arise under the assumption for lapse set out in Scenario 3 under “*Sensitivity Analysis*” under which the Defined Book will receive RPI on the notional principal of the hedge and will pay 3.1 per cent. per annum on the notional principal of the hedge, thereby hedging the inflation risk to the extent the expenses correspond to that notional amount. The notional principal of the Inflation Hedge in each period from 1 January 2005 to (and including) 31 December 2019 (being the end of the Calculation Period immediately following which the Class A-2 Notes Final Maturity Date) is the amount of expenses for that period which are adjusted by RPI (or RPI plus one per cent.) and are projected to be payable in respect of such Calculation Period under the assumption for lapse set out in Scenario 3 under “*Sensitivity Analysis*” together, in 2019, with the present value of the projected expense base to 2043. As the expenses subject to inflation are determined by the Scheme, the accuracy of the hedge is primarily a function of lapse of Defined Book Policies being different to that assumed for the purposes of the Base Case, resulting in under or over hedging depending on the circumstances; while using Scenario 3 will result in the Inflation Hedge being an under-hedge (compared with the Base Case Assumptions relating to lapse), this is considered preferable to the expenses being over-hedged in a more stressed lapse situation when the effect of overhedging and adverse inflation could be to reduce Defined Book Surplus further at a time when the Defined Book Surplus can least afford to be further reduced. FLP has covenanted in the Reinsurance Agreement not to terminate the Inflation Hedge except in the circumstances permitted in the Reinsurance Agreement without Ambac’s consent and to ensure that the Inflation Hedge is allocated to the Defined Book (breach of which will result in a Breach Adjustment or Capital Injection).

The detailed charging provisions are set out in Schedule 2 to the Scheme. The Reinsurance Agreement makes provisions for these expenses to be interpreted in a certain manner in relation to the allocation of With Profits Fund expenses to the Defined Book.

Unitised With Profits Investment Guarantees on Declared Bonuses

The assets backing the unitised with profits life and pensions contracts of the Defined Book are held within the With Profits/With Profits Fund of the With Profits Fund. Under this arrangement, any premiums received on unitised with profits business are transferred to the With Profits/With Profits Fund for investment after deductions are made for risk premiums and other relevant charges.

In return for these premiums, the With Profits/With Profits Fund guarantees the investment element of the claims which will become payable to the unitised with profits policyholders, including any declared bonuses that have increased policyholder guarantees. The total value of the investment component of the claim payable, including the policyholder guarantee, is known as the “Investment Element” of the claim.

In this way, the investment element of the contract is the responsibility of the With Profits/With Profits Fund. The Schedule 3 Surplus is not therefore exposed to losses that may arise from future investment returns being insufficient to meet guarantees given to unitised with profits policyholders. Any costs arising as a consequence of investment guarantees are therefore a liability of the With Profits/With Profits Fund and outside the Schedule 3 calculation.

In summary, in accordance with Schedule 3 of the Scheme, the surplus arising on unitised with profits contracts in the Defined Book will result from the margin realised on risk and other charges deducted from premiums and the excess of the aggregate of annual management charges (levied on the asset shares which represent the investments built up from premiums rather than the underlying face value of units, and which may be more or less than that face value) over expenses charged to this business.

Calculation of Defined Book Surplus for the purpose of the Reinsurance Agreement

The Reinsurance Agreement contains provisions for calculating the Defined Book Surplus, which are broadly the same as the provisions contained in Schedule 3 to the Scheme. The Defined Book Surplus shall be computed in respect of each Calculation Period as the aggregate of the following, each such item being computed on the same basis as the corresponding item in Schedule 3 to the Scheme as it exists as at the Closing Date (noting that (i) certain items will be calculated net of amounts attributable to reinsurances as described in (C) below, (ii) policyholder tax shall be as

described in paragraph (D) below and (iii) Defined Book Policies shall be treated in the same manner as Schedule 3 Policies (as defined in the Scheme)) (and, for the avoidance of doubt, disregarding the effect on surplus (if any) of any Designated Transaction):

premiums less, in the case of linked policies or unitised with profits policies, the investment element of those premiums plus any emerging annual management charges due from the linked funds including, in respect of unitised with profits policies, notional annual management charges equal to the annual management charge which is applicable to the corresponding linked policy at the Effective Date

plus

investment income and gains received or accrued which are attributable to the statutory reserves of Defined Book Policies excluding any unit linked reserves

plus

risk premiums charged to unitised with profits policy or linked policy units

less (or plus) as the case may be

increase (or reduction) in non linked reserves in respect of Defined Book Policies arising from any factor other than a Designated Transaction

less

claims less, in the case of linked policies or unitised with profits policies, the investment element of those claims

less

expenses determined in accordance with Schedule 2 to the Scheme attributable to the Defined Book Policies

less

amount (if any) by which the Defined Book Surplus in respect of the previous Calculation Period was negative.

Other Designated Transactions are ignored so that entry into further Designated Transactions does not affect the calculation of Defined Book Surplus (while it may affect the calculation of the Schedule 3 Surplus). There is no restriction on FPLP entering into other Designated Transactions.

In calculating the Defined Book Surplus pursuant to the Reinsurance Agreement:

(A) Mis-Selling Liabilities and levies imposed by, *inter alia*, the Financial Services Compensation Scheme will be ignored;

“**Mis-Selling Liability**” means any anticipated losses, any costs and expenses incurred or expected, or any payments made, by FPLP (a) which result from or arise in connection with any complaint, claim, legal action or proceedings brought against a Relevant Originator, a Relevant Insurer or FPLP, by or on behalf of any person or group of persons whether as a result of any judgment of any court, any arbitration, any decision of the Ombudsman (and any former ombudsman the role of which has been replaced by the Ombudsman) or any other ombudsman, any direction of the FSA or any other regulatory body or any agreed settlement or compromise (including an ex gratia payment made in the interests of saving or reducing any such losses so arising) or otherwise, including the costs and expenses incurred in investigating and defending against any such complaint, claim, legal action or proceeding; (b) which result from or arise in connection with FPLP or a Relevant Insurer complying with (or, as the case may be, failing to comply with) rules, regulations, directions or guidance (whether formal or informal) set by or given by the FSA or the Ombudsman (and any former ombudsman the role of which has been replaced by the Ombudsman), including in connection with the review process relating to the mis-selling of personal pension policies and free standing AVCs, as overseen by the FSA, and the directions given by the FSA in relation to endowment policies, including, without limitation, the costs and expenses of any review so required; or (c) which comprise, result from or arise in connection with any penalty or fine levied, or which result from or arise in connection with any disciplinary action undertaken, by the FSA, the Ombudsman and any similar body or authority, in each case resulting from or arising in connection with the marketing or sale of any Policies by any of the Relevant Originators or by any person for the activities of whom

one of the Relevant Originators has or had legal responsibility, but excluding all such losses, costs and expenses in respect of enhancements to policy benefits which are properly reserved for in accordance with Applicable Law and best actuarial practice in the Mathematical Reserves of the Defined Book as at 31 May 2004, as such Mathematical Reserves may change from time to time, deriving from settlements of claims (or other matters) prior to that date of the kind referred to in paragraphs (a) – (c) above. “**Relevant Insurer**” means, in respect of a Policy, any one or more of Friends’ Provident Life Office, UK Temperance and General Provident Institution or London and Manchester Assurance Company Limited (which changed its name to Friends Provident (London and Manchester) Assurance Limited on 26 November 1998), as applicable, in respect of the period for which each of them was the insurance company obliged in respect of the relevant Policy; and “**Relevant Originator**” means, in respect of a Policy, whichever of FPLP or the Relevant Insurers originally issued the relevant Policy;

- (B) new annuities arising from vested deferred annuity contracts within the With Profits Fund (as defined in the Scheme) are not Defined Book Policies and will not affect the calculation of Defined Book Surplus;
- (C) premiums, claims, non linked reserves, expenses and attributed investment income and gains taken into account in determining Defined Book Surplus shall be calculated net of amounts attributable to reinsurances, other than the Reinsurance Agreement;
- (D) investment income and gains and expenses taken into account in this calculation shall be adjusted for policyholder tax attributable thereto;
- (E) adjustments to charges which may be made pursuant to the Scheme by the FPLP With Profits Actuary shall not apply unless:
 - (i) such adjustments are notified in advance to the Relevant Person; and
 - (ii) the reasonable comments of the Relevant Person are fairly reflected in the adjustments made;
- (F) for the avoidance of doubt, as the Inflation Hedge (or any replacement thereof) will be allocated to the assets backing the liabilities of the Defined Book, income and expenses associated therewith, and the regulatory value of any asset or liability which it represents, shall be reflected in items in the second and/or fourth indent above; and
- (G) for the avoidance of doubt, references to “investment income and gains” in the item in the second indent of the Defined Book Surplus calculation above and in paragraph (E) above shall include a reference to losses.
- (H) Linked Policies include, for the avoidance of doubt, hybrid policies (as such terms are defined in the Scheme).

As at each Calculation Date, to the extent that the Defined Book Surplus in respect of the Calculation Period ending on such Calculation Date is greater than zero, FPLP shall apply such Defined Book Surplus as described in “*Summary of the Transaction Documents – Reinsurance Agreement*”.

The calculation of the Defined Book Surplus in respect of each Calculation Period will be made by FPLP. However, certain processes have been introduced to ensure that the interests of Ambac (and, following the occurrence of an Ambac Termination Event, Noteholders) are taken into account in the process. A description of the process is described under “*Surplus Calculation Process and Interaction*”.

Policy Categories

The Defined Book Policies currently in-force fall into four generic product types each of which is described below:

- Conventional non profit life business;
- Conventional non profit pensions business (including annuities);
- Unit linked business (life and pensions); and
- Unitised with profits business (life and pensions).

Summary of In-Force Products at 31 May 2004

Policy Category	Contracts in force ¹	In-force premium (£m)	Non-unit reserves (£m)	Unit reserves (£m)	Total NPV ² (£m)	NPV per cent.
Conventional non profit life	233,436	27	113		96	11
Conventional non profit pensions	138,157	7	2,492		266	31
Unit linked life	294,253	107	2	1,680	85	10
Unit linked pensions	505,330	116	26	2,732	145	17
Unitised with profits life	370,965	145		2,835	168	20
Unitised with profits pensions	413,814	79		2,702	97	11
Total	1,955,955	481	2,633	9,949	857	100

Notes

1 Number of policies, in-force premium and reserves amounts are as at 31 May 2004.

2 Net Present Value ("NPV") is the aggregate value of all Defined Book Surplus cash flows projected (under the Base Case Assumptions) to arise in the future, in respect of all policies in force as at 31 May 2004, discounted to 16 December 2004, assuming that cash flows are available on 15 April of each year following the Calculation Period. The discount rate is 5.47 per cent. per annum.

The above table summarises the projected Base Case value of the Aggregate Defined Book Surplus of the four different policy categories (splitting unit linked and unitised with profits between the life and pensions products) overall (for the details and assumptions relating to the Base Case see "The Base Case" below). The time at which the Defined Book Surplus is projected to emerge, and accordingly the projected value for future periods, under the Base Case is different for the different policy categories.

A summary of the principal policy types is included at Appendix 5.

Principal Factors Contributing to the Emergence of Defined Book Surplus

The following summarises the principal factors which contribute to surplus from the Defined Book Policies looked at by the different categories of policy.

Conventional Non Profit Life Business

Conventional non profit life business generally involves the policyholder or the insured paying premiums throughout the term of the policy (or possibly throughout a predefined, limited premium term) to the life company which pays out when the specified event insured against occurs (such as death (term assurance), and/or diagnosis of a specified condition ('critical illness' or disability policies)). No surrender or maturity benefit is usually paid on this business.

Policies may also be written on a 'whole of life' basis, although the premium paying term is often limited to a set number of years, or a maximum age. Whole of life products generally acquire a surrender value.

The surplus to the life company in a period from conventional non profit life policies will generally arise from the excess of premiums over claims from such policies in that period (after taking account of expenses of administration and changes to reserves arising from factors other than claims paid).

Risks: As there is usually no opportunity for the company to increase premium rates in the future for existing business, the company bears the risk of deteriorating mortality or critical illness rates. With general improvements in health this risk is minimal although there is a risk that improvements in medical science might lead to earlier diagnosis of some critical illnesses leading to earlier payment of claims. The value of the business may also be reduced by an increase in the lapse rates. As it is the more healthy lives that are more likely to lapse policies rather than those which might have greater reason to expect to claim, there is the potential for policyholders to create an adverse selective effect on the claim experience.

Reserving: Policy reserves are determined by placing a present value on the likely claims payments and deducting from this the present value of future premiums. The reserving basis is required to be prudent and so would not usually allow for future policy discontinuance. Expenses are allowed for explicitly by adding their present value to the present value of claims or implicitly by valuing less than 100 per cent. of premiums.

Reinsurance: Companies make extensive use of reinsurance on this type of contract to protect against adverse claim experience (see “*Summary of reinsurance arrangements on the Defined Book*” below).

Conventional Non Profit Pensions Business (including Annuities)

The bulk of this business covers policies where the policyholder receives a regular income, generally for the remainder of his/her life, in exchange for a single initial premium. The business may be written on a single or joint life basis (where the annuity payments continue until the death of the second policyholder, although they may often be reduced under the terms of the particular annuity after the death of the first life). The annuity payments may be guaranteed for a minimum period, and also may increase by a fixed percentage set at outset, or (less commonly) in line with a published index, usually the retail prices index, sometimes subject to a maximum increase in any year.

In the case of annuities, when an annuity is acquired by an annuitant the amount paid by the annuitant is normally invested in appropriate fixed income securities with a view to matching the expected liabilities to minimize the investment risk (this is done on a pooled basis). Surplus arises where the reserves established (invested in the appropriate fixed income securities) exceed expected liabilities. Accordingly surplus is primarily a factor of the ability to match (i) actual investment returns with those expected when the annuity was written and (ii) actual and future expected mortality experience of annuitants and actual administration expenses with the mortality experience and administration expenses projected when the reserve was established.

Risks: FPLP bears all the investment and mortality risk for these policies. The main risk is that the mortality experience is lighter than expected when the policy was last valued. A further possible risk is credit risk. The main contribution of these types of policy to Defined Book Surplus will emerge as the difference between the mortality and interest rate assumptions used to calculate the statutory reserves and the actual mortality experience and investment returns earned on the invested assets.

Reserving: The assets and liabilities for annuity business are matched as far as possible to mitigate the investment risk. The assumptions used to calculate the statutory reserves make prudent provision for expected future improvements in mortality. However FPLP would be at risk from a requirement to strengthen the reserving basis, for example if the expected improvements in mortality or default of corporate bonds were greater than assumed at the last valuation.

Unit Linked Business (Life Products and Pension Products)

Unit linked policies are contracts which are structured so that investment benefits payable are set by reference to the value of unitised investment funds maintained by the company.

The premiums are normally paid by the policyholder and, after the deduction of certain specified charges, units in the appropriate unitised investment funds having a value corresponding to the amount remaining are allocated to the policy. Units allocated to a policy are also cancelled on a regular basis to meet the costs of providing insurance benefits (such as death, critical illness, permanent health, disability and premium waiver benefits) and some ongoing contract charges associated with the policy.

Charges are levied on policies in a number of ways. The aim at the time each policy was originated was for the charges deducted to cover the insurance (as opposed to savings) benefits provided under the policy, the direct costs of operating the policy, such as administration expenses and tax attributed to policyholders, together with a contribution towards the overheads and profit of the company.

Standard charges are of the following types:

- Annual management charges (“AMC”): these are deductions from unitised funds allocated to a policy expressed as a defined percentage of the value so allocated, accrued daily and deducted at regular intervals. The rate varies from policy to policy. There is often provision for the AMC to be increased if necessary to meet future increases in expenses, although this is rarely carried out.
- Policy fees: these are fees for administering the policy and are generally fixed or increase annually (generally in line with the retail prices index or the index of national average earnings). They are levied either as a reduction in the policy allocation of units or directly from premiums received.

- Risk premium deductions: these are charges generally established when the policy is originated (which may be reviewable) and are levied mostly by the cancellation of units allocated to the policy. The charges are to meet the cost of providing life assurance, critical illness benefit (including permanent total disability benefit) and waiver of premium and permanent health insurance (sickness) benefits. The charges are age and gender related and may vary because of other factors, such as whether the insured is a smoker. The charge for waiver of premium benefit may be a percentage of the premium payable.
- Bid/offer spread: this is a charge on acquiring new units or on selling units levied by way of different prices being used to allocate or cancel units allocated to a policy. (In addition, the bid/offer spread covers the expenses of buying and selling assets).
- Percentage of the premiums allocated to the unit fund: fees may be levied by reducing the proportion of premiums allocated to units to below 100 per cent. or offset by allocating more than 100 per cent. of premiums.
- Tax deductions: these apply only to life business (both unit linked and non participating policies), as opposed to pensions business, and are intended broadly to match the tax payable by FPLP on taxable investment income and gains allocated to policyholders.

As the initial costs of setting up a policy are usually much higher than the ongoing administration expenses, various charging structures are applied on regular premium contracts to help minimise the capital strain on a company writing unit linked business. The most common of these are:

- Nil allocation period – an initial period (specified in the contract terms) in which premiums are not applied to buying units, but will instead be used to meet the initial costs arising in the non-unit account.
- Reduced allocations – the percentage of the premium used to buy units is reduced over an extended period (or possibly the whole term of the policy).
- Capital or initial units – for an initial period units are allocated to a separate unit class which attracts higher annual management charges over the period of the contract. These higher charges are used to offset the initial costs.

Where reduced allocations or capital or initial units are used, there is a mismatch between the timing of the initial expense to FPLP and the charges taken to meet these costs. The reserving regulations allow for FPLP to take credit for the future charges it expects to receive to meet these costs, and hence hold lower reserves, provided that the appropriate penalties can be charged to a policy which surrenders early.

For reduced allocations, the anticipation of the future proportion of premiums not allocated to the unit fund may be shown as a negative non-unit reserve. This is permitted, provided that the sum of the unit and non-unit reserves is not less than the surrender value.

For capital and initial units, the higher future AMC can be anticipated and used to hold a discounted value of the unit fund (where the discount rate is a maximum of the additional AMC rate). This process is referred to as 'actuarial funding' of unit values.

Claims: In the event of a policyholder or the insured surrendering, the terms of the contract will usually specify that a proportion of the unit fund will be paid, often with a deduction made in the earlier years of the contract for FPLP to recoup some of the initial costs of setting up the policy. On maturity or death, the unit fund would be expected to be paid (together with any additional risk benefit in the case of a death or, in a minority of cases, guaranteed benefit in the case of death or maturity).

Risks: The main risk for FPLP is that the future charges made on the policy are insufficient to meet the ongoing costs of the company. Where there is sufficient scope to vary charges (subject to the charges remaining reasonable) this risk can be reduced. Most of the investment risk is borne by the policyholder, although there is a secondary risk to FPLP since management charges are related to the value of the units. The value of the business may also be reduced by an increase in the lapse rates since future margins will no longer arise, although surrender penalties may often recoup at least part of this. Adverse mortality experience will increase the level of payout on the risk elements of the policies, as well as resulting in a reduction in the value of the units on the basis of which the management charge is calculated, reducing the overall unit value on which future expense profits can be derived.

Reserving: The statutory reserves for these policies have two separate components:

- unit reserve – calculated as the number of units multiplied by current unit price; and
- non-unit (or ‘sterling’) reserve.

The non-unit reserve is calculated using a cash flow projection, on prudent assumptions, of the charges and expenses that FPLP expects for the policy, i.e. the cashflows that are not included in the unit fund. The reserve is set at a level which will eliminate any future negative cash flows in the non-unit account. This reserve can be negative. It should be noted that the unit price and unit reserve should move in line with the value of the assets held by the unit fund. However, any requirement for changes to non-unit reserves will directly affect the Defined Book Surplus arising on this business.

The terms of most unit linked policies allow management charges, risk premium deductions and policy fees to be increased or reviewed, in some cases only at defined times under the relevant contract. Where increases or reviews are permitted, there is generally no contractual restriction on the extent of the increase; however, there are constraints arising from expectations of policyholders, from current regulatory principles, from the principles of financial management adopted by FPLP, as well as from the Unfair Terms restrictions in Consumer Contracts Acts.

Unitised With Profits Business

Unitised with profits business generally works in a similar way to unit linked business described above. Unitised with profits and unit linked business differ in the type of units purchased. The former invests policyholder assets in a with profits fund while the price of units of the latter is based directly on the value of a pool of underlying assets.

The price of unitised with profit units is not based directly on the value of underlying assets, but rather on the initial value when the premiums are invested plus the impact of guarantees and discretionary bonuses. At the time the policy is taken out, the insurer guarantees that unit prices will increase at a certain annual rate (which may be nil) before charges. The unit price is increased daily by regular bonuses set by the insurer and variable at its discretion. This discretion in setting bonuses allows the insurer to “smooth” policyholder returns.

Differences from unit linked policies are described below.

Charges: The AMC charge is calculated based on the underlying asset values rather than the number of unitised with profits units and their price.

Claims: A policyholder who surrenders is paid the value of the policy units. Depending on the terms of the contract, this amount may be subject to a market value reduction or the addition of any final bonus.

On maturity or death, the value of the units is paid together with the addition of any additional final bonus. (There may also be a risk benefit on death or, in a minority of cases, a guaranteed benefit on death or maturity.)

Risks: Generally, an insurer takes significant investment risk through providing guaranteed bonuses on death or maturity. The unitised with profits business of the Defined Book, however, is not exposed to this risk, which has been assumed by the With Profits/With Profits Fund. Other risks are the same as those applying to unit linked business.

Reserving: Reserves are calculated using cash flow projections similar to those for unit linked policies. The major difference concerns the ‘unit value’ where account is also taken of the underlying asset share (if greater than face value) and the effect of future bonuses that might be declared before maturity. These reserves are held in the With Profits/With Profits Fund.

Summary of Reinsurance Arrangements on the Defined Book

The unitised with profits investment component of Defined Book policies is reinsured to the With Profits/With Profits Fund. Similarly, the investment component of unit linked business in the Defined Book is reinsured into the Non Profit Fund (life policies) or Friends Provident Pensions Limited (pensions policies). Reinsurance is also used to spread mortality and sickness risk by sharing this with third party reinsurers. This reinsurance may be on original terms or risk premium bases. Original terms involves paying the reinsurer a proportion of the premium received and the reinsurer effectively covering a share of the whole policy proceeds, including any investment content. Risk premium insurance involves the payment of a premium to cover the death or sickness risk only and not the investment content.

Asset Investment

The following summarises asset investment as at 31 December 2003.

The aggregate assets allocated to the Defined Book as at 31 December 2003 were allocated as follows:

Assets Allocated to the Defined Book – Investment Summary As at 31 December 2003

	UK Equity		Overseas Equity		Property		Fixed Interest		Cash and Other		Total
	%	£m	%	£m	%	£m	%	£m	%	£m	£m
Conventional non profit life							100	119			119
Conventional non profit pensions							100	2,619			2,619
Unit linked life	51	876	16	272	4	73	23	409	6	98	1,728
Unit linked pensions	54	1,537	26	756	2	50	13	358	5	157	2,858
Unitised with profit life	26	784	7	211	13	368	52	1,552	2	53	2,968
Unitised with profit pensions	26	767	7	206	13	361	52	1,520	2	52	2,906
Totals	30	3,964	11	1,445	6	852	50	6,577	3	360	13,198

Appendix 1 contains a summary of the investment strategy, controls and performance relating to the unit linked funds in which Defined Book Policies may be invested, the With Profits/With Profits Fund in which unitised with profits policies are invested and the investment objectives and controls of the conventional non profit life and conventional non profit pensions investment strategy.

Investment Strategy

Unit linked and unitised with profits policies

Assets backing allocated units in respect of the various unit linked funds are invested with a view to achieving the objectives of the relevant fund as described in Appendix I. The investment objective of the With Profits Fund is set out below.

Conventional non profit pensions business

For pre-demutualisation annuities, gilts and corporate bonds are held to match projected cashflows for the non linked annuity payments. Index-linked gilts and index-linked corporate bonds are held to match projected cashflows for the index linked annuity payments.

Conventional non profit life business

Gilts and corporate bonds are held to provide a broad match to other liabilities (e.g. sterling reserves for unitised business and Mathematical Reserves in respect of conventional non profit business within the defined book).

Principal Risks to the Emergence of Defined Book Surplus

The amount and the timing of the emergence of Defined Book Surplus, and hence its value, will depend on the actual experience of the Defined Book and expected future experience which affects reserving parameters. The main factors which will affect Defined Book Surplus in any period are the actual investment returns achieved, actual mortality and morbidity, actual lapse rates, actual expenses and taxation. In addition, should future expectation of these factors change (either through a factual change, such as a change in taxation rates, or a prudent assessment of future experience, such as an increase in annuitants' life expectancy), this is likely to result in a change in reserving levels which will affect Defined Book Surplus.

This section describes certain of these and other risks which may have an impact on Defined Book Surplus. Other aspects of risks are also referred to elsewhere in this document, including, in particular, the previous section headed “– *Principal factors contributing to the emergence of Defined Book Surplus*”.

Investment Returns

Unit linked and unitised with profits business

The annual management charge for unit linked policies is calculated on a daily basis as a percentage of the value of units allocated to policies; accordingly the amount of the annual management charge will be affected by, *inter alia*, volatility in asset values. Similarly, the annual management charge levied in relation to the unitised with profits policies is calculated as a percentage of their asset shares, which reflect the investment performance of the With Profits/With Profits Fund.

The type of asset in which units are invested and the overall asset mix also affects investment returns. The investment returns on the unit linked funds is a risk borne primarily by the policyholders invested in such funds. Many of FPLP's unit linked funds have a high equity content. Conversely, the investment risk in the With Profits Fund may affect FPLP's solvency and, following falls in equity values since 2000, the proportion invested in equities in the With Profits Fund has been reduced. The asset mix of the funds in which both the unit linked policies and the unitised with profits policies comprised in the Defined Book are invested is reflected in the Base Case Assumptions relating to asset mix (see "*The Base Case – Base Case Assumptions used in projecting Defined Book Surplus*" below).

Conventional non profit business (life and pensions including annuities)

The main investment return risks in respect of conventional non profit business (life and pensions including annuities) are the risks that interest rates move unfavourably compared to that assumed for the policy, or that assets are not sufficiently well matched to liabilities or that assets default, in each case resulting in a corresponding reduction in Defined Book Surplus.

Protection against higher than expected bond defaults in the annuity business in the Defined Book is provided by allowing only a limited proportion of the portfolio (7.5 per cent.) to be invested in bonds rated BBB or lower. The average rating of bonds backing annuity liabilities in the Defined Book is currently around AA. Further protection is given by taking credit for only a limited amount of the extra income compared to gilts.

Strengthening of non-unit (statutory) reserves

In accordance with FSMA and regulations made thereunder, FPLP has to calculate and hold reserves appropriate for each policy. If the valuation basis for determining reserves is altered, the change may lead to an increase or fall in the amount of reserves and this will reduce or increase surplus. The timing of the emergence of Defined Book Surplus will therefore be affected by any changes to the valuation basis for determining reserves. Changes to such basis may occur in response to changing experience or changes to requirements arising from regulation or practice, including fiscal laws. Actual future experience will determine the extent to which any strengthening of reserves represents an actual reduction in surplus rather than a deferral of surplus.

Protection against changes in the valuation basis for determining reserves is provided by regulation which prohibits arbitrary changes. In addition, the procedure under which Defined Book Surplus is determined provides for Ambac (for so long as Ambac is the Relevant Person, and thereafter the Reinsurer Controlling Creditor) to be able to consider changes to the reserving basis and to be consulted as to whether, and to dispute whether, a change is a Permitted Change. If, following the disputes procedure it is determined that the change is not a Permitted Change, a Breach Adjustment may be required, which would have the effect of reversing the reduction in Defined Book Surplus arising from such change not being a Permitted Change (see "*Surplus Calculation Process and Interaction*" below).

Mortality and Morbidity risks

Mortality risks and morbidity risks affect the emergence of Defined Book Surplus in different ways depending on the type of policy. For annuities, the issue is dealt with under "*Longevity*" below. In relation to conventional non profit products and the risk benefit (non-investment) component of unit linked and unitised with profits products (such as life insurance, critical illness and disability), the greatest risk is that mortality and/or morbidity levels are higher than assumed at the last valuation or at the time of underwriting (or the last review of premiums, where this is permitted) with the result that underwriting profit is lower than projected and non-unit (statutory) reserves prove to be insufficient (with the result that additional reserves need to be set aside, thereby reducing Defined Book Surplus).

Exposure to volatility in mortality and morbidity claims is greatly reduced through the large number of contracts and the narrow spread of contract size. Large risks are reinsured with external companies to reduce fluctuations in experience resulting from one large claim or a series of large claims.

Critical illness experience has been deteriorating in recent periods and is expected to deteriorate further. Some contracts offer guaranteed rates, with the balance having premium review facilities, although reviews may generally only be carried out periodically. Exposure to changing experience which was not anticipated when the premium rates were set originally is limited through contracts

under which 75 per cent. of the benefits are reinsured, with the reinsurers' rates matching those set by FPLP.

Morbidity and mortality charges may be reviewed upwards, where permitted under the terms of the policy, having regard to FPLP's and industry-wide experience or other relevant factors only if FPLP's Appointed Actuary (or, after 31 December 2004, the FPLP Board on the advice of the Actuarial Function Holder) has formally concluded that it is appropriate in the circumstances, given the requirement to treat customers fairly.

Longevity

For annuity business, Defined Book Surplus emerges as the difference between reserves established based on interest rate and mortality assumptions set when the annuity was last valued and actual experience. In particular, if annuitants live longer than expected in the assumptions, surplus will be reduced because future annuity payments continue longer than anticipated.

Life expectancy of annuitants has been increasing and may be expected to continue to increase. The Base Case reflects mortality experience in the two and a half years to 30 June 2004 and a mortality improvement allowance, both for reserves and actual experience, which is reviewed regularly.

In recent years, reserves for longevity risk on the Defined Book have been strengthened. FPLP strengthened reserves in response to the results of industry mortality investigations. Expected experience in the Base Case reflects recent FPLP experience and industry studies. Industry mortality tables (which already include an allowance for future improvements in mortality experience) are used as the basis underlying calculations but these are refined by two adjustments. The first adjustment reduces the underlying mortality by a proportion to allow for FPLP's experience. The second adjustment further reduces the underlying mortality by making allowance for future improvements in mortality beyond those included in the underlying mortality table. This adjustment brings the assumed mortality in line with the medium cohorts effect of the interim CMI (Continuous Mortality Investigation) Bureau projections. The longevity stress test takes the allowance for improvements beyond the long cohort effect of these mortality projections.

For the purposes of the Base Case, further margins of 7.5 per cent. in mortality experience and an increase in allowance for improvements in mortality to mid-way between the medium and long cohorts (as set out in the CMI Longevity Paper) and further, subject to a minimum improvement of 0.5 per cent. per annum have been allowed in setting statutory valuation bases applicable from 31 December 2004. The additional reserve is not expected adversely to affect Noteholders because the Defined Book Surplus for the Calculation Period ending 31 December 2004 is retained by FPLP except to the extent needed to pay the Annual Premium in that year or to recapture the increase in the Sum Assured from 16 December to 31 December 2004.

Persistency (early termination)

Early termination occurs where a policy ceases otherwise than due to the death or critical illness of the insured or the early retirement of the insured, or becomes paid up (which may occur where a policyholder ceases to continue paying regular premiums expected to be paid, but does not terminate the policy). For unit linked and unitised with profits policies, the principal effect is to reduce over time the expected assets allocated to policies and accordingly the annual management charge on the Defined Book. For conventional non profit policies (other than annuities), the effect may give rise to a short term increase in Defined Book Surplus arising from a release of expense and mortality/morbidity reserves but over the longer term a reduction in Defined Book Surplus is to be expected.

Persistency rates depend to some extent on economic conditions and market conditions (such as, in the case of endowment policies, high mortgage activity) but might also be affected significantly by regulatory changes, or events which might be specific to FPLP. In addition, some contracts display lapse behaviour that is aligned with a bundled product sale, e.g. a term assurance contract sold in respect of a mortgage. As mortgage redemption and refinancing increase, one might expect the lapse rate on aligned term assurance contracts to increase. This has been taken into account in determining the lapse rates and paid up rates assumed for the Base Case Assumptions which reflect experience and trends in the two and a half years to 30 June 2004.

Expenses

The Defined Book Surplus is affected by the expenses of administering the policies and other expenses of the Defined Book. To the extent that expenses increase at a rate greater than that projected for the Base Case, the Defined Book Surplus may be lower than that projected for the Base Case. To mitigate the risk that expense inflation may be higher than projected FPLP entered into the Inflation Hedge (See further “*Investment Considerations – Expenses Inflation*”).

As described in “– *Summary of Schedule 3 Surplus – Determination of Attributable Expenses*” above, the Scheme contains detailed provisions regarding the maintenance, termination, and investment management expenses that will be allocated to the Defined Book Policies.

To the extent that expense inflation exceeds that assumed, Defined Book Surplus will be lower than would otherwise have been the case.

Taxation

In principle, tax on investment income and realised capital gains for life products reduces Defined Book Surplus while relief for the annual administration expenses of life products increases Defined Book Surplus by reducing the effective amount of such expenses. Provision is made for tax on unrealised capital gains attributable to life policies within unit linked and unitised with profits funds. Any variation between the actual and assumed provision is a cost/release to that fund. Rates of taxation on life business and the basis for taxation may change in the future; accordingly, the amount of surplus could be reduced as a result of changes in tax law (including rates of tax).

Embedded options

The cost of any guaranteed annuity options falls on the With Profits/With Profits Fund and does not materially affect the Defined Book Surplus directly.

Reinsurance counterparty credit risks

The use of reinsurance on the life assurance business exposes the company to a risk that the reinsurer is unable to meet claims. This is not considered material in the context of the Defined Book.

Mis-selling Risks

Other than minor exceptions which have been reserved for, these are excluded from the calculation of the Defined Book Surplus and are met by the With Profits/With Profits Fund and/or the Non Profit Fund.

THE BASE CASE

DESCRIPTION OF THE BASE CASE

The Defined Book Surplus that is projected to be generated has been calculated for each of the 15 Calculation Periods to December 2018 and, for illustrative purposes, for the remaining Calculation Periods after December 2018. These projections together with the projections in Appendix 4 have been prepared by FPLP using actual data as at 31 May 2004 and applying the Base Case Assumptions summarised below under (“– *Base Case Assumptions used in projecting Defined Book Surplus Amounts*”) and reported on by KPMG as set out under “*Actuary’s Report*” below. Insofar as any amounts due on the Reinsurer Loan remain outstanding after the final maturity date in April 2019, Defined Book Surplus arising after 31 December 2018 will be available to release reserves held thereby enabling the Reinsurer to fund, *inter alia*, interest, Reinsurer Ongoing Commitment Fees and principal on the Reinsurer Loan and, to the extent so paid to InterCo and subsequently to the Issuer under the InterCo Loan, will be available to be paid (after payment of amounts ranking higher in the order of priorities of payment of the Issuer) to Noteholders (or, to the extent that Ambac has paid Scheduled Interest or Ultimate Principal on the Notes, Ambac under the Issuer Guarantee and Reimbursement Agreement).

BASE CASE

The following table sets out the Base Case for this Offering Circular projected for the period to 31 December 2043:

Calculation Period ending 31 December all figures in £,000,000	Aggregate Defined Book Surplus ¹	Defined Book Surplus ²	Financing Costs ³	Class A-1 Base Case Amortisation Profile ⁴	Class A-2 Base Case Amortisation Profile ⁴
2004	857	87	7	280	100
2005	786	96	21	205	100
2006	733	85	17	137	100
2007	688	80	12	69	100
2008	645	76	10	3	100
2009	605	72	6	0	37
2010	566	68	2	0	0
2011	529	64	0	0	0
2012	494	61	0	0	0
2013	461	58	0	0	0
2014	428	54	0	0	0
2015	397	51	0	0	0
2016	368	48	0	0	0
2017	339	46	0	0	0
2018	313	43	0	0	0
2019 onwards	287	427			

The Base Case has been calculated on the basis of data as at 31 May 2004 and the Base Case Assumptions. With respect to the projected Defined Book Surplus for the period to 31 December 2004, this has been calculated as the aggregate of (i) the Defined Book Surplus calculated as at 31 May 2004 on the basis set out in Schedule 3 to the Scheme and (ii) the amount projected as the Defined Book Surplus from 31 May 2004 to 31 December 2004 on the basis of the data and Base Case Assumptions as at 31 May 2004. (See “*The Base Case – Base Case Assumptions used in projecting Defined Book Surplus Amounts*”).

- 1 Aggregate Defined Book Surplus is the present value of all Defined Book Surplus cash flows projected (under the Base Case Assumptions) to arise in the future, in respect of all policies in force as at 31 May 2004 discounted at a rate of 5.47 per cent. per annum, being equal to the aggregate of (i) the fixed rate of the Reinsurer Loan plus (ii) the premium payable to Ambac (expressed as a rate per cent. per annum) (and assuming no step up) plus (iii) a spread of 0.21 per cent. per annum reflecting the initial weighted average spread of the Notes over LIBOR (the “Financing Rate”) (the other ancillary costs of the Issuer and InterCo have not been included in the costs). The Aggregate Defined Book Surplus has been calculated assuming that cash flows are available on 15 April of each year following the Calculation Period, discounted to 15 April of the year in which the Calculation Period ends (i.e. the 2005 value is discounted to 15 April 2005). The 2004 value is the present value of all future surplus payable from April 2005 and onwards, discounted to 16 December 2004.
- 2 The Defined Book surplus is the non-discounted amount projected under the Base Case Assumptions to be the Defined Book Surplus in respect of each future Calculation Period on the basis such period ends on 31 December in each year.
- 3 Financing Costs are the amount projected under the Base Case Assumptions to be the aggregate of (i) the fixed rate of interest under the Reinsurer Loan plus (ii) the premiums payable to Ambac (expressed as a rate per cent. per annum) (and assuming no

step up) plus (iii) a spread of 0.21 per cent. per annum reflecting the initial weighted average spread of the Notes over LIBOR (the other ancillary costs of the Issuer and InterCo have not been included in the costs).

- 4 The Base Case Amortisation Profile is the then projected Principal Amount Outstanding of the Notes following the April Interest Payment Date following each Calculation Period less the Available Defined Book Surplus after deducting from the Available Defined Book Surplus the aggregate of the Financing Costs. It assumes that the Reinsurer Regulatory Surplus in respect of the corresponding Reinsurer Calculation Period is at least equal to the Available Defined Book Surplus.
- 5 The table excludes any Defined Book Surplus emerging after the Calculation Period ending in December 2043.
- 6 Under Schedule 3 of the Scheme, increments to Defined Book Policies after the demutualisation are not part of the Schedule 3 Amount and therefore not included in Defined Book Surplus. For practical reasons, they are processed together on an original policy records basis. In order efficiently to return value to FPLP's Shareholder Fund the increments so written have been valued and the value fixed, £51 million, has been deducted from the amount determined for the Base Case and the amounts determined for the Sensitivity Analysis after the relevant assumption has been varied. The effect of this methodology, however, is that the variations in the relevant assumption may have a "geared" effect on the result, increasing the effect of the relevant change by up to 3 per cent.

Cashflow Analysis by Policy Category

The table below shows the projection on the Base Case Assumptions (rounded to the nearest million) of the first 15 years of cashflows by policy category (rounded to the nearest million). The actuarial assumptions underlying these cashflows are the same as FPLP uses for its published achieved profits reporting. Key elements of these assumptions can be found in "Base Case Assumptions used in projecting Defined Book Surplus" below and in Appendix 7 entitled "Base Case Assumptions Tables".

	Conventional Non Profit		Unit Linked		Unitised With profits		Total
	Life	Pensions	Life	Pensions	Life	Pensions	
2004	16	7	8	13	32	11	87
2005	15	24	11	10	27	9	96
2006	13	23	11	10	19	9	85
2007	12	22	11	10	16	9	80
2008	11	21	10	11	15	8	76
2009	9	21	10	11	13	8	72
2010	8	20	9	11	12	8	68
2011	7	19	8	11	11	8	64
2012	6	19	7	11	10	8	61
2013	5	19	7	11	9	7	58
2014	4	18	6	11	8	7	54
2015	3	18	5	11	8	6	51
2016	3	17	4	11	7	6	48
2017	2	17	4	11	6	6	46
2018	2	17	3	10	5	6	43
2019 and onwards	10	238	5	94	41	39	427
NPV of VIF	96	266	85	145	168	97	857
	11%	31%	10%	17%	20%	11%	100%

Net Present Value ("NPV") is the aggregate value of all Defined Book Surplus cash flows projected to arise in the future, in respect of all policies in force as at 31 May 2004, discounted to 16 December 2004, assuming that cash flows are available on 15 April of each year following the Calculation Period. The discount rate is 5.47 per cent. per annum.

BASE CASE ASSUMPTIONS USED IN PROJECTING DEFINED BOOK SURPLUS AMOUNTS

The following assumptions relate to the realistic experience projection basis rather than the valuation basis required by the current regulatory regime.

The Base Case (as defined below) projections included above and in Appendix 4 may be 'forward looking statements' within the meaning of applicable securities laws. These projections and statements may relate to matters such as assumptions about future experience, including investment returns, tax, early termination rates, paid up rates, mortality, morbidity, expenses, reinsurance and legislation as well as other factors beyond FPLP's control. Projections and forward looking statements are subject to inherent uncertainties and risk. In light of these risks and uncertainties, actual events and results may vary significantly from those included in, or contemplated or implied by, such projections and forward looking statements. Prospective investors are cautioned not to place undue reliance on such statements.

The projections below (and such projections as are referred to elsewhere in this document) set out (or refer to) (i) a base case (the "Base Case") and (ii) certain scenarios.

- (a) The Base Case is based on the Base Case Assumptions (as defined below).

The Base Case Assumptions relating to mortality, morbidity and discontinuance (being those relating to persistency rates and paid-up rates) (all as described below) represented an estimate, as at 31 May 2004 (the "Base Case Assumptions Date") (adjusted, in the case of

longevity, to reflect an increase in allowance for improvements in mortality to mid-way between the medium and long cohorts set out in the CMI Longevity Paper in setting the statutory valuation basis applicable from 31 December 2004 and, in the case of persistency, to reflect recent experience) of FPLP or Defined Book Policies (to the extent FPLP has recorded experience in relation to these separately) made in accordance with actuarial practice which takes account of the historic experience of FPLP and, in the case of mortality and morbidity, of information relating to the life assurance industry in respect of comparable business to the Defined Book generally available to FPLP as at the Base Case Assumption Date.

The Base Case Assumptions relating to investment returns and the risk free investment rate (being those related to the long term estimated investment returns by asset class, the future investment return assumption and long term asset allocation assumption, all as described below) were, as at the Base Case Date, a projection of the Defined Book Surplus in the current and subsequent Calculation Periods, as at the Base Case Date having regard to the conditions at the time as at which the determination was made and made in accordance with actuarial practice.

The Base Case Assumptions relating to taxation represented, at the Base Case Date, an estimate of the taxation to be borne by the Defined Book and the assets backing the Defined Book.

The other Base Case Assumptions not referred to above (including those relating to reserving), each as described in this Offering Circular and in each case as at the Base Case Date, were an estimate made for the purpose of projecting the Defined Book Surplus in the current and subsequent Calculation Periods, and made in accordance with actuarial practice as at the Base Case Date.

- (b) In (and subject to the terms of) the Actuary's Report KPMG consider the Base Case Assumptions to be reasonable at the date as at which they were made (see "*Actuary's Report*" below).
- (c) The Base Case Assumptions (which are long term assumptions) are considered by KPMG in its Actuary's Report (subject to the terms set out therein) to be reasonable at the date of this Offering Circular, taken as a whole over the period over which Defined Book Surplus is projected to arise; to the extent that changes in investment returns generally have occurred since the date as at which the Base Case Assumptions were made, KPMG considers that such changes are not likely to result in a material reduction in the amount of Aggregate Defined Book Surplus projected in the Base Case.
- (d) The scenarios set out under "*Sensitivity Analysis*" below and in Appendix 4 are designed to illustrate the effects of the variability of certain specific Base Case Assumptions on the Base Case projections, and are not intended to be projections, estimates, forecasts or forward looking statements or indications of the likelihood that these scenarios may occur. These scenarios do not purport to be comprehensive, are not based on any view of FPLP, KPMG, the Reinsurer, InterCo, the Issuer, Ambac, the Lead Manager or any of their respective affiliates or any other person as to the likelihood of their occurrence, are not the worst case scenarios which could prevail and do not reflect variations in anything other than the relevant Base Case Assumptions; other scenarios may show different effects on the Base Case projections (and, accordingly, the ability of the Issuer to pay interest on the Notes may differ from the scenarios illustrated and may be worse).

Actual future experience is likely to differ from that assumed in the calculation of the Base Case, and such variations may be material. Consequently, the inclusion of the Base Case projections herein should not be regarded as a representation by FPLP, KPMG, the Reinsurer, InterCo, the Issuer, Ambac, the Lead Manager or any of their respective affiliates or any other person that the projections of Defined Book Surplus over this period or the projection of Defined Book Surplus in respect of any particular Calculation Period, will be achieved.

None of FPLP, KPMG, the Reinsurer, InterCo, the Issuer, Ambac, the Lead Manager or any of their respective affiliates or any other person undertakes any obligation to update any forward looking statement contained herein.

The principal assumptions used in the projections of the Defined Book Surplus in the Base Case are as follows and as set out in Appendix 7 – ("*Base Case Assumptions Table*") (collectively, the "**Base Case Assumptions**").

Mortality and Morbidity

Mortality: Mortality rates assumed in the Base Case are derived from standard actuarial tables used widely throughout the life assurance industry using appropriate percentages based on FPLP's own experience and future expectations. The assumptions used for future experience are set out below and are based on recent experience.

Term assurance mortality rates assumed:

Sex	Aggregate	Smoker	Non-Smoker
Male	60 per cent. TM92 (5)	99 per cent. TM92 (5)	52 per cent. TM92 (5)
Female	65 per cent. TF92 (5)	96 per cent. TF92 (5)	60 per cent. TF92 (5)

Morbidity: Morbidity rates are based on 100 per cent. of reinsurer's rates used for Standalone and Accelerated Critical Illness products.

Longevity:

Purchased Life Annuities (scheme)	Male	100% PMA 92
	Female	100% PFA 92
Purchased Life Annuities (individual)	Male	100% IMA 92
	Female	105% IFA 92
Pension Annuities (Group)	Male	PMA 92 ⁽¹⁾
	Female	PFA 92 ⁽¹⁾
Pension Annuities (individual)	Male	RMU 92 ⁽¹⁾
	Female	RFU 92 ⁽¹⁾

Footnotes:

(1) Age banded factors are used. In addition, 100% and 75% of medium cohort future improvement factors have been used for male and female lives respectively, e.g. individual male age 65 and individual female age 60 exactly at 1/1/2005 have a life expectancy of 21.79 and 28.41 respectively.

Early Termination Rates

The rates of early termination (including lapse rates and the rate at which policies become paid up) (other than in respect of early retirement) assumed in the Base Case vary by policy type based on historic experience of FPLP or Defined Book Policies (to the extent FPLP has recorded experience in relation to these separately) up to 30 June 2004.

Future investment return assumptions

Future investment returns for the Base Case are projected using the following economic assumptions as to asset mix and investment returns.

Asset Mix:

per cent.	Conventional Non Profit Pensions	Conventional Non Profit Life	Unit Linked (Life and Pensions)	Unitised With profit (Life and Pensions)
Equities	—	—	65.0	37.5
Property	—	—	10.0	7.5
Government Bonds	—	50.0	5.0	22.5
Corporate fixed interest	100.0	50.0	15.0	27.5
Cash and other	—	—	5.0	5.0
Total	100.0	100.0	100.0	100.0

Investment Returns:

	per cent. p.a.
Government Bonds	5.10
Corporate fixed interest	5.86
Cash	5.10
Equities	7.60
Property	7.60
of which	
Dividend yield (gross)	3.08
Property rental yield	6.24

The return on Government bonds was based on the gross redemption yield on the FT Actuaries 15 year gilt index at 31 May 2004, rounded to the nearest 0.1 per cent.. Equity and property investments were assumed to yield an overall return 2.5 per cent. pa higher than the rounded gilt index return. Cash was assumed to yield the same as the gilt index return.

The investment return assumption for assets backing conventional non profit business and sterling reserves on unitised business is 5.5 per cent. per annum.

It should be noted that in projecting Defined Book Surplus for a particular year (and therefore projecting the expected amount available to amortise Notes in that year) the use of a long term rate has the effect of averaging out years where investment performance is above and below the assumed long term rates, whereas actual Defined Book Surplus in those years will in fact reflect the actual performance (whether below or above the long term rate assumed) which will give rise to greater volatility of actual surplus in each year (and therefore greater variation of the cash flow on the Notes than the Base Case may indicate). A long-term rate has been used as short-term rates cannot reasonably be projected for each future Calculation Period throughout the term of the Notes. Prospective investors should not assume that the investment returns projected for the Base Case, and therefore the Base Case projections, are likely to emerge in a smooth way as indicated in the Base Case by virtue of the Base Case using a long term rate for the projection.

Administration expense assumptions

As described above, the Scheme contains detailed provisions regarding maintenance, termination, and investment management expenses that limit the Defined Book's exposure to increases in its expense base in accordance with the Scheme.

The following tables show the Scheme expenses (for pre-demutualisation business). These are the expenses as at 30 June 2001, inflated to 31 December 2003.

Where policies are written in clusters, the expenses shown are applied to each policy record within a cluster. The expenses per record reflect the average number of records in each cluster for each category of business.

Maintenance Expenses for Pre-Demutualisation Business (Scheme Expenses):

Category	Per Policy p.a. (£)		Paid-Up
	Regular Premium	Single Premium	
Conventional			
Non profit life	14.33		10.74
Non profit pensions (non annuities)	17.90		12.53
Non profit pensions (annuities)		14.33	
Unit linked / unitised with profits			
Life	21.16	17.05	
Pensions (Individual)	24.42	20.46	19.53
Pensions (Protected Rights)		7.68	
Pensions (Group)	20.14	19.28	15.67
Pensions (Executive)	78.12	64.46	58.59
Pensions (New generation)	12.46	10.74	9.34
Overseas Business	7.75	25.06	

In addition to unit costs, the Base Case Assumptions assume annual investment related expenses of 0.250 per cent. for unit linked (0.100 per cent. for post 1999 new business), 0.104 per cent. for conventional and unitised with profits and 0.05 per cent. for annuity business.

FPLP Scheme Maintenance Expenses:

Category	Per Policy p.a. (£) Regular Premium			Per Policy p.a. (£) Single Premium		
	Inflating	Non-inflating	Net	Inflating	Non-inflating	Net
All policies	33.06	-4.10	28.96	16.53	-2.05	14.48

In addition, the Base Case Assumptions assume annual investment related expenses of 0.25 per cent. of non-unit (sterling) reserves for unit linked and 0.104 per cent. for conventional non profit business.

Inflation

The Base Case assumes that inflation is 3.1 per cent. per annum and that the expenses for Calculation Periods after 31 December 2009 will be the same as those prior to that date (adjusted for RPI or RPI plus one per cent., as applicable).

Taxation

Tax has been assumed at the following rates:

	Tax rate (per cent.)
Savings income	20
Franked income	0
Other income	20
Realised chargeable gains	20
Tax relief on maintenance expenses	20
Shareholder tax	0

Reserving basis

Unless otherwise stated, the principal non economic elements of the actuarial basis used for the Base Case are unchanged from those as at 31 December 2003. A full description is included in the Returns filed by FPLP which may be obtained from the Companies Registry, Companies House, Crown Way, Cardiff CF14 3UZ.

The valuation interest rates used for the main products are summarised in the table below.

Conventional Non Profit Life	3.50 per cent.
Conventional Non Profit Pensions (Annuities)	5.10 per cent.
Unit linked Life	3.50 per cent.
Unit linked Pensions and Overseas Business	4.40 per cent.
Unitised with profits Life	3.50 per cent.
Unitised with profits pensions and overseas business	4.40 per cent.

SENSITIVITY ANALYSIS

The Base Case set out in “*The Base Case*” above is based upon the Base Case Assumptions (see above). The projection of Defined Book Surplus under the Base Case Assumptions can be used to calculate certain coverage ratios.

The “**Aggregate Defined Book Surplus**” in respect of a period is the amount projected in relation to data available as at 31 May 2004 and on the relevant Base Case Assumptions (or, in the case of the sensitivity analysis, as amended by the relevant Sensitivity Assumption(s)) to be the aggregate of Defined Book Surplus projected to emerge in respect of each future Calculation Period discounted to 16 December 2004 at a rate of 5.47 per cent. per annum. **For the purposes of analysing the liability structure, it is appropriate to discount at an estimated cost of financing. The Base Case and Sensitivity Analysis has been performed using a discount rate of 5.47 per cent. per annum. This figure is not an estimate of the cost of financing either by FPLP, the Reinsurer or by the Lead Manager.**

The Base Case Amortisation Profile represents the outstanding principal of the Notes following the April Interest Payment Date following each Calculation Period on the basis that the Defined Book Surplus is as projected in the Base Case and the financing costs are the amount projected under the Base Case Assumptions to be 5.47 per cent. per annum on the April Interest Payment Date immediately following each future Calculation Period.

The Base Case Assumptions together with the alternatives to the Base Case Assumptions set out below (the “**Sensitivity Assumptions**”), represent possible scenarios designed to illustrate certain characteristics of the recapture of the Assumed Liabilities by FPLP and are not intended to be projections, estimates, forecasts or forward-looking statements. The table below has been developed by fixing the Base Case Assumptions other than the ones corresponding to the particular Sensitivity Assumption and by applying that Sensitivity Assumption to determine its effect on the amount projected as the Defined Book Surplus in respect of each future Calculation Period or as the amount of the Aggregate Defined Book Surplus. The Sensitivity Assumptions do not represent a complete list of factors that may affect the projection of Defined Book Surplus or Aggregate Defined Book Surplus but rather indicate those factors that are likely to affect the performance of the Defined Book. In addition, the range of possible outcomes with respect to each Sensitivity Assumption and combinations of the Sensitivity Assumptions set forth below do not purport to be a comprehensive set of possible results for the policies, are not based on any view of FPLP, KPMG, the Reinsurer, InterCo, the Issuer, the Lead Manager or any of their respective affiliates or any other person as to the likelihood of their occurrence, are not the worst case scenarios which could prevail and do not reflect variations in anything other than the relevant Base Case Assumptions. In particular, more severe assumptions may show payments of interest and/or principal on the Notes being delayed or decreased.

Prospective Noteholders should note that the following table is intended merely to illustrate certain, but not all, payment sensitivities of the Notes to certain, but not all, market and economic stresses. It is highly likely that actual experience of the Defined Book will vary from the Base Case Assumptions and from the Sensitivity Assumptions and the possible scenarios represented by the tables. Some of the principal factors that could cause the actual Defined Book Surplus to differ materially from such scenarios are described in “*Defined Book Surplus – Principal Risks to the Emergence of Defined Book Surplus*” and “*Investment Considerations*” above.

The Sensitivity Assumptions for the various scenarios are set out below. Appendix 4 sets out the full projections applying the relevant Base Case Assumptions as amended by the relevant Sensitivity Assumption below. Below is a summary of these tables and the relevant scenarios.

Scenario	Scenario Type	Description of Scenario	Comment
1	Mortality	25 per cent. increase in mortality and critical illness assumptions (except annuities) + immediate remarking of reserves for a 25 per cent. increase to the mortality table used in the base valuation (i.e. assume that full impact of the deteriorating experience would immediately be recognised in the reserving basis).	This is to assess the impact of higher mortality and critical illness costs on the conventional business and the unit linked business.

Scenario	Scenario Type	Description of Scenario	Comment
2	Longevity	For the annuity book only, move the future improvement factors in the experience basis from medium cohort to half way between medium and long cohort with a minimum of 0.5% p.a. Plus an additional 0.5% p.a. on top of the cohort improvement factors in both the experience and valuation bases plus remarking of reserves spread over first 10 years evenly.	Longevity is a significant risk to the emergence of profits on the annuity book. This stress gives a minimum improvement factor of 1 per cent. per annum.
3	Lapse	100 per cent. increase in lapse rate assumptions. Assume pensions become fully paid-up rather than lapse.	Future fee income will be highly sensitive to persistency of the business.
4	Lapse	200 per cent. increase in lapse rate assumptions. Assume pensions become fully paid-up rather than lapse.	Future fee income will be highly sensitive to persistency of the business.
5	Lapse	300 per cent. increase in lapse rate assumptions. Assume pensions become fully paid-up rather than lapse.	Future fee income will be highly sensitive to persistency of the business.
6	Investment Return	100bps fall in investment return assumption (except for annuities), including non-unit reserves. Assume the matching assets for the annuity book suffer 25bps per annum defaults.	The main effect under investigation is the impact on future fee income.
7	Investment Return	Immediate 25 per cent. fall in equity and property investment asset values in year 1, including non-unit reserves, followed by long-term growth assumption.	The main effect under investigation is the impact on future fee income.
8	Investment Return	Immediate 50 per cent. fall in equity and property investment asset values in year 1, including non-unit reserves, followed by long-term growth assumption.	The main effect under investigation is the impact on future fee income.
9	Investment Return	Immediate 50 per cent. fall in equity and property investment asset values in year 1, including non-unit reserves, followed by no growth for ten years.	The main effect under investigation is the impact on future fee income.
10	Combination	Mortality: Stress 1 Longevity: Stress 2 Lapse: Stress 3 (100 per cent.) Investment return: Stress 7 (25 per cent.)	To test the robustness of the cashflows to a combination of stresses.

Projected Net Present Value Defined Book Surplus for Base Case and Sensitivity scenarios:

Scenario	Base	Mortality	Longevity	Lapse	Lapse
	1	2*	3	4	
	(£m)	(£m)	(£m)	(£m)	(£m)
Conventional non profit life	96	80	96	84	76
Conventional non profit pensions	266	263	204	263	261
Unit linked life	85	65	85	60	45
Unit linked pensions	145	144	145	127	116
Unitised with profits life	168	153	168	112	86
Unitised with profits pensions	97	97	97	88	82
Total NPV	857	802	795	734	666
% of Total	100%	94%	93%	86%	78%

Scenario	Lapse	Investment	Investment	Investment	Investment	Combination
	5	6	7	8	9	10*
	(£m)	(£m)	(£m)	(£m)	(£m)	(£m)
Conventional non profit life	70	90	95	96	96	74
Conventional non profit pensions	260	205	266	266	265	203
Unit linked life	36	81	71	56	43	40
Unit linked pensions	108	123	111	76	33	91
Unitised with profits life	71	160	151	133	114	94
Unitised with profits pensions	79	83	78	58	32	68
Total NPV	624	742	772	685	583	570
% of Total	73%	87%	90%	80%	68%	67%

Notes:

Net Present Value ("NPV") is the aggregate value of all Defined Book Surplus cash flows projected to arise in the future, in respect of all policies in force as at 31 May 2004, discounted to 16 December 2004, assuming that cash flows are available on 15 April of each year following the Calculation Period. The discount rate is 5.47 per cent. per annum.

* Remarking of increase in Annuity Reserve due to longevity stress is applied over 10 years for scenarios 2 and 10.

ACTUARY'S REPORT

The following is the text of a report received by, *inter alios*, the Directors of FPLP and the Issuer from KPMG, the consulting actuaries to FPLP. KPMG have been appointed as consulting actuaries pursuant to the terms of an engagement letter which includes, *inter alia*, certain limitations on liability.

The Directors
Box Hill Life Finance plc (the "Issuer")
Fifth Floor
100 Wood Street
London
EC2V 7EX

The Directors
Box Hill Loan Finance Limited ("InterCo")
Blackwell House, Guildhall Yard
London EC2V 5AE

The Directors
Friends Provident Reinsurance Services Limited (the "Reinsurer" or "FP Re")
Pixham End, Dorking
Surrey, RH4 1QA

The Directors
Friends Provident Life and Pensions Limited (the "Originator" or "FPLP")
Pixham End, Dorking
Surrey, RH4 1QA

The Directors
Barclays Bank PLC (the "Lead Manager")
5 The North Colonnade
Canary Wharf
London
E14 4BB

13 December 2004

Dear Sirs

Project Renaissance; Box Hill Life Finance plc: £280,000,000 Class A-1 Floating Rate Secured Notes due 2016 and £100,000,000 Class A-2 Floating Rate Secured Notes due 2019 (together, the "Notes" or the "Issue")

Dear Sirs

1. Introduction

KPMG LLP ("KPMG") has been engaged by you to provide actuarial opinions on certain matters in connection with the proposed issue of Class A-1 and Class A-2 Floating Rate Secured Notes by Box Hill Life Finance plc (the "Issuer"). This letter, which is included in the offering circular dated 13 December 2004, sets out the scope of the work that we have been engaged to undertake and summarises the results of our work.

Terms defined in the Offering Circular have the same meaning in this letter.

2. Background

The proceeds of the Notes will be used by the Issuer to make the InterCo Loan to InterCo. The proceeds of the InterCo Loan will be used by InterCo to make the Reinsurer Loan to the Reinsurer. The Reinsurer's obligations, under the Reinsurer Loan, to make interest payments, payments of

Reinsurer Ongoing Commitment Fees and to repay principal will be limited to the Available Reinsurer Surplus. Available Reinsurer Surplus is defined in the Offering Circular. The purpose is to pass Defined Book Surplus arising in FPLP to InterCo.

FPLP has prepared projections of Defined Book Surplus according to a number of scenarios concerning, *inter alia*, future investment returns and operational experience. We have been asked to comment on certain aspects of these projections and the results are set out below.

We have not been asked to comment on the implications or impact of the transaction on the With Profits Fund or with profit policyholders of FPLP. We have had no responsibility for the selection of the sensitivities used for the Sensitivity Analysis.

Sections 3, 4 and 5 describe our work and conclusions. Our conclusions are subject to the Reliances and Limitations set out in Section 6.

3. Base Case Assumptions

The Base Case Assumptions, which have been determined by FPLP, (which are set out under the heading "*The Base Case – Base Case Assumptions used in projecting Defined Book Surplus*" and in Appendix 7 entitled "*Base Case Assumptions Tables*" in the Offering Circular) have been set having regard to the operating experience of FPLP and in respect of future investment return and expense inflation by reference to available yields and market expectations of inflation, in each case as at 31 May 2004.

Most of the operational experience analysed related to periods up to and including 31 May 2004, but future persistency assumptions have, where appropriate, been revised to take into account more recent, adverse, experience to 30 June 2004.

We have reviewed the Base Case Assumptions by comparing them to the operating experience, investment conditions as at the date of which the Base Case Assumptions are stated to be made (subject to the adjustments referred to above) and having regard to our knowledge of the UK life insurance market generally. On the basis of the work performed, we have concluded that the Base Case Assumptions (which are long term assumptions) are, in our opinion, reasonable at the date of the Offering Circular, taken as a whole over the period over which Defined Book Surplus is projected to arise.

To the extent that changes in investment returns generally have occurred since the date as at which the Base Case Assumptions were made, we consider that such changes are not likely to result in a material reduction in the amount of Aggregate Defined Book surplus projected in the Base Case.

For the Offering Circular a discount rate has been used by FPLP to analyse the liability structure. The discount rate should relate to the estimated cost of financing, but this figure is stated in the Offering Circular not to be an estimate of the cost of financing either by FPLP, the Reinsurer or by the Lead Manager. Accordingly we give no opinion on this figure.

4. Modelling Systems

The projections of Defined Book Surplus prepared by FPLP are derived from the Prophet proprietary actuarial projection systems (as programmed by FPLP). We have carried out the following checks:

- independently reproduced results for individual policies for each of the six principal product groups; and
- examined the comparisons performed by FPLP management of the policy data used in the models with the in-force policy data at 31 May 2004, and of that with the data in the 31 December 2003 FSA Return.

Based on this work we have concluded that the modelling systems and approaches used are appropriate for the purpose of projecting Defined Book Surplus.

5. Results

In addition to the checks noted in Section 4 above, we have:

- checked that the assumptions were input correctly for the Base Case either directly or through reviewing checks performed by FPLP;
- examined aggregate projection results for reasonableness; and

- in the Sensitivity Analyses, checked that the changes in the components of Defined Book Surplus are consistent with the changes in the assumptions.

Based on these checks we have concluded that the projections of Defined Book Surplus, including the timing of its emergence, are, in our opinion, reasonable. The projections produced for the scenarios set out in the Sensitivity Analysis properly reflect the changes in the underlying assumptions.

We can confirm that the tables included in the Offering Circular on the population of policies, Base Case Cashflows and Sensitivity Analyses on pages 15, 16, 73, 81, 82, 89 and 306 to 316 agree to the Prophet output for the Defined Book which we have examined.

We confirm that the descriptions in the Offering Circular on pages 72 to 76 of the way a policy theoretically contributes to surplus (and the risks to that surplus emerging) and the principal risks to the emergence of Defined Book Surplus on pages 77 to 80 are consistent with our knowledge of the Defined Book.

There are no issues which have come to our attention during the course of our work which would lead us to believe that representations, warranties or covenants given in the sections entitled "*Summary of Transaction Documents – Reinsurance Agreement – Part A Warranties*" under "*No Material Adverse Change*", "*Records*", "*Defined Book Policies*" and "*Model/Base Case*" on pages 107 to 112 by FPLP in respect of the Defined Book should be qualified at the date of the Offering Circular.

6. Reliances and Limitations

In our work we have relied on audited and unaudited information provided to us by FPLP for periods up to and including 30 June 2004, and on information from public sources. Where possible we have reviewed the information provided to us for reasonableness and consistency with our knowledge of the industry but we have not carried out independent checks of the data and other information supplied to us.

We have not reviewed the methodology or assumptions used by FPLP to establish their Defined Book reserves, nor have we considered how such reserves compare with the component of FPLP's regulatory Individual Capital Adequacy requirement which may be attributable to the Defined Book. We have not reviewed the discount rate or tax assumptions and methodology used by FPLP.

We have not investigated, nor made any allowance for the cost of claims made by policyholders other than in the normal course of business under the terms of the policies issued.

We have not investigated the implications or impact of the transaction on the With Profit Fund or with profit policyholders of FPLP.

In developing projections of Defined Book Surplus, numerous assumptions about future experience have been made by FPLP. Most of these factors are beyond FPLP's control. Actual future experience will differ from the assumptions made for the Base Case, and hence actual future Defined Book Surplus will differ from that projected, perhaps materially.

The Sensitivity Analysis has been produced to quantify the effect of the specific scenarios illustrated. However, the scenarios are in no way intended to represent a likely range of possible outcomes and should not be regarded as such.

The limitations on liability contained in our engagement letter dated 13 December 2004 apply to this letter.

Yours faithfully

Nick Dexter
Director KPMG LLP

Fellow of the Institute of Actuaries

REINSURER REGULATORY SURPLUS

The Reinsurer maintains two funds; the long-term insurance fund (the “**Reinsurer’s Long Term Business Fund**”) and the shareholders’ fund (the “**Reinsurer’s Shareholder Fund**”). The reserves required to back the Sum Reinsured from time to time are held within the Reinsurer’s Long Term Business Fund; in addition, the Reinsurer may maintain a part of its capital in the Reinsurer’s Long Term Business Fund for the reasons explained below. Capital, to the extent not held in the Reinsurer’s Long Term Business Fund, may be held in the Reinsurer’s Shareholder Fund at the Reinsurer’s discretion (though all the Reinsurer’s assets are subject to the security created by the Reinsurer Deed of Charge, whichever fund they are allocated to). The Reinsurer’s Regulatory Surplus is the surplus in the Reinsurer’s Long Term Business Fund at the end of a Calculation Period (and can be increased by the transfer of assets from the Reinsurer’s Shareholder Fund to the Reinsurer’s Long Term Business Fund and reduced if the transfer is from the Reinsurer’s Long Term Business Fund to the Reinsurer’s Shareholder Fund). The initial capital of £30 million is expected initially to be allocated as to £20 million to the Reinsurer’s Long Term Business Fund and as to £10 million to the Reinsurer’s Shareholder Fund. The proceeds of the Reinsurer Loan will be allocated to the Reinsurer’s Long Term Business Fund.

The Reinsurer is intended to operate as a conduit, passing Available Defined Book Surplus plus any Regulatory Surplus Deficiency in each Calculation Period to InterCo (which will pass them on to the Issuer, as interest, InterCo Ongoing Commitment Fees and principal, subject to paying or providing for costs and expenses of InterCo ranking higher in the InterCo Priorities of Payments). Accordingly, in order for the Reinsurer to act as a conduit for Available Defined Book Surplus plus any Regulatory Surplus Deficiency, it is necessary to ensure that the regulatory surplus available to the Reinsurer is not less than the aggregate of the Available Defined Book Surplus plus any Regulatory Surplus Deficiency in respect of the corresponding Calculation Period.

As a regulated insurance company, and so as to be able not to have to separately value, as a cash outflow, payments in respect of interest, Reinsurer Ongoing Commitment Fees and principal under the Reinsurer Loan Agreement pursuant to Policy Statement 04/24 (Integrated Prudential sourcebook for insurers), the payments in respect of such amounts need to be unambiguously linked to surplus and satisfy certain other criteria. Accordingly, the obligation of the Reinsurer to pay interest, Reinsurer Ongoing Commitment Fees and principal (and any gross up or corresponding amounts, but not any break costs (see below)) in respect of the Reinsurer Loan, including on a Loan Interest Payment Date (being 15 April in each year, subject to adjustment for the following business day convention), is contingent (other than on termination of the Reinsurance Agreement, as to which, see below) on the amount of the Available Reinsurer Surplus (see below) at the end of the Calculation Period ending on the preceding 31 December (assuming that the Calculation Period remains a calendar year - it cannot be changed without the consent of the Relevant Person).

The effect of FPLP paying an Annual Premium and recapturing liabilities in an amount equal to the value of the Recapture Amount is that the aggregate of the Annual Premium and the value of the Recapture Amount contribute to an amount of surplus in the Reinsurer (ignoring other events in the Reinsurer) which is generally expected to be a little higher than the Available Defined Book Surplus (see “*Executive Overview – The Reinsurance Agreement and Defined Book Surplus*” above for an explanation). The Reinsurer has other assets and liabilities (principally, the yield on the Reinsurer Eligible Investments and bank accounts, amounts accruing under the Reinsurer Swap Agreement and amounts payable under the Reinsurer Swap Agreement). If the yield on the Reinsurer Eligible Investments were to equal the floating rate amount payable by the Reinsurer under the Reinsurer Swap Agreement, then, very broadly, the accruing fixed rate payable by the Reinsurer Swap Provider on the Reinsurer Swap corresponds to the increase in the Adjusted Sum Reinsured by the Benefit Increase Rate over the corresponding period and therefore, absent any other events (and ignoring differences in valuation rates of interest between the Reinsurer’s assets and liabilities), the Reinsurer Regulatory Surplus in a Calculation Period would, very broadly, be expected to increase by an amount slightly in excess of the aggregate of the Annual Premium and Recapture Amount in that Calculation Period.

However, there are certain business and regulatory risks in relation to such analysis. Examples of the business risks which could result in Reinsurer Regulatory Surplus being less than the Available Defined Book Surplus plus any Regulatory Surplus Deficiency include, for example, default on Reinsurer Eligible Investments or realisation of Reinsurer Eligible Investments at less than the

amount paid to acquire them (taking account of purchased and sold accrued interest), or that the yield on the Reinsurer Eligible Investments is insufficient to fund the floating amounts payable to the Reinsurer Swap Provider. Regulatory risks include changes to the regulatory regime or the way in which the Reinsurer's surplus is expected to be determined, such as changing the valuation basis of the Reinsurer or the valuation rates of interest applicable to the Reinsurer's assets and liabilities.

The Reinsurer expects to allocate to the Long Term Business Fund an amount of £20 million which is designed to absorb the impact of these risks. In addition, FPLP has covenanted that it will ensure that, (i) in relation to each Calculation Period during the term of the Reinsurance Agreement the Reinsurer Regulatory Surplus is no less than the Available Defined Book Surplus together with Capital Injections plus any Regulatory Surplus Deficiency and (ii) the capital resources of the Reinsurer at all times meet the applicable regulatory capital or capital ratios as required by FSA. It is expected that the Reinsurer will, in the first instance, manage the cost by transferring assets from the Reinsurer Shareholder Fund to the Reinsurer's Long Term Business Fund to make good any deficit. To the extent risks arise which mean this is not the case and such risks are not borne out of the transfer of assets from the Reinsurer's Shareholder Fund to the Reinsurer's Long Term Business Fund, the effect is that they will be funded by FPLP.

As noted above, the amount payable by the Reinsurer as interest, Reinsurer Ongoing Commitment Fees and principal (and withholdings and related amounts in respect thereof) are limited to Available Reinsurer Surplus. Available Reinsurer Surplus, the detailed definition of which is set out below, is, essentially, the Reinsurer Regulatory Surplus reduced if it exceeds the Available Defined Book Surplus plus any Regulatory Surplus Deficiency and increased to the extent Reinsurer Regulatory Surplus was less than the Available Defined Book Surplus in a prior year (for example because a dispute had not been settled or because, due to timing factors, it was not possible to remedy the deficiency in the prior Calculation Period).

The "**Available Reinsurer Surplus**" (A) in respect of a Calculation Period, other than the Calculation Period in which the Reinsurance Agreement is terminated, is the lower of (i) the Available Defined Book Surplus in respect of such Calculation Period and any Regulatory Surplus Deficiency in respect of any prior Calculation Period and (ii) Adjusted Regulatory Surplus in respect of the relevant Calculation Period provided that, for the Calculation Period ending 31 December 2004, the Available Defined Book Surplus will be treated as reduced to the extent it would otherwise result in the principal amount of Notes being repaid, and, (B) in the Calculation Period in which the Reinsurance Agreement is terminated, is the Adjusted Regulatory Surplus.

The "**Adjusted Regulatory Surplus**" means the Reinsurer Regulatory Surplus of the Reinsurer at the end of the Calculation Period (the second Calculation Period) together with an amount equal to the Regulatory Surplus Deficiency from the immediately preceding Calculation Period (the first Calculation Period) to the extent not transferred into the Reinsurers' Long Term Business Fund from the Reinsurer's Shareholder Fund on or prior to the end of the second Calculation Period (to such extent, the "**Unfunded Regulatory Surplus Deficiency**").

The "**Reinsurer Regulatory Surplus**" means, in respect of a Calculation Period, the surplus of the Reinsurer's Long Term Business Fund shown in Line 39 of Form 58 or such other position on Form 58, as amended from time to time, or on any other form of forms as shall from time to time serve the same purpose as is served by Line 39 of Form 58 as at the Closing Date (for the avoidance of doubt, calculated ignoring amounts which are payable subject to there being Available Reinsurer Surplus).

The "**Regulatory Surplus Deficiency**" in respect of a Calculation Period means the aggregate of:

- (i) the amount by which the aggregate of Available Defined Book Surplus at the end of that Calculation Period exceeds the Adjusted Regulatory Surplus in respect of such Calculation Period; and
- (ii) plus (if positive) or minus (if negative), the Disputed Amount;

in each case, to the extent not included in the Reinsurer Regulatory Surplus of the Reinsurer in that or a prior Calculation Period.

If any dispute results in an adjustment to Defined Book Surplus or Breach Adjustments or Reinsurer Regulatory Surplus in respect of prior Calculation Periods, the "**Disputed Amount**" is (a) the amount determined following the disputes procedure to be the amount which should have been the Available Defined Book Surplus, Breach Adjustment or Reinsurer Regulatory Surplus in respect

of such prior Calculation Period less (b) the Available Defined Book Surplus, Breach Adjustment or Reinsurer Regulatory Surplus actually used in such prior Calculation Period.

If the Reinsurance Agreement is terminated, the Reinsurer is required to determine the Adjusted Regulatory Surplus for the Calculation Period in which the termination occurs and may apply up to that amount (whether or not it exceeds Available Defined Book Surplus) in paying interest, Reinsurer Ongoing Commitment Fees and principal on the Reinsurer Loan Agreement. The Reinsurer will transfer all funds in the Reinsurer's Shareholder Fund to the Reinsurer's Long Term Business Fund prior to the end of the relevant Calculation Period. To the extent that there are insufficient funds to repay the Notes and other secured creditors of the Issuer, InterCo and the Reinsurer, FPLP will be required to continue paying Ongoing Premiums equal to Available Defined Book Surplus until such time as such amounts are discharged.

SURPLUS CALCULATION – PROCESS AND INTERACTION

Process for determining Defined Book Surplus

The Reinsurance Agreement sets out the procedure for determining the Defined Book Surplus with respect to each Calculation Period and for resolving disputes in relation to the Defined Book Surplus as determined by FPLP on any Calculation Date. The timetable described below may be amended in future with the consent of Ambac, for so long as Ambac is the Reinsurer Controlling Creditor, and thereafter the Note Trustee (such consent not to be unreasonably withheld or delayed).

Step 1: FPLP will undertake to calculate the Defined Book Surplus in respect of each Calculation Period in accordance with all applicable Laws, accounting and actuarial practice and guidelines.

Step 2: FPLP will, in establishing its reserves for the purposes of calculating the Defined Book Surplus, do so in accordance with the Initial Reserving Basis or the then Permitted Reserving Basis (each as defined below).

For these purposes:

“**Initial Reserving Basis**” means the reserving basis of FPLP as at 31 December 2003 as used in compiling the statutory return to the Financial Services Authority for its financial year ending 31 December 2003 and as used in establishing the reserves for the Defined Book, subject to changes (which shall be taken into account in the determination of Defined Book Surplus in the Calculation Period ending 31 December 2004), in the case of longevity, to reflect an increase in allowance for improvements in mortality to mid way between medium and long cohorts as specified in the CMI Longevity Paper, in Appendix 7 and on the Disc. The Initial Reserving Basis will be notified by FPLP to the Relevant Person in writing, with a copy to the Note Trustee, on or before the Closing Date.

“**Permitted Reserving Basis**” means the Initial Reserving Basis as changed by any Permitted Change.

Step 3: In September in each Calculation Period, FPLP will consult with the Relevant Person (or its duly appointed actuarial consultants) with a view to discussing the proposed methodology to be adopted in determining the items and the value and/or amounts of such items to be taken into account in the calculation of the Defined Book Surplus, as determined for the purposes of the Reinsurance Agreement. The purpose of such discussions and consultation will be for FPLP to provide information about its current thinking (which may be subject to change) with a view to assisting both parties when the Proposed Valuation Basis (as defined below) is to be determined and agreed. The Relevant Person shall not be constrained or restricted in any way by such discussions or consultation when it provides its final comments under Step 6 or Step 10.

In determining the Defined Book Surplus in respect of any Calculation Period, the basis to be used shall be the Initial Reserving Basis or the Permitted Reserving Basis, as the case may be adjusted to take into account any changes thereto which have been agreed by FPLP and the Relevant Person or determined in accordance with the procedures set out in Step 9 and/or Step 12 in respect of any previous Calculation Period (the “**Current Valuation Basis**”).

Step 4: FPLP will notify the Relevant Person in writing by no later than 20 October (or if such a day is not a Business Day, the immediately preceding Business Day) (the “**Preliminary Notification Date**”) giving details of the significant aspects of the proposed valuation basis, together with any changes in methodology as against the Current Valuation Basis for allocating investment income and gains and taxation (the “**Proposed Valuation Basis**”) to be used in calculating the Defined Book Surplus in respect of such Calculation Period.

FPLP will notify the Relevant Person in writing by no later than 31 October (or if such a day is not a Business Day, the immediately preceding Business Day) giving full details of the Proposed Valuation Basis to be used in calculating the Defined Book Surplus in respect of such Calculation Period.

The Proposed Valuation Basis will:

- (A) highlight changes proposed to be made to the Current Valuation Basis (or, in the case of the year ending 31 December 2004, to the valuation basis used in determining the Schedule 3 Amount (as defined in the Scheme) for the year ended 31 December 2003);
- (B) include certain supporting details and documentation, which shall, without limitation, include:

- (1) information, in form and detail as that customarily produced by FPLP, in relation to the decrement and expense assumptions, mortality/morbidity, persistency, taxation and any other basic information contained in the documents referred to in the Covenant set out in paragraphs (a) and (b) of paragraph 1.15 of Part A of Schedule 3 of the Reinsurance Agreement (the “**General Information**”);
 - (2) in the event of any changes or events that have affected the Defined Book Surplus then emerging, such reasonable additional supporting information or details relating to such changes as will be taken into account in the formulation of the Proposed Valuation Basis for determining the Defined Book Surplus (the “**Specific Information**”); and
 - (3) any other information which is readily available and that may reasonably be expected materially to affect the formulation of the Proposed Valuation Basis for determining the Defined Book Surplus (“**Additional Information**”);
- (C) include a preliminary calculation of the Defined Book Surplus (the “FPLP Preliminary Calculation”) using a best efforts assessment of the likely data as at the end of the Calculation Period (the “**Projected Data**”), together with supporting documentation (consisting of the General Information, the Specific Information and the Additional Information together with such additional information as the Relevant Person (for so long as it is the Controlling Creditor) has reasonably required to assist in determining whether such calculation is justifiable) and an analysis of the results on or prior to the Preliminary Notification Date; and
- (D) include an explanation of the rationale of the Proposed Valuation Basis for determining the Defined Book Surplus.

FPLP will notify the Relevant Person of any other changes or events other than insignificant or extraneous changes or events in respect of the Calculation Period which may have a material impact on the Defined Book Surplus as soon as practicable following becoming aware of the same.

The actuarial consulting costs of the Relevant Person in considering the information provided by FPLP and the calculations to be performed by FPLP, up to £30,000 per Calculation Period, shall be reimbursed to the Relevant Person as a third party cost under the Reinsurer Deed of Charge.

Step 5: Within 14 days of the Preliminary Notification Date, the Relevant Person shall use all reasonable endeavours to inform FPLP of any aspects of the Proposed Valuation Basis that the Relevant Person considers may not be consistent with the Permitted Reserving Basis and shall discuss issues identified with FPLP. The Relevant Person shall not be constrained or restricted in any way by such discussions or consultation when it provides its final comments under Step 6 or 11.

Step 6: Over the 41 days following the Preliminary Notification Date, FPLP and the Relevant Person shall continue to consult with a view to resolving any matters in dispute.

To the extent that the Relevant Person considers that FPLP has not complied with its undertakings as described in Steps 1 and 2 or considers, following the consultation referred to in Steps 3 and 5, that the valuation basis is not justifiable or that it has not received sufficient information in respect of the determination of the FPLP Preliminary Calculation on the Preliminary Notification Date or subsequently to make an assessment, the Relevant Person shall no later than 41 days following the Preliminary Notification Date, notify FPLP in writing (a “**Dispute Notice**”) either:

- (A) that it requires further information and what that information is; or
- (B) that it considers that one or more of the components of the valuation basis adopted in determining the FPLP Preliminary Calculation is not justifiable and, so far as it is practicable to do so, the valuation basis which would be justifiable in respect thereof (the “**Relevant Person’s Valuation Basis**”), the reasons why the valuation basis in determining the FPLP Preliminary Calculation is not justifiable, the reason why the Relevant Person’s Valuation Basis (if applicable) is justifiable and the amount it estimates would be the Defined Book Surplus if the Relevant Person’s Valuation Basis was adopted (the “**Relevant Person’s Projection**”).

Step 7: As soon as reasonably practicable following receipt of the Dispute Notice and (if applicable) the Relevant Person’s Projection, FPLP shall determine whether it proposes to accept the Relevant Person’s Valuation Basis. If it determines that the valuation basis which it should properly use for determining the Defined Book Surplus is different from the Relevant Person’s Valuation Basis, it shall notify the Relevant Person no later than 15 December.

If FPLP determines that the valuation basis to be used is the Relevant Person's Valuation Basis FPLP shall notify the Relevant Person no later than 15 December and the Dispute Notice in respect thereof shall cease to be effective.

If the parties do not agree on a valuation basis for determining the Defined Book Surplus (a "**Valuation Dispute**"), subject to Step 8, FPLP or the Relevant Person may seek to have the Valuation Dispute resolved by the Independent Actuary following the procedures set out in Step 9 below.

Step 8: If a Valuation Dispute has not been resolved following discussions between FPLP and the Relevant Person over the 5 days following 15 December and either:

- (A) the difference between the Relevant Person's Projection and the FPLP Preliminary Calculation is greater than the Materiality Threshold in respect of that year; or
- (B) the cumulative amount of the differences between the Relevant Person's Projection over the FPLP Preliminary Calculations in respect of prior years which are not or have not been agreed by FPLP and the Relevant Person and which have not been referred to an Independent Actuary or in respect of which an amount has not been paid by way of indemnity or by adjustment to the valuation basis as described above, when added to the amount in respect of that year, are greater than the Cumulative Materiality Threshold,

the matter shall be referred to the Independent Actuary.

"**Materiality Threshold**" means in any year 10 per cent. of the Defined Book Surplus projected to emerge in that Calculation Period, as set out in the Base Case.

"**Cumulative Materiality Threshold**" means £15 million.

Step 9: The Independent Actuary (as defined below) shall select either the Proposed Valuation Basis or the Relevant Person's Valuation Basis as being the most appropriate valuation basis. The Independent Actuary shall be requested to make its determination, if practicable, no later than 15 January (or if such day is not a Business Day the immediately preceding Business Day) in such year (the "**IA Determination Date**").

The "**Independent Actuary**" will be a person, acting as expert and not as arbitrator, who is agreed between the Relevant Person and FPLP or, failing agreement, who is nominated by the then President of the Institute of Actuaries (or any successor body) for the purpose.

The costs of the Independent Actuary will be allocated as follows:

- (A) to the extent that the Independent Actuary determines that the Relevant Person's Valuation Basis is unreasonable, the Independent Actuary's costs will be borne by the Relevant Person;
- (B) to the extent that the Independent Actuary determines that the Proposed Valuation Basis is unreasonable, the Independent Actuary's costs will be a third party cost under the Reinsurer Deed of Charge; and
- (C) to the extent that the Independent Actuary does not make a determination under (A) or (B) above, the Independent Actuary's costs shall be allocated such that half will be a third party cost under the Reinsurer Deed of Charge and half shall be borne by the Relevant Person.

Step 10: No later than 24 January in each year (the "**Second Notification Date**") following the end of a Calculation Period, FPLP shall provide the Relevant Person with the actual data in respect of which the Defined Book Surplus for such Calculation Period will be determined and to which will be applied the valuation basis determined in accordance with Steps 1 to 9 above (provided that if such basis is still the subject of a dispute which has not been resolved by the Independent Actuary, FPLP shall use the Proposed Valuation Basis for such Calculation Period as amended to reflect any matters which have been agreed or resolved prior to that date for determining the Defined Book Surplus) (and, in addition, by 24 January 2005, FPLP shall also give the Relevant Person full details of the Proposed Valuation Basis referred to in Step 4 in respect of the Calculation Period ending 31 December 2004) and shall notify the Relevant Person of the Defined Book Surplus so determined for such Calculation Period (the "**Proposed Defined Book Surplus**").

Over the following 7 days, FPLP and the Relevant Person shall continue to consult with a view to resolving any matters in dispute.

To the extent that the Relevant Person considers that FPLP has not complied with its undertakings as described in this Step 10 or considers that it has not received sufficient information in respect of the determination of the Proposed Defined Book Surplus to make an assessment or considers

that the Proposed Defined Book Surplus is incorrect, the Relevant Person shall no later than 14 days following the Second Notification Date, notify FPLP in writing (a “**Second Dispute Notice**”) either:

- (A) that it requires further information and what that information is; or
- (B) that it considers that FPLP has not calculated the Proposed Defined Book Surplus correctly; and
- (C) so far as it is practical to do so the amount it estimates would be the Defined Book Surplus (the “**Relevant Person’s Estimate**”) if FPLP had calculated the Proposed Defined Book Surplus correctly and, insofar as a dispute was referred to the Independent Actuary under Step 9 and the matter has not been resolved pursuant to Step 9 above by the Independent Actuary, the valuation basis it considers justifiable were adopted,

provided that the Relevant Person shall not be entitled to include in a Second Dispute Notice any issue or dispute which it could, in the light of the information then available to the Relevant Person, had it used all reasonable endeavours to do so, have raised in a Dispute Notice given in accordance with Step 6.

Step 11: If FPLP does not accept the Relevant Person’s Estimate, and if agreement is not reached following discussions between FPLP and the Relevant Person by 14 February and either:

- (A) the difference between the Relevant Person’s Estimate over the Proposed Defined Book Surplus is greater than the Materiality Threshold in respect of that year; or
- (B) the cumulative amount of the differences between the Relevant Person’s Estimate and the Proposed Defined Book Surpluses in respect of prior years which are not or have not been agreed by FPLP and the Relevant Person and which have not been referred to an Independent Actuary or in respect of which an amount has not been paid by way of indemnity or by adjustment to the valuation basis as described above, when added to the amount in respect of that year, are greater than the Cumulative Materiality Threshold,

the matter shall be referred to the Independent Actuary.

Step 12: The Independent Actuary (as defined above) shall:

- (A) if the same has not previously been resolved between the parties or by the Independent Actuary at Step 9 above, select either the Proposed Valuation Basis or the Relevant Person’s Valuation Basis as being the most appropriate valuation basis; and
- (B) select either the Proposed Defined Book Surplus or the Relevant Person’s Estimate as being the most appropriate estimate of the Defined Book Surplus.

The Independent Actuary shall be requested to make its determination, if practicable, no later than 15 March (or if such day is not a Business Day the immediately preceding Business Day) in such year (the “**Second IA Determination Date**”).

The costs of the Independent Actuary will be allocated as follows:

- (A) to the extent that the Independent Actuary determines that the Relevant Person’s Estimate is unreasonable, the Independent Actuary’s costs will be borne by the Relevant Person;
- (B) to the extent that the Independent Actuary determines that the Proposed Defined Book Surplus is unreasonable, the Independent Actuary’s costs will be a third party cost under the Reinsurer Deed of Charge; and
- (C) to the extent that the Independent Actuary does not make a determination under (A) or (B) above, the Independent Actuary’s costs shall be allocated such that half will be a third party cost under the Reinsurer Deed of Charge and half shall be borne by the Relevant Person.

Step 13: On the “**Surplus Notification Date**” in each calendar year (being the day falling three months after the end of the relevant Calculation Period or such earlier day as FPLP shall specify) (or, if such day is not a Business Day, the succeeding Business Day), FPLP shall inform the Relevant Person of the Defined Book Surplus for such Calculation Period determined in accordance with the above procedures.

In the event that the Independent Actuary fails to make its selection under Step 9 and/or Step 12 on or by the Second IA Determination Date, FPLP will determine the Defined Book Surplus for such Calculation Period as the Proposed Defined Book Surplus (or such other amount as may be agreed with the Relevant Person) (the “**Assumed Evaluation**”).

If, after the Second IA Determination Date, the Independent Actuary selects the Relevant Person's Valuation Basis as the most appropriate valuation basis under Step 9 and/or selects the Relevant Person's Estimate as the most appropriate Defined Book Surplus under Step 12 and the Relevant Person's Estimate exceeds the amount of the Assumed Evaluation:

- (A) FPLP may, except in the Calculation Period ending 31 December 2004, accept such determination of the Independent Actuary and make such adjustments to the valuation basis for the next succeeding Calculation Period as are necessary to ensure that the Defined Book Surplus in respect of such Calculation Period will be increased by an amount equal to the excess of the Relevant Person's Estimate over the Assumed Evaluation;
- (B) FPLP may elect not to accept the determination of the Independent Actuary, in which case it will be treated as a Breach Adjustment and dealt with under the Reinsurance Agreement accordingly, on the next following Payment Date in an amount equal to the excess of the Relevant Person's Estimate over the Assumed Evaluation; or
- (C) FPLP may make an election partially under (A) and partially under (B).

In relation to the Calculation Period ending 31 December 2004, FPLP shall treat the amount by which the Relevant Person's Estimate was less than the amount of the Assumed Evaluation as a Breach Adjustment to be dealt with on the Payment Date in April 2006.

Determination of the Reinsurer Regulatory Surplus

In the Reinsurer Deed of Charge, the Reinsurer covenants with the parties to it to calculate the Reinsurer Regulatory Surplus for each Reinsurer Calculation Period as at 31 December or, if applicable, immediately following termination of the Reinsurance Agreement and to follow a procedure for resolving disputes in relation to the Reinsurer Regulatory Surplus as determined by the Reinsurer. This procedure is substantially similar to the procedure for determining Defined Book Surplus outlined above.

SUMMARY OF THE TRANSACTION DOCUMENTS

The following is a summary of certain provisions of the Transaction Documents and is qualified in its entirety by reference to the detailed provisions of the Transaction Documents.

All Transaction Documents are governed by English Law.

THE REINSURANCE AGREEMENT

In this summary of the Reinsurance Agreement the following definitions are used:

“**Adjusted Sum Reinsured**” means the aggregate maximum liability of the Reinsurer at any date to indemnify FPLP in respect of Assumed Liabilities, which shall be equal to the Sum Reinsured, as adjusted to reflect Discounting to such date, as reduced by an amount equal to the aggregate of:

- (i) any Recapture Amount, as adjusted by Grossing Up to such date; and
- (ii) all Claims paid by the Reinsurer, as adjusted by Grossing Up to such date.

“**Annual Premium**” means an amount calculated in accordance with the Reinsurance Agreement, described below, payable by FPLP to the Reinsurer under the Reinsurance Agreement.

The Annual Premium (which may be negative, and if so is also a “**Premium Rebate**”) is calculated as the lower of:

- (A) the Available Defined Book Surplus; and
- (B) such amount as is equal to:
 - (i) the Reinsurer Ongoing Commitment Fees (determined on the basis that such amount is not contingent on Available Reinsurer Surplus) adjusted for Calculation Periods ending after 31 December 2004 as described below and, if the interest on the Reinsurer Loan is accruing at a floating rate due to partial termination of the Reinsurer Swap following a Claim having been made by FPLP under the Reinsurance Agreement, such floating amount of interest; and
 - (ii) in the case of the Annual Premium payable in respect of the Loan Interest Period ending on 15 April 2005, an amount equal to the aggregate of the Reinsurer Initial Commitment Fee and the interest under the Reinsurer Loan Agreement for the Loan Interest Period from (and including) 1 January 2005 to the end of such Loan Interest Period.

On the Closing Date FPLP pre-paid an amount, which is an addition to the first Annual Premium described above, equal to the Reinsurer Initial Commitment Fee.

The adjustment to be made to paragraph (B)(i) shall be such amount as results in an additional amount being added which will result (assuming that the Recapture Amount is sufficient to recapture the NPV Increase in the Sum Reinsured and no Claim is made in the Calculation Period) (i) in the aggregate of the Annual Premium and the value in FPLP of the Sum Reinsured Recaptured being equal to Available Defined Book Surplus (including where the Annual Premium is a Premium Rebate (so that any Premium Rebate gives rise to a corresponding increase in the Recapture Amount)), and (ii) on the assumption that the Available Reinsurer Surplus equals the Available Defined Book Surplus and following recapture, in the NPV of the Sum Reinsured being equal to the Principal Amount Outstanding on the Notes. Such adjustment is necessary to ensure that the rate at which the Reinsurer Loan is repaid is such that it will be repaid at the same time that the Adjusted Sum Reinsured is reduced to zero (in the absence of any Claim), and that they otherwise decline at the same rate.

For these purposes:

“**NPV of the Sum Reinsured**” means the Sum Reinsured Discounted at the Reinsurer’s valuation rate of interest from time to time.

“**NPV Increase in the Sum Reinsured**” means the NPV of the Sum Reinsured at the end of the Calculation Period less the NPV of the Sum Reinsured at the beginning of the Calculation Period (ignoring any Claim).

The Reinsurance Agreement includes a formula designed to achieve the objective described above.

“**Assumed Liabilities**” means the last amounts contractually required to be paid by FPLP to holders of Defined Book Policies, together with associated expenses, but excluding:

- (a) the Investment Element of linked policies which are not hybrid policies;

- (b) the Mathematical Reserves in respect of unitised with profits policies; and
- (c) the aggregate of (i) the Investment Element of hybrid policies which relates to unit linked units and (ii) the Mathematical Reserves in respect of the with profits part of a hybrid policy in relation to each such hybrid policy;

“**Available Defined Book Surplus**” in respect of a Calculation Period means the Defined Book Surplus plus any Breach Adjustment less any Recapture Reduction which may apply in respect of such Calculation Period;

“**Benefit Increase Rate**” means 4.6 per cent. per annum;

“**Breach Adjustment**” means together:

- (A) FPLP shall owe such amount as would, upon being received by the Reinsurer, have the effect of reversing the effect on the Reinsurer Regulatory Surplus of (i) the relevant Part A Breach or Part B Breach or, (ii) in the case of the Base Case Warranty, the Aggregate Base Case Breach Amount, or (iii) in the case of Part B Breaches, if higher, the amount of damages (including costs and interest) awarded in respect of the relevant Part B Breach (each such amount a “**Repurchase Amount**”); or
- (B) to the extent FPLP has not paid the Repurchase Amount to the Reinsurer by the Payment Date immediately following the end of the relevant Calculation Period, the Reinsurer’s reinsurance obligations under the Reinsurance Agreement shall be reduced by an amount equal thereto, by way of reduction in the Adjusted Sum Reinsured (but not so as to reduce the Adjusted Sum Reinsured to less than zero);

“**Calculation Date**” means 31 December in each calendar year, or, following termination, the date 10 days after the date of termination, unless FPLP, the Reinsurer and the Relevant Person agree otherwise;

“**Calculation Period**” means the period from (but excluding) one Calculation Date to (and including) the next Calculation Date, and, in the case of the first Calculation Period, means the period from (and including) 1 January 2004 to (and including) the first Calculation Date;

“**Claim**” means a claim by FPLP pursuant to the Reinsurance Agreement;

“**Defined Book Surplus**” means amounts calculated in accordance with the Reinsurance Agreement;

“**Deferred Element**” means the amount by which any Premium (ignoring the ability to defer payments) payable by FPLP on a Payment Date including in the case of the first Calculation Period, the pre-payment of Annual Premium made on the Closing Date exceeds the amount of Available Defined Book Surplus on such Payment Date.

“**Discounting**” means in relation to any amount (“A”), such amount as discounted according to the following formula:

$$A \div (1 + \text{BIR})^t$$

where:

BIR means the Benefit Increase Rate expressed as a decimal; and

^t means the period between the date on which A is determined and 15 April 2019 (expressed as the number of years, including fractions of any year on the basis of actual days elapsed and a year comprising three hundred and sixty-five (365) days (or, if any portion of such period falls in a leap year, the sum of (x) actual number of days in that portion of the relevant period falling in a leap year divided by three hundred and sixty-six (366) and (y) actual number of days in that portion of such period falling in a non-leap year divided by three hundred and sixty-five)),

and “**Discounted**” shall be construed accordingly;

“**Final Premium**” is a premium calculated under a formula in the Reinsurance Agreement and which becomes payable only once no liabilities remain outstanding on the Notes (or to Ambac under the Ambac Guarantee and Reimbursement Agreement or the Ambac InterCo Guarantee and Reimbursement Agreement) or under the other Transaction Documents.

“**Grossing Up**” means, in relation to any amount (“B”), such amount as increased according to the following formula:

$$B \times (1 + \text{BIR})^t$$

where:

BIR has the meaning in the definition of Discounting; and

^t means the period between the date on which the obligation to recapture or, as the case may be, the liability to pay B arose and the date on which the Adjusted Sum Reinsured falls to be determined (expressed as the number of years, including fractions of any year on the basis of actual days elapsed and a year comprising three hundred and sixty-five (365) days (or, if any portion of such period falls in a leap year, the sum of (x) actual number of days in that portion of the relevant period falling in a leap year divided by three hundred and sixty-six (366) and (y) actual number of days in that portion of such period falling in a non-leap year divided by three hundred and sixty-five)),

and “**Grossed Up**” shall be construed accordingly;

“**Investment Element**” means, in relation to linked policies (including, for the avoidance of doubt, hybrid policies), the value of all unit linked units by reference to which the benefits under such linked policies are determined (each such term as defined in the Scheme);

“**IPS**” means the Integrated Prudential Sourcebook issued by the FSA;

“**Long Term Business Reserves**” means, as at any date, FPLP’s Mathematical Reserves representing FPLP’s liabilities to policyholders under Defined Book Policies other than:

- (a) the Investment Element of linked policies which are not hybrid policies;
- (b) the Mathematical Reserves in respect of unitised with profits policies; and
- (c) the aggregate of (i) the Investment Element of hybrid policies which relates to unit linked units and (ii) the Mathematical Reserves in respect of the with profits part of a hybrid policy in relation to each such hybrid policy,

(each such term as defined in the Scheme) as at that date and determined using the Permitted Reserving Basis adjusted to exclude the effect of the reinsurance provided under the Reinsurance Agreement, but, for the avoidance of doubt, taking full account of the effect of any other reinsurance reserves;

“**Material Adverse Effect**” means:

- (a) in respect of an event or circumstance relating to FPLP, an effect which would reduce the present value of the aggregate of the Defined Book Surplus by £1 million or more; or
- (b) in respect of an event or circumstance relating to the Reinsurer: (1) where the balance of surplus carried forward unappropriated in the Long Term Business Fund of the Reinsurer is greater than or equal to £10 million, an effect which would reduce the Reinsurer Regulatory Surplus by £1 million or more; and (2) where the balance of surplus carried forward unappropriated in the Long Term Business Fund of the Reinsurer is less than £10 million, an effect which would reduce the Reinsurer Regulatory Surplus;

“**Material Adverse Impact**” means:

- (a) a material adverse effect on FPLP’s or the Reinsurer’s (as the case may be) ability to perform the obligations expressed to be imposed on it under the Transaction Documents (in the case of payment obligations, determined ignoring any limitation of recourse) or any of them; or
- (b) a material adverse effect on the financial position of FPLP or the Reinsurer (as the case may be);

“**Mathematical Reserves**” has the meaning given in the glossary to the FSA’s Handbook of Rules and Guidance for the purposes of the IPS;

“**Ongoing Premium**” means a cash premium payable by FPLP, out of the balance of the Defined Book Surplus (after paying the Annual Premium and taking into account any Recapture Reduction) in respect of the Calculation Period in which the Adjusted Sum Reinsured is reduced to zero and in respect of any subsequent Calculation Period, to the Reinsurer to the extent necessary to ensure that, assuming the Reinsurer, Issuer and InterCo use such funds to pay amounts outstanding under or payable under the Transaction Documents, their respective obligations under the Transaction Documents shall be fully discharged.

“**Payment Date**” means:

- (a) in respect of a Calculation Period ending on 31 December, 15 April in the following year, or, where that day is not a Business Day, the immediately subsequent Business Day; or

- (b) in respect of a Calculation Period ending otherwise than on 31 December, the date falling three months and two weeks after that date, or, where that day is not a Business Day, the immediately subsequent Business Day;

“**Premium**” means Annual Premium, Ongoing Premium and Final Premium, or any of them;

“**Recapture Amount**” means the Sum Reinsured Recaptured, Discounted from 15 April 2019 to the date of recapture.

“**Regulatory Capital Requirement**” means the minimum applicable regulatory capital or capital ratios required from time to time to be maintained for insurance companies or insurance holding companies generally by the FSA;

“**Regulatory Event**” means:

- (a) FPLP ceasing to be able, under PRU 7.3, to disregard some or all of the cash outflows deriving from surplus which are to be applied under this Agreement;
- (b) the Reinsurance Agreement ceasing to be treated, in whole or in part, as counting towards FPLPs Regulatory Capital Requirement;
- (c) the Reinsurer Loan ceasing to be treated, in whole or in part, as counting towards the Reinsurer’s Regulatory Capital Requirement; or
- (d) any change in Applicable Law (or the application or official interpretation thereof) occurring which leads to the transaction contemplated by the Transaction Documents becoming, in the reasonable opinion of the board of FPLP, inefficient or uneconomic, or which results in such transaction no longer achieving its intended purpose;

“**Sum Reinsured**” means £723,939,156 (being $£380,000,000 \times (1 + \text{BIR})^Z$);

where:

‘BIR’ has the meaning given in Discounting; and

‘Z’ is the number of years (and any fraction of a year) from (and including) the Closing Date to (and including) 15 April 2019.

“**Sum Reinsured Recaptured**” means,

- (a) in respect of the Calculation Period ending 31 December 2004, an amount equal to the lower of:
 - (i) the excess of:
 - (A) Defined Book Surplus and Breach Adjustments for such Calculation Period; over
 - (B) the Annual Premium for such Calculation Period (including that part of the Annual Premium pre-paid by FPLP on the Closing Date); and
 - (ii) £380,000,000 multiplied by the Benefit Increase Rate multiplied by the number of days from (and including) the Closing Date to (and including) 31 December 2004 and divided by 365.

Grossed Up to 15 April 2019; and

- (b) in respect of a Calculation Period commencing after 31 December 2004, an amount equal to:
 - (i) the Available Defined Book Surplus in respect of such Calculation Period; less
 - (ii) the Annual Premium (including any Deferred Element);

Grossed Up to 15 April 2019 and in respect of the above calculation, the Benefit Increase Rate shall be the rate used by FPLP to value the Reinsurance Agreement as at the end of the Calculation Period in respect of which such calculation is made),

which may in any case apply in respect of such Calculation Period.

The Reinsurance

Payment of Claims: The Reinsurer shall, in accordance with the claims payment procedure specified in the Reinsurance Agreement, indemnify FPLP against all Assumed Liabilities which become due for payment by FPLP to the extent, from time to time, that the Long Term Business Reserves, determined as at the most recent Calculation Date, are less than or equal to the Adjusted Sum Reinsured as at that date, subject always to the aggregate maximum liability of the Reinsurer at

any time to indemnify FPLP in respect of Assumed Liabilities being equal to the Adjusted Sum Reinsured.

On the first Payment Date falling in 2019, the Reinsurer shall pay to FPLP, as a Claim under the Reinsurance Agreement, an amount equal to the Adjusted Sum Reinsured as at that date (unless the Adjusted Sum Reinsured has reduced to zero before such date) in settlement of all future obligations of the Reinsurer under the Reinsurance Agreement.

To the extent that the liability of the Reinsurer for any payment made or to be made by FPLP in respect of Assumed Liabilities is greater than zero, the Reinsurer will pay to FPLP a sum equal to the amount of that liability on the earlier of the first Interest Payment Date after the date 40 days after the date of termination of the Reinsurance Agreement and the first Payment Date following the Calculation Period in which such liability becomes due for payment and gives rise to a Claim. Claims shall accrue interest from day to day from (and including) the date on which the liability to pay such Claim arose to (but excluding) the date on which such Claim is paid at a rate equal to the fixed rate accruing on the Reinsurer Swap.

Application of Available Defined Book Surplus in paying premiums: In respect of each Calculation Period during which any amount remains outstanding under the Notes and the Transaction Documents (other than the Reinsurance Agreement), FPLP shall apply the Available Defined Book Surplus first (in the case of the Calculation Period ending 31 December 2004, subject as below) in paying to the Reinsurer the Annual Premium in cash. The Annual Premium in respect of a Calculation Period shall be payable by FPLP on the Payment Date immediately following the end of such Calculation Period.

In relation to the first Calculation Period, part of the Annual Premium will be pre-paid to the Reinsurer on the Closing Date in respect of the period from the Closing Date to the first Payment Date otherwise than by application of Available Defined Book Surplus but, upon Defined Book Surplus being calculated for 2004, FPLP shall apply part thereof in reimbursing the fund from which such prepayment was made in an amount equal to such prepayment before paying the remaining Annual Premium.

If, following the Adjusted Sum Reinsured being reduced to zero, an amount remains outstanding under or payable under any Transaction Document other than the Reinsurance Agreement FPLP shall apply the balance of the Available Defined Book Surplus (after paying the Annual Premium and taking account of any Recapture Reduction) in respect of the Calculation Period in which the Adjusted Sum Reinsured is reduced to zero and in respect of any subsequent Calculation Period in paying to the Reinsurer the Ongoing Premiums until no amounts remain outstanding under any Transaction Documents.

Once the last Ongoing Premium has been paid by FPLP, FPLP shall apply the balance of the Defined Book Surplus (if any) in respect of the Calculation Period in which such last Ongoing Premium was paid, and the Available Defined Book Surplus in respect of each succeeding Calculation Period, in paying Final Premiums.

If there is insufficient Available Defined Book Surplus to pay a Premium, the balance will be deferred (a “**Deferred Element**”) and the Deferred Element shall be due and payable by FPLP on the next succeeding Payment Date to the extent that Available Defined Book Surplus (as calculated in respect of the relevant Calculation Period) is sufficient to pay such Deferred Element. To the extent that any Deferred Element remains unpaid on the next Payment Date, it shall be added to the Premium determined as being due and payable on such succeeding Payment Date, and so on in respect of subsequent Payment Dates.

In certain limited circumstances, the Annual Premium may be negative. This may arise only where the Reinsurer’s valuation rate of interest is reduced. The effect, however, is to give rise to a corresponding increase in the Recapture Amount, resulting in no negative net result. The cash which the Reinsurer would have received as an Annual Premium (which, very generally, can be seen as funding the Reinsurer Ongoing Commitment Fee and any floating rate interest on the Reinsurer Loan payable on the following Loan Interest Payment Date) would instead be funded by the Reinsurer realising additional Reinsurer Eligible Investments.

Order of application of Available Defined Book Surplus: As at each Calculation Date, to the extent that the Available Defined Book Surplus in respect of the Calculation Period ending on such Calculation Date is greater than zero, FPLP shall apply such Available Defined Book Surplus in the following order of priority (and applications in or towards an item of lower priority shall be made

only to the extent that items of higher priority have been satisfied to the maximum extent possible):

- (a) first, in retaining in FPLP an amount equal to that part of the first Annual Premium which has been pre-paid by FPLP on the Closing Date;
- (b) second, in paying Annual Premiums (including any Deferred Element);
- (c) third:
 - (i) in respect of the Calculation Period ending 31 December 2004:
 - (A) in the recapture of liabilities of an amount equal to the increase in the Adjusted Sum Reinsured from the Closing Date to (and including) 31 December 2004; and
 - (B) subject to paragraph (c)(i)(A) above, FPLP shall be entitled to retain any balance in accordance with the provisions of the Scheme; and
 - (ii) in respect of Calculation Periods commencing after 31 December 2004, in the recapture of liabilities in accordance with the Reinsurance Agreement;
- (d) fourth, in paying Ongoing Premiums (including any Deferred Element); and
- (e) fifth, in paying Final Premiums (including any Deferred Element),

and FPLP shall be entitled to retain any balance of Defined Book Surplus in accordance with the provisions of the Scheme.

Application of Available Defined Book Surplus, after paying premiums, in recapturing the liabilities reinsured: Subject to the provisions of the Reinsurance Agreement which define the Recapture Amount, on and from each Calculation Date on which the Adjusted Sum Reinsured is greater than zero, FPLP shall automatically recapture Assumed Liabilities with a value to the Reinsurer equal to the Recapture Amount in respect of the Calculation Period in which such Calculation Date falls. In the first Calculation Period, however, the Recapture Amount will not exceed the increase in the Adjusted Sum Reinsured from the Closing Date to (and including) 31 December 2004.

Termination of the Reinsurance Agreement: On and from the date on which FPLP has complied in full with its obligations to pay the Final Premiums (the “**Termination Date**”) and its obligations to make Capital Injections and Breach Adjustments, FPLP shall be released from any obligation, actual or contingent, present or future, to make payment or repayment to the Reinsurer under the Reinsurance Agreement.

The Reinsurer may, subject to the prior written consent of the Relevant Person, at any time by giving notice in writing to FPLP terminate the Reinsurance Agreement with immediate effect on the occurrence of any of the events set out below:

- (a) FPLP having committed a fraudulent breach of any of the Warranties or the “Funded Covenants” (being those set out under “*Funded Covenants*” below) which is intended to defraud the Relevant Person and/or holders of the Notes;
- (b) FPLP or the Reinsurer having committed a breach of any of the Part B Warranties for which the remedy expressed therein is termination;
- (c) FPLP having failed to pay any Annual Premium or Ongoing Premium within 10 Business Days of it becoming due;
- (d) FPLP having failed to calculate the Defined Book Surplus by the relevant Payment Date; or
- (e) FPLP having presented to the Court an application to effect a transfer of all or any part of the Defined Book pursuant to Part VII of FSMA, other than a Permitted Transfer (i.e. a transfer of all or substantially all of the business of FPLP or of the Defined Book, in each case as approved by the Reinsurer and by the Relevant Party).

FPLP may give notice in writing to the Reinsurer to terminate the Reinsurance Agreement with immediate effect at any time after the occurrence of a Regulatory Event or a Tax Event, and provided that:

- (a) FPLP satisfies the Solvency Condition both at the time of and immediately after such termination; and
- (b) sufficient funds will be received by:

- (i) the Issuer (through InterCo) to enable it to redeem the Notes at their Principal Amount Outstanding together with all accrued but unpaid interest and to pay its other obligations under the Transaction Documents in full; and
- (ii) the Reinsurer and InterCo to enable them to pay all their obligations under the Transaction Documents (other than the Reinsurance Agreement) in full.

For these purposes, FPLP will satisfy the “Solvency Condition” if it meets its Regulatory Capital Requirement.

On termination, the reinsurance provided by the Reinsurer to FPLP will cease and FPLP will not be entitled to make a Claim (other than for Claims which have already occurred).

Warranties and Covenants: Under the Reinsurance Agreement, to the extent that any of the Representations described in the section entitled Part A Warranties immediately following below (together the “**Part A Warranties**”) or the covenants described in the section “*Funded Covenants*” below (other than the Conduit Covenant) is incorrect or has been breached, a “**Part A Breach**” will occur. The effect of a Part A Breach is described under “*Funding of Part A Breaches*” below.

Part A Warranties

Origination Procedures

To the extent that the Defined Book Policies were not originated in accordance with procedures (including underwriting standards) and on terms which were consistent with:

- (a) those which would, to the reasonable knowledge and belief of FPLP, have been applied by a reasonable insurer carrying on a business similar to that of the Relevant Originator at the relevant time when each Defined Book Policy was originated; and
- (b) the procedures and terms required, from time to time, by third party providers of reinsurance to the Relevant Originator in respect of all or part of the risks under the Defined Book Policies reinsured,

the departure from such procedures described in paragraphs (a) or (b) above has not, either individually or in aggregate, had a Material Adverse Effect.

Compliance with Laws/Regulations

In the last 3 years, neither FPLP nor any of its directors, officers or agents has defaulted under or failed to comply with any law, statute, regulation, treaty, directive, by-law, rule, order, delegated legislation or any official request of any governmental authority, whether local, regional, national or supranational (including rules and regulations relating to the conduct of business of any regulatory body applicable to FPLP (from time to time) was required to comply), in each case, as in force from time to time and interpreted at the relevant time in relation to FPLP (“**Applicable Law**”) (excluding any defaults which might relate to a Mis-selling Liability) which, in each case, would, individually or together, have a Material Adverse Effect.

There are no litigation, arbitration, administration or ombudsman proceedings (including any which are pending or threatened to the knowledge and belief of FPLP) involving FPLP which, either individually or in aggregate, would have a Material Adverse Effect.

FPLP and the Reinsurer have, as at the Closing Date, all authorisations, approvals, licences, permissions and consents (“**Licences**”) under any Applicable Law in force (including FSMA) to carry on business of the class in which each Defined Book Policy falls and otherwise to carry on the business it proposes to carry on pursuant to the Transaction Documents, the absence of which would have a Material Adverse Effect.

The Relevant Originator had, at all relevant times, all relevant Licences under all Applicable Laws at the relevant time in force to carry on business of the class in which each Defined Book Policy falls, the absence of which would have a Material Adverse Effect.

No outstanding complaints, warnings or notices (excluding any complaints, warnings or notices which, if upheld, may give rise to a Mis-selling Liability) have been received by FPLP or (to the knowledge and belief of FPLP) are threatened against FPLP which would, either individually or in aggregate, have a Material Adverse Effect and there are no current, pending or (to the knowledge and belief of FPLP) threatened investigations or enforcement proceedings (excluding in relation to any matters which may give rise to a Mis-selling Liability) by the Insurance Regulator, the Inland Revenue or the Inland Revenue Pension Schemes Office or any other regulator or tax authority into

any of the activities of FPLP which, either individually or in aggregate, would have a Material Adverse Effect.

In the last 3 years, save for correspondence (i) relating to the amendments to the Scheme made by order of the Court on 29 July 2004, (ii) in respect of the investigation of any matters which may give rise to a Mis-selling Liability, or (iii) by way of Consultation Paper or any other generic regulatory publication (including any actual or proposed regulatory change of a generic nature), no written communication has been received by either of FPLP or the Reinsurer from the Insurance Regulator which:

- (a) alleges a failure, or possible failure, to comply with an Applicable Law or a Licence;
- (b) requires any alteration in the way in which FPLP proposes to carry out its business as required by the terms of the Transaction Documents;
- (c) requires FPLP to provide information or documents to the Insurance Regulator under section 165 of FSMA;
- (d) requires FPLP to provide the Insurance Regulator with a Report under section 166 of FSMA;
- (e) leads to an increase of FPLP's liabilities in calculating the Defined Book Surplus or a reduction in the value of its assets in calculating the Defined Book Surplus as shown in the Base Case;
- (f) requests or requires the provisions of additional capital for either of FPLP or the Reinsurer, which request or requirement has not been complied with; or
- (g) raises any other matters which would have an adverse effect on FPLP or the Reinsurer, and, in each case, which would have a Material Adverse Effect.

Compliance with Agreements

FPLP is not in breach of or in default under any agreement (excluding, for avoidance of doubt, the Defined Book Policies) or arrangement to which it is a party or which is binding on it (excluding any defaults to the extent that they give rise to a Mis-Selling Liability) or on any of its assets, which breach or default would have a Material Adverse Effect.

No Material Adverse Change

At the Closing Date, save as disclosed in the Offering Circular, since 31 December 2003 there has been no material adverse change in the financial position of the Defined Book and the assets backing it (the Defined Book and relevant assets being taken as a whole) that has not been properly reflected in the Base Case.

Records

To the extent that the following were incorrect, it would not have a Material Adverse Effect:

FPLP has, or on the Closing Date will have, in respect of the Defined Book Policies, recorded on its computer systems or those of Friends Provident Management Services Limited an accurate record comprised of such information relating to the Defined Book Policies as is necessary to enable FPLP to fulfil its contractual obligations under such Defined Book Policies, to administer such Defined Book Policies properly and to calculate the Defined Book Surplus appropriately.

Defined Book Policies

To the extent that the following were incorrect, it would not have a Material Adverse Effect:

Each Defined Book Policy is a valid and binding obligation of the parties thereto enforceable according to its terms (subject, in the event of insolvency or analogous proceedings, to applicable laws relating to creditors' rights (including policyholders' rights under their policy terms) and to limitations on the availability of remedies as a result of equitable considerations) and the Relevant Insurer (and FPLP after the effective date of the Scheme) has complied with its terms.

None of the Defined Book Policies gives the holder:

- (a) a right to elect to convert a cash benefit into an annuity at a guaranteed rate;
- (b) a right to elect to convert an annuity into a cash sum at a guaranteed rate; or
- (c) a right to a maturity guarantee,

whether implicit or explicit, where such policy is not properly reserved for in accordance with law and best actuarial practice, such that the absence of proper reserving would cause a Material Adverse Effect.

None of the Defined Book Policies is a Precipice Bond.

“**Precipice Bond**” means a product which provides a fixed level of income (or has an income option) over a fixed investment period displaying the following characteristics:

- (a) return of initial capital invested at the end of the investment period is linked by a pre-set formula to the performance of an equity index, a combination of indices or a basket of selected stocks;
- (b) if the equity index, indices or basket performs within certain thresholds, full repayment of initial capital investment occurs, but if the performance is outside the thresholds, the customer could lose all or a substantial part of the initial capital invested; and
- (c) the customer is exposed to a range of outcomes in respect of the return of his/her initial capital invested.

To the extent that the following were incorrect, it would not have a Material Adverse Effect at all relevant times in respect of each unit linked fund of each of the Relevant Insurers and FPLP, whether such fund is now open or closed for new business, the price of units for such fund has been calculated in accordance with the terms of the relevant Defined Book Policy and/or relevant scheme particulars and the standard accounting and actuarial valuation formulae applicable to such fund from time to time, and where such unit price has been published or represented to any of the policyholders of the Relevant Insurer or FPLP, such published price has, save for unit pricing errors which have been corrected and for which policyholders have been compensated, accurately reflected the true value of the applicable unit price at that time;

FPLP is not a party to any reinsurance contract with respect to the Defined Book which will remain outstanding after the Closing Date other than:

- (i) those set out in the Insurance Returns prepared and filed in respect of the financial year of FPLP ended on 31 December 2003; and
- (ii) the Reinsurance Agreement.

Model/Base Case

- (a) (i) The model (including, for the avoidance of doubt, the adjustments which have been made outside the main (Prophet) model) being the computer systems (including the model which performed the analysis of experience and the spreadsheets showing modelling adjustments and into which the Actual Data is input) used by FPLP to calculate the Base Case and the Stress Cases (the “**Original Model**”) was designed for the purposes of achieved profits reporting so that if the actual policy data at the start of a Calculation Period and the economic conditions and economic experience known at the end of a Calculation Period were accurately input into the Original Model, the Original Model would calculate projected surpluses for the life of the Defined Book from such inputs to within 5 per cent. of the amount of the actual surpluses emerging from the Defined Book over the life of the Defined Book. The Original Model was constructed to this specification and achieves the degree of accuracy set out in this paragraph.
- (ii) The Original Model used the Actual Data and Base Case Assumptions or, as the case may be, the relevant Stress Case Assumptions, in projecting, on the basis of Applicable Law, the Aggregate Defined Book Surplus in respect of the Defined Book Policies to produce the Base Case or, as applicable, the Stress Cases.
- (b) The Actual Data (i) was complete and accurate as at 31 May 2004 (the “**Base Case Date**”), (ii) was an accurate extraction of the data relating to, and accurately reflected, the Defined Book Policies in force as at the Base Case Date, and (iii) was properly and accurately input into the Original Model.
- (c) The Base Case Assumptions were properly and accurately input into the Original Model.
- (d) (i) The calculations of actual mortality, morbidity and discontinuance (being those relating to persistency and paid up rates), from historical data from which the Base Case Assumptions were developed, were carried out correctly.

- (ii) The Base Case Assumptions relating to investment returns and the risk free investment rate (being those relating to the long term estimated investment returns by asset class, the future investment return assumption and long term asset allocation assumption) and the inflation of maintenance expenses are set out in the Offering Circular. The long term asset allocation is substantially similar to the asset allocation of the Defined Book as at 31 May 2004.
 - (iii) The Base Case Assumptions relating to taxation are set out in the Offering Circular and are the rates of tax on such items in the Defined Book and the assets backing the Defined Book Policies at current tax rates.
 - (iv) The other Base Case Assumptions not referred to above (including those relating to reserving), are set out in the Offering Circular.
 - (v) FPLP has disclosed all material information that would enable the Relevant Person to assess the appropriateness of the Base Case Assumptions for the purposes of this transaction and such information is correct and complete in all material respects.
 - (vi) The Disc accurately includes the information set out in the definition of Disc.
- 2 (a) Each year, as part of the process for determining the Defined Book Surplus pursuant to the Reinsurance Agreement, FPLP and the Relevant Person shall monitor, in accordance with paragraph (b) below, the Defined Book Surplus which has emerged up to and including the most recent Calculation Date, with a view to assessing whether there has been a breach of any of the warranties in (a), (b), (c) or (d)(i) of paragraph 1 above (together, the “**Base Case Warranty**”).
- (b) FPLP shall carry out a detailed annual reconciliation of the Defined Book Surplus arising during the preceding Calculation Period (starting with the Calculation Period ending on 31 December 2004) as against the Defined Book Surplus which the model used by FPLP at the beginning of the relevant Calculation Period (the “**Revised Model**”) projected, allowing for actual experience. A copy of the initial conclusions of the reconciliation shall be provided to the Relevant Person by 24 January in each year and FPLP will provide the final conclusions as soon as reasonably practicable thereafter and in any event by no later than 30 April in each year.
- (c) If the Defined Book Surplus for a Calculation Period is less than the amount which had been projected to emerge by the Revised Model, then FPLP will cooperate with the Relevant Person by providing such information as the Relevant Person may reasonably require to establish whether there has been a breach of the Base Case Warranty (including a right to call for a full copy of the detailed reconciliation together with the supporting calculations and information and access to the Original Model and the Revised Model and all data and assumptions input into it by FPLP and full changes made to the Revised Model).
- (d) Notwithstanding paragraph 6, if the Relevant Person reasonably concludes that a breach of the Base Case Warranty may have occurred, it may serve notice on FPLP (a “**Potential Breach Notice**”). FPLP shall on receiving a Potential Breach Notice review the Original Model in the light of the issues identified by the Relevant Person in order to identify whether the Original Model overstated the Aggregate Defined Book Surplus, on the basis set out in paragraph 3. FPLP and the Relevant Person shall seek to agree amongst themselves whether the Original Model overstated the projection of the Aggregate Defined Book Surplus and by what amount.
- 3 (a) Whether the Original Model overstated the Aggregate Defined Book Surplus shall be determined by comparing:
- (i) the aggregate of: (A) the Defined Book Surplus calculated in respect of each Calculation Period up to and including the Calculation Period in respect of which the comparison is being made (the “**Current Calculation Period**”) using the actual policy data as at the start of the relevant Calculation Period and actual economic conditions and operating experience known at the end of the relevant Calculation Period and inputting such data and experience into the projection module of the Original Model (the “**Model**”) and (B) the present value of projected Defined Book Surplus for periods from the end of the Current Calculation Period to 2043 calculated using actual policy data as at the start of the Current Calculation Period

and projected, using the Model, using actual experience for the Current Calculation Period and then using the assumptions at the end of the Current Calculation Period (the “**Latest Assumptions**”) for succeeding Calculation Periods up to 2043; with

- (ii) the aggregate of: (A) the Defined Book Surplus actually arising in respect of such Calculation Period (as calculated in accordance with Schedule 5 to the Reinsurance Agreement); and (B) the present value of projected Defined Book Surplus for periods from the end of the Current Calculation Period to 2043 calculated using the Model and actual policy data as at the end of the Current Calculation Period and the Latest Assumptions.
 - (b) Any difference in the period up to the Final Maturity Date between items (i) and (ii) in paragraph (a) above in relation to any Calculation Period (any excess of (i) over (ii) in respect of a Calculation Period being treated as positive and vice versa) shall be discounted to 1 January 2005 at a rate of 5.47 per cent. per annum and aggregated, to give the “**Aggregate Base Case Breach Amount**”.
- 4 In the event of a claim for breach of the Base Case Warranty, the Breach Amount shall be equal to the Aggregate Base Case Breach Amount grossed up at 5.47 per cent. per annum to the date of the claim.
- 5 The Relevant Person shall be entitled to make a claim for breach of the Base Case Warranty:
 - (a) on a payment being made or being projected to be made under the Ambac Note Policy; or
 - (b) at the Final Maturity Date to the extent that any amount is outstanding under the Notes, the Interco Loan Agreement or the Reinsurer Loan Agreement or, if earlier, when a claim has been made under the Ambac Note Financial Guarantee, but not earlier.
- 6 The Base Case Warranty shall be deemed not to have been breached unless:
 - (a) the Aggregate Base Case Breach Amount is greater than or equal to 10% of the Aggregate Defined Book Surplus projected by the Original Model, where paragraph 5(a) above applies; or
 - (b) the Aggregate Base Case Breach Amount is greater than or equal to 5% of the Aggregate Defined Book Surplus projected by the Original Model, where paragraph 5(b) above applies.
- 7 In the event that a Potential Breach Notice is served on FPLP and paragraph 3 applies accordingly, FPLP shall be entitled to review the Original Model at any time thereafter in order to identify whether the Original Model overstated the Aggregate Defined Book Surplus, in which case (i) FPLP and the Relevant Person shall seek to agree whether this was the case and (ii) paragraph 3 shall apply.
- 8 To the extent that FPLP becomes liable for a breach of the Base Case Warranty but it subsequently transpires that the Original Model did not overstate the Aggregate Defined Book Surplus, for the avoidance of doubt, paragraph 6 of Schedule 6 of the Reinsurance Agreement shall apply, with a view to effecting a Recapture Reduction.
- 9 If FPLP and the Relevant Person are unable to determine whether the Base Case Warranty has been breached, the matter shall be referred to an independent actuary, and paragraph 9 of Schedule 6 of the Reinsurance Agreement shall apply, *mutatis mutandis*.

For these purposes:

“**Actual Data**” means information about Defined Book Policies and the reinsurances thereof input directly into the Original Model for the purposes of calculating the Base Case.

“**Aggregate Defined Book Surplus**” means Defined Book Surplus for the period from 1 January 2005 to 31 December 2018;

“**Assumptions**” means the Base Case Assumptions and the Stress Case Assumptions;

“**Base Case**” has the meaning given in the Offering Circular;

“**Base Case Assumptions**” means the assumptions relating to, *inter alia*, mortality, morbidity, persistency rates, paid up rates, long term future investment returns, inflation, long term asset allocation, expenses, taxation and reserving set out, and described as such, in the Disc;

“**Disc**” means the computer disc which contains the Actual Data, Stress Case Assumptions, Base Case Assumptions and experience analyses, together with the Original Model, a copy of which has been or will be lodged with each of the Relevant Person and FPLP in accordance with the Reinsurance Agreement;

“**Stress Case Assumptions**” means the assumptions relating to *inter alia*, mortality, morbidity, persistency rates, paid up rates, long term future investment returns, inflation, long term asset allocation, expenses, taxation and reserving set out, and described as such, in the Disc including those set out in the Offering Circular.

Tax Assumption

The assumed tax analysis for the Defined Book Surplus is that the taxable profits are subject to policyholder rates of tax and not to shareholder rates of tax.

Tax Treatment of InterCo

InterCo is a company with investment business within the meaning of section 130 of the Income and Corporation Taxes Act 1988, and will be taxed on the excess of its investment income and gains over management expenses.

Funded Covenants

Persistency

Subject to Applicable Law, FPLP shall not and shall procure that no other FPLP Group Entity shall, operate a commission structure for product sales in such a way as a reasonable person would consider likely to encourage the sales force of any FPLP Group Entity or financial advisers to seek to procure that existing Policyholders cancel Defined Book Policies and take out any new policies with FPLP or a different insurer, provided that:

- (a) nothing in this paragraph shall prohibit any FPLP Group Entity from introducing stakeholder charging structures to any of its new policies in the future; and
- (b) FPLP shall be entitled to operate a commission structure which is in line with that operated by its main UK life insurance competitors.

“**FPLP Group Entity**” means FPLP, its subsidiaries and holding company, and any subsidiaries of its holding company.

FPLP shall not make available, and shall procure that no other FPLP Group Entity shall make available, records in relation to the Policyholders to any person unless that person agrees in writing not to market or sell any policies as a replacement of a Defined Book Policy provided that nothing in this paragraph shall prevent FPLP from making a Policyholder’s records available to a financial adviser appointed by such Policyholder, or to an entity with which an FPLP Group Entity is conducting marketing of policies which are materially different from the Defined Book Policies. FPLP shall take reasonable action to enforce any such agreement given by a person as a result of this paragraph.

FPLP will manage the Defined Book and shall procure that other relevant FPLP Group Entities are managed with a view to ensuring that the number of Policyholders who cancel their Defined Book Policies and take up replacement policies with an FPLP Group Entity does not exceed 0.5% of the average number of all Defined Book Policies in force from time to time during a Calculation Period.

FPLP shall procure that the Intra-Group Lapse Information is made available to the Relevant Person within the period of 31 days following the end of each Calculation Period.

“**Intra-Group Lapse Information**” means information specifying the number of Defined Book Policies which are subject to Intra-Group Lapses, divided by types of policy.

“**Intra-Group Lapses**” means lapses of Defined Book Policies where the relevant Policyholder has taken out a similar policy with another FPLP Group Entity within a period of 3 months before or after the lapse of the relevant Defined Book Policy.

FPLP will not enter into or amend Material Contracts with any FPLP Group Entity unless:

- (a) such contract is entered into on Arms-length terms or better (from the perspective of FPLP); or

- (b) if such contract is not entered into on Arms-length terms or better (from the perspective of FPLP) then, to the extent that the Relevant Person determines that entering into any such arrangement or contract has or is likely to have a Material Adverse Effect (but not otherwise), the consent of the Relevant Person is obtained (such consent not to be unreasonably withheld or delayed).

“**Material Contract**” means any contract (other than any of the Transaction Documents):

- (a) where the aggregate consideration to be provided under the contract by FPLP which is to be taken into account in calculating Defined Book Surplus exceeds £1 million per annum; and
- (b) which relates to the management or servicing of the Defined Book Policies or the investment of assets backing Defined Book Policies.

“**Arms-length terms**” means a transaction between two or more entities each of which has a separate and distinct interest and agreed terms with a mind to its own interest in a normal commercial manner unaffected by any special relationship.

FPLP shall ensure that:

- (a) the overall standard of service provided to Policyholders is no less favourable than that provided to holders of policies written by any FPLP Group Entity which carries on Long Term Business in the United Kingdom; and
- (b) the same level of skill and diligence is applied to the investment management of the property backing the liabilities of the Defined Book as to the property allocated to the long term business funds of any other FPLP Group Entity which carries on Long Term Business in the United Kingdom.

“**Long Term Business**” means the business of effecting or carrying out long term insurance contracts as principal contracts falling within Part II of Schedule 1 to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001;

FPLP shall not, without the consent of the Relevant Person, invest in assets backing the Defined Book liabilities which are not Admissible Assets.

“**Admissible Assets**” means assets which can be brought into account in accordance with IPS.

Reinsurance

In relation to the Defined Book Policies, FPLP shall be permitted to enter into contracts of reinsurance additional to policies of reinsurance already subsisting (including such policies as renewed) in respect of the Defined Book Policies only with the prior written consent of the Relevant Person (such consent not to be unreasonably withheld or delayed).

Ex Gratia Payments

FPLP shall not make *ex gratia* payments (excluding those made in connection with a Mis-selling Liability) in respect of Defined Book Policies which exceed an aggregate amount of £1,000,000 in each Calculation Period.

Prudent Insurer

FPLP shall carry out and otherwise perform its rights and obligations in respect of the Defined Book Policies and administer the Defined Book Policies and its assets as a Prudent Insurer in the position of FPLP would reasonably be expected to do, and in acting as a Prudent Insurer, FPLP shall, subject to Applicable Law (including, for the avoidance of doubt, the Principles for Businesses), manage the Defined Book and the assets backing the Defined Book in a way which recognises the interests of its creditors including the Reinsurer’s interest in optimising the embedded value of the Defined Book Policies (including by appropriately managing its lapse rates and charges).

A “**Prudent Insurer**” is an insurer who acts in accordance with the Principles for Businesses set out in the FSA’s Handbook of Rules and Guidance.

Compliance with Laws/Regulations

Each of FPLP and the Reinsurer shall not, and none of its directors, officers or agents shall, default under or fail to comply with any Applicable Law which default or failure would have a Material Adverse Effect.

Each of FPLP and the Reinsurer shall maintain all Licences under any Applicable Law in force (including FSMA) to carry on business of the class in which each Defined Book Policy falls and otherwise to carry on the business it proposes to carry on pursuant to the Transaction Documents.

Records/Computer Systems

FPLP shall record, or procure that there is recorded, on its or Friends Provident Management Services Limited's computer systems, an accurate record comprised of such information relating to the Defined Book Policies as is necessary to enable FPLP to fulfil its contractual obligations under such Defined Book Policies, to properly administer such Defined Book Policies and to enable it to calculate the Defined Book Surplus appropriately.

FPLP shall maintain, or procure that there are maintained, such computer and other systems and such software licences or enter into such other appropriate arrangements as are necessary to enable it to maintain an accurate record comprised of such information relating to the Defined Book Policies as is necessary to enable FPLP to fulfil its contractual obligations under such Defined Book Policies and to enable it to calculate the Defined Book Surplus appropriately.

Provision of Information

Save as prohibited by Applicable Law, FPLP shall permit the Relevant Person, the Independent Actuary appointed pursuant to the Reinsurance Agreement and the Reinsurer (and their duly appointed agents) access to such information and records in relation to the assets and liabilities of the Defined Book as are reasonably required to enable each recipient of information (each a "**Recipient**") to perform its functions under the Transaction Documents or to review compliance by FPLP and the Reinsurer with their obligations under the Transaction Documents and the reasonableness of the Defined Book Surplus, including without limitation:

- (a) a copy of the annual actuarial report to the board and any supporting information relating to such actuarial report;
- (b) a copy of the annual lapse report in relation to the Defined Book; and
- (c) access to the annual computer download of Defined Book Policy information and performance.

To the extent that FPLP is prohibited from providing access to such information, FPLP shall, promptly following a reasonable request, use all reasonable endeavours to provide such information in a form which is not prohibited by Applicable Law (including, where necessary, without disclosing the policyholder), to enable such Recipient to perform its functions under the Transaction Documents or review compliance by FPLP or other parties with their respective obligations under the Transaction Documents and the reasonableness of the Defined Book Surplus.

FPLP shall co-operate with each Recipient, including making available on reasonable notice during normal office hours access to its premises to inspect records, reasonable access to relevant personnel to answer enquiries and the provision of reasonable facilities to such Recipient to enable it to perform its functions or review compliance by other parties with their obligations under the Transaction Documents and the reasonableness of the Defined Book Surplus.

Transfer

FPLP shall not at any time, prior to the repayment in full of the Reinsurer Loan, cease to own directly (or indirectly) 100 per cent. of the issued share capital of the Reinsurer or at any time hold directly or indirectly less than 100 per cent. of the voting rights of the issued share capital from time to time of the Reinsurer.

FPLP shall not make any disposal or transfer of all or any of the Defined Book Policies to any person other than with the prior written consent of the Relevant Person.

Disposal of Assets

FPLP shall not transfer, sell, dispose of, create a trust over, grant any option over or otherwise deal with the assets comprised within reserves for the Defined Book (including the creation of any Security Interest) otherwise than in the ordinary course of business and on arm's length terms (taking into account all the circumstances and not only the value at which such dealing is effected) or otherwise as permitted or contemplated by the Transaction Documents.

Guarantees

FPLP will not provide any guarantee of any third party which in aggregate has or is likely to have a Material Adverse Effect, otherwise than in the ordinary course of its business or with the prior written consent of the Relevant Person (such consent not to be unreasonably withheld or delayed).

Amendment to the Scheme

FPLP shall not amend the Scheme where the effect of such amendment would be to reduce the amount of Defined Book Surplus for the relevant Calculation Period or any future Calculation Period, without the prior written consent of the Relevant Person (such consent not to be unreasonably withheld or delayed).

Notification

FPLP shall promptly notify the Relevant Persons of any representations, warranties and covenants set out in the Reinsurance Agreement (of which FPLP becomes aware) which have had or will have a Material Adverse Effect.

Third Party Reinsurance

FPLP shall promptly take all reasonable steps to seek recovery from Third Party Reinsurers in respect of reinsurance agreements relating to the Defined Book.

“**Third Party Reinsurer**” means a reinsurer which is not an FPLP Group Entity;

Breach Reserves

In setting a reserve in respect of a Part A Breach, FPLP shall use a discount rate which does not exceed the reasonably estimated rate of return on the investments backing such reserve.

Investment Restrictions relating to the Annuity Book

FPLP shall ensure that, at all times during the Term, the Assets shall be invested in accordance with the Annuity Backed Investment Criteria (as described below) in an attempt in good faith to meet the Annuity Backed Investment Objective (as described below) and subject to the credit policies and procedures substantially similar to those in place as at the Closing Date, unless otherwise approved by the Relevant Person. Notwithstanding the foregoing, if at any time any of the criteria within the Annuity Backed Investment Criteria is contrary to any Applicable Law to which FPLP is then subject, FPLP shall:

- (a) consult with the Relevant Person in good faith so as to agree amendments to the Annuity Backed Investment Criteria necessary in order that, thereafter, the Annuity Backed Investment Criteria as so amended are not contrary to any then Applicable Law; and
- (b) realise Assets which are invested in accordance with the criteria which is contrary to Applicable Law and reinvest the proceeds in accordance with the amended Annuity Backed Investment Criteria.

Where:

“**Annuity Business**” means the annuity Defined Book Policies within the Defined Book;

“**Assets**” means those of FPLP’s assets backing the Mathematical Reserves established in connection with the Annuity Business;

“**Glossary**” means the Glossary to the Handbook of Rules and Guidance published by the FSA, as amended from time to time; and

The “**Annuity Backed Investment Objective**” is at any time during the Term to invest the Assets so as to match projected cash flows of the Annuity Business as determined periodically by FPLP. The Annuity Business cash flows linked to inflation will be separately matched.

The Assets shall be invested in accordance with the following criteria (the “**Annuity Backed Investment Criteria**”), which are required to be met at the Closing Date and subsequently at the time of acquisition of a relevant Asset:

- (a) debt securities or other money-market instruments (each as defined in the Glossary) that are:
 - (i) issued or guaranteed by the government of the United Kingdom; or
 - (ii) issued or guaranteed by an entity other than the government of the United Kingdom which are:

- (A) denominated in Pounds Sterling or Euro, subject to the Credit Limits (as defined below); or
- (B) denominated in a currency other than Pounds Sterling or Euro, subject to the Credit Limits and provided that foreign exchange risk hedging arrangements are in place and provided that any such debt securities or other money-market instruments do not constitute more than 5% of the market value of the total Assets;
- (b) any structured or synthetic credit investment including, without limitation, collateralised debt obligations and collateralised synthetic obligations, subject to the Credit Limits and provided that:
 - (i) where such investment is not in Pounds Sterling, foreign exchange risk hedging arrangements are in place;
 - (ii) any such structured or synthetic investments do not constitute more than 15% of the market value of the total Assets; and
 - (iii) the counterparty to any such structured or synthetic investment has a rating of at least A1 from Moody's and A+ from S&P.
- (c) cash on deposit that:
 - (i) if deposited for a period of less than 12 months is so deposited with any EU Credit Institution (as defined in FSMA) or a bank authorised in:
 - (A) the remaining member states of the European Economic Area ("EEA") (Norway, Iceland, Liechtenstein); or
 - (B) a signatory state, other than an EU member state or a member state of the EEA, to the Basle Capital Convergence Agreement of July, 1988 ("BCCA") (Switzerland, Canada, Japan, United States),
 in each case, which has a senior, unsecured and unguaranteed short term debt rating of P-1 Moody's or A-1 or better from S&P;
 - (ii) if deposited for a period of 12 months or more is so deposited with any EU Credit Institution (as defined in FSMA) or a bank authorised in:
 - (A) the remaining member states of the EEA (Norway, Iceland, Liechtenstein); or
 - (B) a signatory state, other than an EU member state or a member state of EEA, to the BCCA (Switzerland, Canada, Japan, United States),
 provided that the Credit Limits are satisfied;
- (d) units or shares in any money-market scheme (as defined in the Glossary), in either case being of a class denominated in Pounds Sterling;
- (e) units or shares in any securities scheme (as defined in the Glossary), in either case being of a class denominated in Pounds Sterling provided that such scheme is dedicated to debt securities (as defined in the Glossary) (each such scheme being a "Debt Scheme") and subject to the Credit Limits;
- (f) any derivative investment relating to the hedging of foreign exchange risk, interest rate risk, inflation risk, mortality risk and any other market risk;
- (g) any:
 - (i) underwriting activity where the security underwritten meets (or would on issue meet) the Annuity Book Investment Criteria; and
 - (ii) stock lending activity;
- (h) any other assets that are or become available during the Term that a Prudent Insurer (acting as described under – *Prudent Insurer* above) would reasonably regard as being appropriate for the reduction of investment risk or efficient portfolio management, provided that prior to any investment in such Assets, FPLP shall obtain the prior written consent of the Relevant Person, such consent not to be unreasonably withheld.

Any assets or class of assets which are not specified above, including, without limitation, equity securities, partly paid debt securities, convertible debt securities, warrants and real estate, shall not, save to the extent permitted below, satisfy the Annuity Backed Investment Criteria.

Borrowings shall be permitted only for short-term overdrafts on settlement accounts.

Where:

“**Credit Limits**” means that:

- (a) debt securities, or deposits which have been deposited for a period of 12 months or more in accordance with the provisions described above, rated lower than:
 - (i) Baa3 from Moody’s or BBB- from S&P will not, in aggregate, have a market value of more than 3 per cent. of the market value of the total Assets; and
 - (ii) A3 from Moody’s or A- from S&P will not, in aggregate, have a market value of more than 20 per cent. of the market value of the total Assets; and
- (b) up to 1 per cent. of the market value of the Assets may be invested in partly paid securities, warrants relating to debt securities and bonds convertible into shares, provided that the criteria in (a)(i) and (ii) immediately above will not apply to unrated debt securities acquired at any time by FPLP on or before the Closing Date and provided further that the restriction in (B) immediately above will not apply with respect to Gilts.

For the purposes of these Credit Limits any Debt Scheme shall be deemed to be debt securities rated A2 from Moody’s and A from S&P.

In addition to the above a diversity score test will be established.

Additional Reinsurer Covenants

FPLP shall ensure that the Reinsurer shall carry out and otherwise perform its obligations and enforce its rights in respect of the Reinsurance Agreement.

FPLP shall ensure that the Reinsurer will not enter into or amend contracts (other than the Transaction Documents):

- (a) with any FP Group Entity unless:
 - (i) such contract is entered into on Arms-length terms or better (from the perspective of the Reinsurer); or
 - (ii) if such contract is not entered into on Arms-length terms or better (from the perspective of the Reinsurer), then to the extent that the Relevant Person determines that entering into any such arrangement or contract has or is likely to have a Material Adverse Effect (but not otherwise), the consent of the Relevant Person is obtained (such consent not to be unreasonably withheld or delayed); or
- (b) with any person unless such contract substantially incorporates the limited recourse and non-petition provisions of the Reinsurer Deed of Charge.

FPLP shall, as soon as it becomes aware of the same, promptly notify the Relevant Person of the occurrence of any breach of the representations, warranties and covenants set out in the Reinsurance Agreement.

Investment Restrictions relating to the Reinsurer

At any time during the Term, the Assets shall be invested in Reinsurer Eligible Investments which are cash or financial collateral as defined in the Financial Collateral Arrangements (No.2) Regulation and in accordance with the Reinsurer Investment Criteria (as described below) in an attempt in good faith to meet the Reinsurer Investment Objective (as described below).

Where:

“**Assets**” means the assets of the Reinsurer covering the technical provisions, excluding for the avoidance of doubt the Reinsurer’s right, title and interest to, in and under the Reinsurer Swap.

“**Reinsurer Eligible Investments**” means assets which meet the Reinsurer Investment Criteria and Reinsurer Admissible Assets Criteria.

Reinsurer Investment Objective

The “**Reinsurer Investment Objective**” is at any time during the Term to invest the Reinsurer Eligible Investments such as to endeavour to:

- (a) yield a rate of return exceeding 3 month GBP-LIBOR-BBA (as such term is defined in the ISDA 2002 Definitions) as set on each Note Interest Payment Date;

- (b) return the principal so invested; and
- (c) manage its liquidity with a view to ensuring that it has sufficient cash available to pay its obligations as they fall due (ignoring any limit on recourse and assuming a sufficiency of Reinsurer Available Funds to pay such obligations).

Reinsurer Investment Criteria

The Assets shall be invested solely in accordance with the following criteria (the “**Reinsurer Investment Criteria**”), which are required to be met at the time of acquisition of the relevant Asset:

- (a) floating rate debt securities or other money-market instruments (as defined in the Glossary) denominated in Pounds Sterling that:
 - (i) either:
 - (A) have a senior, unsecured and unguaranteed long-term debt rating of A2 or better from Moody’s or A or better from S&P or a senior, unsecured and unguaranteed short-term debt rating of P-1 or better from Moody’s or A-1 or better from S&P; or
 - (B) have been issued or guaranteed by an entity that has a long-term credit rating of A2 or better from Moody’s or A or better from S&P;
 - (ii) pay interest:
 - (A) not less frequently than annually; and
 - (B) at a rate based on GBP-LIBOR-BBA (as such term is defined in the ISDA 2002 Definitions) plus or minus a spread;
- (b) fixed rate debt securities or other money-market instruments (as defined in the Glossary) denominated in Pounds Sterling that:
 - (i) mature in less than 12 months;
 - (ii) pay interest not less frequently than annually; and
 - (iii) either:
 - (A) have a senior, unsecured and unguaranteed long-term debt rating of A2 or better from Moody’s or A or better from S&P or a senior, unsecured and unguaranteed short-term debt rating of P-1 or better from Moody’s or A-1 or better from S&P; or
 - (B) have been issued or guaranteed by an entity that has a long-term credit rating of A2 or better from Moody’s or A or better from S&P; or
 - (iv) are certificates of deposit with a maximum term to maturity of less than two years and which meet the criteria in (iii) above, subject to a maximum limit of 20 per cent. of the market value of the total Assets; or
 - (v) are gilts with a maximum term to maturity of less than five years, subject to a maximum limit of 10 per cent. of the market value of the total Assets;
- (c) cash on deposit in Pounds Sterling that:
 - (i) if deposited for a period of less than 12 months is so deposited with any EU Credit Institution (as defined in FSMA) or a bank authorised in:
 - (A) the remaining member states of the EEA (Norway, Iceland, Liechtenstein); or
 - (B) a signatory state, other than an EU member state or a member state of EEA, to the BCCA (Switzerland, Canada, Japan, United States),
 in each case, which has a senior, unsecured and unguaranteed short-term debt rating of P-1 or better from Moody’s or A-1 or better from S&P;
 - (ii) if deposited for a period of 12 months or more up to and including 15 April 2019 is so deposited:
 - (A) with any EU Credit Institution (as defined in FSMA) or a bank authorised in:
 - (aa) the remaining member states of the EEA (Norway, Iceland, Liechtenstein); or

- (bb) a signatory state, other than an EU member state or a member state of EEA, to the BCCA (Switzerland, Canada, Japan, United States), provided that such entity shall have a senior, unsecured and unguaranteed long-term debt rating of A2 or better from Moody's or A or better from S&P;
- (B) on the basis that it shall:
 - (aa) mature on or before 15 April 2019; and
 - (bb) pay interest in cash:
 - (1) not less frequently than annually; and
 - (2) at a rate based on GBP-LIBOR-BBA or a similar GBP floating rate basis plus or minus a spread so that it can pay its 3 month GBP-LIBOR-BBA obligations under the Reinsurer Swap Agreement on time and without having to realise principal amounts invested; and
- (d) any money-market scheme (as defined in the FSA Handbook) denominated in Pounds Sterling that either:
 - (i) has been awarded a Fund Management Rating of Aa2/MRI by Moody's; or
 - (ii) has been awarded a Fund Management Rating of AAm by S&P,
 provided that the restrictions in (i) and (ii) above shall be deemed to have been breached if following the date on which the investment is made the money market scheme ceases to have the relevant Fund Management Rating and all units in such fund are not realised within a period of 60 Business Days following the date of such cessation,

Notwithstanding the provisions of this subsection "*Investment Restrictions relating to the Reinsurer*", each Asset must be an admissible asset (as such term is defined in Rule 2.2 under Annex 1R of the IPS), pay interest without withholding or deduction of tax if held by or on behalf of the Reinsurer and, under the law in force as at the date of the Reinsurer Investment Management Agreement, be an asset the acquisition of which would not give rise to stamp duty or SDRT for the Reinsurer (the "**Reinsurer Admissible Asset Criteria**").

Conduit Covenant

FPLP shall ensure that, in relation to each Calculation Period (other than the Calculation Period ending 31 December 2004):

- (a) the Reinsurer Regulatory Surplus is no less than
 - (b) the Available Defined Book Surplus (together with Capital Injections taken into account in such Calculation Period) plus any Regulatory Surplus Deficiency,
- and any shortfall shall be treated for the purposes of the Reinsurance Agreement as a breach of this Covenant (the "**Conduit Covenant**") (and the amount of such shortfall shall be the "**Conduit Breach Amount**").

Internal Reinsurances

In relation to:

- (a) unitised benefits under unit linked policies (including, for the avoidance of doubt hybrid policies);
- (b) unitised with profits benefits under unitised with profits policies or hybrid policies; and
- (c) investment benefits under deposit administration contracts,

where a sub-fund of FPLP or another company which is a FPLP Group Entity (each an "**Internal Reinsurer**") reinsures such benefits, FPLP shall ensure that each such Internal Reinsurer shall perform its respective obligations in full.

Investment Restrictions relating to the non annuity book

FPLP shall use its best endeavours to ensure that, at all times during the Term, the assets backing the Mathematical Reserves established in connection with the non linked non profit business (other than annuities) within the Defined Book shall be invested in an attempt in good faith to meet credit policies and procedures substantially similar to those in place as at the Closing Date, unless otherwise approved by the Relevant Person (such approval not to be unreasonably withheld or delayed).

Inflation Hedge

- (a) FPLP covenants that it will not terminate the transaction constituting the inflation hedge under a confirmation dated 10 December 2004 between Barclays Bank PLC (the “**Inflation Hedge Swap Counterparty**”) and FPLP (the “**Inflation Hedge**”) (entered into pursuant to an ISDA Master Agreement and schedule thereto dated as of 31 December 2003 (the “**Inflation Hedge ISDA Agreement**”) other than pursuant to an Event of Default or Termination Event affecting Barclays Bank PLC or if FPLP is an Affected Party in respect of a Termination Event (as each such term is defined in such Inflation Hedge ISDA Agreement).
- (b) FPLP will allocate the Inflation Hedge wholly to the Defined Book.
- (c) If (i) the Inflation Hedge ISDA Agreement is terminated and (ii) in connection with such termination, a termination amount would have been due and payable to the Defined Book in the event that the Inflation Hedge were the only Transaction under the ISDA Inflation Hedge Agreement (such amount, the “**Transaction Termination Amount**”), FPLP shall allocate funds to the Defined Book in an amount equal to the Transaction Termination Amount regardless of whether FPLP received any payments in connection with an early termination of the Inflation Hedge ISDA Agreement.
- (d) If the Inflation Hedge ISDA Agreement is terminated, FPLP agrees that it shall use best efforts to obtain a replacement inflation hedge provider for an inflation hedge (the “**Replacement Inflation Hedge**”) on terms substantially similar to those in the Inflation Hedge ISDA Agreement (or as otherwise agreed with the Relevant Person) and FPLP agrees that it shall allocate the Replacement Inflation Hedge wholly to the Defined Book.

Increments

FPLP shall ensure that there shall be no change to the method of allowing for non-contractual increments written prior to 31 May 2004 (which, for the avoidance of doubt, are not part of the Defined Book) without the prior written consent of the Relevant Person.

Funding of Part A Breaches

To the extent any of the Part A Warranties or Funded Covenants (other than the “**Conduit Covenant**”) in the Reinsurance Agreement are incorrect or have been breached, a “**Part A Breach**” will occur. A Part A Breach will give rise to the consequences stated in the Reinsurance Agreement as described below.

A breach of the Conduit Covenant (“**Conduit Breach**”) shall require FPLP to pay to the Reinsurer the Conduit Breach Amount.

The only consequences of a Part A Breach or a Conduit Breach will be those described in this section (other than termination for fraudulent misrepresentation or breach as referred to above). The parties have agreed that, save in the case of fraudulent breach which is intended to defraud the Relevant Person and/or Noteholders, no person shall have any other claim or remedy (including any right to claim damages or any injunctive relief or any right to rescind, avoid or otherwise terminate any Transaction Document) under the Reinsurance Agreement or the other Transaction Documents or in law (whether tort, contract, trust or arising from any fiduciary obligations or otherwise) in respect of any of the Part A Warranties or Funded Covenants being or becoming incorrect or being breached or otherwise not complied with, in each case, without limiting the same, whether due to misrepresentation (whether negligent or otherwise) or untrue statement in connection with the Part A Warranties or Funded Covenants or the failure by any person to comply with or perform any act referred to in any Part A Warranty or Funded Covenant. For the avoidance of doubt, remedies available to any person in respect of or in connection with any other event (including a Part B Breach) other than a Part A Breach or Conduit Breach shall not be affected.

In the case of Part A Breaches relating to FPLP, FPLP shall notify the Reinsurer and the Relevant Person (each a “**Notifiable Party**”) and in the case of Part A Breaches and Conduit Breaches relating to the Reinsurer, FPLP and/or the Reinsurer shall notify the Notifiable Parties, in any case promptly on becoming aware of any Part A Breach or Conduit Breach of such reasonable details of the breach are as then available to it and such further information as the relevant person may reasonably request and shall maintain such records as will enable FPLP and the Reinsurer to inform the Notifiable Parties of the matters required to be notified and to make the calculations and determinations under the Reinsurance Agreement as described below.

FPLP shall, in addition, make the calculations and determinations required to be made under the Reinsurance Agreement as described below in order for the obligations of FPLP to be performed under the Reinsurance Agreement.

Nothing in this subsection "*Funding of Part A Breaches*" prevents a Notifiable Party from claiming that a Part A Breach or a Conduit Breach has occurred or that any aspect of the transactions contemplated by the Reinsurance Agreement has been carried out incorrectly. Any dispute arising in relation to a Part A Breach or a Conduit Breach shall be determined in accordance with the procedure described in the subsection entitled "*Warranty Dispute Notice*" below.

Part A Breach Determinations

In respect of each Part A Breach, FPLP shall make the determinations set out below.

In the first Calculation Period in respect of which a Part A Breach occurred, the amount of reduction in Defined Book Surplus and/or Reinsurer Regulatory Surplus (as applicable) arising as a result of such Part A Breach shall be determined as at the Calculation Date falling at the end of such Calculation Period. The amount so determined (which may be zero) is the "**Breach Amount**" in respect thereof, save that the Breach Amount in respect of a breach of the Base Case Warranty shall be the Aggregate Base Case Breach Amount and the remainder of this sub-section shall not apply to any such breaches of the Base Case Warranty.

The Breach Amount shall be divided into two parts:

- (a) the amount of any reserve set aside in respect of such Part A Breach (the "**Reserve Amount**"), which amount may be zero; and
- (b) the excess of the Breach Amount over the Reserve Amount in respect of such Part A Breach (the "**Current Loss Amount**"), which amount may be zero.

In respect of each subsequent Calculation Period, the following shall be determined in respect of such Part A Breach:

- (a) if the reserve in respect of such Part A Breach as at the end of the relevant Calculation Period exceeds the reserve in respect of such Part A Breach as at the beginning of the Calculation Period, the amount of the excess shall be determined (such amount being a "**Breach Reserve Increase**");
- (b) if the reserve in respect of such Part A Breach as at the end of the relevant Calculation Period is less than the reserve in respect of such Part A Breach as at the beginning of the Calculation Period, or there is no reserve in respect of such Part A Breach at the end of the relevant Calculation Period (including, for the avoidance of doubt, by virtue of any reserve established in respect of such Part A Breach at the beginning of the Calculation Period being applied in paying any actual cost, loss, expense or liability in respect of such Part A Breach in such Calculation Period (as to which see paragraph (d) below)), the reduction shall be determined (such amount being a "**Breach Reserve Reduction**");
- (c) the amount of Breach Reserve Increase which results from the operation of the relevant discount rate (a "**Breach Gross Up**");
- (d) the amount of any reserve in respect of such Part A Breach at the beginning of the Calculation Period which has been applied in paying any actual cost, loss, expense or liability in respect of such Part A Breach (in respect of such Part A Breach, an "**Applied Reserve**");
- (e) the amount applied in paying any actual cost, loss, expense or liability in respect of such Part A Breach which is not included within paragraph (d) above (in respect of such Part A Breach, an "**Additional Amount**"); and
- (f) if the Defined Book Surplus has increased by reason of a recovery made by FPLP in respect of any amount taken into account in this subsection "*Breach Determinations*" (whether from the person paying the relevant amount or any other person) the amount of such recovery (after deducting the costs of recovery) shall be determined (a "**Recovery Amount**").

Timing of Determinations

The determinations required to be made under the Reinsurance Agreement in respect of a Breach in any Calculation Period shall, subject to the warranty dispute procedure described in the subsection entitled "*Warranty Dispute Notice*" below, be made by FPLP no later than the end of the Determination Period immediately following the relevant Calculation Period. The "**Determination Period**" in respect of a Calculation Period is the period from the Calculation Date at the end of

such Calculation Period to the fifth Business Day prior to the Payment Date following such Calculation Period.

Minimum Thresholds

In respect of each Calculation Period, FPLP shall calculate the following in order to determine whether a Part A Breach needs to be funded, or whether any funding in respect of a Part A Breach can be reduced or needs to be changed:

- (a) the “**Aggregate Current Amount**” as at the end of such Calculation Period, being the aggregate of the following amounts in respect of all Part A Breaches which have occurred in that Calculation Period or any prior Calculation Period:
 - (i) the Current Loss Amounts; plus
 - (ii) the Applied Reserves; plus
 - (iii) the Additional Amounts; less
 - (iv) Recovery Amounts;
- (b) the “**Aggregate Future Amount**” as at the end of such Calculation Period, being the aggregate of the following amounts in respect of all Part A Breaches which have occurred in that Calculation Period or any prior Calculation Period:
 - (i) the Reserve Amounts; plus
 - (ii) the Breach Reserve Increases; less
 - (iii) the Breach Reserve Reductions; and less
 - (iv) the Breach Gross Ups;
- (c) the aggregate as at the end of such Calculation Period of the Aggregate Future Amount and the Aggregate Current Amount (in respect of such Calculation Period, being the “**Aggregate Loss Amount**”).

Funding of Losses

If the Aggregate Loss Amount (including, for the avoidance of doubt, the Aggregate Base Case Breach Amount (if any)) exceeds the Aggregate Funded Loss Amount by £7,500,000 or more, then FPLP shall fund such the amount by which the Aggregate Loss Amount (including, for the avoidance of doubt, the Aggregate Base Case Breach Amount (if any)) exceeds the Aggregate Funded Loss Amount as follows:

- (a) to the extent the Aggregate Loss Amount arises from a Part A Breach affecting the Defined Book Surplus or an Aggregate Base Case Breach Amount, by way of a Breach Adjustment; and
- (b) to the extent the Aggregate Loss Amount arises from a Part A Breach affecting the Reinsurer Regulatory Surplus (but not the Defined Book Surplus), by way of Capital Injection.

provided that, at any time when FPLP is paying Ongoing Premiums, it shall fund Part A Breaches by way of Capital Injection only.

Any Conduit Breach shall give rise to an obligation to fund the corresponding Conduit Breach Amount by way of Capital Injection on the basis that the threshold of £7,500,000 shall not apply. In addition, the threshold of £7,500,000 shall not apply in respect of a breach of the Funded Covenant entitled “Internal Reinsurances”.

The actions set out in this subsection “*Funding of Losses*” shall, in the case of Capital Injections, be taken so as to provide funding in or in respect of the Calculation Period for which the relevant Aggregate Loss Amount and the relevant Aggregate Funded Loss Amount have been calculated. To the extent a Capital Injection is made which is not taken into account until a subsequent Calculation Period it shall be treated as not having been made until such subsequent Calculation Period.

For these purposes:

“**Aggregate Funded Loss Amount**” means, at any time, the aggregate of:

- (a) the amounts at that time by which the Adjusted Sum Reinsured have been reduced as a result of Breach Adjustments; and
- (b) the amounts advanced by way of Capital Injections, less any Recapture Reductions.

“**Capital Injection**” means any subscription for shares in the Reinsurer, any capital contribution, contingent loan, subordinated loan or other legally binding form of financing of the Reinsurer (each a “**Financing**”), to the extent that the funds made available to the Reinsurer reverse the effect of the relevant Part A Breach on the Reinsurer Regulatory Surplus or reverse the effect of the Conduit Breach or, in the case of a breach of the Base Case Warranty, increase the Reinsurer Regulatory Surplus by the Aggregate Base Case Breach Amount.

A Capital Injection shall be treated as made in a Calculation Period to the extent it is taken into account in such Calculation Period:

- (a) in having the relevant effect referred to in the definition of Capital Injection in such Calculation Period, which reversing would not have occurred but for the Financing occurring (or, in accordance with the paragraph above, a later Calculation Period); and/or
- (b) in establishing a reserve which, but for the making of such Financing, would have reduced the Reinsurer Regulatory Surplus in such Calculation Period.

For the avoidance of doubt, it is acknowledged that Reinsurer Regulatory Surplus may be reduced by a Part A Breach which reduces Defined Book Surplus.

The funding of Part A Breaches and Conduit Breaches shall be effected so as to take account of the period between:

- (a) the date on which the Reinsurer suffers the effect of such a breach; and
- (b) the date on which the effect thereof is reversed,

such that the Reinsurer receives funding to compensate it for any delay in the Reinsurer receiving funding for the Breach

Overfunded Amounts

If the Aggregate Funded Loss Amount exceeds the Aggregate Loss Amount (such excess being the “**Overfunded Amount**”) at a Calculation Date, FPLP may take any of the following actions in its absolute discretion during that or the next following Calculation Period provided that the aggregate amount in relation to which it takes such action does not exceed the Overfunded Amount:

- (a) FPLP may direct that all or part of a Capital Injection be reduced, in which case the amount of that Capital Injection will be withdrawn from the Reinsurer Fund and (if requested by FPLP and permitted by Applicable Law) repaid to FPLP, and the amount so withdrawn shall be a deduction in calculating the Reinsurer Regulatory Surplus in that Calculation Period to the extent necessary to repay such amount.
- (b) FPLP may:
 - (i) direct that the next Recapture Amount falling to be recaptured or the Ongoing Premium if Ongoing Premiums are being paid shall be reduced by an amount not greater than the Overfunded Amount (any such reduction being a “**Recapture Reduction**”); and
 - (ii) notify the Relevant Person in writing at least 14 days before the relevant Payment Date as to the amount of, and reasons for, such Recapture Reduction.

Substitution of Funding

Subject to Applicable Law, FPLP will be at liberty, if a Capital Injection (the “**Original Capital Injection**”) has been made, to:

- (a) make a further Capital Injection (a “**Substitute Capital Injection**”); and/or
- (b) make a Breach Adjustment (a “**Substitute Breach Adjustment**”),

up to the amount of such Original Capital Injection and in replacement of such Original Capital Injection.

To the extent that such Substitute Capital Injection or Substitute Breach Adjustment would result (when taken together with any prior Substitute Capital Injection or Substitute Breach Adjustment) in an increase in the Reinsurer Regulatory Surplus in respect of the next following (or any subsequent) Calculation Period and provided that such increase at least equals the amount by which the Reinsurer Regulatory Surplus will be decreased on repayment of the Original Capital Injection, the amount by which the Reinsurer Regulatory Surplus would increase as a result of such Substitute Capital Injection(s) and/or Substitute Breach Adjustment(s) will be applied by the

Reinsurer in repaying the Original Capital Injection in priority to repaying the Reinsurer Loan or interest on it, in accordance with the Reinsurer Priorities of Payments.

Records

FPLP shall (in respect of itself and the Reinsurer) maintain, and shall procure that the Reinsurer (in respect of itself) maintains, a ledger recording each Part A Breach and Conduit Breach applicable to it and all other matters necessary to enable the provisions of the Reinsurance Agreement to be operated.

Warranty Dispute Notice

In the event of a dispute as to the occurrence of a Part A Breach or a Conduit Breach or the determination of any of the amounts referred to in the provisions of the Reinsurance Agreement dealing with funding Part A Warranties and Funded Covenants, such dispute shall be resolved by an Independent Actuary (as defined below) who shall be appointed following the service by either FPLP or the Relevant Person of a notice identifying the issues in dispute and requesting the appointment of the Independent Actuary (the “**Warranty Dispute Notice**”).

Each of FPLP and the Relevant Person shall provide to each other and the Independent Actuary a statement setting out their arguments in respect of the issues specified in the Warranty Dispute Notice within 10 Business Days of the later of:

- (a) the Independent Actuary being appointed; and
- (b) the Relevant Person receiving the information it has requested pursuant to the Reinsurance Agreement.

The Independent Actuary will consider the arguments set out in the statements provided by each of FPLP and the Relevant Person, together with such other information as the Independent Actuary may require them to provide to him, and determine the matter in dispute (the “**Independent Determination**”).

Following determination by the Independent Actuary, FPLP, the Reinsurer, the Relevant Person and the Reinsurer Security Trustee shall:

- (a) use the Independent Determination for the purposes of determining whether a Part A Breach Amount or Conduit Breach has occurred, and for the purposes of making a Breach Adjustment or Capital Injection in respect of such Calculation Period; and
- (b) adopt the Independent Determination:
 - (i) for projecting surplus for future Calculation Periods; and
 - (ii) in determining the effect of any relevant Part A Breach or Conduit Breach.

The Independent Actuary’s determination shall be final and binding except in the case of manifest error.

The Independent Actuary will be a person, acting as expert and not as arbitrator, who is agreed between the Relevant Person and FPLP or, failing agreement, such person as may be nominated by the then President of the Faculty of Actuaries (or any successor body). The Independent Actuary may take such professional advice as he considers necessary or desirable.

Each party will bear its own costs in relation to all matters contemplated by Schedule 6 of the Reinsurance Agreement. The costs and expenses of the Independent Actuary will be allocated such that part will be a third party cost under the Reinsurer Deed of Charge and part will be borne by the Relevant Person as determined by the Independent Actuary.

Part B Warranties

In addition to the Part A Warranties, the Reinsurer and FPLP will give representations, warranties and covenants which are common for transactions of this nature (the “**Part B Warranties**”). In addition, the Reinsurer will covenant not to pay any dividend or make any other distribution to its shareholders, provided that it may pay dividends from time to time so long as the Reinsurer’s paid up share capital is not reduced to less than £30,000,000 and provided that such dividend is in respect of profits emerging in the shareholder fund of the Reinsurer and, subject to the prior written consent of the Relevant Person, profits transferred from the Reinsurer Fund. The Part B Warranties also include a representation given by FPLP that each of FPLP and the Reinsurer has, as at the Closing Date, capital resources sufficient to:

- (a) meet the applicable regulatory capital or capital ratios required by the FSA; and
- (b) ensure that a parent undertaking solvency calculation prepared by FPLP under chapter 10 of IPRU shall be positive.

In addition, FPLP covenants to ensure that, at all times, its capital resources and those of the Reinsurer are sufficient to meet the applicable regulatory capital or capital ratios (including in relation to group solvency once legally binding) required by the FSA. These representations and covenants together with similar representations and covenants given by the Reinsurer form the “**Capital Maintenance Warranties**”. The remedy for a breach of the Capital Maintenance Warranties (a “**Capital Maintenance Breach**”) are different from the remedies available for other Part B Breaches. The remedies for the breach of a Part B Warranty (a “**Part B Breach**”) differ from those available in respect of a Part A Warranty.

Funding of Part B Breaches and Part B Breach Determination

A Part B Breach shall be deemed not to have occurred:

- (a) if such breach is expressly waived in writing by the Relevant Person; or
- (b) in relation to a Curable Event if FPLP and/or the Reinsurer has remedied a Part B Breach to the satisfaction of the Relevant Person (acting reasonably) within the applicable Cure Period (or such longer period as the Relevant Person and FPLP may agree in writing).

If a Part B Breach has occurred and:

- (a) the termination and the Material Adverse Impact rights are indicated in the Matrix of Remedies (as set out in the Reinsurance Agreement) as being applicable to such Part B Breach, a Part B Breach shall give rise to a right to terminate the Reinsurance Agreement by the Relevant Person only if that Part B Breach has a Material Adverse Impact;
- (b) the general remedies are indicated in the Matrix of Remedies (as set out in the Reinsurance Agreement) as being applicable to such Part B Breach, a Part B Breach shall give rise to all rights and remedies under general law but, with respect to a claim for damages, subject to the restrictions summarised below; and
- (c) if a Part B Breach has occurred and the Matrix of Remedies indicates that step-up applies, such Part B Breach shall give rise to such step-up of fees payable to Ambac as the Issuer and Ambac may agree in writing on or before the Closing Date.

The Part B Breach remedies described in (a) above only apply in respect of certain representations which are considered to be important to the integrity of the transaction structure (including, but not limited to, representations relating to: incorporation, corporate power, solvency, conflicts, validity and enforceability of obligations, statutory filings, cross default, absence of litigation, *pari passu* claims, no immunity, carrying on insurance business, material adverse change, capital resources, title to assets and security). The Part B Breach remedies described in (b) above apply to all Part B representations, warranties and covenants.

“**Curable Event**” means, in relation to the representations, warranties and covenants, a breach which, or the consequences of which, is capable of being remedied or cured and which is identified as having a cure period in the Matrix of Remedies;

“**Cure Period**” means, in relation to a Curable Event, the period as indicated in the Matrix of Remedies, which shall commence upon FPLP and/or the Reinsurer becoming aware (or the time at which it should have become aware of it, acting as a Prudent Insurer) of such breach.

To the extent that a Part B Breach specified in paragraph (b) above has occurred and an amount is payable in relation thereto by FPLP, FPLP may fund the amount of such breach:

- (a) by way of a Capital Injection;
- (b) by way of a Breach Adjustment; or
- (c) by a combination of (a) and (b),

provided that any Capital Maintenance Breach, and any Part B Breach arising at a time when FPLP is paying Ongoing Premiums, shall always be funded by way of a Capital Injection.

“**Breach Adjustment**” in relation to a Part B Breach means together:

- (a) FPLP shall owe such amount as would, upon being received by the Reinsurer, have the effect of reversing the effect on Reinsurer Regulatory Surplus of the relevant Part B Breach or, if higher, the amount of damages (including costs and interest) awarded in respect of the relevant Part B Breach (“**Repurchase Amount**”); and
- (b) instead of paying the Repurchase Amount to the Reinsurer, the Reinsurer’s reinsurance obligations shall be reduced by an amount equal thereto, by way of reduction in the Adjusted Sum Reinsured (but not so as to reduce the Adjusted Sum Reinsured to less than zero).

“**Capital Injection**” in relation to a Part B Breach means any subscription for shares in the Reinsurer, any capital contribution, contingent loan, subordinated loan or other legally binding form of financing of the Reinsurer (each a “**Financing**”), to the extent that the funds made available to the Reinsurer reverse the effect of the relevant Part B Breach on the Reinsurer Regulatory Surplus or, if higher, increase Reinsurer Regulatory Surplus by the amount of damages (including costs and interest) awarded in respect of the relevant Part B Breach.

A Capital Injection shall be treated as made in a Calculation Period to the extent it is taken into account in such Calculation Period:

- (a) in having the relevant effect referred to in the definition of Capital Injection in such Calculation Period (or a later Calculation Period), which reversing would not have occurred but for the Financing occurring; and/or
- (b) in establishing a reserve which, but for the making of such Financing, would have reduced the Reinsurer Regulatory Surplus in such Calculation Period.

The actions set out above shall, in the case of Capital Injections, be taken so as to provide funding in or in respect of the Calculation Period for which the Part B Breach has been calculated. To the extent a Capital Injection is made which is not taken into account until a subsequent Calculation Period, it shall be treated as not having been made until such subsequent Calculation Period.

For the avoidance of doubt, it is acknowledged that Reinsurer Regulatory Surplus may be reduced by a Part B Breach which reduces Defined Book Surplus.

The funding of Part B Breaches shall be effected so as to take account of the period between:

- (a) the date on which the Reinsurer suffers the effect of such a breach; and
- (b) the date on which the effect thereof is reversed,

such that the Reinsurer receives funding to compensate it for any delay in the Reinsurer receiving funding for the relevant breach.

No claim in damages may be made in relation to a Part B Breach other than in relation to a Capital Maintenance Breach to the extent that the relevant facts or circumstances which give rise to such claim also give rise to a claim for a Part A Breach.

Notwithstanding any other provision of the Reinsurance Agreement, no party shall be entitled to recover damages or obtain payment, reimbursement, compensation, restitution or indemnity more than once in respect of any one damage, deficiency, breach or other set of circumstances which give rise to both a Part A Breach and a Part B Breach.

REINSURER LOAN AGREEMENT

On or before the Closing Date the Reinsurer will enter into a loan agreement with InterCo under which InterCo will agree to advance to the Reinsurer on the Closing Date £380,000,000 to enable the Reinsurer to acquire Reinsurer Eligible Investments to be held as reserves in respect of its liabilities under the Reinsurance Agreement (the “**Reinsurer Loan Agreement**”).

The advance made under the Reinsurer Loan Agreement (the “**Reinsurer Loan**”) will be made on the Closing Date and is a contingent and limited recourse obligation of the Reinsurer.

The obligation to pay interest, Reinsurer Ongoing Commitment Fees and principal (and any gross ups for withholdings or loans in respect of withholdings in respect of such amounts) on any Loan Interest Payment Date is contingent on (i) the amount of Available Reinsurer Surplus at the end of the Calculation Period immediately prior to such Loan Interest Payment Date and (ii) the Reinsurer having Reinsurer Available Funds (after having paid or provided for amounts ranking higher in the Reinsurer Order of Priorities of Payment).

“**Available Reinsurer Surplus**” (A) in respect of a Calculation Period, other than the Calculation Period in which the Reinsurance Agreement is terminated, shall be the lower of (i) the Available

Defined Book Surplus in respect of such Calculation Period and any Regulatory Surplus Deficiency in respect of any prior Calculation Period and (ii) the Adjusted Regulatory Surplus in respect of such Calculation Period provided that for the Calculation Period ending 31 December 2004 the Defined Book Surplus will be treated as reduced to the extent it would otherwise result in the principal amount of the Notes being repaid and, (B) in the Calculation Period in which the Reinsurance Agreement is terminated, the Adjusted Regulatory Surplus.

“**Adjusted Regulatory Surplus**” means the Reinsurer Regulatory Surplus at the end of the Calculation Period (the second Calculation Period) together with an amount equal to the Regulatory Surplus Deficiency from the immediately preceding Calculation Period (the first Calculation Period) to the extent not transferred into the Reinsurer’s Long Term Business Fund from the Reinsurer’s Shareholder Fund on or prior to the end of the second Calculation Period (to such extent, the “**Unfunded Regulatory Surplus Deficiency**”).

“**Reinsurer’s Long Term Business Fund**” means, in respect of the Reinsurer, the long-term insurance fund of the Reinsurer established in respect of the long-term business of the Reinsurer comprising the Reinsurance Agreement (or, if no such fund is established, the fund which would be maintained were one required to be established).

“**Reinsurer Regulatory Surplus**” means, in respect of a Calculation Period, the surplus of the Reinsurer’s Long Term Business Fund shown in Line 39 of Form 58 or such other position on Form 58, as amended from time to time, or on any other form or forms as shall from time to time serve the same purpose as is served by Line 39 of Form 58 as at the Closing Date;

“**Regulatory Surplus Deficiency**” in respect of a Calculation Period means the aggregate of:

- (i) the amount by which the Available Defined Book Surplus at the end of that Calculation Period exceeds the Adjusted Regulatory Surplus in respect of such Calculation Period; and
- (ii) plus (if positive) or minus (if negative), the Disputed Amount;

in each case, to the extent not included in the Reinsurer Regulatory Surplus in that or a prior Calculation Period.

If any dispute results in an adjustment to Defined Book Surplus or Breach Adjustments or Reinsurer Regulatory Surplus in respect of prior Calculation Periods, the “**Disputed Amount**” is (a) the amount determined following the disputes procedure to be the amount which should have been the Defined Book Surplus or Breach Adjustments or Reinsurer Regulatory Surplus in respect of such prior Calculation Period less (b) the Defined Book Surplus or Breach Adjustments or Reinsurer Regulatory Surplus actually used for calculating Reinsurer Regulatory Surplus in such prior Calculation Period.

The Available Reinsurer Surplus will, in accordance with the Reinsurer Priorities of Payment, be applied first in paying Reinsurer Ongoing Commitment Fees, then interest and then principal.

Reinsurer Available Funds: On each Loan Interest Calculation Date, the Reinsurer Cash Manager is required to determine the amount which is required to be paid on the immediately succeeding Loan Interest Payment Date to the Reinsurer Secured Creditors (and any person to whom payment may be made in accordance with the Reinsurer Priorities of Payment). The Reinsurer Cash Manager is required to instruct the Reinsurer Investment Manager to realise sufficient assets so that there will be (taking into account receipts expected on such Loan Interest Payment Date under the Reinsurer Swap Agreement) sufficient funds in the Reinsurer Transaction Account available to pay the amounts due to the Reinsurer Secured Creditors (and any person to whom payment may be made in accordance with the Reinsurer Priorities of Payment) on such Loan Interest Payment Date on the assumption that there were no limit on recourse in respect of such amounts. The “**Reinsurer Available Funds**” on any day is the amount standing to the credit of the Reinsurer Transaction Account on that day prior to any payments out of the Reinsurer Transaction Account on that day. Such amount is required to be paid or applied in accordance with the Reinsurer Priorities of Payment in paying the Reinsurer Secured Creditors and other amounts specified in the Reinsurer Priorities of Payment. Accordingly, while the Reinsurer has any Reinsurer Eligible Investments (or other securities or investments) available, it will be required to realise such assets and apply the amounts in paying the Reinsurer Secured Creditors (and any person to whom payment may be made in accordance with the Reinsurer Priorities of Payment).

Loan Interest Period: The period for which the Reinsurer Loan is outstanding will be divided into successive periods (each a “**Loan Interest Period**”). The duration of each Loan Interest Period shall be the period commencing on (and including) a Loan Interest Payment Date to (but excluding) the

immediately succeeding Loan Interest Payment Date, provided that the first Loan Interest Period for the Reinsurer Loan shall be a period commencing on (and including) the Closing Date and ending on (but excluding) the immediately succeeding Loan Interest Payment Date. “**Loan Interest Payment Date**” means 15 April in each year (and if such day is not a Business Day, the immediately succeeding Business Day) or, if the Reinsurance Agreement is terminated, the Interest Payment Date on the Notes first following the expiry of 40 days following the termination of the Reinsurance Agreement.

In certain instances interest on some or all of the Reinsurer Loan may accrue at a floating rate (see below). In such a case, a Loan Interest Period will be sub-divided into quarterly Reinsurer Interim Interest Periods. For these purposes:

“**Reinsurer Interim Interest Period**” means from (and including) a Reinsurer Interest Calculation Date to (but excluding) the next Reinsurer Interest Calculation Date.

“**Reinsurer Interest Calculation Date**” means each Interest Payment Date.

“**Loan Interest Calculation Date**” in respect of a Loan Interest Payment Date is the fifth Business Day prior to such Loan Interest Payment Date.

Reinsurer Interest Amount and Reinsurer Ongoing Commitment Fees

The Adjusted Sum Reinsured increases each year by, in effect, the Adjusted Sum Reinsured at the beginning of the Calculation Period multiplied by the Benefit Increase Rate for the Calculation Period (the “**Annual Increase Amount**”). If the Adjusted Sum Reinsured is reduced due to recapture or a Claim, the notional principal of the Reinsurer Swap (and, in an aggregate principal amount, the InterCo Swap and the Issuer Fixed/Floating Swap) will be reduced by a corresponding amount. If the Adjusted Sum Reinsured is reduced by an amount in excess of the Annual Increase Amount due to recapture in an amount exceeding the Annual Increase Amount, a corresponding part of the notional amount of the Reinsurer Swap will terminate (as well as the amount equal to the Annual Increase Amount) on the relevant Loan Interest Payment Date and a corresponding amount of Reinsurer Loan principal should generally become repayable on that date. If, however, the Adjusted Sum Reinsured is reduced due to a Claim, while a corresponding part of the notional amount of the Reinsurer Swap will terminate, there will not be a corresponding reduction in the principal of the Reinsurer Loan. Accordingly, that part of the Reinsurer Loan which exceeds the Adjusted Sum Reinsured will carry interest at a floating rate as described below.

The interest payable for each Loan Interest Period (the “**Reinsurer Interest Amount**”) shall be calculated at the following rate:

- (a) on the Reinsured Fixed Principal Amount and deferred interest in respect thereof, a fixed rate of 4.906 per cent. per annum; or
- (b) on the Reinsurer Floating Principal Amount and deferred interest in respect thereof, LIBOR.

The “**Reinsurer Floating Principal Amount**” is the amount by which the aggregate principal amount outstanding in respect of the Reinsurer Loan exceeds the Reinsurer Fixed Principal Amount. The “**Reinsurer Fixed Principal Amount**” is the amount corresponding to the lower of the aggregate Principal Amount Outstanding on all the Notes and the lowest amount of the Adjusted Sum Reinsured on or prior to that date. The Reinsurer Floating Principal Amount will accrue (and compound) interest at LIBOR quarterly but be payable annually on the relevant Loan Interest Payment Date. As principal of the Reinsurer Loan is repaid, it will repay the Reinsurer Floating Principal Amount after the Reinsurer Fixed Principal Amount. The Annual Premium will increase (which will result in a reduction in the Recapture Amount) to include the amount of floating rate interest payable by the Reinsurer.

Reinsurer Loan Interest: The rate of interest payable under the Reinsurer Loan Agreement in respect of a Loan Interest Period shall:

- (a) be calculated on the basis of actual days elapsed and a year comprising three hundred and sixty-five (365) days (or, if any portion of that Loan Interest Period in respect of the Reinsurer Fixed Principal Amount (or, Reinsurer Interim Interest Period in the case of any Reinsurer Floating Principal Amount) falls in a leap year, the sum of (x) the actual number of days in that portion of the Loan Interest Period (or Reinsurer Interim Interest Period) falling in a leap year divided by 366 and (y) the actual number of days in that portion of the Interest Period (or Reinsurer Interim Interest Period) falling in a non-leap year divided by 365);

- (b) accrue from day to day from (and including) the first day of such Loan Interest Period (or Reinsurer Interim Interest Period) to (but excluding) the last day thereof (and, in the case of interest accruing in a Reinsurer Interim Interest Period will itself accrue interest at the relevant LIBOR rate on a compounding basis from the previous Reinsurer Interest Calculation Date to the next Reinsurer Interest Calculation Date during the relevant Loan Interest Period); and
- (c) be paid by the Reinsurer to InterCo on the relevant scheduled Loan Interest Payment Date to the extent there are Reinsurer Available Funds remaining after paying or providing for payments with a higher ranking priority in the Reinsurer Priorities of Payments (and to the extent there is any Available Reinsurer Surplus remaining after having paid out of it any Reinsurer Ongoing Commitment Fees, Deferred Reinsurer Ongoing Commitment Fees and any additional amounts payable (by way of payment or by way of gross-up loan in respect of any withholding tax).

Interest determined in respect of each Loan Interest Period and deferred interest shall, subject to the terms of the Reinsurer Loan Agreement, be payable on the immediately succeeding Loan Interest Payment Date falling at the end of such Loan Interest Period (ignoring any adjustment for business day conventions) or, following termination of the Reinsurance Agreement, the next Interest Payment Date first occurring following the expiry of 40 days from the date of such termination.

In consideration of InterCo agreeing to make available the advance on the Closing Date under the Reinsurer Loan Agreement, the Reinsurer will agree to pay to InterCo:

- (a) on the Closing Date, an initial commitment fee (the “**Reinsurer Initial Commitment Fee**”); and
- (b) on each Loan Interest Payment Date, an annual Reinsurer Ongoing Commitment Fee.

The Reinsurer Ongoing Commitment Fee in respect of a Loan Interest Period will be calculated by InterCo by applying the following formula:

“**Reinsurer Ongoing Commitment Fee**” on any day equals Reinsurer Aggregate Cost of Funds minus the Reinsurer Interest Amount.

The “**Reinsurer Aggregate Cost of Funds**” is the aggregate of the amounts required by:

- (a) the Issuer (i) to pay when due all Issuer Amounts (other than Principal Amounts) accruing (or, insofar as they do not accrue, arising) in the Related Period to the Loan Interest Period, (ii) to set aside in the relevant bank accounts the Issuer Amounts (other than Principal Amounts) required to be set aside in such bank accounts in such Related Period, after taking account of all amounts (other than Principal Amounts, any InterCo Loan Interest, any InterCo Ongoing Commitment Fee) accruing (or, insofar as they do not accrue, arising) to the Issuer in such Related Period and (iii) to provide a pre-tax profit to the Issuer per annum equal to the higher of 0.75 basis points of the principal amount outstanding under the Notes and £7,000 (plus an amount equal to VAT which would be payable at then current standard rate on an amount of £7,000), (such amount being the “**InterCo Aggregate Cost of Funds**”); and
- (b) InterCo (i) to pay when due all InterCo Amounts (other than Principal Amounts and any InterCo Loan Interest and any InterCo Ongoing Commitment Fee) accruing (or, insofar as they do not accrue, arising) in the Related Period to the Loan Interest Period, (ii) to set aside in the relevant bank accounts the InterCo Amounts (other than Principal Amounts) required to be set aside in such bank accounts in such Related Period, after taking account of all amounts (other than Principal Amount, any Reinsurer Loan Interest, any Reinsurer Ongoing Commitment Fee or any amounts accruing in respect of the InterCo General Reserve Account (or any InterCo Eligible Investments or other amounts held by the InterCo Custodian)) accruing (or, insofar as they do not accrue, arising) to InterCo in such Related Period and (iii) to provide a pre-tax profit to InterCo per annum equal to 0.01 per cent. of the principal amount outstanding of the Reinsurer Loan (the “**InterCo Profit Margin**”);

excluding in each case amounts taken into account in the calculation of Reinsurer Aggregate Cost of Funds in respect of the preceding Related Period, and provided that the amount taken into account (including in determining whether an amount is due, payable, accrued or arising) shall be determined ignoring any limit on recourse or the insufficiency of funds to pay or provide for amounts which would otherwise be due, payable, accrued or arising or to be set aside by the Issuer or InterCo in accordance with the Issuer Priorities of Payment or the InterCo Priorities of Payment.

For these purposes:

“InterCo Amounts” means amounts payable or to be provided by or on behalf of InterCo under or in connection with the Transaction Documents or contemplated by the Transaction Documents;

“InterCo Loan Interest” means the interest payable by InterCo to (i) the Issuer under the InterCo Loan Agreement (including any tax withheld in respect thereof and any InterCo Gross-up Loan made to the Issuer) and any drawing on the Liquidity Facility to pay any such interest amounts (and any payment of any such drawing under the Ambac Liquidity Financial Guarantee) and (ii) the InterCo Subordinated Loan Provider and the InterCo Subordinated Loan Agreement (except in relation to interest on any Expenses Advances);

“Issuer Amounts” means amounts payable or to be provided by or on behalf of the Issuer under or in connection with the Transaction Documents or contemplated by the Transaction Documents and any tax liability in the Issuer howsoever arising to the extent that such liability is a liability for or on account of tax payable by the Issuer which exceeds corporation tax at the appropriate rate on annual profits equal to the higher of 0.75 basis points of the principal amount outstanding under the Notes and £7,000 (plus an amount equal to VAT which would be payable at then current standard rate on an amount of £7,000);

“Principal Amounts” means amounts payable or paid by:

- (a) the Issuer in respect of the principal amount of the Notes;
- (b) InterCo in respect of the principal amount of the InterCo Loan;
- (c) the Reinsurer in respect of the principal amount of the Reinsurer Loan;
- (d) Ambac in respect of the Ultimate Principal paid under the Ambac Note Financial Guarantee;
- (e) the Issuer or InterCo in respect of break costs payments under the InterCo Loan Agreement;
- (f) InterCo or the Reinsurer in respect of break costs payments under the Reinsurer Loan Agreement;
- (g) the Issuer to the Issuer Swap Provider in respect of break costs payments in respect of partial or full early termination under the Issuer Swap Confirmation;
- (h) InterCo to the InterCo Swap Provider in respect of break costs payments in respect of partial or full early termination under the InterCo Swap Confirmation;
- (i) InterCo in respect of the amount advanced under the InterCo Subordinated Loan other than any Expenses Advance;
- (j) the Issuer in respect of the Issuer Subordinated Loan Agreement; and
- (k) InterCo in respect of the Deposit Amount under the InterCo Deposit Agreement.

“Reinsurer Loan Interest” means the interest payable by the Reinsurer to InterCo under the Reinsurer Loan Agreement (including any tax withheld in respect thereof and any Reinsurer Gross-up Loan made to InterCo);

“Related Period” in respect of a Loan Interest Period means, where the payor is:

- (a) the Issuer, each and every Interest Period ending after the immediately preceding Loan Interest Period and on or before the Interest Payment Date falling closest to the last day of the relevant Loan Interest Period and shall include amounts payable on such Interest Payment Date but exclude amounts payable on the Interest Payment Date falling closest to the first day of such relevant Loan Interest Period;
- (b) paying to the Issuer, other than where the payor is InterCo, each Interest Period ending after the immediately preceding Loan Interest Period and on or before the Interest Payment Date falling closest to the last day of the relevant Loan Interest Period and shall include amounts payable on such Interest Payment Date but exclude amounts payable on the Interest Payment Date falling closest to the first day of the relevant Loan Interest Period;
- (c) InterCo, such Loan Interest Period (including payments made on the Loan Interest Payment Date falling at the end of such Loan Interest Period and exclude payments made on the Loan Interest Payment Date falling at the beginning of such Loan Interest Period); and
- (d) paying to InterCo, such Loan Interest Period (including payments made on the Loan Interest Payment Date falling at the end of such Loan Interest Period and exclude payments made on the Loan Interest Payment Date falling at the beginning of such Loan Interest Period).

“Reinsurer Loan Outstanding” means, in respect of a Loan Interest Payment Date, the principal amount outstanding of the Reinsurer Loan immediately prior to such Loan Interest Payment Date.

Deferral of Reinsurer Loan interest: To the extent that (i) the aggregate of the interest payable by the Reinsurer on a Loan Interest Payment Date (ignoring the ability to defer payments) exceeds (ii) the amount of the Reinsurer Available Funds on such Loan Interest Payment Date, after providing for all amounts payable on such Loan Interest Payment Date higher in the Reinsurer Priorities of Payments, such excess shall be deferred and shall be due and payable (together with accrued interest thereon) by the Reinsurer on the next succeeding Loan Interest Payment Date to the extent that the Reinsurer Available Funds (as calculated in respect of such succeeding Loan Interest Payment Date) are sufficient to pay such amounts after providing for all amounts payable on such succeeding Loan Interest Payment Date higher in the Reinsurer Priorities of Payments. To the extent that such deferred interest (and interest accrued thereon) remains unpaid on such succeeding Loan Interest Payment Date, it shall be added to the deferred interest determined as being due and payable on such succeeding Loan Interest Payment Date, and so on in respect of subsequent Loan Interest Payment Dates. In determining interest which is to be deferred, the Available Reinsurer Surplus shall be applied in paying interest accruing at the applicable floating rate in priority to interest accruing at the applicable fixed rate. Thereafter, any floating rate component of the relevant deferred interest will accrue interest at the applicable floating rate and the fixed rate component of the relevant deferred interest will accrue interest at the applicable fixed rate. However, if at any time the Adjusted Sum Reinsured is less than the Reinsurer Fixed Principal Amount and the fixed interest component of deferred interest accrued in respect thereof, and, thereafter, for so long as this remains the case, interest will accrue at the applicable floating rate in respect of such fixed interest component of such deferred interest.

Deferral of Reinsurer Loan Ongoing Commitment Fee: To the extent that (i) the Reinsurer Ongoing Commitment Fee payable by the Reinsurer on a Loan Interest Payment Date exceeds (ii) the amount of the Reinsurer Available Funds on such Loan Interest Payment Date, after providing for all amounts payable on such Loan Interest Payment Date higher in the Reinsurer Priorities of Payments as set out in the Reinsurer Deed of Charge, such excess shall be deferred (the **“Deferred Reinsurer Ongoing Commitment Fee”**) and shall be added to the Reinsurer Ongoing Commitment Fee due and payable by the Reinsurer on the next succeeding Loan Interest Payment Date to the extent that the Reinsurer Available Funds (as calculated in respect of such succeeding Loan Interest Payment Date) are sufficient to pay such amounts after providing for all amounts payable on such succeeding Loan Interest Payment Date higher in the Reinsurer Priorities of Payments. To the extent that such Reinsurer Ongoing Commitment Fees remain unpaid on such succeeding Loan Interest Payment Date they shall be added to the Reinsurer Ongoing Commitment Fee determined as being due and payable on such succeeding Loan Interest Payment Date, and so on in respect of subsequent Loan Interest Payment Dates. No interest shall be payable in respect of any Deferred Reinsurer Ongoing Commitment Fee but any interest charged in respect of any component of such amount shall form part of the calculation of the Reinsurer Ongoing Commitment Fee on the succeeding Loan Interest Payment Date.

Reinsurer Loan prepayment break costs: The Reinsurer and InterCo (as applicable) will be required to pay break costs (i) to the extent fixed interest is paid on a Loan Interest Payment Date, (ii) for the Reinsurer Loan being prepaid (in whole or in part) prior to the Class A-2 Notes Final Maturity Date and (iii) for the interest rate on the Reinsurer Loan becoming in whole or in part based on a floating rate (or for any accrued unpaid fixed interest starting to accrue interest at a floating rate). (Item (iii) should occur only if a Claim is paid or the Reinsurer Swap, InterCo Swap and Issuer Swap Agreements are terminated in whole without replacement).

In respect of (i) and (ii), on each Loan Interest Calculation Date immediately preceding a Loan Interest Payment Date on which fixed interest is paid and/or the Reinsurer Loan is repaid in whole or part, the Reinsurer Swap Provider will calculate the market value as at the immediately succeeding Fixed Rate Payer Payment Date under the Reinsurer Swap Agreement of a Notional Swap and if such market value is positive to the Reinsurer, the Reinsurer will pay to InterCo such market value (a **“Reinsurer/InterCo Early Termination Payment”**), and if such market value is positive to the Reinsurer Swap Provider, InterCo will pay to the Reinsurer such market value (an **“InterCo/Reinsurer Early Termination Payment”**). The InterCo/Reinsurer Early Termination Payment or, as applicable, the Reinsurer/InterCo Early Termination Payment, shall be paid by InterCo or, as applicable, the Reinsurer, on the Loan Interest Payment Date immediately following the Loan Interest Calculation Date with respect to which such amount is calculated.

In respect of (iii), the relevant party (as determined under the Reinsurer Swap Agreement) will calculate the amount payable under the Reinsurer Swap Agreement of a Conversion Notional Swap and if such market value is positive to the Reinsurer, the Reinsurer will pay to InterCo such market value (a “**Reinsurer/InterCo Conversion Termination Payment**”) and, if such market value is positive to the Reinsurer Swap Provider, InterCo will pay to the Reinsurer such market value (an “**InterCo/Reinsurer Conversion Termination Payment**”). The InterCo/Reinsurer Conversion Termination Payment or, as applicable, the Reinsurer/InterCo Conversion Termination Payment, shall be paid by the Reinsurer or, as applicable, InterCo, on the Early Termination Date designated under the Reinsurer Swap Agreement.

For these purposes:

“**Notional Swap**” means an accreting interest rate swap having the same terms as the swap in the Reinsurer Swap Confirmation (as amended by prior partial terminations) and having a notional amount equal to the fixed interest paid and Reinsurer Fixed Principal Amount repaid which increases annually at the fixed rate payable under the Reinsurer Swap.

“**Conversion Notional Swap**” means an interest rate swap having the same terms as the Transaction in the Reinsurer Swap Agreement Confirmation (as amended by prior partial terminations) and having a notional amount equal to the amount of Reinsurer Fixed Principal Amount and the fixed income component of any deferred interest accrued in respect thereof which thereafter accrues interest at the applicable floating rate which has become, on such date, a Reinsurer Floating Principal Amount and any accrued unpaid fixed interest which thereafter accrues interest at the applicable floating rate.

Withholding tax: Interest will be paid without set off, deduction or withholding for or on account of tax unless the deduction or withholding is required by law in which event the payor will subject to the Reinsurer Deed of Charge and the InterCo Deed of Charge (including, as applicable, there being Reinsurer Available Funds and payment being subject to the Reinsurer Priorities of Payments and there being InterCo Available Funds and payment being subject to the InterCo Priorities of Payments):

- (a) pay such additional amount as will result in the recipient receiving the amount it would have received had no such withholding or deduction been required; or
- (b) lend to the recipient such additional amount as will result in the recipient receiving the amount it would have received had no such withholding or deduction been required (the “**Payor Gross-up Loan**” and, if made by InterCo, an “**InterCo/Reinsurer Gross-up Loan**” or, if made by the Reinsurer, a “**Reinsurer/InterCo Gross-up Loan**”).

Repayment of the Reinsurer Loan: On each Loan Interest Payment Date or, following termination of the Reinsurance Agreement, the Interest Payment Date first following the expiry of 40 days after such termination the Reinsurer will repay an amount equal to the lower of:

- (a) the principal amount outstanding on the Reinsurer Loan; and
- (b) the Available Reinsurer Surplus less the amounts paid in respect of Reinsurer Ongoing Commitment Fees, interest, deferred interest, Deferred Reinsurer Ongoing Commitment Fees and gross ups in respect of withholding tax (and loans in respect thereof) under the provisions of the Reinsurer Loan Agreement.

The Reinsurer shall repay the Reinsurer Fixed Principal Amount before Reinsurer Floating Principal Amount.

Reinsurer Loan Agreement representations, warranties and covenants: The Reinsurer will acknowledge that InterCo has entered into the Reinsurer Loan Agreement and agreed to make the Reinsurer Loan to the Reinsurer in full reliance on the representations given by the Reinsurer contained in the Reinsurance Agreement.

In addition, the Reinsurer will covenant with and undertake to InterCo at all times from the date of the Reinsurer Loan Agreement, until the Reinsurer Security Trustee is satisfied that all the Reinsurer Secured Obligations and/or all other moneys and other liabilities for the time being due or owing by the Reinsurer have been paid or discharged in full (the “**Final Discharge Date**”), on the terms of each of the covenants and undertakings set out in the Reinsurance Agreement.

Reinsurer Enforcement Events: The enforcement events with respect to the Reinsurer (the “**Reinsurer Enforcement Events**”) will be standard events for a transaction of this nature, including

events in respect of: non payment, breaches, misrepresentation, insolvency, insolvency proceedings, analogous events, suspension of business, security, repudiation and execution and distress.

Recourse and non-petition: Each of the parties to the Reinsurer Loan Agreement will acknowledge and agree that the provisions of:

- (a) the InterCo Deed of Charge with respect to recourse and non petition shall be incorporated in the Reinsurer Loan Agreement *mutatis mutandis*, and shall be deemed to be part of the Reinsurer Loan Agreement as if set out in full therein; and
- (b) the Reinsurer Deed of Charge with respect to recourse and non petition shall be incorporated in the Reinsurer Loan Agreement *mutatis mutandis*, and shall be deemed to be part of the Reinsurer Loan Agreement as if set out in full therein.

REINSURER ADMINISTRATION AGREEMENT

On or before the Closing Date, the Reinsurer will enter into an administration agreement (the “**Reinsurer Administration Agreement**”) with the Reinsurer Administrator under which the Reinsurer Administrator will agree to provide corporate administration services to the Reinsurer.

The Reinsurer Administrator will be entitled to charge a fee per annum, payable on each Loan Interest Payment Date subject to the Reinsurer having sufficient funds available to pay out of the Reinsurer Available Funds having paid all other higher ranking amounts in the Reinsurer Priorities of Payments.

REINSURER INVESTMENT MANAGEMENT AGREEMENT

On or before the Closing Date, the Reinsurer and the Reinsurer Security Trustee will enter into an investment management agreement (the “**Reinsurer Investment Management Agreement**”) with the Reinsurer Investment Manager under which the Reinsurer Investment Manager shall at any time during the term of the Reinsurance Agreement invest the Assets of the Reinsurer in Reinsurer Eligible Investments which are cash or financial collateral as defined in the Financial Collateral Arrangements (No.2) Regulation and in accordance with the Reinsurer Investment Criteria (as described below) with a view, in good faith, to meeting the Reinsurer Investment Objective (as described below).

Where:

“**Reinsurer Eligible Investments**” means assets which meet the Reinsurer Investment Criteria and Reinsurer Admissible Assets Criteria.

Reinsurer Investment Objective

The “**Reinsurer Investment Objective**” is at any time during the term of the Reinsurance Agreement to invest the Reinsurer Eligible Investments such as to endeavour to:

- (a) yield a rate of return exceeding 3 month GBP-LIBOR-BBA (as such term is defined in the ISDA 2002 Definitions) as set on each Note Interest Payment Date;
- (b) return the principal so invested; and
- (c) manage its liquidity, with a view to ensuring that it has sufficient cash available to pay its obligations as they fall due (ignoring any limit on recourse and assuming sufficiency of Reinsurer Available Funds to pay its obligations).

Reinsurer Investment Criteria

The Assets of the Reinsurer shall be invested solely in accordance with the following criteria (the “**Reinsurer Investment Criteria**”), which are required to be met at the time of acquisition of the relevant Reinsurer Asset:

- (a) floating rate debt securities or other money-market instruments denominated in Pounds Sterling (as defined in the Glossary) that:
 - (i) either:
 - (A) have a senior, unsecured and unguaranteed long-term debt rating of A2 or better from Moody’s Investor Services (“Moody’s”) or A or better from Standard & Poor’s Ratings Services (“S&P”) or a senior, unsecured and unguaranteed short-term debt rating of P1 or better from Moody’s or A-1 or better from S&P; or

- (B) have been issued or guaranteed by an entity that has a long-term credit rating of A2 or better from Moody's or A or better from S&P;
- (ii) pay interest:
 - (A) not less frequently than annually; and
 - (B) at a rate based on GBP-LIBOR-BBA (as such term is defined in the ISDA 2002 Definitions) plus or minus a spread;
- (b) fixed rate debt securities or other money-market instruments (as defined in the Glossary) denominated in Pounds Sterling that:
 - (i) mature in less than 12 months;
 - (ii) pay interest not less frequently than annually;
 - (iii) either:
 - (A) have a senior, unsecured and unguaranteed long-term debt rating of A2 or better from Moody's Investor Services ("Moody's") or A or better from Standard & Poor's Ratings Services ("S&P") or a senior, unsecured and unguaranteed short-term debt rating of P1 or better from Moody's or A-1 or better from S&P; or
 - (B) have been issued or guaranteed by an entity that has a long-term credit rating of A2 or better from Moody's or A or better from S&P; or
- (c) cash on deposit in Pounds Sterling that:
 - (i) if deposited for a period of less than 12 months is so deposited with any EU Credit Institution (as defined in FSMA) or a bank:
 - (A) authorised in the remaining member states of the EEA (Norway, Iceland, Liechtenstein); or
 - (B) authorised in a signatory state, other than an EU member state or a member state of EEA, to the BCCA (Switzerland, Canada, Japan, United States),

in each case, which has a senior, unsecured and unguaranteed short-term debt rating of P1 or better from Moody's or A-1 or better from S&P;
 - (ii) if deposited for a period of 12 months or more up to and including 15 April 2019 is so deposited:
 - (A) with any EU Credit Institution (as defined in FSMA) or a bank authorised in:
 - (I) the remaining member states of the EEA (Norway, Iceland, Liechtenstein); or
 - (II) a signatory state, other than an EU member state or a member state of EEA, to the BCCA (Switzerland, Canada, Japan, United States),

provided that such entity shall:

 - (X) have a senior, unsecured and unguaranteed long-term debt rating of A2 or better from Moody's or A or better from S&P; or
 - (Y) have been issued or guaranteed by an entity that has a long-term credit rating of A2 or better from Moody's or A from S&P; and
 - (B) on the basis that it shall:
 - (I) mature on or before 15 April 2019; and
 - (II) pay interest in cash:
 - (aa) not less frequently than annually; and
 - (bb) at a rate based on GBP-LIBOR-BBA or a similar GBP floating rate basis plus or minus a spread so that it can pay its 3 month GBP-LIBOR-BBA obligations under the Reinsurer Swap Agreement on time and without having to realise principal amounts invested; and
- (d) any money-market scheme (as defined in the FSA Handbook) denominated in Pounds Sterling that either:
 - (i) has been awarded a Fund Management Rating of Aaa/MRI by Moody's; or
 - (ii) has been awarded a Fund Management Rating of AAAm by S&P,

provided that the restrictions in (i) and (ii) above shall be deemed to have been breached if following the date on which the investment is made the money market scheme ceases to have the relevant Fund Management Rating and all units in such fund are not realised within a period of 60 Business Days following the date of such cessation,

Notwithstanding the provisions of the Reinsurer Investment Criteria above, each asset to be acquired by the Reinsurer must be an admissible asset (as such term is defined in Rule 2.2 under Annex 1R of the Integrated Prudential Sourcebook for Insurers), pay without withholding or deduction of tax if held by or on behalf of the Reinsurer and, under the law in force as at the date of the Reinsurer Investment Management Agreement, an asset the acquisition of which would not give rise to stamp duty or SDRT for the Reinsurer (the “**Reinsurer Admissible Asset Criteria**”).

REINSURER ACCOUNT BANK AGREEMENT

On or before the Closing Date the Reinsurer will enter into a bank account agreement (the “**Reinsurer Account Bank Agreement**”) with the Reinsurer Account Bank pursuant to which the Reinsurer will establish a transaction bank account (the “**Reinsurer Transaction Account**”) and a bank account into which will be paid the share capital of the Reinsurer (and any subsequent capital issued by way of issue of shares or capital contribution from FPLP) (the “**Reinsurer Share Capital Account**”), and together with the Reinsurer Transaction Account, the “**Reinsurer Bank Accounts**”).

REINSURER CASH MANAGEMENT AGREEMENT

On or before the Closing Date, *inter alios*, the Reinsurer, the Reinsurer Security Trustee and, the Reinsurer Cash Manager will enter into a cash management agreement (the “**Reinsurer Cash Management Agreement**”) under which the Reinsurer Cash Manager will agree to provide cash management services.

The Reinsurer Cash Manager will be entitled to charge a fee per annum, payable on each Loan Interest Payment Date subject to the Reinsurer having sufficient funds available to pay out of the Reinsurer Available Funds having paid all other higher ranking amounts in the Reinsurer Priorities of Payments.

REINSURER CUSTODY AGREEMENT

On or before the Closing Date, *inter alios*, the Reinsurer and the Reinsurer Security Trustee will enter into a custody agreement (the “**Reinsurer Custody Agreement**”) with the Reinsurer Custodian under which the Reinsurer Custodian will agree to provide custody services to the Reinsurer Security Trustee in respect of the Reinsurer Eligible Investments.

Under the Reinsurer Custody Agreement, a series of sub-accounts will be established with the Reinsurer Custodian into which, respectively:

- (a) Reinsurer Eligible Investments (and any other investments) will be deposited (the “**Reinsurer Reserve Securities Sub-Accounts**”);
- (b) the proceeds of the realisation of Reinsurer Eligible Investments (and any other investments) will be deposited (the “**Reinsurer Reserve Cash Sub-Accounts**”).

Separate sub-accounts will be maintained for the Reinsurer’s Long Term Business Fund and the Reinsurer’s Shareholder Fund.

The Reinsurer Custodian may appoint a global sub-custodian and both the Reinsurer Custodian and global sub-custodian may appoint sub-custodians in individual locations.

The Reinsurer Custodian will keep records that identify the Reinsurer’s investments as separate from any other investments held by the Reinsurer Custodian and may pool Reinsurer Eligible Investments with investments belonging to other clients of the Reinsurer Custodian.

REINSURER SWAP AGREEMENT

The Reinsurer will on or before the Closing Date enter into the Reinsurer Swap Agreement with the Reinsurer Swap Provider. Under the terms of the Reinsurer Swap:

- (a) on each Interest Payment Date the Reinsurer will pay to the Reinsurer Swap Provider an amount equal to the product of (i) the Reinsurer Swap Notional Principal in respect of such Interest Payment Date, (ii) 3-month LIBOR on such Interest Payment Date (or, on the first Interest Payment Date, an interpolation of three and four month LIBOR and (iii) the actual number of days in such Interest Period divided by 365 (or, if any portion of that Interest

Period falls in a leap year, the sum of (i) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366 and (ii) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365); and

- (b) on each Loan Interest Payment Date, the Reinsurer Swap Provider will pay to the Reinsurer an amount equal to the product of (i) the Reinsurer Swap Notional Principal in respect of the Swap Fixed Interest Period ending on such Loan Interest Payment Date, (ii) a fixed swap rate of 4.906 per cent. per annum (the “**Reinsurer Swap Fixed Rate**”) and (iii) the actual number of days in such Interest Period divided by 365 (or, if any portion of that Interest Period falls in a leap year, the sum of (i) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366 and (ii) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365), the “**Reinsurer Swap Scheduled Amount**” (such amount being the “**Reinsurer Swap Fixed Amount**” in respect of the Loan Interest Period ending closest to such Loan Interest Payment Date)).

The LIBOR rate for the Reinsurer Swap will be fixed at the same rate as LIBOR on the Notes for the corresponding Interest Period.

For these purposes:

“**Swap Fixed Interest Period**” means the period from (and including) one Loan Interest Payment Date (or, in the case of the first Swap Fixed Interest Period, the Closing Date) to (and excluding) the immediately succeeding Loan Interest Payment Date.

“**Reinsurer Swap Notional Principal**” means, initially £380,000,000, which increases (subject to any partial termination) at the Reinsurer Swap Fixed Rate each year.

Partial Early Termination: On each day on which the Reinsurer Fixed Principal Amount is repaid or a Claim is paid under the Reinsurance Agreement or the Adjusted Sum Reinsured is otherwise reduced below the then Reinsurer Swap Notional Principal, the Reinsurer Swap Notional Principal will be subject to automatic partial early termination in an amount equal to the amount of such principal repayment, Claim or reduction. An amount will be payable by or to the Reinsurer in respect of such partial early termination depending on whether the Reinsurer Swap is in-the-money to the Reinsurer (in which case the amount will be payable to the Reinsurer) or out-of-the-money to the Reinsurer (in which case the amount will be payable by the Reinsurer).

The amount to be paid by or to the Reinsurer (the “**Reinsurer Swap Partial Termination Amount**”) will be calculated as follows. A hypothetical accreting swap will be constructed with a floating rate payable by the Reinsurer and a fixed rate payable to the Reinsurer both equal to the rates in the Reinsurer Swap and with the same payment dates as the Reinsurer Swap. Its effective date will be the date of automatic partial early termination and its scheduled termination date will be the scheduled termination date of the Reinsurer Swap. It will have an initial notional principal equal to the amount of such principal repayment, Claim or reduction and it will accrete at the same rate as the Reinsurer Swap Fixed Rate; the Reinsurer Swap Calculation Agent will calculate the value of such hypothetical swap, using standard market practices at mid-market.

Withholding tax: Neither the Reinsurer nor the Reinsurer Swap Provider will be obliged to gross up any payments under the Reinsurer Swap in the event of any withholding or deduction being required from any payment thereunder.

Limited Recourse: The obligations of the Reinsurer under the Reinsurer Swap will be limited to the proceeds of enforcement of the Reinsurer Security as applied in accordance with the Reinsurer Priorities of Payments.

Termination Provisions: The Reinsurer may terminate the Reinsurer Swap if there is an Event of Default or a Termination Event (each as defined in the Reinsurer Swap and summarised below) with respect to the Reinsurer Swap Provider and the Reinsurer Swap Provider may terminate the Reinsurer Swap if there is an Event of Default or a Termination Event with respect to the Reinsurer. The Reinsurer Swap will contain termination events commonly found in the standard 1992 ISDA Master Agreement documentation save for (i) the disapplication as regards the Reinsurer of the Events of Default relating to “Breach of Agreements”, “Credit Support Default”, “Misrepresentation”, “Default under Specified Transactions”, “Bankruptcy”, “Cross Default” and “Merger without Assumption” and (ii) the disapplication as regards both the Reinsurer and the Reinsurer Swap Provider of the Termination Events relating to “Tax Event”, “Tax Event upon Merger” and “Credit Event Upon Merger”.

Reinsurer Additional Termination Events: The following shall constitute Additional Termination Events with respect to the Reinsurer:

- (a) a Reinsurer Enforcement Event occurs and the Reinsurer Security Trustee gives a Reinsurer Enforcement Notice to the Reinsurer;
- (b) an Early Termination Date (as defined in either of the InterCo Swap Agreement and Issuer Swap Agreement) is designated under the InterCo Swap Agreement or Issuer Swap Agreement; or
- (c) the Reinsurance Agreement is terminated in full.

Downgrade Termination Events: The following shall constitute an Additional Termination Event with respect to the Reinsurer Swap Provider:

- (i) In the event that the short-term, unsecured and unsubordinated debt obligations of the Reinsurer Swap Provider (or its successor or assignee) and, if relevant, any Credit Support Provider of the Reinsurer Swap Provider, are downgraded below "A-2" by Standard & Poor's Rating Services, a division of The McGraw-Hill Companies Inc. ("S&P") and, as a result of such downgrade, the then current rating of the Notes may in the reasonable opinion of S&P be downgraded or placed under review for possible downgrade (an "S&P Rating Event"), and the Reinsurer Swap Provider does not, within 30 days of the occurrence of such S&P Rating Event, at its own cost, either:
 - (A) transfer all of its rights and obligations with respect to the Reinsurer Swap Agreement to either (x) Ambac (or a replacement entity nominated by Ambac which has the Required Ratings), if Ambac exercises its step-in rights in respect of the Issuer Swap Agreement, the InterCo Swap Agreement and the Reinsurer Swap Agreement or (y) a replacement third party whose short-term, unsecured and unsubordinated debt obligations are rated at least as high as "A-1+" by S&P and whose long-term, unsecured and unsubordinated debt obligations are rated at least as high as "A1" by Moody's Investors Services ("Moody's") or, in each case, such other ratings as are commensurate with the ratings assigned to the Notes by such rating agencies from time to time provided that such replacement third party must also be appointed as the Issuer Swap Provider and the InterCo Swap Provider at the same time as the transfer of rights and obligations with respect to the Reinsurer Swap Agreement; or
 - (B) procure another person to become co-obligor in respect of the obligations of the Reinsurer Swap Provider under the Reinsurer Swap Agreement or take such other action as the Reinsurer Swap Provider may agree with S&P as will result in the rating of the Notes then outstanding following the taking of such action being rated no lower than the rating of the Notes immediately prior to such downgrade.
- (ii) In the event that (A) the long-term, unsecured and unsubordinated debt obligations of the Reinsurer Swap Provider (or its successor) and, if relevant, any Credit Support Provider of the Reinsurer Swap Provider, are downgraded below "Baa2" (or its equivalent) by Moody's or (B) the short-term, unsecured and unsubordinated debt obligations of the Reinsurer Swap Provider (or its successor) and, if relevant, any Credit Support Provider of the Reinsurer Swap Provider, are downgraded below "Prime-2" (or its equivalent) by Moody's, and the Reinsurer Swap Provider does not, on a best efforts basis and at its own cost, attempt to:
 - (1) transfer all of its rights and obligations with respect to the Reinsurer Swap Agreement to either (x) Ambac (or a replacement entity nominated by Ambac which has the Required Ratings), if Ambac exercises its step-in rights in respect of the Issuer Swap Agreement, the InterCo Swap Agreement and the Reinsurer Swap Agreement, (y) a replacement third party with the Required Ratings (defined below) domiciled in the same legal jurisdiction as the Reinsurer Swap Provider or the Reinsurer provided that such replacement third party must also be appointed as the Issuer Swap Provider and the InterCo Swap Provider at the same time as the transfer of rights and obligations with the Reinsurer Swap Agreement, or (z) a replacement third party as agreed with Moody's provided that such replacement

third party must also be appointed as the Issuer Swap Provider and the InterCo Swap Provider at the same time as the transfer of rights and obligations with the Reinsurer Swap Agreement; or

- (2) procure another person to become co-obligor in respect of the obligations of the Reinsurer Swap Provider under the Reinsurer Swap Agreement, such co-obligor may be either (x) a person with the Required Ratings (defined below) domiciled in the same legal jurisdiction as the Reinsurer Swap Provider or the Reinsurer, or (y) such other person as agreed with Moody's; or
- (3) take such other action agreed with Moody's.

No transfer as is mentioned above will be permitted where it would result in the Reinsurer being unable to claim relief as a deduction against its taxable income for the full amount of each payment that it makes in connection with this Agreement which is (or, subject to the making or accrual of payment, would be) debited to its profit and loss account.

For the purposes of (ii), "**Required Ratings**" means, in respect of the relevant entity, its short-term, unsecured and unsubordinated debt obligations are rated at least as high as "Prime-1" and its long-term, unsecured and unsubordinated debt obligations are rated at least as high as "A1", or such other ratings as may be agreed with Moody's from time to time.

If any event occurs which is, or with the giving of notice and/or lapse of time would give rise to, an Event of Default or Termination Event (including an Additional Termination Event) with respect to the Reinsurer Swap Provider, the Reinsurer Swap Provider shall at its own costs (upon request by Ambac), without the consent of any other person, transfer (by way of novation) all of its rights and obligations under the Reinsurer Swap Agreement to Ambac (or such other third party replacement nominated by Ambac), provided that the InterCo Swap Agreement and the Issuer Swap Agreement are transferred (by way of novation) to the same third party replacement at the same time. The Reinsurer Security Trustee and the Reinsurer shall enter into such agreements as are necessary to effect such transfer.

Termination

Upon the occurrence of any Event of Default or Termination Event and subject to the foregoing paragraph, the Reinsurer Swap Agreement may be terminated in accordance with the detailed provisions thereof and a lump sum (the "**Termination Payment**") may become payable by the Reinsurer to the Reinsurer Swap Provider or vice versa.

The Termination Payment will generally be based on the sum of (a) payments under the Reinsurer Swap that became due prior to the date on which the Reinsurer Swap Agreement is terminated, but remain unpaid and (b) an amount determined by obtaining firm quotations from at least three leading swap dealers of the amount that each such dealer would pay to, or be required to be paid by, the party obtaining such quotations in consideration for having that dealer enter into a hedge transaction which such party on the same terms as the hedge transaction that was terminated, for the remaining maturity of such hedge transaction (or if such market quotations are unavailable or do not produce a commercially reasonable result, the losses suffered by either the Reinsurer Swap Provider or the Reinsurer, as applicable, as a result of termination of the Reinsurer Swap Agreement).

The party making such determination will be the Non-defaulting Party (as defined in the Reinsurer Swap) in the case of the occurrence of an Event of Default, or upon the occurrence of a Termination Event where there is one Affected Party, the party making such determination will be the party which is not the Affected Party. Interest will be payable on any Termination Payment calculated as provided above from (and including) the relevant Early Termination Date to (but excluding) the date such amount is paid at the "**Default Rate**" determined as provided in the Reinsurer Swap Agreement and shall continue to be so payable notwithstanding the occurrence of any Event of Default under the Reinsurer Loan and any failure to accelerate the Reinsurer Loan or to enforce the Reinsurer Security on the part of the Reinsurer Security Trustee or any of the Reinsurer Secured Creditors.

Collateral: The Reinsurer Swap Provider will be required to post Eligible Collateral, which counts as an Admissible Asset, under the Reinsurer Swap if the value of the Reinsurer Swap to the Reinsurer at any time exceeds 10 per cent. of the value of its assets. The Reinsurer and the Reinsurer Swap Provider have entered into a Credit Support Deed pursuant to which the collateral required to be posted will be "**Eligible Collateral**"

Notwithstanding the provisions of Section 6(e), if an amount would be payable pursuant to Section 6(e) of the Issuer Swap Agreement and/or Section 6(e) of the InterCo Swap Agreement in respect of the Early Termination Date (as defined in the Issuer Swap Agreement or the InterCo Swap Agreement) arising at the same time as the Early Termination Date under the Reinsurer Swap Agreement and the Issuer Swap Provider or the InterCo Swap Provider has failed to pay to the Issuer or InterCo the amount determined to be payable in respect of such early termination under the Issuer Swap Agreement (the “**Issuer Swap Corresponding Payment**”) or the InterCo Swap Agreement (the “**InterCo Swap Corresponding Payment**”), the amount payable by the Reinsurer to the Reinsurer Swap Provider shall be payable only to the extent of the aggregate amount paid to the Issuer and InterCo in respect of the Issuer Swap Corresponding Payment and InterCo Swap Corresponding Payment.

REINSURER DEED OF CHARGE

On or before the Closing Date, the Reinsurer will create security over all its assets pursuant to a deed of charge (the “**Reinsurer Deed of Charge**”) in favour of the Reinsurer Security Trustee (acting on behalf of itself, InterCo, the InterCo Security Trustee, FPLP, the Reinsurer Swap Provider, the Reinsurer Administrator, the Reinsurer Account Bank, the Reinsurer Cash Manager, the Reinsurer Investment Manager and the Reinsurer Custodian (together the “**Reinsurer Secured Creditors**”)).

Reinsurer Security

The Reinsurer will grant the following security (the “**Reinsurer Security**”) in order to provide security in respect of the obligations of the Reinsurer to the Reinsurer Secured Creditors:

- (1) an assignment, by way of first fixed security for the payment or discharge of the Reinsurer Secured Obligations, to and in favour of the Reinsurer Security Trustee of all of its rights, title, interest and benefit, existing at the date of the Reinsurer Deed of Charge or in the future, in, to, under or in respect of the:
 - (a) Reinsurance Agreement;
 - (b) Reinsurer Loan Agreement;
 - (c) Reinsurer Swap Agreement;
 - (d) Reinsurer Account Bank Agreement;
 - (e) Reinsurer Cash Management Agreement;
 - (f) Reinsurer Investment Management Agreement;
 - (g) Reinsurer Custody Agreement; and
 - (h) Reinsurer Administration Agreement,(together the “**Reinsurer Assigned Agreements**”) and any other agreement, instrument or notice to which the Reinsurer is or becomes a party or in respect of which it has or may have any right, interest, title or benefit, either existing at the date of the Reinsurer Deed of Charge or at any time in the future (the “**Reinsurer Other Secured Contractual Rights**”), including without limitation:
 - (i) the benefit of all representations, warranties, covenants, undertakings and indemnities under or in respect of the Reinsurer Assigned Agreements and Reinsurer Other Secured Contractual Rights;
 - (ii) all of its rights to receive payment of any amounts which may become payable to it pursuant or with respect to such Reinsurer Assigned Agreements and Reinsurer Other Secured Contractual Rights;
 - (iii) all payments received by it pursuant to, or with respect to, such Reinsurer Assigned Agreements and Reinsurer Other Secured Contractual Rights;
 - (iv) all its rights to serve notices and/or make demands pursuant to such Reinsurer Assigned Agreements and/or to take such steps as are required to cause payments to become due and payable thereunder or with respect to such Reinsurer Assigned Agreements and Reinsurer Other Secured Contractual Rights;
 - (v) all of its rights of action in respect of any breach of such Reinsurer Assigned Agreements and Reinsurer Other Secured Contractual Rights;

- (vi) all of its rights to receive damages, compensation or obtain other relief in respect of, including in respect of any breach of or default in respect of such Reinsurer Assigned Agreements and Reinsurer Other Secured Contractual Rights; and
 - (vii) all of its rights relating to the termination of and remedies under or in connection with the Reinsurance Agreement.
- (2) a charge, by way of first fixed security for the payment or discharge of the Reinsurer Secured Obligations to and in favour of the Reinsurer Security Trustee of all of its right, title, interest and benefit, existing at the date of the Reinsurer Deed of Charge or in the future, in and to the Reinsurer Custodian Accounts and all sums of moneys and all Securities which may be at or after the date of the Reinsurer Deed of Charge from time to time standing to the credit of the Reinsurer Custodian Accounts or any other bank account or book debt or custodial arrangement in which the Reinsurer may at any time acquire any right, title, interest or benefit and each debt represented by the same, including all interest accrued and other moneys received in respect thereof;
 - (3) a charge, by way of first fixed security for the payment or discharge of the Reinsurer Secured Obligations, to and in favour of the Reinsurer Security Trustee of all of its right, title, interest and benefit, existing at the date of the Reinsurer Deed of Charge or in the future, in and to the Reinsurer Bank Accounts and all sums of moneys which may be at or after the date of the Reinsurer Deed of Charge from time to time standing to the credit of the Reinsurer Bank Accounts, and any other bank account or book debt in which the Reinsurer may at any time acquire any right, title, interest or benefit and each debt represented by these, including all interest accrued and other moneys received in respect thereof;
 - (4) a charge, as beneficial owner and by way of first fixed security for the payment or discharge of the Reinsurer Secured Obligations, to and in favour of the Reinsurer Security Trustee of all its rights, title, interest and benefit, existing at the date of the Reinsurer Deed of Charge or in the future, in and to the Reinsurer Eligible Investments and all other Securities which the Reinsurer may at any time acquire, make or otherwise obtain an interest or benefit in, together with all moneys received in respect thereof and all interest accruing on them from time to time, all dividends and distributions paid or payable thereon, all property paid, distributed, accruing or offered at any time on, to or in respect or in substitution therefor and the proceeds of sale, redemption or discharge thereof and the benefit of all covenants relating to such Reinsurer Eligible Investments and other Securities and all rights and remedies for enforcing the same; and
 - (5) a charge to and in favour of the Reinsurer Security Trustee, by way of first floating charge for the payment or discharge of the Reinsurer Secured Finance Obligations, the whole of its undertaking and all of its property and assets whatsoever and wheresoever situate, present and future, other than any property or assets from time to time or for the time being effectively charged by way of fixed charge, or otherwise assigned as security, pursuant to the Reinsurer Deed of Charge.

Reinsurer Pre Enforcement Priority of Payments

Notwithstanding the security interests created by or pursuant to the Reinsurer Deed of Charge, on each Loan Interest Payment Date or, following termination of the Reinsurance Agreement, the Interest Payment Date first falling after the expiry of 40 days following such termination, which falls prior to the service of a Reinsurer Enforcement Notice on the Reinsurer by the Reinsurer Security Trustee in accordance with the Reinsurer Deed of Charge, the Reinsurer Cash Manager, as agent for the Reinsurer, shall, subject to obtaining the prior consent of the Reinsurer Security Trustee pursuant to the provisions of the Reinsurer Deed of Charge, instruct the Reinsurer Account Bank to withdraw the amount calculated as the amount of the Reinsurer Available Funds standing to the credit of the Reinsurer Transaction Account (but only to the extent that such withdrawal does not cause the Reinsurer Transaction Account to become overdrawn), to be applied by the Reinsurer in making the following payments in the following order of priority (in each case only if and to the extent that payments or provisions of a higher order of priority have been made in full):

- (a) first, in or towards satisfaction of, *pro rata* (i) the Reinsurer/InterCo Early Termination Payment due and payable under the Reinsurer Loan Agreement to InterCo, (ii) the Reinsurer/InterCo Conversion Termination Payment due and payable under the Reinsurer Loan Agreement to InterCo and (iii) the Reinsurer Swap Break Costs Payment under the Reinsurer Swap Agreement due and payable to the Reinsurer Swap Provider;
- (b) second, in or towards satisfaction of the fees and other remuneration and indemnity payments (if any) which are then due and payable to the Reinsurer Security Trustee and any costs, charges, liabilities and expenses incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the Reinsurer Deed of Charge;
- (c) third, in or towards satisfaction of, *pro rata*, the fees and other remuneration and indemnity payments (if any) which are then due and payable to the Reinsurer Account Bank and the Reinsurer Cash Manager and any costs, charges, liabilities and expenses properly incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the Reinsurer Account Bank Agreement and the Reinsurer Cash Management Agreement (as applicable);
- (d) fourth, in or towards satisfaction of, *pro rata*, the fees and other remuneration and indemnity payments (if any) which are then due and payable to the Reinsurer Custodian and the Reinsurer Investment Manager and any costs, charges, liabilities and expenses properly incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the Reinsurer Investment Management Agreement and the Reinsurer Custody Agreement (as applicable);
- (e) fifth, in or towards satisfaction of the fees, costs, liabilities and expenses (together with interest on those amounts) of the Reinsurer Administrator for which it is entitled to be reimbursed or indemnified under the Reinsurer Administration Agreement;
- (f) sixth, in or towards satisfaction of the amounts then due and payable in respect of repayment of any InterCo/Reinsurer Gross-up Loan made to the Reinsurer by InterCo, but only to the extent the Reinsurer has recovered the tax withheld in respect of which the InterCo/Reinsurer Gross-up Loan was made;
- (g) seventh, in or towards satisfaction of, *pro rata*, amounts which are then due to third parties under obligations incurred in the ordinary course of the Reinsurer's business (other than amounts specifically provided for elsewhere in this order of priority), including any amounts due to the relevant taxation authority in respect of the Reinsurer's liability for any corporation tax (if any);
- (h) eighth, in or towards satisfaction of the amounts then due and payable to the Reinsurer Swap Provider in respect of the Reinsurer Swap Agreement (to the extent not paid under (a) above) and any amounts due and payable in respect of replacement of a Reinsurer Swap Provider;
- (i) ninth, in or towards satisfaction of (i) amounts which are then due and payable to FPLP in connection with the repayment of a Capital Injection to the extent of any Overfunded Amounts and (ii) repayment of Original Capital Injection but only to the extent that the Reinsurer Regulatory Surplus has been increased by an equivalent amount by the making of a Substitute Capital Injection and/or a Substitute Breach Adjustment and (iii) any Premium Rebate under the Reinsurance Agreement;
- (j) tenth, in or towards satisfaction of amounts which are then due and payable to InterCo under the Reinsurer Loan Agreement (i) by way of Reinsurer Ongoing Commitment Fee (ii) by way of Deferred Reinsurer Ongoing Commitment Fee and (iii) for the funding of any Reinsurer/InterCo Gross-up Loan to InterCo in respect thereof, but only to the extent that the Reinsurer has sufficient funds pursuant to the Reinsurer Loan Agreement;
- (k) eleventh, in or towards satisfaction of amounts which are then due and payable to InterCo under the Reinsurer Loan Agreement (i) by way of interest, (ii) by way of Deferred Interest and (iii) for the funding of any Reinsurer/InterCo Gross-up Loan to InterCo in respect thereof, but only to the extent that the Reinsurer has sufficient funds pursuant to the Reinsurer Loan Agreement;
- (l) twelfth, in or towards satisfaction of amounts which are then due and payable to InterCo under the Reinsurer Loan Agreement by way of principal, but only to the extent that the Reinsurer has sufficient funds pursuant to the Reinsurer Loan Agreement;

- (m) thirteenth, in or towards satisfaction of all amounts which are then due and payable to FPLP under, or in connection with, the Reinsurance Agreement;
- (n) fourteenth, in or towards satisfaction of all amounts which are then due and payable to FPLP in connection with any Capital Injection or Substitute Capital Injection by FPLP to the Reinsurer in accordance with the terms of the Reinsurance Agreement;
- (o) fifteenth, while any Reinsurer Secured Obligations remain outstanding, to pay the remainder (if any) to the Reinsurer Reserve Cash Sub-Account for reinvestment; and
- (p) sixteenth, if there are no Reinsurer Secured Obligations and subject to the release of the Reinsurer Charged Property to the Reinsurer.

Payments to Reinsurer Swap Provider

Notwithstanding the security interests created by or pursuant to the provisions of the Reinsurer Deed of Charge, on each Floating Amount Payment Date under the Reinsurer Swap Agreement which falls prior to the service of a Reinsurer Enforcement Notice on the Reinsurer by the Reinsurer Security Trustee in accordance with the provisions of the Reinsurer Deed of Charge, the Reinsurer Cash Manager, as agent for the Reinsurer, shall, subject to obtaining the prior consent of the Reinsurer Security Trustee pursuant to the provisions of the Reinsurer Deed of Charge, instruct the Reinsurer Account Bank to withdraw the amount calculated as the amount of Reinsurer Available Funds, standing to the credit of the Reinsurer Transaction Account (but only to the extent that such withdrawal does not cause the Reinsurer Transaction Account to become overdrawn) to be applied by the Reinsurer in paying to the Reinsurer Swap Provider all amounts then payable to the Reinsurer Swap Provider in respect of the Reinsurer Swap Agreement.

Realisation of Reinsurer Eligible Investments

Notwithstanding the Reinsurer Pre Enforcement Priority of Payments, in the event that any sum under, or in connection with, the Reinsurer Deed of Charge, becomes due and payable to the Reinsurer Security Trustee by the Reinsurer other than on a Loan Interest Payment Date, the Reinsurer Cash Manager shall, if so instructed by the Reinsurer Security Trustee, be entitled to instruct the Reinsurer Investment Manager to sell Securities held in the Reinsurer Reserve Securities Sub-Account in order that the proceeds of the sale of such Securities and the Reinsurer's other available funds may be applied in satisfaction of all moneys then due and payable pursuant to such claim. The Reinsurer Security Trustee may request that the liability be satisfied by transferring cash and securities to it which have a value (determined by the Reinsurer Investment Manager) equal to the amount of such liability.

Intra-Period Expenses

Notwithstanding the security interests created by or pursuant to the provisions of the Reinsurer Deed of Charge, on any Business Day prior to the service of a Reinsurer Enforcement Notice, the Reinsurer Cash Manager, as agent for the Reinsurer, may, subject to obtaining the prior consent of the Reinsurer Security Trustee pursuant to the provisions of the Reinsurer Deed of Charge, instruct the Reinsurer Account Bank to withdraw moneys standing to the credit of the Reinsurer Transaction Account (but only to the extent that such withdrawal does not cause the Reinsurer Transaction Account to become overdrawn) to pay any amounts that are due and payable in respect of any costs, charges, liabilities and expenses of the Reinsurer Security Trustee and any other amounts that are due and payable of a type described in the Reinsurer Deed of Charge.

Conflicts of Interest

The Reinsurer Security Trustee shall have regard to the interests of the Reinsurer Secured Creditors as a whole as regards the exercise and performance of all powers, trusts, authorities, duties and discretions of the Reinsurer Security Trustee in respect of the Reinsurer Security under the Reinsurer Deed of Charge and each of the other Transaction Documents or the rights or benefits which are comprised in the Reinsurer Security (except where expressly provided otherwise). Without prejudice to the generality of the foregoing, the Reinsurer Security Trustee shall be under no obligation to take any steps to call in or to enforce the rights of the Reinsurer under or in respect of the Reinsurer Charged Property and shall not be liable for any loss arising from any omissions on its part to take any such steps.

Notwithstanding the generality of the paragraph above the Reinsurer Security Trustee shall have regard only:

- (a) to the interests of InterCo (as directed by the InterCo Controlling Creditor) in respect of matters relating to the floating charge created pursuant to the Reinsurer Deed of Charge;
- (b) in any other case, to the interests of InterCo (as directed by the InterCo Controlling Creditor) under the Reinsurer Loan, so long as the Reinsurer Loan and obligations under the Reinsurance Agreement remain outstanding; and
- (c) if no obligations (actual or contingent, present or future) are owed to InterCo, to the interests of the Reinsurer Controlling Creditor,

provided that the Reinsurer Security Trustee is not required to have regard to the interests of any individual Reinsurer Secured Creditor other than as specified in (a) to (c) above.

Obligation of Reinsurer Security Trustee to enforce

The Reinsurer Security Trustee shall only be bound to take any action with respect to enforcement of the Reinsurer Security if:

- (a) it shall have been so directed in writing by the Reinsurer Controlling Creditor; and
- (b) it shall first have been indemnified and/or secured to its satisfaction.

Reinsurer Security Trustee entitled to assume that Ambac is the Reinsurer Controlling Creditor

The Reinsurer Security Trustee shall be entitled to assume that Ambac is the Reinsurer Controlling Creditor at any time whilst any of the Notes remains outstanding unless and until the Reinsurer Security Trustee is otherwise notified in writing by the Reinsurer, the Note Trustee, Ambac, or any other person of the occurrence of an Ambac Termination Event, and the Reinsurer Security Trustee shall have no liability to any person for any consequence of acting on such assumption.

Reinsurer Security Trustee acting at direction of the Reinsurer Controlling Creditor

When acting at the instruction of the Reinsurer Controlling Creditor, the Reinsurer Security Trustee shall have no duty to take into account the interests of the other Reinsurer Secured Creditors and no liability for acting in accordance with such directions.

Upon Enforcement

The Reinsurer Security Trustee shall, upon receipt of a Reinsurer Enforcement Notice issued in accordance with the Reinsurer Loan Agreement, serve a copy thereof on the Reinsurer, the Reinsurer Secured Creditors, Ambac and the Rating Agencies.

With immediate effect from the date upon which a Reinsurer Enforcement Notice is served on the Reinsurer Security Trustee, the whole of the Reinsurer Security shall become enforceable and:

- (a) no payments shall be made out of the Reinsurer Bank Accounts without the prior written consent of the Reinsurer Security Trustee;
- (b) the Reinsurer Security Trustee shall be entitled to take such proceedings against the Reinsurer as it may think fit to enforce the Reinsurer Security pursuant to and in accordance with the provisions of the Reinsurer Deed of Charge and to enforce payment in respect of the Reinsurer Secured Obligations;
- (c) if not already crystallised, any charge which is a floating charge shall automatically crystallise; and
- (d) all proceeds of enforcement of the Reinsurer Security and any payment or distribution of any kind or character, whether in cash, securities or other property which is payable or deliverable upon or with respect to any of the Reinsurer Secured Obligations or any part thereof by the Reinsurer shall forthwith be paid or delivered directly to or to the order of the Reinsurer Security Trustee for application in accordance with the provisions set out in the Reinsurer Deed of Charge.

Reinsurer Post Enforcement Priority of Payments

On each Loan Interest Payment Date or, following termination of the Reinsurance Agreement, the Interest Payment Date first falling after the expiry of 40 days following such termination, following the service of a Reinsurer Enforcement Notice, the amounts held or received in respect of the

Reinsurer Security shall be applied in or towards making the following payments to the extent required to be made on such Loan Interest Payment Date in the following order of priority (and applications in or towards an item of lower priority shall be made only to the extent that items of a higher priority have been satisfied to the maximum extent possible):

- (a) first, in or towards satisfaction of, *pro rata* (i) the Reinsurer/InterCo Early Termination Payment due and payable under the Reinsurer Loan Agreement to InterCo, (ii) the Reinsurer/InterCo Conversion Termination Payment due and payable under the Reinsurer Loan Agreement to InterCo and (iii) the Reinsurer Swap Break Costs Payment under the Reinsurer Swap Agreement due and payable to the Reinsurer Swap Provider;
- (b) second, in or towards satisfaction of, *pro rata*, according to the respective amounts due and payable (i) the fees and other remuneration which are then due and payable to a Receiver in accordance with the Reinsurer Deed of Charge and (ii) the fees and other remuneration and indemnity payments (if any) which are then due and payable to the Reinsurer Security Trustee and any costs, charges, liabilities and expenses incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the Reinsurer Deed of Charge;
- (c) third, in or towards satisfaction of all amounts which are then due and payable under the Reinsurer Swap Agreement and any amounts then due and payable in respect of the replacement of a Reinsurer Swap Provider;
- (d) fourth, in or towards satisfaction of, *pro rata*, according to the respective amounts then due and payable (i) the fees and other remuneration and indemnity payments (if any) which are then due and payable to the Reinsurer Account Bank and any costs, charges, liabilities and expenses properly incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the Reinsurer Account Bank Agreement and (ii) the fees or other remuneration and indemnity payments (if any) which are then due and payable to the Reinsurer Cash Manager and any costs, charges, liabilities and expenses properly incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the Reinsurer Cash Management Agreement;
- (e) fifth, in or towards satisfaction of, *pro rata*, the fees and other remuneration and indemnity payments (if any) which are then due and payable to the Reinsurer Custodian and the Reinsurer Investment Manager and any costs, charges, liabilities and expenses properly incurred by them (together with interest on those amounts) for which they are entitled to be reimbursed or indemnified under the Reinsurer Investment Management Agreement and the Reinsurer Custody Agreement;
- (f) sixth, in or towards satisfaction of the fees, costs, liabilities and expenses (together with interest on those amounts) of the Reinsurer Administrator for which it is entitled to be reimbursed or indemnified under the Reinsurer Administration Agreement;
- (g) seventh, in or towards satisfaction of (i) amounts which are then due and payable to FPLP in connection with the repayment of a Capital Injection to the extent of any Overfunded Amounts and (ii) repayment of Original Capital Injection made by way of contingent or subordinated loan but only to the extent that the Reinsurer Regulatory Surplus has been increased by the making of a substitute Capital Injection and/or a Substitute Breach Adjustment and (iii) any Premium Rebate under the Reinsurance Agreement;
- (h) eighth, in or towards satisfaction of amounts which are then due and payable to InterCo under the Reinsurer Loan Agreement (i) by way of Reinsurer Ongoing Commitment Fee or (ii) by way of Deferred Reinsurer Ongoing Commitment Fee (iii) for the funding of any Reinsurer/InterCo Gross-up Loan to InterCo in respect thereof, but only to the extent that the Reinsurer has sufficient funds pursuant to the Reinsurer Loan Agreement;
- (i) ninth, in or towards satisfaction of amounts which are then due and payable to InterCo under the Reinsurer Loan Agreement (i) by way of interest, (ii) by way of Deferred Interest and (iii) for the funding of any Reinsurer/InterCo Gross-up Loan to InterCo in respect thereof, but only to the extent that the Reinsurer has sufficient funds pursuant to the Reinsurer Loan Agreement;
- (j) tenth, in or towards satisfaction of amounts which are then due and payable to InterCo under the Reinsurer Loan Agreement by way of principal, but only to the extent that the Reinsurer has sufficient funds pursuant to the Reinsurer Loan Agreement;

- (k) eleventh, in or towards satisfaction of all amounts which are then due and payable to FPLP under, or in connection with, the Reinsurance Agreement and not dealt with above;
- (l) twelfth, in or towards satisfaction of all amounts which are then due and payable to FPLP under, or in connection with, any Capital Injection or Substitution Capital Injection by FPLP to the Reinsurer in accordance with the terms of the Reinsurance Agreement; and
- (m) thirteenth, to pay the remainder (if any) to the Reinsurer.

Reinsurer Deed of Charge representations, warranties and covenants: the Reinsurer will give representations and warranties to the Reinsurer Security Trustee, for itself and for the benefit of the Reinsurer Secured Creditors, as at the date of the Reinsurer Deed of Charge, on the terms of each of the representations and warranties set out in the Reinsurance Agreement.

In addition, the Reinsurer will covenant with and undertake to the Reinsurer Security Trustee, for itself and for the benefit of the Reinsurer Secured Creditors, on the terms of each of the covenants and undertakings set out in the Reinsurance Agreement, and, upon termination of the Reinsurance Agreement, to calculate the Reinsurer Regulatory Surplus and take any other steps necessary to enable it to pay amounts which have become due and payable in accordance with the Reinsurer Pre Enforcement Priority of Payments on the Interest Payment Date first falling after the expiry of 40 days following such termination.

The Reinsurer will also give certain tax representations, warranties and covenants.

Limited Recourse: Notwithstanding any other provision of the Reinsurer Deed of Charge or any other Transaction Document but subject as provided below, each of the Reinsurer Secured Creditors that is a party to the Reinsurer Deed of Charge shall acknowledge and agree with the Reinsurer and the Reinsurer Security Trustee that:

- (a) it will only have recourse in respect of any amount, claim or obligation due or owing to it by the Reinsurer under or in connection with the Reinsurer Deed of Charge or under any other Transaction Documents (the “**Reinsurer Claims**”) to the extent of Reinsurer Available Funds as the same are payable in accordance with the Reinsurer Priorities of Payments which shall be applied by the Reinsurer or, as the case may be, the Reinsurer Security Trustee subject to and in accordance with the terms of this Deed and after all prior ranking claims in respect of those funds have been paid or discharged in full in accordance with the Reinsurer Priorities of Payments;
- (b) if, after enforcement of the Security Interests created by this Deed to the greatest extent practicable and the application of the proceeds of enforcement in accordance with the Reinsurer Post Enforcement Priority of Payments, any Reinsurer Claim remains outstanding, that Claim shall be extinguished and such Reinsurer Secured Creditor shall have no further claim against the Reinsurer.

Non Petition: Each of the Reinsurer Secured Creditors (other than FPLP) that is a party to the Reinsurer Deed of Charge shall acknowledge and agree with each other and with the Reinsurer and the Reinsurer Security Trustee, that it shall not take or join in taking any corporate action or other steps or legal proceedings in respect of Insolvency Proceedings.

FPLP shall acknowledge and agree with each of the Reinsurer Secured Creditors and the Reinsurer Security Trustee, that it shall not take or join in taking any corporate action or other steps or legal proceedings in respect of Insolvency Proceedings. In addition, FPLP shall covenant that no shares will, prior to the satisfaction of all Reinsurer Secured Obligations be beneficially owned other than by FPLP and FPLP will procure its nominees act accordingly.

Enforcement of Reinsurer Security: Each of the Reinsurer Secured Creditors that is a party to the Reinsurer Deed of Charge shall agree and acknowledge with the Reinsurer and the Reinsurer Security Trustee that:

- (a) only the Reinsurer Security Trustee (or any Receiver where applicable) is entitled to enforce the Reinsurer Security;
- (b) unless otherwise provided for in the Reinsurer Deed of Charge, such Reinsurer Secured Creditor shall not take any steps to direct the Reinsurer Security Trustee to enforce the Reinsurer Security or any part of it nor take any steps or pursue any action whatsoever for the purpose of recovering any debts due or owing to it by the Reinsurer or in respect of Insolvency Proceedings in respect of the Reinsurer unless the Reinsurer Security Trustee having become bound to take any steps or proceedings to enforce the Reinsurer Security fails

to do so within a reasonable period of becoming so bound and such failure is continuing (in which case each Reinsurer Secured Creditor shall be entitled to take any such steps and proceedings as it shall deem necessary provided that a Reinsurer Secured Creditor shall not take any steps or proceedings which would lead to the commencement of Insolvency Proceedings in respect of the Reinsurer); and

- (c) in the case of each of the Reinsurer Secured Creditors that is a party to the Reinsurer Deed of Charge, it shall not exercise or claim any right of set off or combination (unless expressly provided for under the terms of the Transaction Documents) or lien in respect of any Reinsurer Secured Obligation owed to it or take any Security Interest or guarantee or other assurance therefore or take or do or omit to take or do any act or thing to prejudice or impair in any way the subordination contemplated by the Reinsurer Deed of Charge or any other Transaction Document.

This will not prevent any Reinsurer Secured Creditor from taking any steps against the Reinsurer which do not amount to the initiation or the threat of initiation of insolvency proceedings against the Reinsurer.

Certain of the rights, duties and discretions of the Reinsurer Security Trustee are subject to the direction or control of the Reinsurer Controlling Creditor (including, but not limited to the right to direct the Reinsurer Security Trustee to enforce the Reinsurer Security or any part of it).

“**Reinsurer Controlling Creditor**” means, at any time:

- (a) subject to (b) and (c), the person who is the InterCo Controlling Creditor at that time within paragraphs (a)(i), (b)(i), (c), (d) or (e) of the definition of “InterCo Controlling Creditor”;
- (b) if the InterCo Controlling Creditor is the InterCo Subordinated Loan Provider and any amounts (actual, contingent, current or future) are or may become payable by the Reinsurer to the Reinsurer Swap Provider under or in connection with the Reinsurer Swap Agreement, the Reinsurer Swap Provider;
- (c) if (b) is not applicable (i) the full amount of the then possible Claim under the Reinsurance Agreement is then due and payable, FPLP as the reinsured under the Reinsurance Agreement and (ii) if (c)(i) is not applicable and a Claim is due under the Reinsurance Agreement but is unpaid on the relevant date, FPLP as the reinsured under the Reinsurance Agreement with respect to enforcing security in respect of the amount of the Claim and until such time as the Claim is satisfied;
- (d) if (a) to (c) above are not applicable, FPLP under the Reinsurance Agreement.

INTERCO LOAN AGREEMENT

On or before the Closing Date InterCo will enter into the InterCo Loan Agreement with, *inter alia*, the Issuer under which the Issuer will agree to advance to InterCo on the Closing Date £380,000,000 to enable InterCo to make available to the Reinsurer the Reinsurer Loan.

The advance made under the InterCo Loan Agreement (the “**InterCo Loan**”) will be made on the Closing Date and is a limited recourse obligation of InterCo.

Loan Interest Period: The period for which the InterCo Loan is outstanding will be divided into successive periods in relation to the payment of interest on the InterCo Floating Principal Amount and the InterCo Fixed Principal Amount (each a “**Loan Interest Period**”). The duration of each Loan Interest Period shall be the period commencing on (and including) an InterCo Loan Interest Payment Date to (but excluding) the immediately succeeding InterCo Loan Interest Payment Date, provided that the first InterCo Loan Interest Period for the InterCo Loan shall be a period commencing on (and including) the Closing Date and ending on (but excluding) the immediately succeeding InterCo Loan Interest Payment Date.

“**InterCo Loan Interest Payment Date**” means, (i) in relation to the InterCo Fixed Principal Amount, the Interest Payment Date falling in April of each year, or, (ii) in relation to the InterCo Floating Principal Amount, each Interest Payment Date (or, if such day is not a Business Day, the immediately succeeding Business Day) or, in either case, if the Reinsurance Agreement is terminated, the Interest Payment Date first following the expiry of 40 days following the termination of the Reinsurance Agreement.

“**Loan Interest Calculation Date**” in respect of an InterCo Loan Interest Payment Date is the fifth Business Day prior to such InterCo Loan Interest Payment Date.

Calculation of interest rate: The interest payable on the InterCo Loan Outstanding for each Loan Interest Period (the InterCo Interest Amount) shall be calculated at the following rate:

- (a) on the InterCo Fixed Principal Amount, a fixed rate of 4.906 per cent. per annum; or
- (b) on the InterCo Floating Principal Amount, LIBOR.

The “**InterCo Floating Principal Amount**” is the amount by which the aggregate principal amount outstanding in respect of the InterCo Loan exceeds the InterCo Fixed Principal Amount. The InterCo Fixed Principal Amount is the amount corresponding to the lower of the aggregate Principal Amount Outstanding on all the Notes and the lowest amount of the Adjusted Sum Reinsured on or prior to that date. The InterCo Floating Principal Amount will accrue interest at LIBOR quarterly, which will be paid quarterly by InterCo drawing (to the extent it is available to be drawn) on the Liquidity Facility and recovering such amount out of InterCo Available Funds on the next Loan Interest Payment Date. As principal of the InterCo Loan is repaid, it will repay the InterCo Floating Principal Amount after the InterCo Fixed Principal Amount.

InterCo Loan Interest: The rate of interest payable under the InterCo Loan Agreement in respect of a Loan Interest Period shall be notified by the Issuer to InterCo at least 5 Business Days prior to the InterCo Loan Interest Payment Date on which such interest is payable and:

- (a) be calculated on the basis of actual days elapsed and a year comprising three hundred and sixty-five (365) days (or, if any portion of that Loan Interest Period falls in a leap year, the sum of:
 - (i) the actual number of days in that portion of the Loan Interest Period falling in a leap year divided by 366; and
 - (ii) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365);
- (b) accrue from day to day from (and including) the first day of such Loan Interest Period to (but excluding) the last day thereof; and
- (c) be paid by InterCo to the Issuer on the relevant scheduled InterCo Loan Interest Payment Date to the extent there are InterCo Available Funds remaining after paying or providing for payments with a higher ranking priority in the InterCo Priorities of Payments.

Payment of Interest

Interest determined in respect of each Loan Interest Period and deferred interest under the InterCo Loan Agreement shall be payable on the Loan Interest Payment Date falling at the end of such Loan Interest Period (ignoring any adjustment for business day conventions) or, following termination of the Reinsurance Agreement, the next Interest Payment Date first occurring following the expiry of 40 days from such termination.

Commitment Fees

In consideration of the Issuer agreeing to make available the advance on the Closing Date under this Agreement, InterCo has agreed to pay to the Issuer:

- (a) on the Closing Date, an initial commitment fee (the “**InterCo Initial Commitment Fee**”); and
- (b) on each Loan Interest Payment Date, an annual InterCo Ongoing Commitment Fee calculated in the manner set out below.

The InterCo Ongoing Commitment Fee in respect of a Loan Interest Period is calculated by InterCo by applying the following formula:

“**InterCo Ongoing Commitment Fee**” equals the InterCo Aggregate Cost of Funds minus the InterCo Interest Amount

“**InterCo Aggregate Cost of Funds**” has the meaning given to that term in “*Summary of the Transaction Documents – Reinsurer Loan Agreement*” above, notwithstanding that, in this context, the meaning of “**Principal Amounts**” shall be read as meaning any amounts payable or paid by:

- (a) the Issuer in respect of the principal amount of the Notes;
- (b) InterCo in respect of the principal amount of the InterCo Loan;
- (c) Ambac in respect of the Ultimate Principal paid under the Ambac Note Financial Guarantee;
- (d) the Issuer or InterCo in respect of break costs payments under the InterCo Loan Agreement;

- (e) InterCo or the Reinsurer in respect of break costs payments under the Reinsurer Loan Agreement;
- (f) the Issuer to the Issuer Swap Provider in respect of break costs payments in respect of partial or full early termination under the Issuer Swap Confirmation;
- (g) InterCo to the InterCo Swap Provider in respect of break costs payments in respect of partial or full early termination under the InterCo Swap Confirmation;
- (h) InterCo in respect of the amount advanced under the InterCo Subordinated Loan other than any Expenses Advance;
- (i) the Issuer in respect of the Issuer Subordinated Loan Agreement; and
- (j) InterCo in respect of the Deposit Amount under the InterCo Deposit Agreement.

The provisions with respect to Deferral of InterCo Loan interest, Deferral of InterCo Loan Ongoing Commitment Fee, InterCo Loan Prepayment Break Costs and withholding tax are similar to the equivalent provisions in respect of the Reinsurer Loan (see “*Summary of the Transaction Documents – Reinsurer Agreement*” above).

Repayment of the InterCo Loan: InterCo will repay an amount of the principal amount outstanding of the InterCo Loan to the extent that InterCo Available Funds remain available on such Loan Interest Payment Date or following termination of the Reinsurance Agreement, the Interest Payment Date first falling following the expiry of 40 days from such termination, having paid or made provision for the payment of all amounts ranking higher in the InterCo Priorities of Payments.

InterCo shall repay the InterCo Fixed Principal Amount before the InterCo Floating Principal Amount.

“**InterCo Available Funds**” means in respect of a Loan Interest Period, (i) the amounts received by InterCo pursuant to the Reinsurer Loan Agreement, the InterCo Swap Agreement and the InterCo Subordinated Loan Agreement on or prior to the Loan Interest Payment Date falling at the end of such Loan Interest Period (excluding the initial advance of £14,000,000) plus (ii) any amounts received from the Issuer in respect of the repayment of any InterCo Gross-up Loan made by InterCo pursuant to the terms of the InterCo Loan Agreement or in payment of any Issuer/InterCo Break Costs under the InterCo Loan Agreement, plus, (iii) on the Final Maturity Date of the Class A-2 Notes if an InterCo Enforcement Event has occurred, the amount standing to the credit of the InterCo General Reserve Account, (iv) less the InterCo Profit Margin plus, (v) any amounts received by InterCo in respect of a Shortfall Drawing pursuant to the Liquidity Facility Agreement in each case to the extent not applied in such Loan Interest Period in accordance with the InterCo Priorities of Payment).

InterCo Loan Agreement Representations, warranties and covenants: InterCo will acknowledge that the Issuer has entered into the InterCo Loan Agreement and agreed to make the InterCo Loan to InterCo in full reliance on representations by InterCo contained in the InterCo Deed of Charge.

In addition, InterCo will covenant with and undertake to the Issuer at all times from the date of the InterCo Loan Agreement, until the Final Discharge Date, on the terms of each of the covenants and undertakings set out in the InterCo Deed of Charge.

The provisions of the InterCo Loan with respect to InterCo Enforcement Events will be the same as the equivalent provisions in the Reinsurer Loan Agreement.

- (a) the InterCo Deed of Charge with respect to recourse and non petition shall be incorporated in the InterCo Loan Agreement *mutatis mutandis*, and shall be deemed to be part of the InterCo Loan Agreement as if set out in full therein; and
- (b) the Issuer Deed of Charge with respect to recourse and non petition shall be incorporated in the InterCo Loan Agreement *mutatis mutandis*, and shall be deemed to be part of the InterCo Loan Agreement as if set out in full therein.

INTERCO SWAP AGREEMENT

InterCo will on or before the Closing Date enter into the InterCo Swap Agreement with the InterCo Swap Provider. Under the terms of the InterCo Swap:

- (a) on each Interest Payment Date the InterCo Swap Provider will pay to InterCo an amount equal to the product of (i) the InterCo Swap Notional Principal in respect of such Interest Payment Date, (ii) 3 month LIBOR on such Interest Payment Date and (iii) the actual number of days in such Interest Period divided by 365 (or, if any portion of that Interest Period falls in a leap year, the sum of (i) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366 and (ii) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365); and
- (b) on each Loan Interest Payment Date, InterCo will pay to the InterCo Swap Provider an amount equal to the product of (i) the InterCo Swap Notional Principal in respect of the Swap Fixed Interest Period ending on such Loan Interest Payment Date, (ii) a fixed swap rate of 4.906 per cent. per annum (the “**InterCo Swap Fixed Rate**”) and (iii) the actual number of days in such Interest Period divided by 365 (or, if any portion of that Interest Period falls in a leap year, the sum of (i) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366 and (ii) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365), (such amount being the “**InterCo Swap Fixed Amount**” in respect of the Loan Interest Period ending closest to such Loan Interest Payment Date)).

The LIBOR rate for the InterCo Swap will be fixed at the same rate as LIBOR on the Notes for the corresponding Interest Period.

For these purposes:

“**InterCo Swap Notional Principal**” means initially zero and thereafter will be the difference (subject to partial early termination) between the Reinsurer Swap Notional Principal and the Issuer Swap Notional Principal.

“**Swap Fixed Interest Period**” has the same meaning as the equivalent term in respect of the Reinsurer Swap Agreement (see “*Summary of Transaction Documents – Reinsurer Swap Agreement*”) and the provisions of the InterCo Swap Agreement with respect to Withholding Tax and Limited Recourse are the same as those in respect of the Reinsurer Swap Agreement, save that the word “Reinsurer” should be read as “InterCo” in respect of reference to the “Reinsurer”, “Reinsurer Loan”, “Reinsurer Swap”, “Reinsurer Security” and the “Reinsurer Priorities of Payments”.

Partial Early Termination: If there is any partial termination of the Reinsurer Swap in respect of the amount by which the notional amount of the Reinsurer Swap exceeds the notional amount of the Issuer Fixed/Floating Swap, the InterCo Swap will be subject to automatic partial termination. An amount will be payable by or to InterCo in respect of such partial early termination depending on whether the InterCo Swap is in-the-money to InterCo (in which case the amount will be payable to InterCo) or out-of-the-money to InterCo (in which case the amount will be payable by InterCo).

The amount to be paid by or to InterCo will be calculated as follows. A notional accreting swap will be constructed having (a) an initial notional principal equal to the lower of (i) the amount by which the Reinsurer Swap Notional Principal is reduced on that date and (ii) the InterCo Swap Notional Principal, accreting annually on a compound basis at the InterCo Swap Fixed Rate, (b) a floating rate payable to InterCo and a fixed rate payable by InterCo equal to the rates in the InterCo Swap and (c) having the same payment dates as the InterCo Swap and (d) with a term starting from the date of automatic partial early termination and ending on the scheduled termination date of the InterCo Swap; the InterCo Swap Calculation Agent will calculate the value of such notional swap, discounting at the then current fixed rate it determines for the period from the date of such termination to the scheduled termination date.

Termination Provisions: Save as provided below, InterCo may terminate the InterCo Swap if there is an Event of Default or a Termination Event (each as defined in the InterCo Swap and summarised below) with respect to the InterCo Swap Provider and the InterCo Swap Provider may, terminate the InterCo Swap if there is an Event of Default or a Termination Event with respect to InterCo. The InterCo Swap will contain termination events commonly found in the standard 1992 ISDA Master Agreement documentation save for (i) the disapplication as regards InterCo of the Events of Default relating to “Breach of Agreement”, “Credit Support Default”, “Misrepresentation”, “Default under Specified Transaction”, “Cross Default”, “Bankruptcy” and “Merger without Assumption” and (ii) the disapplication as regards both InterCo and the Swap Provider of the Termination Events relating to “Tax Event”, “Tax Event Upon Merger” and “Credit Event Upon Merger”.

InterCo Additional Termination Events: The following shall constitute Additional Termination Events with respect to InterCo:

- (a) an InterCo Enforcement Event occurs and the InterCo Security Trustee gives an InterCo Enforcement Notice to InterCo and Party B shall be the sole Affected Party;
- (b) an Early Termination Date (as defined in either of the Issuer Swap Agreement and the Reinsurer Swap Agreement) is designated under the Issuer Swap Agreement or the Reinsurer Swap Agreement.

Downgrade Termination Events and Termination: The provisions with respect to Downgrade Termination Events and Termination in respect of the InterCo Swap are the same as those in respect of the Reinsurer Swap (see “*Summary of the Transaction Documents – Reinsurer Swap Agreement*” above, save that the word “Reinsurer” should be read as “InterCo” with respect to references to the “Reinsurer”, “Reinsurer Swap”, “Reinsurer Swap Agreement”, “Reinsurer Swap Provider”, “Reinsurer Security Trustee”, “Reinsurer Secured Creditors” and “Reinsurer Loan”).

INTERCO SUBORDINATED LOAN AGREEMENT

On or before the Closing Date, FPLP will enter into a subordinated loan agreement with, *inter alios*, InterCo (the “**InterCo Subordinated Loan Agreement**”) under which:

- (a) FPLP will advance to InterCo on the Business Day prior to the Closing Date, £14,000,000 (the “**Initial Advance**”);
- (b) FPLP will advance to InterCo 30 days before each date on which InterCo is liable to make any payment for or on account of tax to the extent it exceeds the daily weighted average standard rate of corporation tax in the accounting period (as defined in section 12 of the Income and Corporation Taxes Act 1988) in respect of which the tax is payable on an amount of profits equal to 0.01 per cent. per annum of the principal amount outstanding of the Reinsurer Loan, a further advance in an amount equal to the amount of such excess tax;
- (c) FPLP shall, upon request by the InterCo Cash Manager, make a further advance on any day to InterCo to cover transaction costs and expenses including, but not limited to, the costs, charges, liabilities and expenses of the InterCo Security Trustee (other than interest, InterCo Ongoing Commitment Fees and principal on the InterCo Loan) provided that the aggregate amount of such advances which are outstanding may not exceed £100,000 at any time (an “**Expenses Advance**”); and

each such amount advanced under (b) and (c) above being a “**Further Advance**”.

Interest will accrue annually in arrears on all outstanding advances under the InterCo Subordinated Loan Agreement (other than any Expense Advance) in an amount equal to the InterCo Asset Yield Amount in that Loan Interest Period. Expenses Advances will accrue interest at LIBOR plus 1 per cent. per annum from the date of drawing to the date of repayment.

The “**InterCo Asset Yield Amount**” is the amount determined by the InterCo Investment Manager to be the interest accrued and gains (or losses) realised in respect of the investments held by the InterCo custodian.

Interest will be payable subject to applicable withholding or deduction for or on account of UK tax, provided always that if there is any such withholding or deduction, no additional amount will be payable in respect thereof.

Subject to the provisions of the InterCo Subordinated Loan Agreement with respect to recourse and non-petition, the (i) accrued interest and principal on the Initial Advance and the Further Advances (other than Expenses Advances) are repayable by InterCo on the earlier of the Loan Interest Payment Date in April 2019 and the date on which no Notes remain outstanding and no amounts are owed to Ambac pursuant to the Issuer Guarantee and Reimbursement Agreement and the InterCo Guarantee and Reimbursement Agreement (ii) accrued interest and principal on the Expenses Advances are repayable on the first Loan Interest Payment Date following its draw down, but, in each case, only to the extent that funds are available after paying or providing for any amounts ranking higher under the priority of payments set out in the InterCo Deed of Charge.

LIQUIDITY FACILITY AGREEMENT

On or about the Closing Date, InterCo will enter into a liquidity facility with, *inter alios*, the Liquidity Facility Provider.

The Liquidity Facility Provider will be a bank which, as at the Closing Date, has a rating assigned for its short-term unsecured and unguaranteed debt obligations of at least “A-1” (or its long-term or short-term equivalent) from S&P and P-1 from Moody’s (the “**Liquidity Requisite Rating**”). As at the Closing Date, the Liquidity Facility Provider shall be Barclays. Thereafter, any Liquidity Facility Provider must have a short-term rating of at least the Liquidity Requisite Rating.

Under the terms of the Liquidity Facility Agreement, the Liquidity Facility Provider will initially provide a 364-day commitment to permit a drawing to be made (a “**Liquidity Facility Drawing**”) of up to a maximum aggregate principal amount of £42,180,000. Thereafter the amount will decline as the outstanding principal amount of the InterCo Loan declines.

InterCo (or the InterCo Cash Manager acting on behalf of InterCo) may make a Liquidity Facility Drawing to the extent that:

- (a) InterCo has insufficient InterCo Available Funds on any Interest Payment Date within such 364 day period to pay in full any of the items specified in (b) to (m) (inclusive) in the InterCo Pre-Enforcement Priority of Payments (see *InterCo Deed of Charge – Pre-Enforcement Priority of Payments* below) (such shortfall, a “**Liquidity Shortfall**” and each such drawing a “**Shortfall Drawing**”); or
- (b) a Liquidity Facility Standby Event occurs and a Liquidity Facility Drawing Notice is served on the Liquidity Facility Provider no later than 9.30 a.m. (London time) on the Business Day before the date of the proposed Liquidity Facility Drawing (a “**Standby Drawing**”), in which case InterCo may make such Standby Drawing up to an amount equal to the undrawn portion of the Liquidity Facility Limit at that time provided that the proceeds of such Standby Drawing shall be immediately paid into the Liquidity Reserve Account.

It shall be a condition precedent to any Liquidity Facility Drawing that the Borrowing Base test, as calculated by the Liquidity Facility Provider on the basis of the Investor Report to be supplied to it by InterCo is satisfied.

Borrowing Base Test: The Borrowing Base test will be met if the net present value of the Defined Book Surplus in all Calculation Periods to (and including) that ending on 31 December 2018, as shown in the most recent Investor Report is at least equal to 100 per cent. of the amount proposed to be drawn (including, for the avoidance of doubt, any amount which would be deemed to be drawn as a result of a withdrawal being made by InterCo from the Liquidity Reserve Account).

The Liquidity Facility Agreement will provide that if at any time the rating of the short-term unsecured, and unguaranteed debt obligations of the Liquidity Facility Provider falls below the Liquidity Facility Requisite Rating (or the rating which is otherwise acceptable to the Rating Agencies) or the Liquidity Facility Provider refuses to extend the term of the Liquidity Facility (each a “**Liquidity Facility Standby Event**”), InterCo shall require the Liquidity Facility Provider to pay into a designated bank account of InterCo (the “**Liquidity Reserve Account**”) maintained with an appropriately rated bank an amount equal to its undrawn commitment under the Liquidity Facility Agreement. Amounts standing to the credit of such account will be available to InterCo for drawing in the event of there being a Liquidity Shortfall and in the circumstances provided in the Liquidity Facility Agreement. InterCo may also, at any time, replace such Liquidity Facility Provider provided that such Liquidity Facility Provider is replaced by a bank which has a short-term rating of at least the Liquidity Facility Requisite Rating and all amounts outstanding to such Liquidity Facility Provider are repaid in full.

Interest shall accrue on each Liquidity Facility Drawing daily, from (and including) the Liquidity Facility Drawdown Date in respect of such Liquidity Facility Drawing up to (but excluding) the first Liquidity Facility Interest Payment Date after that Liquidity Facility Drawing and, to the extent that the Liquidity Facility Drawing is not repaid in full on that date, thereafter from (and including) that Liquidity Facility Interest Payment Date to (but excluding) the next Liquidity Facility Interest Payment Date and so on until repaid in full. Interest shall be calculated on the outstanding daily balance of each Liquidity Facility Drawing on the basis of actual days elapsed and a 365 day year.

The rate of interest payable by InterCo on each Liquidity Facility Drawing will be the rate per annum determined by the Liquidity Facility Provider to be the aggregate of:

- (a) LIBOR;
- (b) a margin (the “**Liquidity Facility Margin**”); and
- (c) the Mandatory Costs Rate.

Subject to the provisions of the Liquidity Facility Agreement relating to recourse and non petition, InterCo shall repay each Shortfall Drawing on the earlier of:

- (a) the first Liquidity Facility Interest Payment Date after that Shortfall Drawing is made or deemed under the Liquidity Facility Agreement to be made; and
- (b) the Class A-2 Notes Final Maturity Date,

subject to and in accordance with the InterCo Priorities of Payments under the InterCo Deed of Charge.

Shortfall Drawings repaid may be redrawn in accordance with and subject to the terms of the Liquidity Facility Agreement.

Any Shortfall Drawing which is deemed to be made under the Liquidity Facility Agreement by virtue of an amount being withdrawn from the Liquidity Reserve Account shall be repaid by crediting such amount to the Liquidity Reserve Account.

Subject to the provisions of the Liquidity Facility Agreement relating to recourse and non petition, InterCo shall repay the Standby Drawing, as reduced by any withdrawal from the Liquidity Reserve Account, in full, or, in the case of partial cancellation of the Liquidity Facility, in part together with accrued interest thereon in accordance with the Liquidity Facility Agreement, on the earliest of:

- (a) if the reason for the making of the Standby Drawing was a Rating Event:
 - (i) InterCo electing to cancel the Liquidity Facility in full or the Liquidity Facility Provider entering into a liquidity facility transfer certificate in respect of the whole of the Liquidity Facility with a qualifying bank having the Liquidity Requisite Ratings; and
 - (ii) the day which is two Business Days after the date on which the Liquidity Facility Provider has given notice to InterCo that it again has the Liquidity Requisite Ratings;
- (b) the Class A-2 Notes Final Maturity Date; and
- (c) InterCo electing, with the consent of the InterCo Security Trustee, to repay the Standby Drawing as a result of InterCo not having available to it sufficient funds to pay interest and other amounts due and payable in respect of the Standby Drawing.

Subject to the provisions of the Liquidity Facility Agreement relating to recourse and non petition, amounts standing to the credit of the Liquidity Reserve Account shall be withdrawn on the relevant due date and applied in making:

- (a) prior to the delivery of an InterCo Enforcement Notice by the InterCo Security Trustee, payment of all principal due to the Liquidity Facility Provider under the Liquidity Facility Agreement; or
- (b) following the delivery of an InterCo Enforcement Notice by the InterCo Security Trustee, payment of all principal and interest due to the Liquidity Facility Provider under the Liquidity Facility Agreement and crediting any remaining amounts to the InterCo Transaction Account,

all other amounts due to the Liquidity Facility Provider shall be payable by InterCo by application of amounts standing to the credit of the InterCo Transaction Account in accordance with the provisions of the InterCo Deed of Charge.

Recourse and Non Petition: Each of the parties to the Liquidity Facility Agreement will acknowledge and agree that the provisions of the InterCo Deed of Charge with respect to recourse and non petition shall be incorporated in the Liquidity Facility Agreement *mutatis mutandis*, and shall be deemed to be part of the Liquidity Facility Agreement as if set out therein.

AMBAC INTERCO SWAP FINANCIAL GUARANTEE

On or before the Closing Date, Ambac will issue in favour of the InterCo Swap Provider, an unconditional and irrevocable financial guarantee (the “**Ambac InterCo Swap Financial Guarantee**”) in respect of InterCo’s obligations to pay the InterCo Swap Fixed Amount under the InterCo Swap Agreement.

AMBAC LIQUIDITY FINANCIAL GUARANTEE

On or before the Closing Date, Ambac will issue in favour of the Liquidity Facility Provider, an unconditional and irrevocable financial guarantee (the “**Ambac Liquidity Financial Guarantee**”) in respect of, respectively, InterCo’s obligations to pay interest (other than Liquidity Gross-up Amounts) and to repay principal outstanding under the Liquidity Facility on terms that Ambac will

pay interest (other than Liquidity Gross-up Amounts) on a current basis and, to the extent that the Liquidity Facility has been drawn and not repaid, repay principal on the earlier of the Final Maturity Date and the date on which the Notes are redeemed in full.

INTERCO AMBAC FEE LETTER

On or before the Closing Date, InterCo and Ambac will enter into an arrangement under a fee letter (the “**InterCo Ambac Fee Letter**”) whereby InterCo will agree to pay to Ambac a fee, on the terms as set out in the InterCo Ambac Fee Letter, in consideration for the provision by Ambac of the Ambac Liquidity Financial Guarantee and the Ambac InterCo Swap Financial Guarantee.

INTERCO GUARANTEE AND REIMBURSEMENT AGREEMENT

On or before the Closing Date, InterCo and Ambac will enter into a guarantee and reimbursement agreement (the “**InterCo Guarantee and Reimbursement Agreement**”) under which InterCo will be obliged, *inter alia*, to reimburse Ambac in respect of any payments made by Ambac under the Ambac Liquidity Financial Guarantee or the Ambac InterCo Swap Financial Guarantee and will be obliged to pay any fees and expenses of Ambac in respect of the provision of the Ambac Liquidity Financial Guarantee and the Ambac InterCo Swap Financial Guarantee.

In so far as Ambac makes payments under the Ambac Liquidity Financial Guarantee, it shall be subrogated to the rights of the Liquidity Facility Provider against InterCo. In so far as Ambac makes payments under the Ambac InterCo Swap Financial Guarantee, it shall be subrogated to the rights of the InterCo Swap Provider against InterCo. Payments due to Ambac pursuant to the InterCo Guarantee and Reimbursement Agreement will be paid by InterCo in accordance with the terms (including the InterCo Priorities of Payments) of the InterCo Deed of Charge and such payment obligations will be limited recourse obligations of InterCo.

Under the InterCo Guarantee and Reimbursement Agreement, for so long as Ambac is the InterCo Controlling Creditor, Ambac will be entitled to control how the InterCo Security Trustee enforces its rights. By virtue of the provisions of the Issuer Deed of Charge, the InterCo Deed of Charge and the Reinsurer Deed of Charge, the effect is that, for so long as Ambac is the Issuer Controlling Creditor, the InterCo Controlling Creditor and the Reinsurer Controlling Creditor, Ambac will control the actions of the Issuer Security Trustee, the InterCo Security Trustee and the Reinsurer Security Trustee under, respectively, the Issuer Deed of Charge, the InterCo Deed of Charge and the Reinsurer Deed of Charge.

INTERCO ADMINISTRATION AGREEMENT

On or before the Closing Date, InterCo will enter into an administration agreement (the “**InterCo Administration Agreement**”) with the InterCo Administrator under which the InterCo Administrator will agree to provide corporate administration services to InterCo.

The InterCo Administrator will be entitled to charge a fee per annum, payable on each Loan Interest Payment Date subject to InterCo having sufficient funds available to pay out of the InterCo Available Funds having paid all other higher ranking amounts in the InterCo Priorities of Payments.

INTERCO INVESTMENT MANAGEMENT AGREEMENT

On or before the Closing Date, InterCo will enter into an investment management agreement (the “**InterCo Investment Management Agreement**”) with the InterCo Investment Manager under which the InterCo Investment Manager shall at any time during the term of the Reinsurance Agreement invest the amounts standing to the credit of the InterCo General Reserve Account (together with all interest, dividend and other income arising on any InterCo Eligible Investment and amounts payable on redemption or repayment and any other proceeds of realisation derived from such InterCo Eligible Investments and any reinvestment thereof in InterCo Eligible Investments) in cash or in InterCo Eligible Investments.

“**InterCo Eligible Investments**” means any security which meets the following criteria:

- (i) it is a Sterling denominated unsubordinated debt security issued by a company, sovereign state or an agency of a sovereign state;
- (ii) it matures after 30 September 2018 and on or prior to 15 April 2019 (and contains no provisions permitting the maturity to be extended beyond such date);

- (iii) it pays interest at a fixed rate and is not convertible into or exchangeable for any other share, security or asset (other than cash) and repays in cash on its maturity date;
- (iv) it is issued by an obligor whose (or is unconditionally and irrevocably guaranteed by a guarantor whose) senior unsecured unguaranteed long term debt at the date on which the investment in such security is made is rated AAA by S&P and Aaa by Moody's;
- (v) it will pay interest without withholding or deduction for or on account of tax if held by or on behalf of InterCo;
- (vi) no stamp duty or stamp duty reserve tax would be payable on its acquisition by InterCo under the tax law in force as at the date of the InterCo Investment Management Agreement; and
- (vii) it falls within the meaning of "financial collateral" as defined in the Financial Collateral Arrangements (No.2) Regulation (SI 2003/3226).

If at any time prior to the Class A-2 Notes Final Maturity Date the ratings of any InterCo Eligible Investment become less than A- by S&P and A3 by Moody's, the InterCo Eligible Investments shall be disposed of and the proceeds deposited in the InterCo General Reserve Account. Upon maturity of an InterCo Eligible Investment the proceeds shall be deposited in the InterCo General Reserve Account.

INTERCO ACCOUNT BANK AGREEMENT

On or before the Closing Date, InterCo will enter into a bank account agreement (the "**InterCo Account Bank Agreement**") with the InterCo Account Bank pursuant to which InterCo will establish a transaction bank account (the "**InterCo Transaction Account**"), a bank account into which the proceeds of the Deposit Agreement with the Issuer will be deposited ("**InterCo General Reserve Account**") and a bank account into which will be paid the share capital of InterCo (and any subsequent capital issued by way of issue of shares or capital contribution from FPLP) and to which the InterCo Profit Margin will be transferred (the "**InterCo Share Capital Account**").

INTERCO CASH MANAGEMENT AGREEMENT

On or before the Closing Date, InterCo and, *inter alios*, the InterCo Cash Manager will enter into a cash management agreement (the "**InterCo Cash Management Agreement**") under which the InterCo Cash Manager will agree to provide cash management services to InterCo.

The InterCo Cash Manager will be entitled to charge a fee per annum, payable on each Loan Interest Payment Date subject to InterCo having sufficient funds available to pay out of the InterCo Available Funds having paid all other higher ranking amounts in the InterCo Priorities of Payments.

INTERCO CUSTODY AGREEMENT

On or before the Closing Date, InterCo will enter into a custody agreement (the "**InterCo Custody Agreement**") with the InterCo Custodian under which the InterCo Custodian will agree to provide custody services to InterCo in respect of the InterCo Eligible Investments.

Under the InterCo Custody Agreement, InterCo will establish a series of sub-accounts with the InterCo Custodian, into which, respectively:

- (a) InterCo Eligible Investments will be deposited (the "**InterCo Reserve Securities Sub-Account**"); and
- (b) the proceeds of the realisation of InterCo Eligible Investments backing the InterCo General Reserve will be deposited (the "**InterCo Reserve Cash Sub-Account**").

The InterCo Custodian may appoint a global sub-custodian and both the InterCo Custodian and global sub-custodian may appoint sub-custodians in individual locations. References to the InterCo Custodian in the InterCo Custody Agreement include, where appropriate, any such sub-custodians.

The InterCo Custodian will keep records that identify the InterCo Eligible Investments as separate from any other investments held by the InterCo Custodian and may pool investments belonging to InterCo with investments belonging to other clients of the InterCo Custodian.

INTERCO DEED OF CHARGE

On or before the Closing Date, InterCo will create security over all its assets pursuant to a deed of charge (the "**InterCo Deed of Charge**") in favour of the InterCo Security Trustee (acting on behalf

of itself, the Issuer, the Issuer Security Trustee, Ambac, the Liquidity Facility Provider, the InterCo Cash Manager, the InterCo Account Bank, the InterCo Swap Provider the InterCo Administrator, the InterCo Investment Manager, the InterCo Custodian, FPLP, the Reinsurer and the Reinsurer Security Trustee (together the “**InterCo Secured Creditors**”).

InterCo Security

InterCo will grant the following security (the “**InterCo Security**”) in order to provide security in respect of its obligations to the InterCo Secured Creditors (the “**InterCo Secured Obligations**”):

- (1) an assignment, by way of first fixed security for the payment or discharge of the InterCo Secured Obligations, to and in favour of the InterCo Security Trustee of all of its rights, title, interest and benefit, existing at the date of the InterCo Deed of Charge or in the future, in, to, under or in respect of the:
 - (a) Reinsurer Loan Agreement;
 - (b) InterCo Loan Agreement;
 - (c) Liquidity Facility Agreement;
 - (d) InterCo Account Bank Agreement;
 - (e) InterCo Guarantee and Reimbursement Agreement;
 - (f) InterCo Administration Agreement;
 - (g) InterCo Cash Management Agreement
 - (h) InterCo Investment Management Agreement;
 - (i) InterCo Custody Agreement;
 - (j) InterCo Subordinated Loan Agreement;
 - (k) Issuer Subordinated Loan Agreement;
 - (l) InterCo Deposit Agreement;
 - (m) InterCo Swap Agreement; and
 - (o) Reinsurer Deed of Charge,(together the “**InterCo Assigned Agreements**”) and any other agreement, instrument or notice to which InterCo is or becomes a party or in respect of which it has or may have any right, interest, title or benefit, either existing at the date of the InterCo Deed of Charge or at any time in the future (the “**InterCo Other Secured Contractual Rights**”), including without limitation:
 - (i) the benefit of all representations, warranties, covenants, undertakings and indemnities under or in respect of InterCo Assigned Agreements and InterCo Other Secured Contractual Rights;
 - (ii) all of its rights to receive payment of any amounts which may become payable to it pursuant or with respect to such InterCo Assigned Agreements and InterCo Other Secured Contractual Rights;
 - (iii) all payments received by it pursuant to, or with respect to, such InterCo Assigned Agreements and InterCo Other Secured Contractual Rights;
 - (iv) all its rights to serve notices and/or make demands pursuant to such InterCo Assigned Agreements and InterCo Other Secured Contractual Rights and/or to take such steps as are required to cause payments to become due and payable thereunder or with respect to such InterCo Assigned Agreements and InterCo Other Secured Contractual Rights;
 - (v) all of its rights of action in respect of any breach of such InterCo Assigned Agreements and InterCo Other Secured Contractual Rights; and
 - (vi) all of its rights to receive damages, compensation or obtain other relief, including in respect of any breach of or default in respect of such InterCo Assigned Agreements and InterCo Other Secured Contractual Rights;
- (2) a charge, by way of first fixed security for the payment or discharge of the InterCo Secured Obligations, to and in favour of the InterCo Security Trustee of all of its right, title, interest and benefit, existing at the date of the InterCo Deed of Charge or in the future, in and to the InterCo Custodian Accounts and all sums of moneys and all Securities and other investments

which may at the date of the InterCo Deed of Charge be or thereafter are from time to time standing to the credit of the InterCo Custodian Accounts or any other bank account or book debt or custodial arrangement in which InterCo may at any time acquire any right, title, interest or benefit and each debt represented by the same, including all interest accrued and other moneys received in respect thereof.

- (3) a charge, by way of first fixed security for the payment or discharge of the InterCo Secured Obligations, to and in favour of the InterCo Security Trustee of all of its right, title, interest and benefit, existing at the date of the InterCo Deed of Charge or in the future, in and to the InterCo Bank Accounts and all sums of moneys which may at or after the date of the InterCo Deed of Charge be from time to time standing to the credit of the InterCo Bank Accounts and any other bank account or book debt in which InterCo may at any time acquire any right, title, interest or benefit and each debt represented by these, including all interest accrued and other moneys received in respect thereof;
- (4) a charge, by way of first fixed security for the payment or discharge of the InterCo Secured Obligations, to and in favour of the InterCo Security Trustee of all of its right, title, interest and benefit, existing at the date of the InterCo Deed of Charge or in the future, in and to the InterCo Eligible Investments and all other Securities which InterCo may at any time acquire, make or otherwise obtain an interest or benefit in, together with all moneys received in respect thereof and all interest accruing on them from time to time, all dividends and distributions paid or payable thereon, all property paid, distributed, accruing or offered at any time on, to or in respect of or in substitution therefor and the proceeds of sale, redemption or discharge thereof and the benefit of all covenants relating to such InterCo Eligible Investments and other Securities and all rights and remedies for enforcing the same.
- (5) a charge to and in favour of InterCo Security Trustee, by way of first floating charge for the payment or discharge of the InterCo Secured Obligations, of the whole of its undertaking and all of its property and assets whatsoever and wheresoever situate, present and future, other than any property or assets from time to time or for the time being effectively charged by way of fixed charge, or otherwise assigned as security, pursuant to the InterCo Deed of Charge.

InterCo Priorities of Payment

InterCo Pre Enforcement Priority of Payment

Notwithstanding the security rights created by or pursuant to the InterCo Deed of Charge, on each Interest Payment Date prior to the delivery of an InterCo Enforcement Notice by the InterCo Security Trustee the InterCo Cash Manager, as agent for InterCo, shall, subject to obtaining the prior consent of the InterCo Security Trustee pursuant to the InterCo Deed of Charge, on each Interest Payment Date instruct the InterCo Account Bank to withdraw InterCo Available Funds standing to the credit of the InterCo Transaction Account (but only to the extent that such withdrawal does not cause the InterCo Transaction Account to become overdrawn) such InterCo Available Funds to be applied in the following order of priority (in each case only if and to the extent that payments or provisions of a higher order of priority have been made in full):

- (a) first, in or towards satisfaction, *pro rata*, as applicable (i) of the InterCo/Reinsurer Early Termination Payment due and payable under the Reinsurer Loan Agreement to the Reinsurer, (ii) of the InterCo/Reinsurer Conversion Termination Payment due and payable under the Reinsurer Loan Agreement to the Reinsurer and (iii) of the InterCo Swap Break Costs Payment due and payable by InterCo to the InterCo Swap Provider under the InterCo Swap Agreement, (iv) of the InterCo/Issuer Early Termination Payment due and payable under the InterCo Loan Agreement to the Issuer and (v) of the InterCo/Issuer Conversion Termination Payment due and payable under the InterCo Loan Agreement to the Issuer;
- (b) second, in or towards satisfaction, *pro rata*, of (i) the fees or other remuneration and indemnity payments (if any) which are then due and payable to the InterCo Security Trustee and any costs, charges, liabilities and expenses incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the InterCo Deed of Charge;
- (c) third, in or towards satisfaction, *pro rata* of (i) the fees or other remuneration and indemnity payments (if any) which are then due and payable to the InterCo Account Bank and any costs, charges, liabilities and expenses properly incurred by it (together with interest on those

- amounts) for which it is entitled to be reimbursed or indemnified under the InterCo Account Bank Agreement, and (ii) the fees or other remuneration and indemnity payments (if any) which are then due and payable to the InterCo Cash Manager and any costs, charges, liabilities and expenses properly incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the InterCo Cash Management Agreement;
- (d) fourth, in or towards repayment of interest and principal in respect of any Expenses Advances made under the InterCo Subordinated Loan Agreement and any deferred interest and deferred principal in relation to the Expenses Advances;
- (e) fifth, in or towards satisfaction, *pro rata*, of (i) the fees or other remuneration and indemnity payments (if any) which are then due and payable to the InterCo Investment Manager and any costs, charges, liabilities and expenses properly incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the InterCo Investment Management Agreement and (ii) the fees or other remuneration and indemnity payments (if any) which are then due and payable to the InterCo Custodian and any costs, charges, liabilities and expenses properly incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the InterCo Custody Agreement;
- (f) sixth, in or towards satisfaction of the fees, costs, liabilities and expenses (together with interest on those amounts) of the InterCo Administrator for which it is entitled to be reimbursed or indemnified under the InterCo Administration Agreement;
- (g) seventh, in or towards satisfaction of the amounts then due and payable to the InterCo Swap Provider in respect of the InterCo Swap Agreement (to the extent not paid under (a) above) and any amount due and payable in respect of replacement of an InterCo Swap Provider;
- (h) eighth, in or towards satisfaction of, *pro rata*, amounts which are then due and payable to third parties under obligations incurred in the ordinary course of InterCo's business (other than amounts specifically provided for elsewhere in this order of priority), including amounts due to the auditors and any amounts due to the relevant taxation authority in respect of InterCo's liability to corporation tax (if any);
- (i) ninth, in or towards satisfaction of the amounts then due and payable in respect of the InterCo Financial Guarantee Fee, premium, fees or other amounts (other than in reimbursement of amounts paid by Ambac under the Ambac Liquidity Financial Guarantee or the Ambac InterCo Swap Financial Guarantee) (if any) payable to Ambac pursuant to the terms of the InterCo Guarantee and Reimbursement Agreement;
- (j) tenth, in or towards satisfaction, *pro rata*, of the amounts then due and payable in respect of (i) repayments of any Reinsurer/InterCo Gross-up Loan made to InterCo by Reinsurer, but only to the extent InterCo has recovered the tax withheld in respect of which the Reinsurer/InterCo Gross-up Loan was made and (ii) repayments of any Issuer/InterCo Gross-up Loan made to InterCo by the Issuer, but only to the extent InterCo has recovered the tax withheld in respect of which the Issuer/InterCo Gross-up Loan was made;
- (k) eleventh, in or towards satisfaction of (i) first, for so long as amounts have been drawn under the Liquidity Facility Agreement and credited to the Liquidity Reserve Account, the amount required to maintain the balance of the Liquidity Reserve Account at an amount equal to the then maximum aggregate principal amount available under the Liquidity Facility Agreement and (ii) secondly, the amounts then due and payable to the Liquidity Facility Provider in respect of the Liquidity Facility Agreement other than additional amounts payable by virtue of a gross up following a withholding or deduction for or on account of any tax imposed in the United Kingdom ("**Liquidity Gross up Amounts**");
- (l) twelfth, in or towards satisfaction of amounts which are due and payable to the Issuer under the InterCo Loan Agreement (i) of InterCo Ongoing Commitment Fees, (ii) of Deferred InterCo Ongoing Commitment Fees and (iii) for the funding of any InterCo/Issuer Gross-up Loan in respect thereof;
- (m) thirteenth, in or towards satisfaction of amounts which are then due and payable to the Issuer under the InterCo Loan Agreement (i) by the way of interest, (ii) by way of Deferred Interest and (iii) for the funding of any InterCo/Issuer Gross-up Loan in respect thereof;

- (n) fourteenth, in or towards satisfaction of the amounts then due and payable (other than InterCo Financial Guarantee Fee, premium, fees or other amounts provided for in item (g) above) to Ambac pursuant to the terms of the InterCo Guarantee and Reimbursement Agreement;
- (o) fifteenth, in or towards satisfaction of Liquidity Gross up Amounts;
- (p) sixteenth, in or towards satisfaction of any other amounts payable to the Issuer and in connection with the InterCo Loan Agreement, other than principal;
- (q) seventeenth, in or towards satisfaction of the principal under the InterCo Loan Agreement that is then due and payable on that Interest Payment Date;
- (r) eighteenth, following no amount (whether of interest, principal, fees, indemnity or other amount) being payable (whether then or in the future or absolutely or subject to any contingency) under or in connection with the InterCo Loan, in or towards satisfaction of all amounts that are due and payable on that Interest Payment Date under the InterCo Deposit Agreement;
- (s) nineteenth, following no amount (whether of interest, principal, fees, indemnity or other amount) being payable (whether then or in the future or absolutely or subject to any contingency) under or in connection with the InterCo Loan, in or towards satisfaction of all amounts that are due and payable on that Interest Payment Date under the InterCo Subordinated Loan Agreement; and
- (t) twentieth, to pay the remainder (if any) to InterCo.

Expenses Advances

Notwithstanding the security interests created by or pursuant to the InterCo Deed of Charge, on any Business Day prior to the service of an InterCo Enforcement Notice on which an Expenses Advance is made, the InterCo Cash Manager may, subject to obtaining the prior consent of the InterCo Security Trustee, instruct the InterCo Account Bank to withdraw moneys standing to the credit of the InterCo Transaction Account (but only to the extent that such withdrawal does not cause the InterCo Transaction Account to become overdrawn) in any amount equal to the Expenses Advance in order to pay any amounts which are due and payable in respect of any costs, charges, liabilities or expenses of the InterCo Security Trustee and any other amounts that are due and payable of the type described in paragraph (h) of the InterCo Pre Enforcement Priority of Payments.

Liquidity Reserve Account

If a Liquidity Standby Drawing has been paid into the Liquidity Reserve Account pursuant to the terms of the Liquidity Facility Agreement, then notwithstanding the security rights created by or pursuant to the InterCo Deed of Charge, but prior to the service of an InterCo Enforcement Notice, the InterCo Cash Manager, on behalf of InterCo, shall, subject to obtaining the prior consent of the InterCo Security Trustee pursuant to the InterCo Deed of Charge, instruct the InterCo Account Bank to withdraw moneys from the Liquidity Reserve Account in accordance with the provisions of the Liquidity Facility Agreement.

InterCo General Reserve Account

Prior to the service of an InterCo Enforcement Notice, the amount deposited by the Issuer under the Deposit Agreement shall be credited to a separate account with the InterCo Account Bank (the “**InterCo General Reserve Account**”).

The amount standing to the credit of the InterCo General Reserve Account shall be invested in InterCo Eligible Investments. InterCo Eligible Investments funded out of the InterCo General Reserve Account (together with all interest, dividend and other income arising on such InterCo Eligible Investments and amounts payable on redemption or repayment and any other proceeds of realisation derived from such InterCo Eligible Investments and any reinvestment thereof in InterCo Eligible Investments) shall be held by the Custodian in the relevant InterCo Custodian Account and recorded in a separate securities or, in the case of cash, cash sub-accounts of the Custodian (respectively, the “**InterCo Reserve Securities Sub-Account**” and the “**InterCo Reserve Cash Sub-Account**”) to any other securities or cash held by the Custodian on behalf of the InterCo Security Trustee and shall be subject to the security created by the InterCo Deed of Charge.

InterCo Tax Costs

30 days before each date on which InterCo is liable to make any payment for or on account of tax to the extent it exceeds the daily weighted average standard rate of corporation tax in the accounting period (as defined in section 12 of the Income and Corporation Taxes Act 1988) in respect of which the tax is payable on an amount of profits equal to 0.01 per cent. per annum of the principal amount outstanding of the Reinsurer Loan, the InterCo Cash Manager shall notify the Interco Subordinated Loan Provider who shall make a Further Advance under the Interco Subordinated Loan Agreement equal to such excess tax and shall credit such amount to the InterCo Transaction Account. Such amount shall be applied by the InterCo Cash Manager in paying InterCo's tax liability.

Application of Cash Post-Enforcement

InterCo Post-Enforcement Priority of Payments

All monies received or recovered by the InterCo Security Trustee or the Receiver for the benefit of the InterCo Secured Creditors in respect of the InterCo Secured Obligations following the delivery of an InterCo Enforcement Notice by the InterCo Security Trustee shall, subject to the InterCo Deed of Charge, be held by the InterCo Security Trustee or the Receiver, as the case may be, on trust, and shall be applied in the following order of priority (and in each case only if and to the extent that payments or provisions of a higher order of priority have been made in full):

- (a) first, in or towards satisfaction, as applicable (i) of the InterCo/Reinsurer Early Termination Payment due and payable under the Reinsurer Loan Agreement to the Reinsurer, (ii) of the InterCo/Reinsurer Conversion Termination Payment due and payable under the Reinsurer Loan Agreement to the Reinsurer and (iii) of the InterCo Swap Break Costs Payment due and payable by InterCo to the InterCo Swap Provider under the InterCo Swap Agreement, (iv) of the InterCo/Issuer Early Termination Payment due and payable under the InterCo Loan Agreement to the Issuer and (v) of the InterCo/Issuer Conversion Termination Payment due and payable under the InterCo Loan Agreement to the Issuer;
- (b) second, in or towards satisfaction of, *pro rata*, according to the respective amounts due and payable, of (i) the fees or other remuneration and indemnity payments (if any) then payable to any Receiver and any costs, charges, liabilities and expenses properly incurred by it (together with any interest thereon), (ii) the fees and indemnity payments (if any) payable to the Issuer Security Trustee and any costs, charges, liabilities and expenses incurred by it for which it is entitled to be reimbursed or indemnified under the Issuer Deed of Charge (together with any interest) and (iii) the fees and indemnity payments (if any) payable to the InterCo Security Trustee and any costs, charges, liabilities and expenses incurred by it for which it is entitled to be reimbursed or indemnified under the InterCo Deed of Charge, (together with any interest thereon as provided for therein);
- (c) third, in or towards satisfaction of, *pro rata* according to the respective amounts then due and payable, such amounts being (i) the fees or other remuneration and indemnity payments (if any) which are then due and payable to the InterCo Account Bank and any costs, charges, liabilities and expenses properly incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the InterCo Account Bank Agreement (ii) the fees or other remuneration and indemnity payments (if any) which are then due and payable to the InterCo Cash Manager and any costs, charges, liabilities and expenses properly incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the InterCo Cash Management Agreement (iii) the fees or other remuneration and indemnity payments (if any) which are then due and payable to the InterCo Investment Manager and any costs, charges, liabilities and expenses properly incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the InterCo Investment Management Agreement and (iv) the fees or other remuneration and indemnity payments (if any) which are then due and payable to the InterCo Custodian and any costs, charges, liabilities and expenses properly incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the InterCo Custody Agreement;
- (d) fourth, in or towards repayment of interest and principal in respect of any Expenses Advances made under the InterCo Subordinated Loan Agreement and any deferred interest and deferred principal in relation to the Expenses Advances;

- (e) fifth, in or towards satisfaction of the fees, costs, liabilities and expenses (together with interest on those amounts) of the InterCo Administrator for which it is entitled to be reimbursed or indemnified under the InterCo Administration Agreement;
- (f) sixth, in or towards satisfaction of the amounts then due and payable in respect of the InterCo Financial Guarantee Fee, premium, fees and other amounts payable (other than in reimbursement of amounts paid by Ambac under any of the Ambac Liquidity Financial Guarantee and the Ambac InterCo Swap Financial Guarantee) (if any) to Ambac pursuant to the terms of the InterCo Guarantee and Reimbursement Agreement;
- (g) seventh, in or towards satisfaction of the amounts (including principal, interest and any other amounts other than Liquidity Gross up Amounts) then due and payable or outstanding to the Liquidity Facility Provider under the Liquidity Facility Agreement and the InterCo Swap Provider under the InterCo Swap Agreement, *pro rata*;
- (h) eighth, in or towards satisfaction, *pro rata*, of all amounts of interest, principal and other amounts due or accrued due and payable in respect of the InterCo Deposit Agreement.
- (i) ninth, in or towards satisfaction, *pro rata*, of all amounts of InterCo Ongoing Commitment Fee, interest, principal, and other amounts due or accrued due and payable in respect of the InterCo Loan Agreement;
- (j) tenth, in or towards satisfaction of the amounts then due and payable (other than InterCo Guarantee Fee, premium, fees or other amounts provided for in item (d) above) to Ambac pursuant to the terms of the InterCo Guarantee and Reimbursement Agreement;
- (k) eleventh, in or towards satisfaction of all Liquidity Gross up Amounts then due and payable;
- (l) twelfth, following no amount (whether of interest, principal, fees, indemnity or other amount) being payable (whether then or in the future or absolutely or subject to any contingency) under or in connection with the InterCo Loan, in or towards satisfaction of all amounts (other than interest and principal in respect of any Expenses Advance) that are due and payable on that Interest Payment Date under the InterCo Subordinated Loan Agreement;
- (m) thirteenth, to pay the remainder (if any) to InterCo.

Liquidity Reserve Account

After the service of an InterCo Enforcement Notice, all amounts standing to the credit of the Liquidity Reserve Account will be applied first in or towards payment of all amounts of principal and interest in respect of any Liquidity Facility Drawing and any remaining amounts will be applied in accordance with the Post-Enforcement Priority of Payments.

InterCo General Reserve Account

Following the service of an InterCo Enforcement Notice, any amount advanced by the InterCo Subordinated Lender under the InterCo Subordinated Loan shall remain credited to the InterCo General Reserve Account.

Following the service of an InterCo Enforcement Notice:

- (a) all amounts standing to the credit of the InterCo Reserve Cash Sub-Accounts shall be transferred and credited to the InterCo General Reserve Account;
- (b) the InterCo Security Trustee (acting as directed by the InterCo Controlling Creditor) shall direct the InterCo Investment Manager, and the InterCo Investment Manager shall use its best endeavours, acting in a commercially reasonable manner, to invest such amounts in InterCo Eligible Investments and to realise all InterCo Eligible Investments on or shortly before the fifth Business Day prior to the Final Maturity Date of the Class A-2 Notes and for the amounts received in respect of such realisations (and any other amounts received in respect of the InterCo Eligible Investments credited to the InterCo Reserve Securities Sub-Account) to be credited to the InterCo General Reserve Account; and
- (c) following (a) and (b) to credit the amounts to the InterCo Transaction Account on the fifth Business Day prior to the Final Maturity Date of the Class A-2 Notes.

Suspense Account

Following service of an InterCo Enforcement Notice, the InterCo Security Trustee may at its absolute discretion pending application thereof pursuant to the Post-Acceleration Priority of

Payments deposit all amounts from time to time received by it from InterCo or any person or persons liable to pay or in respect of the InterCo Charged Property or from the realisation or enforcement of the InterCo Security Interests in a separate suspense account for so long as, and on the terms which, it considers appropriate without any obligation to apply the same or any part thereof in or towards the discharge of any of the InterCo Secured Obligations.

InterCo Charged Property on Trust

To the extent permitted to do so under the Transaction Documents, for the purpose of giving effect to this Deed, InterCo agrees that, after service of an InterCo Enforcement Notice, it will hold all of the InterCo Charged Property to which it is entitled (subject to the right of redemption of any obligor) upon trust to convey, assign or otherwise deal with such InterCo Charged Property in accordance with the InterCo Security Trustee's directions.

Conflicts of Interest

The InterCo Security Trustee shall have regard to the interests of the InterCo Secured Creditors as a whole as regards the exercise and performance of all powers, trusts, authorities, duties and discretions of the InterCo Security Trustee in respect of the InterCo Security and each of the other Transaction Documents or the rights or benefits which are comprised in the InterCo Security (except where expressly provided otherwise). Without prejudice to the generality of the foregoing, the InterCo Security Trustee shall be under no obligation to take any steps to call in or to enforce the rights of InterCo under or in respect of the InterCo Charged Property and shall not be liable for any loss arising from any omissions on its part to take any such steps.

Notwithstanding the generality of the paragraph above, the InterCo Security Trustee shall have regard only:

- (a) to the interests of the InterCo Controlling Creditor (other than with respect to the InterCo Reserved Matters, any amendment to the Liquidity Facility Agreement or, save to the extent provided in Condition 13(d), any Basic Terms Modification) if in the InterCo Security Trustee's opinion, there is a conflict between the interests of (A) the InterCo Controlling Creditor and (B) any other InterCo Secured Creditor;
- (b) in all other cases whilst any amounts are payable (currently or in the future and whether or not subject to any contingency or condition) under the InterCo Loan, to the interests of the Issuer (other than with respect to the InterCo Reserved Matters or any amendments to the Liquidity Facility Agreement), if in the InterCo Security Trustee's opinion, there is a conflict between the interests of (A) the Issuer and (B) the other InterCo Secured Creditors;
- (c) if Ambac is not the InterCo Controlling Creditor and the InterCo Loan is not outstanding, to the interests of the InterCo Secured Creditor (other than the InterCo Security Trustee or the InterCo Administrator) ranking highest in the InterCo Priorities of Payments and, if more than one has the same level of ranking, the InterCo Secured Creditor owed the largest amount at such level of ranking; and
- (d) with respect to InterCo Reserved Matters, and any amendments to the Liquidity Facility, to the interests of the Liquidity Facility Provider.

So long as the InterCo Loan remains outstanding, the InterCo Security Trustee is not required to have regard to the interest of any InterCo Secured Creditor other than those specified in (a) to (d) above.

Giving of InterCo Enforcement Notice

The InterCo Security Trustee shall, if:

- (a) instructed by the InterCo Controlling Creditor to take enforcement steps in relation to the InterCo Security; and
- (b) the InterCo Controlling Creditor has provided the InterCo Security Trustee with a copy of the InterCo Enforcement Notice,

give an InterCo Enforcement Notice to InterCo declaring the whole of the InterCo Security to be enforceable.

Obligation of InterCo Security Trustee to enforce

The InterCo Security Trustee shall only be bound to take action to enforce the InterCo Security if:

- (a) it shall have been so directed in writing by an InterCo Controlling Creditor (or, if applicable, the Issuer Security Trustee on behalf of an Issuer Controlling Creditor); and
- (b) it shall first have been indemnified and/or secured to its satisfaction.

InterCo Security Trustee entitled to assume that Ambac is the InterCo Controlling Creditor

The InterCo Security Trustee shall be entitled to assume that Ambac is the InterCo Controlling Creditor at any time whilst the InterCo Loan remains outstanding unless and until the InterCo Security Trustee is otherwise notified in writing by InterCo, the InterCo Cash Manager, the Issuer Security Trustee, Ambac, or any other person of the occurrence of an Ambac Termination Event, and the InterCo Security Trustee shall have no liability to any person for any consequences of acting on such assumption.

Upon Enforcement

With immediate effect from the time upon which the InterCo Controlling Creditor serves an InterCo Enforcement Notice on InterCo, the whole of the InterCo Security shall become enforceable and:

- (a) no payments shall be made out of the InterCo Bank Accounts without the prior written consent of the InterCo Security Trustee;
- (b) if not already crystallised, any charge created by the InterCo Deed of Charge, which is a floating charge, shall automatically crystallise pursuant to the InterCo Deed of Charge;
- (c) InterCo may not sell, realise or otherwise dispose of any InterCo Eligible Investment except with the prior written consent of the InterCo Security Trustee;
- (d) the InterCo Security Trustee shall be entitled to take such proceedings against InterCo as it may think fit to enforce all or any part of the InterCo Security pursuant to and in accordance with the provisions of this Deed and to enforce payment in respect of the InterCo Secured Obligations; and
- (e) all proceeds of enforcement of the InterCo Security and any payment or distribution of any kind or character, whether in cash, securities or other property (other than the InterCo Eligible Investments or amounts standing to the credit of the InterCo General Reserve Account which shall not be available for application prior to the Loan Interest Payment Date falling in April 2019 or when there are no Notes outstanding and no amounts owed by the Issuer to Ambac under the Issuer Guarantee and Reimbursement Agreement or the InterCo Guarantee and Reimbursement Agreement whichever is earlier) which is payable or deliverable upon or with respect to any of the InterCo Secured Obligations or any part thereof by InterCo shall immediately be paid or delivered directly to or to the order of the InterCo Security Trustee for application in accordance with the InterCo Post Enforcement Priority of Payments or to be held by it in the InterCo Suspense Account.

InterCo Deed of Charge representations, warranties and covenants: InterCo will represent and warrant to the InterCo Security Trustee, for itself and for the benefit of the InterCo Secured Creditors, in relation to matters common for transactions of this nature.

In addition, InterCo will undertake with the InterCo Security Trustee in relation to matters common for this type of transaction and will also give certain tax representations, warranties and covenants.

Limited Recourse: Subject as provided below, each of the InterCo Secured Creditors that is a party to the InterCo Deed of Charge shall acknowledge and agree with InterCo and the InterCo Security Trustee that:

- (a) it will only have recourse in respect of any amount, claim or obligation due or owing to it by InterCo under or in connection with the InterCo Deed of Charge or under any other Transaction Documents (the “**InterCo Claims**”) to the extent of the InterCo Available Funds as the same are payable in accordance with the InterCo Priorities of Payments which shall be applied by InterCo or, as the case may be, the InterCo Security Trustee subject to and in accordance with the terms of this Deed and after all prior ranking claims in respect of those funds have been paid or discharged in full in accordance with the InterCo Priorities of Payments; and

- (b) if, after enforcement of the Security Interests created by the InterCo Deed of Charge to the greatest extent practicable and the application of the proceeds of enforcement in accordance with the priority of payments as set out in the InterCo Post-Enforcement Priority of Payments, any InterCo Claim remains outstanding, that Claim shall be extinguished and such InterCo Secured Creditor shall have no further claim against InterCo.

Non Petition: each of the InterCo Secured Creditors that is a party to the InterCo Deed of Charge shall acknowledge and agree with each other and with InterCo and the InterCo Security Trustee, that it shall not take or join in taking any corporate action or other steps or legal proceedings in respect of Insolvency Proceedings.

Enforcement of InterCo Security: each of the InterCo Secured Creditors that is a party to the InterCo Deed of Charge shall agree and acknowledge with InterCo and the InterCo Security Trustee that:

- (a) only the InterCo Security Trustee (or any Receiver where applicable) is entitled to enforce the InterCo Security;
- (b) unless otherwise provided for in the InterCo Deed of Charge, such InterCo Secured Creditor (other than the InterCo Controlling Creditor) shall not take any steps to direct the InterCo Security Trustee to enforce the InterCo Security or any part of it nor take any steps or pursue any action whatsoever for the purpose of recovering any debts due or owing to it by InterCo or in respect of Insolvency Proceedings in respect of InterCo unless the InterCo Security Trustee having become bound to take any steps or proceedings to enforce the InterCo Security fails to do so within a reasonable period of becoming so bound and such failure is continuing (in which case each of the InterCo Secured Creditors shall be entitled to take any such steps and proceedings as it shall deem necessary provided that an InterCo Secured Creditor (other than Ambac for so long as Ambac is the InterCo Controlling Creditor and thereafter the InterCo Security Trustee) shall not take any steps or proceedings which would lead to the commencement of Insolvency Proceedings in respect of InterCo); and
- (c) in the case of each of the InterCo Secured Creditors that is a party to the InterCo Deed of Charge, it shall not exercise or claim any right of set off or combination (unless expressly provided for under the terms of the Transaction Documents) or lien in respect of any InterCo Secured Obligation owed to it or take any Security Interest or guarantee or other assurance therefore or take or do or omit to take or do any act or thing to prejudice or impair in any way the subordination contemplated by the InterCo Deed of Charge or any other Transaction Document.

This will not prevent any InterCo Secured Creditor from taking any steps against InterCo which do not amount to the initiation or the threat of initiation of insolvency proceedings against InterCo.

Certain of the rights, duties and discretions of the InterCo Security Trustee are subject to the direction or control of the InterCo Controlling Creditor.

“**InterCo Controlling Creditor**” means, at any time:

- (a) (i) the Issuer Controlling Creditor at that time, other than in respect of any InterCo Reserved Matters and for so long as any amounts (actual, contingent, current or future) are or may become payable by InterCo to the Issuer or the InterCo Loan Agreement remains outstanding;
- (ii) in respect of any InterCo Reserved Matters, the Noteholders (insofar as it relates to the InterCo Loan Agreement) and the Liquidity Facility Provider (insofar as it relates to the Liquidity Facility Agreement);
- (b) (i) Ambac, if (I) there is no person under (a) and (II) for so long as any amounts (actual, contingent, current or future) are or may become payable by InterCo to Ambac under or in connection with the InterCo Guarantee and Reimbursement Agreement (prior to the occurrence of an Ambac Termination Event), and (III) other than in respect of any InterCo Reserved Matters or InterCo Basic Terms Modification;
- (ii) in respect of any InterCo Reserved Matters, the Noteholders (insofar as it relates to the InterCo Loan Agreement) and the Liquidity Facility Provider (insofar as it relates to the Liquidity Facility Agreement);

- (c) the Liquidity Facility Provider, if (a) and (b) are not applicable and for so long as any amounts (actual, contingent, current or future) are payable by InterCo to the Liquidity Facility Provider or the Liquidity Facility remains outstanding;
- (d) the InterCo Swap Provider, if (a) to (c) (inclusive) are not applicable and for so long as any amounts (actual, contingent, current or future) are or may become payable by InterCo to the InterCo Swap Provider or the InterCo Swap remains in place and has not been terminated; or
- (e) the InterCo Subordinated Loan Provider if (a) to (d) (inclusive) are not applicable;

TRUST DEED

On or before the Closing Date, the Issuer, the Note Trustee and Ambac will enter into the Trust Deed (the “Trust Deed”).

ISSUER SUBORDINATED LOAN AGREEMENT

On or before the Closing Date, InterCo will enter into a subordinated loan agreement with, *inter alios*, the Issuer (the “**Issuer Subordinated Loan Agreement**”) under which InterCo will make available to the Issuer a limited recourse non-interest bearing loan facility up to an aggregate principal amount of £14,000,000. The aggregate principal amount outstanding of the advances made to the Issuer from time to time under the Issuer Subordinated Loan Agreement shall be the “**Issuer Subordinated Loan**”. The Issuer Subordinated Loan will be applied by the Issuer for the purpose of funding the InterCo Deposit.

There will be no interest payable on the Issuer Subordinated Loan.

Subject to the terms of the Issuer Subordinated Loan Agreement, on the earlier of (i) all Notes being redeemed in full and (ii) the Maturity Date of the Class A-2 Notes, and to the extent of the Issuer Available Funds remaining after paying or providing for payments with a higher ranking priority in the Issuer Priorities of Payments applicable on such date all amounts outstanding shall be repaid.

The Issuer Subordinated Loan shall be paid in accordance with the Issuer Subordinated Loan Agreement and subject to the provisions of the Issuer Deed of Charge, in sterling for value by or on behalf of the Issuer to such account as may be specified by InterCo.

INTERCO DEPOSIT AGREEMENT

On or before the Closing Date, the Issuer will enter into a deposit agreement (the “**InterCo Deposit Agreement**”) with, *inter alios*, InterCo under which the Issuer will deposit with InterCo the sum of £14,000,000 (the “**InterCo Deposit**”). The obligation of InterCo to repay an amount equal to the Deposit (the “**Deposit Amount**”) is a secured non-interest bearing obligation of InterCo intended to be used as a first loss amount. InterCo shall use the Deposit to fund the InterCo General Reserve Account on the Closing Date.

The Issuer shall not be entitled to withdraw or claim repayment of the Deposit Amount or any part thereof until the earlier of (i) the Loan Interest Payment Date falling in 2019 and (ii) the date on which no Notes remain outstanding and no amounts remain outstanding to Ambac under the Issuer Guarantee and Reimbursement Agreement or the InterCo Guarantee and Reimbursement Agreement.

ISSUER SWAP AGREEMENT

The Issuer will on or before the Closing Date enter into the Issuer Swap Agreement with the Issuer Swap Provider and will enter into the Issuer Fixed/Floating Swap and the Issuer Funding Swap.

Issuer Fixed/Floating Swap

Under the terms of the Issuer Fixed/Floating Swap:

- (a) on each Interest Payment Date the Issuer Swap Provider will pay to the Issuer an amount equal to the product of (i) the Issuer Swap Notional Principal in respect of such Interest Payment Date, (ii) 3 month (or, in the first Interest Period, an interpolation of 3 month and four month) LIBOR on such Interest Payment Date and (iii) the actual number of days in such Interest Period divided by 365 (or, if any portion of that Interest Period falls in a leap year, the sum of (i) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366 and (ii) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365); and

- (b) on each Loan Interest Payment Date, the Issuer will pay to the Issuer Swap Provider an amount equal to the product of (i) the Issuer Swap Notional Principal in respect of the Swap Fixed Interest Period ending on such Loan Interest Payment Date, (ii) a fixed swap rate of 4.906 per cent. per annum (the “**Issuer Swap Fixed Rate**”) and (iii) the actual number of days in such Interest Period divided by 365 (or, if any portion of that Interest Period falls in a leap year, the sum of (i) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366 and (ii) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365), (such amount being the “**Issuer Swap Fixed Amount**” in respect of the Loan Interest Period ending closest to such Loan Interest Payment Date)).

The LIBOR rate for the Issuer Fixed/Floating Swap will be fixed at the same rate as LIBOR on the Notes for the corresponding Interest Period.

Issuer Funding Swap

Under the terms of the Issuer Funding Swap:

- (a) on each Interest Payment Date, the Issuer Swap Provider will pay to the Issuer an amount equal to the product of (i) the Principal Amount Outstanding on the Notes in respect of such Interest Payment Date, (ii) the weighted average margin of the Notes over LIBOR rate of interest on the outstanding Notes in the Interest Period ending on such Interest Payment Date and (iii) the actual number of days in such Interest Period divided by 365 (or, if any portion of that Interest Period falls in a leap year, the sum of (i) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366 and (ii) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365) less the amount payable to the Issuer Swap Provider on such date; and
- (b) on each Loan Interest Payment Date, the Issuer will repay to the Issuer Swap Provider an amount equal to the amount received under (a) together with the interest thereon at LIBOR plus 0.40 per cent. per annum from the respective dates of payment.

Common Terms

The Issuer Fixed/Floating Swap and the Issuer Funding Swap will share certain common terms (as set out below except that the Issuer Funding Swap shall not be taken into account in calculating the Issuer Swap Partial Termination Amount).

“**Issuer Swap Notional Principal**” means £380,000,000 (as reduced by any partial termination).

“**Swap Fixed Interest Period**” has the same meaning as the equivalent term in respect of the Reinsurer Swap Agreement (see “*Summary of Transaction Documents – Reinsurer Swap Agreement*”) and the provisions of the Issuer Swap Agreement with respect to Withholding Tax and Limited Recourse are the same as the equivalent provisions in respect of the Reinsurer Swap Agreement, notwithstanding the word “Reinsurer” should be read as “Issuer” in respect of references to the “Reinsurer”, “Reinsurer Loan”, “Reinsurer Swap”, “Reinsurer Swap Notional Principal”, “Reinsurer Swap Breach Costs Discount Rate”, “Reinsurer Security” and the “Reinsurer Priorities of Payments”.

Partial Early Termination: If the Notes are redeemed in whole or part or the Reinsurer Swap Agreement is subject to Partial Early Termination as a result of a Claim being made under the Reinsurance Agreement or the Adjusted Sum Reinsured is otherwise reduced below the then Reinsurer Swap Notional Principal, the notional principal of the Issuer Fixed/Floating Swap will be terminated in whole or in part so that the remaining notional amount is equal to the lower of the Adjusted Sum Reinsured and the aggregate Principal Amount Outstanding on all the Notes and break costs will be payable by or to the Issuer in respect of such partial termination. An amount will be payable by or to the Issuer in respect of such partial early termination depending on whether the Issuer Swap is in-the-money to the Issuer (in which case the amount will be payable to the Issuer) or out-of-the-money to the Issuer (in which case the amount will be payable by the Issuer). The amount to be paid by or to the Issuer (the “**Issuer Swap Partial Termination Amount**”) will be calculated as follows. A hypothetical swap will be constructed with a floating rate payable to the Issuer and a fixed rate payable by the Issuer both equal to the respective rates in the Issuer Fixed/Floating Swap and with the same payment dates as the Issuer Fixed/Floating Swap. Its effective date will be the date of automatic partial early termination and its scheduled termination date will be the scheduled termination date of the Issuer Fixed/Floating Swap. It will have an initial notional amount equal to the amount by which the notional amount of the Issuer

Fixed/Floating Swap has been reduced on that date; the Issuer Swap Calculation Agent will calculate the value of such hypothetical swap, using standard market practices at mid-market. No partial termination payment will be payable in respect of the Issuer Funding Swap other than the repayment (with accrued interest) by the Issuer of amounts already funded by the Issuer Swap Provider prior to such termination in relation to the Issuer Swap Notional Principal which has been reduced as a result of the termination.

Termination Provisions: Save as provided below, the Issuer may terminate the Issuer Swap if there is an Event of Default or a Termination Event (each as defined in the Issuer Swap and summarised below) with respect to the Issuer Swap Provider and the Issuer Swap Provider may, terminate the Issuer Swap if there is an Event of Default or a Termination Event with respect to the Issuer. The Issuer Swap will contain termination events commonly found in standard 1992 ISDA Master Agreement documentation save for (i) the disapplication as regards the Issuer of the Events of Default relating to “Breach of Agreement”, “Credit Support Default”, “Misrepresentation”, “Default under Specified Transactions”, “Bankruptcy”, “Cross Default” and “Merger without Assumption” and (ii) the disapplication as regards both the Issuer and the Swap Provider of the Termination Events relating to “Tax Event”, “Tax Event upon Merger” and “Credit Event Upon Merger”.

The Issuer Additional Termination Events: The following shall constitute Additional Termination Events with respect to the Issuer:

- (a) an Issuer Event of Default (as defined in the Master Definitions Agreement dated on or about the Closing Date between, *inter alios*, the Issuer Swap Provider and the Issuer (the Master Definitions Agreement) occurs and the Issuer Security Trustee gives an Issuer Acceleration Notice to the Issuer that the Notes are to be immediately due and payable and the Issuer shall be the sole Affected Party.
- (b) an Early Termination Date (as defined in either of the InterCo Swap Agreement and the Reinsurer Swap Agreement) is designated under the InterCo Swap Agreement or the Reinsurer Swap Agreement.

Downgrade Termination Events and Termination

The provisions with respect to Downgrade Termination Events and Termination in respect of the Issuer Swap Agreement are the same as those in respect of the Reinsurer Swap (see “*Summary of the Transaction Documents – Reinsurer Swap Agreement*” above, save that the word “Reinsurer” should be read as “Issuer” with respect to references to the “Reinsurer”, “Reinsurer Swap”, “Reinsurer Swap Agreement”, “Reinsurer Swap Provider”, “Reinsurer Security Trustee” and “Reinsurer Secured Creditors” and reference to the “Reinsurer Loan” should be read as reference to the “Notes”).

Termination

Upon the occurrence of any Event of Default or Termination Event and subject to the foregoing paragraph, the Issuer Swap Agreement may be terminated in accordance with the detailed provisions thereof and a lump sum (the “**Termination Payment**”) may become payable by the Issuer to the Issuer Swap Provider or vice versa.

The Termination Payment will generally be based on the sum of (a) payments under the Issuer Swap Agreement that became due prior to the date on which the Issuer Swap Agreement is terminated, but remain unpaid and (b) an amount determined by obtaining firm quotations from at least three leading swap dealers of the amount that each such dealer would pay to, or be required to be paid by, the party obtaining such quotations in consideration for having that dealer enter into a hedge transaction with such party on the same terms as the hedge transaction that was terminated, for the remaining maturity of such hedge transaction (or if such market quotations are unavailable or do not produce a commercially reasonable result, the losses suffered by either the Issuer Swap Provider or the Issuer, as applicable, as a result of termination of the Issuer Swap Agreement).

The party making such determination will be the Non-defaulting Party (as defined in the Issuer Swap Agreement) in the case of the occurrence of an Event of Default, or upon the occurrence of a Termination Event where there is one Affected Party, the party making such determination will be the party which is not the Affected Party. Interest will be payable on any Termination Payment calculated as provided above from (and including) the relevant Early Termination Date to (but excluding) the date such amount is paid at the “**Default Rate**” determined as provided in the Issuer

Swap Agreement and shall continue to be so payable notwithstanding the occurrence of any Event of Default under the Notes and any failure to accelerate the Notes or to enforce the Issuer Security on the part of the Issuer Security Trustee or any of the Noteholders.

ISSUER DEED OF CHARGE

The Issuer will enter into the Issuer Deed of Charge on the Closing Date to grant security (the “**Issuer Security**”) to the Issuer Security Trustee on behalf of itself, the Noteholders, Ambac, the Note Trustee, any Receiver, the Paying Agents, the Agent Bank, the Issuer Account Bank, the Issuer Administrator, the Issuer Cash Manager, the Issuer Swap Provider, InterCo and the InterCo Security Trustee (together, the “**Issuer Secured Creditors**”).

Issuer Security

The Issuer will grant the following security (the “**Issuer Security**”) in order to provide security in respect of its obligations to the Issuer Secured Creditors:

- (1) an assignment, by way of first fixed security for the payment or discharge of the Issuer Secured Obligations, to and in favour of the Issuer Security Trustee of all of its rights, title, interest and benefit, existing at the date of the Issuer Deed of Charge or in the future, in, to, under or in respect of the:
 - (a) InterCo Loan Agreement;
 - (b) Issuer Subordinated Loan Agreement;
 - (c) Issuer Swap Agreement;
 - (d) InterCo Deposit Agreement;
 - (e) Agency Agreement;
 - (f) Issuer Account Bank Agreement;
 - (g) Issuer Guarantee and Reimbursement Agreement;
 - (h) Issuer Administration Agreement;
 - (i) Issuer Cash Management Agreement; and
 - (j) InterCo Deed of Charge,(together, the “**Issuer Assigned Agreements**”), and any other agreement, instrument or notice to which the Issuer becomes a party or in respect of which it has or may have any right, interest, title or benefit, either existing now or at any time in the future (the “**Issuer Other Secured Contractual Rights**”), including, without limitation:
 - (i) the benefit of all representations, warranties, covenants, undertakings and indemnities under or in respect of the Issuer Assigned Agreements and the Issuer Other Secured Contractual Rights;
 - (ii) all of its rights to receive payment of any amounts which may become payable to it pursuant or with respect to such Issuer Assigned Agreements and Issuer Other Secured Contractual Rights;
 - (iii) all payments received by it pursuant to, or with respect to, such Issuer Assigned Agreements and Issuer Other Secured Contractual Rights;
 - (iv) all its rights to serve notices and/or make demands pursuant to such Issuer Assigned Agreements and Issuer Other Secured Contractual Rights and/or to take such steps as are required to cause payments to become due and payable thereunder or with respect to such Issuer Assigned Agreements and Issuer Other Secured Contractual Rights;
 - (v) all of its rights of action in respect of any breach of such Issuer Assigned Agreements or Issuer Other Secured Contractual Rights; and
 - (vi) all of its rights to receive damages, compensation or obtain other relief, including in respect of any breach of or default in respect of such Issuer Assigned Agreements or Issuer Other Secured Contractual Rights.
- (2) a charge, by way of first fixed security for the payment or discharge of the Issuer Secured Obligations, to and in favour of the Issuer Security Trustee of all of its right, title, interest and benefit, existing at the date of the Issuer Deed of Charge or in the future, in and to the Issuer Bank Accounts and all sums of moneys which may be at or after the date of the Issuer Deed

of Charge from time to time standing to the credit of the Issuer Bank Accounts and any other bank account or book debt in which Issuer may at any time acquire any right, title, interest or benefit and each debt represented by these, including all interest accrued and other moneys received in respect thereof.

- (3) a charge by way of first fixed security for the payment or discharge of the Issuer Secured Obligations, to and in favour of the Issuer Security Trustee of all of its right, title, interest and benefit, existing at the date of the Issuer Deed of Charge or in the future, in and to the Issuer Eligible Investments and other securities and investments which the Issuer may at any time acquire, make or otherwise obtain an interest or benefit in, together with all moneys, received in respect thereof and all interest accruing on them from time to time, all dividends and distributions paid or payable thereon, all property paid, distributed, accruing or offered at any time on, to or in respect of or in substitution therefor and the proceeds of sale, redemption or discharge thereof and the benefit of all covenants relating to such Issuer Eligible Investments and other Securities and all rights and remedies for enforcing the same.
- (4) a charge to and in favour of the Issuer Security Trustee, by way of first floating charge for the payment or discharge of the Issuer Secured Obligations, of the whole of its undertaking and all of its property and assets whatsoever and wheresoever situate, present and future, other than any property or assets from time to time or for the time being effectively charged by way of fixed charge, or otherwise assigned as security, pursuant to the Issuer Deed of Charge.

Issuer Priorities of Payment

Issuer Pre-Acceleration Priority of Payments

Notwithstanding the security interests created by or pursuant to the Issuer Deed of Charge, on each Interest Payment Date which is also a Loan Interest Payment Date which falls prior to the delivery of an Note Acceleration Notice the Issuer Cash Manager shall, subject to obtaining the prior consent of the Issuer Security Trustee pursuant to the Issuer Deed of Charge, instruct the Issuer Account Bank to withdraw Issuer Available Funds standing to the credit of the Issuer Transaction Account (but only to the extent that such withdrawal does not cause the Issuer Transaction Account to become overdrawn), to be applied in the order of priority set out in Condition 3(j) (*Status, Priority and Security – Issuer Transaction Account – Pre-Acceleration Priority of Payments*).

Payments to Noteholders

Notwithstanding the security interests created by or pursuant to the Issuer Deed of Charge, on each Interest Payment Date which is not a Loan Interest Payment Date which falls prior to the delivery of a Note Acceleration Notice by the Note Trustee, the Issuer Cash Manager, as agent for the Issuer shall, subject to obtaining the prior consent of the Issuer Security Trustee pursuant to the provisions of the Issuer Deed of Charge, instruct the Issuer Account Bank to withdraw Issuer Available Funds standing to the credit of the Issuer Transaction Account (but only to the extent that such withdrawal does not cause the Issuer Transaction Account to become overdrawn) to be applied in or towards satisfaction, of all amounts of interest which are then due and payable under the Notes.

Intra-Period Expenses/Issuer Reserve Account

Notwithstanding the security interests created by or pursuant to the Issuer Deed of Charge, on any Business Day prior to the service of a Note Acceleration Notice, the Issuer Cash Manager, as agent for the Issuer, may, subject to obtaining the prior consent of the Issuer Security Trustee pursuant to the Issuer Deed of Charge, instruct the Issuer Account Bank to withdraw moneys standing to the credit of the Issuer Reserve Account (but only to the extent that such withdrawal does not cause the Issuer Reserve Account to become overdrawn) to pay any amounts that are due and payable in respect of any costs, charges, liabilities and expenses of the Issuer Security Trustee and/or the Note Trustee and any other amounts that are due and payable of the type described in subparagraph (v) Condition 3(j).

Intra-Period Expenses/Issuer Share Capital Account

Notwithstanding the security interests created by or pursuant to the Issuer Deed of Charge, on any Business Day prior to the service of a Note Acceleration Notice, the Issuer Cash Manager, as agent

for the Issuer, may, subject to obtaining the prior consent of the Issuer Security Trustee pursuant to the Issuer Deed of Charge, instruct the Issuer Account Bank to withdraw moneys standing to the credit of the Issuer Share Capital Account (but only to the extent that such withdrawal does not cause the Issuer Share Capital Account to become overdrawn) to pay a dividend equal to, in respect of the financial period ending 31 December 2005, £21,000 (together with an amount equal to VAT which would be payable at the then current standard rate on an amount equal to such amount) and, in respect of any subsequent financial year, £7,000 (together with an amount equal to VAT which would be payable at the then current standard rate on an amount equal to such amount).

Issuer Post-Acceleration Priority of Payments

All monies received or recovered by the Issuer Security Trustee or the Receiver for the benefit of the Issuer Secured Creditors in respect of the Issuer Secured Obligations following the delivery of a Note Acceleration Notice shall be held by the Issuer Security Trustee or the Receiver, as the case may be, on trust, and shall be applied in the order of priority set out in Condition 3(k) (*Status Priority and Security – Issuer Post-Acceleration Priority of Payments*).

Suspense Account

Following service of a Note Acceleration Notice, the Issuer Security Trustee may at its absolute discretion pending application thereof pursuant to the Issuer Deed of Charge deposit all amounts from time to time received by it from the Issuer or any person or persons liable to pay or in respect of the Issuer Charged Property or from the realisation or enforcement of the Issuer Security in a separate suspense account for so long as, and on the terms which, it considers appropriate without any obligation to apply the same or any part thereof in or towards the discharge of any of the Issuer Secured Obligations.

the Issuer Charged Property on Trust

To the extent permitted to do so under the Transaction Documents, for the purpose of giving effect to the Issuer Deed of Charge, the Issuer agrees that, after service of a Note Acceleration Notice, it will hold all of the Issuer Charged Property to which it is entitled (subject to the right of redemption of any obligor) upon trust to convey, assign or otherwise deal with such the Issuer Charged Property in accordance with the the Issuer Security Trustee's directions.

Conflicts of Interest

Subject to the Issuer Deed of Charge, the Issuer Security Trustee shall have regard to the interests of the Issuer Secured Creditors as a whole as regards the exercise and performance of all powers, trusts, authorities, duties and discretions of the Issuer Security Trustee in respect of the Issuer Security under the Issuer Deed of Charge and each of the other Transaction Documents or the rights or benefits which are comprised in the Issuer Security (except where expressly provided otherwise). Without prejudice to the generality of the foregoing or to the obligations of the Issuer Cash Manager under the Issuer Cash Management Agreement, the Issuer Security Trustee shall be under no obligation to take any steps to call in or to enforce the rights of the Issuer under or in respect of the Issuer Charged Property and shall not be liable for any loss arising from any omissions on its part to take any such steps.

The Issuer Security Trustee will have regard only:

- (a) to the interests of Ambac (for so long as Ambac is the Issuer Controlling Creditor (other than with respect to the Reserved Matters or, save to the extent provided in Condition 13(d), any Basic Terms Modification) if in the Issuer Security Trustee's opinion, there is a conflict between the interests of:
 - (i) Ambac; and
 - (ii) any other Issuer Secured Creditor;
- (b) to the interests of Noteholders, in all other cases whilst any amounts are payable (currently or in the future and whether or not subject to any contingency or condition) under any Notes (other than with respect to the Reserved Matters) for so long as there are any Notes outstanding, if in the Issuer Security Trustee's opinion, there is a conflict between the interests of:
 - (i) the Noteholders; and

- (ii) the other Issuer Secured Creditors; and
- (c) if Ambac is not the Issuer Controlling Creditor (other than with respect to the Reserved Matters or, save to the extent provided in Condition 13(d), any Basic Terms Modification) and there are no Notes outstanding, to the interests of the Issuer Secured Creditor (other than the Issuer Security Trustee or the Issuer Administrator) ranking highest in the then applicable Issuer Priorities of Payments and, if more than one has the same level of ranking, the Issuer Secured Creditor owed the largest amount and having such level of such ranking.

So long as any of the Notes remain outstanding, the Issuer Security Trustee is not required to have regard to the interest of any Issuer Secured Creditor other than those specified in (a) to (c) above.

Upon Enforcement

With immediate effect from the date upon which the Issuer Security Trustee gives an Issuer Enforcement Notice to the Issuer, the whole of the Issuer Security shall become enforceable and:

- (a) no payments shall be made out of the Issuer Accounts without the prior written consent of the Issuer Security Trustee;
- (b) if not already crystallised the charge created by the Issuer Deed of Charge which is a floating charge shall automatically crystallise;
- (c) the Issuer may not sell, realise or otherwise dispose of any Eligible Investment except with the prior written consent of the Issuer Security Trustee;
- (d) the Issuer Security Trustee shall be entitled to take such proceedings against the Issuer as it may think fit to enforce all or any part of the Issuer Security pursuant to and in accordance with the provisions of the Issuer Deed of Charge and to enforce payment in respect of the Issuer Secured Obligations; and
- (e) all proceeds of enforcement of the Issuer Security and any payment or distribution of any kind or character, whether in cash, securities or other property which is payable or deliverable upon or with respect to any of the Issuer Secured Obligations or any part thereof by the Issuer shall immediately be paid or delivered directly to or to the order of the Issuer Security Trustee for application in accordance with the Issuer Deed of Charge.

Issuer Deed of Charge representations, warranties and covenants: the Issuer will covenant, represent and warrant to the Issuer Security Trustee, for itself and for the benefit of the Issuer Secured Creditors, in relation to matters common for transactions of this nature.

In addition, the Issuer will undertake with the Issuer Security Trustee and the Issuer Controlling Creditor in relation to matters common for this type of transaction.

Limited Recourse: notwithstanding any other provision of the Issuer Deed of Charge or any other Transaction Document but subject as provided below, each of the Issuer Secured Creditors that is a party to the Issuer Deed of Charge shall acknowledge and agree with the Issuer and the Issuer Security Trustee that:

- (a) it will only have recourse in respect of any amount, claim or obligation due or owing to it by the Issuer under or in connection with the Issuer Deed of Charge or under any other Transaction Documents (the “**Issuer Claims**”) to the extent of available funds in accordance with the Issuer Priorities of Payments which shall be applied by the Issuer or, as the case may be, the Issuer Security Trustee subject to and in accordance with the terms of the Issuer Deed of Charge and after all prior ranking claims in respect of those funds have been paid or discharged in full in accordance with the Issuer Priorities of Payments;
- (b) if, after enforcement of the Security Interests created by the Issuer Deed of Charge to the greatest extent practicable and the application of the proceeds of enforcement in accordance with the priority of payments set out in the Issuer Post Acceleration Priority of Payments any Issuer Claim remains outstanding, that Claim shall be extinguished and such Issuer Secured Creditor shall have no further claim against the Issuer,

provided always that the obligation of the Issuer to pay interest and principal in respect of the Notes shall not be subject to (a) and (b) above.

Non Petition: each of the Issuer Secured Creditors that is a party to the Issuer Deed of Charge shall acknowledge and agree with each other and with the Issuer and the Issuer Security Trustee, that it shall not take or join in taking any corporate action or other steps or legal proceedings in respect of Insolvency Proceedings.

Enforcement of Issuer Security: each of the Issuer Secured Creditors that is a party to the Issuer Deed of Charge shall agree and acknowledge with the Issuer and the Issuer Security Trustee that:

- (a) only the Issuer Security Trustee (or any Receiver where applicable) is entitled to enforce the Issuer Security;
- (b) unless otherwise provided for in the Issuer Deed of Charge, such Issuer Secured Creditor (other than the Issuer Controlling Creditor) shall not take any steps to direct the Issuer Security Trustee to enforce the Issuer Security or any part of it nor take any steps or pursue any action whatsoever for the purpose of recovering any debts due or owing to it by the Issuer or in respect of Insolvency Proceedings in respect of the Issuer unless the Issuer Security Trustee having become bound to take any steps or proceedings to enforce the Issuer Security fails to do so within a reasonable period of becoming so bound and such failure is continuing (in which case each Issuer Secured Creditor shall be entitled to take any such steps and proceedings as it shall deem necessary provided that an Issuer Secured Creditor (other than Ambac for so long as Ambac is the Issuer Controlling Creditor and thereafter the Note Trustee (acting on behalf of the Noteholders)) shall not take any steps or proceedings which would lead to the commencement of Insolvency Proceedings in respect of the Issuer); and
- (c) in the case of each of the Issuer Secured Creditors that is a party to the Issuer Deed of Charge, it shall not exercise or claim any right of set off or combination (unless expressly provided for under the terms of the Transaction Documents) or lien in respect of any Issuer Secured Obligation owed to it or take any Security Interest or guarantee or other assurance therefore or take or do or omit to take or do any act or thing to prejudice or impair in any way the subordination contemplated by the Issuer Deed of Charge or any other Transaction Document.

This will not prevent any Issuer Secured Creditor from taking any steps against the Issuer which do not amount to the initiation or the threat of initiation of insolvency proceedings against the Issuer.

Certain of the rights, duties and discretions of the Issuer Security Trustee are subject to the direction or control of the Issuer Controlling Creditor.

“Issuer Controlling Creditor” means:

- (a) other than in respect of any Reserved Matter or Basic Terms Modification:
 - (i) Ambac, prior to the occurrence of an Ambac Termination Event;
 - (ii) the Noteholders at any time following the occurrence of an Ambac Termination Event, at which any amount remains outstanding under the Notes; and thereafter
 - (iii) the Issuer Secured Creditor ranking highest in the Issuer Priorities of Payments then applicable (or, if more than one ranking *pari passu*, the one owed the largest amounts);
- (b) in the case of any Reserved Matter or Basic Terms Modification, the Noteholders;

Obligation of the Issuer Security Trustee to enforce

The Issuer Security Trustee shall only be bound to take action to enforce the Issuer Security if:

- (a) it shall have been so directed in writing by the Issuer Controlling Creditor; and
- (b) it shall first have been indemnified and/or secured to its satisfaction.

ISSUER ADMINISTRATION AGREEMENT

On or before the Closing Date, the Issuer will enter into an administration agreement (the **“Issuer Administration Agreement”**) with the Issuer Administrator under which the Issuer Administrator will agree to provide corporate administration services to the Issuer.

The Issuer Administrator will be entitled to charge a fee per annum, payable on each Loan Interest Payment Date subject to the Issuer having sufficient funds available to pay out of the Issuer Available Funds having paid all other higher ranking amounts in the InterCo Priorities of Payments.

ISSUER ACCOUNT BANK AGREEMENT

On or before the Closing Date, the Issuer will enter into a bank account agreement (the **“Issuer Account Bank Agreement”**) with the Issuer Account Bank pursuant to which the Issuer will establish a transaction bank account (the **“Issuer Transaction Account”**), a share capital account

(the “**Issuer Share Capital Account**”) and an expenses reserve account (the “**Expenses Reserve Account**”) (together, the “**Issuer Accounts**”).

ISSUER CASH MANAGEMENT AGREEMENT

On or before the Closing Date, the Issuer and, *inter alios*, the Issuer Cash Manager will enter into a cash management agreement (the “**Issuer Cash Management Agreement**”) under which the Issuer Cash Manager will agree to provide cash management services to the Issuer.

The Issuer Cash Manager will be entitled to charge a fee per annum, payable on each Loan Interest Payment Date subject to the Issuer having sufficient funds available to pay out of the Issuer Available Funds having paid all other higher ranking amounts in the Issuer Priorities of Payments.

THE EXPENSES LOAN AGREEMENT

On or before the Closing Date, the Issuer will enter into an expenses loan agreement with, *inter alios*, FPLP under which FPLP will agree to advance to the Issuer on the Closing Date £100,000 to enable the Issuer to fund certain ongoing costs and expenses associated with the transaction (the “**Expenses Loan Agreement**”).

The advance made under the Expenses Loan Agreement (the “**Expenses Loan**”) will be made on the Closing Date and is a limited recourse obligation of the Issuer.

The period for which the Expenses Loan is outstanding will be divided into successive periods which match the Loan Interest Periods in respect of the Reinsurer Loan Agreement and the Issuer Subordinated Loan Agreement (each an “**Expenses Loan Interest Period**”).

In relation to the Expenses Loan, the Interest Payment Date falling in April of each year (or, if such day is not a Business Day, the immediately succeeding Business Day) will be the “**Expenses Loan Interest Payment Date**”.

The rate of interest payable under the Expenses Loan Agreement will be payable annually in arrears at LIBOR plus 1 per cent. per annum (the “**Expenses Loan Interest Rate**”) and is payable in accordance with the Issuer Priorities of Payment. Unpaid interest is deferred.

Interest will be paid subject to withholding or deduction for or on account of tax. To the extent any amount is required to be withheld or deducted for or on account of tax, the Issuer will not be required to pay any additional amounts.

The Expenses Loan will be repayable on the Final Maturity Date (to the extent there are Issuer Available Funds remaining after paying or providing for payments with a higher ranking priority in the Issuer Priorities of Payment).

AMBAC ISSUER SWAP FINANCIAL GUARANTEE

On or before the Closing Date, Ambac will issue in favour of the Issuer Swap Provider, an unconditional and irrevocable financial guarantee (the “**Ambac Issuer Swap Financial Guarantee**”) in respect of the Issuer’s obligations to pay the Issuer Swap Fixed Amount under the Issuer Fixed/Floating Swap and repay the amounts funded in advance by the Issuer Swap Provider under the Issuer Funding Swap.

AMBAC NOTE FINANCIAL GUARANTEE

On or before the Closing Date, Ambac will issue in favour of the Issuer, an unconditional and irrevocable financial guarantee (the “**Ambac Note Financial Guarantee**”) in respect of the Issuer’s obligations to pay Scheduled Interest and Ultimate Principal under the Notes.

ISSUER AMBAC FEE LETTER

On or before the Closing Date, the Issuer and Ambac will enter into an arrangement under a fee letter (the “**Issuer Ambac Fee Letter**”) whereby the Issuer will agree to pay to Ambac certain fees, on the terms as set out in the Issuer Ambac Fee Letter, in consideration for the provision by Ambac of the Ambac Note Financial Guarantee and the Ambac Issuer Swap Financial Guarantee.

ISSUER GUARANTEE AND REIMBURSEMENT AGREEMENT

On or before the Closing Date, the Issuer and Ambac will enter into a guarantee and reimbursement agreement (the “**Issuer Guarantee and Reimbursement Agreement**”) under which the Issuer will be obliged, *inter alia*, to reimburse Ambac in respect of any payments made by

Ambac under the Ambac Note Financial Guarantee and/or the Ambac Issuer Swap Financial Guarantee and will be obliged to pay any fees and expenses of Ambac in respect of the provision of the Ambac Note Financial Guarantee and/or the Ambac Issuer Swap Financial Guarantee.

In so far as Ambac makes payments under the Ambac Note Financial Guarantee and/or the Ambac Issuer Swap Financial Guarantee, it shall be subrogated to the rights of the Noteholders against the Issuer or the Issuer Swap Provider against the Issuer (as applicable) in respect of any payments so made. Payments due to Ambac pursuant to the Issuer Guarantee and Reimbursement Agreement will be paid in accordance with the terms (including the Issuer Priorities of Payments) of the Issuer Deed of Charge and such payment obligations will be limited recourse obligations of the Issuer.

Under the Issuer Guarantee and Reimbursement Agreement, for so long as Ambac is the Issuer Controlling Creditor, Ambac will be entitled to control how the Issuer Security Trustee enforces its rights. By virtue of the provisions of the Issuer Deed of Charge, the InterCo Deed of Charge and the Reinsurer Deed of Charge, the effect is that, for so long as Ambac is the Issuer Controlling Creditor, the InterCo Controlling Creditor and the Reinsurer Controlling Creditor, Ambac will control the actions of the Issuer Security Trustee, the InterCo Security Trustee and the Reinsurer Security Trustee under, respectively, the Issuer Deed of Charge, the InterCo Deed of Charge and the Reinsurer Deed of Charge.

Notwithstanding that the Notes are full recourse obligations of the Issuer, Ambac agrees with the Issuer that its rights in respect of subrogation and reimbursement will be subject to limit on recourse.

USE OF PROCEEDS

The gross proceeds from the issue of the Notes (from which there will be no deduction) will be approximately £380,000,000.

On the Closing Date, the Issuer will lend to InterCo under the InterCo Loan Agreement an aggregate principal amount of approximately £380,000,000 as described in “*Summary of Transaction Documents – InterCo Loan Agreement*” above. InterCo will immediately thereafter on-lend the proceeds of the InterCo Loan to the Reinsurer under the Reinsurer Loan as described in “*Summary of Transaction Documents – Reinsurer Loan Agreement*” above.

An amount equal to the fees and expenses incurred by the Issuer in connection with the issue and listing of the Notes will be funded by the Issuer out of the InterCo Initial Commitment Fee. No fees and expenses incurred by the Issuer in connection with the issue and listing of the Notes will be deducted from the gross proceeds of the Notes.

On or following the Closing Date, the Reinsurer will use the proceeds of the Reinsurer Loan and some of its capital to purchase Reinsurer Eligible Investments which form part of the assets backing the reserves required for the Reinsurance Agreement under which it reinsures liabilities of FPLP which will be held in the Reinsurer’s Long Term Business Fund; the balance will be invested in Reinsurer Eligible Investments to be held in the Reinsurer’s Shareholder Fund.

FPLP

Friends Provident Life and Pensions Limited (“FPLP”) was incorporated on 25 October 2000 under the Companies Acts 1985 and 1989 (as amended) as a company with limited liability in England and Wales and registered in England and Wales with registered number 4096141.

The authorised share capital of FPLP is £2,000,000,000 divided into 1,700,000,000 ordinary shares of £1 each of which £653,750,000 are issued and fully paid and 300,000,000 non-cumulative preference shares (4.8125 per cent.) of £1 each of which 300,000,000 are issued and fully paid, both issues being held by Friends Provident plc, the holding company of the Friends Provident Group.

The principal objects of FPLP are, *inter alia*, to carry on all kinds of long-term insurance business.

The auditors of FPLP are KPMG Audit Plc of 7th Floor, 1 Canada Square, London E14 5AG.

Principal Subsidiaries and Associated Undertakings of FPLP

The principal subsidiaries and associated undertakings of FPLP at the date of this Offering Circular are shown below.

Except where stated, each of these is wholly owned and incorporated in England and Wales and has only one class of issued ordinary shares. The voting rights are equal to the percentage holdings unless otherwise stated. Other subsidiaries do not materially affect FPLP.

	Percentage held
Friends Provident Pensions Limited	100
Friends Provident International Limited ⁽ⁱ⁾	100
Friends Provident Investment Holdings PLC ⁽ⁱⁱ⁾	100
Friends Provident Life Assurance Limited	100*
Friends Milestones Limited	100
FP Finance PLC	100
Friends Provident Reinsurance Services Limited ⁽ⁱⁱ⁾	100
Friends Provident Marketing Limited	100
London Capital Holdings Limited	
Ordinary shares	
— Direct Holding	65
— Indirect Holding	35*
Deferred shares	
— Direct Holding	84
— Indirect Holding	16*

* held by subsidiary

(i) Registered in the Isle of Man. Name changed from Royal & SunAlliance International Financial Services Limited on 15 August 2002.

(ii) Has issued class ‘A’ and ‘B’ ordinary shares.

Directors

The directors of FPLP are:

Name	Responsibility in relation to FPLP	Other significant directorships
Keith Satchell, BSc, FIA	Executive Chairman	Friends Provident plc Banco Comercial Português SA European Alliance Partners Company AG FP Finance PLC F&C Asset Management plc Swiss Mobiliar Cooperative Company
Graham Kenneth Aslet, MA, FIA	Executive Director and Actuary	Friends Provident plc FP Finance PLC
Simon John Clamp, BSc	Executive Director	None
Alastair Roy Geoffrey Gunn, MA, FCII	Executive Director	Friends Provident plc
Michael Anthony Hampton, MA, FPMI	Executive Director	None
Graham Harvey, FCCA, MBA	Executive Director	None
Andrew Philip Jackson, BSc, FIA	Executive Director	None
Jamie Robert McIver	Executive Director	None
Philip Wynford Moore, TD, MA, FIA	Executive Director	Friends Provident plc FP Finance PLC
Jane Stevens BSc, FIA	Executive Director	None
Paul Thomas Tunnicliffe MSc	Executive Director	None

The Secretary of FPLP is Brian William Sweetland.

The registered and head office of FPLP and the business address of each of the directors for matters covering the FPLP business is Pixham End, Dorking, Surrey, RH4 1QA.

CAPITAL AND INDEBTEDNESS

The following table sets out the capitalisation and indebtedness of FPLP as extracted without adjustment from the consolidated unaudited accounts of FPLP as at 30 June 2004 and the underlying financial records of FPLP:

	30 June 2004 £m
Borrowings	
Subordinated loan from FP Finance PLC to FPLP repayable between 2 and 5 years	215
Total borrowings	215
Shareholders' funds	
Ordinary share capital ⁽¹⁾	654
4.8125 per cent. non-cumulative preference shares	300
Share premium account	722
Profit and loss account	348
Total shareholders' funds	2,024

(1) The authorised share capital of FPLP is £2,000,000,000, divided into 1,700,000,000 ordinary shares of £1 and 300,000,000 4.8125 per cent. non-cumulative preference shares of £1 each, of which 653,750,000 ordinary shares and 300,000,000 4.8125 per cent. non-cumulative preference shares were issued at 30 June 2004 and are fully paid up.

(2) Guarantees:

- (a) On 25 November 1996 FP Finance PLC, then a wholly owned subsidiary of Friends' Provident Life Office, issued £215,000,000 of 9.125 per cent. Undated Subordinated Guaranteed Bonds, guaranteed by FPLO. The borrowing is unsecured and redemption is at the option of FP Finance PLC and is not generally allowable prior to 25 November 2006. The Bonds were guaranteed on a subordinated basis by FPLO after the claims of FPLO's senior creditors including all policyholder liabilities. On 9 July 2001, FPLO demutualised under the terms of a scheme under Schedule 2C to the Insurance Companies Act 1982, and FPLP replaced FPLO as the guarantor of the bonds. The market value of the bonds at 30 June 2004 was £228,000,000 (31 December 2003: £232,000,000).
 - (b) £32,256,756 of loan notes issued by FP Business Holdings Limited on 25 November 1998 are fully paid, unsecured and guaranteed by FPLP. The loan Noteholders exchanged these loan notes for identical loan notes issued by Friends Provident Investment Holdings PLC on 13 April 2004. The notes are repayable at par in 2006 and may be redeemed at the holder's request on set dates in any year until 2006. £8,869,263 of these loan notes remained outstanding at 30 June 2004.
 - (c) On 21 November 2003, Friends Provident plc issued £300,000,000 6.875 per cent. Step-up Tier one Insurance Capital Securities ("STICS"), guaranteed by FPLP on a subordinated basis with the intention of providing the holders with rights against the company in respect of guaranteed payments as nearly as possible as if the STICS had been directly issued preference shares of FPLP. The STICS have no maturity date but may be redeemed at the request of Friends Provident plc on 21 November 2019 and subsequently, on the coupon date falling on or nearest the successive fifth anniversaries of this date. Interest is payable semi-annually in arrears on 21 May and 21 November each year.
 - (d) FPLP has given a guarantee to FP Business Holdings Limited ("FPBH") for up to £45 million (expiring on 31 December 2007), to cover the failure of FPBH to pay any debt or claim following its capital reduction. As a result of the pending dissolution of FPBH, the guarantee has been transferred to Friends Provident Investment Holdings plc, the immediate holding Company of FPBH.
- (3) Contingent liabilities of FPLP: FPLP has contingent liabilities in respect of mortgage endowment complaints, future reviews in respect of the suitability of past sales of other products and provisions in connection with policyholder contracts. Please refer to Note 30 of the audited FPLP's Modified Statutory Accounts for the year ended 31 December 2003 and page 181 below (Other Complaints). All complaints received by the Group, in respect of mortgage endowment policies and an estimate of complaints not yet received, have been provided for at an estimate of the likely costs of settling such complaints. Future regulatory actions or statements could change the estimated costs. The impact of such potential future actions cannot be estimated with reliability. The endowment complaint provision (accounting provision and actuarial reserve) was increased to £104,000,000 at 30 June 2004 (end 2003; £64,000,000). The majority of complaints relate to With Profits Fund policies. Of the £72,000,000 charge made in the first half of 2004, £10,000,000 relates to pre-demutualisation unit linked policies.
- (4) Except as disclosed above, FPLP had, as at 30 June 2004, no borrowings, indebtedness, material guarantees or material contingent liabilities.
- (5) All material amounts of the above borrowings are unsecured.
- (6) There has been no material change in the capitalisation or indebtedness or contingent liabilities or guarantees of FPLP since 30 June 2004.

Corporate History

Friends' Provident Life Office ("FPLO") was established as a friendly society in 1832 and was subsequently incorporated and regulated as a mutual life assurance company. In 1998, FPLO merged its asset management business with Ivory & Sime plc to create Friends Ivory & Sime plc ("FIS") as a separately listed asset management subsidiary. FIS subsequently changed its name to ISIS Asset Management plc ("ISIS"). In 1998 FPLO acquired London and Manchester Group plc. In 2001, FPLO demutualised and the whole of the life assurance business of FPLO was transferred to FPLP, a newly incorporated life assurance company. Friends Provident plc, as the new holding company for the Group, was listed on the London Stock Exchange on 9 July 2001. As part of the listing, the Friends Provident Group raised £1,600,000,000 of new capital, £1,200,000,000 of which was used to increase the financial strength of FPLP and its subsidiary, Friends Provident Pensions Limited, through which the new pension business for the Friends Provident Group is written. Most new life assurance business has been written through Friends Provident Life Assurance Limited since 1 January 2004. In 2004, ISIS acquired F&C Group (Holdings) Limited and changed its name to F&C Asset Management plc.

THE LIFE AND PENSIONS BUSINESS

FPLP and its subsidiaries operate primarily in the UK and selected international markets mainly targeting the protection, pensions and discretionary savings and investment markets. Its new business annualised premium equivalent ("APE") in 2003 was £429 million and in the nine months ended 30 September 2004 was £323.4 million, up 3.5 per cent. on the nine months to 30 September 2003 (2003: £312.5 million). FPLP and its subsidiaries distribute a comprehensive range of pension, protection, annuity and savings products to both corporate and individual clients.

Life and Pensions new business

The table below shows FPLP's and its subsidiaries' gross new business premiums, including APE, by class of business for the years ended 31 December 2003 and 2002:

	Year ended 31 December 2003			Year ended 31 December 2002			Change in APE per cent.
	Regular Premiums £m	Single Premiums £m	APE £m	Regular Premiums £m	Single Premiums £m	APE £m	
Life							
Protection	69	—	69	45	—	45	53
Savings and investment	41	730	114	25	717	97	18
	<u>110</u>	<u>730</u>	<u>183</u>	<u>70</u>	<u>717</u>	<u>142</u>	
Pensions							
Individual pensions	14	264	40	18	281	46	(13)
Group pensions	134	420	176	137	214	158	11
Annuities	-	294	30	-	307	31	(3)
	<u>148</u>	<u>978</u>	<u>246</u>	<u>155</u>	<u>802</u>	<u>235</u>	
Total Life and Pensions	<u>258</u>	<u>1,708</u>	<u>429</u>	<u>225</u>	<u>1,519</u>	<u>377</u>	14

Life Business

New Life APE increased by 16.2 per cent. to £151.3 million in the first nine months of 2004 (2003: £130.2 million) and by 5.7 per cent. for the third quarter of 2004 to £53.5 million (2003: £50.6 million).

New protection business, including income protection, increased by 21.5 per cent. to £58.3 million in the first nine months of 2004 (2003: £48 million) and by 7.5 per cent. for the third quarter to £21.4 million (2003: £19.9 million).

New investment business increased by 13.1 per cent. to £93 million in the first nine months of 2004 (2003: £82.2 million) and by 4.6 per cent. for the third quarter to £32.1 million (2003: £30.7 million). More than half (£50.1 million) of investment new business comes from FPLP's and its subsidiaries' international operations.

Pensions Business

New pensions APE decreased by 5.6 per cent. to £172.1 million in the first nine months of 2004 (2003: £182.3 million) and by 9.1 per cent. for the third quarter of 2004 to £57.8 million (2003: £63.6 million).

New group pensions business decreased by 3.7 per cent. to £124.9 million in the first nine months of 2004 (2003: £129.7 million) and by 13.1 per cent. for the third quarter to £38.4 million (2003: £44.2 million).

New individual pensions business decreased by 12.4 per cent. to £24.8 million in the first nine months of 2004 (2003: £28.3 million) and by 5.3 per cent. for the third quarter to £12.4 million (2003: £13.1 million). FPLP's position remains to focus on the more profitable segments of pensions business, which are currently within the group market.

New annuity business decreased by 7.8 per cent. to £22.4 million in the first nine months of 2004 (2003: £24.3 million) but increased by 11.1 per cent. for the third quarter to £7 million (2003: £6.3 million). FPLP continues to focus on maintaining adequate margins over volumes for annuity business.

With Profits Business

The With Profits market continues its decline and accounted for only 7 per cent. of total new business in the first nine months of 2004 (2003: 13 per cent.) and for 2 per cent. of new savings and investment business (2003: 9 per cent.).

Products

FPLP and its subsidiaries offer a wide range of life and pensions products.

The protection products offered include term assurance and income protection, providing protection in the event of death, critical illness and disability. In March 2004, the Group launched eSelect Protection which enables IFAs to write term assurance, waiver of premium and critical illness business via the internet and features quotes, pre-populated applications, interactive underwriting and electronic processing through to policy issue. This has now been further advanced by the launch of the Group's online Income Protection application.

The savings and investment range of products includes the following single premium products: the Investment Portfolio Bond and the Income Distribution Bond. A range of regular premium savings products is offered, giving access to various unit linked funds and unitised with profits funds. In the final quarter of 2003, the Group introduced a dedicated multi-manager fund proposition to the Group's investment bond business, and also the UK Safeguard Optimiser fund which was designed to offer smoothed returns from the UK equity market whilst providing some protection against stock market falls.

In the pensions market, leading pensions systems have been developed for FPLP's New Generation pension plans. The focus of these products is to use technology to enhance services and reduce administration costs so as to compete effectively. FPLP and its subsidiaries also write pension annuities for its own maturing pension monies and those moving from other life insurance companies. An alternative is offered in the form of a self-invested personal pension. In July 2003, the Group launched its multi-manager facility, "Activ Investment Solutions", for the group pensions market which widens the range of funds and fund managers available to Group customers.

Distribution

UK IFAs are the primary distributors of FPLP's products, accounting for 67 per cent. of FPLP's new business in the nine months ended 30 September 2004 (2003: 63 per cent.). International new business contributed 17 per cent. of the nine months' total (2003: 16 per cent.).

Depolarisation, the new framework for the marketing of products, is expected to be implemented within a six month transitional period commencing at the end of 2004. This will extend the opportunities for product providers to secure distribution arrangements, particularly with large IFA firms and intermediary networks. The past two years have witnessed a concentration of new business among the top ten providers and depolarisation is likely to increase the combined market share of the top ten still further.

A key strand of FPLP's and its subsidiaries' strategy is to secure distribution agreements and in the first nine months of 2004 it has entered into such agreements for protection products with St. James's Place and three of the UK's largest IFA networks: Bankhall, Lighthouse Group and Sesame.

International life assurance business

FPLP and its subsidiaries conduct international life assurance business through Friends Provident International Limited based in the Isle of Man, as well as FPLP's Guernsey-based operations. This is one of the largest European offshore life operations with an estimated market share at 31 December 2003 of 9 per cent. (based on annual premium equivalent). The Isle of Man business was acquired from Royal & SunAlliance Insurance Group in 2002.

The international business offers a range of products including periodic premium savings, single premium investment and overseas life assurance protection (including term assurance and critical illness protection). It offers multi-currency contracts (on selected products) and access to third party fund management groups.

Financial position of FPLP and its subsidiaries

Information about FPLP's financial position is contained in FPLP's annual report and accounts and interim accounts and in the documents filed each year with the FSA by FPLP and other subsidiary insurance companies. The FSA is required to monitor the financial position of all UK life assurance companies and requires each to hold sufficient assets to cover its contractual liabilities and an additional solvency margin.

The FSA has been working over the last two years with all the leading life and pensions companies having significant with profits business to develop the realistic reporting framework. The FSA has

recently published policy statements on the new regulatory solvency reporting requirements in the form of PS 04/25 (Amendments to switch on the Integrated Prudential sourcebook as it applies to insurers) and PS 04/24 (Integrated Prudential Sourcebook and feedback on Supplementary feedback on Insurance Groups) ahead of the expected formal introduction from the end of 2004.

Realistic Solvency

FPLP has been managing its life and pensions business on a realistic balance sheet (“RBS”) basis for some time.

At 30 June 2004, the FPLP With Profits Fund assets continued to exceed the liabilities, including the cost of guaranteed benefits and options calculated on a market consistent stochastic basis. The excess of assets over liabilities at 30 June 2004 was calculated to be £90 million, little changed from the £81 million reported at 31 December 2003.

One of the important features of the RBS is its resilience in the event of falls or rises in investment markets. In large measure, this is due to actions taken to hedge the provisions made to cover the cost of guarantees and options.

In addition to calculating assets and liabilities on a realistic basis, FPLP holds a risk capital margin (“RCM”). This margin is derived from assessing the effects of various adverse economic scenarios on the balance sheet. Since the end of 2003, both the RCM and the capital available to cover the RCM have increased as a result of PS 04/25. The RCM has increased primarily due to the inclusion of a persistency test and the capital available now includes 50 per cent. of the embedded value profits arising in the non profit fund of FPLP as set out in PS 04/25. At 30 June 2004, the RCM was £308 million, and the capital available to cover this RCM was £1,718 million. If the RCM is compared to FPLP’s available capital, the RCM cover as at 30 June 2004 was over five times.

Statutory Solvency

Whilst the realistic reporting basis is due to be formally introduced by the end of 2004, on the current statutory basis the FPLP With Profits Fund showed a surplus at 30 June 2004.

The statutory solvency calculation for FPLP at 30 June 2004 includes an implicit item representing future profits of £400 million (31 December 2003 – £400 million) and a stop loss reinsurance agreement to the value of £260 million (31 December 2003 – £300 million). In comparison with the realistic basis, the margins in the statutory basis are substantial and are more than enough to support the inclusion of the implicit item and stop loss reinsurance, and it is for this reason that they are used in this calculation. FPLP has continued to reduce these items as it moves towards the new reporting requirements.

The Free Asset Ratio for FPLP, which represents the excess of available assets over long-term liabilities expressed as a percentage of actuarial reserves for FPLP, was estimated to be 9.7 per cent. as at 30 June 2004, down from 10.1 per cent. at 31 December 2003, mainly as a result of reducing the value of the stop loss reinsurance agreement.

FPLP With Profits Fund Investments

The proportion of equities and property backing the FPLP With Profits Fund asset shares was 47 per cent. (34 per cent. in equities, 13 per cent. in property) as at 30 June 2004.

Credit Rating

As at 15 November 2004 (the latest practicable date prior to the printing of this document) the financial strength credit rating of FPLP from Standard & Poor’s was A+ (strong), with a stable outlook. FPLP’s Moody’s rating was A2 (good), also with a stable outlook.

Pension transfers and opt-outs liabilities

In accordance with guidance issued by the Financial Services Authority and the Personal Investment Authority, FPLP, Friends Provident Life Assurance Limited and Friends Provident Pensions Limited have reviewed the appropriateness of advice given to policyholders who effected personal pension contracts after 1988. As at 31 December 2003 these reviews were substantially completed. A provision of £27 million (2002: £51 million) remains within the long-term business provision in respect of outstanding redress and associated costs.

Other Complaints

All complaints received by FPLP and its subsidiaries in respect of mortgage endowment policies and an estimate of complaints not yet received have been provided for at an estimate of the likely cost of settling such complaints. Future regulatory actions or statements could change the estimated costs. The impact of such potential future actions cannot be estimated with reliability.

The FSA and other regulatory bodies may wish, in future, to examine the suitability of past sales of other products which could affect FPLP and its subsidiaries or the industry in general. The directors of FPLP also conduct ongoing reviews of such products. As a result, it is possible that additional unprovided liabilities could arise which currently cannot be quantified.

Provisions for liabilities in connection with policyholder contracts are based on best estimate assumptions, using historical experience but adjusted where there is reasonable cause to expect future experience to be different. However, actual experience may differ from that assumed. Regulatory action, legal judgements, and future economic or other unforeseen events may impact ultimate settlements made.

REINSURER

Introduction

The Reinsurer was incorporated in England on 29 June 2004 (under registered number 05165822) as a private company limited by shares under the Companies Act 1985 under the name Friends Provident Reinsurance Services Limited. The registered office of the Reinsurer is at Pixham End, Dorking, Surrey RH4 1QA, United Kingdom. The authorised share capital of the Reinsurer is £1,000,000,000 shares divided into 400,000,000 A ordinary shares of £1 each and 600,000,000 B ordinary shares of £1 each of which 12,000,000 A ordinary shares and 18,000,000 B ordinary shares are issued and fully paid and held by FPLP.

The principal objects of the Reinsurer are set forth in clause 2 of its Memorandum of Association and are, *inter alia*, to carry on in the United Kingdom any class or classes of insurance business including the business of reinsurance and to reinsure or counter-insure all or any risks or liabilities and to carry on all classes of insurance and reinsurance business.

The Reinsurer has not engaged, since its incorporation, in any activity other than those incidental to its incorporation under the Companies Act 1985, the execution of the Reinsurer Loan Agreement and the Reinsurance Agreement and of the other documents and matters referred to or contemplated in this Offering Circular to which it is or will be a party and matters which are incidental or ancillary to the foregoing.

The Reinsurer will covenant to observe certain restrictions on its activities, pursuant to the Reinsurer Loan Agreement.

The auditors of the Reinsurer are KPMG Audit Plc of 7th Floor, 1 Canada Square, London E14 5AG.

Directors and Secretary

The directors of the Reinsurer and their respective addresses and other principal activities are:

Name	Address	Principal Activities
Keith Satchell	Pixham End, Dorking, Surrey, RH4 1QA	Chairman
Philip Wynford Moore	Pixham End, Dorking, Surrey, RH4 1QA	Chief Executive
Alastair Roy Geoffrey Gunn	Pixham End, Dorking, Surrey, RH4 1QA	Director
Graham Kenneth Aslet	Pixham End, Dorking, Surrey, RH4 1QA	Director and Actuary

The secretary of the Reinsurer is Brian William Sweetland.

The Reinsurer has no employees.

Capitalisation and Indebtedness Statement

The capitalisation and indebtedness of the Reinsurer as at the date of this Offering Circular, adjusted for the Reinsurer Loan to be made by InterCo to the Reinsurer on the Closing Date, is as follows:

Share capital

Authorised:

£1,000,000,000 divided into 400,000,000 A ordinary shares of £1 each and 600,000,000 B ordinary shares of £1 each

Issued:

12,000,000 A ordinary share of £1 each	12,000,000
18,000,000 B ordinary shares of £1 each	18,000,000

Total Capitalisation	30,000,000
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Loan capital:

The Reinsurer Loan	380,000,000
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Total capitalisation and indebtedness:	<u>£410,000,000</u>
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Save for the foregoing, at the date of this Offering Circular, the Reinsurer has no borrowings or indebtedness in the nature of borrowings (including loan capital issued or created but unissued), term loans, liabilities under acceptances or acceptance credits, mortgages, charges or guarantees or other contingent liabilities.

Accountants' Report

The following is the text of a report received by the directors of the Issuer from KPMG Audit Plc, the Reporting Accountants to the Reinsurer. The financial information contained therein does not comprise the Reinsurer's statutory accounts. No statutory accounts of the Reinsurer have been prepared or delivered to the Registrar of Companies in England and Wales since incorporation. The Reinsurer's accounting reference date will be 31 December, with the first statutory accounts being drawn up to 31 December 2004.

The Directors
Friends Provident Reinsurance Services Limited
Pixham End,
Dorking,
Surrey, RH4 1QA

13 December 2004

Dear Sirs

Friends Provident Reinsurance Services Limited (the "Reinsurer")

We report on the financial information set out below. This financial information has been prepared for inclusion in the offering circular dated 13 December 2004 (the "Offering Circular") of Box Hill Life Finance plc (the "Issuer").

Basis of Preparation

The financial information below is based on the financial statements of the Reinsurer from incorporation to 9 December 2004 prepared on the basis described in the notes below.

Responsibility

Such financial statements are the responsibility of the directors of the Reinsurer.

The directors of the Issuer are responsible for the contents of the Offering Circular in which this report is included.

It is our responsibility to form an opinion on the financial information and to report our opinion to you.

Basis of Opinion

We conducted our work in accordance with the Statements of Investment Circular Reporting Standards issued by the Auditing Practices Board of the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. It also included an assessment of significant estimates and judgements made by those responsible for the preparation of the financial statements underlying the financial information and whether the accounting policies are appropriate to the entity's circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement whether caused by fraud or other irregularity or error.

Opinion

In our opinion the financial information gives, for the purposes of the Offering Circular, a true and fair view of the state of affairs of the Reinsurer at 9 December 2004.

Yours faithfully

KPMG Audit Plc

Balance Sheet as at 9 December 2004

	£
<i>Current assets</i>	
Cash at bank and in hand	30,000,000
<i>Capital and reserves</i>	
Called up equity share capital	
12,000,000 A ordinary shares 100 per cent. paid, 18,000,000 B ordinary shares 100 per cent. paid	30,000,000

Notes

Accounting Policies

The financial information has been prepared under the historical cost convention and in accordance with accounting standards currently applicable in the United Kingdom.

Trading Activity

The Reinsurer was incorporated on 29 June 2004. The Reinsurer has not yet commenced business, no audited financial statements have been prepared and no dividends have been declared or paid since the date of incorporation.

Share Capital

The Reinsurer was incorporated and registered as a private company on 29 June 2004, with the name of Friends Provident Reinsurance Services Limited.

On incorporation, the authorised share capital of the Reinsurer was 1,000,000,000 shares divided into 400,000,000 A ordinary shares of £1 each and 600,000,000 B ordinary shares of £1 each.

On 29 June 2004, 1 A ordinary share, on 15 November 2004, 2,499,999 B ordinary shares, and on 8 December 2004, 11,999,999 A and 15,500,001 B ordinary shares were issued by the Reinsurer to Friends Provident Life and Pensions Limited and fully paid for a total cash consideration of £30,000,000.

Auditors

KPMG Audit Plc was appointed as auditor on 30 June 2004.

INTERCO

Introduction

InterCo was incorporated in England on 23 November 2004 (under registered number 5294776) as a private company limited by shares under the Companies Act 1985 under the name Box Hill Loan Finance Limited. The registered office of InterCo is at Blackwell House, Guildhall Yard, London, EC2V 5AE. The authorised share capital of InterCo is £1,000 divided into 1,000 ordinary shares of £1.00 each, of which 2 are issued and fully paid and held by a share trustee on trust for charitable purposes.

The principal objects of InterCo are set forth in clause 4 of its Memorandum of Association and are to borrow the InterCo Loan from the Issuer and to lend the Reinsurer Loan to the Reinsurer.

InterCo has not engaged, since its incorporation, in any activity other than those incidental to its incorporation under the Companies Act 1985, the execution of InterCo Loan Agreement and the Liquidity Facility Agreement and of the other documents and matters referred to or contemplated in this Offering Circular to which it is or will be a party and matters which are incidental or ancillary to the foregoing.

InterCo's other general administrative services will be provided by Structured Finance Management Limited having its registered office at Blackwell House, Guildhall Yard, London EC2V 5AE.

InterCo will covenant to observe certain restrictions on its activities, pursuant to InterCo Loan Agreement.

The auditors of InterCo are KPMG Audit Plc of 7th Floor, 1 Canada Square, London E14 5AG.

Directors and Secretary

The directors of InterCo and their respective addresses and other principal activities are:

Name	Address	Principal Activities
SFM Directors Limited	Blackwell House, Guildhall Yard, London EC2V 5AE	Acting as corporate director of special purpose companies
SFM Directors (No. 2) Limited	Blackwell House, Guildhall Yard, London EC2V 5AE	Acting as corporate director of special purpose companies

The Secretary of the company is SFM Corporate Services Limited of Blackwell House, Guildhall Yard, London EC2V 5AE.

InterCo has no employees.

The Directors of SFM Directors Limited, SFM Directors (No. 2) Limited and SFM Corporate Services Limited are Jonathan Keighley, James Macdonald and Robert Berry each of whose business address is Blackwell House, Guildhall Yard, London EC2V 5AE. Annika Goodwille and Helena Whitaker each of whose business address is St James House, 13 Kensington Square, London, W8 5UD are Company Secretaries to SFM Directors Limited, SFM Directors (No. 2) Limited and SFM Corporate Services Limited.

Capitalisation and Indebtedness Statement

The capitalisation and indebtedness of InterCo as at the date of this Offering Circular, adjusted for the InterCo Loan and the InterCo Deposit to be made by the Issuer to InterCo on the Closing Date and the InterCo Subordinated Loan to be made to InterCo by FPLP on the Closing Date, is as follows:

Share capital

Authorised:

£1,000 divided into 1,000 ordinary shares of £1.00 each

Issued:

2 ordinary shares of £1.00 each (fully paid)

£2

Capital reserve:

Non-distributable capital reserve

Total Capitalisation

£2

Loan capital:

InterCo Loan

£380,000,000

InterCo Deposit

£14,000,000

InterCo Subordinated Loan

£14,000,000

Total capitalisation and indebtedness:

£408,000,002

Save for the foregoing, at the date of this Offering Circular, InterCo has no borrowings or indebtedness in the nature of borrowings (including loan capital issued or created but unissued), term loans, liabilities under acceptances or acceptance credits, mortgages, charges or guarantees or other contingent liabilities.

Accountants' Report

The following is the text of a report received by the directors of the Issuer from KPMG Audit Plc, the Reporting Accountants to InterCo. The financial information contained therein does not comprise InterCo's statutory accounts. No statutory accounts of InterCo have been prepared or delivered to the Registrar of Companies in England and Wales since incorporation. InterCo's accounting reference date will be 31 December, with the first statutory accounts being drawn up to 31 December 2005.

The Directors
Box Hill Loan Finance Limited
Blackwell House
Guildhall Yard
London, EC2V 5AE

13 December 2004

Dear Sirs

Box Hill Loan Finance Limited ("InterCo")

We report on the financial information set out below. This financial information has been prepared for inclusion in the offering circular dated 13 December 2004 (the "Offering Circular") of Box Hill Life Finance plc (the "Issuer").

Basis of Preparation

The financial information set out below is based on the financial statements of the InterCo from incorporation to 9 December 2004 prepared on the basis described in the notes below.

Responsibility

Such financial statements are the responsibility of the directors of InterCo.

The directors of the Issuer are responsible for the contents of the Offering Circular in which this report is included.

It is our responsibility to form an opinion on the financial information and to report our opinion to you.

Basis of Opinion

We conducted our work in accordance with the Statements of Investment Circular Reporting Standards issued by the Auditing Practices Board of the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. It also included an assessment of significant estimates and judgements made by those responsible for the preparation of the financial statements underlying the financial information and whether the accounting policies are appropriate to the entity's circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement whether caused by fraud or other irregularity or error.

Opinion

In our opinion the financial information gives, for the purposes of the Offering Circular, a true and fair view of the state of affairs of InterCo at 9 December 2004.

Yours faithfully

KPMG Audit Plc

Balance Sheet as at 9 December 2004

	£
<i>Current assets</i>	
Cash at bank and in hand	2
<i>Capital and reserves</i>	
Called up equity share capital	
2 ordinary shares 100 per cent. paid	2

Notes

Accounting Policies

The financial information has been prepared under the historical cost convention and in accordance with accounting standards currently applicable in the United Kingdom.

Trading Activity

InterCo was incorporated on 23 November 2004. InterCo has not yet commenced business, no audited financial statements have been prepared and no dividends have been declared or paid since the date of incorporation.

Share Capital

InterCo was incorporated and registered as a private company on 23 November 2004, with the name of Box Hill Loan Finance Limited.

On incorporation, the authorised share capital of InterCo was divided into 1,000 ordinary shares of £1 each.

On 23 November 2004, two ordinary shares were issued by InterCo to SFM Corporate Services Limited and fully paid for a total cash consideration of £2.

Auditors

KPMG Audit Plc was appointed as auditor on 6 December 2004.

ISSUER

Introduction

The Issuer was incorporated in England on 14 October 2004 (under registered number 5259209) as a public company limited by shares under the Companies Acts 1985 under the name Box Hill Life Finance plc. The registered office of the Issuer is at Fifth Floor, 100 Wood Street, London EC2V 7EX. The authorised and issued share capital of the Issuer is £50,000 divided into 50,000 ordinary shares of £1.00 each, all of which are issued and paid-up as to £12,500 and 49,999 of which are held by Box Hill Holdings Limited (the “HoldCo”) and the remaining 1 of which is held by Law Debenture Corporate Services Limited as nominee on behalf of Holdco. The shares of Holdco are beneficially held on a discretionary trust for a number of charitable objects.

The principal objects of the Issuer are set forth in clause 3 of its Memorandum of Association and are, *inter alia*, to originate, purchase, take transfer of, invest in and acquire by any means whatsoever loans and other obligations involving the extension of credit to any persons, to raise or borrow money, and to secure any indebtedness or obligation of the Issuer by mortgage, charge, pledge, assignment, trust or any other means.

The Issuer has not engaged, since its incorporation, in any activity other than those incidental to its incorporation under the Companies Act 1985, the authorisation and issue of the Notes, the execution of the Subscription Agreement and of the Transaction Documents and matters referred to or contemplated in this Offering Circular and matters which are incidental or ancillary to the foregoing.

The Issuer will covenant to observe certain restrictions on its activities, which are detailed in Condition 3 of the Terms and Conditions of the Notes.

The Issuer’s company secretarial and other general administrative services will be provided by Law Debenture Corporate Services Limited having its registered office at Fifth floor, 100 Wood Street, London, EC2V 7EX as corporate administrator under the Issuer Administration Agreement.

The auditors of the Issuer are KPMG Audit Plc of 7th Floor, 1 Canada Square, London E14 5AE.

Directors and Secretary

The directors of the Issuer and their respective addresses and other principal activities are:

Name	Address	Principal Activities
L.D.C. Securitisation Director No.3 Limited	Fifth Floor, 100 Wood Street, London EC2V 7EX	Acting as corporate director of special purpose companies
L.D.C. Securitisation Director No.4 Limited	Fifth Floor, 100 Wood Street, London EC2V 7EX	Acting as corporate director of special purpose companies

The directors of L.D.C. Securitisation Director No. 3 Limited and L.D.C. Securitisation Director No. 4 Limited and their principal activities or business occupations are:

Name	Address	Principal Activities
L.D.C. Securitisation Services Limited	Fifth Floor, 100 Wood Street, London EC2V 7EX	Provision of directors for special purpose companies

The affairs of L.D.C. Securitisation Director No. 3 Limited and L.D.C. Securitisation Director No. 4 Limited and Law Debenture Securitisation Services Limited are represented by its directors Denyse Monique Anderson, Julian Robert Mason-Jebb, Richard David Rance and Robert James Williams each of whose business address is at Fifth Floor, 100 Wood Street, London EC2V 7EX and (other than Robert James Williams) each of whose principal activities are as director of The Law Debenture Trust Corporation plc. The principal activity of Robert James Williams is director of The Law Debenture Corporation plc.

The secretary of the Issuer is Law Debenture Corporate Services Limited.

The Issuer has no employees.

Capitalisation and Indebtedness Statement

The capitalisation and indebtedness of the Issuer as at the date of this Offering Circular, adjusted for the Notes to be issued and for the Issuer Subordinated Loan and the Expenses Loan to be made on the Closing Date, is as follows:

Share capital

Authorised:

£50,000 divided into 50,000 ordinary shares of £1.00 each

Issued:

50,000 ordinary shares of £1.00 each (paid up as to £0.25 pence per share) £12,500

Loan capital:

£280,000,000 Class A-1 Floating Rate Secured Notes due 2016 £280,000,000

£100,000,000 Class A-2 Floating Rate Secured Notes due 2019 £100,000,000

Issuer Subordinated Loan £14,000,000

Expenses Loan £100,000

Total capitalisation and indebtedness: £394,112,500

Save for the foregoing, at the date of this Offering Circular, the Issuer has no borrowings or indebtedness in the nature of borrowings (including loan capital issued or created but unissued), term loans, liabilities under acceptances or acceptance credits, mortgages, charges or guarantees or other contingent liabilities.

Accountants' Report

The following is the text of a report received by the directors of the Issuer from KPMG, the Reporting Accountants to the Issuer. The balance sheet contained therein does not comprise the Issuer's statutory accounts. No statutory accounts of the Issuer have been prepared or delivered to the Registrar of Companies in England and Wales since incorporation. The Issuer's accounting reference date will be 31 December, with the first statutory accounts being drawn up to 31 December 2005.

The Directors
Box Hill Life Finance plc
Fifth Floor
100 Wood Street
London
EC2V 7EX

13 December 2004

Dear Sirs

Box Hill Life Finance plc (the "Issuer"): £280,000,000 Class A-1 Notes due 2016 and £100,000,000 Class A-2 Notes due 2019 (together, the "Notes")

We report on the financial information set out below. This financial information has been prepared for inclusion in the offering circular dated 13 December 2004 (the "Offering Circular") of the Issuer.

Basis of Preparation

The financial information set out below is based on the financial statements of the Issuer from incorporation to 9 December 2004 prepared on the basis described in the notes below.

Responsibility

Such financial statements are the responsibility of the directors of the Issuer.

The directors of the Issuer are responsible for the contents of the Offering Circular in which this report is included.

It is our responsibility to form an opinion on the financial information and to report our opinion to you.

Basis of Opinion

We conducted our work in accordance with the Statements of Investment Circular Reporting Standards issued by the Auditing Practices Board of the United Kingdom. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. It also included an assessment of significant estimates and judgements made by those responsible for the preparation of the financial statements underlying the financial information and whether the accounting policies are appropriate to the entity's circumstances, consistently applied and adequately disclosed.

We planned and performed our work so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial information is free from material misstatement whether caused by fraud or other irregularity or error.

Opinion

In our opinion the financial information gives, for the purposes of the Offering Circular, a true and fair view of the state of affairs of the Issuer at 9 December 2004.

Yours faithfully

KPMG Audit Plc

Balance Sheet as at 9 December 2004

	£
<i>Current assets</i>	
Cash at bank and in hand	12,500
<i>Capital and reserves</i>	
Called up equity share capital	
50,000 shares 25 per cent. paid	12,500

Notes

Accounting Policies

The financial information has been prepared under the historical cost convention and in accordance with accounting standards currently applicable in the United Kingdom.

Trading Activity

The Issuer was incorporated on 14 October 2004. The Issuer has been established for the purpose of issuing the Notes and entering into related transactions. The Issuer has not yet commenced business, no audited financial statements have been prepared and no dividends have been declared or paid since the date of incorporation.

Registration

During the period the Issuer has applied for and obtained registrations as follows:

Certificate that a public Company is entitled to do business and borrow — S117(1) of the Companies Act 1985.

Share Capital

The Issuer was incorporated and registered as a public limited company on 14 October 2004, with the name of Box Hill Life Finance plc.

On incorporation, the authorised share capital of the Issuer was divided into 50,000 ordinary shares of £1 each.

On 14 October, one ordinary share was issued by the Issuer to Law Debenture Corporate Services Limited and 49,999 ordinary shares were issued by the Issuer to Box Hill Holdings Limited. All were one quarter paid for a total cash consideration of £12,500.

Auditors

KPMG Audit Plc was appointed as auditor on 15 October 2004.

BARCLAYS BANK PLC

Barclays Bank PLC is a public limited company registered in England and Wales under number 1026167. The liability of the members of Barclays Bank PLC is limited. It has its registered and head office at 54 Lombard Street, London EC3P 3AH. Barclays Bank PLC was incorporated on 7 August 1925 under the Colonial Bank Act 1925 and on 4 October 1971 was registered as a company limited by shares under the Companies Act 1948 to 1967. Pursuant to The Barclays Bank Act 1984, on 1 January 1985, Barclays Bank was re-registered as a public limited company and its name was changed from “Barclays Bank International Limited” to “Barclays Bank PLC”.

Barclays Bank PLC and its subsidiary undertakings (taken together, the “**Barclays Group**”) is an international financial services group engaged primarily in banking, investment banking and asset management. In terms of assets employed, it is one of the largest financial services groups in the United Kingdom. The Barclays Group also operates in many other countries around the world and is the leading provider of co-ordinated global services to multinational corporations and financial institutions in the world’s main financial centres. The whole of the issued ordinary share capital of Barclays Bank PLC is beneficially owned by Barclays PLC, which is the ultimate holding company of the Barclays Group.

The short term unsecured obligations of Barclays Bank PLC are rated A-1+ by S&P, P-1 by Moody’s and F1+ by Fitch Ratings Limited and the long-term obligations of Barclays Bank PLC are rated Aa1 by Moody’s, and AA by S&P and AA+ by Fitch Ratings Limited.

As at 30 June 2004, the Barclays Group had total assets of £498,127 million, total net loans and advances of £323,750 million, total deposits of £322,040 million and equity shareholders funds of £17,067 million. The profit before taxation of the Barclays Group in respect of the six months ended 30 June 2004 was £2,411 million after charging net provisions for bad and doubtful debts of £589 million.

As at 31st December 2003, the Barclays Group had total assets of £443,373 million (31st December 2002: £403,066 million), total net loans and advances of £288,743 million (31st December 2002: £260,572 million), total deposits of £278,960 million (31st December 2002: £258,932 million) and equity shareholders funds of £16,485 million (31st December 2002: £15,205 million). The profit before taxation of the Barclays Group in respect of the year ended 31st December 2003 was £3,845 million (31st December 2002: £3,203 million) after charging net provisions for bad and doubtful debts of £1,347 million (31st December 2002: £1,484 million).

AMBAC ASSURANCE UK LIMITED

General

Ambac Assurance UK Limited (“**Ambac**”) is a direct wholly-owned subsidiary of Ambac Assurance Corporation, (“**Ambac Assurance**”), a monoline insurance company incorporated under the laws of the State of Wisconsin, U.S.A.. Ambac was incorporated with limited liability in England on 11 September 1996 pursuant to the Companies Act 1985 with registered number 3248674. Ambac became authorised to transact a credit, suretyship and financial loss insurance business in the United Kingdom on 8 February 1997. Ambac is also licensed to offer insurance services into thirteen other European countries on a freedom of services basis. Ambac’s registered office is located at Hasilwood House, 60 Bishopsgate, London EC2N 4BE, United Kingdom. Ambac has no subsidiaries.

Ratings

Ambac has obtained “AAA/Aaa/AAA” financial strength ratings from S&P, Moody’s, and Fitch, Inc.

Information

Copies of the annual regulatory return filed by Ambac with the Financial Services Authority (“**FSA**”) and the annual financial statements filed with the Registrar of Companies in the United Kingdom are available upon request to Ambac at its registered office. Copies of the statutory quarterly and annual statements filed by Ambac Assurance in the United States are available upon request to Ambac Assurance at its principal place of business, One State Street Plaza, New York, NY 10004, USA.

Recent Developments

Since 31 December 2003, the date as at which its latest audited accounts were prepared, Ambac has continued to conduct its insurance business in the United Kingdom and the other European countries into which it is licensed to offer insurance services. There has been no material adverse change in its financial or trading position since 31 December 2003.

Directors of Ambac

The following sets forth a list of the directors of Ambac by name and principal activity:

Name	Function	Principal Activities
Robert John Genader	Executive	President and Chief Executive Officer, Ambac Assurance Corporation and Ambac Financial Group Inc.
John Wyatt Uhlein III	Executive	Executive Vice President, Ambac Assurance Corporation and Ambac Financial Group, Inc. and Chairman, Ambac Assurance UK Limited
Martin Roberts	Non-Executive	Independent Consultant Director, Financial Management Assurance Consultants Ltd.
David William Wallis	Executive	Managing Director, Ambac Assurance Corporation
David Ronald Larwood	Executive	Secretary and Financial Controller (part-time) Ambac Assurance UK Limited Director, Stonebridge International Insurance Co. Ltd.

The business address of Messrs. Genader, Uhlein and Wallis is One State Street Plaza, New York, NY 10004, U.S.A. The business address of Messrs. Roberts and Larwood is Hasilwood House, 60 Bishopsgate, London EC2N 4BE, United Kingdom.

Insurance Regulation

Ambac is subject to regulation by the FSA in the conduct of its insurance business in the United Kingdom. Under United Kingdom regulations, Ambac is subject to certain limits and requirements, including the maintenance of a minimum margin of solvency and the establishment of loss and unearned premium reserves. Other FSA requirements include regulation of transactions with connected persons and investments made by Ambac.

Financial Information

The audited accounts of Ambac for the year ended 31 December 2003 are annexed at the Appendix hereto.

Capitalisation and Indebtedness

The following table sets forth the audited capitalisation and indebtedness of Ambac prepared in accordance with the provisions of Section 255 of, and Schedule 9A to, the Companies Act 1985, and in accordance with applicable accounting standards and under the historical cost accounting rules, modified to include the revaluation of investments, and comply with the Statement of Recommended Practice issued by the Association of British Insurers as at 31 December 2003.

	As at 31 December 2003 (£)
Short term debt ⁽¹⁾	0
Long term debt ⁽¹⁾	0
	<hr/>
Total Issued and Paid up Share Capital ⁽²⁾	17,000,000
Profit and Loss Account	4,539,000
	<hr/>
Total Shareholders' Equity	21,539,000
	<hr/> <hr/>

Notes:

- (1) On 31 December 2003 Ambac did not have any reserves, loan capital outstanding or created but unissued, term loans or any other borrowings or indebtedness in the nature of a borrowing, including bank overdrafts and liabilities under acceptances or acceptance credits, mortgages, charges, finance lease commitments, hire purchase obligations or guarantees or contingent liabilities.
- (2) As at 31 December 2003 the issued and paid up share capital of Ambac comprised 17,000,000 ordinary shares of £1 each. This was increased to 22,000,000 ordinary shares of £1 each on 29 March 2004. The authorised share capital of Ambac is £60,000,000.

There has been no material change in the authorised and issued share capital, capitalisation or indebtedness (including guarantees or contingent liabilities) of Ambac since 31 December 2003.

Auditors

Ambac's auditors are KPMG Audit Plc, 8 Salisbury Square, London EC4Y 8BB.

Their reports on the audited accounts of Ambac for the year ended 31 December 2003 are included in "*Financial Statements of Ambac for the year ended 31 December 2003*" below.

AMBAC ASSURANCE CORPORATION

General

Ambac Assurance Corporation (“**Ambac Assurance**”), a leading financial guarantee insurance company that is primarily engaged in insuring municipal and structured finance obligations and is the successor of the oldest municipal bond insurance company, which wrote the first municipal bond insurance policy in 1971. Ambac Assurance was incorporated in the State of Wisconsin, U.S.A. with limited liability on 25 February 1970. Ambac Assurance maintains its principal executive offices at One State Street Plaza, New York, NY 10004, U.S.A.. Ambac Assurance is a wholly-owned subsidiary of Ambac Financial Group, Inc., a holding company that provides financial guarantee insurance and financial services to both public and private clients around the world.

Financial guarantee insurance written by Ambac Assurance in both the primary and secondary markets guarantees payment when due of the principal of and interest on the obligation insured. In the case of a default on the insured obligation, payments under the insurance policy may not be accelerated by the policyholder without Ambac Assurance’s consent. Ambac Assurance primarily insures newly issued obligations and seeks to maintain a diversified insurance portfolio which spreads its risk across a number of criteria, including issue size, type of bond, geographic area and issuer. At 30 September 2004, Ambac Assurance’s net par outstanding and net insurance in force was US\$ 442.8 billion and US\$ 659.0 billion, respectively.

Ambac Assurance has been assigned triple-A financial strength ratings by Moody’s, S&P, Fitch, Inc. and Rating and Investment Information, Inc. These ratings are an essential part of Ambac Assurance’s ability to provide credit enhancement. See “*Rating Agencies*” below.

Ambac Assurance has nine wholly-owned subsidiaries, Ambac Assurance UK Limited, a UK licensed insurance company, Ambac Credit Products, LLC, Ambac Capital Services, LLC, Ambac Credit Products Limited, and Ambac Financial Services, LLC, derivatives companies, Ambac Private Holdings, LLC, a company that owns and invests in securities, Ambac Japan Co., Ltd., a Japanese services company which markets financial guarantees in Japan, and Connie Lee Holdings, Inc., a holding company for Connie Lee Insurance Company (“**Connie Lee**”). Ambac Assurance acquired Connie Lee in December 1997. Connie Lee, a triple-A rated financial guarantee insurance company, which guaranteed bonds issued primarily for college and hospital infrastructure projects, is not expected to write any new business.

Financial guarantee industry overview

Financial guarantee insurance generally guarantees to the holder of the underlying obligation the timely payment of principal and interest on such obligation in accordance with such obligation’s original payment schedule. Accordingly, in the case of an issuer default on the insured obligation, payments under the insurance policy may not be accelerated by the policyholder without Ambac Assurance’s consent.

Financial guarantee insurance provides a form of credit enhancement that benefits both the issuer and the investor. Issuers benefit because their securities are generally sold with a higher credit rating than securities sold on a stand-alone basis, resulting in interest cost savings and greater marketability. In addition, for complex financings and obligations of issuers that are not well known by investors, insured obligations receive greater market acceptance than uninsured obligations. Investor’s benefit from greater marketability and a reduction in the risk of loss associated with an issuer’s default.

Structured finance obligations

Insurance on structured finance or asset-backed obligations is typically issued in connection with transactions in which the securities being issued are secured by or payable from a specific pool of assets having an ascertainable cash flow or market value and held by a special purpose issuing entity. While most structured finance obligations are secured by or represent an interest in pools of assets, monoline financial guarantors have also insured asset-backed obligations secured by one of a few assets.

Municipal obligations

Municipal obligations and municipal bonds include taxable and tax-exempt bonds, notes and other evidences of indebtedness issued by states, political subdivisions (cities, counties, towns and villages), water, sewer and other utility districts, higher educational institutions, hospitals,

transportation and housing authorities and other similar agencies. Municipal obligations are supported by the taxing authority of the issuer or the issuer's or underlying obligor's ability to collect fees or assessments for certain projects or public services. References herein to "**municipal bonds**" and "**municipal obligations**" are to debt obligations of states and other political subdivisions in the United States.

International Finance Obligations

Outside of the United States, structured and asset-backed issuers, utilities, sovereign and sub-sovereign issuers, and other issuers are increasingly using financial guarantee products, particularly in markets throughout Western Europe. A number of important trends in international markets have contributed to this expansion. In the United Kingdom, Australia and elsewhere, ongoing privatisation efforts have shifted the burden of funding from the government to the public and private capital markets, where investors may seek the security of financial guarantee products. In Europe, Australia, Japan and the emerging markets, there is also growing interest in asset-backed securitisations.

Insurance Written

Ambac Assurance sells most of its insurance in the new issue U.S. bond market. During the nine months ended 30 September 2004, Ambac Assurance insured gross par amount of \$82.9 billion, of which \$31.0 billion, or 37 per cent., was related to new issue and secondary market policies on municipal bonds. Approximately \$38.0 billion, or 46 per cent. of gross par written during the nine months ended 30 September 2004 represented domestic (U.S.) structured finance exposure. Approximately \$13.9 billion, or 17 per cent., of gross par written during the nine months ended 30 September 2004 represented international exposure.

Rating Agencies

Moody's, S&P, Fitch, Inc., and Rating and Investment Information Inc. periodically review the business and financial condition of Ambac Assurance and other companies providing financial guarantee insurance. Rating agency reviews focus on the insurer's underwriting policies and procedures and the quality of the obligations insured. The rating agencies frequently perform assessments of the credits insured by Ambac Assurance to confirm that Ambac Assurance continues to meet the capital allocation criteria considered necessary by the particular rating agency to maintain Ambac Assurance's triple-A financial strength ratings. A rating by Moody's, S&P, Fitch or Rating and Investment Information, Inc., however, is not a "market rating" or a recommendation to buy, hold or sell any security. Ambac Assurance's ability to attract new business, or to compete with other triple-A rated financial guarantors, and its results of operations and financial condition, would be materially adversely affected by any reduction in its financial strength ratings.

Reinsurance

U.S. State insurance laws and regulations (as well as the rating agencies) impose minimum capital requirements on financial guarantee insurance companies, limiting the aggregate amount of insurance which may be written and the maximum size of any single risk exposure which may be assumed. Such companies can use reinsurance to diversify risk, increase underwriting capacity, reduce additional capital needs, stabilise shareholder returns and strengthen financial ratios. See "*Insurance Regulatory Matters*" below.

As a primary insurer, Ambac Assurance is required to honour its obligations to its policyholders whether or not its reinsurers perform their obligations under the various reinsurance agreements with Ambac Assurance. Ambac Assurance has surplus share treaties with various reinsurers, which provide for a program of reinsurance with respect to large risks underwritten by Ambac Assurance in the public finance and structured finance sectors.

Ambac Assurance has entered into municipal bond and structured and international finance facultative reinsurance agreements. These agreements allow Ambac Assurance to reduce its large risks, to manage its portfolio of insurance by bond type and geographic distribution, and to provide additional capacity for frequent municipal bond issuers. Under these agreements, portions of Ambac Assurance's interests and liabilities are ceded on an issue-by-issue basis. A ceding commission is withheld to defray Ambac Assurance's underwriting expenses.

As of 30 September 2004, Ambac Assurance had retained 90 per cent. of its gross insurance in force of \$728.8 billion and had ceded approximately 10 per cent. to its treaty and facultative reinsurers.

Insurance Regulatory Matters

General Law

Ambac Assurance is licensed to do business as an insurance company in all 50 states of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the territory of Guam and the U.S. Virgin Islands. It is subject to the insurance laws and regulations of the State of Wisconsin, its state of incorporation, and the insurance laws and regulations of other states in which it is licensed to transact business, particularly the State of New York, which has a comprehensive financial guarantee insurance law. These laws and regulations, as well as the level of supervisory authority that may be exercised by the various state insurance departments, vary by jurisdiction, but generally require insurance companies to maintain minimum standards of business conduct and solvency, meet certain financial tests, including single risk limits and minimum policyholders' surplus and reserve levels, file certain reports with regulatory authorities, including information concerning their capital structure, ownership and financial condition, and require prior approval of certain changes in control of domestic insurance companies and their direct and indirect parents and the payment of certain dividends and distributions. In addition, these laws and regulations require approval of certain intercorporate transfers of assets and certain transactions between insurance companies and their direct and indirect parents and affiliates, and generally require that all such transactions have terms no less favourable than terms that would result from transactions between parties negotiating at arm's length.

Ambac Assurance is required to file quarterly and annual statutory financial statements in each jurisdiction in which it is licensed, and is subject to single and aggregate risk limits and other statutory restrictions concerning the types and quality of investments and the filing and use of policy forms and premium rates. Additionally, Ambac Assurance's accounts and operations are subject to periodic examination by the Wisconsin Insurance Commissioner and other state insurance regulatory authorities.

Investments and Investment Policy

As of 30 September 2004, Ambac Assurance's investment portfolio had an aggregate fair value of \$8.5 billion and an aggregate amortised cost of \$8.1 billion. The investment policy established by the board of directors for Ambac Assurance's investments is designed to achieve diversification of the portfolio and generally to preclude investments in obligations insured by Ambac Assurance. Ambac Assurance's investment policy only permits investment in investment grade fixed-income securities, consistent with its goal to achieve the highest after-tax, long-term return.

Capitalisation

The following table sets forth Ambac Assurance's consolidated capitalisation as of 31 December 2002, 31 December 2003, and 30 September 2004, respectively, on the basis of accounting principles generally accepted in the United States of America.

	31 December 2002	30 September 2003	2004 (unaudited)
	<i>(U.S. Dollars in Millions)</i>		
Unearned Premiums	\$2,137	\$2,553	\$2,736
Other liabilities	1,865	2,197	2,167
Long term debt	60	12	13
Short term debt	51	72	0
Total liabilities	<u>4,113</u>	<u>4,834</u>	<u>4,916</u>
Stockholders' Equity			
Preferred stock par value \$1,000 per share; Authorised shares – 285,000; issued and outstanding – none	—	—	—
Common Stock, par value \$2.50 per share; Authorised shares – 40,000,000; issued and outstanding shares – 32,800,000	82	82	82
Additional paid-in capital	920	1,144	1,179
Accumulated other comprehensive income	231	243	234
Retained earnings	2,849	3,430	3,921
Total stockholders' equity	<u>4,082</u>	<u>4,899</u>	<u>5,416</u>
Total liabilities and stockholders equity	<u><u>\$8,195</u></u>	<u><u>\$9,733</u></u>	<u><u>\$10,332</u></u>

Note: There has been no material adverse change in the capitalisation of Ambac Assurance and subsidiaries from 30 September 2004 to the date of the Offering Circular.

Directors of Ambac Assurance

The following information for each director of Ambac Assurance is set forth below – name, business or home address and description of principal activities performed outside the Ambac Financial Group, Inc. group but which are significant with respect to the Ambac Financial Group, Inc. group:

Name	Home or Business Address	Principal Activities
Phillip B. Lassiter	Ambac Financial Group, Inc. One State Street Plaza New York, NY 10004	Chairman of the Board of Ambac Financial Group, Inc. and Ambac Assurance; Director of Diebold, Inc., and Certegy Inc.
Michael A. Callen	Avalon Argus & Associates, LLC 10901 Riverwood Drive Potomac, MD 20854	Non-executive director; President of Avalon Argus & Associates, LLC since April 1996; Director of Intervest Corporation of New York and Intervest Bancshares Corporation.
Renso L. Caporali	9376 Hunting Valley South Clarence, NY 14031	Non-executive director; Director of Bank of Akron.
Jill M. Considine	The Depository Trust & Clearing Corporation 55 Water Street New York, NY 10041	Non-executive director; Chairman and Chief Executive Officer of The Depository Trust Company and The Depository Trust & Clearing Corporation; Director of the Atlantic Mutual Insurance Companies, The Interpublic Group of Companies, Inc. and the Federal Reserve Bank of New York.
Richard Dulude	P.O. Box 537 1106 Lake Avenue George Mills, NH 03751	Non-executive director; Director of Landec Corporation Inc.
Robert J. Genader	Ambac Financial Group, Inc. One State Street Plaza New York, NY 10004	President and Chief Executive Officer of Ambac Financial Group, Inc. and Ambac Assurance.

Name	Home or Business Address	Principal Activities
W. Grant Gregory	Gregory & Hoenemeyer, Inc. Two Greenwich Plaza Greenwich, CT 06830	Non-executive director; Chairman of Gregory Hoenemeyer, Inc., Director of Double Click Inc.
Thomas C. Theobald	8 Sand Shore Drive Suite 285 Greenwich, CT 06830	Non-executive director; Chairman of the Board of Columbia Mutual Funds; Director of Anixter International, Jones Lang La Salle Incorporated, and Ventas, Inc.
Laura S. Unger	3308 N Street, N.W. Washington, D.C. 20007	Non-executive director; former Acting Chairperson of the U.S. Securities and Exchange Commission, Director of Borland Software Corporation and MBNA.
Henry D.G. Wallace	15543 Monterosso Lane Unit 201 Naples, Florida 34110	Non-Executive director; former Group Vice President and Chief Financial Officer of Ford Motor Company; Director of Diebold, Inc. and Hayes Lemmerz International, Inc.

RELATIONSHIP BETWEEN AMBAC ASSURANCE UK LIMITED AND AMBAC ASSURANCE CORPORATION

General

Ambac is a direct wholly-owned subsidiary of Ambac Assurance. Ambac does not have any subsidiaries.

Net Worth Maintenance Agreement

Ambac and Ambac Assurance have entered into a net worth maintenance agreement dated as of 1 January 1997 (the “**Net Worth Maintenance Agreement**”), which is governed by the laws of the State of Wisconsin. Pursuant to the Net Worth Maintenance Agreement, Ambac Assurance is required to cause Ambac to maintain free assets of £10,500,000 or such greater amount as may be required by FSA provided that no contribution can be required to be made which would have the effect of reducing Ambac Assurance’s financial strength ratings from S&P, Moody’s or Fitch, Inc..

Reinsurance Agreement

The obligations of Ambac under the Ambac Financial Guarantees will be reinsured with Ambac Assurance pursuant to a reinsurance agreement dated as of 1 January 1997 (the “**Ambac Reinsurance Agreement**”) which is governed by the laws of the State of New York.

Pursuant to the Ambac Reinsurance Agreement, a substantial portion of all liabilities on financial guarantees issued by Ambac are reinsured by Ambac Assurance. Such reinsurance is used as a risk management device and to comply with certain statutory and rating agency requirements; it does not alter or limit the obligations of Ambac under any financial guarantee.

In addition, the Ambac Reinsurance Agreement also contains “stop loss” provisions that require Ambac Assurance to make payments to Ambac if Ambac’s losses exceed a certain amount. Under these provisions Ambac Assurance will reimburse Ambac for the amount by which annual net losses incurred by Ambac (paid losses plus any increase in loss reserves, net of reinsurance) exceed £500,000.

Noteholders should note that the Net Worth Maintenance Agreement and the Ambac Reinsurance Agreement (together, the “Ambac Assurance Agreements”) are entered into for the benefit of Ambac and are not, and should not be regarded as, guarantees by Ambac Assurance of the payment of any indebtedness, liability or obligations of the Issuer, InterCo or Ambac including the Notes or the Ambac Financial Guarantees.

Information in this Offering Circular concerning Ambac Assurance is provided for background purposes only in view of the importance to Ambac of the Ambac Assurance Agreements. It does not imply that the Ambac Assurance Agreements are guarantees for the benefit of Noteholders. Payment of principal and interest on the Notes will be guaranteed by Ambac pursuant to the Ambac Note Financial Guarantee and will not be additionally guaranteed by Ambac Assurance.

Noteholders should note that Ambac’s ability to perform its obligations under the Ambac Financial Guarantees and to maintain its current ratings substantially depends on the ability of Ambac Assurance to perform its obligations under the Ambac Assurance Agreements.

FORM OF AMBAC NOTE FINANCIAL GUARANTEE

Financial Guarantee Number UK [●]
Issued by:

Ambac Assurance UK Limited
Hasilwood House
60 Bishopsgate
London EC2N 4BE
Telephone: 020 7786 4300
Fax: 020 7786 4343
Registered in England
Registered Number 3248674

Effective Date of this Financial Guarantee: 16 December 2004

Ambac Assurance UK Limited (“**Ambac**”), in consideration of the payment of the Issuer Financial Guarantee Fee and subject to the terms of this Financial Guarantee, hereby agrees unconditionally and irrevocably to pay to the Beneficiary for the benefit of the Holders of the Guaranteed Obligations that portion of the Guaranteed Amounts which has become Due for Payment but is unpaid by reason of Non-payment and any Additional Amounts that may be payable hereunder.

1 Payments

- 1.1 Save in respect of Accelerated Payments (which may be made at the election of Ambac only), Ambac will make payments which are due under this Financial Guarantee to the Beneficiary by 12:00 noon, London time, on the later of (a) the second Business Day following Receipt by Ambac of a duly completed Notice of Demand and Certificate from the Beneficiary and (b) the applicable Scheduled Payment Date.
- 1.2 Payments due under this Financial Guarantee will be satisfied by payment in full by Ambac to the Account in the appropriate currency or currencies. Save as otherwise provided herein, payment in full to the Account shall discharge the obligations of Ambac under this Financial Guarantee to the extent of such payment, whether or not such payment is properly applied by or on behalf of the Beneficiary or any Paying Agent. Save as otherwise provided herein, once payment by Ambac of an amount in respect of any Guaranteed Obligation (whether on a Scheduled Payment Date or on an Accelerated Payment Date) has been made to the Account, Ambac shall have no further obligations under this Financial Guarantee in respect of such Guaranteed Obligation to the extent of such payment.
- 1.3 The obligations of Ambac under this Financial Guarantee shall not be affected by any redenomination of the Guaranteed Obligations into euro pursuant to Condition 7(k) (*Change in Currency*) save that following such redenomination payments hereunder shall be made in euro.

2 Insolvency

In the event the Beneficiary has notice that any payments of Guaranteed Amounts which have become Due for Payment and which have been made to the Beneficiary or to any Holders by or on behalf of the Issuer have been declared (in whole or in part) a Preference and recovered from the Beneficiary or such Holders pursuant to any Insolvency Law in accordance with a final non-appealable order of a court of competent jurisdiction, the Beneficiary on behalf of such Holders will be entitled under this Financial Guarantee to payment from Ambac upon receipt by Ambac from the Beneficiary of a duly completed Notice of Demand and Certificate to the extent of such recovery (such amounts being referred to herein as “**Avoided Payment Amounts**”).

3 Subrogation

Upon Ambac making any payment in respect of any Guaranteed Obligations, including, for the avoidance of doubt, any Accelerated Payments, to the Account hereunder and upon receipt by the Beneficiary of such payment pursuant to this Financial Guarantee, Ambac shall, to the extent of such payment, be fully and automatically subrogated pursuant to applicable law to all of the rights of the Holders of the Affected Guaranteed Obligations to payment of the Guaranteed Amounts and/or any Accelerated Payments (as the case may be) (including, without limitation, any rights

and benefits attached to, and any security granted at law by contract or under the Issuer Deed of Charge or otherwise in respect of, the Affected Guaranteed Obligations) to the extent of such payment.

4 UK Withholding Tax

All payments by Ambac under this Financial Guarantee shall be made without withholding or deduction for, or on account of, any taxes, duties, assessments or other governmental charges of whatever nature imposed, levied, collected, withheld or assessed by the United Kingdom or any political subdivision or taxing authority therein or thereof unless such withholding or deduction is required by law. If any withholding or deduction is so required by law, Ambac shall account to the appropriate tax authority for the amount to be withheld or deducted and shall pay such amounts (“Additional Amounts”) for the account of each Holder in respect of which a withholding or deduction has been made as may be necessary in order that the net amounts receivable by the relevant Holder after such withholding or deduction shall equal the Guaranteed Amounts or the Accelerated Payment (as the case may be) which would have been receivable by such Holder from the Issuer in respect of the Affected Guaranteed Obligations in the absence of such withholding or deduction, provided, however, that no such Additional Amounts shall be payable in respect of any Guaranteed Obligations which will result from any payment by Ambac of Guaranteed Amounts or Accelerated Payments (as the case may be):

- 4.1 to or in respect of Holders who are liable or subject to such withholding or deduction by reason of them having some connection with the United Kingdom other than the mere holding or beneficial ownership of the Guaranteed Obligations;
- 4.2 to or in respect of Holders who would not be subject to such withholding or deduction if they had made a declaration of non-residence or other similar claim for exemption to the relevant tax authority;
- 4.3 to or in respect of Holders who have presented such Guaranteed Obligations for payment more than 30 days after the Relevant Date except to the extent that the relevant Holders would have been entitled to such Additional Amounts if they had presented the Guaranteed Obligations for payment on the last day of such period of 30 days; or
- 4.4 where such withholding or deduction is imposed on a payment to an individual Holder and is required to be made pursuant to (1) any European Union Directive on the taxation of savings implementing the conclusions of the ECOFIN Council Meeting of 26-27 November 2000 and/or (2) any approval by the EU Council of Economic and Finance Ministers on 13 December 2001, in connection with such Directive and/or (3) any law implementing or complying with, or introduced in order to conform to, such Directive.

5 Scope of Guarantee

This Financial Guarantee is not cancellable by Ambac for any reason, including the failure of Ambac to receive payment of any Issuer Financial Guarantee Fee due in respect of this Financial Guarantee. The Issuer Financial Guarantee Fee is not refundable for any reason. This Financial Guarantee does not guarantee any accelerated payment (whether by way of prepayment of the Guaranteed Obligations or otherwise), other than at the sole option of Ambac as specified below, nor provide protection by way of guarantee or otherwise against any risk (including, without limitation, the risk of failure of the Beneficiary or any Paying Agent to make any payment due to Holders of any Guaranteed Amounts) other than Non-payment, withholding tax risk in relation to Additional Amounts and insolvency claw back risk in relation to Avoided Payment Amounts, in each case as provided herein.

6 Accelerated Payments

There shall be no accelerated payment of any Guaranteed Amount due under this Financial Guarantee unless Ambac elects to make an Accelerated Payment of all or any part of the Guaranteed Obligations at its sole option. If Ambac elects to make an Accelerated Payment, it shall, not later than two Business Days prior to the date on which it shall effect such payment, deliver to the Issuer and the Beneficiary, by fax or letter delivered by registered post or courier, a written notice duly executed by an authorised officer of Ambac, notifying the Issuer and the Beneficiary of the exercise of (1) its option hereunder and (2) the proposed Accelerated Payment Date for such Accelerated Payment. Ambac shall, unless otherwise directed by the Beneficiary, make such Accelerated Payment to the Paying Agent. Such notice shall be deemed to have been delivered

when (a) in the case of a letter, delivered to the relevant addressee; or (b) in the case of a fax, when transmission of such fax communication has been received in a legible form and receipt has been confirmed.

7 Waiver of Defences

7.1 The obligations of Ambac under this Financial Guarantee shall not be affected by any lack of validity or enforceability of or any modification or any amendment to the Guaranteed Obligations or the Trust Deed or the granting of any time, indulgence or concession by any party to the Issuer.

7.2 Ambac acknowledges that there is no duty of disclosure by the Beneficiary under this Financial Guarantee but nonetheless, to the fullest extent permitted by applicable law, hereby waives for the benefit of the Beneficiary and each Holder and agrees not to assert any and all rights (whether by counterclaim, rescission, set-off or otherwise), equities and defences (including, without limitation (a) any defence of fraud by any Person (other than the Beneficiary itself) or (b) any defence based on misrepresentation, breach of warranty or non-disclosure of information by any Person), to the extent such rights, equities and defences may be available to Ambac to avoid payment of its obligations under this Financial Guarantee in accordance with the express provisions hereof, but without prejudice to any subsequent recourse Ambac may have to or against any Person.

8 Definitions

For all the purposes of this Financial Guarantee, the following terms shall have the following meanings:

“**Accelerated Payment**” means any payment of any Guaranteed Amount in advance of the Scheduled Payment Date for such Guaranteed Amount (whether by way of prepayment of any Guaranteed Amount or otherwise) made by Ambac to the Account at Ambac’s sole option and in accordance with this Financial Guarantee, but subject to the Guaranteed Obligations having become due and payable by the Issuer pursuant to the Conditions;

“**Accelerated Payment Date**” means any date on which Ambac makes an Accelerated Payment;

“**Account**” means in respect of any payment made by Ambac on:

- (a) a Scheduled Payment Date, the bank account specified in the relevant Notice of Demand and Certificate; and
- (b) an Accelerated Payment Date, the bank account notified by the Beneficiary to Ambac in writing at least one Business Day prior to the Accelerated Payment Date;

“**Affected Guaranteed Obligations**” means those Guaranteed Obligations (identified in the relevant duly completed Notice of Demand and Certificate) in respect of which a Non-payment has occurred or will occur, as specified in the relevant Notice of Demand and Certificate;

“**Beneficiary**” means the Trustee;

“**Business Day**” means any day (other than a Saturday or Sunday) on which commercial banks are generally open for business in London;

“**Conditions**” means the terms and conditions of the Notes as set out in Schedule 6 of the Trust Deed as at the date of this Financial Guarantee, or as amended with Ambac’s consent (each being a “**Condition**”);

“**Due for Payment**” means, in relation to any Guaranteed Amounts, that the Scheduled Payment Date for such amount has been reached. For the avoidance of doubt, “**Due for Payment**” does not refer to any earlier date upon which payment of any Guaranteed Amounts may become due under the Guaranteed Obligations, by reason of prepayment, acceleration of maturity, mandatory or optional redemption or otherwise;

“**Financial Guarantee Excluded Amounts**” means, in respect of the Guaranteed Obligations:

- (a) any principal or other sums payable on an accelerated basis by the Issuer in respect of any redemption of the Notes pursuant to Condition 6(c) (*Redemption for taxation or other reasons*) or Condition 10(b) (*Events of Default*);
- (b) any default interest on any of the Guaranteed Obligations; and

(c) any amounts which the Issuer would be obliged to pay under Condition 9 (*Taxation*) (by way of withholding to the tax authority).

“**Guaranteed Amounts**” means, with respect to any Scheduled Payment Date, the sum of (i) Scheduled Interest payable on such Scheduled Payment Date, and (ii) Ultimate Principal payable on such Scheduled Payment Date. “**Guaranteed Amounts**” excludes (a) any Scheduled Interest, and Ultimate Principal in respect of which, in either case, Ambac has made an Accelerated Payment on an Accelerated Payment Date falling prior to such Scheduled Payment Date and (b) any Financial Guarantee Excluded Amounts;

“**Guaranteed Obligations**” means the Notes, and shall include, where the context so requires, the coupons and receipts relating to the Notes, but shall in all cases exclude all Financial Guarantee Excluded Amounts provided always, in the case of (a) under the definition of Financial Guarantee Excluded Amounts, such amount shall cease to be a Financial Guarantee Excluded Amount on the Scheduled Payment Date for such amount or, at Ambac’s sole option, the Accelerated Payment Date for such amount;

“**Holder**” means (i) if and to the extent that the Guaranteed Obligations are represented by definitive bonds held outside of Euroclear Bank S.A./N.V., as operator of the Euroclear System (“**Euroclear**”) and/or Clearstream Banking, societe anonyme (together with Euroclear and any additional or alternative clearing systems nominated by the Issuer and/or the Trustee and approved by Ambac, the “**Clearing Systems**” and each, a “**Clearing System**”), the bearers thereof and (ii) if and to the extent the Guaranteed Obligations are represented by a temporary or permanent global bond or definitive bonds held in a Clearing System, the Persons for the first time being shown in the records of the relevant Clearing System (except for a Clearing System in its capacity as an accountholder of another Clearing System) as being holders of Guaranteed Obligations (each an “**Accountholder**”) in which regard any certificate or other document issued by the relevant Clearing System as to the principal amount of the Guaranteed Obligations standing to the account of any Accountholder shall be conclusive and binding for all purposes hereof;

“**Insolvency Law**” means any applicable United Kingdom bankruptcy or insolvency law, including the Enterprise Act 2002, the Insolvency Act 2000, the Insolvency Act 1986, the Insolvency Rules 1986, the Insolvency Regulations 1994 or any legislation passed in substitution or replacement thereof or amendment thereof;

“**Issuer**” means Box Hill Life Finance plc (a company incorporated in England and Wales with limited liability under registered number 5259209);

“**Issuer Ambac Fee Letter**” means the letter (described on its face as “**Issuer Ambac Fee Letter**”) dated on or about the date of this Financial Guarantee between Ambac and the Issuer;

“**Issuer Financial Guarantee Fee**” means the guarantee fee(s) payable by the Issuer in consideration of the issue of this Financial Guarantee, as specified in the Issuer Ambac Fee Letter;

“**Non-payment**” means, as of any Scheduled Payment Date, the failure of the Issuer to pay or to have paid all or any part of the Guaranteed Amounts which are Due for Payment on such Scheduled Payment Date (or which would have been due on such Scheduled Payment Date but for such Guaranteed Amounts having become due prior to such Scheduled Payment Date by reason of prepayment, acceleration of maturity, mandatory or optional redemption or otherwise);

“**Notes**” means the £280,000,000 Class A-1 Floating Rate Secured Notes due 2016 and the £100,000,000 Class A-2 Floating Rate Secured Notes due 2019;

“**Notice of Demand and Certificate**” means a notice of demand and certificate in the form attached hereto, duly executed by the Beneficiary;

“**Paying Agent**” has the meaning given to that term in the Trust Deed;

“**Person**” means any person, firm, company or body corporate, corporation, government, state or agency of a state or any association or partnership (whether or not having separate legal personality) or two or more of the foregoing;

“**Preference**” means (i) a preference pursuant to Clause 239 of the Insolvency Act 1986 (as amended, varied or supplemented from time to time) (the “**Insolvency Act**”) (ii) an avoidance of any property disposition pursuant to section 127 of the Insolvency Act and (iii) a transaction at an undervalue pursuant to section 238 of the Insolvency Act.

“**Receipt**” means actual delivery to Ambac at the address specified at the beginning of this Financial Guarantee (or such other address as Ambac may, from time to time, designate in writing

to the Beneficiary) prior to 12:00 noon, London time, on a Business Day. Delivery either on a day that is not a Business Day or after 12:00 noon, London time, shall be deemed to be Receipt on the next succeeding Business Day;

“**Relevant Date**” means whichever is the later of (a) the date on which any Guaranteed Amount becomes Due for Payment and (b) if the full amount payable has not been paid by Ambac on or prior to such date, the date on which the full amount payable has been paid by Ambac;

“**Scheduled Interest**” means, in respect of the Notes, interest payable thereon as specified in Condition 5 (*Interest*);

“**Scheduled Payment Date**” means each Interest Payment Date (as defined in Condition 1 (*Definitions*)) on which any Scheduled Interest or any Ultimate Principal is due and payable;

“**Trust Deed**” means the trust deed dated 16 December 2004 between the Issuer, Ambac and the Trustee in respect of the issue of the Notes;

“**Trustee**” means Bank of New York, London Branch or any successor trustee, in each case as appointed pursuant to the terms of the Trust Deed, as trustee for the Holders of the Guaranteed Obligations;

“**Ultimate Principal**” means, in respect of the Guaranteed Obligations, principal repayable as specified in Condition 6(a) (*Redemption, Purchase and Cancellation – Final Redemption*);

Any capitalised terms used in this Financial Guarantee and not defined herein shall have the meaning given to them in the Master Definitions Agreement dated on or about the date hereof between, *inter alios*, the Issuer, the Trustee and Ambac.

9 Miscellaneous

- 9.1 This Financial Guarantee constitutes the entire agreement between Ambac and the Beneficiary in relation to Ambac’s obligation to make payments to the Beneficiary for the benefit of the Holders of the Guaranteed Obligations in respect of Guaranteed Amounts which become Due for Payment but shall have remained unpaid by reason of Non-payment and supersedes any previous agreement between Ambac and the Beneficiary in relation thereto and, save for the provision of a Notice of Demand and Certificate as provided for herein, nothing in this Financial Guarantee constitutes a warranty or a condition precedent to this Financial Guarantee.
- 9.2 This Financial Guarantee shall terminate upon the earlier of: (i) the payment by Ambac of an amount (disregarding any Additional Amounts) equal to the aggregate amount of all Guaranteed Amounts payable hereunder; and (ii) two years and one day following the last Scheduled Payment Date provided that if the Issuer becomes subject to any proceedings pursuant to Insolvency Law (“**Insolvency Proceedings**”) during the period of two years following the last Scheduled Payment Date, then this Financial Guarantee shall terminate on the later of (a) the date of the conclusion or dismissal of the relevant Insolvency Proceedings without continuing jurisdiction by the court in such Insolvency Proceedings and (b) if the Holder of any Guaranteed Obligation is required to return any payment (or portion thereof) in respect of such Guaranteed Obligation that is voided as a result of such Insolvency Proceedings, the date on which Ambac has made all payments required to be made under the terms of this Financial Guarantee to the Beneficiary in respect of all such voided payments.
- 9.3 No Person (other than the Trustee) shall have rights under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Financial Guarantee, but this shall not affect any such right any person may have otherwise than by virtue of such Act.
- 9.4 This Financial Guarantee shall be governed by and construed in accordance with the laws of England and Wales. The courts of England and Wales shall have jurisdiction to hear and determine any suits, action or proceedings and to settle any disputes which may arise at or in connection with this Financial Guarantee and each of Ambac and the Beneficiary irrevocably submits to the jurisdiction of such courts.

In witness whereof, this Financial Guarantee has been executed by (1) two duly authorised officers on behalf of Ambac and (2) the Beneficiary and duly delivered on the date inserted above.

Executed

By AMBAC ASSURANCE UK LIMITED

By:

By:

Name:

Name:

Title:

Title:

Executed as a deed By **THE BANK OF NEW YORK, LONDON BRANCH**

By:

Name:

Title:

NOTICE OF DEMAND AND CERTIFICATE

Under
Financial Guarantee Number UK [●]
Issued by

Ambac Assurance UK Limited
Hasilwood House
60 Bishopsgate
London EC2N 4BE
Telephone 020 7786 4300
Fax 020 7786 4343
Registered in England
Registered Number 3248674

Attention: Managing Director, Ambac Assurance UK Limited

The undersigned, a duly authorised officer of The Bank of New York, London Branch (the “Beneficiary”), hereby certifies to Ambac Assurance UK Limited (“Ambac”), with reference to the Financial Guarantee No. UK [●] dated 16 December 2004 (the “Financial Guarantee”) issued by Ambac in respect of the obligations of Box Hill Life Finance plc (the “Issuer”), that

- (i) the Beneficiary is the Trustee under the Trust Deed for the Holders;
- (ii) the Beneficiary has calculated that the deficiency in respect of the Guaranteed Amounts which [are/were] Due for Payment on [insert Scheduled Payment Date] under the Class A-1/Class A-2 Notes (the “Affected Guaranteed Obligations”) [will be/was/is] [insert applicable currency and amount] (the “Shortfall”). Of such Shortfall, [insert applicable currency and amount] is Scheduled Interest on the Affected Guaranteed Obligations; and [insert applicable currency and amount] is Ultimate Principal on the Affected Guaranteed Obligations;
- (iii) the Beneficiary is making a claim under the Financial Guarantee for the [Shortfall/Avoided Payment Amount] to be applied to the payment of the Guaranteed Amounts which [are Due for Payment/were paid but found to be a Preference];
- (iv) the Beneficiary agrees that, following payment of funds by Ambac, it shall use reasonable endeavours to procure (a) that such amounts are applied directly to the payment of Guaranteed Amounts which are Due for Payment; (b) that such funds are not applied for any other purpose; and (c) the maintenance of an accurate record of such payments with respect to each Guaranteed Obligation and the corresponding claim on the Financial Guarantee and the proceeds thereof. For the purposes of (a) and (b) above, it shall be sufficient if the Beneficiary directs Ambac to make payment to the Principal Paying Agent; and
- (v) payment should be made by Ambac in [currency] by credit to an account in the name of [insert name of Beneficiary or Principal Paying Agent] with [insert name of bank], of [insert address of bank]. Sort Code [●] Account Number [●];

The Beneficiary acknowledges that Clause 7.6 of the Trust Deed and the Financial Guarantee provide that effective as of the date on which the Shortfall is credited to such account, Ambac shall, to the extent of such Shortfall, be fully and automatically subrogated, pursuant to applicable law to all of the rights of the Holders of the Affected Guaranteed Obligations to payment of any amounts in respect of such Affected Guaranteed Obligations (including, without limitation, any rights and benefits attached thereto and any security granted at law or by contract (whether under the Trust Deed or otherwise) in respect of the Affected Guaranteed Obligations.

Unless the context otherwise requires, capitalised terms used in this Notice of Demand and Certificate and not defined herein shall have the meanings provided in the Financial Guarantee.

No person, other than Ambac, shall have any right under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Notice of Demand and Certificate but this shall not affect any such right any person may have otherwise than by virtue of the Act.

This Notice of Demand and Certificate may be revoked by written notice by the Beneficiary to Ambac at any time prior to the date specified above on which Guaranteed Amounts are Due for Payment to the extent that moneys are actually received in respect of the Guaranteed Obligations prior to such date from a source other than Ambac.

This Notice of Demand and Certificate shall be governed by and construed in accordance with the laws of England and Wales.

In witness whereof, the Beneficiary has executed and delivered this Notice of Demand and Certificate on [●] 200[●].

[Insert Name of Trustee]

By (sign):

Name (print):

Title:

Phone Number:

TERMS AND CONDITIONS OF THE NOTES

The following are the terms and conditions of the Notes in the form (subject to completion and amendment) in which they will be set out in the Trust Deed. They will be incorporated by reference into the Notes in global form and will be endorsed on the Notes in definitive form (if any) issued in exchange for the Permanent Global Notes. These terms and conditions are subject to the provisions of the Trust Deed, the Issuer Deed of Charge and the other Transaction Documents (each as defined below).

The £280,000,000 Class A-1 Floating Rate Secured Notes due 2016 (the “**Class A-1 Notes**”) and the £100,000,000 Class A-2 Floating Rate Secured Notes due 2019 (the “**Class A-2 Notes**”) and, together with the Class A-1 Notes, the “**Notes**”) of Box Hill Life Finance plc (the “**Issuer**”) are constituted by a trust deed dated on or about 16 December, 2004 (or such later date as the Issuer and Lead Manager may agree) (the “**Closing Date**”) (the “**Trust Deed**”) between the Issuer, Ambac Assurance UK Limited (“**Ambac**”) and The Bank of New York, London Branch (in this capacity, the “**Note Trustee**” which expression includes its successors or any other trustee appointed pursuant to the Trust Deed) as trustee for the holders for the time being of the Notes (the “**Noteholders**”), the holders for the time being of the Coupons (the “**Couponholders**”) and the holders for the time being of the Talons (the “**Talontholders**”) and are subject to these terms and conditions (the “**Conditions**”).

Under a financial guarantee and the endorsement thereto dated on or about the Closing Date (the “**Ambac Note Financial Guarantee**”) issued by Ambac, Ambac will unconditionally and irrevocably guarantee the Scheduled Interest and Ultimate Principal (each as defined in the Ambac Note Financial Guarantee) payable in respect of the Notes.

Under an agency agreement dated on or about the Closing Date (the “**Agency Agreement**”) between the Issuer, the Note Trustee, and The Bank of New York, London Branch as security trustee (in this capacity, the “**Issuer Security Trustee**”), The Bank of New York, London Branch as principal paying agent (the “**Principal Paying Agent**”) and, together with any other paying agents appointed from time to time in respect of the Notes under the Agency Agreement, the “**Paying Agents**”) and The Bank of New York, London Branch as agent bank (the “**Agent Bank**”) and, together with the Paying Agents, the “**Agents**”), the Issuer will appoint the Paying Agents to, among other things, make payments of principal, interest and other amounts, if any in respect of the Notes on its behalf and will appoint the Agent Bank to make certain calculations in respect of the Notes. The Bank of New York, London Branch, as Principal Paying Agent and Agent Bank is acting out of its offices at One Canada Square, London E14 5AL (or such other office as it may specify in accordance with the Agency Agreement and notify to Noteholders pursuant to Condition 17 (*Notices and Information*)).

Security for the Notes is created by a deed of charge (the “**Issuer Deed of Charge**”) dated on or about the Closing Date between, among others, the Issuer, the Issuer Security Trustee and Ambac.

Any reference in these Conditions to the Trust Deed, the Issuer Deed of Charge, the Agency Agreement or any other Transaction Document (as defined below) is to such document as from time to time amended, varied or novated in accordance with its provisions and includes any deed or other document expressed to be supplemental to it, as from time to time so amended.

The statements in these Conditions include summaries of, and are subject to, the detailed provisions of the Trust Deed, the Issuer Deed of Charge, the Agency Agreement and the other Transaction Documents.

The Noteholders, the Couponholders and the Talontholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed, the Issuer Deed of Charge and the Agency Agreement and are deemed to have notice of all the provisions of the other Transaction Documents.

The issue of the Notes was authorised by resolution of the Board of Directors of the Issuer passed on or about the Closing Date.

1. DEFINITIONS

1.1 In these Conditions:

“**Agency Agreement**” means the agency agreement dated on or about the Closing Date between the Issuer, the Note Trustee, the Issuer Security Trustee and the Agents;

“Agent Bank” means, as at the Closing Date, The Bank of New York, London Branch;

“Agents” means the Paying Agents and the Agent Bank or, where the context so requires, any of them;

“Ambac” means Ambac Assurance UK Limited, a company incorporated in England and Wales with limited liability (registered number 3248674) whose registered office is at Hasilwood House, 52-68 Bishopsgate, London EC2N 4BE;

“Ambac Event of Default” means each of the following events:

- (a) any Guaranteed Amount (as defined in the Ambac Note Financial Guarantee) which is Due for Payment (as defined in the Ambac Note Financial Guarantee), is unpaid and is not paid by Ambac on the Scheduled Payment Date (as defined in the Ambac Note Financial Guarantee);
- (b) Ambac disclaims, disaffirms, repudiates and/or challenges the validity of any of its obligations under the Ambac Note Financial Guarantee or seeks to do so;
- (c) a court of competent jurisdiction enters into a final and non-appealable order, judgement or decree for the winding-up, or the appointment of an administrator or receiver (including an administrative receiver or manager) of Ambac (or, as the case may be, of a material part of its property or assets); or
- (d) Ambac:
 - (i) presents and petitions or takes any proceedings for the winding-up or the appointment of an administrator or receiver (including an administrative receiver or manager) of Ambac (or, as the case may be, of a material part of its property or assets);
 - (ii) makes or enters into any general assignment, composition, arrangement (including, without limitation, a voluntary arrangement under Part 1 of the Insolvency Act 1986) or compromise with or for the benefit of any of its creditors;
 - (iii) becomes unable to pay its debts within the meaning of section 123(2) or section 123(1)(e) of the Insolvency Act 1986 or admits in writing its inability, or fails generally, to pay its debts as they become due; or
- (e) an event of default in respect of Ambac occurs under the Ambac Note Financial Guarantee, the Ambac Issuer Swap Financial Guarantee, the Ambac Liquidity Financial Guarantee or the Ambac InterCo Swap Financial Guarantee;

“Ambac Financial Guarantees” means the Ambac InterCo Swap Financial Guarantee, the Ambac Issuer Swap Financial Guarantee, the Ambac Liquidity Financial Guarantee and the Ambac Note Financial Guarantee;

“Ambac InterCo Swap Financial Guarantee” means the unconditional and irrevocable financial guarantee dated on or about the Closing Date that Ambac provides in favour of the InterCo Swap Provider pursuant to which Ambac guarantees the payment of certain amounts under the InterCo Swap Agreement;

“Ambac Issuer Swap Financial Guarantee” means the unconditional and irrevocable financial guarantee dated on or about the Closing Date that Ambac provides in favour of the Issuer Swap Provider pursuant to which Ambac guarantees the payment of certain amounts under the Issuer Swap Agreement;

“Ambac Liquidity Financial Guarantee” means the unconditional and irrevocable financial guarantee dated on or about the Closing Date that Ambac provides in favour of the Liquidity Facility Provider pursuant to which Ambac guarantees the payment of certain amounts under the Liquidity Facility Agreement;

“Ambac Note Financial Guarantee” means the unconditional and irrevocable financial guarantee dated on or about the Closing Date that Ambac provides in favour of the Note Trustee on behalf of the Noteholders from time to time pursuant to which Ambac guarantees the payment of Scheduled Interest and Ultimate Principal under the Notes;

“Ambac Termination Event” means:

- (a) an Ambac Event of Default has occurred and is continuing; and/or
- (b) Ambac has no further obligations, actual or contingent, under any of the Ambac Financial Guarantees and no amounts are then owing to Ambac under the Issuer Guarantee and Reimbursement Agreement and the InterCo Guarantee and Reimbursement Agreement;

“**Available Redemption Funds**” means, on any Interest Payment Date, the lower of:

- (a) the Principal Amount Outstanding of the Notes immediately prior to such date; and
- (b) the amount determined on the immediately preceding Issuer Report Date as the amount of Issuer Available Funds available to be paid in or towards redeeming the Notes in accordance with the Issuer Pre-Acceleration Priority of Payments;

“**Basic Terms Modification**” means, in respect of the Notes:

- (a) any modification of the date of maturity of the Notes;
- (b) any modification which would have the effect of (A) postponing any day for repayment of principal thereof or payments of interest thereon, (B) reducing or cancelling the amount of principal or the rate of interest payable in respect of the Notes, (C) altering the priority of payment of interest and principal on the Notes or the Issuer Security, (D) altering the currency of payment of the Notes or the Coupons (other than pursuant to Condition 7 (*Payments – Change in Currency*) or (E) making alternative arrangements in relation to the Issuer Security pursuant to paragraph (b)(vii) of Condition 10 (*Issuer Events of Default – Events*);
- (c) removing or replacing the Note Trustee; or
- (d) an alteration of (A) the definition of Basic Terms Modification, (B) the majority required to effect a Basic Terms Modification or (C) the majority required to pass an Extraordinary Resolution;

“**Breach**” means a determination under which any Part A Warranties or Part B Warranties are determined to be incorrect or determined to have been breached pursuant to the provisions of the Reinsurance Agreement;

“**Breach Adjustment**” means a Breach Adjustment determined under the Reinsurance Agreement to compensate the Reinsurer for a Breach;

“**Business Day**” means a day (other than a Saturday or Sunday) on which commercial banks are generally open for business in London;

“**Class**” means either the Class A-1 Notes or the Class A-2 Notes as the context may require;

“**Class A-1 Noteholders**” means the holders of the Class A-1 Notes;

“**Class A-2 Noteholders**” means the holders of the Class A-2 Notes;

“**Class A-1 Notes**” means the class A-1 floating rate secured notes due 2016 issued by the Issuer;

“**Class A-2 Notes**” means the class A-2 floating rate secured notes due 2019 issued by the Issuer;

“**Clearstream, Luxembourg**” means Clearstream Banking, *société anonyme*;

“**Closing Date**” means 16 December, 2004 or such later date as may be agreed between the Issuer and the Lead Manager;

“**Conditions**” means these terms and conditions;

“**Coupon Sheet**” has the meaning given to it in Condition 7(i) (*Payments – Exchange of Talons*);

“**Couponholders**” means the holders from time to time of the Coupons;

“**Coupons**” means the bearer interest coupons in or substantially in the form set out in Schedule 4 (*Form of Coupon*) to the Trust Deed and for the time being outstanding or, where the context so requires, a specific number of them and includes (where applicable) the Talons in respect of such Coupons;

“**Defined Book Surplus**” means the amount determined as such pursuant to the Reinsurance Agreement;

“**Definitive Note**” means in respect of each Class of Notes, each bearer note issued or to be issued in definitive form for that Class of Notes in or substantially in the form set out in Schedule 3 (*Form of Definitive Note*) to the Trust Deed;

“**Euroclear**” means Euroclear Bank S.A./N.V., as operator of the Euroclear System;

“**Exchange Date**” means with respect to a Note the first day following the expiry of forty days after the date of issue of such Note;

“Exchange Event” means:

- (a) both Euroclear and Clearstream, Luxembourg are closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or announce an intention permanently to cease business and in fact do so cease business and no other alternative clearing system satisfactory to the Note Trustee is available; or
- (b) as a result of any amendment to, or change in or in the interpretation or administration of, the laws or regulations of the United Kingdom (or any political sub-division thereof) or of any authority in it or of it having power to tax, which becomes effective on or after the Closing Date, the Issuer or any Paying Agent is or will be required to make any deduction or withholding from any payment in respect of the Notes which would not be required if the Notes were in definitive form;

“Expenses Loan Agreement” means the expenses loan agreement dated on or about the Closing Date to be entered into between, *inter alia*, FPLP and the Issuer under which FPLP will advance to the Issuer £100,000 which sum may be applied by the Issuer in satisfaction of ongoing expenses of the Issuer;

“Extraordinary Resolution” means a resolution passed at a Meeting duly convened and held in accordance with the Provisions for Meetings of Noteholders by a majority of not less than 75 per cent. of the votes cast;

“Final Maturity Date” means in relation to the Class A-1 Notes, the Interest Payment Date falling in April 2016 and in relation to the Class A-2 Notes, the Interest Payment Date falling in April 2019;

“FPLP” means Provident Life and Pensions Limited, a company incorporated in England and Wales with limited liability (registered number 4096141) whose registered office is at Pixham End, Dorking, Surrey, RH41 1QA;

“FSA” means the Financial Services Authority of the United Kingdom or such other governmental, statutory or other authority as shall from time to time carry out such functions in relation to long term business carried on in the United Kingdom as were at the date of this Agreement allocated to the Financial Services Authority under the Financial Services and Markets Act 2000;

“Global Notes” means the Temporary Global Notes and the Permanent Global Notes for each Class of Notes or, where the context so requires, any of them;

“Holdco” means Box Hill Holdings Limited, a company incorporated under the laws of England and Wales with registered number 5258329 whose registered office is at Fifth Floor, 100 Wood Street, London, EC2V 7EX;

“Indebtedness” means any indebtedness of any person for money borrowed or raised including (without limitation) any indebtedness for or in respect of:

- (a) amounts raised by acceptance under any acceptance credit facility;
- (b) amounts raised under any note purchase facility;
- (c) the amount of any liability in respect of leases which would, in accordance with applicable law and generally accepted accounting principles, be treated as finance or capital leases;
- (d) the amount of any liability in respect of any purchase price for assets or services the payment of which is deferred for a period in excess of 30 days; and
- (e) amounts raised under any other transaction (including without limitation, any forward sale or purchase agreement) having the commercial effect of a borrowing;

“Insolvency Official” means, in respect of any company, a liquidator, provisional liquidator, administrator (whether appointed by the court or otherwise), administrative receiver, receiver or manager, nominee, supervisor, trustee in bankruptcy, conservator, guardian or other similar official in respect of such company or in respect of all (or substantially all) of the company’s assets or in respect of any arrangement or composition with creditors;

“Insolvency Proceedings” means the winding-up, dissolution, company voluntary arrangement or administration of a company or corporation and shall be construed so as to include any equivalent or analogous proceedings under the law of the jurisdiction in which such company or corporation is incorporated or of any jurisdiction in which such company or corporation carries on business or with which it has a connection permitting equivalent analogous proceedings to be commenced against it, including the seeking of liquidation, winding-up, reorganisation, dissolution,

administration, arrangement, adjustment, protection or relief from creditors or the appointment of an Insolvency Official;

“**InterCo**” means Box Hill Loan Finance Limited, a private company limited by shares incorporated in England and Wales under the Companies Act 1985 (registered no. 5294776) and having its registered office at Blackwell House, Guildhall Yard, London, EC2V 5AE;

“**InterCo Account Bank**” means, as at the Closing Date, The Bank of New York, London Branch;

“**InterCo Account Bank Agreement**” means the bank account agreement dated on or about the Closing Date between InterCo and the InterCo Account Bank pursuant to which InterCo will establish the InterCo Bank Accounts;

“**InterCo Accounts**” means, as the case may be, any of the InterCo Bank Accounts or InterCo Custodian Accounts;

“**InterCo Administration Agreement**” means an administration agreement dated on or about the Closing Date between, *inter alios*, InterCo and the InterCo Administrator, under which the InterCo Administrator will provide corporate administration services to InterCo;

“**InterCo Administrator**” means Structural Finance Management Limited, a company incorporated with limited liability in England and Wales (registered number 03853947) and having its registered office at Blackwell House, Guildhall Yard, London, EC2V 5AE;

“**InterCo Ambac Fee Letter**” means the fee letter from InterCo to, and countersigned by, Ambac dated on or about the Closing Date pursuant to which InterCo agrees to pay a fee to Ambac in consideration for the provision by Ambac of the Ambac Liquidity Financial Guarantee and the Ambac InterCo Swap Financial Guarantee;

“**InterCo Bank Accounts**” means the InterCo Transaction Account, the InterCo General Reserve Account, the Liquidity Reserve Account and any other accounts of InterCo other than the InterCo Custodian Accounts;

“**InterCo Cash Management Agreement**” means the cash management agreement dated on or about the Closing Date between *inter alios*, InterCo and the InterCo Cash Manager;

“**InterCo Cash Manager**” means, as at the Closing Date, The Bank of New York, London Branch;

“**InterCo Controlling Creditor**” means, at any time:

- (a) (i) the Issuer Controlling Creditor at that time, other than in respect of any InterCo Reserved Matters and for so long as any amounts (actual, contingent, current or future) are or may become payable by InterCo to the Issuer or the InterCo Loan Agreement remains outstanding;
- (ii) in respect of any InterCo Reserved Matters, the Noteholders (insofar as it relates to the InterCo Loan Agreement), the InterCo Swap Provider (insofar as it relates to the InterCo Swap Agreement) and the Liquidity Facility Provider (insofar as it relates to the Liquidity Facility Agreement);
- (b) (i) Ambac, (I) if there is no person under (a) and (II) for so long as any amounts (actual, contingent, current or future) are or may become payable by InterCo to Ambac under or in connection with the InterCo Guarantee and Reimbursement Agreement (prior to the occurrence of an Ambac Termination Event), and (III) other than in respect of any InterCo Reserved Matters;
- (ii) in respect of any InterCo Reserved Matters, the Noteholders (insofar as it relates to the InterCo Loan Agreement), the InterCo Swap Provider (insofar as it relates to the InterCo Swap Agreement) and the Liquidity Facility Provider (insofar as it relates to the Liquidity Facility Agreement);
- (c) the Liquidity Facility Provider, if (a) and (b) are not applicable and for so long as any amounts (actual, contingent, current or future) are payable by InterCo to the Liquidity Facility Provider or the Liquidity Facility remains outstanding;
- (d) the InterCo Swap Provider, if (a) to (c) (inclusive) are not applicable and for so long as any amounts (actual, contingent, current or future) are or may become payable by InterCo to the InterCo Swap Provider or the InterCo Swap remains in place and has not been terminated; or
- (e) the InterCo Subordinated Loan Provider if (a) to (d) (inclusive) are not applicable;

“**InterCo Custodian**” means, as at the Closing Date, The Bank of New York, London Branch;

“InterCo Custodian Accounts” means the InterCo Reserve Securities Sub-Account and the InterCo Reserve Cash Sub-Account;

“InterCo Custody Agreement” means the custody agreement dated on or about the Closing Date between, *inter alios*, InterCo and the InterCo Custodian under which InterCo has established the InterCo Custody Account;

“InterCo Deed of Charge” means a deed of charge dated on or about the Closing Date between, *inter alios*, the InterCo and the InterCo Security Trustee (acting on behalf of itself and other InterCo Secured Creditors);

“InterCo Deposit Agreement” means the deposit agreement dated on or about the Closing Date between the Issuer and InterCo pursuant to which the Issuer will deposit £14,000,000 with InterCo;

“InterCo Eligible Investments” means investments made by the InterCo Investment Manager in accordance with the provisions of the InterCo Investment Management Agreement;

“InterCo General Reserve Account” means the Sterling denominated general reserve account held by InterCo with the InterCo Account Bank designated as such in the InterCo Account Bank Agreement;

“InterCo Guarantee and Reimbursement Agreement” means the guarantee and reimbursement agreement dated on or about the Closing Date, between, *inter alios*, InterCo and Ambac, pursuant to which InterCo will be obliged, *inter alia*, to reimburse Ambac in respect of any payments made by Ambac under the Ambac Liquidity Financial Guarantee and the Ambac InterCo Swap Financial Guarantee;

“InterCo Investment Management Agreement” means the investment management agreement dated on or about the Closing Date between, *inter alios*, InterCo and the InterCo Investment Manager;

“InterCo Investment Manager” means, as at the Closing Date, F&C Asset Managers Limited, a company limited by shares incorporated in England and Wales (registered number 02550699) and having its registered office at Exchange House, Primrose Street, London, EC2A 2NY;

“InterCo Loan” means the advance made by the Issuer to InterCo under the InterCo Loan Agreement;

“InterCo Loan Agreement” means the loan agreement dated on or about the Closing Date between, *inter alios*, InterCo and the Issuer, under which the Issuer will advance an amount of £380,000,000 to InterCo;

“InterCo/Issuer Gross-up Loan” means a loan equal to any withholding or deduction for or on account of tax pursuant to the InterCo Loan Agreement in the event that a payment made pursuant to the InterCo Loan is subject to withholding or deduction for or on account of tax;

“InterCo Reserve Cash Sub-Account” means the cash sub-account to be held with the InterCo Custodian into which all proceeds from the realisation of InterCo Eligible Investments will be deposited;

“InterCo Reserve Securities Sub-Account” means the securities sub-account to be held with the InterCo Custodian into which InterCo Eligible Investments will be deposited;

“InterCo Reserved Matters” means each and every right, power, authority and discretion of, or exercisable by, the InterCo Security Trustee, the Issuer Security Trustee or the Reinsurer Security Trustee:

- (a) to make any claim under, enforce or agree to any amendment to or novation of the Ambac Liquidity Financial Guarantee and the Ambac InterCo Swap Financial Guarantee;
- (b) to agree to any amendment, waiver or consent which has the effect of (i) amending the Ambac Liquidity Financial Guarantee or the the Ambac InterCo Swap Financial Guarantee, (ii) being a Basic Terms Modification or (iii) amending the rights and discretions of the InterCo Trustee, the Issuer Security Trustee or the Issuer in respect of the Reserved Matters or any Basic Terms Modification;
- (c) to agree to any amendment (i) to the definition of “InterCo Controlling Creditor”, (ii) to any of the Transaction Documents which affects the manner in which any amounts owing to the Issuer Security Trustee (either on its own account or on the account of the Issuer) are paid, (iii) to certain provisions of the InterCo Deed of Charge, (iv) to certain provisions of the Issuer Deed of Charge, the Reinsurer Deed of Charge or to any other provision of the Transaction

Documents which has the effect of amending the provisions of the InterCo Deed of Charge with respect to the application of cash pre-acceleration or post acceleration of the InterCo Deed of Charge or the InterCo Priorities of Payments or (v) of any provision which is provided for the purposes of enabling the InterCo Security Trustee or Issuer Security Trustee to protect its own interests;

- (d) which relates to the application pursuant to the InterCo Deed of Charge or the Issuer Deed of Charge of any sums paid to the Issuer Security Trustee or the InterCo Security Trustee;
- (e) to make any determination contemplated or required under the InterCo Deed of Charge or the Issuer Deed of Charge as to the occurrence or otherwise of an Ambac Event of Default or the occurrence of an InterCo Enforcement Event or in relation to the InterCo Reserved Matters or any Basic Terms Modification;
- (f) unless at such time Ambac is the InterCo Controlling Creditor, to determine whether to require prepayment of the InterCo Loan in accordance with the InterCo Loan Agreement;
- (g) to require the making of payments due and payable to the Issuer Security Trustee or the Issuer;
- (h) to recover or receive any sum due to the InterCo Security Trustee or Issuer Security Trustee for its own account (including, without limitation, in relation to indemnities in favour of the InterCo Security Trustee or the Issuer Security Trustee, or the payment of expenses and stamp duties owed to it), to determine the amount thereof and to make any claim in respect thereof; and
- (i) any amendment to or waiver of any provisions of the Transaction Documents which may affect or amend the rights and/or obligations of the Issuer Security Trustee and the InterCo Security under the Transaction Documents;

“InterCo Secured Creditors” means the InterCo Security Trustee, the Issuer, the Issuer Security Trustee, Ambac, the Liquidity Facility Provider, the InterCo Cash Manager, the InterCo Account Bank, InterCo Administrator, the InterCo Investment Manager, the InterCo Swap Provider, the InterCo Custodian, the Reinsurer, the Reinsurer Security Trustee and the InterCo Subordinated Loan Provider;

“InterCo Security Trustee” means, as at the Closing Date, The Bank of New York, London Branch;

“InterCo Subordinated Loan” means the subordinated loan granted to InterCo by FPLP on or about the Closing Date pursuant to the InterCo Subordinated Loan Agreement;

“InterCo Subordinated Loan Agreement” means the subordinated loan agreement dated on or about the Closing Date between, *inter alios*, InterCo and FPLP, under which FPLP will agree to advance an amount equal to £14,000,000 to InterCo on the Closing Date to enable InterCo to make available to the Issuer the Issuer Subordinated Loan and thereafter to make advances to InterCo on each Loan Interest Payment Date in such amount as is notified by InterCo to FPLP on the immediately preceding Calculation Date as set out therein;

“InterCo Subordinated Loan Provider” means FPLP;

“InterCo Swap Agreement” means the ISDA Master Agreement, the Schedule thereto and Confirmation, each dated on or about the Closing Date between InterCo, the InterCo Swap Provider and the InterCo Security Trustee;

“InterCo Swap Provider” means, as at the Closing Date, Barclays Bank Plc;

“InterCo Transaction Account” means the Sterling denominated transaction account held by InterCo with the InterCo Account Bank designated as such in the InterCo Account Bank Agreement;

“Interest Amount” has the meaning given to it in Condition 5(d) (*Interest – Determination of Rates of Interest and Calculation of Interest Amounts*);

“Interest Determination Date” means the day on which each Interest Period commences or in the case of the first Interest Period, the Closing Date;

“Interest Payment Date” means 15 January, 15 April, 15 July and 15 October in each year or, if that day is not a Business Day, the next succeeding Business Day;

“Interest Period” means each period from (and including) an Interest Payment Date to (but excluding) the next Interest Payment Date provided that the first Interest Period shall be the period from (and including) the Closing Date to (but excluding) the Interest Payment Date falling in April

2005 and (i) in the case of the Class A-1 Notes the last Interest Period shall be the Interest Period ending on (but excluding) the Class A-1 Notes Final Maturity Date and in the case of the Class A-2 Notes, the Interest Period ending on (but excluding) the Class A-2 Notes Final Maturity Date;

“**Investor Report**” means the annual report to be prepared by the Issuer Cash Manager and including the information set out in Schedule 1 to the Issuer Cash Management Agreement;

“**ISDA Master Agreement**” means the 1992 ISDA Master Agreement (Multicurrency – Cross Border) published by the International Swaps and Derivatives Association, Inc.;

“**Issuer**” means Box Hill Life Finance plc, a public company incorporated with limited liability in England and Wales (registered number 5259209) and having its registered office at Pixham End, Dorking, Surrey, RH4 1QA;

“**Issuer Account Bank**” means, as at the Closing Date, The Bank of New York, London Branch;

“**Issuer Account Bank Agreement**” means the account bank agreement dated on or about the Closing Date, between, *inter alios*, the Issuer and the Issuer Account Bank, pursuant to which the Issuer will establish the Issuer Accounts;

“**Issuer Accounts**” means the Issuer Transaction Account, the Issuer Share Capital Account, the Issuer Reserve Account or, where the context so requires, any of them;

“**Issuer Administration Agreement**” means the administration agreement dated on or about the Closing Date, between, *inter alios*, the Issuer, the Issuer Administrator and the Note Trustee;

“**Issuer Administrator**” means, as at the Closing Date, The Law Debenture Corporate Services Limited a company incorporated in England and Wales (registered number 3388362) and having its registered address at Fifth Floor, 100 Wood Street, London EC2U 7EX;

“**Issuer Ambac Fee Letter**” means the fee letter from the Issuer to, and countersigned by, Ambac dated on or about the Closing Date pursuant to which Issuer agrees to pay certain fees to Ambac in consideration for the provision by Ambac of the Ambac Note Financial Guarantee and the Ambac Issuer Swap Financial Guarantee;

“**Issuer Assigned Agreements**” has the meaning given to it in Condition 3(i) (*Status, Priority and Security – Security*);

“**Issuer Available Funds**” means, in respect of an Interest Payment Date, the aggregate of (i) funds which are standing to the credit of the Issuer Transaction Account on the Issuer Report Date immediately preceding such Interest Payment Date, plus (ii) the amount determined on the Issuer Report Date immediately preceding such Interest Payment Date to be the net amount payable to the Issuer under the Issuer Swap Agreement on such Interest Payment Date (or, if negative, zero), plus (iii) the amount determined on the Issuer Report Date immediately preceding such Interest Payment Date to be the amount payable by InterCo under the InterCo Loan on such Interest Payment Date;

“**Issuer Cash Management Agreement**” means the agreement dated on or about the Closing Date between, *inter alios*, the Issuer, the Issuer Cash Manager and the Issuer Security Trustee;

“**Issuer Cash Manager**” means, as at the Closing Date, The Bank of New York, London Branch;

“**Issuer Charged Property**” means the whole of the right, title, benefit and interest of the Issuer in the property, assets and rights of the Issuer described in Clause 3 (*Security and Declaration of Trust*) of the Issuer Deed of Charge and all other property, assets and rights whatsoever of the Issuer and wheresoever situated, present and future of the Issuer;

“**Issuer Controlling Creditor**” means:

- (a) other than in respect of any Reserved Matter or Basic Terms Modification:
 - (i) Ambac, prior to the occurrence of an Ambac Termination Event;
 - (ii) the Noteholders at any time, following the occurrence of an Ambac Termination Event, at which any amount remains outstanding under the Notes; and thereafter
 - (iii) the Issuer Secured Creditor ranking highest in the Issuer Priorities of Payments then applicable (or, if more than one ranking *pari passu*, the one owed the largest amounts);
- (b) in the case of any Reserved Matter or Basic Terms Modification, the Noteholders;

“Issuer Deed of Charge” means the deed of charge dated on or about the Closing Date between, *inter alios*, the Issuer and the Issuer Security Trustee (acting on behalf of itself and the other Issuer Secured Creditors);

“Issuer Eligible Investments” means demand or time deposits or certificates of deposit of any credit institution whose short-term, senior, unsecured, unguaranteed debt obligations are rated at least P-1 by Moody’s and A-1 by S&P provided that in all cases such deposits have a maturity date falling no later than the next following date on which a payment is required to be made with the moneys invested therein;

“Issuer Event of Default” has the meaning given to it in Condition 10(b) (*Issuer Events of Default – Events of Default*);

“Issuer Guarantee Fees” means the guarantee fee(s) payable by the Issuer as specified in the Issuer Ambac Fee Letter;

“Issuer Guarantee and Reimbursement Agreement” means a guarantee and reimbursement agreement dated on or about the Closing Date, between, *inter alios*, the Issuer and Ambac, pursuant to which the Issuer will be obliged, *inter alia*, to reimburse Ambac in respect of any payments made by Ambac under each of the Ambac Note Financial Guarantee and the Ambac Issuer Swap Financial Guarantee and will be obliged to pay any fees and expenses of Ambac in respect of the provision of the Ambac Note Financial Guarantee and the Ambac Issuer Swap Financial Guarantee;

“Issuer Other Secured Contractual Rights” has the meaning given to it in Condition 3(i) (*Security*);

“Issuer Post-Acceleration Priority of Payments” has the meaning given to it in Condition 3(k) (*Issuer Post-Acceleration Priority of Payments*);

“Issuer Pre-Acceleration Priority of Payments” has the meaning given to it in Condition 3(j) (*Issuer Pre-Acceleration Priority of Payments*);

“Issuer Priorities of Payments” means, at any time, the Issuer Pre-Acceleration Priority of Payments if applicable at that time or the Issuer Post-Acceleration Priority of Payments if applicable at that time;

“Issuer Report Date” means the fifth Business Day before each Interest Payment Date, where an Issuer Acceleration Notice has not been served before such date in question and the Interest Payment Date in any other case;

“Issuer Reserve Account” means a Sterling denominated account of the Issuer with the Issuer Account Bank designated as such in the Issuer Account Bank Agreement;

“Issuer Secured Creditors” means the Noteholders, the Couponholders, Ambac, the Note Trustee, the Issuer Security Trustee, any Receiver, the Paying Agents, the Agent Bank, the Issuer Account Bank, the Issuer Administrator, the Issuer Cash Manager, the Issuer Swap Provider, FPLP, the Issuer Subordinated Loan Provider, InterCo and the InterCo Security Trustee;

“Issuer Secured Obligations” means all moneys, obligations and liabilities of any kind which are now or may from time to time after the date of the Issuer Deed of Charge become due, owing or payable by the Issuer, actually or contingently, in any currency to, or to the order of:

- (a) the Noteholders, the Issuer Security Trustee, the Note Trustee and any Receiver under or in respect of the Issuer Deed of Charge, the Note Trust Deed or the Agency Agreement;
- (b) the Issuer Swap Provider under or in respect of the Issuer Swap Agreement and the Issuer Deed of Charge;
- (c) FPLP in respect of amounts payable under the Expenses Loan Agreement and the Issuer Deed of Charge;
- (d) InterCo in respect of the InterCo Gross-Up Loan under the InterCo Loan Agreement, the Issuer Subordinated Loan Agreement and the Issuer Deed of Charge;
- (e) Ambac, in respect of amounts payable under the Issuer Guarantee and Reimbursement Agreement, the Issuer Ambac Fee Letter and the Issuer Deed of Charge;
- (f) the Agents under the Agency Agreement and the Issuer Deed of Charge;
- (g) the Issuer Cash Manager under the Issuer Cash Management Agreement and the Issuer Deed of Charge;

- (h) the Issuer Administrator under the Issuer Administration Agreement and the Issuer Deed of Charge; and
- (i) the Issuer Account Bank under the Issuer Account Bank Agreement and the Issuer Deed of Charge,

in each case, to which each is respectively entitled, and in any capacity and on any basis;

“**Issuer Security**” means the security created pursuant to the Issuer Deed of Charge over all of the assets, revenue and property of the Issuer, as more fully described in Condition 3(i) (*Status, Priority and Security – Security*);

“**Issuer Security Trustee**” means, as at the Closing Date, The Bank of New York, London Branch;

“**Issuer Share Capital Account**” means the account of the Issuer with the Issuer Account Bank designated as such in the Issuer Account Bank Agreement;

“**Issuer Subordinated Loan**” means the subordinated loan having a maximum aggregate principal amount of £14,000,000 made by InterCo to the Issuer on or about the Closing Date pursuant to the Issuer Subordinated Loan Agreement;

“**Issuer Subordinated Loan Agreement**” means the subordinated loan agreement dated on or about the Closing Date between InterCo and the Issuer under which InterCo will agree to advance the Issuer Subordinated Loan to the Issuer;

“**Issuer Swap Agreement**” means the ISDA Master Agreement, the schedule thereto and the confirmations, each dated the Closing Date between the Issuer, the Issuer Swap Provider and the Issuer Security Trustee;

“**Issuer Swap Provider**” means, as at the Closing Date, Barclays Bank PLC;

“**Issuer Transaction Account**” means the Sterling denominated account of the Issuer with the Issuer Account Bank designated as such in the Issuer Account Bank Agreement;

“**Lead Manager**” means Barclays Capital;

“**LIBOR**” means:

- (a) the interest rate for three-month Sterling deposits offered to prime banks in the London inter-bank market which appears on Telerate Screen Page No. 3750 (or such other page as may replace Telerate Screen Page No. 3750 on that service for the purpose of displaying such information or if that service ceases to display such information, such page as displays such information on an equivalent service (or, if more than one, that one which is approved in writing by the Note Trustee to replace the Telerate Monitor)) at or about 11.00 a.m. (London time) on the Interest Determination Date (the “**Screen Rate**”); or in the case of the first Interest Period only, the rate obtained by the linear interpolation of the rate for three-month and four-month Sterling deposits in the market; or
- (b) if the Screen Rate is unavailable at such time, then the rate for the relevant Interest Period shall be the arithmetic mean (rounded to four decimal places with the mid-point rounded up) of the rates notified to the Agent Bank at its request by each of the Reference Banks as the rate at which three-month Sterling deposits or in the case of the first Interest Period only, two and/or three month Sterling deposits (as the case may be) in a representative amount are offered by that Reference Bank to prime banks in the London inter-bank market at or about 11.00 a.m. (London time) on the Interest Determination Date. If on any such Interest Determination Date, at least two of the Reference Banks provide such offered quotations to the Agent Bank, the relevant rate shall be determined, as aforesaid, on the basis of the offered quotations of those Reference Banks providing such quotations. If, on any such Interest Determination Date, only one of the Reference Banks provides the Agent Bank with such an offered quotation, the Agent Bank shall forthwith consult with the Note Trustee and the Issuer for the purposes of agreeing one additional bank to provide such a quotation or quotations to the Agent Bank (which bank is in the opinion of the Note Trustee suitable for such purpose) and the Rate of Interest for the Interest Period in question shall be determined, as aforesaid, on the basis of the offered quotations of such banks as so agreed. If no such bank or banks is or are so agreed or such bank or banks as so agreed does not or do not provide such a quotation or quotations, then the rate for the relevant Interest Period other than the first Interest Period shall be the rate in effect as at the last preceding Interest Determination Date to which paragraph (i) of this definition shall have applied and in respect

of the first Interest Period shall be the arithmetic mean of the rates quoted by such other major banks selected by the Agent Bank and approved by the Note Trustee on the relevant Interest Determination Date;

“**Liquidity Facility Agreement**” means the liquidity facility agreement dated on or about the Closing Date between InterCo, the Liquidity Facility Provider and the Issuer Security Trustee;

“**Liquidity Facility Provider**” means Barclays Bank PLC;

“**Liquidity Reserve Account**” means the Sterling denominated account of InterCo with the InterCo Account Bank, designated as such in the InterCo Account Bank Agreement, for the deposit of certain drawings made pursuant to the Liquidity Facility Agreement;

“**Loan Interest Payment Date**” means, in relation to the InterCo Loan, the Interest Payment Date falling in April of each year (or, if such day is not a Business Day, the immediately succeeding Business Day);

“**Master Definitions Agreement**” means the master definitions agreement dated on or about the Closing Date between, *inter alios*, the Issuer, the Note Trustee, the Issuer Security Trustee and Ambac;

“**Meeting**” means a meeting of the Class A-1 Noteholders and/or the Class A-2 Noteholders (as applicable) (whether originally convened or resumed following an adjournment);

“**Moody’s**” means Moody’s Investors Service Limited (or any successor to its rating business);

“**Note Principal Payment**” has the meaning given to it in Condition 6(d) (*Redemption, Purchase and Cancellation – Note Principal Payments, Principal Amount Outstanding and Pool Factor*);

“**Note Trustee**” means, as at the Closing Date, The Bank of New York, London Branch;

“**Noteholders**” means:

- (a) in relation to any Notes represented by a Global Note, each person (other than Euroclear or Clearstream, Luxembourg) who is for the time being shown in the records of Euroclear or Clearstream, Luxembourg as the holder of a particular Principal Amount Outstanding of those Notes, for which purpose any certificate or letter of confirmation (or any other form of record made by any of them) as to the Principal Amount Outstanding of Notes standing to the account of any person shall be conclusive and binding on the basis that that person shall be treated by the Issuer, the Note Trustee and all other persons as the holder of that Principal Amount Outstanding of those Notes for all purposes other than the right to payments in respect of those Notes which shall be vested, as against the Issuer, solely in the bearer of the relevant Global Note, who shall be regarded as the Noteholder for that purpose; and
- (b) in relation to any Definitive Notes issued under Condition 2(d) (*Form, Denomination and Title – Issue of Definitive Notes*), the bearers of those Definitive Notes,

and related expressions shall be construed accordingly;

“**Notes**” means the Definitive Notes and the Global Notes or, where the context so requires, any of them;

“**Offering Circular**” means the offering circular dated 13 December, 2004 relating to the issue and offering of the Notes;

“**outstanding**” means, in relation to the Notes, all the Notes other than:

- (a) those which have been redeemed in full in accordance with the Conditions;
- (b) those in respect of which the date for redemption in accordance with the provisions of the Conditions has occurred and for which the redemption moneys (including all interest and other amounts (if any) accrued thereon to such date for redemption) have been duly paid to the Principal Paying Agent or the Note Trustee in the manner provided for in the Agency Agreement (and, where appropriate, notice to that effect has been given to the Noteholders in accordance with Condition 17 (*Notices and Information*) and remain available for payment in accordance with the Conditions);
- (c) those which have become void under Condition 8 (*Prescription*);
- (d) those mutilated or defaced Notes which have been surrendered or cancelled and in respect of which replacement Notes have been issued pursuant to Condition 16 (*Replacement of Notes, Coupons and Talons*);

- (e) the Temporary Global Note of any Class, to the extent that it shall have been exchanged for the Permanent Global Note of such Class, or the Permanent Global Note of such Class, to the extent that it shall have been exchanged for Definitive Notes of such Class; and
- (f) (for the purpose only of ascertaining the Principal Amount Outstanding of the Notes then outstanding and without prejudice to the status for any other purpose of the relevant Notes) those Notes which are alleged to have been lost, stolen or destroyed and in respect of which replacements have been issued pursuant to Condition 16 (*Replacement of Notes, Coupons and Talons*),

provided that those Notes (if any) which are for the time being held by any person for the benefit of the Issuer shall (unless and until ceasing to be so held) be deemed not to remain outstanding;

“Part A Warranties” means certain representations, warranties, covenants and undertakings made and given by FPLP in Part A of Schedule 1 and Schedule 3 of the Reinsurance Agreement;

“Part B Warranties” means certain representations, warranties, covenants and undertakings made and given by FPLP in Part B of Schedule 1, Schedule 2, Part B of Schedule 3 and Schedule 4 of the Reinsurance Agreement;

“Paying Agents” means the Principal Paying Agent and any successor or additional paying agents appointed from time to time in connection with the Notes under the Agency Agreement and **“Paying Agent”** means any one of them;

“Permanent Global Note” means, in respect of each Class of Notes, the bearer permanent global note for that Class of Notes in or substantially in the form set out in Schedule 2 (*Form of Permanent Global Note*) to the Trust Deed;

“Pool Factor” has the meaning given to it in Condition 6(d) (*Redemption, Purchase and Cancellation – Note Principal Payments, Principal Amount Outstanding and Pool Factor*);

“Principal Amount Outstanding” means, on any date in relation to a Note, the principal amount outstanding of that Note as at the Closing Date less the aggregate of all Note Principal Payments that have been paid by the Issuer in respect of that Note on or prior to that date;

“Principal Paying Agent” means, as at the Closing Date, The Bank of New York, London Branch;

“Provisions for Meetings of Noteholders” means the provisions contained in Schedule 10 (*Provisions for Meetings of Noteholders*) to the Trust Deed;

“Rate of Interest” has the meaning given to it in Condition 5(c) (*Interest – Rate of Interest*);

“Rating Agencies” means as at the Closing Date, Moody’s and S&P;

“Rating Condition” means, with respect to any action taken or to be taken, a condition that is satisfied when each Rating Agency has confirmed in writing that such action will not result in the withdrawal of, or a reduction with respect to, the then-current rating of the Notes;

“Receiver” means any person (being a licensed insolvency practitioner), who is appointed by the Issuer Security Trustee to be a receiver of the Issuer Charged Property to act jointly, or jointly and severally, as the Issuer Security Trustee shall determine;

“Reference Banks” means Barclays Bank PLC, Deutsche Bank AG London, Lloyds TSB Bank, and National Westminster Bank Plc or such other four major banks in the London inter-bank market as may be approved by the Note Trustee from time to time;

“Regulatory Capital Requirement” means, for FPLP, the minimum applicable regulatory capital or capital ratios from time to time required to be maintained for insurance companies or insurance holding companies generally by the FSA;

“Reinsurance Agreement” means the reinsurance agreement dated on or about the Closing Date between, *inter alios*, the Reinsurer and FPLP;

“Reinsurer” means Friends Provident Reinsurance Services Limited, a private company limited by shares incorporated in England and Wales (registered number 0516582), whose registered address is at Pixham End, Dorking, Surrey, RH4 1QA;

“Reinsurer Account Bank” means, as at the Closing Date, The Bank of New York, London Branch;

“Reinsurer Account Bank Agreement” means an account bank agreement dated on or about the Closing Date between, *inter alios*, the Reinsurer and the Reinsurer Account Bank, under which the Reinsurer Account Bank provides banking services to the Reinsurer;

“Reinsurer Administration Agreement” means an administration agreement dated on or about the Closing Date between, *inter alios*, the Issuer and the Reinsurer Administrator, under which the Reinsurer Administrator will provide corporate administration services to the Reinsurer;

“Reinsurer Administrator” means, as at the Closing Date, Friends Provident Management Services Limited a company limited by shares and incorporated in England and Wales (registered number 983330) and having its registered office at Pixham End, Dorking, Surrey, RH4 1QA;

“Reinsurer Cash Management Agreement” means the cash management agreement dated on or about the Closing Date between the Reinsurer, the Reinsurer Cash Manager, the Reinsurer Account Bank and the Reinsurer Security Trustee;

“Reinsurer Cash Manager” means, as at the Closing Date, The Bank of New York, London Branch;

“Reinsurer Controlling Creditor” means, at any time:

- (a) subject to (b) and (c), the person who is the InterCo Controlling Creditor at that time within paragraphs (a)(i), (b)(i), (c), (d) or (e) of the definition of “InterCo Controlling Creditor”;
- (b) if the InterCo Controlling Creditor is the InterCo Subordinated Loan Provider and any amounts (actual, contingent, current or future) are or may become payable by the Reinsurer to the Reinsurer Swap Provider under or in connection with the Reinsurance Swap Agreement, the Reinsurer Swap Provider;
- (c) if (b) is not applicable (i) the full amount of the then possible Claim under the Reinsurance Agreement is then due and payable, FPLP as the reinsured under the Reinsurance Agreement and (ii) if (c)(i) is not applicable and a Claim is due under the Reinsurance Agreement but is unpaid by the relevant due date, FPLP as the reinsured under the Reinsurance Agreement with respect to enforcing security in respect of the amount of the Claim and until such time as the Claim is satisfied;
- (d) if (a) to (c) above are not applicable, FPLP under the Reinsurance Agreement.

“Reinsurer Custodian” means, as at the Closing Date, The Bank of New York, London Branch;

“Reinsurer Custodian Accounts” means the Reinsurer Reserve Securities Sub-Account and Reinsurer Reserve Cash Sub-Account;

“Reinsurer Custody Agreement” means a custody agreement dated on or about the Closing Date between, *inter alios*, the Reinsurer and the Reinsurer Custodian under which the Reinsurer Custodian will hold the Eligible Investments made by the Reinsurer Investment Manager in custody for the Reinsurer;

“Reinsurer Deed of Charge” means a deed of charge dated on or about the Closing Date between, *inter alios*, the Reinsurer, Ambac and the Reinsurer Security Trustee (acting on behalf of itself and other Reinsurer Secured Creditors);

“Reinsurer Eligible Investments” means investments made by the Reinsurer Investment Manager in accordance with the provision of the Reinsurer Investment Management Agreement;

“Reinsurer Investment Management Agreement” means a Reinsurer Investment Management Agreement dated on or about the Closing Date between, *inter alios*, the Reinsurer, and the Reinsurer Investment Manager, in its capacity as Reinsurer Investment Manager;

“Reinsurer Investment Manager” means, as at the Closing Date, F&C Asset Managers Limited, a company limited by shares incorporated in England and Wales (registered number 02550699) and having its registered office at Exchange House, Primrose Street, London, EC2A 2NY;

“Reinsurer Loan” means the advance made by InterCo to the Reinsurer on or about the Closing Date under the Reinsurer Loan Agreement;

“Reinsurer Loan Agreement” means the loan agreement dated on or about the Closing Date between, *inter alios*, the Reinsurer and InterCo, under which InterCo will advance an amount of £380,000,000 to the Reinsurer;

“Reinsurer Reserve Cash Sub-Account” means the cash sub-account to be held with the Reinsurer Custodian into which all proceeds from the realisation of the Reinsurer Eligible Investments will be deposited;

“Reinsurer Reserve Securities Sub-Account” means the securities sub-account(s) to be held with the Reinsurer Custodian into which the Reinsurer Eligible Investments will be deposited;

“Reinsurer Secured Creditors” means the Reinsurer Security Trustee, InterCo, the InterCo Security Trustee, the Reinsurer Swap Provider, FPLP, the Reinsurer Administrator, the Reinsurer Account Bank, the Reinsurer Cash Manager, the Reinsurer Investment Manager and the Reinsurer Custodian;

“Reinsurer Security Trustee” means, as at the Closing Date, The Bank of New York, London Branch;

“Reinsurer Share Capital Account” means the Sterling denominated account of the Reinsurer with the Reinsurer Account Bank designated as such in the Reinsurer Account Bank Agreement;

“Reinsurer Swap Agreement” means the agreement between the Reinsurer and the Reinsurer Swap Provider dated on or about the Closing Date comprising an ISDA Master Agreement, a schedule thereto, the confirmation and a credit support deed thereunder;

“Reinsurer Swap Provider” means, as at the Closing Date, Barclays Bank PLC;

“Reinsurer Transaction Account” means the Sterling denominated transaction account held by the Reinsurer with the Reinsurer Account Bank designated as such in the Reinsurer Account Bank Agreement;

“Relevant Date” means, in respect of any payment in relation to the Notes, whichever is the later of:

- (a) the date on which the payment in question first becomes due; and
- (b) if the full amount payable has not been received by the Principal Paying Agent or the Note Trustee on or prior to such date, the date on which (the full amount having been so received) notice to that effect has been given to the Noteholders in accordance with Condition 17 (*Notices and Information*);

“Relevant Margin” has the meaning given to it in Condition 5(c) (*Interest – Rate of Interest*);

“Reserved Matter” means each and every right, power, authority and discretion of, or exercisable by, the Note Trustee, the Issuer Security Trustee, the InterCo Security Trustee or the Reinsurer Security Trustee:

- (a) to make any claim under, enforce or agree to any amendment to or novation of any of the Ambac Financial Guarantees;
- (b) to agree to make any amendment, waiver or consent which has the effect of (i) amending the Ambac Financial Guarantee, (ii) being a Basic Terms Modification or (iii) amending the rights and discretions of the Note Trustee, the Issuer Security Trustee or the Noteholders in respect of the Reserved Matters or any Basic Terms Modification;
- (c) to agree to any amendment (i) to the definitions of “Issuer Controlling Creditor”, “InterCo Controlling Creditor” or “Reinsurer Controlling Creditor” (ii) to any of the Transaction Documents which affects the manner in which any amounts owing to the Note Trustee (either on its own account or on the account of the Noteholders) are paid, (iii) to certain provisions of the Trust Deed, (iv) to certain provisions of the Issuer Deed of Charge, the InterCo Deed of Charge, the Reinsurer Deed of Charge or to any other provision of the Transaction Documents which has the effect of amending Clause 8 (*Application of Cash on Closing Date*), Clause 9 (*Application of Cash Prior to Enforcement*) or Clause 11 (*Application of Cash upon Enforcement*) of the Issuer Deed of Charge or the Issuer Priority of Payments or (v) of any provision which is provided for the purposes of enabling the Note Trustee or Issuer Security Trustee to protect its own interests;
- (d) which relates to the application pursuant to the Trust Deed or the Issuer Deed of Charge of any sums paid to the Note Trustee or the Issuer Security Trustee;
- (e) to make any determination contemplated or required under the Trust Deed or the Issuer Deed of Charge as to the occurrence or otherwise of an Ambac Event of Default or the occurrence of an Issuer Event of Default or in relation to the Reserved Matters or any Basic Terms Modification;
- (f) unless at such time Ambac is the Issuer Controlling Creditor, the InterCo Controlling Creditor and the Reinsurer Controlling Creditor, to determine whether to require prepayment of the Notes in accordance with the Conditions;
- (g) to require the making of payments due and payable to the Note Trustee or the Noteholders;

- (h) to recover or receive any sum due to the Note Trustee or Issuer Security Trustee for its own account (including, without limitation, in relation to indemnities in favour of the Note Trustee or the Issuer Security Trustee, or the payment of expenses and stamp duties owed to it), to determine the amount thereof and to make any claim in respect thereof; and
- (i) to agree to any amendment to or waiver of any provisions of the Transaction Documents which may affect or amend the rights and/or obligations of the Note Trustee and the Issuer Security Trustee under the Transaction Documents;

“S&P” means Standard & Poor’s Ratings Services, a division of The McGraw-Hill Companies, Inc. (or any successor to its ratings business);

“Secured Contractual Rights” means, at any time, each of the Issuer Assigned Transaction Documents to which the Issuer is a party and the Issuer Other Secured Contractual Rights at such time;

“Security Powers of Attorney” means the powers of attorney dated on or about the Closing Date and granted by:

- (a) the Issuer in favour of the Issuer Security Trustee and set out in Schedule 1 (*Power of Attorney*) to the Issuer Deed of Charge (the “Issuer Security Power of Attorney”);
- (b) InterCo in favour of the InterCo Security Trustee and set out in Schedule 1 (*Power of Attorney*) to the InterCo Deed of Charge; and
- (c) the Reinsurer in favour of the Reinsurer Security Trustee and set out in Schedule 1 (*Power of Attorney*) to the Reinsurer Deed of Charge;

“Securities” means all bonds, notes, debt securities, deposits, money market funds, collective investment schemes, shares, units or other investments (other than pursuant to the Transaction Documents);

“Solvency Condition” means the condition which will be met by FPLP if it is able to meet its Regulatory Capital Requirement for the time being.

“Specified office” means with respect to the Paying Agents the offices referred to in these Conditions or such other offices as may from time to time be duly notified pursuant to Condition 17 (*Notices and Information*);

“Sterling” means the lawful currency of the United Kingdom;

“Stock Exchange” means the London Stock Exchange PLC;

“Subscription Agreement” means the subscription agreement dated on or about the Closing Date between, *inter alios*, the Lead Manager and the Issuer, under which the Lead Manager agreed (subject to certain conditions) with the Issuer to subscribe, or to procure subscriptions, for the Notes;

“Talonholders” means the holders from time to time of the Talons;

“Talons” means the bearer talons in or substantially in the form set out in Schedule 5 (*Form of Talon*) to the Trust Deed and exchangeable in accordance with the Conditions for further Coupons and/or talons or, where the context so requires, a specific number of them;

“Tax Event” means the occurrence of any of the events set out in Condition 6(c)(i), (ii) and (iii) which has been proved to the satisfaction of the Note Trustee and (for so long as Ambac is the Issuer Controlling Creditor) Ambac;

“Temporary Global Note” means, in respect of each Class of Notes, the bearer temporary global note for that Class of Notes in or substantially in the form set out in Schedule 1 (*Form of Temporary Global Note*) to the Trust Deed;

“Transaction Documents” means the:

- (a) Master Definitions Agreement;
- (b) Global Notes;
- (c) Trust Deed;
- (d) Agency Agreement;
- (e) Subscription Agreement;
- (f) Ambac Note Financial Guarantee;

- (g) Issuer Swap Agreement;
- (h) Ambac Issuer Swap Financial Guarantee;
- (i) Issuer Ambac Fee Letter;
- (j) Issuer Guarantee and Reimbursement Agreement;
- (k) Issuer Subordinated Loan Agreement;
- (l) Expenses Loan Agreement;
- (m) Issuer Administration Agreement;
- (n) Issuer Account Bank Agreement;
- (o) Issuer Cash Management Agreement;
- (p) InterCo Loan Agreement;
- (q) InterCo Swap Agreement;
- (r) Ambac InterCo Swap Financial Guarantee;
- (s) Liquidity Facility Agreement;
- (t) Ambac Liquidity Financial Guarantee;
- (u) InterCo Ambac Fee Letter;
- (v) InterCo Guarantee and Reimbursement Agreement;
- (w) InterCo Subordinated Loan Agreement;
- (x) InterCo Deposit Agreement;
- (y) InterCo Administration Agreement;
- (z) InterCo Account Bank Agreement;
- (aa) InterCo Cash Management Agreement;
- (bb) InterCo Investment Management Agreement;
- (cc) InterCo Custody Agreement;
- (dd) Reinsurance Agreement;
- (ee) Reinsurer Loan Agreement;
- (ff) Reinsurer Swap Agreement;
- (gg) Reinsurer Administration Agreement;
- (hh) Reinsurer Account Bank Agreement;
- (ii) Reinsurer Cash Management Agreement;
- (jj) Reinsurer Investment Management Agreement;
- (kk) Reinsurer Custody Agreement;
- (ll) Issuer Deed of Charge;
- (mm) InterCo Deed of Charge;
- (nn) Reinsurer Deed of Charge; and
- (oo) Security Powers of Attorney.

“**Trust Deed**” means the trust deed constituting the Notes dated on or about the Closing Date between the Issuer and the Note Trustee;

“**Trust Documents**” means the Trust Deed, the Issuer Deed of Charge, the Issuer Security Power of Attorney and any deed or document expressed to be supplemental to the Trust Deed or the Issuer Deed of Charge (as applicable);

“**Unguaranteed Rating**” means the underlying rating given, or which would have been given, by the Rating Agencies to the Notes, disregarding the benefit of the Ambac Financial Guarantees;

“**Value**” means (i) in the case of cash, the amount of that cash and (ii) in the case of any Securities not the subject of a binding contract for sale, the market value as at the close of business on the Business Day preceding the relevant Calculation Date as determined by the InterCo Investment Manager acting in a commercially reasonable manner and (iii) in the case of any Securities the subject of a binding contract for sale, the present value of the sale price (present

value being determined by reference to prevailing interest rates for the period from the date of determination to the date of settlement of such sale);

“**Written Resolution**” means a resolution in writing signed by or on behalf of all holders of Notes who for the time being are entitled to receive notice of a Meeting in accordance with the Provisions for Meetings of Noteholders, whether contained in one document or several documents in the same form, each signed by or on behalf of one or more such holders of the Notes.

1.2 Headings and Clauses

(a) The headings in these Conditions shall not affect their interpretation.

Singular and Plural

(b) Unless the context otherwise requires, words denoting the singular number only shall include the plural number also and *vice versa*, words denoting one gender only shall include the other genders and words denoting persons only shall include firms, corporations and other organised entities, whether separate legal entities or otherwise, and *vice versa*.

Agreements and Statutes

(c) Unless the context otherwise requires, any reference in these Conditions to:

- (i) any agreement or other document shall be construed as a reference to the relevant agreement or document as the same may have been, or may from time to time be, replaced, extended, amended, varied, novated, supplemented or superseded; and
- (ii) any statutory provision or legislative enactment shall be deemed also to refer to any re-enactment, modification or replacement thereof and any statutory instrument, order or regulation made thereunder or under any such re-enactment.

Different Capacities

(d) Where any Transaction Party from time to time acts in more than one capacity hereunder, the provisions of these Conditions shall apply to such Transaction Party as though it were a separate party in each such capacity except insofar as they may require such party in one capacity hereunder to give any notice or information to itself in another capacity.

Successors and assigns

(e) References to a party or a person in these Conditions shall be construed so as to include its successors, transferees, assigns and novatees and any other person who in accordance with a relevant Transaction Document replaces such party or person and, in the case of the Note Trustee, the Issuer Security Trustee, the InterCo Security Trustee or the Reinsurer Security Trustee includes any additional trustee appointed under the Trust Deed, the Issuer Deed of Charge, the InterCo Deed of Charge or the Reinsurer Deed of Charge, as the case may be.

2. FORM, DENOMINATION AND TITLE

Form and Denomination of Temporary Global Notes

(a) Each Class of Notes will be in the denomination of £100,000 each, will be in bearer form and will initially be represented by a Temporary Global Note, without Coupons or Talons attached, in the aggregate principal amount on issue of £280,000,000 for the Class A-1 Notes and £100,000,000 for the Class A-2 Notes.

Exchange for Permanent Global Notes

(b) Interests in each Temporary Global Note are exchangeable on and after the Exchange Date, upon certification of non-US beneficial ownership by the relevant Noteholders, for interests in a Permanent Global Note, without Coupons or Talons attached.

Title to Global Notes

(c) Title to the Global Notes will pass by delivery. For so long as any Notes are represented by a Global Note, those Notes will be transferable only in accordance with the rules and procedures for the time being of Clearstream, Luxembourg or Euroclear, as appropriate.

Issue of Definitive Notes

- (d) If, while any Notes are represented by a Global Note, an Exchange Event occurs, the Issuer will issue Definitive Notes to Noteholders whose accounts with the relevant clearing system are credited with interests in such Global Note in exchange for those interests within 30 days of the occurrence of the relevant event but not earlier than the Exchange Date. The Global Notes will not be exchangeable for Definitive Notes in any other circumstances.

Form and Denomination of Definitive Notes

- (e) Definitive Notes, if issued, will be in the denomination of £100,000 each, serially numbered and in bearer form with (at the date of issue) Coupons and Talons for further Coupons attached. The Definitive Notes, Coupons and Talons will be security printed in accordance with applicable legal and stock exchange requirements and shall be endorsed with these Conditions.

Title to Definitive Notes

- (f) Title to the Definitive Notes, Coupons and Talons will pass by delivery. The holder of any Definitive Note, Coupon or Talon may (except as ordered by a court of competent jurisdiction or otherwise required by law) be treated at all times, by all persons and for all purposes, including the making of any payments in respect of the Notes, as the absolute owner of that Definitive Note, Coupon or Talon (regardless of any notice of ownership, destruction theft or loss or of any trust or other interest in it or any writing on it). The holder of any Coupon (whether or not it is attached to the relevant Definitive Note) in his capacity as such shall be subject to and bound by all the provisions contained in the relevant Definitive Note.

3. STATUS, PRIORITY AND SECURITY

Status and relationship between the Notes

- (a) The Notes and the Coupons constitute direct obligations of the Issuer and are secured by the Issuer Security pursuant to the Issuer Deed of Charge.
- (b) The Notes of each Class rank *pari passu* without preference or priority amongst themselves. Certain other obligations of the Issuer (set out below) rank in priority to the Notes.
- (c) The Class A-1 Notes and the Class A-2 Notes shall be treated as a single class, except as provided in Condition 12(b) (*Meetings of Noteholders – Relationship between Classes*).
- (d) The Notes and the Coupons have the benefit of the Ambac Note Financial Guarantee (issued pursuant to the Issuer Guarantee and Reimbursement Agreement) pursuant to which Ambac unconditionally and irrevocably agrees to pay to the Noteholders, subject to the next paragraph, all sums due and payable but unpaid by the Issuer in respect of payments of Scheduled Interest on and Ultimate Principal (each as defined in the Ambac Note Financial Guarantee) of the Notes, all as more particularly described in the Ambac Note Financial Guarantee.

Under the terms of the Ambac Note Financial Guarantee, Ambac does not guarantee any amounts payable by the Issuer upon an early redemption of the Notes pursuant to Conditions 6(b) (*Redemption, Purchase and Cancellation – Mandatory Redemption in Part*), or 6(c) (*Redemption, Purchase and Cancellation – Redemption for Taxation or other reasons*). Upon any such early redemption, if the amounts payable are not paid in full, Ambac's obligations will continue to be to pay the Guaranteed Amounts (as defined in the Ambac Note Financial Guarantee) on each Interest Payment Date. Ambac will not be obliged under any circumstances to accelerate payment under the Ambac Note Financial Guarantee. However, it may, at its sole option, accelerate payment under the Ambac Note Financial Guarantee, in whole or in part, and the amount payable will be the outstanding principal amount (or the *pro rata* amount that has become due and payable) of the Notes together with the accrued interest (any amounts due in excess of such outstanding principal amount and accrued interest thereon will not be guaranteed by Ambac under the Ambac Note Financial Guarantee). Under the Ambac Note Financial Guarantee there is no obligation on Ambac to guarantee any withholding required to be made by or on behalf of the Issuer in respect of the Notes.

- (e) The Ambac Note Financial Guarantee provided by Ambac in respect of the Notes constitutes a direct, unsecured obligation of Ambac, which will rank at least *pari passu* with all other unsecured obligations of Ambac.
- (f) If Ambac makes a payment under the Ambac Note Financial Guarantee in respect of Scheduled Interest and/or Ultimate Principal, Ambac shall be subrogated to the rights of the Noteholders against the Issuer in respect of such amount and for this purpose, the Issuer shall not be discharged from its obligations under the Notes and the Trust Deed by any payment made by Ambac under the Ambac Note Financial Guarantee. Such right of subrogation is, however, subject to limited recourse provisions.
- (g) The Trust Deed contains provisions requiring the Note Trustee (except where expressly provided otherwise) to have regard to the interests of the Noteholders as a whole in exercising all of its rights, powers, trusts, authorities, duties, discretions and obligations.
- (h) The Issuer Deed of Charge contains provisions requiring the Issuer Security Trustee (except where expressly provided otherwise) to have regard to the interests of the Issuer Secured Creditors as a whole as regards all powers, trusts, authorities, duties and discretions of the Issuer Security Trustee but requiring the Issuer Security Trustee to have regard only to the interests of Ambac (for so long as Ambac is the Issuer Controlling Creditor) (other than in respect of Reserved Matters or any Basic Terms Modification) if in the Issuer Security Trustee's opinion, there is a conflict between the interests of (A) Ambac and (B) any other Issuer Secured Creditor, and in all other cases while there are any amounts payable (currently or in the future and whether or not subject to any contingency or condition) under any Notes, to have regard only to the interests of the Noteholders if, in the opinion of the Issuer Security Trustee, there is a conflict between the interests of the Noteholders and the other Issuer Secured Creditors.

Security

- (i) The Issuer will grant the Issuer Security with or in respect of the following in order to provide security in respect of the obligations of the Issuer to the Issuer Secured Creditors:
 - (1) an assignment, by way of first fixed security for the payment or discharge of the Issuer Secured Obligations, to and in favour of the Issuer Security Trustee of all of its rights, title, interest and benefit, existing at the date of the Issuer Deed of Charge or in the future, in, to, under or in respect of the:
 - (i) InterCo Loan Agreement;
 - (ii) Issuer Subordinated Loan Agreement;
 - (iii) Issuer Swap Agreement;
 - (iv) InterCo Deposit Agreement;
 - (v) Agency Agreement;
 - (vi) Issuer Account Bank Agreement;
 - (vii) Issuer Guarantee and Reimbursement Agreement;
 - (viii) Issuer Administration Agreement;
 - (ix) Issuer Cash Management Agreement; and
 - (x) InterCo Deed of Charge,
 (together, the “**Issuer Assigned Agreements**”), and any other agreement, instrument or notice to which the Issuer becomes a party or in respect of which it has or may have any right, interest, title or benefit, either existing as at the date of the Issuer Deed of Charge or at any time in the future (the “**Issuer Other Secured Contractual Rights**”), including, without limitation:
 - (i) the benefit of all representations, warranties, covenants, undertakings and indemnities under or in respect of the Issuer Assigned Agreements and the Issuer Other Secured Contractual Rights;
 - (ii) all of its rights to receive payment of any amounts which may become payable to it pursuant or with respect to such Issuer Assigned Agreements and Issuer Other Secured Contractual Rights;

- (iii) all payments received by it pursuant to, or with respect to, such Issuer Assigned Agreements and Issuer Other Secured Contractual Rights;
 - (iv) all its rights to serve notices and/or make demands pursuant to such Issuer Assigned Agreements and Issuer Other Secured Contractual Rights and/or to take such steps as are required to cause payments to become due and payable thereunder or with respect to such Issuer Assigned Agreements and Issuer Other Secured Contractual Rights;
 - (v) all of its rights of action in respect of any breach of such Issuer Assigned Agreements or Issuer Other Secured Contractual Rights; and
 - (vi) all of its rights to receive damages, compensation or obtain other relief, including in respect of any breach of or default in respect of such Issuer Assigned Agreements or Issuer Other Secured Contractual Rights.
- (2) a charge, by way of first fixed security for the payment or discharge of the Issuer Secured Obligations, to and in favour of the Issuer Security Trustee of all of its right, title, interest and benefit, existing at the date of the Issuer Deed of Charge or in the future, in and to the Issuer Bank Accounts and all sums of moneys which may be at or after the date of the Issuer Deed of Charge from time to time standing to the credit of the Issuer Bank Accounts and any other bank account or book debt in which the Issuer may at any time acquire any right, title, interest or benefit and each debt represented by these, including all interest accrued and other moneys received in respect thereof.
- (3) a charge by way of first fixed security for the payment or discharge of the Issuer Secured Obligations, to and in favour of the Issuer Security Trustee of all of its right, title, interest and benefit, existing at the date of the Issuer Deed of Charge or in the future, in and to the Issuer Eligible Investments and other securities and investments which the Issuer may at any time acquire, make or otherwise obtain an interest or benefit in, together with all moneys, received in respect thereof and all interest accruing on them from time to time, all dividends and distributions paid or payable thereon, all property paid, distributed, accruing or offered at any time on, to or in respect of or in substitution therefor and the proceeds of sale, redemption or discharge thereof and the benefit of all covenants relating to such Issuer Eligible Investments and other Securities and all rights and remedies for enforcing the same.
- (4) a charge to and in favour of Issuer Security Trustee, by way of first floating charge for the payment or discharge of the Issuer Secured Obligations, the whole of its undertaking and all of its property and assets whatsoever and wheresoever situate, present and future, other than any property or assets from time to time or for the time being effectively charged by way of fixed charge, or otherwise assigned as security, pursuant to the Issuer Deed of Charge.

Issuer Pre-Acceleration Priority of Payments

- (j) Notwithstanding the security interests created by or pursuant to the Issuer Deed of Charge, on each Interest Payment Date which is also a Loan Interest Payment Date or on the next Interest Payment Date following 40 days after termination of the Reinsurance Agreement which falls prior to the delivery of a Note Acceleration Notice the Issuer Cash Manager shall, subject to obtaining the prior consent of the Issuer Security Trustee pursuant to the Issuer Deed of Charge, instruct the Issuer Account Bank to withdraw Issuer Available Funds standing to the credit of the Issuer Transaction Account (but only to the extent that such withdrawal does not cause the Issuer Transaction Account to become overdrawn), to be applied in the following order of priority (in each case only if and to the extent that payments or provisions of a higher order of priority have been made in full):
- (i) first, in or towards satisfaction, *pro rata*, of (i) the Issuer/InterCo Early Termination Payment due and payable under the InterCo Loan Agreement to InterCo, (ii) the Issuer/InterCo Conversion Termination Payment due and payable under the InterCo Loan Agreement to InterCo and (iii) the Issuer Swap Break Costs Payment under the Issuer Swap Agreement due and payable to the Issuer Swap Provider;
 - (ii) second, in or towards satisfaction, *pro rata*, of (i) the fees or other remuneration and indemnity payments (if any) which are then due and payable to the Issuer Security Trustee and any costs, charges, liabilities and expenses incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under this Issuer Deed of Charge and (ii) the fees or other remuneration and indemnity

payments (if any) which are then due and payable to the Note Trustee and any costs, charges, liabilities and expenses incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the Trust Deed;

- (iii) third, in or towards satisfaction, *pro rata*, of (i) the fees or other remuneration and indemnity payments (if any) which are then due and payable to each of the Paying Agents and the Agent Bank and any costs, charges, liabilities and expenses properly incurred by any of them (together with interest on those amounts) for which any of them is entitled to be reimbursed or indemnified under the Agency Agreement, (ii) the fees or other remuneration and indemnity payments (if any) which are then due and payable to the Issuer Account Bank and any costs, charges, liabilities and expenses properly incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the Issuer Account Bank Agreement, (iii) the fees or other remuneration and indemnity payments (if any) which are then due and payable to the Issuer Cash Manager and any costs, charges, liabilities and expenses properly incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the Issuer Cash Management Agreement and (iv) the amount required to maintain the balance of the Issuer Reserve Account to £100,000 on such date and to pay interest accrued and unpaid on the Expenses Loan;
- (iv) fourth, in or towards satisfaction of the fees, costs, liabilities and expenses (together with interest on those amounts) of the Issuer Administrator for which it is entitled to be reimbursed or indemnified under the Issuer Administration Agreement and in payment to the Issuer Share Capital Account of such amount as would (assuming it gave rise to an equal amount of profits available for distribution) enable a dividend of £21,000 (together with an amount equal to VAT which would be payable at the then current standard rate on an amount equal to such amount) to be paid on the Interest Payment Date falling in April 2006 and annual dividends of £7,000 (together with an amount equal to VAT which would be payable at the then current standard rate on an amount equal to such amount) per annum on each subsequent Interest Payment Date falling in April in each year;
- (v) fifth, in or towards satisfaction, *pro rata*, of amounts which are then due and payable to third parties under obligations incurred in the ordinary course of the Issuer's business (other than amounts specifically provided for elsewhere in this order of priority), including amounts due to the Rating Agencies, the Stock Exchange, the auditors and listing agent and any amounts due to the relevant taxation authority in respect of the Issuer's liability to corporation tax (if any);
- (vi) sixth, in or towards satisfaction of the amounts then due and payable in respect of the Issuer Financial Guarantee Fees, premium, fees or other amounts (other than in reimbursement of amounts paid by Ambac under any of the Ambac Financial Guarantees) (if any) payable to Ambac pursuant to the terms of the Issuer Guarantee and Reimbursement Agreement;
- (vii) seventh, in or towards satisfaction of the amounts then due and payable in respect of repayments of any InterCo/Issuer Gross-up Loan made to the Issuer by InterCo, but only to the extent the Issuer has recovered the tax withheld in respect of which the InterCo/Issuer Gross-up Loan was made;
- (viii) eighth, in or towards satisfaction of the amounts then due and payable to the Issuer Swap Provider in respect of the Issuer Swap Agreement (to the extent not paid under (i) above) and any amounts due and payable in respect of replacement of an Issuer Swap Provider;
- (ix) ninth, in or towards satisfaction, *pro rata*, of all amounts of interest which are then due and payable under the Notes;
- (x) tenth, in or towards satisfaction of the amounts then due and payable (other than Issuer Financial Guarantee Fees, premium, fees or other amounts provided for in item (v) above) to Ambac pursuant to the terms of the Issuer Guarantee and Reimbursement Agreement;
- (xi) eleventh, to pay or provide for redeeming the Class A-1 Notes *pro rata* and *pari passu*;
- (xii) twelfth, to pay or provide for redeeming the Class A-2 Notes *pro rata* and *pari passu*;

- (xiii) thirteenth, on and following the date on which no Notes are Outstanding, in or towards satisfaction of all amounts due under the Expenses Loan Agreement;
- (xiv) fourteenth, on and following the date on which no Notes are Outstanding, in or towards satisfaction of all amounts due and payable under the Issuer Subordinated Loan Agreement; and
- (xv) fifteenth, to pay the remainder (if any) to the Issuer.

Notwithstanding the security interests created by or pursuant to the Issuer Deed of Charge, on each Interest Payment Date which is not a Loan Interest Payment Date which falls prior to the delivery of a Note Acceleration Notice by the Note Trustee, the Issuer Cash Manager, as agent for the Issuer shall, subject to obtaining the prior consent of the Issuer Security Trustee pursuant to the provisions of the Issuer Deed of Charge, instruct the Account Bank to withdraw Issuer Available Funds standing to the credit of the Issuer Transaction Account (but only to the extent that such withdrawal does not cause the Issuer Transaction Account to become overdrawn) to be applied in or towards satisfaction, of all amounts of interest which are then due and payable under the Notes.

Notwithstanding the security interests created by or pursuant to the Issuer Deed of Charge, on any Business Day prior to the service of a Note Acceleration Notice, the Issuer Cash Manager, as agent for the Issuer, may, subject to obtaining the prior consent of the Issuer Security Trustee pursuant to the Issuer Deed of Charge, instruct the Issuer Account Bank to withdraw moneys standing to the credit of the Issuer Reserve Account (but only to the extent that such withdrawal does not cause the Issuer Reserve Account to become overdrawn) to pay any amounts that are due and payable in respect of any costs, charges, liabilities and expenses of the Issuer Security Trustee and/or the Note Trustee and any other amounts that are due and payable of the nature described in subparagraph (v) above.

Notwithstanding the security interests created by or pursuant to the Issuer Deed of Charge, on any Business Day prior to the service of a Note Acceleration Notice, the Issuer Cash Manager, as agent for the Issuer, may, subject to obtaining the prior consent of the Issuer Security Trustee pursuant to the Issuer Deed of Charge, instruct the Issuer Account Bank to withdraw moneys standing to the credit of the Issuer Share Capital Account (but only to the extent that such withdrawal does not cause the Issuer Share Capital Account to become overdrawn) to pay a dividend equal to, in respect of the financial period ending 31 December 2005 £21,000 (together with an amount equal to VAT which would be payable at the then current standard rate on an amount equal to such amount) and, in respect of any subsequent financial year, £7,000 (together with an amount equal to VAT which would be payable at the then current standard rate on an amount equal to such amount).

Issuer Post-Acceleration Priority of Payments

- (k) All monies received or recovered by the Issuer Security Trustee or the Receiver for the benefit of the Issuer Secured Creditors in respect of the Issuer Secured Obligations following the delivery of a Note Acceleration Notice by the Note Trustee shall be held by the Issuer Security Trustee or the Receiver, as the case may be, on trust, and shall be applied in the following order of priority (and in each case only if and to the extent that payments or provisions of a higher order of priority have been made in full):
 - (i) first, in or towards satisfaction, *pro rata*, of (i) the Issuer/InterCo Early Termination Payment due and payable under the InterCo Loan Agreement to InterCo, (ii) the Issuer/InterCo Conversion Termination Payment due and payable under the InterCo Loan Agreement to InterCo and (iii) of the Issuer Swap Break Costs Payment under the Issuer Swap Agreement due and payable to the Issuer Swap Provider;
 - (ii) second, in or towards satisfaction, *pro rata*, according to the respective amounts due, of (i) the fees or other remuneration and indemnity payments (if any) then payable to any Receiver and any costs, charges, liabilities and expenses incurred by it (together with any interest thereon), (ii) the fees and indemnity payments (if any) payable to the Note Trustee and any costs, charges, liabilities and expenses incurred by it for which it is entitled to be reimbursed or indemnified under the Trust Deed (together with any interest thereon) and (iii) the fees and indemnity payments (if any) payable to the Issuer Security Trustee and any costs, charges, liabilities and expenses incurred by it for which it is entitled to be reimbursed or indemnified under the Issuer Deed of Charge, (together with any interest thereon as provided for therein);

- (iii) third, in or towards satisfaction of, *pro rata*, according to the respective amounts then due (i) the fees or other remuneration and indemnity payments (if any) which are then due to each of the Paying Agents and the Agent Bank and any costs, charges, liabilities and expenses properly incurred by any of them (together with interest on those amounts) for which any of them is entitled to be reimbursed or indemnified under the Agency Agreement, (ii) the fees or other remuneration and indemnity payments (if any) which are then due to the Issuer Account Bank and any costs, charges, liabilities and expenses properly incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the Issuer Account Bank Agreement and (iii) the fees or other remuneration and indemnity payments (if any) which are then due to the Issuer Cash Manager and any costs, charges, liabilities and expenses properly incurred by it (together with interest on those amounts) for which it is entitled to be reimbursed or indemnified under the Issuer Cash Management Agreement;
- (iv) fourth, in or towards satisfaction of the fees, costs, liabilities and expenses (together with interest on those amounts) of the Issuer Administrator for which it is entitled to be reimbursed or indemnified under the Issuer Administration Agreement;
- (v) fifth, in or towards satisfaction of the amounts then due in respect of the Issuer Financial Guarantee Fees, premium, fees and other amounts payable (other than in reimbursement of amounts paid by Ambac under any of the Ambac Financial Guarantees) (if any) to Ambac pursuant to the terms of the Issuer Guarantee and Reimbursement Agreement;
- (vi) sixth, in or towards satisfaction of the amounts then due to the Issuer Swap Provider under the Issuer Swap Agreement;
- (vii) seventh, in or towards satisfaction of, *pro rata*, all amounts of interest, principal and other amounts due and payable in respect of the Notes;
- (viii) eighth, in or towards satisfaction of the amounts then due (other than Issuer Financial Guarantee Fees, premium fees or other amounts provided for in item (iv) above) to Ambac pursuant to the terms of the Issuer Guarantee and Reimbursement Agreement;
- (ix) ninth, on and following the date on which no Notes are Outstanding, in or towards satisfaction of all amounts due under the Expenses Loan Agreement;
- (x) tenth, in or towards satisfaction of all amounts of interest, principal, and other amounts due and payable in respect of the Issuer Subordinated Loan Agreement;
- (xi) eleventh, to pay the remainder (if any) to the Issuer.

Following service of a Note Acceleration Notice, the Issuer Security Trustee may at its absolute discretion pending application thereof pursuant to the Issuer Deed of Charge deposit all amounts from time to time received by it from the Issuer or any person or persons liable to pay or in respect of the Issuer Charged Property or from the realisation or enforcement of the Issuer Security in a separate suspense account for so long as, and on the terms which, it considers appropriate without any obligation to apply the same or any part thereof in or towards the discharge of any of the Issuer Secured Obligations.

To the extent permitted to do so under the Transaction Documents, for the purpose of giving effect to the Issuer Deed of Charge, the Issuer agrees that, after service of a Note Acceleration Notice, it will hold all of the Issuer Charged Property to which it is entitled (subject to the right of redemption of any obligor) upon trust to convey, assign or otherwise deal with such Issuer Charged Property in accordance with the Issuer Security Trustee's directions.

4. COVENANTS

The Issuer has given certain covenants to, *inter alios*, the Note Trustee and the Issuer Security Trustee pursuant to the Trust Deed and the Issuer Deed of Charge, respectively. In particular, except with the prior written consent of the Issuer Security Trustee and Ambac (so long as Ambac is the Issuer Controlling Creditor) or as expressly provided in these Conditions, the Trust Documents or any of the other Transaction Documents, the Issuer shall not:

Negative Pledge

- (a) create or permit to subsist any mortgage, charge, pledge, lien, (unless arising by operation of law) or other encumbrance or security interest of any kind including, without limitation, anything analogous to any of the foregoing under the laws of any jurisdiction over the whole or any part of its present or future assets, revenues (including any uncalled capital) or undertaking or the Issuer Charged Property;

Restrictions on Activities

- (b) carry on any business other than as described in the Offering Circular and in respect of that business, shall not engage in any activity or do anything whatsoever except that the Issuer shall be entitled to:
 - (i) enter into the Transaction Documents to which it is a party and preserve, exercise and/or enforce any of its rights and perform and observe its obligations under and pursuant to the Transaction Documents to which it is a party and under any modifications or supplements thereto;
 - (ii) issue the Notes;
 - (iii) perform any act, incidental to or necessary in connection with any of the above; and
 - (iv) engage in those activities necessary for its continued existence and proper management;

Disposal of Assets

- (c) transfer, sell, lend, part with or otherwise dispose of, or deal with, or grant any option or present or future right to acquire, any of its assets or undertaking or any interest, right or benefit in respect of any of them or agree or purport to do so;

Indebtedness

- (d) create, incur or permit to subsist any Indebtedness whatsoever or give any guarantee or indemnity in respect of Indebtedness or of any other obligation of any person;

Dividends, Distributions and Shares

- (e) pay any dividend in excess of, in respect of its financial period ending 31 December 2005, £21,000 and in respect of any subsequent financial year, £7,000 or make any other distribution to its shareholders or issue any further shares;

Subsidiaries, Employees and Premises

- (f) have or form or cause to be formed, any subsidiaries or subsidiary undertakings of any other nature or have any employees or premises;

Merger

- (g) amalgamate, consolidate or merge with any other person or convey or transfer its assets or undertaking substantially in their entirety to any other person;

No Variation or Waiver

- (h) permit (i) any of the Transaction Documents to which it is a party to become invalid or ineffective; (ii) the priority of the Issuer Security to be amended, released, postponed or discharged or consent to any variation of, or exercise any powers of consent or waiver pursuant to the terms of, any such Transaction Documents, or (iii) permit any party to any of such Transaction Documents or any other person whose obligations form part of the Issuer Security to be released from its obligations or dispose of the Issuer Charged Property, save as envisaged in the Transaction Documents to which it is a party;

Bank Accounts

- (i) have an interest in any bank account other than the Issuer Accounts, unless that account or interest is charged to the Issuer Security Trustee on terms acceptable to it; or

Separateness

- (k) permit or consent to any of the following occurring:
 - (i) its books and records being maintained with or co-mingled with those of any other person or entity;

- (ii) its bank accounts and the debts represented thereby being co-mingled with those of any other person or entity;
 - (iii) its assets or revenues being co-mingled with those of any other person or entity; or
 - (iv) its business being conducted other than in its own name;
- and, in addition and without limitation to the above, the Issuer shall or shall procure that, with respect to itself:
- (A) separate financial statements in relation to its financial affairs are maintained;
 - (B) all corporate formalities with respect to its affairs are observed;
 - (C) separate stationery, invoices and cheques are used;
 - (D) it always holds itself out as a separate entity; and
 - (E) any known misunderstandings regarding its separate identity are corrected as soon as possible.

In giving any consent to any action referred to in paragraphs (a) to (k) above, the Issuer Security Trustee acting in accordance with Condition 13 may require the Issuer to make any modifications or additions to the provisions of any of the Transaction Documents to which it is a party, or may impose any other conditions or requirements, which the Issuer Security Trustee considers to be expedient (in its absolute discretion) in the interests of the Issuer Secured Creditors.

5. INTEREST

Period of Accrual

- (a) Each Note bears interest on its Principal Amount Outstanding from (and including) the Closing Date. Each Note (or in the case of the redemption of part only of a Note, that part only of that Note) shall cease to bear interest from and including its due date for redemption, unless, upon due presentation of the Note, payment of the relevant amount of principal or any part of it is improperly withheld or refused. In such event, interest will continue to accrue on that unpaid amount (before and after the date of any judgment) at the rate from time to time applicable to that Note up to (but excluding) the date on which, on further presentation of that Note, payment of the relevant amount of principal is made in full or (if earlier) the seventh day after notice is duly given by the Principal Paying Agent to the relevant Noteholder in accordance with Condition 17 (*Notices and Information*) that, upon presentation thereof being duly made, such payment will be made (except to the extent that there is failure in the subsequent payment to the relevant holders under these Conditions).

Interest Payment Dates and Interest Periods

- (b) Interest on each Note is payable quarterly in arrear on each Interest Payment Date in respect of the Interest Period ending on (but excluding) that Interest Payment Date, subject to Condition 7(a) (*Payment in respect of Global Notes*) in accordance with the Trust Deed.

Whenever it is necessary to compute an amount of interest in respect of the Notes for any period (including any Interest Period), such interest shall be calculated on the basis of actual days elapsed and a 365 day year (or, if any portion of that Interest Period falls in a leap year, the sum of (i) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366 and (ii) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365).

Rate of Interest

- (c) (i) The rate of interest payable from time to time in respect of the Notes (the “**Rate of Interest**”) will be determined by the Agent Bank in accordance with this Condition 5 (*Interest*).
- (ii) The Rate of Interest in respect of each Class of Notes for each Interest Period shall be the aggregate of:
 - (A) the Relevant Margin; and
 - (B) LIBOR.
- (ii) For the purposes of these Conditions, the “**Relevant Margin**” shall be:
 - (A) for the Class A-1 Notes 0.20 per cent. per annum; and

- (B) for the Class A-2 Notes 0.23 per cent. per annum.

Determination of Rates of Interest and Calculation of Interest Amounts

- (d) The Agent Bank shall, on each Interest Determination Date, determine and as soon as practicable after 11.00 a.m. (London time) notify to the Issuer, the Issuer Cash Manager, the Note Trustee and the Paying Agents in respect of each Class of Notes:
- (i) the Rate of Interest applicable to the relevant Interest Period; and
 - (ii) the amount of interest due on each Note for the relevant Interest Period, which shall be an amount equal to the product of (A) an amount equal to the product of (aa) the Rate of Interest for that Class of Note and (bb) the Principal Amount Outstanding of such Note on the first day of the relevant Interest Period (after giving effect to any Note Principal Payments made by the Issuer on that date) and (B) an amount equal to the quotient of (aa) the actual number of days in the relevant Interest Period and (2) 365 days (or if any portion of that Interest Period falls in a leap year, the sum of (i) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366 and (ii) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365) (the “Interest Amount”). The resulting figure shall be rounded down to the nearest penny.

Publication of Rate of Interest and Interest Amounts

- (e) As soon as practicable after making the determination pursuant to Condition 5(d) (*Interest – Determination of Rates of Interest and Calculation of Interest Amounts*), the Agent Bank shall cause the Rate of Interest, and the Interest Amounts applicable to each Class of Notes for the relevant Interest Period and the Interest Payment Date on which that Interest Period will end to be notified to the Stock Exchange (for so long as the Notes are listed on the Stock Exchange) and will cause the same to be published in accordance with Condition 17 (*Notices and Information*). The Interest Amount and Interest Payment Date so notified may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without notice if the Interest Period is extended or shortened.

Determination or Calculation by Note Trustee

- (f) If the Agent Bank does not at any time for any reason determine the Rate of Interest and/or calculate the Interest Amount for any Class of Notes for any Interest Period in accordance with this Condition 5 (*Interest*), the Note Trustee shall in respect of each Class of Notes:
- (i) determine the Rate of Interest for the Notes of each Class in the manner specified in this Condition 5 (*Interest*); and/or
 - (ii) calculate the Interest Amount for the Notes of each Class in the manner specified in this Condition 5 (*Interest*),

and any such determination and/or calculation shall be deemed to have been made by the Agent Bank.

Agent Bank

- (g) The Issuer shall ensure that, so long as any of the Notes remains outstanding, there will at all times be an Agent Bank. If the Agent Bank resigns under the Agency Agreement the Issuer may (with the prior written approval of the Note Trustee) or, if the Issuer fails to do so, the Agent Bank may (with the prior approval of the Note Trustee and the Issuer), appoint a successor Agent Bank. If the Agent Bank resigns, its resignation will not take effect until a successor has been appointed and notice of such appointment has been given to the Noteholders in accordance with Condition 17 (*Notices and Information*).

Accrual

- (h) The amount by which the aggregate amount of interest paid on each Class of Notes on any Interest Payment Date in accordance with this Condition 5 (*Interest*) falls short of the aggregate amount of interest which otherwise would be payable on the relevant Notes on that date, shall accrue interest while it remains outstanding at the relevant Rate of Interest for that Class of Note and shall be aggregated with the amount of, and treated for the purposes of, this Condition 5 (*Interest*) as if it were interest due on each such Note of the relevant Class and, subject as provided below, payable on the next succeeding Interest Payment Date.

If, on the Final Maturity Date applicable to the relevant Class of Notes (or on any earlier redemption of the relevant Class of Notes in full), there remains any such shortfall, the amount of such shortfall will become due and payable on the relevant Final Maturity Date (or, in the case of any earlier redemption of the relevant Class of Notes in full, on the date of such redemption).

Notification to be final

- (i) All notifications, opinions, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained for the purposes of this Condition 5 (*Interest*), whether by the Issuer, the Agent Bank or the Note Trustee, shall (in the absence of manifest error, wilful default, negligence or fraud) be binding on the Issuer, the Agent Bank, the Note Trustee and all Noteholders and Couponholders and (in the absence of wilful default, negligence or fraud) the Issuer, the Agent Bank and the Note Trustee shall not have any liability to the Noteholders or Couponholders in connection with the exercise or non-exercise by any of them of their rights, powers, duties and discretions under these Conditions.

6. REDEMPTION, PURCHASE AND CANCELLATION

Final Redemption

- (a) Unless the Notes have been previously redeemed in full and cancelled, the Issuer shall redeem each of the Notes at their Principal Amount Outstanding as follows:
 - (i) the Class A-1 Notes on the Interest Payment Date falling in April 2016; and
 - (ii) the Class A-2 Notes on the Interest Payment Date falling in April 2019.

Mandatory Redemption in Part

- (b) If, on any Issuer Report Date prior to the service of an Issuer Enforcement Notice, the Issuer determines that there will be Available Redemption Funds on the next Interest Payment Date, the Issuer shall:
 - (i) notify Ambac (for so long as Ambac is the Issuer Controlling Creditor), the Note Trustee and the Principal Paying Agent by no later than 10.00 a.m. on that Issuer Report Date that it intends to redeem all or part of the Notes, specifying the amount to be redeemed; and
 - (ii) on the immediately succeeding Interest Payment Date, apply any Available Redemption Funds in redeeming the Notes *pro rata* to their Principal Amount Outstanding in accordance with the Issuer Pre-Acceleration Priority of Payments;

Each Note will be redeemed in an amount calculated in accordance with Condition 6(e) (*Redemption, Purchase and Cancellation – Note Principal Payments, Principal Amount Outstanding and Pool Factor*) together with interest and other amounts (if any) accrued to the date fixed for redemption. Notice of redemption under this Condition 6(b) (*Redemption, Purchase and Cancellation – Mandatory Redemption in Part*) will be given to Noteholders in accordance with Condition 6(e) (*Redemption, Purchase and Cancellation – Note Principal Payments, Principal Amount Outstanding and Pool Factor*).

Redemption for taxation or other reasons

- (c) If FPLP so requests and if the Issuer at any time satisfies the Note Trustee and (for so long as Ambac is the Issuer Controlling Creditor) Ambac that:
 - (i) (I) FPLP under the Reinsurance Agreement, the InterCo Subordinated Loan Agreement or the Expenses Loan Agreement, (II) the Reinsurer under the Reinsurance Agreement, the Reinsurer Loan Agreement or the Reinsurer Swap Agreement, (III) InterCo under the Reinsurer Loan Agreement, the InterCo Subordinated Loan Agreement, the InterCo Swap Agreement, the InterCo Loan Agreement, the Issuer Subordinated Loan Agreement, the InterCo Deposit Agreement, the Liquidity Facility Agreement, the InterCo Ambac Fee Letter or the InterCo Guarantee and Reimbursement Agreement, (IV) the Issuer under the Notes, the InterCo Loan Agreement, the Issuer Subordinated Loan Agreement, the InterCo Deposit Agreement, the Issuer Swap Agreement, the Issuer Ambac Fee Letter or the Issuer Guarantee and Reimbursement Agreement, (V) the Reinsurer Swap Provider under the Reinsurer Swap Agreement, (VI) the Issuer Swap Provider under the Issuer Swap Agreement, (VII) the InterCo Swap Provider under the InterCo Swap Agreement,

(VIII) the Liquidity Facility Provider under the Liquidity Facility Agreement, (IX) Ambac under the Ambac Note Financial Guarantee, the Ambac Liquidity Financial Guarantee, the Ambac Issuer Swap Financial Guarantee or the Ambac InterCo Swap Financial Guarantee, in each case is required to withhold or deduct any amount for or on account of any present or future taxes, duties, assessments or governmental charges of any nature imposed, levied, collected, withheld or assessed by the United Kingdom or any political sub-division of it or any authority of it or in it; or

- (ii) the Issuer, InterCo or the Reinsurer, by reason of a change in tax law (or in the application or official interpretation of any tax law), would not be entitled to relief for tax purposes in the United Kingdom for any amount which it is obliged to pay and which is treated as an expense in its profits and loss account or would be treated as receiving for tax purposes in the jurisdiction of tax residency of the Issuer, InterCo or the Reinsurer as applicable, an amount which it was not entitled to receive, under the Issuer Swap Agreement, the InterCo Swap Agreement or the Reinsurer Swap Agreement as applicable; or
- (iii) by reason of a change in law (or the application or official interpretation thereof), it has become or will become unlawful in the United Kingdom for (I) the Issuer to make, fund or allow to remain outstanding all or any advances made or to be made by it under the InterCo Loan Agreement, (II) InterCo to make, fund or allow to remain outstanding all or any advances made or to be made by it under the Reinsurer Loan Agreement or the Issuer Subordinated Loan Agreement, (III) the Liquidity Facility Provider to make, fund or allow to remain outstanding all or any advances made or to be made by it under the Liquidity Facility Agreement or (IV) FPLP to make, fund or allow to remain outstanding all or any advances made or to be made by it under the InterCo Subordinated Loan Agreement,

then the Issuer shall, if to do so would avoid the relevant event described in (i), (ii) or (iii) above, use all reasonable endeavours to arrange a substitution of a company incorporated in another jurisdiction as principal debtor under the Notes, which is approved in writing by the Note Trustee and subject to obtaining (i) the consent of Ambac (for so long as Ambac is the Issuer Controlling Creditor) and (ii) confirmation from the Rating Agencies that the ratings of the Notes (including the Unguaranteed Rating) in effect immediately prior to substitution would not be adversely affected by such substitution.

If the Issuer is unable to arrange such a substitution which would have the result of avoiding the relevant event described above, then the Issuer may, on any Interest Payment Date immediately following its having satisfied the Note Trustee and Ambac that such event has occurred, redeem all, but not some only, of the Notes at their Principal Amount Outstanding together with accrued but unpaid interest to (but excluding) the date of redemption, provided that:

- (A) the Issuer has given not more than 60 nor less than 30 days' notice (or, in the case of an event described in (iii) above, such shorter period expiring on or before the latest date permitted by relevant law) to the Note Trustee and the Noteholders in accordance with Condition 17 (*Notices and Information*); and
- (B) the Issuer has delivered to the Note Trustee and Ambac (for so long as Ambac is the Issuer Controlling Creditor), prior to the giving of the notice referred to in sub-clause (i) above, a certificate signed by two directors of the Issuer to the effect that it will have the necessary funds, not subject to the interest of any other person, available for the purpose and to discharge any amounts required under the Issuer Post-Acceleration Priority of Payments to be paid in priority to, or *pari passu* with, and including the Notes.

Note Principal Payments, Principal Amount Outstanding and Pool Factor

- (d) The aggregate principal amount redeemable in respect of each Class of Notes on any Interest Payment Date from and including the Interest Payment Date in April 2006 (the "**Note Principal Payment**") under Condition 6(b) (*Redemption, Purchase and Cancellation – Mandatory Redemption in Part*) shall be the amount of the Available Redemption Funds on the Issuer Report Date immediately preceding that Interest Payment Date to be applied in

redemption of Notes of that Class. Each Note will be redeemed in an amount equal to the Note Principal Payment for that Class divided by the number of Notes of that Class and rounded down to the nearest pound.

On each Issuer Report Date (or as soon as practicable after), the Agent Bank shall determine in respect of each Note (i) the amount of any Note Principal Payment (if any) due on the Interest Payment Date next following such Issuer Report Date, (ii) the Principal Amount Outstanding of each such Note and (iii) the fraction expressed as a decimal to the sixth point (the “**Pool Factor**”), of which the numerator is the Principal Amount Outstanding of a Note of that Class (as referred to in (ii) above) and the denominator is 100,000.

The Agent Bank will cause each determination of a Note Principal Payment, Principal Amount Outstanding and Pool Factor to be notified by not less than three Business Days prior to the relevant Interest Payment Date to the Issuer, the Note Trustee, the Paying Agents and (for so long as the Notes are listed on the Stock Exchange) the Stock Exchange, and will immediately cause notice of each such determination to be given in accordance with Condition 17 (*Notices and Information*) by not later than three Business Days prior to the relevant Interest Payment Date. If no Note Principal Payment is due to be made on the Notes of any Class on any Interest Payment Date falling in April a notice to this effect will be given by the Agent Bank to the Noteholders.

If the Agent Bank does not at any time for any reason determine a Note Principal Payment, the Principal Amount Outstanding or the Pool Factor for any Class of Notes in accordance with this Condition 6 (*Redemption, Purchase and Cancellation*), the Note Trustee shall in respect of each Class of Notes:

- (i) determine the Note Principal Payment for the Notes of each Class in the manner specified in this Condition 6(d) (*Redemption, Purchase and Cancellation – Note Principal Payments, Principal Amount Outstanding and Pool Factor*);
- (ii) determine the Principal Amount Outstanding for the Notes of each Class in the manner specified in this Condition 6(e) (*Redemption, Purchase and Cancellation – Note Principal Payments, Principal Amount Outstanding and Pool Factor*); and/or
- (iii) determine the Pool Factor for the Notes of each Class in the manner specified in this Condition 6(d) (*Redemption, Purchase and Cancellation – Note Principal Payments, Principal Amount Outstanding and Pool Factor*).

Any such determination shall be deemed to have been made by the Agent Bank.

Notice of Redemption

- (e) A notice of redemption under Condition 6(c) (*Redemption, Purchase and Cancellation – Redemption for taxation or other reasons*) and Condition 6(d) (*Redemption, Purchase and Cancellation – Note Principal Payments, Principal Amount Outstanding and Pool Factor*) shall be irrevocable and the Issuer shall be bound to redeem the relevant Notes in accordance with these Conditions on expiry of the notice.

No Purchase by Issuer

- (f) The Issuer will not be permitted to purchase any of the Notes.

Cancellation

- (g) All Notes redeemed under this Condition or otherwise surrendered under Condition 16 (*Replacement of Notes, Coupons and Talons*) will be cancelled upon redemption or surrender, together with any unmatured Coupons and any Talons relating to them which are attached to them or surrendered with them, and may not be resold or re-issued.

7. PAYMENTS

Payments in respect of Global Notes

- (a) Payments of interest on the Temporary Global Notes will only be made upon certification of non-US beneficial ownership unless such certification has already been made. On and after the Exchange Date, no payment will be made on any Temporary Global Note unless exchange for an interest in the corresponding Permanent Global Note has been improperly withheld or refused.

Payments of principal, interest and other amounts (if any) in respect of Notes represented by a Global Note will be made against presentation for endorsement and, if no further payment falls to be made in respect of the Notes, surrender of such Global Notes at the specified office of the Principal Paying Agent. A record of each payment made will be endorsed on the appropriate schedule to the relevant Global Note by the Issuer (or by the Principal Paying Agent on its behalf). Such endorsement shall be *prima facie* evidence that such payment has been made in respect of the Global Notes.

Payments of Principal in respect of Definitive Notes

- (b) Payments of principal in respect of the Definitive Notes (if issued) will be made against presentation and (in the case of final redemption, provided that payment is made in full) surrender of the Definitive Notes (and any unmatured Coupons and Talons) at the specified office of any Paying Agent.

Payments of Interest in respect of Definitive Notes

- (c) Payments of interest in respect of the Definitive Notes will (subject as provided in Condition 7(f) (*Payments – Unmatured Coupons and Talons Void*) and Condition 7(g) (*Payments – Payment of Interest on Withheld Amounts*) below) be made against presentation and (provided that payment is made in full) surrender of the relevant Coupons at the specified office of any Paying Agent.

Currency of Payment

- (d) Payments of principal and interest in respect of the Notes will be made in Sterling by cheque drawn on a bank in the United Kingdom or, at the option of the Noteholder, by transfer to a Sterling account maintained by the payee.

Payments subject to the Issuer Deed of Charge and all Fiscal Laws

- (e) Payments of principal and interest in respect of the Notes are subject in all cases to the Issuer Priorities of Payments and the Issuer Deed of Charge and to any fiscal or other laws and regulations applicable thereto.

Unmatured Coupons and Talons Void

- (f) On the date on which any Definitive Note becomes due and payable in full, unmatured Coupons and Talons relating entirely to unmatured Coupons (whether or not attached to such Definitive Note) shall become void and no payment or, as the case may be, exchange shall be made in respect thereof. If the due date for redemption for any Definitive Note is not an Interest Payment Date, accrued interest will be paid only against presentation and surrender of the relevant Definitive Note.

Payment of Interest on Withheld Amounts

- (g) If payment of principal is improperly withheld or refused on or in respect of any Note or part thereof, or a shortfall occurs pursuant to Condition 5(h) (*Interest – Accrual*), the interest which continues to accrue in respect of such Note in accordance with Condition 5(a) (*Interest – Period of Accrual*) or Condition 5(h) (*Interest- Accrual*) (as the case may be) will become due and payable on the date on which the payment of such principal or such shortfall (as the case may be) becomes due and payable and such interest will be paid against presentation of such Note, at the specified office of any Paying Agent in accordance with this Condition 7 (*Payments*).

Paying Agents

- (h) The initial Principal Paying Agent and the other Paying Agents and their respective initial specified offices are specified in these Conditions. The Issuer reserves the right, subject to the prior written approval of the Note Trustee and following written notice to (so long as Ambac remains the Issuer Controlling Creditor), at any time to vary or terminate the appointment of the Principal Paying Agent and/or the other Paying Agents and to appoint additional or other paying agents. If and so long as the Notes are listed on the Stock Exchange and any Note is outstanding, the Issuer will at all times maintain a paying agent with a specified office in England and Wales. The relevant Agent shall at its own expense (if such change or addition was at the sole request of the relevant Paying Agent) on behalf of the Issuer not less than 14 days prior to the date on which any change in its specified office or any change in or

addition to the Paying Agents is to take effect give notice of such change to the Noteholders in accordance with Condition 17 (*Notices and Information*). The Issuer agrees that there will at all times be a Paying Agent in a member state of the European Union that will not be obliged to withhold or deduct tax pursuant to (1) the European Council Directive 2003/48/EC, (2) any Directive implementing the conclusions of the ECOFIN Council meeting of 26-27 November 2000 and/or (3) any law implementing or complying with, or introduced in order to conform to, such Directives.

Exchange of Talons

- (i) On or after the Interest Payment Date of the final Coupon which is (or was at the time of issue) part of any coupon sheet relating to the Notes (each a “**Coupon Sheet**”), the Talon which is (or was at the time of issue) part of such Coupon Sheet may be surrendered at the specified office of any of the Paying Agents in exchange for a further Coupon Sheet (including a further Talon, if applicable, but excluding any Coupons which shall have become void). Upon the due date for redemption in full of any Definitive Note, any unmatured Talon relating to it shall become void and no Coupons will be delivered in respect of such Talon.

Payments on Business Days

- (j) If any payment under a Note or Coupon is due and payable and the Note or Coupon is presented for payment on a day which is not a business day in the place of presentation, the holder of the Note or Coupon shall not be entitled to payment in such place until the next succeeding business day in that place and no further payments or additional amounts by way of interest, principal or otherwise shall be due in respect of the Note or, as the case may be, the Coupon.

Change in Currency

- (k) (i) If at any time there is a change in the currency of the United Kingdom such that the Bank of England recognises a different currency or currency unit as the lawful currency of the United Kingdom, then references in, and obligations arising under, the Notes outstanding at the time of any such change and which are expressed in Sterling shall be converted into, and/or any amount becoming payable under the Notes thereafter as specified in these Conditions shall be paid in, the currency or currency unit of the United Kingdom, and in the manner designated by the Principal Paying Agent. Any such conversion shall be made at the official rate of exchange recognised for that purpose by the Bank of England.
- (ii) Where such a change in currency occurs, the Notes and Coupons then outstanding and the Conditions shall be amended in the manner agreed by the Issuer, Ambac (for so long as Ambac is the Issuer Controlling Creditor), the Note Trustee and the Principal Paying Agent so as to reflect that change and, so far as is practicable, to place the Issuer, Ambac (for so long as Ambac is the Issuer Controlling Creditor), the Noteholders and the Couponholders in the same position they would have been in had no change in currency occurred (such amendments to include, without limitation, changes required to reflect any modification to business day or other conventions arising in connection with such change in currency).

All amendments made pursuant to this Condition 7(k) (*Payments – Change in Currency*) shall be binding upon the Noteholders, the Couponholders and the Talonholders and none of the Issuer, the Note Trustee, the Issuer Security Trustee and the Paying Agents shall be liable to any Noteholder, Couponholder, Talonholder or other person for any costs, losses or expenses in relation to or resulting from the credit or transfer of such other currency or currency unit or any currency conversion or rounding effected in connection therewith.

- (l) All payments on the Notes shall be made only outside the United States.

8. PRESCRIPTION

General

- (a) After the date on which a Note or Coupon becomes void in its entirety, no claim may be made in respect of it.

Principal

- (b) Claims for payment of principal in respect of Notes shall become void unless the relevant Notes are presented for payment within ten years of the appropriate Relevant Date.

Interest

- (c) Claims for interest in respect of Notes, shall become void unless the relevant Coupons are presented for payment within five years of the appropriate Relevant Date.

9. TAXATION

- (a) All payments in respect of the Notes and the Coupons will be made without withholding or deduction for or on account of any present or future taxes, duties or charges of whatsoever nature unless the Issuer or the relevant Paying Agent (as applicable) is required by law to make any payment in respect of the Notes subject to any withholding or deduction for or on account of any such taxes, duties or charges.
- (b) In that event, the Issuer or the relevant Paying Agent (as the case may be) shall make such payment after such withholding or deduction has been made and shall account to the relevant authorities for the amount so withheld or deducted. Neither the Issuer nor the Paying Agents will be obliged to make any additional payments to the Noteholders or Couponholders in respect of such withholding or deduction.

10. ISSUER EVENTS OF DEFAULT

Determination of an Issuer Event of Default

- (a) At any time after the occurrence of an Issuer Event of Default, the Note Trustee:
 - (i) may in its absolute discretion; and
 - (ii) subject to the indemnification of the Note Trustee in accordance with the provisions of the Trust Deed, shall if it has been directed to do so:
 - (A) for so long as Ambac is the Issuer Controlling Creditor, in writing by Ambac; or
 - (B) if Ambac is no longer the Issuer Controlling Creditor in writing by the holders of not less than 25 per cent. of the Principal Amount Outstanding of the Most Senior Class of Notes then outstanding; or
 - (C) by an Extraordinary Resolution of the holders of the Most Senior Class of Notes then outstanding,give a notice (a “**Note Acceleration Notice**”) to the Issuer declaring the Notes to be immediately due and repayable.

Events of Default

- (b) The occurrence of any of the following events shall be an “**Issuer Event of Default**”:
 - (i) default is made for a period of three Business Days or more in the payment of the principal of, or for a period of five Business Days or more in the payment of any interest or other amount (if any) on the Notes then outstanding on the date on which it ought to be paid in accordance with these Conditions; or
 - (ii) the Issuer fails duly to perform or observe any other obligation binding upon it under the Notes, the Trust Deed, the Issuer Deed of Charge or any of the other Transaction Documents to which it is a party, and such failure is in the opinion of the Issuer Controlling Creditor incapable of remedy or capable of remedy but remains unremedied for a period of 30 days following the service by the Note Trustee (or the Issuer Security Trustee, as applicable), on the Issuer of notice requiring the same to be remedied and provided, in each case, that the Note Trustee shall have certified to the Issuer and Ambac that such failure is, in its opinion, materially prejudicial to the interests of the Noteholders or Ambac; or
 - (iii) the Issuer, otherwise than for the purposes of such amalgamation or reconstruction as is referred to in paragraph (iv) below, ceases or, through an official action of the Board of Directors of the Issuer, threatens to cease, to carry on business or is unable to pay its debts as and when they fall due (within the meaning of Section 123 of the Insolvency Act 1986); or

- (iv) an order is made or an effective resolution passed for the winding up of the Issuer except a winding up for the purposes of or pursuant to an amalgamation or reconstruction the terms of which have previously been approved by the Note Trustee in writing or by an Extraordinary Resolution of the Noteholders; or
- (v) (A) any steps are taken (whether out of court or otherwise) against the Issuer under any applicable liquidation, insolvency, composition, reorganisation or other similar laws (including, but not limited to, presentation of a petition for the appointment of an administration order or giving notice of the intention to appoint or any steps taken with the view to the appointment of an administrator (whether out of court or otherwise)) and such proceedings are not, in the opinion of the Note Trustee, being disputed in good faith; or
 - (B) an administration order is granted or an administrative receiver or other receiver, liquidator, administrator or other similar official is appointed (whether out of court or otherwise) in relation to the Issuer or in relation to the whole or any substantial part of the undertaking or assets of the Issuer; or
 - (C) an encumbrancer takes possession of the whole or any substantial part of the undertaking or assets of the Issuer; or
 - (D) a distress, execution, diligence or other process being levied or enforced upon or sued out against the whole or any substantial part of the undertaking or assets of the Issuer and such possession or process (as the case may be) is not being discharged or does not otherwise cease to apply within 14 days; or
 - (E) the Issuer initiates or consents to judicial proceedings relating to itself under applicable liquidation, insolvency, administration, composition, reorganisation or other similar laws or makes a conveyance or assignment for the benefit of its creditors, generally; or
- (vi) any event occurs which under any applicable laws has an analogous effect to any of the events referred to in paragraphs (iii), (iv) and (v) above; or
- (vii) the Issuer Security (or any part thereof) is terminated or is or becomes void, illegal, invalid or unenforceable or if any or all of the material provisions of a Transaction Document are terminated, rescinded or voided and alternative arrangements approved by an Extraordinary Resolution of the holders of Notes are not made within 60 days of the earlier of the date of the Note Trustee requiring alternative arrangements to be made or of such an event; or
- (viii) an Ambac Event of Default occurs.

Acceleration

- (c) Upon delivery of a Note Acceleration Notice, the Notes shall immediately become due and repayable at their Principal Amount Outstanding together with accrued interest up to (but excluding) the earlier of (i) the date on which all principal, interest and other amounts (if any) are paid in full and (ii) the seventh day after notice has been given to the Noteholders in accordance with Condition 17 (*Notices and Information*) that the full amount has been received by the Principal Paying Agent or the Note Trustee.

11. ENFORCEMENT

Note Trustee's right to instruct Issuer Security Trustee to give an Issuer Enforcement Notice

- (a) At any time on or after a Note Acceleration Notice has been given in accordance with the provisions of the Trust Deed and the Conditions, the Note Trustee:
 - (i) may in its absolute discretion on or following on Ambac Termination Event; and
 - (ii) subject to the indemnification of the Note Trustee in accordance with the terms of the Trust Deed, shall, (A) prior to the occurrence of an Ambac Termination Event if so required in writing by Ambac; or (B) on or following an Ambac Termination Event, if it has been directed to do so:
 - (A) in writing by the holders of not less than 25 per cent. of the Principal Amount Outstanding of the Most Senior Class of Notes then outstanding; or
 - (B) by or pursuant to an Extraordinary Resolution of the Notes then outstanding,

instruct the Issuer Security Trustee to give an Issuer Enforcement Notice to the Issuer.

The Note Trustee shall not be obliged to act on the directions of Ambac or the Noteholders, as the case may be, unless it is indemnified by Ambac (if Ambac is directing the Note Trustee to act) or by the Noteholders (if the Noteholders are directing the Note Trustee to act) to its satisfaction.

The Note Trustee may give notice of the delivery of any Note Acceleration Notice in accordance with Condition 17 (*Notices and Information*) and provide a copy of any such Note Acceleration Notice to the Issuer Security Trustee.

Note Trustee's right to take action after an Issuer Enforcement Notice

- (b) At any time after an Issuer Enforcement Notice has been delivered, the Note Trustee shall have the right to, and if so instructed by the Issuer Controlling Creditor shall, instruct the Issuer Security Trustee to take enforcement steps in relation to the Issuer Security and the Note Trustee shall promptly provide the Issuer Security Trustee with all notices and demands in connection therewith.

Limit on Noteholder action

- (c) No Noteholder, Couponholder or Talonholder shall be entitled to take any proceedings or other action directly against the Issuer provided that:
- (i) if the Note Trustee, having been directed to give a Note Acceleration Notice to the Issuer pursuant to Condition 10(a), fails to do so within a reasonable time and that failure is continuing, the holders of not less than 25 per cent. in aggregate of the Principal Amount Outstanding of the Notes then outstanding may sign and give a Note Acceleration Notice in accordance with Condition 10 (*Issuer Events of Default*) and direct the Note Trustee to instruct the Issuer Security Trustee to give an Issuer Enforcement Notice to the Issuer in accordance with Condition 11 (*Enforcement*); or
 - (ii) if the Note Trustee, having been directed to instruct the Issuer Security Trustee to give an Issuer Enforcement Notice to the Issuer pursuant to Condition 11 (*Enforcement*), fails to do so within a reasonable time and that failure is continuing, the holders of not less than 25 per cent. in aggregate of the Principal Amount Outstanding of the Notes then outstanding may themselves instruct the Issuer Security Trustee to give an Issuer Enforcement Notice to the Issuer in accordance with Condition 11 (*Enforcement*); or
 - (iii) if the Issuer Security Trustee, having been directed to give an Issuer Enforcement Notice to the Issuer in accordance with Condition 11 (*Enforcement*), fails to do so within a reasonable time and that failure is continuing, the holders of not less than 25 per cent. in aggregate of the Principal Amount Outstanding of the Notes then outstanding may themselves sign and give an Issuer Enforcement Notice to the Issuer in accordance with Condition 11 (*Enforcement*) and instruct the Issuer Security Trustee to take enforcement steps in relation to the Issuer Security, and an Ambac Termination Event has occurred.

12. MEETINGS OF NOTEHOLDERS

Convening

- (a) The Trust Deed contains provisions for convening Meetings of Noteholders to consider any matter relating to the Notes, including the modification of any provision of these Conditions, the Trust Deed or the other Transaction Documents. Any such modification may be made if sanctioned by an Extraordinary Resolution.

Relationship between Classes

- (b) No Extraordinary Resolution involving a Basic Terms Modification that is passed by the holders of one Class of Notes shall be effective unless it is sanctioned by an Extraordinary Resolution of the holders of the other Class of Notes (to the extent that there are Notes outstanding in such other Class).

Where, in the opinion of the Note Trustee, a Basic Terms Modification gives rise or may give rise to a conflict between the interests of the Class A-1 Noteholders and the Class A-2 Noteholders, the Note Trustee shall require an Extraordinary Resolution to be passed by each of them before approving such Basic Terms Modification.

Quorum and Rules

- (c) Subject as provided below, the quorum at any Meeting of the Noteholders for passing an Extraordinary Resolution in respect of any matter other than a Basic Terms Modification will be two or more persons representing or holding in aggregate more than 50 per cent. of the aggregate Principal Amount Outstanding of the outstanding Notes of the relevant Class or Classes or at any adjourned Meeting two or more persons representing or holding Notes of the relevant Class or Classes, whatever the aggregate Principal Amount Outstanding.

The quorum at any Meeting of the Noteholders for passing an Extraordinary Resolution in respect of a Basic Terms Modification shall be two or more persons representing or holding in aggregate at least 75 per cent. of the aggregate Principal Amount Outstanding of the Notes then outstanding or at any adjourned Meeting two or more persons representing or holding at least $33\frac{1}{3}$ per cent. in aggregate of the aggregate Principal Amount Outstanding of the Notes then outstanding.

The rules relating to Meetings of Noteholders, including matters relating to quorums and resolutions, shall apply *mutatis mutandis* to any Meeting of any Class of Noteholders. The majority required for an Extraordinary Resolution shall be a majority of not less than 75 per cent. of the votes cast on that resolution, whether on a show of hands or a poll.

- (d) For so long as it is the Issuer Controlling Creditor, Ambac shall have the right to direct the Note Trustee in respect of the interests of the Noteholders save in respect of any Basic Terms Modification or Reserved Matters.

When acting at the instruction of Ambac, the Note Trustee shall have no duty to take into account the interests of Noteholders and no liability for acting in accordance with such directions.

Resolutions in Writing

- (e) A Written Resolution shall take effect as if it were an Extraordinary Resolution.

13. MODIFICATION AND WAIVER OF BREACH

Modification without consent

- (a) The Note Trustee may without the consent of the Noteholders, the Couponholders or the Talonholders agree to any modification (other than a Basic Terms Modification) to the Trust Deed, the Notes (including these Conditions), or any of the other Transaction Documents if:
- (i) (A) in the opinion of the Note Trustee, such modification is not materially prejudicial to the interests of the Noteholders (which may be determined by Ambac by virtue of Condition 12(d)); and
 - (B) save in respect of Reserved Matters, for so long as Ambac is the Issuer Controlling Creditor, Ambac has given its prior written consent to such modification (which consent will be deemed to have been given if not refused in writing to the Note Trustee within 15 Business Days of receipt by Ambac of notice of such proposed modification); and
 - (C) each Rating Agency has confirmed in writing that the then current ratings by such Rating Agency of the Notes will not be downgraded as a result of such modification; or
 - (ii) in the opinion of the Note Trustee, such modification is to correct a manifest error or is of a formal, minor or technical nature.

Basic Terms Modification

- (c) No Basic Terms Modification will be effective in respect of the Notes without the prior written consent of Ambac having been obtained.

Waiver of breach without consent

- (d) The Note Trustee may, without prejudice to its rights in respect of any subsequent breach, condition, event or act, from time to time and at any time, but only if and in so far as in its opinion the interests of the Noteholders shall not be materially prejudiced (which may be determined by Ambac by virtue of Condition 12(d)) thereby:

- (i) authorise or waive, on such terms and subject to such conditions (if any) as shall seem fit and proper to it, any proposed breach or breach of any of the covenants or provisions contained in the Trust Deed, the Notes, the Coupons, the Talons or any of the other Transaction Documents; or
 - (ii) determine that any Issuer Event of Default shall not be treated as such,
- without any consent or sanction of the Noteholders, the Couponholders or the Talonholders, provided always that:
- (i) save in the case of Reserved Matters or any proposed breach or breach which would have the same effect as a Basic Terms Modification, for so long as Ambac is the Issuer Controlling Creditor, Ambac has given its prior written consent (which consent will be deemed to have been given if not refused in writing to the Note Trustee within 15 Business Days of receipt by Ambac of notice of such proposed authorisation, waiver or modification); and
 - (ii) each Rating Agency has confirmed in writing that its then current ratings of the Notes will not be downgraded as a result of such authorisation, waiver or determination.

Binding Nature and Notice

- (e) Any modification, waiver, authorisation or determination made pursuant to this Condition shall be binding on the Noteholders, the Couponholders and the Talonholders, Ambac and the other Issuer Secured Creditors and, unless the Note Trustee agrees otherwise, any such modification or waiver shall be notified to the Noteholders as soon as practicable thereafter in accordance with Condition 17 (*Notices and Information*).

14. SUBSTITUTION OF PRINCIPAL DEBTOR

The Trust Deed contains provisions permitting the Note Trustee to agree, subject to such amendment of the Trust Deed and such other conditions as the Note Trustee may require, without the consent of the Noteholders, Couponholders, Talonholder but subject to obtaining the prior consent of Ambac (for so long as Ambac is the Issuer Controlling Creditor), to the substitution including without limitation pursuant to Condition 6(c) (*Redemption, Purchase and Cancellation – Redemption for taxation or other reasons*) of another body corporate in place of the Issuer (or of any previous substitute) as principal debtor in respect of the Trust Deed, the Notes, the Coupons and the Talons. Any such body corporate shall be a newly formed single purpose company and will be required to undertake to be bound by provisions corresponding to those set out in the Trust Deed, the Notes, the Coupons and the Talons.

In the case of a substitution pursuant to this Condition 14 (*Substitution of Principal Debtor*), the Note Trustee may in its absolute discretion and without the consent of the Noteholders, the Couponholders or the Talonholders, agree to a change of the law governing the Notes, the Coupons, the Talons, the Trust Deed and/or any of the other Transaction Documents provided that such change, in the opinion of the Note Trustee, would not be materially prejudicial to the interests of the Noteholders and Ambac provides prior written consent (for so long as Ambac is the Issuer Controlling Creditor) and the Rating Condition is satisfied.

15. NOTE TRUSTEE, ISSUER SECURITY TRUSTEE AND PAYING AGENTS

Note Trustee's and Issuer Security Trustee's Right to Indemnity

- (a) The Trust Deed and the Issuer Deed of Charge contain provisions governing the responsibility (and relief from responsibility) of the Note Trustee and the Issuer Security Trustee and provide that the Note Trustee and the Issuer Security Trustee are each, respectively, entitled to be indemnified and/or secured and relieved from responsibility in certain circumstances and to be paid or reimbursed for any liabilities incurred by them in priority to the claims of the Noteholders. In addition, the Note Trustee and the Issuer Security Trustee are each, respectively, entitled to enter into business transactions with the Issuer and any entity relating to the Issuer and any other party to the Transaction Documents without accounting for any profit.

Note Trustee, Issuer Security Trustee and Issuer Security

- (b) Neither the Note Trustee nor the Issuer Security Trustee shall be responsible for matters relating to the Issuer Security or the Issuer Charged Property including without limitation the creation of, title to, sufficiency of or the registration, perfection or priority of the Issuer Security or Issuer Charged Property.

Removal and Replacement of Note Trustee and Issuer Security Trustee

- (c) There shall at all times be a Note Trustee and an Issuer Security Trustee and each of the Trust Deed and the Issuer Deed of Charge provide that the retirement or removal of any Note Trustee or Issuer Security Trustee shall not become effective unless and until a replacement Note Trustee or Issuer Security Trustee (as the case may be), which must be approved in writing by Ambac (so long as Ambac is the Issuer Controlling Creditor) is appointed.

Paying Agents Solely Agents of Issuer

- (d) In acting under the Agency Agreement and in connection with the Notes, the Coupons or the Talons, the Paying Agents act solely as agents of the Issuer and (to the extent provided therein) the Note Trustee and do not assume any fiduciary duty or other obligation towards or have any relationship of agency or trust for or with any of the Noteholders, Couponholders or Talonholders.

16. REPLACEMENT OF NOTES, COUPONS AND TALONS

If any Note, Coupon or Talon is lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of any of the Paying Agents upon payment by the claimant of the expenses incurred in connection with such replacement and on such terms as to evidence, security, indemnity and otherwise as the Issuer and/or the relevant Paying Agent may reasonably require. Mutilated or defaced Notes, Coupons or Talons must be surrendered before replacements will be issued.

17. NOTICES AND INFORMATION

Valid Notices

- (a) Any notice to Noteholders shall be validly given if such notice is published in a leading English language daily newspaper having general circulation in London (which is expected to be *The Financial Times*) or, if this is not practicable, in another leading English language newspaper as the Note Trustee shall approve having general circulation in England and Wales. Any such notice shall be deemed to have been given on the date of such publication or, if published more than once or on different dates, on the first date on which publication is made in the manner required in the newspaper referred to above.

Notices While Notes in Global Form

- (b) For so long as any of the Notes are represented by a Global Note and such Global Note is held on behalf of Euroclear and/or Clearstream, Luxembourg, notices to Noteholders may be given by delivery of the relevant notice to Euroclear and/or Clearstream, Luxembourg (as the case may be) for communication to the relevant accountholders rather than by publication as required by Condition 17(a) (*Notices and Information – Valid Notices*). Any notice delivered to Euroclear and/or Clearstream, Luxembourg shall be deemed to have been given to Noteholders on the seventh day after the day on which such notice was delivered to Euroclear and/or Clearstream, Luxembourg (as the case may be).

Notices on Bloomberg Screen

- (c) Any notice specifying an Interest Payment Date, a Rate of Interest, an Interest Amount, a Note Principal Payment, a Principal Amount Outstanding or a Pool Factor or that an Issuer Enforcement Notice has been given shall also appear on a page on Bloomberg or such other medium for the electronic display of data as may be approved by the Note Trustee and notified to the Noteholders in accordance with Condition 17(a) (*Notices and Information – Valid Notices*) or Condition 17(b) (*Notices and Information – Notices While Notes in Global Form*).

Other Methods for Notice

- (d) The Note Trustee shall be at liberty to sanction some other method of giving notice to the Noteholders or to a Class or category of them if, in its opinion, such other method is reasonable having regard to market practice then prevailing and to the requirements of the stock exchange on which the Notes are then listed and provided that notice of such other method is given to the Noteholders in such manner as the Note Trustee shall require.

Copy of Notices

- (e) A copy of each notice given in accordance with this Condition 17 (*Notices and Information*) shall be provided to the Rating Agencies and, for so long as the Notes are listed on the Stock Exchange and the rules of that exchange so require, the Stock Exchange.

Couponholders and Talonholders deemed to have notice

- (f) The Couponholders and Talonholders will be deemed for all purposes to have notice of the contents of any notice given to the Noteholders in accordance with this Condition.

Noteholder Information

- (g) The Issuer shall provide the Note Trustee, the Principal Paying Agent and the other Paying Agents with three copies of:
- (i) its audited annual financial statements (including balance sheet, profit and loss and cash flow statements) as soon as they become publicly available (together with the related auditors' report); and
 - (ii) on or before each Interest Payment Date falling in April, the Investor Report.

The audited annual financial statements (together with the related auditors' report) and the Investor Report shall be available for inspection by the Noteholders on reasonable notice on any business day at the specified office for the time being of the Principal Paying Agent and the other Paying Agents or such other place as the Issuer may specify.

18. DETERMINATIONS CONCLUSIVE

All notifications, opinions, determinations, certificates, calculations, quotations and decisions given, expressed, made or obtained, whether by the Reference Banks (or any of them), the Agent Bank or the Note Trustee shall (in the absence of negligence, wilful default or fraud) be binding on the Issuer, the Reference Banks, the Agent Bank, the Note Trustee, the Issuer Cash Manager, the Noteholders, the Couponholders, the Talonholders and Ambac and (in the absence of negligence, wilful default or fraud) no liability to the Noteholders, Couponholders, Talonholders or Ambac shall attach to the Reference Banks, the Agent Bank or the Note Trustee in connection with the exercise or non-exercise by them or any of them of their powers, duties and discretions hereunder.

- (a) to take or join any person in taking steps against the Issuer or Ambac for the purpose of obtaining payment of any amount due from the Issuer to it; or
- (b) to initiate or join any person in initiating any Insolvency Proceedings in relation to the Issuer or the appointment of an Insolvency Official in relation to the Issuer or in relation to the whole or any substantial part of the undertakings or assets of the Issuer; or
- (c) to take any steps or proceedings that would result in either of the Issuer Priorities of Payments in the Issuer Deed of Charge not being observed.

20. CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999

No person shall have any right under the Contracts (Rights of Third Parties) Act 1999 to enforce any term or condition of these Notes.

21. GOVERNING LAW

The Trust Deed, the Notes, the Coupon, the Talons, the Ambac Note Financial Guarantee, the Issuer Deed of Charge, the Agency Agreement and the other Transaction Documents and the relationship between the parties shall be governed by, and interpreted in accordance with, English law.

FORM OF THE NOTES

General

Each Class of Notes will initially be represented by a Temporary Global Note without Coupons or Talons attached.

On the Closing Date each Temporary Global Note will be deposited on behalf of the subscribers of the Notes with a common depository (the “**Common Depository**”) for Euroclear and Clearstream, Luxembourg. Upon deposit of the Temporary Global Note, Euroclear or Clearstream, Luxembourg (as the case may be) will credit each subscriber of Notes with the principal amount of Notes for which it has subscribed and paid.

Interests in each Temporary Global Note will be exchangeable no earlier than the first day following the expiry of forty days after the Closing Date (the “**Exchange Date**”), for interests in a Permanent Global Note without Coupons or Talons attached to the extent that certification (in a form to be provided) to the effect that the beneficial owners of interests in such Notes are not US persons or persons who have purchased such interests for resale to any US person, as required by US Treasury regulations, has been received by Euroclear and/or Clearstream, Luxembourg and Euroclear and/or Clearstream, Luxembourg (as the case may be) has given a like certification (based on the certifications it has received) to the Principal Paying Agent. On the first exchange of an interest in each Temporary Global Note for an interest in the Permanent Global Note of the same Class, such Permanent Global Note will be deposited with the Common Depository.

References herein to Euroclear and/or Clearstream, Luxembourg shall be deemed to include references to any other clearing system approved by the Note Trustee.

Issue of Notes in definitive form

The Permanent Global Notes will be exchangeable in whole but not in part (free of charge to the holder) for Notes in definitive form if either of the following events occurs (each an “**Exchange Event**”):

- (a) both Euroclear and Clearstream, Luxembourg are closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or announce an intention permanently to cease business and do so cease business and no alternative clearing system satisfactory to the Note Trustee is available; or
- (b) as a result of any amendment to, or change in the laws or regulation of England and Wales (or any political sub-division thereof) or of any authority therein or thereof having power to tax or in the interpretation by a revenue authority or a court or in the administration of such laws or regulations which becomes effective on or after the Closing Date, the Issuer or any Paying Agent is or will be required to make any withholding or deduction from any payment in respect of the Notes which would not be required if the Notes were in definitive form,

in which case the Issuer will deliver definitive Notes with (where applicable) Coupons and Talons attached on issue. Such definitive Notes will be issued to the holder of the relevant Permanent Global Note against its surrender at the specified office of the Principal Paying Agent within 30 days of the occurrence of the relevant Exchange Event.

Legend

The Notes, Coupons and Talons will bear the following legend:

“Any United States Person (as defined in the Internal Revenue Code of the United States of America) who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in Sections 165(j) and 1287(a) of the Internal Revenue Code of the United States of America”.

The sections referred to in the legend provide that United States holders will not, with certain exceptions, be permitted to deduct any loss and will not be eligible for favourable capital gains treatment with respect to any gain realised on a sale, exchange or redemption of any Note, Coupon or Talon.

TAXATION

The following is a general description of certain UK tax considerations relating to the Notes based on current law and practice in the UK. It does not purport to be a complete analysis of all tax considerations relating to the Notes. It relates to the position of persons who are the absolute beneficial owners of Notes and some aspects do not apply to certain classes of taxpayer (such as dealers and beneficial owners who are, or who are EU permanent establishments of, EU associated companies of the Issuer and/or Noteholders who are connected with the Issuer for relevant tax purposes). Prospective Noteholders who may be subject to tax in a jurisdiction other than the UK or who may be unsure as to their tax position should seek their own professional advice.

Interest on the Notes

The Notes will constitute “quoted Eurobonds” within the meaning of section 349 of the Income and Corporation Taxes Act 1988 as long as they are and continue to be listed on a “recognised stock exchange” within the meaning of section 841 of that Act. In the case of Notes to be traded on the London Stock Exchange, which is a recognised stock exchange, this condition will be satisfied if the Notes are admitted to listing on the Official List of the UK Listing Authority and to trading on the London Stock Exchange. Accordingly, payments of interest on the Notes may be made without withholding on account of UK income tax provided the Notes remain so listed at the time of payment.

In all other cases an amount must be withheld on account of income tax at the lower rate (currently 20 per cent.), subject to any direction to the contrary by the Inland Revenue under an applicable double taxation treaty, and except that the withholding obligation is disappplied in respect of payments to Noteholders who the Issuer reasonably believes are either a UK resident company or a non-UK resident company carrying on a trade in the UK through a UK permanent establishment which is within the charge to corporation tax, or fall within various categories enjoying a special tax status (including charities and pension funds), or are partnerships consisting of such persons (unless the Inland Revenue directs otherwise).

Interest on the Notes constitutes UK source income for tax purposes and, as such, may be subject to income tax by direct assessment even where paid without withholding. However, interest with a UK source received without deduction or withholding on account of UK tax will not be chargeable to UK tax in the hands of a Noteholder who is not resident for tax purposes in the UK unless that Noteholder: (i) carries on a trade, profession or vocation in the UK through a UK branch or agency or for holders who are companies through a UK permanent establishment, in connection with which the interest is received or to which the Notes are attributable; or (ii) is a trustee of a trust with a UK beneficiary. There are exemptions for interest received by certain categories of agent (such as some brokers and investment managers).

Any Paying Agent or other person through whom interest is paid to, or by whom interest is received on behalf of, an individual (whether resident in the UK or elsewhere) may be required to provide information in relation to the payment and the individual concerned to the UK Inland Revenue. The Inland Revenue may communicate information to the tax authorities of other jurisdictions.

The EU has adopted a Directive regarding the taxation of savings income. Subject to a number of important conditions being met it is proposed that Member States will be required from 1 July 2005 to provide to the tax authorities of other Member States details of payments of interest or other similar income paid by a person within its jurisdiction to or for an individual in another Member State, except that Austria, Belgium and Luxembourg will instead impose a withholding system, for a transitional period unless during such period they elect otherwise. The transitional period will end after agreement on exchange of information is reached between the European Union and certain non-European Union states. No withholding will be required where the Noteholder authorises the person making the payment to report the payment or presents a certificate from the relevant tax authority establishing exemption therefrom (whichever method or methods is or are applicable under national laws implementing the Directive). The attention of Noteholders is drawn to Condition 9 of the Terms and Conditions of the Notes.

Transfer of the Notes

UK corporation taxpayers

In general Noteholders which are within the charge to UK corporation tax (other than investment trusts, venture capital trusts, authorised unit trusts and open-ended investment companies) will be treated for tax purposes as realising profits, gains or losses (including exchange gains and losses) in respect of the Notes on a basis which is broadly in accordance with their statutory accounting treatment so long as the accounting treatment is in accordance with a mark-to-market basis or an accruals basis which is authorised for tax purposes, or, for accounting periods beginning on or after 1 January 2005, generally accepted accounting practice as that term is defined for tax purposes. Such profits, gains and losses will be taken into account in computing taxable income for corporation tax purposes. Noteholders that are investment trusts, venture capital trusts, authorised unit trusts or open-ended investment companies will be subject to the same taxation treatment in respect of the Notes as other Noteholders that are within the charge to UK corporation tax, other than with respect to profits, gains and losses carried to or sustained by a capital reserve in the case of investment trusts and venture capital trusts, and other than with respect to profits and losses of a capital nature in respect of the Notes in the case of authorised unit trusts and open-ended investment companies.

Other UK taxpayers

Taxation of Chargeable Gains

The Notes may not be treated by the Inland Revenue as “qualifying corporate bonds” within the meaning of section 117 of the Taxation of Chargeable Gains Act 1992 because there is a provision for the Notes to be redeemed in or redenominated in a currency other than sterling. Therefore a disposal (including a redemption) of a Note by a Noteholder who is not subject to United Kingdom corporation tax in respect of the Note but who is resident or ordinarily resident in the United Kingdom or carrying on a trade in the United Kingdom through a branch or agency to which the ownership of the Note is attributable may give rise to a chargeable gain or an allowable loss for the purposes of the United Kingdom taxation of chargeable gains.

Accrued Income Scheme

The provisions of the accrued income scheme may apply to certain Noteholders who are not subject to corporation tax in relation to a transfer of the Notes. On a transfer of securities with accrued interest the accrued income scheme usually applies to deem the transferor to receive an amount of income equal to the accrued interest and to treat the deemed or actual interest subsequently received by the transferee as reduced by a corresponding amount. Generally, persons who are neither resident nor ordinarily resident in the UK and who do not carry on a trade in the UK through a branch or agency to which the bonds are attributable will not be subject to the provisions of these rules.

Payments under the Ambac Note Financial Guarantee

Noteholders should note that the United Kingdom tax treatment of any payment under the Ambac Note Financial Guarantee in respect of Scheduled Interest and Ultimate Principal due on the Notes made by Ambac to the Note Trustee for the benefit of the Noteholders is technically unclear.

In particular, it is uncertain whether amounts paid by Ambac under the Ambac Note Financial Guarantee in respect of interest payable under the terms of the Notes would be regarded as interest, annual payments or some other form of United Kingdom source income for the purposes of United Kingdom taxation.

- (i) If the payments are regarded as interest they will be paid subject to withholding or deduction on account of United Kingdom tax at the lower rate (currently 20 per cent.) unless an exemption applies. It should be noted that the exemption which entitles the Issuer to pay interest on the Notes without deduction of tax because the Notes are listed on a recognised stock exchange (see the section entitled “*Interest on the Notes*” above) may not apply to payments by Ambac under the Ambac Note Financial Guarantee which are treated as interest.
- (ii) If the payments are regarded as “annual payments”, they will be paid subject to withholding or deduction on account of United Kingdom tax at the basic rate (currently 22 per cent.) unless an exemption applies.
- (iii) If the payments are regarded as some other form of United Kingdom source income, there should be no withholding or deduction in respect of UK tax.

In all cases above, the position is subject to such relief as may be available under the provisions of any applicable double taxation treaty.

Under the terms of the Ambac Note Financial Guarantee, in the event that any payments by Ambac are made under deduction of United Kingdom income tax, Ambac will be obliged (subject to certain exceptions – see “*Form of Ambac Note Financial Guarantee*” above) to pay such additional amounts to the Note Trustee as may be necessary so that the net amounts due to be received by the Note Trustee shall equal the amount guaranteed which would have been receivable by Noteholders from the Issuer if such payments due from the Issuer had been paid by the Issuer in the absence of such withholding or deduction.

Stamp Duty and SDRT

No stamp duty or stamp duty reserve tax is payable on issue of the Notes or on a transfer of the Notes by delivery.

SUBSCRIPTION AND SALE

The Lead Manager has, pursuant to a subscription agreement dated 13 December, 2004 between, *inter alios*, the Lead Manager and the Issuer (the “**Subscription Agreement**”), agreed (subject to certain conditions) with, *inter alios*, the Issuer to subscribe and pay for each Class of Notes at the issue price of 100 per cent. of their initial principal amount. The Lead Manager is entitled to be released and discharged from its obligations under the Subscription Agreement in certain circumstances prior to payment for the Notes to the Issuer. The Issuer has agreed to indemnify the Lead Manager against certain liabilities in connection with the issue of the Notes.

United Kingdom

The Lead Manager has represented, warranted and agreed with the Issuer and Ambac, *inter alia*, that:

- (a) it has not offered or sold and will not offer or sell any Notes to persons in the United Kingdom prior to admission of the Notes to listing in accordance with Part VI of the Financial Services and Markets Act 2000 (“**FSMA**”), except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995 or FSMA;
- (b) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of FSMA) received by it in connection with the issue or sale of any Notes in circumstances in which section 21(1) of FSMA does not apply to the Issuer or Ambac; and
- (c) it has complied and will comply with all applicable provisions of FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

United States

The Notes have not been and will not be registered under the Securities Act and the Notes are subject to U.S. tax law requirements. Subject to certain exceptions, the Notes may not be offered, sold or delivered within the United States.

The Lead Manager has agreed that it will not offer, sell or deliver the Notes within the United States. In addition, until 40 days after the commencement of the offering, an offer or sale of the Notes within the United States by any dealer (whether or not participating in this offering) may violate the registration requirements of the Securities Act.

General

Reference should be made to the Subscription Agreement for a complete description of the restrictions on offers and sales of the Notes and on distribution of documents. Attention is also drawn to the inside cover of this Offering Circular.

GENERAL INFORMATION

1. The issue of the Notes has been authorised by a resolution of the board of directors of the Issuer passed on 10 December, 2004.
2. The issue of the Ambac Note Financial Guarantee, the Ambac Liquidity Financial Guarantee, the Ambac Issuer Swap Financial Guarantee and the Ambac InterCo Swap Financial Guarantee by Ambac has been duly authorised by resolutions of the Board of Directors of Ambac passed on 14 September, 2004.
3. Application has been made to admit the Notes to the Official List of the UK Listing Authority.
4. The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The Common Code and the ISIN for each Class of Notes are as follows:

Class of Notes	Common Code	ISIN
Class A-1 Notes:	020587075	XS0205870750
Class A-2 Notes:	020587091	XS0205870917

5. (a) The auditors of Ambac are KPMG Audit Plc, Chartered Accountants of 8, Salisbury Square, London EC4Y 8BB. Audited accounts have been prepared in relation to Ambac for the year ended 31 December 2003. KPMG Audit Plc have given, and have not withdrawn, their consent to the inclusion of their report and references to their name and report in this Offering Circular in the form and context in which they appear and has authorised the contents of that part of the Offering Circular for the purposes of Regulation 6(1)(e) of FSMA (Official Listing of Securities) Regulations 2001 (as amended).
- (b) No statutory or non-statutory accounts in respect of any financial year of the Issuer have been prepared. KPMG Audit Plc has given, and has not withdrawn, its consent to the inclusion of its accountants' report and references to its name in this Offering Circular in the form and context in which they appear and has authorised the contents of that part of the Offering Circular for the purposes of Regulation 6(1)(e) of FSMA (Official Listing of Securities) Regulations 2001 (as amended).
- (c) No statutory or non-statutory accounts in respect of any financial year of InterCo have been prepared. KPMG Audit Plc has given, and has not withdrawn, its consent to the inclusion of its accountants' report and references to its name in this Offering Circular in the form and context in which they appear and has authorised the contents of that part of the Offering Circular for the purposes of Regulation 6(1)(e) of FSMA (Official Listing of Securities) Regulations 2001 (as amended).
- (d) No statutory accounts in respect of any financial year of the Reinsurer have been prepared. KPMG Audit Plc has given, and has not withdrawn, its consent to the inclusion of its accountants' report and references to its name in this Offering Circular in the form and context in which it appears and has authorised the contents of that part of the Offering Circular for the purposes of Regulation 6(1)(e) of FSMA (Official Listing of Securities) Regulations 2001 (as amended).
- (e) KPMG LLP, the consultancy actuary, has given, and has not withdrawn, its consent to the inclusion of its reports thereon and references to its name and report in this Offering Circular in the form and context in which they appear and has authorised the contents of that part of the Offering Circular for the purposes of Regulation 6(1)(e) of FSMA (Official Listing of Securities) Regulations 2001 (as amended).
- (f) Graham Aslet, the Appointed Actuary to FPLP, has given and not withdrawn his written consent to the inclusion in this Offering Circular of his name and references to calculations made by him in the form and context in which they appear and has authorised the contents of that part of the Offering Circular for the purposes of Regulation 6(1)(e) of FSMA (Official Listing of Securities) Regulations 2001 (as amended).
6. (a) Ambac is not, and has not been, involved in any litigation or arbitration proceedings which may have, or have had during the 12 months preceding the date of this Offering Circular a significant effect on its financial position nor is Ambac aware that any such proceedings are pending or threatened.

- (b) The Issuer is not involved in any litigation or arbitration proceedings which may have, or have had, since the date of its incorporation, a significant effect on its financial position, nor is the Issuer aware that any such proceedings are pending or threatened.
 - (c) InterCo is not involved in any litigation or arbitration proceedings which may have, or have had, since the date of its incorporation a significant effect on InterCo's financial position, nor is InterCo aware that any such proceedings are pending or threatened.
 - (d) The Reinsurer is not involved in any litigation or arbitration proceedings which may have, or have had, since the date of its incorporation a significant effect on the Reinsurer's financial position, nor is the Reinsurer aware that any such proceedings are pending or threatened.
 - (e) FPLP is not involved in any litigation or arbitration proceedings which may have, or have had, during the 12 months preceding the date of this Offering Circular, a significant effect on FPLP's financial position, nor is FPLP aware that any such proceedings are pending or threatened.
7. Since the date of its incorporation, the Issuer has not entered into any contract or arrangement not being in its ordinary course of business other than the Subscription Agreement.
 8. The annual accounts for Ambac for the years ended 31 December 2002 and 31 December 2003 have been audited without qualification.
 9.
 - (a) Save as disclosed herein, since 31 December 2003, there has been (i) no material adverse change in the financial position or prospects of Ambac and (ii) no significant change in the trading or financial position of Ambac.
 - (b) There has been (i) no material adverse change in the financial position or prospects of the Issuer and (ii) no significant change in the trading or financial position of the Issuer since 14 October, 2004 (being the date of incorporation of the Issuer).
 - (c) There has been (i) no material adverse change in the financial position or prospects of InterCo and (ii) no significant change in the trading or financial position of InterCo since 27 October, 2004 (being the date of incorporation of InterCo).
 - (d) There has been (i) no material adverse change in the financial position or prospects of Reinsurer and (ii) no significant change in the trading or financial position of the Reinsurer since 29 June, 2004 (being the date of incorporation of the Reinsurer).
 - (e) Save as disclosed in the sections entitled "FPLP", since 31 December 2003, there has been (i) no material adverse change in the financial position or prospects of FPLP and (ii) no significant change in the financial or trading position of FPLP.
 10. The Issuer, InterCo, the Reinsurer and FPLP will each produce and publish non-consolidated audited financial statements but will not produce consolidated audited financial statements. The financial year end in respect of each of the Issuer, InterCo, the Reinsurer and FPLP is the 31 December.
 11. The Notes, Interest Coupons and Talons will bear the following legend: "Any United States person (as defined in the Internal Revenue Code of the United States of America) who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in Section 165(j) and 1287(a) of the Internal Revenue Code of the United States of America."
 12. The Trust Deed, the Issuer Deed of Charge, the InterCo Deed of Charge and the Reinsurer Deed of Charge will provide that the Note Trustee, the Issuer Security Trustee, the InterCo Security Trustee and the Reinsurer Security Trustee may rely on reports or other information from professional advisers or other experts in accordance with the provisions of the Trust Deed, the Issuer Deed of Charge, the InterCo Deed of Charge and the Reinsurer Deed of Charge, respectively, whether or not any such report or other information, or engagement letter or other document entered into by the Note Trustee, the Issuer Security Trustee, the InterCo Security Trustee or the Reinsurer Security Trustee (as the case may be) and the relevant person in connection therewith, contains any limit on the liability of the relevant person.

- 13 Copies of the following documents may be inspected (and, in the case of the documents listed in paragraphs (b), (c), (d) and (e) below, may be obtained) during usual business hours at the registered office of the Issuer and at the specified offices of the Principal Paying Agent at any time after the date of this Offering Circular:
- (a) the memorandum and articles of association of the Issuer, InterCo, the Reinsurer and FPLP;
 - (b) the accountants' reports for the Issuer, InterCo and the Reinsurer;
 - (c) the financial statements of FPLP for the years ended 31 December 2002 and 2003 and the audit reports thereon;
 - (d) the memorandum and articles of association of Ambac;
 - (e) the annual accounts of Ambac for the years ended 31 December 2003, 31 December, 2002 and 31 December, 2001 and audit report on the former;
 - (f) the consents and reports referred to in paragraph 5 above;
 - (g) after the Closing Date, copies of the following documents:
 - (i) Master Definitions Agreement;
 - (ii) Global Notes;
 - (iii) Trust Deed;
 - (iv) Agency Agreement;
 - (v) Subscription Agreement;
 - (vi) Ambac Note Financial Guarantee;
 - (vii) Issuer Swap Agreement and the Schedule and confirmations in respect of the Issuer Fixed/Floating Swap and the Issuer Funding Swap;
 - (viii) Ambac Issuer Swap Financial Guarantee;
 - (ix) Issuer Ambac Fee Letter;
 - (x) Issuer Guarantee and Reimbursement Agreement;
 - (xi) Issuer Subordinated Loan Agreement;
 - (xii) Expenses Loan Agreement;
 - (xiii) Issuer Administration Agreement;
 - (xiv) Issuer Account Bank Agreement;
 - (xv) Issuer Cash Management Agreement;
 - (xvi) InterCo Loan Agreement;
 - (xvii) InterCo Swap Agreement;
 - (xviii) Ambac InterCo Swap Financial Guarantee;
 - (xix) Liquidity Facility Agreement;
 - (xx) Ambac Liquidity Financial Guarantee;
 - (xxi) InterCo Ambac Fee Letter;
 - (xxii) InterCo Guarantee and Reimbursement Agreement;

- (xxiii) InterCo Subordinated Loan Agreement;
- (xxiv) InterCo Deposit Agreement;
- (xxv) InterCo Administration Agreement;
- (xxvi) InterCo Account Bank Agreement;
- (xxvii) InterCo Cash Management Agreement;
- (xxviii) InterCo Investment Management Agreement;
- (xxix) InterCo Custody Agreement;
- (xxx) Reinsurance Agreement;
- (xxxi) Reinsurer Loan Agreement;
- (xxxii) Reinsurer Swap Agreement (including the Schedule, the confirmation in respect of the Reinsurer Swap and the Credit Support Deed thereunder);
- (xxxiii) Reinsurer Administration Agreement;
- (xxxiv) Reinsurer Account Bank Agreement;
- (xxxv) Reinsurer Cash Management Agreement;
- (xxxvi) Reinsurer Investment Management Agreement;
- (xxxvii) Reinsurer Custody Agreement;
- (xxxviii) Issuer Deed of Charge;
- (xxix) InterCo Deed of Charge;
- (xl) Reinsurer Deed of Charge;
- (xli) Security Powers of Attorney;
- (xlii) Preliminary Offering Circular; and
- (xlili) Offering Circular,

shall be available for inspection.

14 So long as any Notes remain outstanding, copies of the most recent:

- (a) annual audited non-consolidated financial statements of the Issuer, InterCo and the Reinsurer;
- (b) the Investor Report (such reports are expected to be provided annually on the Interest Payment Date falling in April); and
- (c) regulatory returns filed by FPLP and the Reinsurer with the United Kingdom's Financial Services Authority together with regulatory returns previously filed by FPLP since 31 December 2001,

may be obtained free of charge from the specified offices of the Principal Paying Agent as soon as they are publicly available.

APPENDIX 1 – INVESTMENT PERFORMANCE AND STRATEGY

Investment Controls

The investment policy, approach and strategy of FPLP are subject to various levels of control to meet the funds' objectives and to ensure investments are made within the regulatory requirements. While there are general restrictions that apply to all the investments, there are also specific constraints that apply to different investments.

The main general restrictions are as follows:

- Any changes to overall instructions and agreed strategy, or actions outside previously agreed authority levels must be agreed by the Board of FPLP and by the Board of FP plc or the "Investment Committee", a sub-committee of the Board of FP plc authorised to approve such changes.
- Any changes to overall instructions to fund managers will be made by amendments to the Investment Management Agreement between FPLP and the appointed investment manager.

The main process for monitoring and controlling FPLP's investment manager is through regular quarterly meetings between the Investment Committee and the investment manager. Three major functions are carried out by these meetings:

1. Discussion of standard reports produced by FPLP management and the investment managers which are intended to:
 - (a) demonstrate compliance with existing servicing level agreement limitations and controls, showing where there have been exceptions. This includes checks on asset allocation, compliance with the credit risk controls and other parameters that define and control strategy; and
 - (b) give a detailed analysis of fund performance compared to both benchmark indices and peer group target performance set by Friends Provident for the different types of funds.
2. There is a general discussion on performance and any other issues relevant to the investment management of the funds;
3. Proposals to change the investment strategy, policy or controls, or any other aspects of the management of the funds are considered; if they are accepted by the Investment Committee and the FPLP Board, and if appropriate the FP plc Board, the changes will be incorporated into the appropriate agreement and/or the individual fund mandate.

Investment Performance

The tables set out below illustrate the performance of the principal unit linked funds of FPLP and show the relative Micropal performance of such funds over 1, 5 and 10 years.

Micropal statistics are produced by S&P and rank the performance of each fund with reference to other comparable funds in each sector.

The score represents the number of firms ranked higher in the rankings and therefore 100 per cent. would be a low score as it would mean that every other fund in the relevant sector was ranked above the fund in question. A score of 1 per cent. would be the highest possible score meaning that no firms ranked higher than the relevant firm.

The historic investment performance of the With Profits Fund is not reproduced because there has been a significant change in the asset mix over the last two years.

Actual future experience is likely to differ from past performance and such variations may be material. Consequently, the inclusion of the performance details below should not be regarded as a representation by FPLP, the Reinsurer, InterCo, the Issuer, Ambac, KPMG, the Lead Manager or any of their respective affiliates or any other person that the future performance will reflect past performance. Prospective investors are cautioned not to place reliance on such past performance.

Investment Strategy

Unit linked and unitised with profits policies

Assets backing allocated units in respect of the various unit linked funds are invested with a view to achieving the objectives of the relevant fund as described below. The investment objective of the With Profits Fund is also set out below.

Conventional non profit pensions annuity business

For pre-demutualisation annuities, Gilts and corporate bonds are held to match projected cashflows for the non-linked annuity payments. Index linked gilts and index-linked corporate bonds are held to match projected cashflows for the index linked annuity payments.

Conventional non profit life and pensions business

Gilts and corporate bonds are held to provide a broad match to liabilities (e.g. sterling reserves for unitised business and Mathematical Reserves in respect of conventional non profit business within the defined book).

Unit Linked Fund Objectives

Each unit linked fund has its own objective and this determines the strategies implemented and the investments selected for each fund. The definition of each fund provided to policyholders of unit linked policies is as follows:

Life Funds	Fund Objective
Cash Fund	The main investments of this Fund are interest bearing deposits with the major London clearing banks and other members of the London money market
Equity Income	This Fund aims to provide a yield significantly higher than that offered by the major UK equity indices together with some long-term capital growth. The higher income is primarily achieved by selecting equities with an above average yield rather than investing in fixed interest securities. The greater part of the portfolio is invested in UK equities, but from time to time, up to approximately 10 per cent. of the scheme may be invested overseas.
European	The European Fund seeks to obtain long-term capital growth from a diversified portfolio of investments spread throughout the countries of Europe, except the UK. The Fund mainly invests in equities, but there may be periods when European fixed interest securities are an attractive investment for part of the portfolio.
Fixed Interest	This Fund invests primarily in British Government gilt-edged stocks and other fixed interest securities. These provide a reliable income and can also offer potential for capital growth. When market conditions permit, the fund managers pursue an active policy of switching between stocks to maximise growth.
Multi Manager Growth	This Fund aims to provide longer-term capital growth by investment in regulated collective investment schemes. The scheme will invest via external fund managers, mainly in equity based Funds in the UK and internationally including smaller companies and markets where appropriate.
High Yield Distribution	This Fund aims to provide a high yield income by investing in corporate bonds, and other fixed interest securities.
Index Linked	This Fund invests in index-linked Treasury stocks which are linked to the retail prices index for both annual interest payments and redemption payments on maturity.
Investment Trust Portfolio	This Fund aims to maximise capital growth by investing in a portfolio of investment trusts from a number of investment houses. The Fund has an international spread, although the main focus is on the UK and Europe. No more than 50 per cent. of the Fund will invest in F&C investment trusts at any time.
Managed	This Fund aims to achieve above average growth over the longer-term. The Fund may invest in UK and overseas quoted equities, fixed interest securities, property or cash at the manager's discretion. Normally, the fund buys units in other Friends Provident investment funds although in appropriate circumstances the managers may invest directly.
Monthly Distribution	This Fund aims to provide a high monthly income and some long-term capital growth. The Fund will invest mainly in UK equities and fixed interest securities.
North American	This Fund aims to provide capital growth by investing in shares of US and Canadian companies. If appropriate, investment may be directed towards attractive prospects arising in Mexico and Central and South America.
Overseas Equity	Although this Fund comprises mainly of overseas shares, it may also include

Life Funds	Fund Objective shares of UK companies, which predominantly invest overseas. The aim of the Fund is to provide long-term growth.
Pacific Basin	The approach of this Fund is to maintain a highly active investment policy aiming for capital growth by investing in the economies of Hong Kong, Japan, Singapore, Australia, New Zealand and other markets of the Pacific region.
Property	This Fund is invested in high quality commercial properties selected for growth in rental and capital values over the longer term.
Stewardship	This Fund invests in UK equities chosen on ethical grounds as well as for financial gain. Stewardship seeks to invest in companies that make a positive contribution to society, and seeks to avoid those that do not. The emphasis of the fund is on achieving longer-term capital growth.
Stewardship International	This Fund combines the benefits of ethical investment with the growth potential of international markets. It invests for long-term capital growth via a focused portfolio of UK and overseas equities.
Stewardship Managed	This Fund aims to provide an ethical investment medium for people who do not regard financial gain as the sole criterion for investment. The emphasis of the Fund is on achieving long-term capital growth, through a diversified portfolio of UK and overseas equities and bonds.
UK Equity	This Fund invests in selected equities on the London Stock Exchange which the fund manager feels offer the best opportunities for capital growth.
UK Index Tracking	This Fund aims to mirror as closely as possible the performance of the FTSE All Share Index (an Index of all companies listed on the London Stock Exchange) by using investment techniques which replicate the index.
Pension Funds	Fund Objective
Annuity Protector	This Fund invests mainly in longer-dated Government gilt-edged stocks, but may also hold overseas and non-government fixed interest securities. The Fund is managed with the aim of achieving an increase in value at times when interest rates are falling. The Fund aims to protect investments against drops in annuity rates by matching the investments held as closely as possible to the cost of buying an annuity.
European	The European Fund seeks to obtain long-term capital growth from a diversified portfolio of investments spread throughout the countries of Europe, except the UK. The Fund mainly invests in equities, but there may be periods when European fixed interest securities are an attractive investment for part of the portfolio.
Fixed Interest	This Fund invests primarily in British Government gilt-edged stocks and other fixed interest securities. These provide a reliable income and can also offer potential for capital growth. When market conditions permit, the fund managers pursue an active policy of switching between stocks to maximise growth.
Index Linked	This Fund invests in index-linked Treasury stocks which are linked to the retail prices index for both annual interest payments and redemption payments on maturity.
Managed	This Fund aims to achieve above average growth over the longer-term. This Fund may invest in UK and overseas quoted equities, fixed interest securities, property or cash at the manager's discretion. Normally, units are purchased in other Friends Provident investment funds although in appropriate circumstances the managers may invest directly.
Managed Portfolio	This Fund aims to provide longer-term capital growth by investment in regulated collective investment schemes, such as unit trusts and OEICs. This Fund will invest mainly in equity based funds, both UK and global including those which invest in smaller companies and markets where suitable.
North American	This Fund aims to provide capital growth by investing in shares of US and Canadian companies. If appropriate, investment may be directed towards

Pension Funds	Fund Objective attractive prospects arising in Mexico and Central and South America.
Overseas Equity	Although this Fund comprises mainly of overseas shares, it may also include shares of UK companies, which predominantly invest overseas. The aim of the Fund is to provide long-term growth.
Pacific Basin	The aim of this Fund is to maintain a highly active investment policy aiming for capital growth by investing in the economies of Hong Kong, Japan, Singapore, Australia, New Zealand and other markets of the Pacific region.
Property	This Fund is invested in high quality commercial properties selected for growth in rental and capital values over the longer term.
Stewardship	This Fund invests in UK equities chosen on ethical grounds as well as for financial gain. Stewardship seeks to invest in companies that make a positive contribution to society, and seeks to avoid those that do not. The emphasis of the fund is on achieving longer-term capital growth.
Stewardship Managed	This Fund aims to provide an ethical investment medium for people who do not regard financial gain as the sole criterion for investment. The emphasis of the Fund is on achieving long-term capital growth, through a diversified portfolio of UK and overseas equities and bonds.
UK Equity	This Fund invests in a balanced portfolio of UK equities, which offer the best opportunities for capital and/or income growth.
UK Index Tracking	This Fund aims to mirror as closely as possible the performance of the FTSE All Share Index (an Index of all companies listed on the London Stock Exchange) by using investment techniques which replicate the index.

With Profits Fund Investment Objective

The investment strategy for the With Profits Fund will be determined after taking into account:

- (a) the overall strategy to achieve above average returns in the longer term;
- (b) the current and projected financial position of the With Profits Fund (treating the With Profits Fund and the mandatory capital support provided under the Scheme as if it were a notional mutual life company and ignoring for this purpose the need to repay that mandatory capital support);
- (c) advice from the investment manager for the FPLP Funds;
- (d) advice from the With Profits Actuary, and relevant committees of the FPLP Board;
- (e) the investment expectations of all classes of policyholder resulting from information provided to them;
- (f) the advantages of reducing overall volatility by investing in a wide range of assets; and
- (g) the equity backing ratios of the with profits funds of peer companies,

provided that the existence of these requirements shall not prevent short term tactical asset allocation decisions from being implemented from time to time.

The liabilities of the With Profits Fund may be grouped into separate pools within the With Profits Fund as a whole (for example non profit business, pre and post demutualisation business, or parts thereof) and the investment strategy for each of the resulting pools determined separately;

FPLP may instruct the investment manager to use derivatives as part of an investment strategy to help manage risk or to aid efficient portfolio management. FPLP uses a range of counterparties in order to limit exposure to any one counterparty;

Assets that would not normally be traded may be held by the With Profits Fund. Their performance will be reflected in the amounts payable under with profits policies. Such assets were allocated to the With Profits Fund at demutualisation and new investments may be made. The assets may continue to be held provided that in the opinion of Directors of FPLP, after taking advice from the With Profits Actuary, they offer sufficient expectation of reward to the With Profits Fund to compensate for lack of liquidity and credit risk taking into account the current and projected financial position of the With Profits Fund. The assets may include investments in Friends Provident group companies and properties occupied by Friends Provident group companies

Investment Performance

These tables demonstrate the historic performance of the principal unit linked funds of FPLP as at 30 September, 2004.

The fund sizes below are related to the underlying linked funds and not just related to the Defined Book.

Life Funds – Performance as at 30 September 2004 (percentile rankings within respective fund sectors)

Fund	Fund Size (£m)	1 Year		5 Years		10 years	
		per cent. Growth	Percentile	per cent. Growth	Percentile	per cent. Growth	Percentile
Friends Provident Cash	33.0	2.6	35	16.2	34	44.1	32
Friends Provident Equity Income	59.7	12.0	62	-2.3	72	68.4	75
Friends Provident European	79.3	12.4	49	-8.5	60	107.5	17
Friends Provident Fixed Interest	220.2	2.8	46	30.4	5	95.0	17
Friends Provident Multi Manager Growth	11.8	8.2	76	—	—	—	—
Friends Provident High Yield Distribution	83.8	10.4	7	—	—	—	—
Friends Provident Index Linked	35.7	4.9	53	23.1	41	84.3	37
Friends Provident Investment Trust Portfolio	82.9	11.9	11	0.9	18	—	—
Friends Provident Managed	845.2	10.4	23	-9.1	72	52.8	49
Friends Provident Monthly Distribution	598.3	6.2	67	23.0	38	104.9	24
Friends Provident North American	18.3	-4.0	96	-31.2	77	44.9	70
Friends Provident Overseas Equity	51.9	5.1	65	-27.2	89	20.3	55
Friends Provident Pacific Basin	17.0	8.7	23	-14.8	73	-7.0	39
Friends Provident Property	288.2	12.2	44	53.4	32	79.6	65
Friends Provident Stewardship	259.7	18.0	7	1.8	14	81.9	20
Friends Provident Stewardship International	0.8	4.2	72	—	—	—	—
Friends Provident Stewardship Managed	37.1	12.2	6	-2.2	42	—	—
Friends Provident UK Equity	184.8	14.0	25	-13.3	63	59.0	59
Friends Provident UK Index Tracking	4.0	13.4	32	-10.8	55	—	—

Pension Funds – Performance as at 30 September 2004 (percentile rankings within respective fund sectors)

Life Fund	Fund Size (£m)	1 Year		5 Years		10 years	
		per cent. Growth	Percentile	per cent. Growth	Percentile	per cent. Growth	Percentile
Friends Provident Cash	173.8	3.5	42	21.8	48	61.7	37
Friends Provident Annuity Protector	69.6	4.3	66	28.4	46	—	—
Friends Provident European	218.8	12.4	80	-7.5	68	140.5	24
Friends Provident Fixed Interest	386.3	3.9	53	38.7	11	130.7	16
Friends Provident Index Linked	37.5	6.1	70	29.0	36	105.8	33
Friends Provident Managed	2,566.0	10.5	31	-8.5	80	66.8	46
Friends Provident Managed Portfolio	9.4	8.5	82	-12.4	73	—	—
Friends Provident North American	45.0	-1.7	85	-32.7	81	65.1	73
Friends Provident Overseas Equity	854.9	7.6	55	-18.8	74	32.1	52
Friends Provident Pacific Basin	52.1	9.4	18	-12.6	66	-1.7	25
Friends Provident Property	176.3	13.9	47	67.6	20	154.6	21
Friends Provident Stewardship	722.8	17.5	14	2.1	16	107.2	17
Friends Provident Stewardship Managed	80.2	11.7	11	-0.9	33	—	—
Friends Provident UK Equity	1,668.5	14.0	41	-14.6	72	72.8	59
Friends Provident UK Index Tracking	74.6	13.2	55	-9.4	47	—	—

Ambac Assurance UK Limited
Directors' Report and Financial Statements
for the year ended 31 December 2003
Registered no: 3248674

Ambac Assurance UK Limited

Directors' Report and Financial Statements
for the year ended 31 December 2003

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Ambac Assurance UK Limited

Directors and advisers

Directors

John W Uhlein III *Chairman & Managing Director*
Robert J Genader
Martin Roberts
David W Wallis
David R Larwood

Secretary and registered office

David R Larwood
Hasilwood House
60 Bishopsgate
London EC2N 4BE

Registered Auditor

KPMG Audit Plc
8 Salisbury Square
London EC4Y 8BB

Bankers

Citibank NA
336 Strand
London WC2R 1HB

Solicitors

Linklaters
One Silk Street
London EC2Y 8HQ

Ambac Assurance UK Limited

Directors' report

The directors present their report and the audited financial statements for the year to 31 December 2003.

Principal activity

The company carries on non-life financial loss insurance business. The company is a wholly owned subsidiary of Ambac Assurance Corporation, a financial guarantee insurance company resident in Wisconsin, United States of America. The ultimate holding company is Ambac Financial Group, Inc. a company publicly quoted on the New York Stock Exchange in New York, United States of America.

Business review

The company is authorised to transact credit, suretyship and financial guarantee insurance business in the United Kingdom. The company is also authorised to provide services in relation to such business to persons in thirteen other European countries. The directors anticipate that the company will continue to expand its current operations by offering services into certain other countries within Europe.

Ambac Assurance UK Limited has earned triple A ratings, the highest ratings available from Moody's Investors Service, Inc., Standard & Poor's Ratings Services, and Fitch Inc.

Results and dividends

The results for the year are set out in the profit and loss account on pages 266 and 267.

The directors do not recommend the payment of a dividend.

Directors and directors' interests

The directors who held office during the year are shown on page 262.

According to the Register of Directors Interests, none of the directors has any interest in the shares of the company. Under the provisions of the Company (Disclosure of Directors' Interests) (Exceptions) Regulations 1985, the directors of the company are exempt from disclosing any interests in the shares of the ultimate parent company.

Statement of directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss for that year. The directors are required to:

- (a) select suitable accounting policies and then apply them consistently;
- (b) make judgements and estimates that are reasonable and prudent;
- (c) state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- (d) prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

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

Auditors

The company has, by elective resolution, dispensed with the need to appoint auditors annually and therefore KPMG Audit Plc continue to hold office.

By order of the board

A handwritten signature in black ink, appearing to read 'D. Larwood', with a large, sweeping flourish above the name.

David R Larwood
Secretary

2 March 2004

Ambac Assurance UK Limited

Independent auditors' report to the members of Ambac Assurance UK Limited

We have audited the financial statements on pages 266 to 276.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the directors' report and, as described on page 3, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

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

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 2003 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London

2 March 2004

Ambac Assurance UK Limited

Profit and loss account

Technical account – general business
for the year ended 31 December 2003

	Notes	2003 £'000	£'000	2002 £'000	£'000
Earned premiums, net of reinsurance					
Gross premiums written	3	78,357		27,994	
Outward reinsurance premiums	4	<u>(70,737)</u>		<u>(25,321)</u>	
			7,620		2,673
Change in the gross provision for unearned premiums	17	(42,560)		(6,911)	
Change in the provision for unearned premiums, reinsurers' share	17	<u>38,305</u>		<u>6,220</u>	
			<u>(4,255)</u>		<u>(691)</u>
			3,365		1,982
Other technical income			60		22
Claims incurred, net of reinsurance					
Claims paid					
Gross amount		—		—	
Reinsurers' share		<u>—</u>		<u>—</u>	
Net claims paid		<u>—</u>		<u>—</u>	
Change in the provision for claims					
Gross amount		—		—	
Reinsurers' share		<u>—</u>		<u>—</u>	
			—		—
Claims incurred, net of reinsurance					
Net operating expenses	5		(1,849)		(1,713)
Other technical expense			<u>—</u>		<u>(443)</u>
Balance on the technical account for general business			<u>1,576</u>		<u>(152)</u>

Ambac Assurance UK Limited

Profit and loss account

**Non – technical account – general business
for the year ended 31 December 2003**

	Notes	2003 £'000	2002 £'000
Balance on the general business technical account		1,576	(152)
Investment income	6	1,320	862
Investment expenses and charges	7	(23)	(20)
Realised gains (losses)		648	(1,008)
Other income and charges		55	—
		<hr/>	<hr/>
Profit (loss) on ordinary activities before tax	8	3,576	(318)
Tax on profit on ordinary activities	11	(1,054)	71
		<hr/>	<hr/>
Profit (loss) on ordinary activities after tax		2,522	(247)
		<hr/>	<hr/>
Retained profit (loss) for the year		<u>2,522</u>	<u>(247)</u>

There is no material difference between the result as disclosed in the profit and loss account and the result on an unmodified historical cost basis and therefore a separate note of historical cost profits and losses has not been included.

All amounts are derived from continuing operations.

Statement of total recognised gains and losses

	2003 £'000	2002 £'000
Retained profit (loss) after tax for the year	2,522	(247)
	<hr/>	<hr/>
Total recognised gains (losses) in the year	<u>2,522</u>	<u>(247)</u>

Reconciliation of movements in shareholder's funds

	2003 £'000	2002 £'000
Total recognised gains (losses) in the year	2,522	(247)
Share capital issued in the period	6,000	—
Balance at beginning of the year	13,017	13,264
	<hr/>	<hr/>
Balance at end of year	<u>21,539</u>	<u>13,017</u>

Ambac Assurance UK Limited

**Balance sheet
at 31 December 2003**

	Notes	2003 £'000	2002 £'000
Assets			
Investments			
Other financial investments	12	38,450	19,853
Reinsurers' share of technical provisions			
Provision for unearned premiums	17	110,718	72,413
Debtors			
Other debtors including taxation	13	1,155	620
Other assets			
Tangible assets	14	227	284
Cash at bank and in hand		2,048	2,110
Prepayments and accrued income			
Deferred acquisition costs	17	9,765	8,753
Total assets		<u>162,363</u>	<u>104,033</u>
Liabilities			
Capital and reserves			
Called up share capital	16	17,000	11,000
Profit and loss account	19	4,539	2,017
Shareholder's funds – equity interests		21,539	13,017
Technical provisions			
Provision for unearned premiums	17	123,019	80,459
Creditors			
Creditors arising out of reinsurance operations		658	722
Other creditors including taxation and social security	15	3,609	1,670
Accruals and deferred income	18	13,538	8,165
Total liabilities		<u>162,363</u>	<u>104,033</u>

The financial statements on pages 266 to 276 were approved by the board of directors on 2 March 2004 and were signed on its behalf by:



John W Uhlein III – *Chairman and Managing Director*

Ambac Assurance UK Limited

Notes to the financial statements for the year ended 31 December 2003

1 Basis of preparation

The financial statements have been prepared in accordance with the provisions of Section 255 of, and Schedule 9A to, the Companies Act 1985, and in accordance with applicable accounting standards and under the historical cost accounting rules, modified to include the revaluation of investments, and comply with the Statement of Recommended Practice issued by the Association of British Insurers.

2 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material to the company's financial statements.

Basis of accounting for underwriting activities

All business is accounted for on an annual basis.

Premium income and unearned premiums

The policy for premium recognition is dependent on the timing of the collection of premiums.

Where the premium on a policy is received up front, the premium is recognised as written at the date of inception, and earned in the technical account on a basis proportionate to the remaining scheduled periodic maturity of principal and payment of interest to the original total principal and interest insured. When an issue insured by the company has been refunded or called, the remaining unrecognised premium is recognised at that time. Where a premium is received in instalments, it is recognised as written on the date the instalment falls due and earned over the period to the next instalment date. The receipt of future amounts is considered to be sufficiently uncertain, that recognition at contract inception would not be deemed prudent.

Outward reinsurance premiums are accounted for in the same accounting period as the premiums for the related insurance business.

Structuring Fee Revenue

Structuring fee revenue represents consideration received from clients in return for the company's involvement in structuring certain insured transactions. These non-refundable fees are generally collected up-front and are earned on a straight line basis over the estimated life of the insured transaction. Structuring fee revenue is reported as other income in the technical account.

Acquisition costs

Certain costs incurred primarily related to the production of business have been deferred. These costs include direct and indirect expenses related to underwriting, marketing and policy issuance. Acquisition costs and ceding commission income which relate to a subsequent financial year are deferred and charged or credited to the accounting periods in which the related premiums are earned. Deferred acquisition costs represent the proportion of acquisition costs incurred which corresponds to the proportion of premiums written or ceded which are unearned at the balance sheet date.

Claims

A case basis loss provision is established for insured obligations when, in the judgement of management, a monetary default in the timely payment of debt service is imminent. A case basis loss provision is established in an amount that is sufficient to cover the present value of the anticipated debt service payments over the expected period of default and estimated expenses associated with setting the claim less estimated recoveries under salvage and subrogation rights.

Investment income

Investment income is accounted for on a receivable basis. Interest is accrued up to the balance sheet date. Realised gains or losses represent, for investments included in the balance sheet at amortised cost, the difference between net sales proceeds and amortised cost, and for investments included in the balance sheet at current value, the difference between net sale proceeds and purchase price. All investment income, including realised gains and losses on investments, is reported in the non-technical account.

Ambac Assurance UK Limited

Notes to the financial statements for the year ended 31 December 2003

2 Accounting policies – *continued*

Investments

Redeemable fixed interest securities are shown at amortised cost. The difference between the purchase price of such securities and the amount repayable at maturity is charged or credited to the profit and loss account over the period to maturity.

Deposits with credit institutions are shown at current value.

Foreign currencies

Assets and liabilities held in foreign currency are translated into sterling at the rates of exchange ruling at the balance sheet date and the exchange differences are taken to the profit and loss account non-technical account. Foreign currency transactions during the year are translated into sterling using average rates of exchange, with the exchange gains and losses included in the profit and loss account non-technical account.

Pension costs

Pension contributions are charged to the profit and loss account and represent the contributions payable to a money purchase pension scheme in respect of the financial year.

Taxation

Provision is made for all taxation expected to be payable on taxable profits of the year.

Except where otherwise required by accounting standards, full provision without discounting is made for all timing differences which have arisen but not reversed at the balance sheet date.

Tangible assets

Expenditure on leasehold improvements, fixtures, fittings and office equipment is capitalised and depreciated over the estimated useful economic lives of the assets on a straight line basis. The periods used are as follows:

Leasehold improvements	–	Remaining life of the lease
Fixtures, fittings and office equipment	–	5 years
Computer Equipment	–	3 years

3 Segmental information

The company only writes one class of business, that being non-life financial loss insurance, therefore the directors regard any segmental analysis as inappropriate at the present time.

4 Reinsurance balance

The reinsurance balance of those items in the technical account which relate to outwards reinsurance transactions is an expense of £29,164,000 (2002: an expense of £17,098,000).

Ambac Assurance UK Limited

**Notes to the financial statements
for the year ended 31 December 2003**

5 Net operating expenses

	2003	2002
	£'000	£'000
Acquisition costs	4,597	3,654
Change in gross deferred acquisition costs	(1,012)	(1,157)
	<u>3,585</u>	<u>2,497</u>
Administrative expenses	1,532	1,219
	<u>5,117</u>	<u>3,716</u>
Gross operating expenses	(7,027)	(2,506)
Reinsurance commissions	3,759	503
Change in deferred reinsurance commission	<u>1,849</u>	<u>1,713</u>

6 Investment income – non-technical account

	2003	2002
	£'000	£'000
Income from other financial investments	<u>1,320</u>	<u>862</u>

Investment income includes £1,150,000 (2002: £582,000) of income from listed investments.

7 Investment expenses and charges

	2003	2002
	£'000	£'000
Investment management expenses and bank charges	<u>23</u>	<u>20</u>

8 Profit on ordinary activities before tax

	2003	2002
	£'000	£'000
<i>Profit on ordinary activities before tax is stated after charging</i>		
Auditors' remuneration		
Audit	35	31
Other services – audit of regulatory returns	12	8
– other non-audit	26	71
Depreciation	<u>100</u>	<u>71</u>

9 Remuneration of directors

	2003	2002
	£'000	£'000
Directors' emoluments	435	493
Company contributions to money purchase schemes	<u>15</u>	<u>15</u>

The emoluments of the highest paid director was £410,000 (2002:£474,000). He is a member of a money purchase pension scheme, under which his accrued pension benefit at the year end was £102,000 (2002:£100,280).

Ambac Assurance UK Limited

**Notes to the financial statements
for the year ended 31 December 2003**

9 Remuneration of directors – continued

Retirement benefits are accruing to the following number of directors under:

	Number of directors	
	2003	2002
Money purchase schemes	1	1
	<u>1</u>	<u>1</u>

The number of directors exercising share options in the ultimate parent company during the year were 3 (2002: 3)

10 Staff numbers and costs

The average number of persons employed by the company (including directors) during the year was as follows:

	Number of directors	
	2003	2002
Underwriting	19	17
Administration	7	5
	<u>7</u>	<u>5</u>

The aggregate payroll costs in respect of these persons were as follows:

	2003	2002
	£'000	£'000
Wages and salaries	3,820	3,163
Payroll taxes	380	276
Other pension costs	197	160
	<u>197</u>	<u>160</u>

11 Taxation

	2003	2002
	£'000	£'000
Current corporation tax expense	(1,043)	71
Deferred corporation tax expense	(11)	—
	<u>(1,054)</u>	<u>71</u>
Tax on profit on ordinary activities	<u>(1,054)</u>	<u>71</u>

The tax assessed for the period is lower than the standard rate of the corporation tax in the United Kingdom. The differences are explained below:

	2003		2002	
	£'000	per cent.	£'000	per cent.
Profit (loss) on ordinary activities before tax	3,576		(318)	
Profit (loss) on ordinary activities at the standard rate of corporation tax	(1,073)	30.0%	95	30.0%
Other	19	(0.5%)	(24)	(7.7%)
	<u>19</u>	<u>(0.5%)</u>	<u>(24)</u>	<u>(7.7%)</u>
Tax (expense) benefit on profit on ordinary activities	<u>(1,054)</u>	<u>29.5%</u>	<u>71</u>	<u>22.3%</u>

Ambac Assurance UK Limited

Notes to the financial statements
for the year ended 31 December 2003

12 Other financial investments

	Market Value		Cost		Carrying Value	
	2003 £'000	2002 £'000	2003 £'000	2002 £'000	203 £'000	2002 £'000
Fixed interest securities:						
Listed on the UK Stock Exchange	38,203	10,763	38,921	10,705	38,450	10,542
Listed on other investment exchanges	—	9,919	—	10,205	—	9,311
	<u>38,203</u>	<u>20,682</u>	<u>38,921</u>	<u>20,910</u>	<u>38,450</u>	<u>19,853</u>

The fixed interest securities are carried at amortised cost, net of foreign currency translation gains or losses. The net excess of the amortised cost over the amount payable on maturity at 31 December 2003 was £2,463,000 (2002: £1,313,000).

13 Other debtors

	2003 £'000	2002 £'000
Deal expenses receivable	788	—
Accrued interest	356	243
Current taxes	—	363
Other	11	14
	<u>1,155</u>	<u>620</u>

14 Tangible assets

The net book value of tangible assets is made up as follows:

	Leasehold Improvements £'000	Fixtures, fittings and office equipment £'000	Total £'000
Cost:			
At beginning of year	240	285	525
Additions	6	37	43
At 31 December 2003	<u>246</u>	<u>322</u>	<u>568</u>
Depreciation:			
At beginning of year	90	151	241
Additions	39	61	100
At 31 December 2003	<u>129</u>	<u>212</u>	<u>341</u>
Net book value:			
At beginning of year	150	134	284
At 31 December 2003	<u>117</u>	<u>110</u>	<u>227</u>

Ambac Assurance UK Limited

**Notes to the financial statements
for the year ended 31 December 2003**

15 Other creditors

The net book value of other creditors is made up as follows:

	2003	2002
	£'000	£'000
Corporation tax payable within one year	523	—
Corporation tax payable not within one year	11	—
Accrued expenditure	2,819	1,564
Other	256	106
	<u>3,609</u>	<u>1,670</u>
	<u>3,609</u>	<u>1,670</u>

Taxation payable amount for 2003 represents 2003 current tax liability of £1,073,000 less payment on account.

16 Called up share capital

	2003	2002
	£'000	£'000
Ordinary shares of £1 each		
Authorised: 60,000,000 shares (2002: 20,000,000)	60,000	20,000
Issued and fully paid: 17,000,000 shares (2002: 11,000,000)	17,000	11,000
	<u>17,000</u>	<u>11,000</u>
	<u>17,000</u>	<u>11,000</u>

17 Technical provisions and deferred acquisition costs

Provision for unearned premiums

	2003		2002	
	£'000	£'000	£'000	£'000
Gross amount				
At beginning of year		80,459		73,548
Movement in the provision		42,560		6,911
At end of period		<u>123,019</u>		<u>80,459</u>
		<u>123,019</u>		<u>80,459</u>
Reinsurance amount				
At beginning of year		72,413		66,193
Movement in the provision		38,305		6,220
At end of period		<u>110,718</u>		<u>72,413</u>
		<u>110,718</u>		<u>72,413</u>
Net technical provisions				
At end of year		<u>12,301</u>		<u>8,046</u>
		<u>12,301</u>		<u>8,046</u>
At beginning of year		<u>8,046</u>		<u>7,355</u>
		<u>8,046</u>		<u>7,355</u>
Net technical provisions at end of year		12,301		8,046
Deferred acquisition costs				
– gross	(9,765)		(8,753)	
– Reinsurance commissions	10,945	1,180	7,186	(1,156)
	<u>10,945</u>	<u>1,180</u>	<u>7,186</u>	<u>(1,156)</u>
Net insurance funds		<u>13,481</u>		<u>6,479</u>
		<u>13,481</u>		<u>6,479</u>

Ambac Assurance UK Limited

Notes to the financial statements for the year ended 31 December 2003

18 Accruals and deferred income

The net book value of the accruals and other income is made up as follows:

	2003 £'000	2002 £'000
Deferred reinsurance commissions	10,945	7,186
Deferred structuring fees	2,593	979
	<u>13,538</u>	<u>8,165</u>

19 Statement of movement on reserves

	2003 £'000	2002 £'000
Profit and loss account		
Balance as 1 January	2,017	2,264
Retained profit (loss) for the year	2,522	(247)
	<u>4,539</u>	<u>2,017</u>

20 Pension scheme

The company operates a money purchase pension scheme in respect of its full time employees and directors. The charge to the profit and loss account for the period was £197,000 (2002:£160,000).

21 Cashflow

The company has not prepared a cashflow statement as it is a wholly owned subsidiary of Ambac Assurance Corporation which prepares financial statements including a consolidated cashflow statement.

22 Related party transactions

The majority of the company's reinsurance protection is provided by its parent. The cover provided is a quota share agreement representing 90 per cent. of all credit and financial guarantee loss exposure. The net retention of all non-life financial loss business is reinsured on an excess of loss basis above an attachment point of £500,000. The reinsurance agreement includes an annual ceding commission payable to the company. Premiums of £70,347,000 (2002: £25,102,000) were ceded to the company's parent during the period, and commission of £7,017,000 (2002: £2,506,000) was payable to the company under the agreement.

In addition the parent company is required under a net worth maintenance agreement to cause the company to maintain free assets of at least £10,500,000.

The company provides suretyship insurance to Ambac Credit Products, LLC ("ACP"), an affiliate domiciled in the United States of America, which obligates the company to make payments to ACP if certain credit events occur in relation to covered structured credit default swaps. The company ceded 100% of these insurance policies to non-affiliated reinsurers. For the year ended 31 December 2003, the company recorded gross premiums written of £390,000 (2002: £219,000) relating to these policies.

The company has issued financial guarantee insurance policies to the swap counterparties of Ambac Credit Products Limited ("ACPL"), a United Kingdom domiciled affiliate subject to FSA regulatory oversight, whereby the company guarantees timely payment of ACPL's obligations under structured credit default swaps. The company recorded gross premiums written of £545,000 during 2003 (2002: £242,000) related to these financial guarantees.

Ambac Assurance UK Limited

Notes to the financial statements for the year ended 31 December 2003

The company has issued a financial guaranty policy to Ambac Private Holdings, LLC (“APH”) an affiliate domiciled in the United States of America, which obligates the company to make payments of scheduled principal and interest to APH if the issuer defaults on such payments relating to the insured obligation. The company recorded gross premiums written of £347,000 during 2003 (2002: £-0-) related to these financial guarantees.

23 Commitments

There are no commitments in respect of contracts for capital expenditure not provided for. Annual commitments under non-cancellable operating leases are as follows:

	Land and Buildings		Office Equipment	
	2003 £'000	2002 £'000	2003 £'000	2002 £'000
Operating leases which expire:				
Within one year	19	19	—	—
Between two through five years	511	476	3	—
In more than five years	—	—	—	2

24 Ultimate Parent Company

The company is a wholly owned subsidiary of Ambac Assurance Corporation. The ultimate holding company is Ambac Financial Group, Inc. a company incorporated under the laws of the State of Delaware, United States of America.

The largest and smallest groups in which the results of the company are consolidated are Ambac Financial Group, Inc. and Ambac Assurance Corporation, respectively. The consolidated financial statements of both groups are available to the public and may be obtained either from One State Street Plaza, New York, NY 10004, USA or via the Company's website: www.Ambac.com.

APPENDIX 3 – FINANCIAL STATEMENTS OF FPLP

PART 1

Friends Provident Life and Pensions Limited

Directors' Report and Financial Statements
for the year ended 31 December 2003

Registered no: 4096141

DIRECTORS

K. SACHELL BSc, FIA (Executive Chairman)
G.K. ASLET MA, FIA, S.J. CLAMP BSc, A.R.G. GUNN MA, FCII, M.A. HAMPTON MA, FPMI,
G. HARVEY FCCA, MBA, A.P. JACKSON BSc, FIA, J. R. MCIVER
P.W. MOORE TD, MA, FIA, A.J. NURSE BSc, FIA, J. STEVENS BSc, FIA

SECRETARY

B.W. SWEETLAND LLB, Solicitor, ACol

PRINCIPAL ACTIVITY

The company is authorised by the Financial Services Authority to transact ordinary long-term insurance business in the United Kingdom. No change in this activity is envisaged in the future.

A fellow subsidiary undertaking, Friends Provident Management Services Limited (“FPMS”), provides the company’s services and administration and employs all staff. Accordingly, the company has no direct employees.

RESULTS AND BUSINESS REVIEW

The company’s results for the year are shown in the profit and loss account on pages 282 and 283.

DIVIDEND

The directors having paid an interim dividend of £Nil (2002: £90m), recommend the payment of a final dividend of £155m (2002: £250m) for the year ended 31 December 2003.

DIRECTORS

The directors named above held office throughout the year with the exception of D.M. Jackson who resigned as a director on 30 September 2003 having held office until that date, A.J. Nurse who resigned as a director on 22 October 2003, and was re-appointed on 17 December 2003 and P.W. Moore who was appointed as a director on 1 September 2003.

DIRECTORS’ INTERESTS

No directors had interests in any other company within the Friends Provident Group other than as disclosed below.

a. Shares

The interests of directors, their spouses and children under the age of eighteen in the shares of companies within the Friends Provident Group are shown in the table below:

	Friends Provident Plc Ordinary shares 10 pence		ISIS Asset Management Plc Ordinary shares 0.1 pence	
	*At 1 January 2003	At 31 December 2003	At 1 January 2003	At 31 December 2003
K. Satchell	60,253	61,602	10,000	10,000
G.K. Aslet	13,788	15,137	—	—
S.J. Clamp	—	1,349	—	—
A.R.G. Gunn	35,498	36,847	—	—
M.A. Hampton	4,124	4,124	—	—
G. Harvey	1,513	1,789	—	—
A.P. Jackson	4,369	5,718	—	—
J.R. Mclver	4,479	5,828	—	—
P.W. Moore*	526	1,332	—	—
A.J. Nurse	7,986	9,335	—	—
J. Stevens	6,035	7,384	—	—

* Or date of appointment if later

Since 31 December 2003, K. Satchell, G.K. Aslet, S.J. Clamp, A.R.G. Gunn, G. Harvey, A.P. Jackson, J.R. Mclver, A.J. Nurse and J. Stevens have each acquired a total of 266 shares through monthly subscriptions into the company’s Share Incentive Plan (“SIP”).

b. Options over Friends Provident Plc ordinary shares of 10 pence

The directors participate in two Inland Revenue approved share schemes, the ShareSave Scheme (a savings-related share option scheme) and the Partnership Share element of the (“SIP”) (formerly the All-Employee Share Ownership Plan) on the same basis as other eligible UK employees of the Group.

The directors participate in the Executive Share Option Scheme (“ESOS”) and the Executive Long-Term Incentive Plan (“LTIP”) on the same terms as other eligible UK employees of the Group.

The tables below provide an analysis of options under each scheme. Further details of the operation of these schemes are contained in the Group Annual Report and Accounts of Friends Provident Plc.

	Options at 1 Jan 2003	Granted/ (Exercised) during year	Lapsed during year	Options at 31 Dec 2003	Exercise price (pence)	Earliest exercise date	Latest exercise date
K. Satchell							
ShareSave 2002	15,358			15,358	107.76	01/10/07	01/04/08
SIP 2002 (a)	1,059	(1,073)					
ESOS 2002	200,000			200,000	195	14/03/05	14/03/12
ESOS 2003		619,719		619,719	71	17/03/06	17/03/13
LTIP 2002	100,000			100,000	10	14/03/05	14/03/12
LTIP 2003		309,859		309,859	10	17/03/06	17/03/13
Total	316,417	928,505	—	1,244,936			
G.K. Aslet							
ShareSave 2002	15,358			15,358	107.76	01/10/07	01/04/08
SIP 2002 (a)	1,059	(1,073)					
ESOS 2002	82,051			82,051	195	14/03/05	14/03/12
ESOS 2003		236,619		236,619	71	17/03/06	17/03/13
LTIP 2002	41,025			41,025	10	14/03/05	14/03/12
LTIP 2003		118,309		118,309	10	17/03/06	17/03/13
Total	139,493	353,855	—	493,362			
S.J. Clamp							
ShareSave 2002	15,358			15,358	107.76	01/10/07	01/04/08
SIP 2002 (a)	1,058	(1,072)					
ESOS 2002	66,667			66,667	195	14/03/05	14/03/12
ESOS 2003		190,140		190,140	71	17/03/06	17/03/13
Total	83,083	189,068	—	272,165			
A.R.G. Gunn							
ShareSave 2002	15,358			15,358	107.76	01/10/07	01/04/08
SIP 2002 (a)	1,059	(1,073)					
ESOS 2002	116,667			116,667	195	14/03/05	14/03/12
ESOS 2003		368,311		368,311	71	17/03/06	17/03/13
LTIP 2002	58,333			58,333	10	14/03/05	14/03/12
LTIP 2003		184,155		184,155	10	17/03/06	17/03/13
Total	191,417	551,393	—	742,824			
M.A. Hampton							
ShareSave 2002	8,815			8,815	107.76	01/10/05	01/04/06
ESOS 2002	51,283			51,283	195	14/03/05	14/03/12
ESOS 2003		154,930		154,930	71	17/03/06	17/03/13
Total	60,098	154,930	—	215,028			
G. Harvey							
ShareSave 2002	15,358			15,358	107.76	01/10/07	01/04/08
ESOS 2002	49,230			49,230	195	14/03/05	14/03/12
ESOS 2003		149,298		149,298	71	17/03/06	17/03/13
Total	64,588	149,298	—	213,886			
A.P. Jackson							
ShareSave 2002	15,358			15,358	107.76	01/10/07	01/04/08
SIP 2002 (a)	1,059	(1,073)					
ESOS 2002	53,846			53,846	195	14/03/05	14/03/12
ESOS 2003		163,381		163,381	71	17/03/06	17/03/13
Total	70,263	162,308	—	232,585			

	Options at 1 Jan 2003	Granted/ (Exercised) during year	Lapsed during year	Options at 31 Dec 2003	Exercise price (pence)	Earliest exercise date	Latest exercise date
D.M. Jackson							
ShareSave 2002	8,815	(3,051)	(5,764)		107.76		
SIP 2002 (a)	1,059	(1,073)					
ESOS 2002	116,667		(116,667)		195		
ESOS 2003							
LTIP 2002	58,333		(58,333)		10		
LTIP 2003		169,014	(169,014)		10		
Total	184,874	164,890	(349,778)	—			
J.R. Mclver							
ShareSave 2002	15,358			15,358	107.76	01/10/07	01/04/08
SIP 2002 (a)	1,059	(1,073)					
ESOS 2002	61,538			61,538	195	14/03/05	14/03/12
ESOS 2003		177,464		177,464	71	17/03/06	17/03/13
Total	77,955	176,391	—	254,360			
P.W. Moore							
ShareSave 2003		8,499		8,499	108.54	01/10/06	01/04/07
ESOS 2003		211,398		211,398	136	06/08/06	06/08/13
LTLP 2003		105,699		105,699	10	06/08/06	06/08/13
Total		325,596	—	325,596			
A.J. Nurse							
ShareSave 2002	8,815			8,815	107.76	01/10/05	01/04/06
SIP 2002 (a)	1,059	(1,073)					
ESOS 2002	62,307			62,307	195	14/03/05	14/03/12
ESOS 2003		183,101		183,101	71	17/03/06	17/03/13
Total	72,181	182,028	—	254,223			
J.Stevens							
ShareSave 2002	15,358			15,358	107.76	01/10/07	01/04/08
SIP 2002 (a)	1,059	(1,073)					
ESOS 2002	55,129			55,129	195	14/03/05	14/03/12
ESOS 2003		166,200		166,200	71	17/03/06	17/03/13
Total	71,546	165,127	—	236,687			

- (a) Partnership Shares in respect of the 2002 SIP scheme were purchased on 5 October 2003 at the Market Value of 139.80p and are held in the Share Incentive Plan (SIP) trust. The difference between the options held at 1 January and the options exercised at 5 October reflects the difference in share price at the two dates.

From October 2003 SIP partnership shares are purchased monthly and there is no option granted in relation to these shares.

AUDITORS

Following the conversion of PricewaterhouseCoopers to a Limited Liability Partnership (LLP) from 1 January 2003, PricewaterhouseCoopers resigned on 23 January 2003 and the directors appointed its successor, PricewaterhouseCoopers LLP, as auditors.

The Board is to recommend that on 20 May 2004 the shareholders approve the appointment of KPMG Audit Plc as the company's auditors in place of PricewaterhouseCoopers LLP. KPMG Audit Plc has indicated its willingness to be appointed from 20 May 2004.

CREDITOR PAYMENT POLICY

Services and supplies to the company are made through a fellow subsidiary undertaking, Friends Provident Management Services Limited, and accordingly, the company does not have any trade creditors.

DIRECTORS' RESPONSIBILITIES

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

- select the most appropriate accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed with any material departures being disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors confirm that they have complied with these requirements.

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

Pixham End
Dorking
Surrey
RH4 1QA

ON BEHALF OF THE BOARD

2 March 2004

Registered Number 4096141

B. W. SWEETLAND
SECRETARY

FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED
PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2003

LONG-TERM BUSINESS TECHNICAL ACCOUNT

	Notes	2003 £m	2002 £m
Earned premiums, net of reinsurance			
Gross premiums written	2	1,940	2,200
Outward reinsurance premiums		<u>(574)</u>	<u>(562)</u>
		1,366	1,638
Investment income	4	999	889
Unrealised gains on investments	4	864	—
Other technical income, net of reinsurance	5	<u>21</u>	<u>24</u>
Total technical income		<u>3,250</u>	<u>2,551</u>
Claims incurred, net of reinsurance			
Claims paid			
– gross amount		2,415	2,926
– reinsurers' share		<u>(456)</u>	<u>(754)</u>
		<u>1,959</u>	<u>2,172</u>
Change in provision for claims			
– gross amount		2	5
– reinsurers' amount		<u>(2)</u>	<u>—</u>
		<u>1,959</u>	<u>2,177</u>
Change in other technical provisions, net of reinsurance			
Long-term business provision, net of reinsurance			
– gross amount	20	(250)	(1,136)
– reinsurers' amount	20	<u>(36)</u>	<u>674</u>
		<u>(286)</u>	<u>(462)</u>
Technical provision for linked liabilities			
– gross amount	20	1,348	(871)
– reinsurers' amount	20	<u>(793)</u>	<u>289</u>
		<u>555</u>	<u>(582)</u>
		<u>269</u>	<u>(1,044)</u>
Net operating expenses	7	291	61
Investment expenses and charges	4	59	56
Unrealised losses on investments	4	—	2,366
Other technical charges, net of reinsurance	6	2	19
Tax attributable to the long-term business	9	9	(30)
Transfers to/from the fund for future appropriations		<u>422</u>	<u>(1,101)</u>
		<u>783</u>	<u>1,371</u>
Total technical charges		<u>3,011</u>	<u>2,504</u>
Balance on the long-term business technical account		<u>239</u>	<u>47</u>

Notes

All amounts above are in respect of continuing operations. The long-term business technical account includes all recognised gains and losses attributable to policyholders.

The notes on pages 287 to 305 form an integral part of these financial statements.

FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED
PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2003

NON-TECHNICAL ACCOUNT

	Notes	2003 £m	2002 £m
Balance on the long-term business technical account		239	47
Tax credit attributable to balance on long-term business technical account	9	<u>102</u>	<u>20</u>
Profit before tax from long-term business		341	67
Investment income	4	30	4
Investment expenses and charges	4	—	(51)
Unrealised losses on investments	4	(5)	(14)
Other charges	8	<u>(6)</u>	<u>(2)</u>
Profit on ordinary activities before tax		360	4
Tax on profit on ordinary activities	9	<u>(102)</u>	<u>(20)</u>
Profit/(Loss) on ordinary activities after tax		<u>258</u>	<u>(16)</u>
Dividend	10	<u>(155)</u>	<u>(340)</u>
Retained profit/(loss) for the financial period transferred to reserves	18	<u>103</u>	<u>(356)</u>

Notes

There are no recognised gains or losses for 2003 or 2002 other than the profit/(loss) for the financial year.

All of the amounts above are in respect of continuing operations.

There is no difference between the results disclosed above and the results on a modified historical cost basis.

The notes on pages 287 to 305 form an integral part of these financial statements.

FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED
RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS
FOR THE YEAR ENDED 31 DECEMBER 2003

	Notes	2003 £m	2002 £m
Share capital issued during the year, including share premium, net of expenses	18	300	634
Total recognised profits/(losses) arising in the year		258	(16)
Dividend	10	<u>(155)</u>	<u>(340)</u>
Net additions to shareholders' funds		403	278
Shareholders' funds at beginning of year		<u>1,693</u>	<u>1,415</u>
Shareholders' funds at end of year		<u>2,096</u>	<u>1,693</u>

The notes on pages 287 to 305 form an integral part of these financial statements.

FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED
BALANCE SHEET
AS AT 31 DECEMBER 2003

ASSETS

	Notes	2003 £m	2002 £m
Intangible assets			
Licence	11	10	16
Investments			
Land and buildings	12	1,076	1,349
Investments in group undertakings and participating interests	13	1,815	1,506
Other financial investments	12	16,106	15,673
		<u>18,997</u>	<u>18,528</u>
Present value of acquired in-force business	14	44	46
Assets held to cover linked liabilities	12	2,368	1,813
Reinsurers' share of technical provisions			
Long-term business provision	20	563	527
Claims outstanding		3	1
Technical provisions for linked liabilities	20	3,305	2,512
		<u>3,871</u>	<u>3,040</u>
Debtors			
Debtors arising out of direct insurance operations			
– Policyholders		11	23
– Intermediaries		24	24
Debtors arising out of reinsurance operations		—	1
Other debtors	16	68	71
		<u>103</u>	<u>119</u>
Other assets			
Cash at bank and in hand		11	6
Prepayments and accrued income			
Accrued interest and rent		172	146
Deferred acquisition costs		677	748
		<u>849</u>	<u>894</u>
TOTAL ASSETS		<u>26,253</u>	<u>24,462</u>

The notes on pages 287 to 305 form an integral part of these financial statements.

FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED
BALANCE SHEET
AS AT 31 DECEMBER 2003

LIABILITIES

	Notes	2003 £m	2002 £m
Capital and reserves			
Called up share capital	17&18	954	654
Share premium account	18	721	721
Profit and loss account	18	421	318
Equity shareholder funds		<u>2,096</u>	<u>1,693</u>
Subordinated liabilities	19&23	215	215
Fund for future appropriations		465	43
Technical provisions			
Long-term business provision	20	17,147	17,397
Claims outstanding		74	71
		<u>17,221</u>	<u>17,468</u>
Technical provisions for linked liabilities	20	5,673	4,325
Provisions for other risks and charges	22	82	64
Creditors			
Creditors arising out of direct insurance operations		18	17
Creditors arising out of reinsurance operations		2	3
Amounts owed to credit institutions	23	20	12
Other creditors including taxation and social security	24	455	604
		<u>495</u>	<u>636</u>
Accruals and deferred income		<u>6</u>	<u>18</u>
TOTAL LIABILITIES		<u>26,253</u>	<u>24,462</u>

Approved by the Board on 2 March 2004 and signed on its behalf by

K. SATCHELL
DIRECTOR

The notes on pages 287 to 305 form an integral part of these financial statements.

FRIENDS PROVIDENT LIFE AND PENSIONS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

1. ACCOUNTING POLICIES

(a) Basis of presentation

The financial statements have been prepared in compliance with Section 255A of, and Schedule 9A to, the Companies Act 1985.

These financial statements comply with the Association of British Insurers' ("ABI") Statement of Recommended Practice on Accounting for Insurance Business ("SORP") issued in December 1998. In addition we have adopted the revised ABI SORP issued in November 2003, other than in respect of the amounts brought forward at 1 January 2002 for the reinsurers' share of long-term business provision and deferred acquisition costs and the related 2002 profit and loss account amounts.

The financial statements have also been prepared in compliance with applicable accounting standards and under the historical cost convention as modified by the revaluation of investments as set out in note 1(i).

The company is a wholly owned subsidiary of Friends Provident Plc, accounts of which are publicly available. Consequently the company has taken advantage of the exemption from preparing a cash flow statement under the terms of Financial Reporting Standard I (Cash Flow Statements).

All accounting policies have been reviewed for appropriateness in accordance with Financial Reporting Standard 18 (Accounting Policies).

(b) Premiums

Premium income in respect of single premium business and pensions business not subject to contractual regular premiums is accounted for on a cash basis. For all other classes of business premium income is accounted for in the year in which it falls due. Reinsurance premiums are accounted for when due for payment. Further details relating to the classification of new business premiums are included in note 2b.

(c) Investment return

Investment return includes dividends, interest, rents, gains and losses on the realisation of investments and unrealised gains and losses. Such income includes any withholding tax but excludes other taxes such as attributable tax credits. Income from fixed interest securities together with interest, rents and associated expenses are accounted for in the period in which they accrue. Dividends are included in the profit and loss account when the securities are listed as ex-dividend. Realised gains and losses on investments are calculated as the difference between the net sales proceeds and original cost. Unrealised gains and losses on investments represent the difference between the valuation of investments at the balance sheet date and their original cost, or if they have been previously revalued, the valuation at the last balance sheet date. The movement in unrealised gains and losses recognised in the period also includes the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

Investment return relating to investments which are directly connected with the carrying on of the long-term business is initially recorded in the long-term business technical account and, where applicable, a transfer is made to or from the non-technical account to ensure that the return remaining in the long-term business technical account attributable to shareholders reflects the long-term investment return. Other than long-term business investment income and unrealised gains and losses are recorded in the non-technical account.

(d) Claims and surrenders

All claims and surrenders due or notified are charged against revenue. Claims payable include claims handling costs. Reinsurance recoveries are accounted for in the same period as the related claim.

(e) Bonuses

Bonuses charged to the long-term business technical account in a given period comprise reversionary bonuses declared in respect of that period, which are provided within the calculation

of the long-term business provision, and terminal bonuses paid, which are included within claims paid.

(f) Deferred acquisition costs

Acquisition costs comprise all direct and indirect costs arising from the writing of insurance contracts. Deferred acquisition costs comprise the costs of acquiring new insurance contracts, which are incurred during a financial period and are deferred to the extent that they are recoverable out of future revenue margins.

The rate of amortisation of deferred acquisition costs is proportional to the future margins emerging in respect of the related policies, over the full lifetime of the policies.

(g) Taxation

Taxation in the non-technical account and long-term business technical account is based on profits and income for the period as determined in accordance with the relevant tax legislation together with adjustments to provisions for prior periods.

Provision is made for deferred taxation liabilities, using the liability method, on all material timing differences, including revaluation gains and losses on investments recognised in the profit and loss account, as the investments are revalued. Deferred taxation is calculated at the rates at which it is expected that the tax will arise and discounted to take into account the likely timing of payments and pattern of expected realisation of investments. Deferred tax liabilities are discounted using gilt yield rates appropriate to the estimated year in which the timing differences are expected to reverse. Deferred taxation is recognised in the profit and loss account for the period, except to the extent that it is attributable to a gain or loss that is recognised directly in the statement of total recognised gains and losses. In this case the attributable deferred taxation is shown separately in the statement of total recognised gains and losses.

Deferred tax assets are recognised to the extent that they are regarded as recoverable.

The transfer of the balance on the long-term business technical account to or from the non-technical account is grossed up by attributable tax, using the full rate of corporation tax applicable for the period.

(h) Intangible assets

Licences acquired are capitalised in the balance sheet at cost and amortised through the profit and loss account over their expected useful economic life.

(i) Valuation of investments

Investments are shown in the balance sheet as follows:

- (i) Land and buildings are valued each year on an open market basis by qualified Chartered Surveyors. Properties are valued by an external valuer at least once every 5 years. Those properties which are occupied by the Friends Provident Group are valued on an existing use basis and with vacant possession.

In accordance with Statement of Standard Accounting Practice No. 19 (Investment Properties), no depreciation is provided in respect of freehold investment properties or amortisation in respect of leasehold properties with over 20 years to expire. This is a departure from the requirements of the Companies Act 1985 which requires all properties to be depreciated. However, these properties are held solely for investment purposes and the directors consider that systematic annual depreciation would be inappropriate. Depreciation or amortisation is only one of the factors reflected in the annual valuations of properties, and the amounts which might otherwise have been shown cannot reasonably be separately identified or quantified. The accounting policy adopted is therefore necessary for the financial statements to give a true and fair view.

- (ii) Unlisted investments, including those in participating interests, for which a market exists, are valued at the average price on the day at which they were last traded. Participations in investment pools are stated at the company's share of the net assets of the investment pool. Other unlisted investments are valued by the directors, having regard to their likely realisable value.

- (iii) Listed and other quoted investments, including those in participating interests, are carried at mid-market value at the balance sheet date with the exception of those held to cover linked liabilities which are stated at market prices consistent with the pricing basis within those funds.
- (iv) OEICs are carried at the market value at the balance sheet date.
- (v) Derivatives and financial instruments are included at market value under the category of investment to which the contract relates. No adjustment is made to the classification of existing investments to reflect the effect of future settlement of these transactions.
- (vi) Shares in and loans to group undertakings are stated at current value.
- (vii) All other investments have been valued at their likely realisable value at the balance sheet date.

(j) Present value of acquired in-force business (“PVIF”)

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

The carrying value of the asset is assessed annually using current assumptions in order to determine whether any impairment has arisen compared to the amortised acquired value based on assumptions made at the time of the acquisition. Any amortisation or impairment charge is recorded in the long-term business technical account within “Other technical charges”.

(k) Long-term reinsurance contracts

Long-term business is ceded to reinsurers under contracts to transfer risk. Such contracts are accounted for in the balance sheet as “reinsurers’ share of technical provisions”.

(l) Fund for future appropriations

The balance on this account represents funds, the allocation of which, to either participating policyholders or to shareholders, has not been determined at the balance sheet date.

(m) Long-term business provision

The long-term business provision is determined by the Appointed Actuary following annual investigation of the long-term fund, and is calculated initially on a statutory solvency basis to comply with the reporting requirements under the Interim Prudential Sourcebook for Insurers. The calculation for conventional business uses the net premium valuation method and, as such, includes explicit provision for vested bonuses (including those vesting following the current valuation). Implicit provision is made for future reversionary bonuses, but not terminal bonuses, by means of a reduction in the valuation rate of interest. The valuation is then adjusted for certain items, including the adding back of deferred acquisition costs implicit within the valuation method of certain contracts, the removal of certain contingency reserves and the adjustments of certain other reserves. This adjusted basis is referred to as the modified statutory solvency basis. The calculation for linked business and for income protection policies, uses the gross premium valuation method and as such includes explicit allowance for future expenses.

(n) Foreign currencies

Assets and liabilities held in foreign currencies at the balance sheet date are expressed in sterling at rates ruling on that date. Income and expenditure denominated in foreign currencies are translated at rates ruling at the date on which the transaction occurs. All resulting exchange gains and losses are included within that part of the profit and loss account in which the underlying transaction is reported.

2. SEGMENTAL INFORMATION

(a) Gross premiums written by type

	2003 £m	2002 £m
Life		
Protection	374	126
Savings and investment	834	1,229
Pensions		
Individual pensions	472	441
Group pensions	255	366
Annuities	5	38
Total Life and Pensions	<u>1,940</u>	<u>2,200</u>
Premiums from non-participating contracts	186	191
Premiums from participating contracts	682	1,122
Premiums from investment linked contracts	1,072	887
TOTAL	<u><u>1,940</u></u>	<u><u>2,200</u></u>

(b) Gross new premiums written by type

	Regular premiums		Single premiums	
	2003 £m	2002 £m	2003 £m	2002 £m
Life				
Protection	69	45	—	—
Savings and investment	11	16	521	636
Pensions				
Individual pensions	5	7	173	186
Group pensions	7	70	60	118
Annuities	—	—	15	38
Total Life and Pensions	<u>92</u>	<u>138</u>	<u>769</u>	<u>978</u>

In classifying new business premiums the following basis of recognition is adopted:

- (i) Single new business premiums consist of those contracts under which there is no expectation of continuing premiums being paid at regular intervals;
- (ii) Regular new business premiums consist of those contracts under which there is an expectation of continuing premiums being paid at regular intervals, including repeated or recurrent single premiums where the level of premiums is defined or where a regular pattern in the receipt of premiums has been established;
- (iii) Non-contractual increments under existing group pensions schemes are classified as new business premiums;
- (iv) Transfers between products where open market options are available are included as new business; and
- (v) Regular new business premiums are included on an annualised basis.

(c) Annualised premium equivalent (APE) by type

	2003 £m	2002 £m
Life		
Protection	69	45
Savings and investment	63	79
Pensions		
Individual pensions	22	26
Group pensions	12	82
Annuities	3	4
Total Life and Pensions	<u>169</u>	<u>236</u>

The new Life & Pensions APE represents gross new regular premiums plus 10 per cent. of gross new single premiums.

(d) Life & Pensions gross premiums

	2003 £m	2002 £m
Source		
United Kingdom	1,851	1,980
Rest of World	89	220
	<u>1,940</u>	<u>2,200</u>
Destination		
United Kingdom	1,809	1,937
Rest of World	131	263
	<u>1,940</u>	<u>2,200</u>

(e) Life & Pensions new business

	Regular premiums 2003 £m	2002 £m	Single premiums 2003 £m	2002 £m
Source				
United Kingdom	85	129	707	789
Rest of World	7	9	58	189
	<u>92</u>	<u>138</u>	<u>765</u>	<u>978</u>
Destination				
United Kingdom	81	124	695	772
Rest of World	11	14	70	206
	<u>92</u>	<u>138</u>	<u>765</u>	<u>978</u>

(f) Profit on ordinary activities before tax

	2003 £m	2002 £m
Source		
United Kingdom	371	10
Rest of World	(11)	(6)
	<u>360</u>	<u>4</u>
Destination		
United Kingdom	385	11
Rest of World	(25)	(7)
	<u>360</u>	<u>4</u>

(g) Net Assets

The net assets supporting the rest of world geographical segment are of a similar nature to the net assets held by the United Kingdom segment.

3. OUTWARD REINSURANCE PREMIUMS

Outward reinsurance premiums include reinsurance premium rebates, net of a provision for clawbacks, of £27m (2002:£31m). For 2003 the movement on the recoverable amount of £Nil (2002:£12m) has been categorised as a recovery of commission and so has reduced acquisition cost within 'Net operating expenses' by this amount (see note 7).

The result attributable to shareholders arising from the aggregate of all reinsurance balances in the long-term business technical account for the year ended 31 December 2003 was a credit balance of £715m (2002: £768m debit balance).

4. INVESTMENT RETURN

	Technical account		Non-technical account	
	2003 £m	2002 £m	2003 £m	2002 £m
Income from land and buildings	94	98	—	—
Income from group undertakings	25	21	—	—
Income from other investments	791	761	17	4
Gains on the realisation of investments	89	9	13	—
Investment income	<u>999</u>	<u>889</u>	<u>30</u>	<u>4</u>
Unrealised gains on investments	864	—	—	—
Investment expenses and charges				
Investment management expenses	(34)	(28)	—	—
Interest on bank loans	—	(3)	—	—
Interest on other loans	(25)	(25)	—	—
Losses on the realisation of investments	—	—	—	(51)
Investment expenses and charges	<u>(59)</u>	<u>(56)</u>	<u>—</u>	<u>(51)</u>
Unrealised losses on investments	—	(2,366)	(5)	(14)
Total investment return	<u>1,804</u>	<u>(1,533)</u>	<u>25</u>	<u>(61)</u>

5. OTHER TECHNICAL INCOME

	2003 £m	2002 £m
Unit management charges	21	24
	<u>21</u>	<u>24</u>

Unit management charges are management charges recoverable from other group companies.

6. OTHER TECHNICAL CHARGES

Other technical charges in the technical account comprise:

	2003 £m	2002 £m
Amortisation of present value of acquired in-force contracts	2	17
Amortisation of licence	6	2
Recharge to Friends Provident Life Assurance Limited	(6)	—
	<u>2</u>	<u>19</u>

7. NET OPERATING EXPENSES

(a) Net operating expenses in the technical account comprise:

	2003 £m	2002 £m
Acquisition costs	69	151
Change in deferred acquisition costs	71	(220)
Administrative expenses	151	130
Net operating expenses	<u>291</u>	<u>61</u>

Auditors' remuneration amounted to £206,000 (2002: £180,000) for audit services and £389,691 (2002: £137,000) for non-audit services. Non-audit services comprise ad hoc accounting, actuarial and tax advice.

Total commissions for direct insurance accounted for by the company during the year, excluding payments to employees of Friends Provident Management Services Limited, amounted to £162m (2002: £121m).

The 2003 commission for direct insurance and acquisition cost lines are reduced by an amount of £Nil relating to the recognition of recoverable amounts relating to premium rebates clawed back by reinsurers but recoverable from external agents. In 2002 the movement on the recoverable amount of £12m was netted off against reinsurance premiums (see note 3).

(b) Operating Exceptional Items

On 19 November 2003 the Friends Provident Group announced the closure of its Life & Pensions direct sales operation (First Call). Operating exceptional costs amount to £7,400,000 and relate to redundancy, asset write-offs and other direct costs of closure.

Operating exceptional costs of £5,300,000 (2002: £1,700,000) have been incurred relating to integration activity following the acquisition of Friends Provident International Limited in August 2002.

A release of £20,000,000 to shareholders of long-term business provision held in respect of the review conducted into pension transfers and opt-outs has been made in 2003. This is offset by a £6,000,000 charge attributable to shareholders in respect of mortgage endowment complaints.

8. OTHER CHARGES

Other charges comprise integration expenses of £5,300,000 (2002: £1,700,000) (see note 7b for explanation) and a £675,000 fine by its regulator, the Financial Services Authority, in respect of mortgage endowments complaints handling.

9. TAXATION

Profit and loss account

United Kingdom and overseas taxation has been charged in the profit and loss account on assessable profits and income on the bases and rates appropriate to the various classes of business.

(a) Tax charged to the long-term business technical account and non-technical account comprises:

	Technical account		Non-technical account	
	2003	2002	2003	2002
	£m	£m	£m	£m
Current Taxation				
United Kingdom corporation tax (30 per cent.)	13	71	—	—
Deferred tax	(6)	(103)	—	—
	<u>7</u>	<u>(32)</u>	<u>—</u>	<u>—</u>
Overseas taxation	2	2	—	—
Tax credit attributable to balance on the long-term business technical account	—	—	102	20
Total current taxation	<u>9</u>	<u>(30)</u>	<u>102</u>	<u>20</u>
Deferred taxation				
Origination and reversal of timing differences	5	(115)	—	—
Effect of discount	(11)	12	—	—
Total deferred taxation	<u>(6)</u>	<u>(103)</u>	<u>—</u>	<u>—</u>

(b) Factors affecting tax charge for the year

The tax assessed for the year is lower than the standard rate of corporation tax in the UK (30 per cent.). The differences are explained below:

	2003	2002
	£m	£m
Profit on ordinary activities before tax	<u>360</u>	<u>4</u>
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 30 per cent.	108	1
Effects of:		
– Deductions not allowable for tax purposes	5	5
– Tax losses not paid for	(11)	14
	<u>102</u>	<u>20</u>

(c) Factors that may affect future tax charges

The deferred tax assets, which have not been recognised due to the uncertainty of the recoverability in the foreseeable future, comprise:

	Technical account		Non-technical account	
	2003	2002	2003	2002
	£m	£m	£m	£m
Unrealised losses on investments	—	15	—	12
Realised losses on investments	9	43	1	18
	<u>9</u>	<u>58</u>	<u>1</u>	<u>30</u>

The unprovided deferred tax assets will be recoverable in the event of an increase in equity values above the values as at 31 December 2003.

(d) Balance Sheet

	£m
Deferred taxation	
At 1 January 2003	—
Charge in year	5
Effect of discounting	(11)
At 31 December 2003	<u>(6)</u>

Deferred taxation

Details of the deferred tax asset are given below:

	2003	2002
	£m	£m
Deferred acquisition costs	5	—
Impact of discounting on deferred taxation	(11)	—
Discounted deferred tax asset	<u>(6)</u>	<u>—</u>

Deferred taxation on chargeable gains relating to the net unrealised appreciation of investments within linked funds, including that relating to the deemed disposal of OEICs, is taken into account in the calculation of technical provisions for linked liabilities and is therefore excluded from the above analysis.

10. DIVIDEND

	2003	2002
	£m	£m
Interim dividend £Nil (2002: 53p)	—	90
Proposed Final dividend 24p per ordinary share (2002: 38p)	155	250
	<u>155</u>	<u>340</u>

11. INTANGIBLE ASSETS

Licence

	2003 £m
Cost	
At 1 January 2003	18
At 31 December 2003	18
Amortisation	
At 1 January 2003	2
Charge for the period	6
At 31 December 2003	8
Net book value	
At 31 December 2003	10

The licence relates to an exclusive distribution agreement secured with Countrywide Assured Group Plc in August 2002. The agreement gives a 15 year exclusive right to distribute mortgage related protection products through Countrywide's 852 estate agency branches and its 790 licensed consultants.

12. INVESTMENTS

	2003		2002	
	Current value £m	Cost £m	Current value £m	Cost £m
Land and buildings				
Owner Occupied				
– Freehold	33	57	34	57
– Long Leasehold	2	4	2	4
Other				
– Freehold	903	719	1,170	1,006
– Long Leasehold	138	96	143	105
Total land and buildings	<u>1,076</u>	<u>876</u>	<u>1,349</u>	<u>1,172</u>
Other financial investments				
Shares and other variable yield securities and OEIC's	4,086	3,792	5,143	5,582
Debt and other fixed income securities	11,251	10,890	9,384	8,903
Participation in investment pools	218	192	90	81
Loans secured by mortgages	3	3	3	3
Deposits with credit institutions	366	366	761	761
Other	182	165	292	212
Total other financial investments	<u>16,106</u>	<u>15,408</u>	<u>15,673</u>	<u>15,542</u>
Assets held to cover linked liabilities	<u>2,368</u>	<u>2,275</u>	<u>1,813</u>	<u>1,993</u>

14. PRESENT VALUE OF ACQUIRED IN-FORCE BUSINESS

	2003 £m
Cost	
At 1 January 2003	72
At 31 December 2003	72
Amortisation	
At 1 January 2003	(26)
Amortisation during year	(2)
At 31 December 2003	(28)
Net book value	
At 1 January 2003	46
At 31 December 2003	44

15. ASSETS ATTRIBUTABLE TO THE LONG-TERM FUND

Of the amount of total assets shown on the balance sheet on page 285, £25,187m (2002: £22,515m) is attributable to the long-term business fund of which the reinsurers' share is £3,871m (2002: £3,040m).

16 OTHER DEBTORS

	2003 £m	2002 £m
Amounts falling due within one year:		
Investment income receivable	19	14
Investments sold for subsequent settlement	21	16
Amounts due from group undertakings	20	32
Deferred taxation	6	—
Other debtors	2	9
	<u>68</u>	<u>71</u>

17. CALLED-UP SHARE CAPITAL

	2003 £m	2002 £m
Authorised		
1,700m (2002 1,000m) ordinary shares of £1 each	1,700	1,000
300m (2002 nil) 4.8125 per cent. non-cumulative preference shares of £1 each	300	—
Allotted and fully paid:		
Ordinary shares of £ 1 each	654	654
4.8125 per cent. non-cumulative preference shares of £1 each	300	—
Total	<u>954</u>	<u>654</u>

On 24 November 2003 the company issued 300m 4.8125 per cent. non-cumulative preference shares to Friends Provident plc, the company's ultimate parent undertaking. Interest is to be paid half yearly on 21 May and 21 November commencing 21 May 2004. These shares have no voting rights, are non-redeemable and rank before the ordinary shares but after the claims of all other creditors in the event of the company being wound up.

18. STATEMENT OF MOVEMENTS ON RESERVES

	Share capital £m	Share premium £m	Profit and loss £m	Total £m
At 1 January 2003	654	721	318	1,693
Retained profit for the year	—	—	103	103
Preference shares issued during the year	300	—	—	300
	<hr/>	<hr/>	<hr/>	<hr/>
At 31 December 2003	954	721	421	2,096
	<hr/>	<hr/>	<hr/>	<hr/>

The distributable reserves of the Company at 31 December 2003 amounted to £143m.

19. SUBORDINATED LIABILITIES

On 18 November 1996 FP Finance PLC, then a wholly owned subsidiary of Friends' Provident Life Office ("FPLO"), issued £215m of 9.125 per cent. Undated Subordinated Guaranteed Bonds, guaranteed by FPLO. Redemption is at the option of FP Finance PLC and is not generally allowable prior to 25 November 2006. The Bonds were guaranteed on a subordinated basis by FPLO after the claims of FPLO's senior creditors including all policyholder liabilities. On 9 July 2001, under the Scheme, FPLP replaced FPLO as the guarantor. The market value of the bonds at 31 December 2003 was £232m (2002: £227m).

20. POLICYHOLDER LIABILITIES

	Long- term business provision £m	Technical provisions for linked liabilities £m
At 1 January 2003		
Gross	17,397	4,325
Reinsurance	(527)	(2,512)
Net	<hr/> 16,870	<hr/> 1,813
Movement during the year		
Gross	(250)	1,348
Reinsurance	(36)	(793)
Net	<hr/> (286)	<hr/> 555
At 31 December 2003		
Gross	17,147	5,673
Reinsurance	(563)	(3,305)
Net	<hr/> 16,584	<hr/> 2,368

On 9 July 2001 the company entered into a stoploss financial insurance contract with a number of leading reinsurers. The amount of reinsurance cover at 31 December 2003 was £300m (2002: £530m, 2001: £600m).

Included within the reinsurers' share of long-term business provision of £806m for 2001 was an amount of £702m, representing the estimated amount recoverable in the event of a claim under the stoploss contract including the recovery of £400m of future premiums payable over the lifetime of the contract. As the contract only pays out in the event of the company having failed to generate sufficient future surpluses to meet its final life policy claim payments, deferred acquisition costs, which are deferred only to the extent that they are recoverable out of future margins, to the value of £302m, were not recognised in the consolidated balance sheet for 2001.

In 2002 and 2003 no amount is included within the reinsurers' share of long-term business provision in respect of the stoploss contract. Accordingly, deferred acquisition costs have been recognised in full in the company's balance sheet. This change in presentation has no effect on the fund for future appropriations.

21. LONG-TERM BUSINESS PROVISION

The long-term business provision is calculated on the basis of recognised actuarial methods with due regard to actuarial principles and best practice. The methodology takes into account risks and uncertainties of the particular classes of long-term business written and the results are certified by the professionals undertaking the valuations.

Calculations are made on an individual policy basis, however where any global provisions are made these are calculated using statistical or mathematical methods. These results are expected to be approximately the same as if an individual liability was calculated for each long-term contract.

There is inherent uncertainty in estimating the technical provisions in respect of Guaranteed Annuity Options, where the option will only be of value to the policyholder depending on the economic and assumed future mortality experience at the time of retirement.

The key area of uncertainty is interest rates. Where these are high at the time of retirement then market annuity rates will mean the value of the guarantee is reduced. Similarly low interest rates will increase the value of the guarantee. Lesser areas of uncertainty relate to assumed mortality at the time of retirement and take up rates for tax free cash. Improving mortality experience increases the value of the guarantees while increasing take up of the tax-free cash option reduces the value of the guarantees since no cost arises in respect of those funds taken as tax-free cash.

The provision for Guaranteed Annuity Options was estimated using a deterministic scenario based on prudent assumptions and the resulting provision is significantly higher than that determined for the realistic balance sheet on a stochastic basis.

The long-term business provision is sensitive to the principal assumptions in respect of interest rates and mortality, although the relative sensitivity will vary depending on the class of long-term business.

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

Valuation interest rates	31 Dec 2003 per cent.	31 Dec 2002 per cent.
Class of Business		
Life fund:		
– Conventional With Profit	3.2	3.4
– Unitised With Profit	3.2	3.2
– Unit linked	3.3	3.2
– Term assurance	3.3	3.2
Income Protection	4.2	4.0
Pension business and annuity funds:		
– With Profits deferred annuities for the self-employed	4.4	4.3
– Deferred annuity under pension schemes:		
– With Profit main series	4.1	3.9
– With Profit UK Provident series	4.4	4.3
– Unitised With Profit	4.1	3.9
Annuities in payment	4.7	4.8

Valuation interest rates have generally increased over the year reflecting increased yields on underlying assets backing the liabilities. The exceptions are for Conventional With Profit life business (where the rate has been reduced to provide an implicit allowance for future bonuses) and annuities in payment (where the valuation rate has been strengthened to reduce the credit taken for credit spreads on corporate bonds). The changes in principal assumptions can be derived from the table above.

The long-term business provision is sensitive to the change in interest rates, falling as interest rates rise and rising as interest rates fall. The underlying assets are similarly sensitive and so the overall impact of any change is minimised. The exception is for with profit benefits where part of the underlying assets is invested in equities. These have increased in value over the year, independent of the movement in interest rates, causing an increase in the Fund for Future Appropriations.

For Conventional With Profit business explicit provision is made for vested bonuses (including those vesting following the year-end 2003 valuation). Implicit allowance for future regular and final

bonuses is made by a small margin in the valuation interest rate. Policies are assumed to remain in force for their full term.

The provision for linked contracts is equal to the value of units. A non-unit liability, consisting mainly of sterling reserves calculated by carrying out cash flow projections on appropriate bases, including allowance for future expenses, is included within the long-term business provision. The non-unit liability makes prudent allowance for the cessation of premiums where such cessation would require an increased reserve.

Accumulating With Profit Business (main series with profit deferred annuities and unitised with profit business) is valued in a similar way to linked business and includes an allowance for surrender values and both an explicit and implicit allowance for future bonuses. The explicit allowance is for the greater of the guaranteed and supportable future level of bonus while an additional implicit allowance is provided by a small margin in the valuation interest rate.

The total cost of regular, interim and final bonuses attributable for the period ended 31 December 2003 was £345m (2002: £535m).

Cashable deferred annuities are valued at the greater of the value of the cash option or the annuity discounted at 4.5 per cent. (2002: 4.4 per cent.) per annum in payment. The interest rate underlying the calculation has been determined by reference to a portfolio of assets where the future cash flows match those arising from the guaranteed annuities. Where a guaranteed annuity option is more valuable than the cash equivalent, it is assumed that 15 per cent. to 23 per cent. of the benefit is taken as tax-free cash, these rates being based on, but prudently below, recent experience.

Single premium income protection contracts have been valued as 90 per cent. of the last three years premiums plus an allowance for outstanding claims in respect of earlier premiums.

Allowance for future mortality and sickness has been made using standard published tables:

	2003 In deferment	2003 In payment	2002 In deferment	2002 In payment
Term assurances (i)	70 per cent.TM92/ 75 per cent.TF92		75 per cent.TM92/ 80 per cent.TF92	—
Life assurances	80 per cent.AM/F80		80 per cent. AM/F80	—
Unitised policies	80 per cent.AM/F80		80 per cent. AM/F80	—
Individual deferred annuities	35 per cent.AM/F80	75 per cent.RM/ FV92C2002(ii)	35 per cent. AM/F80	80 per cent.RM/ FV92C2001 (ii)
Group deferred annuities	35 per cent.AM/F80	95 per cent.PM/ FA92C2002 (ii)	35 per cent. AM/F80	95 per cent. PM/ FA92C2001 (ii)
Individual annuities in payment		75 per cent.RM/ FV92U2004 (iv)	—	80 per cent. RM/ FV92U2003 (iii)
Group annuities in payment		95 per cent.PM/ FA92U2004 (iv)	—	95 per cent.PM/ FA92U2003 (iii)

Notes:

- (i) Aggregate rates. Smokers and non-smokers are assumed to have higher and lower mortality and/or morbidity respectively.
- (ii) Projected thereafter using CMI short cohort per annum improvement factors for males and using standard CMI 92 per annum improvement factors for females.
- (iii) Plus additional 0.5 per cent. per annum onwards for males only.
- (iv) Plus additional 0.25 per cent. per annum and 0.5 per cent. per annum for individual and group males only respectively from 2004 onwards.

The mortality assumptions for annuities in payment have been strengthened to accelerate the recognition of future improvements in mortality. Overall these changes increased reserves for annuities in payment by around 0.5 per cent.. The impact on the total long-term business provision was 0.1 per cent..

Income protection sickness rates are based on recent experience with a 10 per cent. margin for recoveries and a 19 per cent. margin for inceptions. Rates differentiate by smoker status (i), whereas in 2002 aggregate experience was assumed. The impact of this change is minimal. A 10 per cent. change in the inception rate changes reserves for in force policies by the same amount. The impact on the overall Long Term Business Provision of a 10 per cent. change in the inception rate is 0.4 per cent. reflecting the relative size of income protection reserves to total reserves.

22. PROVISIONS FOR OTHER RISKS AND CHARGES

	£m
Vacant Properties	
At 1 January 2003	9
Charge in year	1
Utilised in year	(3)
	<hr/>
At 31 December 2003	7
	<hr/>
Endowment complaints	
At 1 January 2003	31
Charge in year	57
Utilised in year	(38)
	<hr/>
At 31 December 2003	50
	<hr/>
Other	
At 1 January 2003	24
Charge in year	20
Utilised in year	(19)
	<hr/>
At 31 December 2003	25
	<hr/>
Total at 1 January 2003	64
	<hr/>
Total at 31 December 2003	82
	<hr/>

Vacant properties

The company holds leases for a number of vacant and sub-let properties previously occupied by the Group. Provision has been made for the residual lease commitments and for other outgoings where significant, after taking into account the existing and expected sub-tenant arrangements. The remaining terms of the leases are up to 12 years.

Assumptions as to whether each leasehold property may be sub-let or assigned in the future have been made. The discount rate applied to expected future cash flows is 5 per cent.

Endowment Complaints

At 31 December 2003 the accounting provision for endowment complaints stand at £50,000,000. This is based on an assessment of recent experience and estimates of expected future complaints. Net operating expenses within the technical account include a charge of £57,000,000 in 2003, comprising £38,000,000 of compensation and administration costs paid during the year and an increase to provisions of £19,000,000 in respect of endowment complaints. In addition, an actuarial reserve of £14,000,000 was held in the long-term business provision at 31 December 2003 as a further prudential margin.

The majority of endowment complaints relate to With Profits Fund policies. Of the £57,000,000 charge made for 2003, £10,000,000 relates to pre-demutualisation unit linked policies, in which the shareholder had a 60 per cent. interest, resulting in a shareholder charge of £6,000,000 in 2003. This charge is more than offset by a release in the Pensions Review provision of £20,000,000. The net £14,000,000 credit is included within operating exceptional items.

Other

Other provisions include £22,000,000 in respect of reinsurance premium rebate clawbacks.

23. AMOUNTS OWED TO CREDIT INSTITUTIONS

	2003 £m	2002 £m
Bank overdrafts	20	12
	<u>20</u>	<u>12</u>

Total borrowings, including subordinated liabilities, are repayable as follows:

Within one year or on demand	20	12
Between two and three years	215	215
	<u>235</u>	<u>227</u>

24. OTHER CREDITORS INCLUDING TAXATION AND SOCIAL SECURITY

	2003 £m	2002 £m
Amounts falling due within one year:		
Proposed dividend	155	250
Taxation	48	78
Amounts due to group undertakings	217	200
Other creditors	35	76
	<u>455</u>	<u>604</u>

25. FINANCIAL COMMITMENTS

(a) Capital expenditure for which provision has not been made in the financial statements is estimated as follows.

	2003 Property £m	2002 Property £m
Contracted for	0.5	1.3

(b) Annual commitments under non-cancellable operating leases for which no provision has been made in the financial statements, were as follows:

	2003 Land and buildings £m	2002 Land and buildings £m
Operating leases which expire:		
within one year	—	—
in the second to fifth years inclusive	—	—
in over five years	1.6	1.6

26. GUARANTEES

(a) Loan Notes

At 31 December 2003 FP Business Holdings Limited ("FPBH"), a wholly owned indirect subsidiary, had £9,756,065 of loan notes (the "Loan Notes") in issue which are fully paid and are guaranteed by FPLP. The Loan Notes are repayable at par in the year 2006 and may be redeemed at the holders' request on set dates in any year until 2006. FPBH may redeem the Loan Notes if 75 per cent or more of the Loan Notes have been redeemed. The Loan Notes bear interest at a variable rate of 0.5 per cent below the six month London Inter Bank Offer Rate.

- (b) 6.875 per cent. Step-up Tier one Insurance Capital Securities (“STICS”) issued by Friends Provident plc.

On 21 November 2003, Friends Provident plc issued £300m of STICS, which will bear interest from 21 November 2003 to 20 November 2019 at a rate of 6.875 per cent. Interest is payable semi-annually in arrear on 21 May and 21 November each year. The STICS have no maturity date but will be redeemable at the option of the Issuer on 21 November 2019 and thereafter on the coupon payment date falling on or nearest successive fifth anniversaries of this date. The STICS are irrevocably guaranteed on a subordinated basis by FPLP. The guarantee is intended to provide the STICS Holders with rights against FPLP in respect of the guaranteed payments which are as nearly as possible equivalent to those which they would have had if the STICS had been directly issued preference shares of FPLP.

- (c) FPLP has given a guarantee to holders of 9.125 per cent. Undated Subordinated Guaranteed Bonds issued by FP Finance PLC, details of which are given in note 19.
- (d) FPLP has given a guarantee to FP Business Holdings Limited, for up to £45m (expiring on 31 December 2007), to cover the failure of FP Business Holdings Limited to pay any debt or claim following its capital reduction.

27. DIRECTORS' EMOLUMENTS

The emoluments of the directors in respect of their services to FPLP were:

All directors:	2003	2002
	£000	£000
Management salaries and benefits in kind	1,294	1,235
Amounts receivable under annual bonus schemes	589	337
Amounts receivable under long term incentive schemes	249	578
	2,132	2,150
	2,132	2,150

At 31 December 2003 retirement benefits were accruing to eleven directors under a defined benefit scheme and one director received retirement benefits under an unfunded unapproved pension arrangement.

Highest paid director:

The total of salaries, benefits in kind, results-related payments and amounts receivable under long-term incentive schemes payable to directors includes £450,000 (2002: £463,000) in respect of the highest paid director, of which £64,000 relates to long-term incentive schemes. Pension contributions to money purchase pension schemes include £Nil (2002: £Nil) for the highest paid director. The highest paid director is a member of a defined benefit pension scheme, under which the total accrued pension to which he would be entitled from normal retirement date if he were to retire at the year end was £228,000 (2002: £195,000).

28. RELATED PARTY TRANSACTIONS

FPLP is a wholly owned subsidiary undertaking of Friends Provident Plc. The results of both the company and its subsidiaries are consolidated in the results of Friends Provident Plc, the FPLP's ultimate parent and controlling company, whose financial statements are publicly available. Accordingly, FPLP is exempt from the requirements of Financial Reporting Standard No. 8 concerning the disclosure of transactions with other companies which qualify as related parties within the Friends Provident Group.

Key management, which includes their close family and undertakings controlled by them, had various transactions with the company during the year. Key management consists of all directors and executive management of the company.

Payments during the year by key management in respect of policies and investments issued or managed by the company:

	2003	2002
	£000	£000
Periodic payments	148	148
Single payments	58	105
Payments by the company	45	72

29. PROVISION FOR PENSION TRANSFERS AND OPT-OUTS

These reviews have now been substantially completed. £24m remains within the long-term business provision in respect of residual associated costs and contingencies. During the year £20m was released into surplus.

30. CONTINGENT LIABILITIES

Volatile markets during 2003 have led to a considerable increase in the number of complaints received by the industry in respect of endowment policies. All such complaints received by the company, and an estimate of complaints not yet received, have been provided for at an estimate of the likely cost of settling such complaints. Future regulatory actions or statements could increase the estimated costs. The impact of such potential future actions cannot be estimated with reliability.

The Financial Services Authority and other regulatory bodies may wish, in future, to examine the suitability of past sales of other products which could affect the company or the industry in general. It is possible that additional unprovided liabilities could arise as a result.

Provision for liabilities in connection with policyholder contracts are based on best estimate assumptions, using historical experience but adjusted where there is reasonable cause to expect future experience to be different. However, actual experience may differ from that assumed. Regulatory action, legal judgments, future economic conditions or other unforeseen events may impact ultimate settlements made.

31. ULTIMATE PARENT UNDERTAKING

The company's ultimate parent undertaking is Friends Provident Plc which is incorporated in the United Kingdom. Copies of the Group Annual Report and Accounts of Friends Provident Plc can be obtained by writing to its Secretary at Pixham End, Dorking, Surrey, RH4 1QA and can be viewed via its website at www.friendsprovident.com.

APPENDIX 4 – BASE CASE AND SENSITIVITY ANALYSIS TABLES

The following table sets out the Base Case for this Offering Circular projected for the period to the Class A-2 Final Maturity Date.

The Base Case

Calculation Period ending 31 December	Aggregate	Defined Book	Financing Costs ³	Class A-1	Class A-2
	Defined Book Surplus ¹	Surplus ²		Base Case Amortisation Profile ⁴	Base Case Amortisation Profile ⁴
	£m	£m	£m	£m	£m
2004	857	87	7	280	100
2005	786	96	21	205	100
2006	733	85	17	137	100
2007	688	80	12	69	100
2008	645	76	10	3	100
2009	605	72	6	0	37
2010	566	68	2	0	0
2011	529	64	0	0	0
2012	494	61	0	0	0
2013	461	58	0	0	0
2014	428	54	0	0	0
2015	397	51	0	0	0
2016	368	48	0	0	0
2017	339	46	0	0	0
2018	313	43	0	0	0
2019 onward ⁵	287	427			

The Base Case has been calculated on the basis of data as at 31 May 2004 and the Base Case Assumptions. With respect to the projected Defined Book Surplus for the period to 31 December 2004, this has been calculated as the aggregate of (i) the Defined Book Surplus calculated as at 31 May 2004 on the basis set out in Schedule 3 to the Scheme and (ii) the amount projected as the Defined Book Surplus from 31 May 2004 to 31 December 2004 on the basis of the data and Base Case Assumptions as at 31 May 2004. (see “*The Base Case – Base Case Assumptions used in projecting Defined Book Surplus Amounts*”.)

Footnotes:

- 1 Aggregate Defined Book surplus is the present value of all Defined Book Surplus cash flows projected (under the Base Case Assumptions) to arise in the future, in respect of all policies in force as at 31 May 2004 discounted at a rate of 5.47 per cent. per annum, being equal to the aggregate of (i) the fixed rate of the Reinsurer Loan plus (ii) the premium payable to Ambac (expressed as a rate per cent. per annum) plus (iii) a spread of 0.21 per cent. per annum reflecting the initial weighted average spread of the Notes over LIBOR (the “**Financing Rate**”) (the other ancillary costs of the Issuer and InterCo have not been included in the costs). The Aggregate Defined Book Surplus has been calculated assuming that cash flows are available on 15 April of each year following the Calculation Period, discounted to 15 April of the year in which the Calculation Period ends (i.e. the 2005 value is discounted to 15 April 2005). The 2004 value is the present value of all future surplus payable from April 2005 and onwards, discounted to 16 December 2004.
- 2 The Defined Book Surplus is the non-discounted amount projected under the Base Case Assumptions to be the Defined Book Surplus in respect of each future Calculation Period on the basis such period ends on 31 December in each year.
- 3 Financing Costs are the amount projected under the Base Case Assumptions to be the aggregate of (i) the fixed rate of interest under the Reinsurer Loan plus (ii) the premiums payable to Ambac (expressed as a rate per cent. per annum and assuming no Step ups) plus (iii) a spread of 0.21 per cent. per annum reflecting the initial weighted average spread of the Notes over LIBOR (the other ancillary costs of the Issuer and InterCo have not been included in the costs).
- 4 The Base Case Amortisation Profile is the then projected Principal Amount Outstanding of the Notes following the April Interest Payment Date following each Calculation Period less the Available Defined Book Surplus after deducting from the Available Defined Book Surplus the aggregate of the Financing Costs. It assumes that the Reinsurer Regulatory Surplus in respect of the corresponding Reinsurer Calculation Period is at least equal to the Defined Book Surplus.
- 5 The table excludes any Defined Book Surplus emerging after the Calculation Period ending in December 2043.
- 6 Under Schedule 3 of the Scheme, increments to Defined Book Policies after the demutualisation are not part of the Schedule 3 Amount and therefore not included in Defined Book Surplus. For practical reasons, they are processed together on an original policy records basis. In order efficiently to return value to FPLP’s Shareholder Fund the increments so written have been valued and the value fixed, £51 million, has been deducted from the amount determined for the Base Case and the amounts determined for the Sensitivity Analysis after the relevant assumption has been varied. The effect of this methodology, however, is that the variations in the relevant assumption may have a “geared” effect on the result, increasing the effect of the relevant change by up to 3 per cent.

Scenario 1 Higher mortality and morbidity rates

This scenario is based upon the Base Case Assumptions except that there is assumed to be a 25 per cent. increase in mortality assumptions and critical illness assumptions (except annuities) and an immediate remarking of reserves for a 25 per cent. increase to the mortality table used in the base valuation (i.e. it assumes that full impact of the deteriorating experience would immediately be recognised in the reserving basis) (the “Scenario 1 Assumptions”).

Scenario 1 Projection

Calculation Period ending 31 December	Aggregate Defined Book Surplus ¹ £m	Defined Book Surplus ² £m	Financing Costs ³ £m	Class A-1 Scenario Amortisation Profile ⁴ £m	Class A-2 Scenario Amortisation Profile ⁴ £m
2004	802	67	7	280	100
2005	749	92	21	209	100
2006	699	81	17	145	100
2007	656	77	14	82	100
2008	615	72	9	19	100
2009	576	69	7	0	57
2010	539	65	3	0	0
2011	504	61	0	0	0
2012	470	58	0	0	0
2013	438	55	0	0	0
2014	407	52	0	0	0
2015	377	49	0	0	0
2016	349	46	0	0	0
2017	322	44	0	0	0
2018	296	41	0	0	0
2019 onward ⁵	271	402			

The Scenario has been calculated on the basis of data as at 31 May 2004, the Base Case Assumptions and the assumptions described above. With respect to the projected Defined Book Surplus for the period to 31 December 2004, this has been calculated as the aggregate of (i) the Defined Book Surplus calculated as at 31 May 2004 on the basis set out in Schedule 3 to the Scheme and (ii) the amount projected as the Defined Book Surplus from 31 May 2004 to 31 December 2004 on the basis of the data and Base Case Assumptions as at 31 May 2004. (see “The Base Case – Base Case Assumptions used in projecting Defined Book Surplus Amounts”).

- 1 Aggregate Defined Book surplus is the present value of all Defined Book Surplus cash flows projected (under the assumptions described above) to arise in the future, in respect of all policies in force as at 31 May 2004 discounted at a rate of 5.47 per cent. per annum, being equal to the aggregate of (i) the fixed rate of the Reinsurer Loan plus (ii) the premium payable to Ambac (expressed as a rate per cent. per annum) plus (iii) a spread of 0.21 per cent. per annum reflecting the initial weighted average spread of the Notes over LIBOR (the “Financing Rate”) (the other ancillary costs of the Issuer and InterCo have not been included in the costs). The Aggregate Defined Book Surplus has been calculated assuming that cash flows are available on 15 April of each year following the Calculation Period, discounted to 15 April of the year in which the Calculation Period ends (i.e. the 2005 value is discounted to 15 April 2005). The 2004 value is the present value of all future surplus payable from April 2005 and onwards, discounted to 16 December 2004.
- 2 The Defined Book Surplus is the non-discounted amount projected under the assumptions described above to be the Defined Book Surplus in respect of each future Calculation Period on the basis such period ends on 31 December in each year.
- 3 Financing Costs are the amount projected under the assumptions described above to be the aggregate of (i) the fixed rate of interest under the Reinsurer Loan plus (ii) the premiums payable to Ambac (expressed as a rate per cent. per annum assuming no Step ups) plus (iii) a spread of 0.21 per cent. per annum reflecting the initial weighted average spread of the Notes over LIBOR (the other ancillary costs of the Issuer and InterCo have not been included in the costs).
- 4 The Scenario Amortisation Profile is the then projected Principal Amount Outstanding of the Notes following the April Interest Payment Date following each Calculation Period less the Available Defined Book Surplus after deducting from the Available Defined Book Surplus the aggregate of the Financing Costs. It assumes that the Reinsurer Regulatory Surplus in respect of the corresponding Reinsurer Calculation Period is at least equal to the Defined Book Surplus.
- 5 The table excludes any Defined Book Surplus emerging after the Calculation Period ending in December 2043.
- 6 Under Schedule 3 of the Scheme, increments to Defined Book Policies after the demutualisation are not part of the Schedule 3 Amount and therefore not included in Defined Book Surplus. For practical reasons, they are processed together on an original policy records basis. In order efficiently to return value to FPLP’s Shareholder Fund the increments so written have been valued and the value fixed, £51 million, has been deducted from the amount determined for the Base Case and the amounts determined for the Sensitivity Analysis after the relevant assumption has been varied. The effect of this methodology, however, is that the variations in the relevant assumption may have a “geared” effect on the result, increasing the effect of the relevant change by up to 3 per cent.

Scenario 2 Improvement in mortality rate

This scenario is based upon the Base Case Assumptions except that, for the annuity book only, the future improvement factors in the experience basis are moved from medium cohort to half way between medium and long cohort, with a minimum of 0.5 per cent. per annum. An additional 0.5 per cent. per annum on top of the cohort improvement factors in both the experience and valuation bases (and a remarking of reserves over first 10 years) is assumed (the “Scenario 2 Assumptions”).

Scenario 2 Projection

Calculation Period ending 31 December	Aggregate Defined Book Surplus ¹ £m	Defined Book Surplus ² £m	Financing Costs ³ £m	Class A-1 Scenario Amortisation Profile ⁴ £m	Class A-2 Scenario Amortisation Profile ⁴ £m
2004	795	83	7	280	100
2005	726	92	21	209	100
2006	674	81	16	144	100
2007	630	76	14	82	100
2008	588	72	10	20	100
2009	549	68	7	0	59
2010	511	63	3	0	0
2011	476	59	0	0	0
2012	443	56	0	0	0
2013	411	52	0	0	0
2014	382	53	0	0	0
2015	350	50	0	0	0
2016	319	46	0	0	0
2017	291	43	0	0	0
2018	264	40	0	0	0
2019 onward ⁵	238	346			

Scenario has been calculated on the basis of data as at 31 May 2004, the Base Case Assumptions and the assumptions described above. With respect to the projected Defined Book Surplus for the period to 31 December 2004, this has been calculated as the aggregate of (i) the Defined Book Surplus calculated as at 31 May 2004 on the basis set out in Schedule 3 to the Scheme and (ii) the amount projected as the Defined Book Surplus from 31 May 2004 to 31 December 2004 on the basis of the data and Base Case Assumptions as at 31 May 2004. (see “*The Base Case – Base Case Assumptions used in projecting Defined Book Surplus Amounts*”.)

1 See Footnote 1 on page 307.

2 See Footnote 2 on page 307.

3 See Footnote 3 on page 307.

4 See Footnote 4 on page 307.

5 See Footnote 5 on page 307.

6 See Footnote 6 on page 307.

Scenario 3 100 per cent. increase in lapse rate

This scenario is based upon the Base Case Assumptions except that there is a 100 per cent. increase in lapse rate assumptions (in the case of pensions this assumes pensions become fully paid-up rather than lapse) (the “Scenario 3 Assumptions”).

Scenario 3 Projection

Calculation Period ending 31 December	Aggregate Defined Book Surplus ¹ £m	Defined Book Surplus ² £m	Financing Costs ³ £m	Class A-1 Scenario Amortisation Profile ⁴ £m	Class A-2 Scenario Amortisation Profile ⁴ £m
2004	734	90	7	280	100
2005	657	95	21	206	100
2006	597	80	16	142	100
2007	550	71	14	85	100
2008	509	64	9	30	100
2009	473	59	8	0	79
2010	440	54	4	0	29
2011	410	50	2	0	0
2012	383	46	0	0	0
2013	358	43	0	0	0
2014	334	40	0	0	0
2015	312	38	0	0	0
2016	291	36	0	0	0
2017	271	34	0	0	0
2018	252	32	0	0	0
2019 onward ⁵	234	355			

The Scenario has been calculated on the basis of data as at 31 May 2004, the Base Case Assumptions and to assumptions described above. With respect to the projected Defined Book Surplus for the period to 31 December 2004, this has been calculated as the aggregate of (i) the Defined Book Surplus calculated as at 31 May 2004 on the basis set out in Schedule 3 to the Scheme and (ii) the amount projected as the Defined Book Surplus from 31 May 2004 to 31 December 2004 on the basis of the data and Base Case Assumptions as at 31 May 2004. (see “*The Base Case – Base Case Assumptions used in projecting Defined Book Surplus Amounts*”.)

1 See Footnote 1 on page 307.

2 See Footnote 2 on page 307.

3 See Footnote 3 on page 307.

4 See Footnote 4 on page 307.

5 See Footnote 5 on page 307.

6 See Footnote 6 on page 307.

Scenario 4 200 per cent. increase in lapse rates

This scenario is based upon the Base Case Assumptions except that there is a 200 per cent. increase in lapse rate assumptions (in the case of pensions this assumes pensions become fully paid-up rather than lapse) (the “Scenario 4 Assumptions”).

Scenario 4 Projection

Calculation Period ending 31 December	Aggregate Defined Book Surplus ¹ £m	Defined Book Surplus ² £m	Financing Costs ³ £m	Class A-1 Scenario Amortisation Profile ⁴ £m	Class A-2 Scenario Amortisation Profile ⁴ £m
<i>all figures in £,000,000</i>					
2004	666	94	7	280	100
2005	584	94	21	207	100
2006	522	74	17	150	100
2007	477	63	13	100	100
2008	440	55	11	56	100
2009	409	49	9	16	100
2010	382	45	6	0	77
2011	359	41	5	0	41
2012	337	38	2	0	5
2013	318	36	0	0	0
2014	299	34	0	0	0
2015	282	32	0	0	0
2016	264	31	0	0	0
2017	248	30	0	0	0
2018	232	28	0	0	0
2019 onward ⁵	216	332			

The Scenario has been calculated on the basis of data as at 31 May 2004, the Base Case Assumptions and to assumptions described above. With respect to the projected Defined Book Surplus for the period to 31 December 2004, this has been calculated as the aggregate of (i) the Defined Book Surplus calculated as at 31 May 2004 on the basis set out in Schedule 3 to the Scheme and (ii) the amount projected as the Defined Book Surplus from 31 May 2004 to 31 December 2004 on the basis of the data and Base Case Assumptions as at 31 May 2004. (see “The Base Case – Base Case Assumptions used in projecting Defined Book Surplus Amounts”.)

1 See Footnote 1 on page 307.

2 See Footnote 2 on page 307.

3 See Footnote 3 on page 307.

4 See Footnote 4 on page 307.

5 See Footnote 5 on page 307.

6 See Footnote 6 on page 307.

Scenario 5 300 per cent. increase in lapse rates

This scenario is based upon the Base Case Assumptions except that there is a 300 per cent. increase in lapse rate assumptions (in the case of pensions this assumes pensions become fully paid-up rather than lapse) (the “Scenario 5 Assumptions”).

Scenario 5 Projection

Calculation Period ending 31 December	Aggregate Defined Book Surplus ¹ £m	Defined Book Surplus ² £m	Financing Costs ³ £m	Class A-1 Scenario Amortisation Profile ⁴ £m	Class A-2 Scenario Amortisation Profile ⁴ £m
2004	624	98	7	280	100
2005	537	92	21	209	100
2006	475	68	17	158	100
2007	433	56	15	117	100
2008	401	48	12	81	100
2009	375	42	9	48	100
2010	353	39	8	17	100
2011	334	36	7	0	88
2012	316	34	5	0	59
2013	299	32	2	0	29
2014	283	31	2	0	0
2015	268	30	0	0	0
2016	253	29	0	0	0
2017	238	28	0	0	0
2018	223	27	0	0	0
2019 onward ⁵	208	320			

The Scenario has been calculated on the basis of data as at 31 May 2004, the Base Case Assumptions and the assumptions described above. With respect to the projected Defined Book Surplus for the period to 31 December 2004, this has been calculated as the aggregate of (i) the Defined Book Surplus calculated as at 31 May 2004 on the basis set out in Schedule 3 to the Scheme and (ii) the amount projected as the Defined Book Surplus from 31 May 2004 to 31 December 2004 on the basis of the data and Base Case Assumptions as at 31 May 2004. (see “*The Base Case – Base Case Assumptions used in projecting Defined Book Surplus Amounts*”.)

1 See Footnote 1 on page 307.

2 See Footnote 2 on page 307.

3 See Footnote 3 on page 307.

4 See Footnote 4 on page 307.

5 See Footnote 5 on page 307.

6 See Footnote 6 on page 307.

Scenario 6 100 basis point fall in investment returns

This scenario is based upon the Base Case Assumptions except that there is a 100bps fall in the investment return assumption (except for annuities), including non-unit reserves. This scenario also assumes the matching assets for the annuity book suffer 0.25 per cent. per annum defaults (the “Scenario 6 Assumptions”).

Scenario 6 Projection

Calculation Period ending 31 December	Aggregate Defined Book Surplus ¹ £m	Defined Book Surplus ² £m	Financing Costs ³ £m	Class A-1 Scenario Amortisation Profile ⁴ £m	Class A-2 Scenario Amortisation Profile ⁴ £m
2004	742	82	7	280	100
2005	673	88	21	213	100
2006	622	77	17	153	100
2007	579	72	14	95	100
2008	539	67	11	39	100
2009	502	63	7	0	83
2010	466	59	5	0	29
2011	432	55	2	0	0
2012	401	52	0	0	0
2013	371	49	0	0	0
2014	342	46	0	0	0
2015	315	43	0	0	0
2016	290	40	0	0	0
2017	266	37	0	0	0
2018	243	35	0	0	0
2019 onward ⁵	222	329			

The Scenario has been calculated on the basis of data as at 31 May 2004, the Base Case Assumptions and the assumptions described above. With respect to the projected Defined Book Surplus for the period to 31 December 2004, this has been calculated as the aggregate of (i) the Defined Book Surplus calculated as at 31 May 2004 on the basis set out in Schedule 3 to the Scheme and (ii) the amount projected as the Defined Book Surplus from 31 May 2004 to 31 December 2004 on the basis of the data and Base Case Assumptions as at 31 May 2004. (see “*The Base Case – Base Case Assumptions used in projecting Defined Book Surplus Amounts*”.)

1 See Footnote 1 on page 307.

2 See Footnote 2 on page 307.

3 See Footnote 3 on page 307.

4 See Footnote 4 on page 307.

5 See Footnote 5 on page 307.

6 See Footnote 6 on page 307.

Scenario 7 25 per cent. fall in equity/property values

This scenario is based upon the Base Case Assumptions except that there is an immediate 25 per cent. fall in equity and property investment asset values in year 1, including non-unit reserves, followed by long-term growth assumption (the “Scenario 7 Assumptions”).

Scenario 7 Projection

Calculation Period ending 31 December	Aggregate Defined Book Surplus ¹ £m	Defined Book Surplus ² £m	Financing Costs ³ £m	Class A-1 Scenario Amortisation Profile ⁴ £m	Class A-2 Scenario Amortisation Profile ⁴ £m
2004	772	75	7	280	100
2005	710	88	21	213	100
2006	660	78	17	152	100
2007	619	73	14	93	100
2008	580	69	10	34	100
2009	543	65	8	0	77
2010	507	61	3	0	19
2011	474	58	1	0	0
2012	442	55	0	0	0
2013	411	52	0	0	0
2014	382	49	0	0	0
2015	354	46	0	0	0
2016	328	43	0	0	0
2017	302	41	0	0	0
2018	278	38	0	0	0
2019 onward ⁵	255	381			

The Scenario has been calculated on the basis of data as at 31 May 2004, the Base Case Assumptions and the assumptions described above. With respect to the projected Defined Book Surplus for the period to 31 December 2004, this has been calculated as the aggregate of (i) the Defined Book Surplus calculated as at 31 May 2004 on the basis set out in Schedule 3 to the Scheme and (ii) the amount projected as the Defined Book Surplus from 31 May 2004 to 31 December 2004 on the basis of the data and Base Case Assumptions as at 31 May 2004. (see “*The Base Case – Base Case Assumptions used in projecting Defined Book Surplus Amounts*”.)

1 See Footnote 1 on page 307.

2 See Footnote 2 on page 307.

3 See Footnote 3 on page 307.

4 See Footnote 4 on page 307.

5 See Footnote 5 on page 307.

6 See Footnote 6 on page 307.

Scenario 8 50 per cent. fall in equity/property values with subsequent growth

This scenario is based upon the Base Case Assumptions except that there is an immediate 50 per cent. fall in equity and property investment asset values in year 1, including non-unit reserves, followed by long-term growth assumption (the “Scenario 8 Assumptions”).

Scenario 8 Projection

Calculation Period ending 31 December	Aggregate Defined Book Surplus ¹ £m	Defined Book Surplus ² £m	Financing Costs ³ £m	Class A-1 Scenario Amortisation Profile ⁴ £m	Class A-2 Scenario Amortisation Profile ⁴ £m
2004	685	61	7	280	100
2005	636	81	21	220	100
2006	590	71	18	167	100
2007	551	66	14	115	100
2008	515	62	12	65	100
2009	481	59	10	16	100
2010	449	55	6	0	67
2011	419	52	4	0	19
2012	390	49	1	0	0
2013	363	46	0	0	0
2014	337	43	0	0	0
2015	312	41	0	0	0
2016	288	38	0	0	0
2017	266	36	0	0	0
2018	244	34	0	0	0
2019 onward ⁵	224	335			

The Scenario has been calculated on the basis of data as at 31 May 2004, the Base Case Assumptions and the assumptions described above. With respect to the projected Defined Book Surplus for the period to 31 December 2004, this has been calculated as the aggregate of (i) the Defined Book Surplus calculated as at 31 May 2004 on the basis set out in Schedule 3 to the Scheme and (ii) the amount projected as the Defined Book Surplus from 31 May 2004 to 31 December 2004 on the basis of the data and Base Case Assumptions as at 31 May 2004. (see “The Base Case – Base Case Assumptions used in projecting Defined Book Surplus Amounts”.)

1 See Footnote 1 on page 307.

2 See Footnote 2 on page 307.

3 See Footnote 3 on page 307.

4 See Footnote 4 on page 307.

5 See Footnote 5 on page 307.

6 See Footnote 6 on page 307.

Scenario 9 50 per cent. fall in equity/property values with no growth

This scenario is based upon the Base Case Assumptions except that there is an immediate 50 per cent. fall in equity and property investment asset values in year 1, including non-unit reserves, followed by no growth for ten years then followed by long term growth assumptions (the “Scenario 9 Assumptions”).

Scenario 9 Projection

Calculation Period ending 31 December	Aggregate Defined Book Surplus ¹ £m	Defined Book Surplus ² £m	Financing Costs ³ £m	Class A-1 Scenario Amortisation Profile ⁴ £m	Class A-2 Scenario Amortisation Profile ⁴ £m
2004	583	61	7	280	100
2005	533	79	21	222	100
2006	483	67	18	173	100
2007	443	61	15	127	100
2008	406	56	12	83	100
2009	372	51	10	42	100
2010	342	47	8	3	100
2011	314	42	6	0	67
2012	289	38	3	0	32
2013	266	35	2	0	0
2014	246	32	0	0	0
2015	227	30	0	0	0
2016	209	28	0	0	0
2017	192	26	0	0	0
2018	176	24	0	0	0
2019 onward ⁵	162	243			

The Scenario has been calculated on the basis of data as at 31 May 2004, the Base Case Assumptions and the assumptions described above. With respect to the projected Defined Book Surplus for the period to 31 December 2004, this has been calculated as the aggregate of (i) the Defined Book Surplus calculated as at 31 May 2004 on the basis set out in Schedule 3 to the Scheme and (ii) the amount projected as the Defined Book Surplus from 31 May 2004 to 31 December 2004 on the basis of the data and Base Case Assumptions as at 31 May 2004. (see “*The Base Case – Base Case Assumptions used in projecting Defined Book Surplus Amounts*”).

1 See Footnote 1 on page 307.

2 See Footnote 2 on page 307.

3 See Footnote 3 on page 307.

4 See Footnote 4 on page 307.

5 See Footnote 5 on page 307.

6 See Footnote 6 on page 307.

Scenario 10 Combination of scenarios

This scenario is based upon the Base Case Assumptions except that:

- (a) the mortality/critical illness/longevity assumptions are those in the Scenario 1 Assumptions and the Scenario 2 Assumptions;
 - (b) the lapse assumptions are those in the Scenario 3 Assumptions; and
 - (c) the investment return assumptions are those in the Scenario 7 Assumptions;
- (the "Scenario 10 Assumptions").

Scenario 10 Projection

Calculation Period ending 31 December	Aggregate Defined Book Surplus ¹ £m	Defined Book Surplus ² £m	Financing Costs ³ £m	Class A-1 Scenario Amortisation Profile ⁴ £m	Class A-2 Scenario Amortisation Profile ⁴ £m
2004	570	59	7	280	100
2005	521	82	21	219	100
2006	468	67	17	169	100
2007	426	59	14	124	100
2008	390	53	12	83	100
2009	358	48	11	46	100
2010	330	43	8	11	100
2011	306	39	7	0	79
2012	284	35	4	0	48
2013	264	32	2	0	18
2014	246	34	1	0	0
2015	226	31	0	0	0
2016	207	29	0	0	0
2017	190	27	0	0	0
2018	174	25	0	0	0
2019 onward ⁵	158	236			

The Scenario has been calculated on the basis of data as at 31 May 2004, the Base Case Assumptions and the assumptions described above. With respect to the projected Defined Book Surplus for the period to 31 December 2004, this has been calculated as the aggregate of (i) the Defined Book Surplus calculated as at 31 May 2004 on the basis set out in Schedule 3 to the Scheme and (ii) the amount projected as the Defined Book Surplus from 31 May 2004 to 31 December 2004 on the basis of the data and Base Case Assumptions as at 31 May 2004. (see "*The Base Case – Base Case Assumptions used in projecting Defined Book Surplus Amounts*".)

1 See Footnote 1 on page 307.

2 See Footnote 2 on page 307.

3 See Footnote 3 on page 307.

4 See Footnote 4 on page 307.

5 See Footnote 5 on page 307.

6 See Footnote 6 on page 307.

APPENDIX 5 – DEFINED BOOK POLICY DESCRIPTIONS

PART 1 – DEFINED BOOK POLICY DESCRIPTIONS

Conventional Non Profit Life

Annuity (generic description):

These are annuities in payment which may be either level, or increase in payment at a specified rate, and may be payable for the lifetime of one life, or until the second death of two lives.

Temporary assurance (generic description):

These are policies under which a lump sum is payable if the policyholder dies within a specified term. The lump sum may be either level or decrease as the elapsed term of the policy increases.

Endowment assurance (generic description):

These are policies under which a lump sum is payable if the policyholder dies within a specified term, or survives to the end of the term.

Whole of life policies (generic description):

These are policies under which a lump sum is payable when the policyholder dies. In respect of with profits policies, payouts may be increased by means of bonus additions. Premiums may be payable throughout the policyholder's life, or cease at a specified age.

Critical illness (generic description):

These are policies under which a lump sum is payable if the policyholder is diagnosed with one of a specified set of diseases within a specified term.

The Serious Illness Protection Plan:

A non profit term assurance contract which pays out a lump sum in the event of the policyholder surviving for a minimum of 28 days following diagnosis of a specified serious illness or disability.

Mortgage Protection Plans and Homebuyer Protection Plans:

These are decreasing temporary assurances that guarantee to repay the outstanding repayment mortgage on death or pay a minimum sum (which decreases with the elapsed term) if greater. Plans written since 1st January 1999 automatically contain terminal illness benefit.

Senior Plan:

A limited premium whole life non profit plan under which the death benefit is a return of premium in the first two years and the sum assured thereafter.

Conventional Non Profit Pensions

Annuity (generic description):

These are policies under which the policyholder receives a regular series of payments as long as he/she is alive, which may be:

- (i) either level, or increase at a fixed rate, or in accordance with the increases in RPI, or in accordance with RPI subject to a fixed percentage cap (e.g. 3 per cent. or 5 per cent.), and
- (ii) payable until the death of one life, or until the second death of two lives.

Deferred annuity (generic description):

These are annuities which will come into payment at some time in the future, conditional on the policyholder(s) being alive at that time. They may be either fixed or increase at a specified rate, and may be payable for the lifetime of one life, or until the second death of two lives.

Temporary assurance (generic description):

These are policies under which a lump sum is payable if the policyholder dies within a specified term.

Unit Linked & Unitised With Profits Life

Investment products generally offer the policyholder a choice between buying units in the internal linked funds (Unit Linked business) or in the Unitised With Profits fund, or purchasing a

combination of the two. Accordingly, Unit Linked and Unitised With Profits business are originated through the same products.

Capital Investment Bonds:

This is a single contribution non-qualifying whole life assurance policy. Policies may have further payments made into them at any time. The normal death benefit is 101 per cent. of the bid value of units although higher percentages may apply to policies taken out before 19 January 1987.

For policies taken out since 17 January 2000, on surrender in the first five years the following deductions are made:

Duration	0	1	2	3	4	5+
Deduction	8 per cent.	7 per cent.	5 per cent.	4 per cent.	2 per cent.	0 per cent.

Income Distribution Bond:

This is a single contribution non-qualifying whole life assurance policy. Policies may have further payments made into them at any time. The death benefit is 101 per cent. of the bid value of units. On surrender in the first five years the following deductions are made:

Duration	0	1	2	3	4	5+
Deduction	8 per cent.	7 per cent.	5 per cent.	4 per cent.	2 per cent.	0 per cent.

Regular withdrawals of up to 7.5 per cent. may be made without the deduction applying.

Investment Portfolio Bond:

This is a single contribution non-qualifying whole life assurance policy. Policies may have further payments made into them at any time. The death benefit is 101 per cent. of the bid value of units. On surrender in the first five years the following deductions are made:

Duration	0	1	2	3	4	5+
Deduction	8 per cent.	7 per cent.	5 per cent.	4 per cent.	2 per cent.	0 per cent.

Regular withdrawals of up to 7.5 per cent. may be made without the deduction or a market value reduction ("MVR") applying.

Extended Investment Plan:

This is a plan designed to enable maturing qualifying policies to be converted to a qualifying policy. The plan can be whole life, for a nominal annual premium, or for ten years with the premium payable monthly or annually being not more than that payable under the original contract.

At maturity of the endowment option the policyholder may: take the bid value of the units; keep the policy in force and continue to pay premiums at the current level for a further 10 years; or keep the policy in force, converting to a whole life policy paying a nominal premium.

On surrender the bid value of the units is payable. The regular premium policy may also be made paid-up.

Directions:

This is a whole life regular premium assurance policy with a variable sum assured within limits stipulated by FPLP. The policyholder selects the level of the sum assured. The death benefit is the selected sum assured or the surrender value if greater.

After the first 10 years, then at 5-yearly intervals until the policyholder is 70 and annually afterwards, the plan is reviewed by FPLP to establish whether the value of units and future premiums will support the selected sum assured until the next review.

On the policyholder's 65th birthday or after 10 years if later, terminal bonus may be added to the policy and is available on surrender on or after that date. A MVR is guaranteed not to apply on that date but may apply after that date.

If a policy is made paid-up the policyholder has the option either to maintain the guaranteed sum assured at the previous level or at a chosen lower level until units have been exhausted, or to cancel the guaranteed sum assured so that the death benefit will always equal the surrender value.

The selected sum assured is guaranteed until the next review. The policyholder may alter the selected sum assured at any policy anniversary, within limits stipulated by FPLP, in which event the revised selected sum assured is guaranteed until the following review. If it is necessary to reduce the selected sum assured at a review, the policyholder has the option to effect a further Directions policy to replace the loss in sum assured, without further evidence of health. After 10 years a policyholder who effected the policy before 24 February 1988 may leave the Policy in force, while paying only a nominal premium to meet administration costs, and cash units at any time.

Homebuyer Plus Plan:

This is a whole life assurance policy with limited regular premiums. It is designed, but is not guaranteed, to repay a mortgage after a specified term, assuming there is a specified growth rate. Both level and low start premium versions are available. Under the low start version the premium increases by 20 per cent. of the initial premium at each of the first five policy anniversaries, so that the final premium is double the initial premium.

In the event of death during the term of the Plan, the higher of the guaranteed minimum death benefit and the value of the units allocated is payable.

On surrender with less than 5 years' premiums outstanding a final bonus may be payable on the unitised with profits units. A MVR is guaranteed not to apply to these units at the end of the contribution payment term.

Homebuyer Mortgage Plan:

This plan is similar to the Homebuyer Plus Plan but with the following differences. Only a level premium version is available and all investments must be made into the With Profits Fund.

Flexible Mortgage Plan:

This policy is similar to the Homebuyer Plus Plan except for differences in the options and charging structure.

Flexible Investment Plan:

This is a whole life assurance policy with a death benefit equal to 101 per cent. of the bid value of units. Contributions can normally be varied at any time. Premiums may be regular or single. The MVR is guaranteed not to apply on surrender on the 10th, 15th, 20th or 25th anniversaries. On surrender, or switching out, after five years in the With Profits Fund, a terminal bonus may be payable.

Maximum Investment Plan:

This is a 10 year regular premium endowment assurance policy, which was not open to new business in the year, under which the death benefit is the greater of the surrender value and a guaranteed sum assured. After 10 years the policy can continue for another 10 years in which case the premium allocation rate will be 105 per cent.. A final bonus on unitised with profits units may be consolidated after the first 10 year period.

Versatile Investment Plan:

This is a regular premium endowment assurance policy under which the death benefit is the greater of the bid value of the units or a guaranteed minimum death benefit. Contributions may be level or escalating in a similar way to the low start Homebuyer Plus option. On maturity the plan can normally be extended for another 10 years, in which case a final bonus on unitised with profit units then payable may be consolidated.

Ex Friends Provident (London and Manchester) Assurance Limited Single Premium Linked Bond:

This is a single contribution whole life assurance policy. The death benefit is the greater of the value of the units and the guaranteed sum assured. If the bonds are surrendered in the first five years a deduction is made.

Preferred Investment Bond:

The bond is a single premium whole life contract, the death benefit being a multiple of the value of units secured at the date of death. The multiple varies between one and two according to the age at death. Surrender penalties are a percentage of the value of units secured. This percentage decreases by 1 per cent. a year from 6 per cent. in year 1 to 0 per cent. in year seven and

subsequent years for bonds issued before 1st July 1988 and from 5 per cent. in year one to 0 per cent. in year six for bonds issued after 30 June 1988. The contract may be linked to the Investment Trust, Property, Managed, Guaranteed Deposit, Fixed Interest, Equity, International, American, Japan or European Funds.

First Series Endowment Plans:

The benefit on death is normally the greater of the value of the units secured and a guaranteed amount equal to the total premiums payable over the term or to age 65 if less. The benefit on maturity is identical to that on death except there is no restriction to age 65. The contract may be linked to the Investment Trust, Property or Managed Funds.

Investment Mortgage Plan:

The plan is a regular premium unit linked endowment assurance for a minimum term of ten years and a maximum of thirty years. The benefit on maturity is the full value of the units. The benefit on death is the greater of: the current value of units allocated, and the guaranteed death benefit, which is the projected maturity value.

The cash surrender value, available at any time after two years' premiums have been paid, is the full value of accumulation units plus a percentage of the value of capital units.

Low Start Investment Mortgage Plan:

This is an extension of the Investment Mortgage Plan to allow for a low start option. With this facility there is a reduced initial premium. On each of the first five policy anniversaries the premium increases by 20 per cent. of the first year's premium and thereafter remains constant. The benefits, options and plan links are substantially the same as for the Investment Mortgage Plan.

Accelerated Investment Mortgage Plan:

The plan is a regular premium unit linked endowment assurance for a minimum of 10 years and a maximum of 35 years. The benefit on maturity is the full value of units. The units allocated in the first two years are capital units (6 per cent.) and thereafter allocations are to accumulation units (1 per cent.). The benefit on death is the greater of the current value of units allocated and the selected sum assured.

Lifespan:

The plan is a regular premium unit linked whole life assurance. The units allocated in the first two years are capital units (5 per cent. or 6 per cent. depending when written), and thereafter allocations are to accumulation units (0.75 per cent. or 1 per cent. depending when written). The benefit on death is the greater of the current value of units allocated or the selected sum assured. The sum assured can be selected at inception between zero and a maximum, dependent on age next birthday, premium and whether the life assured is a smoker or non-smoker.

International Investment Bond:

This is a single premium whole life assurance policy. The death benefit is equal to 101 per cent. of the value of units allocated. On surrender the bid value of units is paid less a deduction. Terminal bonus may be payable on surrender of unitised with profits units after 3 years.

International With Profits Bond:

This is a single premium whole life assurance policy investing in the OLAB With Profits/With Profits Fund. The death benefit is equal to 101 per cent. of the value of units allocated. On surrender the bid value of units is paid less a deduction as follows:

Years	0	1	2	3	4	5+
Version 1	2 per cent.	1 per cent.	0 per cent.	0 per cent.	0 per cent.	0 per cent.
Version 2	5 per cent.	4 per cent.	3 per cent.	2 per cent.	1 per cent.	0 per cent.

Regular withdrawals of up to 7.5 per cent. p.a. may be made without the deduction or a MVR applying.

International Investment Plan:

This is similar to the Versatile Investment Plan contract written in the Life Fund except that the Permanent and Total Disability Benefit option is not available. Level and escalating premium versions are available.

International Savings Plan

This is an initial unit version of the International Investment Plan. The allocation is (up to) 102.5 per cent. throughout, but during the initial period (between 12 and 24 months) the premiums are allocated to initial units instead of accumulation units.

International Investment Account:

This is a short-term savings plan written on a whole-of-life basis. Regular contributions may continue at the same level or be reduced, increased or suspended and reinstated at any time, subject to certain limits. Single contributions may be paid at any time. The amount payable on death is 101 per cent. of the bid value of units. The plan may be cashed in at any time in full or in part, subject to certain limits.

Guernsey International Pension:

This contract, which can be single or regular premium, is written under Section 40(ee) of the Income Tax (Guernsey) Law 1975 as a retirement annuity contract. On maturity or death the bid value of units is paid. Single premium contracts are subject to a deduction on early surrender.

Unit Linked & Unitised With Profits Pensions

Individual Pensions

Personal Pension Plan (pre 1988):

This is a regular premium pension plan for the self-employed vesting at a selected retirement date normally between ages 60 and 75. There is also a single premium version of the contract. The retirement cash fund may be used to pay a lump sum and/or purchase an immediate annuity. The amount and type of benefits may be restricted by legislation. On death the bid value of the units allocated is paid. A waiver of premium benefit may be added.

Personal Pension Plan (Series 1):

The terms are as for the Personal Pension Plan above, except that under a regular contribution plan the policyholder may take additional life cover with the cost paid for by monthly deduction of units.

Additional Voluntary Contribution Plan (Series 1):

This is a single or regular contribution free standing additional voluntary contribution plan written to a selected retirement date to correspond with the normal retirement date under the employer's scheme. The regular premium version of this contract was closed to new business and increments after 31st March 1999. It is similar to a Personal Pension Plan (Series 1) except that early or late retirement should tie in with retirement from the main scheme, and whether contributions can continue after the selected retirement date will depend on the main scheme practice.

No cash sum can be taken at retirement; the bid value of units must be used to purchase a pension.

Group Additional Voluntary Contribution Plan:

This is an Additional Voluntary Contribution Plan written on a group basis. It is available for groups of 5 or more lives. Conditions are substantially as above.

Personal Pension Plan (Series 2):

This is a version of the Personal Pension Plan under which all premiums are allocated to accumulation units. The plan may be started only by regular contributions, although additional single contributions may be made at any time.

Additional Voluntary Contribution Plan (Series 2):

This is similar to Personal Pension Plan (Series 2). The plan may be started only by regular contributions, although additional single contributions may be made at any time. Charges, allocation rates and bonus unit terms are as for Personal Pension Plan (Series 2).

New Generation Personal Pension:

Both single and regular contributions may be paid, regular contributions being able to be varied at any time. These contributions are invested in the New Generation series of funds, which have a range of possible annual management charges. For each scheme, either a single annual management charge is chosen at outset for all contributions, or one charge is chosen for normal contributions and another for accepting transfer values. The annual management charge may be varied subsequently by FPLP.

Stakeholder:

This has the same charging structure as the New Generation Personal Pension except for the guarantee that the Annual Management Charge will not exceed 1 per cent. per annum. Investment in with profits is not permitted.

Blueprint:

A personal pension product which may be unit linked or invested in unitised with profits Funds. The contract can also be used as a Free Standing Additional Voluntary Contribution plan. The date of retirement is selected at inception, but benefits may be taken earlier or later (normally within the age range of 50 to 75). On death before retirement the benefit is the current value of the units allocated.

Buyouts (generic description):

An individual single premium contract arranged to accept a transfer value from an employer sponsored arrangement. It may be necessary for the buyout contract to mirror certain of the benefits or terms of the scheme, e.g. to ensure that the benefits payable are at least equal to the Guaranteed Minimum Pension that has been transferred.

Employer sponsored Pensions

Executive Pension Plan:

This is a single or regular contribution pension plan vesting at a selected retirement date. Under the regular contribution plan a policyholder may also pay for additional life cover by cancelling units each month. The extra life cover may either be a fixed sum in addition to the value of the units or reducing so that the total benefit is not less than a fixed sum.

The retirement cash fund may be used to pay a lump sum and/or purchase an immediate annuity. On death the bid value of the units allocated is payable in addition to any extra life cover.

Money Purchase Plan:

This is a group money purchase pension scheme, under which contributions may be either single, regular, or variable from year to year.

New Generation Contracted-In Money Purchase Plan:

This is a version of Money Purchase Plan, which has the same charges and conditions as the New Generation Group Personal Pension.

Pension Investment Bond:

This is a single contribution 'non-earmarked' investment medium for trustees of 'exempt approved' pension schemes. At any time further single contributions may be paid. Policies are written for a term of at least 5 years. At maturity there is the option to extend the term for at least another 3 years. The Bond may be surrendered in whole or in part for the bid value of units allocated to the Bond less a surrender deduction.

Investment Trust Retirement Annuity:

The contract provides deferred annuities by single premium payments. The minimum benefit on death before the selected pension age is a return of premiums. Annuity payments are linked to the price of JP Morgan Fleming Save and Prosper Income Share Class units.

Retirement Investment Bond:

This is a single contribution pension contract that can be used as a 'non-earmarked' investment medium or for 'income drawdown'. At any time further single contributions can be paid. The bond may be written for a fixed term. At the end of any selected fixed term an extended investment

term may be chosen which must be at least 3 years. The Bond may be surrendered in whole or in part for the full bid value of units. An MVR is guaranteed not to apply at the end of any chosen fixed term, original or extended, or on regular withdrawals up to 7.5 per cent. of the original investment per annum. Terminal bonus may be added on surrender provided that unitised with profits units have been held for at least 3 years. Bonus units of 0.25 per cent. pa are paid commencing at the end of month 25.

APPENDIX 6 – CONTENTS OF INVESTOR REPORT

The Investor Report to be produced on an annual basis by the Issuer (save that an Investor Report will not be provided in April 2005) will include the following information:

1. Calculation Period ended: [●]
2. Defined Book Surplus plus Breach Adjustments less Recapture Reduction under the Reinsurance Agreement at the end of the Calculation Period: £[●]
- 3.

Notes	Pool Factor	Note Principal Payments already made per Note	Note Principal Payment payable on next Interest Payment Date
Class A-1 Notes	[●]	[●]	[●]
Class A-2 Notes	[●]	[●]	[●]

The following projections have been produced by FPLP for indicative purposes only, without liability (including, without limitation, for negligence) of any nature whatsoever on the part of the Issuer, the Note Trustee, the Issuer Security Trustee, the Issuer Administrator, the Issuer Cash Manager, Ambac, the Issuer Swap Provider, the Reinsurer, the Reinsurer Security Trustee, the Reinsurer Administrator, InterCo, the InterCo Security Trustee, the InterCo Administrator, the InterCo Cash Manager, the Liquidity Facility Provider, the InterCo Swap Provider, FPLP or any director, officer, affiliate or agent of any thereof (each a “**Relevant Person**”) to any person (including, without limitation, any person who holds, acquires or proposes to hold or acquire any Note or interest in any Note). No Relevant Person assumes or undertakes any duty of care to any person (including, without limitation, any person holding or proposing to acquire any, or any interest in, any Notes) in connection with the preparation or publication thereof. The projections have been based on data and assumptions, which are considered to be reasonable as at the end of the Calculation Period referred to in paragraph 1.

The projections may relate to matters such as assumptions about future experience, including investment returns, tax, early termination rates, paid up rates, mortality, morbidity, persistency, expenses, reinsurance and legislation as well as other factors beyond FPLP’s control. Projections are subject to inherent uncertainties and risk. In light of these risks and uncertainties, actual events and results may vary significantly from those included in, or contemplated or implied by, such projections. Prospective investors and Noteholders may not place any reliance on such projections.

The Projected Amortisation Profile represents the outstanding principal of each Class of Notes following the April Interest Payment Date in respect of each Calculation Period, on the assumption that the base fixed interest payable on the Reinsurer Loan is [●] per cent. per annum and the annual expenses of the Reinsurer, InterCo and the Issuer are [●] per cent. per annum (in aggregate) and are paid in accordance with the Reinsurer Priorities of Payments, the InterCo Priorities of Payments and the Issuer Priorities of Payments respectively. The difference between the Projected Amortisation Profile in respect of one Calculation Period and the Projected Amortisation Profile in respect of the next Calculation Period is the amount which, on the projections, would be applied in redeeming the Notes on the April Interest Payment Date following the end of such Calculation Period. The Interest Payment Date in respect of a Calculation Period ending on 31 December in a year is 15 April in the following year (or, if such day is not a Business Day, the immediately succeeding Business Day).

Calculation Period ending 31 December	Aggregate Defined Book Surplus ¹ £m	Defined Book Surplus ² £m	Financing Costs ³ £m	Class A-1 Projected Amortisation Profile ⁴ £m	Class A-2 Projected Amortisation Profile ⁵ £m
2006					
2007					
2008					
2009					
2010					
2011					
2012					
2013					
2014					
2015					
2016					
2017					
2018					
2019 onward ⁶					

The Base Case has been calculated on the basis of data as at 31 December [●] and the Base Case Assumptions (adjusted to reflect actual experience, data and expected changes).

Footnotes:

- 1 Aggregate Defined Book surplus is the present value of all Defined Book Surplus cash flows projected (under the Base Case Assumptions) to arise in the future, in respect of all policies in force as at 31 May 2004 discounted at a rate of [6.00] per cent. per annum, being equal to the aggregate of (i) the fixed rate of the Reinsurer Loan plus (ii) the premium payable to Ambac (expressed as a rate per cent. per annum) plus (iii) a spread of [●] per cent. per annum reflecting the initial weighted average spread of the Notes over LIBOR (the "Financing Rate") (the other ancillary costs of the Issuer and InterCo have not been included in the costs). The Aggregate Defined Book Surplus has been calculated assuming that cash flows are available on 15 April of each year following the Calculation Period, discounted to 15 April of the year in which the Calculation Period ends (i.e. the 2005 value is discounted to 15 April 2005). The 2004 value is the present value of all future surplus payable from April 2005 and onwards, discounted to 15 December 2004.
 - 2 The Defined Book Surplus is the non-discounted amount projected under the Base Case Assumptions to be the Defined Book Surplus in respect of each future Calculation Period on the basis such period ends on 31 December in each year.
 - 3 Financing Costs are the amount projected under the Base Case Assumptions to be the aggregate of (i) the fixed rate of interest under the Reinsurer Loan (being [●] per cent. per annum) plus (ii) the premiums payable to Ambac (expressed as a rate per cent. per annum and assuming no Step ups) plus (iii) a spread of [●] per cent. per annum reflecting the initial weighted average spread of the Notes over LIBOR (the other ancillary costs of the Issuer and InterCo have not been included in the costs).
 - 4 The Base Case Amortisation Profile is the then projected Principal Amount Outstanding of the Notes following the April Interest Payment Date following each Calculation Period less the Available Defined Book Surplus after deducting from the Available Defined Book Surplus the aggregate of the Financing Costs. It assumes that the Reinsurer Regulatory Surplus in respect of the corresponding Reinsurer Calculation Period is at least equal to the Defined Book Surplus.
 - 5 The table excludes any Defined Book Surplus emerging after the Calculation Period ending in December 2043.
 - 6 Under Schedule 3 of the Scheme, increments to Defined Book Policies after the demutualisation are not part of the Schedule 3 Amount and therefore not included in Defined Book Surplus. For practical reasons, they are processed together on an original policy records basis. In order efficiently to return value to FPLP's Shareholder Fund the increments so written have been valued and the value fixed, £51 million, has been deducted from the amount determined for the Base Case and the amounts determined for the Sensitivity Analysis after the relevant assumption has been varied. The effect of this methodology, however, is that the variations in the relevant assumption may have a "geared" effect on the result, increasing the effect of the relevant change by up to 3 per cent.
4. A statement confirming whether any amounts have been drawn under the Liquidity Facility, the Ambac Note Financial Guarantee, the Ambac Issuer Swap Financial Guarantee, the Ambac InterCo Swap Financial Guarantee or the Ambac Liquidity Financial Guarantee.

APPENDIX 7 – BASE CASE ASSUMPTIONS TABLES

Asset mix

The table below shows the assumed asset mix for FPLP (including ex-FPLMA) business

per cent.	Annuities in payment	Non- Profit ⁽¹⁾	Unit Linked	With- Profit
Equities	—	—	65.0	37.5
Property	—	—	10.0	7.5
Government bonds	—	50.0	5.0	22.5
Corporate fixed interest	100.0	50.0	15.0	27.5
Other income producing	—	—	5.0	5.0
Total	100.0	100.0	100.0	100.0

Footnotes:

1. Non-profit includes conventional non-profit and sterling reserves.

Investment returns

The following economic assumptions have been made for with-profits and unit linked funds for all companies.

	per cent. pa
Gilts	5.10
Corporate fixed interest (for Annuity Fund & Other NP business)	5.86
Cash	5.10
Equities	7.60
Property of which	7.60
Dividend yield (gross)	3.08
Property rental yield	6.24

The return on gilts was based on the gross redemption yield on the FT Actuaries 15 year gilt index at 31 May 2004, rounded to the nearest 0.1 per cent..

Equity and property investments were assumed to yield an overall return 2.5 per cent. pa higher than the rounded gilt index return. Cash was assumed to yield the same as the gilt index return.

The investment return assumptions for assets backing conventional non-profit business, and sterling reserves on unitised business in FPLP were 5.5 per cent. pa.

Inflation

The assumed long-term rate of RPI was determined as:

- (i) the gross redemption yield on the FT Actuaries 15 year gilt index
less
- (ii) the average of FTSE Actuaries Over 5 year index linked gilt at 5 per cent. and zero inflation

This results in a rate of 3.1% pa (rounded to the nearest 0.1%). For FPLP, a long-term rate of expense inflation 1% higher at 4.1% pa has been assumed; for FPLMA expense inflation is RPI.

LPI annuities, which increase annually at the lower of the increase in RPI or 5%, were assumed to increase at 3.1%pa.

Tax

The following rates of tax have been assumed:

	Tax rate
Savings income	20%
Franked income ⁽¹⁾	0%
Other income	20%
Realised chargeable gains	20%
Tax relief on maintenance expenses	20%
Shareholder Tax	0%

Footnotes:

1. Franked investment income suffers tax at source and hence no further tax is payable.

Expenses & Commission

Maintenance Expenses

The following tables show the Scheme expenses and expenses charged to asset shares and expenses applied to post-demutualisation business. The latter are the expenses that applied at 30 June 2001, inflated to 31 May 2004.

Where policies are written in clusters, the expenses shown are applied to each policy record within a cluster. The expenses per record reflect the average number of records in each cluster for each category of business as at 30 June 2001.

FPLP Maintenance Expenses for Pre-demutualisation business (Scheme expenses)

Category	Per Policy pa		Paid-Up £
	Regular Premium £	Single Premium £	
Conventional			
Life NP	14.33		10.74
Pensions (Individual) NP	17.90		12.53
Pensions (Executive) NP	17.90		12.53
Annuities (Individual)		14.33	
Unit Linked/UWP			
Life	21.16	17.05	
Pensions (Individual)	24.42	20.46	19.53
Pensions (Protected Rights)		7.68	
Pensions (Group)	20.14	19.28	15.67
Pensions (Executive)	78.12	64.46	58.59
Pensions (New generation)	12.46	10.74	9.34
Overseas Business			
Individual	7.75	25.06	

Footnotes:

1. These figures include a loading for FRS17 costs.

FPLP Maintenance Expenses for Asset Share charges

	Per Policy pa		Paid-Up £
	Regular Premium £	Single Premium £	
Unitised With Profits			
Life	20.21	16.28	
Pensions (Individual)	23.31	19.54	18.65
Pensions (Protected Rights)		7.33	
Pensions (Group)	19.24	18.42	14.96
Pensions (Executive)	74.60	61.55	55.95
Pensions (New generation/stakeholder)	11.90	10.26	8.92
Overseas (Individual)	7.40	23.94	

FPLP Scheme Maintenance Expenses

Category	Per Policy pa (£) Regular Premium			Per Policy pa (£) Single Premium		
	Inflating	Non- inflating	Net	Inflating	Non- inflating	Net
All policies	33.06	-4.10	28.96	16.53	-2.05	14.48

In addition, assumed investment related expenses are 0.250% of reserves for unit linked (0.100% for post 1999 new business) and 0.104% for unitised with-profit and 0.050% for annuity business.

Renewal commission

For FPLP it is assumed that renewal commission of between 1.5% and 2.5% pa is payable. Fund Based commission is allowed for as appropriate.

Demographic

Mortality

The assumptions used for future experience are set out below and are based on recent experience. Select rates have been used where appropriate. Unless stated otherwise, annuitant mortality rates allow for future improvements in mortality in line with those projected in the original tables.

FPLP & Former London & Manchester Assurance Term Assurance Mortality Assumptions

Sex	Aggregate ⁽¹⁾	Smoker	Non-smoker
Male	60% TM92(5)	99% TM92(5)	52% TM92(5)
Female	65% TF92(5)	96% TF92(5)	60% TF92(5)

Footnotes:

1. Aggregate rates are used where the smoker status is unknown.

FPLP Standalone Critical Illness Mortality Assumptions

Sex	Aggregate ⁽¹⁾	Smoker	Non-smoker
Male	60% TM80ult	99% TM80ult	52% TM80ult
Female	65% AF80ult	96% AF80ult	60% AF80ult

Accelerated Critical Illness business use 100% of reinsurer's rates (split by male/female and smoker/non smokers)

FPLP & ex-FPLMA Mortality Assumptions

Category	Type	Sex	Rate
Conventional	Whole of Life & Endowment	Male	65% AM80(2)
		Female	67.5% AF80(2)
	Deferred Annuities	Male	40% AM80(2)
		Female	40% AF80(2)
	Purchased Life Annuities (scheme)	Male	100% PMA92
		Female	100% PFA92
	Purchased Life Annuities (individual)	Male	100% IMA92
		Female	105% IFA92
	Pension Annuities (Group)	Male	PMA92 ⁽¹⁾
		Female	PFA92 ⁽¹⁾
Pension Annuities (Individual)	Male	RMV92 ⁽¹⁾	
	Female	RFV92 ⁽¹⁾	
Unit Linked/UWP	Life	Male	65% AM80
		Female	67.5% AF80
	Pensions	Male	65% AM80
		Female	67.5% AF80

Footnotes:

1. Age banded adjustment factors and medium cohort future improvement factors have been used. For e.g. Individual Male age 65 and Individual Female age 60 exactly at 1/1/2005 have a life expectancy of 21.79 and 28.41 years respectively.

Critical Illness

For Standalone and Accelerated Critical Illness products, 100% of reinsurer tables are used as assumptions.

For the valuation of Reviewable Critical Illness products the same model and assumptions are used as for the guaranteed Critical Illness products.

Longevity

Age banded factors are used. In addition, 100% and 75% of medium cohort future improvement factors have been used for male and female lives respectively, e.g. individual male age 65 and individual female age 60 exactly at 1/1/2005 have a life expectancy of 21.79 and 28.41 years respectively.

Discontinuance and PUP Rates

The following discontinuance rates have been assumed:

FPLP Conventional Discontinuance Rates % pa				
Product	Year 3	Year 4	Year 5	Year 6+
Conventional Life				
Protection	12.5	12.5	12.5	10.0
Standalone Critical Illness	14.0	15.0	12.5	11.0
Whole of life	7.0	7.0	7.0	3.5
Savings	7.0	7.5	7.0	3.5
Conventional Pensions				
Individual Term Assurance	10.0	10.0	10.0	8.0
Group Pensions				
Deferred Annuity (NP)	9.0	9.0	9.0	9.0

FPLP Unit Linked & Unitised With Profits Discontinuance Rates % pa

Product	Lapse/ PUP adj.	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10+
OLAB Bonds⁽²⁾									
All products	Lapse	3.5	3.5	4.0	9.0	9.0	9.0	9.0	7.5
OLAB Investment Plan^(1 & 5)									
UOIIA	Lapse	9.0	8.5	8.5	18.0	18.0	18.0	18.0	18.0
	PUP adj.	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	Total Lapse	11.0	10.5	10.5	20.0	20.0	20.0	20.0	20.0
Other products	Lapse	9.0	8.5	8.5	7.0	7.0	7.0	7.0	7.0
	PUP adj.	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	Total Lapse	11.0	10.5	10.5	9.0	9.0	9.0	9.0	9.0
Bonds (Linked Life)^(2 & 3)									
All products	Lapse	2.5	2.5	3.0	9.0	9.0	9.0	9.0	7.5
Mortgage (Linked Life)⁽¹⁾									
All products	Lapse	14.0	15.0	15.0	13.0	13.0	13.0	13.0	13.0
	PUP adj.	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
	Total Lapse	14.5	15.5	15.5	13.5	13.5	13.5	13.5	13.5
Protection (Linked Life)									
All products	Lapse	7.5	6.5	6.0	6.0	6.0	6.0	6.0	6.0
Savings (Linked Life)⁽¹⁾									
All products	Lapse	8.5	9.5	9.0	6.5	6.5	6.5	6.5	6.5
	PUP adj.	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
	Total Lapse	9.5	10.5	10.0	7.5	7.5	7.5	7.5	7.5
Group Money Purchase (RP)									
All products	Lapse	3.0	3.0	3.0	2.5	2.5	2.5	2.5	2.5
Group Money Purchase (SP)									
All products	Lapse	4.0	4.0	6.0	24.0	24.0	24.0	24.0	24.0
Personal Pensions (RP)									
All products	Lapse	2.0	1.5	1.0	1.0	1.0	1.0	1.0	1.0
Personal Pensions (SP)									
All products	Lapse	1.5	1.5	1.0	0.5	0.5	0.5	0.5	0.5
Stakeholder/NGP (RP)									
All products	Lapse	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Stakeholder/NGP (SP)									
All products	Lapse	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
OLAB Pensions (RP)⁽¹⁾									
All products	Lapse	4.5	4.5	4.5	3.5	3.5	3.5	3.5	3.5
	PUP adj.	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
	Total Lapse	9.5	9.5	9.5	8.5	8.5	8.5	8.5	8.5
OLAB Pensions (SP)									
All products	Lapse	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0

Footnotes:

1. On the OLAB Investment Plan, Mortgage (Linked Life), Savings (Linked Life) and the OLAB Pensions (RP) PUPs are not modelled explicitly and so an approximate lapse adjustment is applied in addition to the lapse assumption.
2. For Bonds (Linked Life) (with exception of Income Distribution Bond) and OLAB Bonds an additional explicit allowance is required for partial withdrawals of 2.6% pa for all years and 10% pa for Retirement Investment Bond business.
3. The Income Distribution Bond model allows for income distributions explicitly.
4. The Lapse rate on OLAB Investment Plan is increased to 10% in the last 5 years of the policy (when an MVA does not apply).

FPLP Unit Linked & Unitised With Profits PUP Rates % pa

Product	Year 3	Year 4	Year 5	Year 6
Group Money Purchase (RP)				
All products	8.5	11.5	9.5	10.0
Personal Pensions (RP)				
All products	14.5	11.5	10.0	7.5
New Generation Pensions (RP)				
All products	10.0	10.0	10.0	10.0

FPLP (Ex-FPLMA) Discontinuance Rates % pa

Product	Channel	Year 3	Year 4	Year 5	Year 6+
AVC	All	2.5	2.5	2.5	2.5
Blueprint	All	2.5	2.5	2.5	2.5
S226 Pensions	All	2.5	2.5	2.5	2.5
Mortgage	All	15.0	15.0	15.0	7.5
Low start mortgage	All	12.0	12.0	12.0	7.5
Savings	All	9.0	9.0	9.0	8.0
Life Term Assurance/PHI	All	18.0	18.0	18.0	10.0
Pensions Term Assurance	All	20.0	20.0	20.0	10.0
Unit Linked Whole Life ⁽¹⁾	All	14.0	14.0	14.0	11.0
Bonds	All	5.0	5.0	5.0	10.0
Traditional OB (include. Welfare with profit)	All	2.0	2.0	2.0	2.0
Welfare non-profit	All	3.0	3.0	3.0	3.0

FPLP (Ex-FPLMA) Paid-up Rates % pa

Product	Year 3	Year 4	Year 5	Year 6+
AVC	9.5	9.5	9.5	7.5
Blueprint	10.5	10.5	10.5	7.5
S226 Pensions	6.5	6.5	6.5	6.5

Early retirements

For FPLP the following early retirements have been assumed:

FPLP Early Retirements %

Age	Unit Linked Pensions						Conventional Pensions
	New Generation	Group Money Purchase (RP)	Personal Pensions (RP)	Personal Pensions (SP)	DSS		
55-59	5	5	5	5	0	0	
60	15	15	20	15	15 (male) 100 (female)	20	
61-64	5	5	10	5	5 (male)	10	
65	50	50	50	50	100 (male)	30	
66-69	5	5	5	5	0	10	
70	100	100	100	100	0	100	

Asset Shares – Mortality

Mortality rates have been based on 80% A67-70(2).

Asset Shares – Charges

The guarantee charge for 2004 is 0.5% of asset share and this has been assumed to continue.

Statutory Valuation Assumptions

Except as entered below, the operating expenses are as at the 31 December 2003 returns and the economic assumptions have been consistently prepared using the same methodology and assumptions as for the 31 December 2003 returns.

Non Linked Contracts

Life & Annuity, Pension and OLAB

These contracts are valued using a net premium valuation method, modified by using a Zillmer adjustment where shown in the table below. Negative reserves are eliminated at individual policy level.

	Interest %	In deferment	Mortality/Morbidity Table	Zillmer adj. % SA	Interest %	In payment ⁽²⁾	
			Males	Females		Males	Females
Life Fund⁽¹⁾							
Non profit term Assurances:	3.50				Nil		
– smoker			115%TM92	120%TF92			
– non smoker			60%TM92	65%TF92			
– not differentiated			70%TM92	75%TF92			
– Acc critical Illness			137.5%	reinsurer's rates			
– FS critical Illness			137.5%	reinsurer's rates			
Other non profit Assurances	3.50		80%AM80	80%AF80	3.00		
Annuity Fund							
Annuities in Possession – Individual					4.10	95%IM92 U2004ult	95%IF92 U2004ult
Annuities in Possession – Scheme					4.10	95%PMA92 U2004	95%PFA92 U2004
Individual NP deferred annuity	3.50	35%AM80ult		35%AF80ult	Nil	95%IM92 C2025ult	95%IF92 C2025ult
Scheme NP deferred annuity	3.50	35%AM80ult		35%AF80ult	Nil	95%PMA92 C2025	95%PFA92 C2025
Pension Fund							
Annuities in possession – Individual ⁽³⁾					5.10	RMV92 U2004	RFV92 U2004
Annuities in possession – Scheme ⁽³⁾					5.10	PMA92 U2004	PFA92 U2004
Individual NP deferred annuity	4.40	35%AM80ult		35%AF80ult	1.25	75%RMV92 C2002	75%RFV92 C2002
Scheme NP deferred annuity	4.40	35%AM80ult		35%AF80ult	1.25	95%PMA92 C2002	95%PFA92 C2002
Non Profit term assurances	4.40		75%TM92	80%TF92	Nil		
Other NP assurances	4.40		80%AM80	80%AF80	3.00		
OLAB Fund							
Non Profit term assurances	4.40		As for Life fund		Nil		
Annuities in possession					5.10	95%IM92 U2004ult	95%IF92 U2004ult

Footnotes:

1. There is no specific allowance for AIDS mortality, it is covered within the margins in the mortality basis.
2. Where deferred annuity policies offer the option of a cash or annuity benefit at pension age, 5% of the proceeds are assumed to be taken as cash and the rest are assumed to be taken in the form that is more onerous on the valuation basis above.
3. Experience Age banded factors with 7.5% margin, in addition, 100% and 95% of half way between medium and long cohort improvement factors (with a minimum of 0.5 per cent. p.a.) have been used for individual and group male lives. For female lives, 75 per cent. of male lives future improvement factors are used. E.g. *Individual Male age 65 and Individual Female age 60 exactly at 1/1/2005 have a life expectancy of 23.31 and 29.70 years respectively.*

Linked Business

The reserves for unit linked and index linked policies (other than index linked annuities) consist of:

- (a) The net unit liability which is the market value of units allocated net of reinsurance (the unit linked liability for Pension Business is reinsured)
- (b) A sterling reserve calculated to cover the cost of future claims and expenses less charges received.

The basis for the sterling reserve calculation is as follows:

	Discount Rate %	Unit Growth ⁽¹⁾ %p.a.	Expenses ⁽²⁾ Reg Prem £	SP £	PUP £	Mortality
Life	3.50	3.50	25.88	18.67	18.67	80%AM/F80ult
OLAB	4.40	4.40	28.24	25.22	N/a	80%AM/F80ult
Protected Rights						
Pensions	4.40	4.40	n/a	20.91	n/a	80%AM/F80ult
New Generation Pensions	4.40	4.40	15.76	10.74	11.78	80%AM/F80ult
Other Individual Personal Pensions	4.40	4.40	29.45	22.05	23.48	80%AM/F80ult
Group Money Purchase Pensions	4.40	4.40	45.25	31.00	35.19	80%AM/F80ult
Executive Pensions	4.40	4.40	90.15	65.04	67.55	80%AM/F80ult

Footnotes:

1. Prior to deducting the annual management charge.
2. Inflating at a rate of 4.1% p.a. (derived RPI assumption of 3.10% plus 1%). Tax relief in the life fund assumed to be 20%.

(c) Valuation of guaranteed GMP liabilities:

Where “in the money” guarantees are not valued directly reserves are increased by 4%.

“Out of the money” guarantees are valued by increasing reserves by 1.25%.

RPI annuities are assumed to increase at 3.10% p.a.

LPI annuities which increase annually at the lower of the increase in RPI or 5%, are assumed to increase at 3.10% p.a.

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