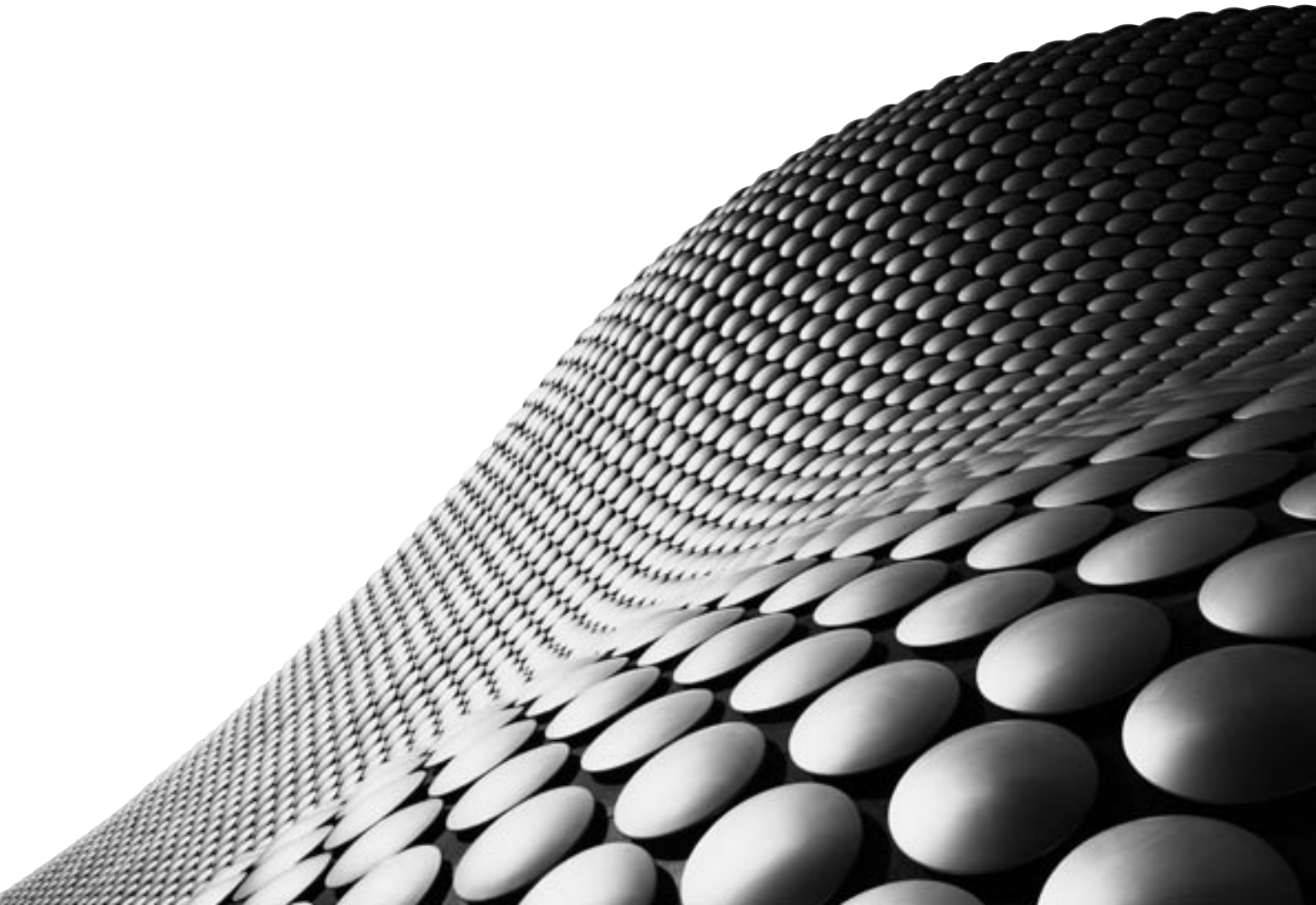
RSA

UNDERWRITING PROGRESS

Annual Report and Accounts 2007



We are a leading general insurer delivering sustainable profitable performance.

We operate in 28 countries and provide general insurance products and services in over 130 countries.

Our portfolio of businesses is diverse and provides exposure to markets at different points in the insurance cycle.

2007 has been another strong year.

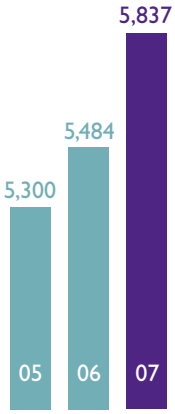
Visit **www.rsagroup.com** for more information. This Annual Report and Accounts contains forward looking statements as defined in the US Private Securities Litigation Reform Act of 1995. For a discussion of factors that could affect future results, reference should be made to the 'Important disclaimer' on page 128. Pages 1 to 31 constitute the business review of RSA and are incorporated by reference into the directors' report set out on pages 37 to 39. The directors' report has been drawn up and presented in accordance with, and in reliance upon applicable English Company Law and the liabilities of the directors in connection with that report shall be subject to the limitations and restrictions provided by such law.

HIGHLIGHTS

- Strong results in challenging market conditions
- Increased net written premiums by 6%
- Operating result up 4% to £814m
- Underlying return on equity 21.3%
- Completed buyout of Codan minorities
- Successful US exit
- Increased dividend 19% to 7.01p

Net written premiums

£5,837m



Combined operating ratio

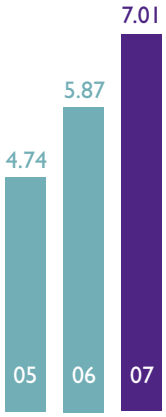
94.9%

Underlying return on equity

21.3%

Dividend

7.01p



	2007	2006
Results		
Net written premiums	£5,837m	£5,484m
Operating result	£814m	£780m
Profit after tax from continuing operations	£641m	£479m
Profit/(loss) after tax	£628m	£(20)m
Balance sheet at 31 December		
Shareholders' funds	£3,077m	£2,561m
Net asset value per share	91p	82p
Dividend		
Total dividend for the year per ordinary share	7.01p	5.87p
Underlying return on equity	21.3%	20.7%

Combined operating ratio (COR): The ratio of claim costs and expenses (including commission) to premiums

AT A GLANCE

A strong and diversified portfolio, balanced between attractive mature markets and emerging markets with higher growth potential

International

International comprises our businesses in the mature markets of Scandinavia, Canada, Ireland and Italy.

Scandinavia accounts for 55% of International premiums. Our businesses, Codan in Denmark and Trygg-Hansa in Sweden, are ranked third largest in their respective markets. We have recently increased our presence in Norway and expanded into Finland.

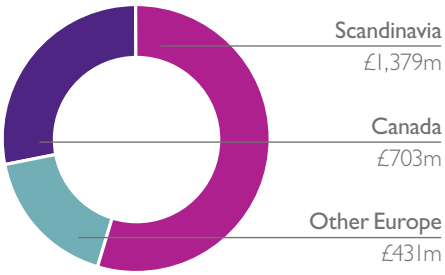
In Canada, we are the sixth largest general insurer. The business comprises Johnson Corporation, one of Canada's leading direct writers, as well as our Personal and Commercial Broker operations.

In Ireland, we are focused on the broker channel and are the leading provider of household insurance.

Our Italian business distributes the majority of its products through non tied agents, with a network focused in northern Italy.

Net written premiums

£2,513m



UK

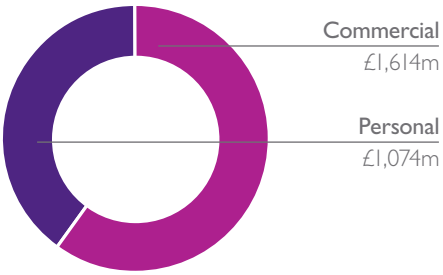
We are the UK's largest Commercial and third largest Personal lines insurer.

Our Commercial business writes property, motor liability and marine insurance. Property is the largest segment, accounting for over 39% of premiums. The business has a strong reputation for technical excellence. It insures around 80% of FTSE 100 retailers and is one of the leading carriers of professional & financial and marine risks outside Lloyd's of London.

Our Personal business is ranked third largest in the UK, and writes business through the broker, affinity and direct channels. MORE TH>N®, our direct business has around 2.3 million covers in place and provides household, motor, travel and pet insurance. Our Affinity business provides a range of insurance products to the retail customers of our corporate partners, and has grown by 23% since 2005.

Net written premiums

£2,688m



Emerging Markets

Emerging Markets is our fastest growing region, covering 20 markets with high growth potential.

Latin America accounts for 57% of Emerging Markets' premiums. Our largest operations are based in Chile, where we are the market leader, Brazil and Mexico. We are also the largest private insurer in Uruguay.

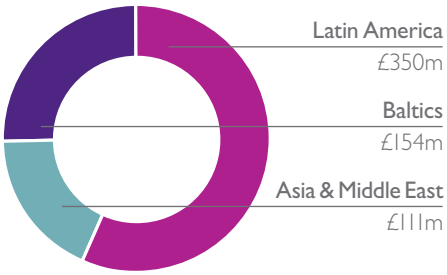
We are the largest general insurer in the Baltics, with market leading positions in Latvia and Lithuania, and in 2007 we expanded into Estonia.

We are located in eight countries across Asia and the Middle East, including India and China.

Our Central and Eastern European joint venture owns Link4, the leading direct insurer in Poland. We established a similar operation in the Czech Republic in 2007 and plan to launch in Russia in 2008.

Net written premiums

£615m



Chairman's statement

MOVING FORWARDS

In my Statement last year I referred to our Company as having a quality set of businesses, led by strong and effective management. This made our Company well able in relative terms, to face with confidence world market uncertainties. I also spoke of our plans to both improve and grow profitably our portfolio of businesses and enhance our leadership position in the markets in which we choose to operate. The financial results we have achieved in 2007 have fully lived up to those expectations, and include:

- Growth in net written premiums of 6%
- A strong investment result
- An improvement in operating results
- A significant increase in post tax profits
- Growth in shareholders' funds and balance sheet strength
- An improvement in credit rating to a full A grade.

Our strategies are both general and specific. We continue to exercise leadership on risk assessment and rate where and when necessary to ensure we achieve sustainable business performance. Specific strategic actions in our regions have included:

- Further strengthening of International with the purchase of the Codan minorities and acquisition growth in Canada
- Strong premium growth in Emerging Markets via organic growth and entry into new markets, particularly China and the Baltics and use of selected JV acquisitions to strengthen our proposition and prospects in Eastern Europe
- Continued discipline in the UK with strong growth in Affinity and in MORE TH>N®
- Completion of our exit from the U.S.A., following receipt of formal U.S. Regulatory approval by Arrowpoint, the background to which was reported in detail in last year's report.

Our financial and strategic results are commendable in their own right, but even more so when it is considered that they were achieved against a background of greater financial and market turbulence and adverse large losses and unexpected weather results, particularly in the UK. The UK floods gave an additional challenge to our management who responded actively and sensitively to the needs of our customers affected by the flood calamities. Our capability to meet an emergency is an important measure of performance and a reflection of the social as well as the commercial role of insurance companies in society.

The common theme that runs through these results is management excellence in the strategic, operational and financial performance of our businesses. We continue to review and improve

our control environment whether it be in the assessment of risk and reinsurance, underwriting discipline or the imperative of achieving sustainable profitable growth. We remain conservative in relation to a prudent reserving policy and continue to pursue a high quality, low risk investment strategy.

Management excellence and a performance culture is embedded at all levels in the Company. There is a bonus pay related plan focused on superior performance. Our Executive Development Programme is in its fourth year, from which two-thirds progress to senior management positions. We continue to both promote from within the business and recruit senior talent to strengthen our overall expertise and performance.

Our confidence in our performance has led the Remuneration Committee and Board to increase the target range of expected ROE performance for LTIP awards by two percentage points. We believe this increase is an appropriate target that compares favourably with our peers. It equally importantly provides a strong alignment between management reward and shareholder return.

A further indication of the Board's confidence in the future of the business was given by the increase in the final dividend of 10%, giving a total dividend increase for the 2007 year of 19%. This follows the 35% increase in the 2006 final dividend and the 42% increase in the 2007 interim dividend made following a review of dividend policy announced last year.

In summary therefore, a strong set of results achieved in difficult and uncertain financial markets. Results which reflect a dedicated and effective Management Team and the efforts of all our colleagues and employees, whom the Board thanks on behalf of shareholders. On outlook we believe, as in previous years, and as set out in the opening sentences of this report, we have the opportunity and ability to continue to develop and deliver a relative increase in profit and profitability and to strategically enhance our market positions where we choose to operate. We believe we also have the experience and control processes to operate effectively in what we expect will continue to be difficult and demanding market environments.

On a final note, there will be a Resolution at the AGM to change the name of the Company from Royal & SunAlliance to RSA. This follows the restructuring process started in 2003 and the subsequent fusion of the Company into a stronger, cohesive and strategically positioned business, combined with the development of a management ethos based on excellence and achievement. Whilst a major transformation to RSA has been achieved, there still remain improvements to make, and opportunities to realise and we are fully focused on continuing to deliver our goal of sustainable profitable performance. We expect to progress further in 2008.

John Napier
Chairman

'Our capability to meet an emergency is an important measure of performance and a reflection of the social as well as the commercial role of insurance companies in society.'

Group CEO's review

ACHIEVING OUR TARGETS

2007 has been a good year for the Group and in challenging market conditions, we have again delivered a strong performance. The results have been achieved against the backdrop of a competitive rate environment, adverse large losses and weather, including the UK floods, and volatile investment markets. The results clearly demonstrate the benefit of our strong and diversified portfolio and our tight operational and financial management.

We have continued to deliver on our strategic priorities. The disposal of our US business last March resolved our last remaining legacy issue and we are now solely focused on continuing to deliver our objective of sustainable profitable performance.

Our results clearly demonstrate the strength of the Group. All our regions – International, Emerging Markets and the UK – have achieved profitable growth and strong bottom line results. International and Emerging Markets delivered over 50% of the Group's premiums and during 2007, we completed the buyout of the Codan minorities and are delighted to have this business under our full ownership.

We have also further strengthened our capital position, and I am pleased we achieved our goal of regaining our full A credit rating from Standard & Poor's last December.

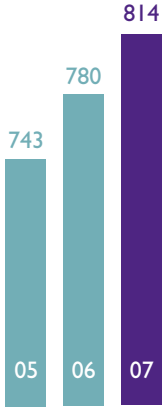
Strong financial performance

In 2007 we increased net written premiums by 6% to £5.8bn, with growth across all three regions coming from both organic initiatives and our bolt on acquisitions. International grew ahead of the market, Emerging Markets delivered double digit growth and, in the UK, we targeted profitable growth in Personal and Commercial specialty lines.

The underwriting result was £278m and was after the UK flood losses of £120m, as well as adverse weather and large loss experience across the Group. The combined operating ratio (COR) for the Group was 94.9%, which included 2.1% for the flood losses. The operating result increased by 4% to £814m and benefited from the strong underwriting result and a 13% increase in the investment result to

Operating result

£814m



	2007	2006
Net written premiums	£5,837m	£5,484m
Underwriting result	£278m	£310m
Operating result	£814m	£780m
Combined operating ratio	94.9%	93.3%
Underlying return on equity	21.3%	20.7%

£629m, which was driven by our high quality portfolio and low risk investment strategy.

Profit after tax rose significantly to £628m, benefiting from one of the early actions taken post the Codan minority buyout.

Regional overview

International

Our objective in International is to drive the businesses harder and deliver growth ahead of the market. We have made good progress in 2007 with some excellent performances from the individual businesses. Premiums were up 8% to £2.5bn, driven by expanded distribution and targeted acquisitions. Underwriting profit increased 38% to £206m, and the COR improved 1.8 points to 91.3%. As expected, International contributed the largest share of the Group's underwriting result.

In Scandinavia, we successfully completed the Codan minority buyout and in 2007, Codan continued to deliver strong results and above market growth. Premiums were up 8% to £1.4bn, driven by a good performance from White Label, our 2006 acquisition, and continued growth in bancassurance, car dealerships and internet channels. Codan is a very attractive business with excellent prospects and following the minority buyout, and as part of the ongoing financial management of the Group, we have identified and released £103m of deferred tax reserves.

In Canada, premiums were up 6% (9% on constant exchange) to £703m, with Johnson delivering 8% growth (11% on constant exchange) and good performances from both our Commercial and Personal Intermediated businesses. We are now the market leader in British Columbia following the acquisition of Canadian Northern Shield, which completed in December 2007.

In Other Europe, Ireland continues to perform strongly, driven by EGI, our specialty motor insurer and in Italy premiums were up by 14% as we expanded our agent network.

UK

The UK remains our most competitive market but we continue to target profitable growth in Personal and Commercial lines. We continued to take a disciplined approach to risk selection and rating, and premiums were up 3% to £2.7bn. In terms of underwriting, the UK delivered a profit of £65m and a COR of 97.6%, even after the impact of the floods.

In Personal, premiums were up 27% to £1.1bn. MORE TH>N® had another strong year with premiums up 8% and new business up 10%. We have made excellent progress on customer focused initiatives and over 170,000 customers signed up to our new Personal Customer Manager service. We're delivering on our plans to significantly grow our Affinity business. Premiums were up 18% and we won five new deals in the year worth around £50m.

Group CEO's review continued

In Commercial, net written premiums were down 9% to £1.6bn as we maintained our commitment to underwriting discipline and the withdrawal of capacity from areas of the market where the rate, terms and conditions do not meet our underwriting criteria. Our focus on specialty lines is paying off. In Marine, premiums were up by 8% and during the year we launched six new trading units, including Property Investors, Construction and Engineering, and Risk Solutions.

Emerging Markets

Emerging Markets had a strong first year as a separate region. In 2007, we focused on building capabilities, putting a high quality central team in place and making two new CEO appointments in India and China. Across the region there are exciting opportunities for profitable growth. We already have established positions in Latin America, Asia and the Middle East and the Baltics and we are targeting double digit premium growth.

In 2007, premiums were up 16% (19% on constant exchange) to £615m reflecting strong growth across all markets. The underwriting result increased 64% to £18m and the COR was 2 points better at 95.3%.

Premiums were up 11% (15% on constant exchange) in Latin America driven by a strong performance in Chile and good growth in Marine across Brazil and Mexico. During 2007, we also took the opportunity to exit the Venezuelan market, as it was not a market where we wanted to increase our exposure.

In Asia and the Middle East, premiums were up 8% (15% on constant exchange), driven by a strong motor performance in the UAE. We were also the first European insurer to secure approval for a subsidiary licence for our Chinese business and this will enable us to accelerate our

Industry overview

2007 was a challenging year for the industry with a competitive rating environment, adverse weather losses and financial market turmoil. In addition, there were developments on future regulation with the European Commission issuing its proposal for the Solvency II Directive.

The rating environment in 2007 has remained mixed by business class and region. As a Group we benefited from our broad portfolio which gave us a balance of exposure to different markets at different points in the cycle. In the UK, we've been consistent in our strategy and actions, putting rate through where required in both Personal and Commercial lines. We expect a similar picture in 2008 with a mixed rating environment by region and class.

The flooding events in the summer meant that the Government's management and funding of flood defences was pushed right to the top of the political agenda. The Government was criticised by the Association of British Insurers and other industry players for allocating less funding for flood defences in the Pre Budget Review than the industry had asked for. The industry has continued to push for increased spending on flood defences and more responsible planning decisions in response to the Environment, Food and Rural Affairs Select Committee Enquiry on Flooding and the Pitt Review on Lessons Learned from the 2007 floods.

There has been much speculation about the impact of the turmoil in the credit markets on the industry. We already had in place a low risk investment strategy and took action during the year to further strengthen the defensive nature of our investment portfolio, which is dominated by high quality bonds and cash. We have no exposure to US subprime mortgage securities and we reported a stronger investment result this year.

In the EU, the main focus was the appearance of the Commission's proposal for a Solvency II Directive on capital requirements for insurance companies. The Directive is intended to replace outdated European insurance legislation with a consolidated set of requirements for supervision, capital, risk management and reporting. It should help improve the effectiveness of supervision of insurance groups by helping to transfer best practice and skills between supervisors. The Commission's proposal will be debated and amended by the European Parliament and Council of Ministers during 2008. RSA is very supportive of the Commission's proposal and has been lobbying to that effect through the Association of British Insurers and the Treasury and also directly with policymakers in Brussels.

expansion plans and open a network of branches across China.

Growth was particularly strong in the Baltics, with premiums up 35%. We have strengthened our number one position in Lithuania and expanded into new markets, opening our Estonian operation in November.

Finally, in Eastern Europe, we are building good momentum through our joint venture. We are the leading direct writer in Poland, have launched in the Czech Republic, and plan to open in Russia in 2008.

Delivering sustainable profitable performance

While 2007 was a strong year, our goal is to deliver sustainable profitable performance over the long term, and that is what we have achieved over the last four years with combineds in the mid 90's. This sustained performance reflects our strong and diversified portfolio and is underpinned by our tight operational and financial management.

Operational management

During 2007, we have continued to take the right action on rate and expenses, as well as continuing to build and improve our capabilities.

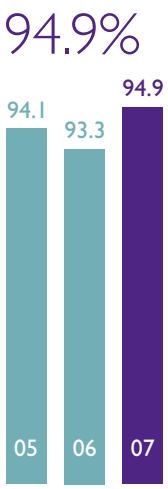
On rate, we put through increases across the board in Scandinavia. In Canada, we increased rate in Household by 5%, while Personal Motor was flat throughout the year. We received approval for small net increases in Ontario Motor and will be making further rate filings during 2008. Canadian Commercial lines remained competitive and rates overall were down. However, this is against the backdrop of significant increases over the last few years and it remains a profitable market.

In the UK, we have been consistent in our strategy and in our actions and have continued to put rate through the book where required. In Personal, we put rates up by mid single digits as we have done consistently over the last five years. In Commercial, we increased rates in Property by 3% and in Motor by 8%. Liability was down 1% but this compares to a 9% reduction at the same time in 2006.

On expenses, we continue to take action to improve our efficiency and performance. We have met our original £130m expense savings target ahead of schedule and are on track to deliver an additional £70m of savings by the middle of 2008.

In terms of building and expanding our capabilities, we have taken a number of actions

Combined operating ratio



'While 2007 was a strong year, our goal is to deliver sustainable profitable performance over the long term, and that is what we have achieved over the last four years with combineds in the mid 90's.'

Group CEO's review continued

Our new brand

As we move the business forward, now is an appropriate time to simplify and refresh our corporate brand. Royal & SunAlliance was created over 10 years ago as the product of the merger and given the fundamental changes that the business has gone through we wanted to develop a new brand strategy to support our growth plans. As part of this we have refreshed and modernised our identity and will now be known simply as RSA.

Across our international markets, RSA is a brand which is more accessible for both our customers and staff, many of whom already refer to us as RSA. We also want to maximise the benefits of an international brand to support our businesses in their local markets and you will start to see brands such as MORE TH>N® and Codan more heavily endorsed by RSA. The new identity is being used for the first time in this Annual Report and Accounts and we will introduce the new style over time as part of a managed roll out process, keeping the cost of the changeover to a minimum.

in 2007. We further strengthened the Executive Team with three significant new appointments: Tim Mitchell was appointed as Group Underwriting and Claims Director, Clare Salmon joined us as Group Strategy, Marketing and Customer Director and David Weymouth joined us as Group Operations and IT Director.

Our underwriting and claims skills are market leading and provide a genuine source of competitive advantage. We launched our Technical Academy in 2006 to develop the next generation of talent and this year we added a global technical graduate programme that aims to attract high calibre new entrants into the industry.

Finally, we have made real progress on employee engagement and our annual global employee survey showed further improvements this year with the overall satisfaction response up 2%. Listening to our employees' feedback and acting on it is a key part of our culture. That is why the work that has been undertaken on our brand has been shaped by significant input from more than 600 employees from across the Group.

Financial management

In terms of financial management, we continue to exercise strong control. This is clearly evident in our approach to reinsurance which protected us against the impact of the UK floods. We also maintain a strong reserving policy and have in place a high quality, low risk investment strategy. Our investment portfolio is dominated by high quality bonds and cash and we have taken further action to strengthen the defensive nature of the portfolio. George covers this in more detail in his Financial review.

Strong outlook

During 2007, we resolved our last remaining legacy issue and we are now fully focused on continuing to deliver our objective of sustainable profitable performance. With our strong portfolio and the actions we are taking, we are confident that we will continue to deliver the profitable performance that we have seen over the last few years.

We are seeing exciting opportunities for profitable growth across the portfolio with good topline momentum across the Group. We expect to achieve above market growth in International, targeted profitable growth in the UK, while continuing to take the right action on rate, and double digit growth in Emerging Markets.

We are confident that each region will continue to deliver strong results and we expect International to again deliver the majority of the Group's underwriting result in 2008, led by a strong Scandinavian performance.

Our overriding commitment is to sustainable profitable performance and as we announced with our full year results we expect to deliver a combined ratio of around 95% in 2008.

Andy Haste

Andy Haste
Group CEO

Group strategy

OUR STRATEGY

We are a leading general insurer delivering sustainable profitable performance

Our strategy is based on delivering our strategic priorities of:

- Strong annual earnings
- Targeted profitable growth
- Driving operational excellence

Key to delivering these strategic priorities are our structure, our capabilities and our focus on delivery.

Structure

We derive real advantage from being a pure general insurer. Our focus on doing one thing and doing it well is evident in our attention to detail, rigorous control and our actions.

We have strong positions in attractive markets and a balanced portfolio of businesses. The shape of the portfolio is deliberate:

- Our geographic spread gives us exposure to markets at different points in the insurance cycle and different stages of development
- It allows us to shift capacity to where we see the best opportunities
- In each of our markets there are opportunities for targeted profitable growth

Capabilities

Our technical skills are market leading; in both underwriting and claims they are a source of real competitive advantage.

In 2007, we added to these skills with new executive appointments in Underwriting and Claims, Strategy, Marketing and Customer and Operations and IT. These appointments support our focus on driving profitable growth and operational excellence.

We are building for the future through our Technical Academy, Executive Development Programme, Leadership Development Programme and FastTrack, our programme for high potential early career candidates. More recently, we launched the Operational Development Programme to develop expertise and strong careers in operations, with the aim of creating processes and systems that will become another source of competitive advantage.

Delivery

Our track record of successful execution is underpinned by our focus on personal accountability and performance management.

Key to delivery is having the right culture and right people. We are focused on developing talent through creating an environment where responsibilities and accountabilities are clearly defined, people are challenged and performance rewarded. We have embedded a strong performance culture across the Group.

Group strategy continued

PROGRESS AGAINST STRATEGIC PRIORITIES

Strategic priorities

Strong annual earnings

Areas of focus

- Our strong portfolio allows us to shift capacity to where we see the best returns
- We are committed to underwriting discipline and taking the right action on rate
- We have a tightly controlled risk appetite and underwriting process and a conservative reinsurance policy
- The sustainability of our earnings is further underpinned by our reserving policy, high quality investment portfolio, and our balance sheet strength

Progress in 2007

Strong combined operating ratio delivered in challenging conditions
In 2007, the Group delivered another strong profitable performance, demonstrating the resilience of our earnings. This result reflects the strength and diversity of our portfolio, the actions we have taken on rate and expenses, as well as our prudent reinsurance programme and investment policy.

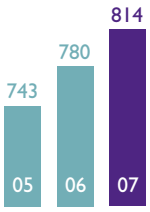
Key performance indicators

Combined operating ratio

94.9%

Operating result

£814m



2008 priorities

2008 combined operating ratio expected to be around 95%
We will continue to use the portfolio to shift capacity to where we see the highest returns. We remain committed to underwriting discipline and taking the right action on rate. Given the actions that we are taking, we are confident that we will continue to deliver sustainable profitable performance in 2008 and beyond.

Targeted profitable growth

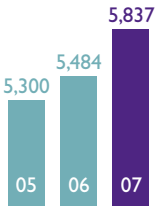
- We target profitable growth in our core trades segments which we know well and have competitive advantage, such as Marine, where we are one of the leading carriers outside Lloyd's of London
- We are using our strong customer focus to develop targeted propositions and maximise retention
- Our focus on customer differentiation for our partners and their customers is driving rapid growth in the Affinity segment in the UK
- Across the Group, we have benefited from expanding distribution as well as targeted acquisitions

6% growth in net written premiums

Net written premiums are up 6%, reflecting above market growth in International, strong double digit growth in Emerging Markets and targeted growth in the UK. This result reflects our positive rating action, organic growth in target segments and the benefits of the bolt on acquisitions made in 2006.

Net written premiums

£5,837m



Opportunities for profitable growth across the portfolio

Our overriding focus remains on maintaining underwriting discipline and taking the right action on rate. International will continue to drive profitable above market growth by expanding distribution and using a segmented approach to target profitable niches. In the UK, the focus will remain on maintaining discipline and targeting profitable growth. Emerging Markets will continue to leverage Group best practice to drive strong double digit growth.

Driving operational excellence

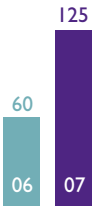
- We continue to focus on operational excellence and deliver on our expense savings targets
- Our technical skills are market leading and a source of real competitive advantage. We will continue to invest in these skills and in the next generation through our Technical Academy and global development programmes
- We continue to attract top talent from both inside and outside the insurance industry. We have instilled a strong performance culture, with over 90% of our employees having their pay linked to their performance

£180m annualised expense savings delivered ahead of schedule

We have achieved this through a reduction in headcount of around 2,000, IT and procurement savings, lower premises costs and a 27% reduction in central expenses. The 2007 impact of these annualised savings was an in year P&L benefit of £125m, offset by implementation costs of £75m.

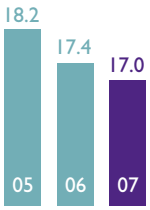
Expense savings delivered

£125m



Expense ratio

17%



Further savings to be delivered by mid 2008

Our operational improvement programme has improved our efficiency and performance. Our objective is to increase our annualised savings from the £180m delivered at the 2007 year end to our targeted £200m by mid 2008, and we are on track to deliver this.

Business review

INTERNATIONAL

Simon Lee
Chief Executive, International businesses

	2007	2006
Net written premiums	£2,513m	£2,334m
Underwriting result	£206m	£149m
Combined operating ratio	91.3%	93.1%

International has had another strong year, delivering above market growth, and strong improvements in the underwriting result and the COR.

Business overview

International comprises the Group's operations in Scandinavia, Canada, Ireland and Italy. These businesses have strong positions in attractive markets and we aim to outperform in terms of both growth and profitability.

Key strategies

We are committed to delivering sustainable profitable performance. We are using three levers to drive the business forward and outperform the competition:

- Delivering profitable growth ahead of the market, by pursuing a segmented approach, expanding our distribution and through selected acquisitions
- Leveraging our market leading capabilities in underwriting and claims
- Applying a rigorous approach to driving continuous operational efficiencies across the business.

The combination of our geographic spread and targeted, segmented approach means that we can choose to expand in specific areas at different points in the insurance cycle. We target growth in profitable segments where our technical expertise gives us competitive advantage.

Customer focus is central to our propositions and we are optimising customer reach through our multi channel distribution strategy, with strong Intermediary, Affinity and Direct propositions.

We delivered our target of £40m of annualised expense savings one year ahead of schedule, and have committed to delivering a further £20m in savings by mid 2008.

Progress against strategies

International delivered another strong performance in 2007, with 8% premium growth to £2,513m and a 1.8 point improvement in the COR to 91.3%. International contributed the majority of the Group's underwriting result, at £206m, which was a 38% increase on 2006.

Scandinavia

Scandinavia is a significant component of the International portfolio and 24% of the RSA Group. Codan and Trygg-Hansa hold the number three positions in Denmark and Sweden respectively, and we have recently increased our presence in Norway and expanded into Finland. In 2007, Scandinavia delivered above market growth of 8% and improved the COR by 2.3 points to 91.4%.

Leaders in renewable energy

We have over 25 years experience in the renewable energy sector, and our technical capability has made us a market leader in several markets including Scandinavia, Canada, UK and Ireland.

In 2007, we launched a Global Renewable Energy business, bringing together over 300 engineers and renewable energy underwriters.

Through our global network of offices we service some of the most prominent players in the renewable sector, including technology manufacturers, utility companies, financiers and developers.

We have increased our presence in the Wind, Hydro, Bio-Energy and Solar Energy sectors and have developed market leading solutions for our customers and brokers. We are well on track to position RSA as the key insurance solutions provider in this important global sector.

Further details can be seen on **www.rsagroup.com/renewables**.

Key targets	2007 achievements
• Profitable growth ahead of the market	• Net written premium growth of 8% and a COR of 91.3%
• Strengthen number three position in Denmark and Sweden	• Net written premium growth exceeds market growth in both countries
• Strong double digit growth in Johnson	• Net written premium growth 11% on constant exchange
• £40m of annualised savings by mid 2008	• Achieved mid 2007, new target of a further £20m announced
• Scandinavian expense ratio sub 15% by mid 2008	• Scandinavian expense ratio 15.3%
• Canadian Intermediated expense ratio sub 10% by mid 2008	• Canadian Intermediated expense ratio 10.5%

Personal delivered a 10% increase in net written premiums, reflecting the strong performance of WLI, our 2006 acquisition as well as continued double digit growth in the bancassurance and car dealership channels. Our car dealership channel gives us access to 30% of the Swedish and Danish car markets, and this year we have increased premiums by over 90%. Our internet channel is a market leading provider in Scandinavia, and increased premiums by 47% during the year.

In Commercial lines, we have maintained strong momentum across the region. We hold a leading position in Marine Hull and have also benefited from our acquisition of the Pohjola Marine portfolio in Finland, which gives us a 40% share of the Finnish marine market. In Construction and Engineering, premiums are up by 13% across the region, building on our strong position in the Danish market.

Canada

Canada has delivered another excellent performance. Net written premiums are up 6% (9% on constant exchange), while the underwriting result of £50m was a 4% improvement on 2006. This reflects our continued focus on underwriting excellence, claims and expense management. The COR was in line with 2006 at 92.4%.

Johnson, our Personal lines direct business, delivered 8% growth (11% on constant exchange), with strong organic growth supplemented by the impact of acquisitions made in 2006, and now represents 36% of the Canadian business. Johnson is one of the leading direct writers in Canada and during the year we signed a national agreement with AIR MILES®, Canada's leading loyalty rewards programme, which has over nine million members.

Personal Broker grew 10% in 2007, with both Travel and Property contributing significantly. During the year we further strengthened the broker distribution channel with the addition of 43 new brokers. Personal Broker also benefits from the agreement with AIR MILES®.

Commercial net written premiums were flat at £183m (4% on constant exchange), reflecting a disciplined approach in increasingly competitive market conditions. The COR improved by 3.7 points to 90.3% and the underwriting result improved by 125%. With a focus on operational excellence, we have driven further efficiencies by investing in our technology platform, with 90% of our SME portfolio now being quoted online.

We also look to acquire businesses that have a strategic fit. The acquisition of Canadian Northern Shield diversifies our geographic spread and makes us the market leader in British Columbia and the sixth largest general insurer in Canada.

Other Europe

Other Europe comprises our operations in Ireland and Italy and continues to deliver strong above market growth with premiums up 10%. The COR improved by 3.7 points to 89.1% and the underwriting result increased by 43% to £40m. Ireland delivered another strong performance, with growth driven by EGI, the specialty lines insurer acquired in 2006.

Italy continued to outperform the market with 14% premium growth. Focused in northern Italy, we operate through brokers and non tied agents. During 2007 we expanded our distribution network, adding 34 new agencies and 12 new brokers.

Market conditions

During the year, we have seen some challenging conditions within our regional markets and the rating environment is showing some signs of increasing competitiveness. Our niche, segmented approach has benefited us in this environment and we are shifting capacity to where we can see the best returns.

Outlook

We have built a track record of delivering strong top and bottom line performance and we are confident that we have the portfolio, the strategy and the capabilities to continue to outperform in our markets, and deliver sustainable profitable performance.

'We have built a track record of delivering strong top and bottom line performance.'

UK

Bridget McIntyre
UK Chief Executive

	2007	2006
Net written premiums	**£2,688m**	£2,618m
Underwriting result	**£65m**	£160m
Combined operating ratio	**97.6%**	92.3%

The UK has delivered another strong performance in a competitive market. The underwriting result of £65m includes the £120m impact of the UK floods and other adverse weather and demonstrates continued profitability in challenging conditions.

Business overview

We are the UK's largest Commercial and third largest Personal lines insurer. We are committed to delivering sustainable profitable performance. We will only write business that is profitable and are driving growth in segments where we can achieve our target returns. We are committed to underwriting discipline and actively withdraw capacity in areas of the market where the rate, terms and conditions do not meet our underwriting criteria.

Key strategies

In Commercial, we are focusing on specialist segments and leveraging our technical expertise to develop innovative risk solutions, deliver profitable growth and manage retention in our target markets.

In Personal, we aim to strengthen our number three position by enhancing our customer focus. Using increased customer segmentation and pricing sophistication, we are launching innovative products to acquire new customers and build retention. We are creating our own space in the affinity market, and our reputation for delivering quality propositions for our partners and their retail customers is attracting new deals.

We achieved our target of £70m of annualised expense savings one year ahead of schedule, and have committed to delivering a further £50m of savings by mid 2008. We are targeting a sub 15% expense ratio for the UK business, and sub 20% expense ratio for MORE TH>N®.

Progress against strategies

In 2007, the UK delivered another strong result. The business continues to grow profitably, with a 3% increase in net written premiums to £2,688m. The COR of 97.6% includes the impact of the summer floods of £120m, as well as other adverse weather through the year. Excluding the floods, the UK COR was 93.0%.

We have continued to take action on rate, and retention remains strong at over 80%. The 2007 expense ratio is 17.5%, down from 18.1% in 2006, and MORE TH>N® delivered its target, with an expense ratio of 19.8%.

Commercial

In Commercial, net written premiums were down 9% to £1,614m (2006: £1,770m) reflecting our commitment to underwriting discipline and selective capacity withdrawal. The Commercial COR was 95.9%.

UK floods

The city of Sheffield was hit particularly hard by the June floods. The River Don rose by 15ft and a 6ft torrent of water swept through the 64 acre site of Sheffield Forgemasters (SFIL), the world's largest independently owned forgemaster and a major local employer.

RSA experts were quickly on the scene, working alongside SFIL to control the scale of the loss. Our work supported the cashflow of the business, secured the 600 jobs and minimised the business interruption suffered. Production resumed in July, just weeks after the water receded. Our proactive stance in understanding management priorities, our flexible approach and our speed in settling the claim, significantly reduced the scale of the final loss.

The Chief Executive of SFIL, praised our 'exceptional support' and said, 'the final settlement was concluded in a friendly and professional manner and this undoubtedly aided our recovery'. Our response to SFIL's claim was also recognised by the Association of British Insurers and by The Prince of Wales.

We work in partnership with our customers, combining our expertise with their specific company needs and together we find the best solution to get them back up and running again as soon as possible.

This is what we do.

Key targets	2007 achievements
• Move to number one in the broker market by choice, reputation, capability and profitability by 2010	• We are working with broker partners to strengthen relationships and our customer propositions. Retention remains strong and we are using a targeted approach to drive growth in specialist lines that are profitable
• Strengthen number three position in Personal lines	• Strong growth in MORE TH>N®, with 8% increase in NWP
• Grow Affinity business by more than 50% by 2010 from 2005 levels	• Increased 23% from 2005 levels
• £70m of annualised savings by mid 2008	• Achieved mid 2007, new target of a further £50m announced
• MORE TH>N® expense ratio sub 20% by end 2007	• MORE TH>N® expense ratio 19.8%
• UK expense ratio sub 15%	• UK expense ratio 17.5%, down from 19.4% in 2005

We continue to focus on implementing our rate plans, maximising retention and driving growth in profitable specialty lines. Marine premiums increased by 8%, and during the year we launched six specialist trading units, including Property Investors, Construction and Engineering, and Risk Solutions. We are successfully using these trading units to increase our levels of specialisation within our target segments, and their niche expertise to improve our customer propositions, and opportunities for cross sales.

Personal

Net written premiums increased by 27% to £1,074m driven by organic growth and recent Affinity deals including Paymentshield. The COR was 100.6%, which includes 6% in respect of the floods. Motor performed strongly, delivering a COR of 98.7%, a 3.8 point improvement over 2006.

MORE TH>N® had another very strong year with an 8% increase in net written premiums to £475m, new business sales up 10% and a 7% increase in average motor premiums.

We have strengthened our MORE TH>N® brand through the 'More Is' proposition focusing on key customer segments, new products that reward customer loyalty and high levels of service. Over 170,000 customers have signed up to our Personal Customer Manager (PCM) initiative which has had a positive impact on retention levels. Our enhanced web capability saw web sales grow by 160% on Household and 30% on Motor since 2005. We continue to focus on driving down cost per sale by implementing initiatives to increase cross sales and marketing efficiency. In 2007, we won Precision Marketing's 'Direct Brand of the Year' Award.

Affinity continues its good momentum. In 2007, we signed five new deals which will bring an additional £50m in premiums at full run rate. With 23% growth in Affinity since 2005, we are on track to deliver our target of increasing this business by 50% by 2010.

Technical capabilities

Our technical skills are market leading and a real source of competitive advantage. During 2007 our Underwriting and Geographical Assessment teams were awarded the Insurance Times 'Training Programme of the Year' Award for their underwriting excellence and training programme. The programme has also been accredited by the Chartered Insurance Institute.

Market conditions

The UK is the Group's most competitive market and we anticipate similar conditions in 2008.

In Commercial, distribution is evolving with increasing consolidation in the broker market and the emergence of specialists. This is creating new opportunities for insurers with strong customer propositions and efficient broker servicing models.

The Personal market remains competitive, and is evolving with an increase in aggregator websites. Aggregators are an increasing source of business for us, and require stringent underwriting, high brand recognition and a strict risk appetite. We externally benchmark the quality of our underwriting and are using our PCM's to build relationships with our aggregator customers to increase retention.

Outlook

We are committed to maintaining underwriting discipline and rigorous risk selection to deliver sustainable profitable performance. We will continue to implement our rate plans and focus on driving growth in profitable segments.

In Commercial, we will continue to focus on our target trades and segments and use our industry recognised technical skills to maintain strong retention. We will continue to innovate our product offerings and pricing to realise the growth potential of MORE TH>N®. In Affinity, we will continue to target new opportunities and deliver profitable growth from our existing deals.

By maintaining discipline and investing in our capabilities, our UK business will remain well positioned to continue delivering sustainable profitable performance.

'We will continue to implement our rate plans and focus on driving growth in profitable segments.'

Business review

EMERGING MARKETS

Paul Whittaker
CEO of Emerging Markets

	2007	2006
Net written premiums	£615m	£531m
Underwriting result	£18m	£11m
Combined operating ratio	95.3%	97.3%

In its first year, Emerging Markets delivered strong double digit growth in net written premiums, with a 2 point improvement in the COR to 95.3%.

Business overview

Emerging Markets has operations in 20 countries across Latin America, Asia and the Middle East, the Baltics and Central and Eastern Europe. We are the number one insurer in Chile and in the Baltics, a leading international insurer in the Middle East, and through our joint venture Link4, the leading direct insurer in Poland.

By 2010, we aim to double net written premiums from 2005 levels in Latin America, Asia and the Middle East and the Baltics.

Key strategies

We are focused on delivering profitable growth through expanding distribution, disciplined underwriting and improving operational performance. Our strategy is to focus on markets where we can establish a meaningful market presence, either in overall market share or in segments where we have a competitive advantage. We are committed to close cooperation across the region to develop customer solutions which can be replicated in our territories cost effectively.

During 2007, we established a platform to accelerate future growth. Significant capability has been added across the region with new CEOs appointed in seven countries. More than 20 senior technical staff have moved from RSA's established businesses into Emerging Markets to continue our focus on leveraging Group best practice in underwriting discipline and operational excellence.

Centres of underwriting excellence have been established in major markets and provide technical expertise to assist our smaller operations underwrite complex risks. In Asia and the Middle East, we have focused on building expertise in Construction and Engineering (C&E), and have recruited market leading capability in the hubs of Hong Kong, Singapore and the Middle East. This initiative has already delivered 51% growth in C&E gross written premiums across the region this year.

We see personal insurance sold through affinity partners such as mobile phone providers and utilities as a major opportunity to satisfy a need for basic insurance products. We focused development activity in Latin America in 2007 and these propositions will be rolled out in Asia and the Middle East in 2008, building on the region's competence with established affinity partners.

Baltics

2007 was a very successful year for the Baltics. The operations in Latvia and Lithuania reaped the benefits of leveraging Group best practice to deliver an excellent underwriting result, and we launched our new operation in Estonia.

In Lithuania, our business grew faster than the market, increasing its market share by 3% to 37% whilst maintaining its COR below 90%. This rapid growth and improved performance was the result of a structured programme to modernise the operational and sales platforms of the business. We were the first in the market to use differential pricing which allows improved risk selection. Over 60% of business is now renewed automatically, cutting administration costs and allowing our sales network greater time to focus on new business.

2008 will be a busy year for the Baltics as further operational enhancements are made, however we have demonstrated our ability to successfully manage change and we anticipate another strong year of performance.

Key targets	2007 achievements
• Double size of Emerging Markets by 2010: 15% growth p.a.	• Net written premium growth 19% on constant exchange
• Latin America COR sub 100% by end 2007	• Latin America COR 98.7%

We are working with our broker partners to develop new propositions targeting Small and Medium sized Enterprises (SMEs). We are looking to automate cover on SMEs, reducing our partners' servicing costs and we aim to replicate this technology across the region.

Progress against strategies

The 2007 results clearly demonstrate the success of these strategies, with 19% premium growth on constant exchange, a 64% increase in underwriting result to £18m and a 2 point improvement in the COR to 95.3%.

Latin America

Latin America delivered a 15% growth in net written premiums on constant exchange, reflecting strong growth in Chile as well as in Marine in Brazil and Mexico. The COR improved by 5 points to 98.7% following actions taken to improve profitability. This result was achieved against the backdrop of a number of weather events in the region, including an earthquake in Chile, floods in Mexico and hailstorms and a tornado in Colombia. In December, we took the opportunity to exit the Venezuelan market.

The Baltics

The Baltics again performed strongly, delivering premium growth of 35% driven by positive economic conditions. Our Lithuanian business increased its share of the market by 3% to 37% and we launched our operation in Estonia in November. The improvement in the COR from 92.2% to 89.6% demonstrates the results of our operational excellence programmes on automatic renewals, pricing and claims.

Asia and the Middle East

Asia and the Middle East continued to perform strongly with 15% premium growth on constant exchange, driven by strong Motor performance in the UAE, and a COR of 88.8%. We were named 'Insurer of the Year' in the UAE and received positive coverage of our response to Cyclone Gonu in Oman. In China, we were the first European insurer to receive a subsidiary licence. This allows us to accelerate our expansion strategy, and subject to regulatory approval, we aim to open 11 branches by 2011, giving us access to 45% of the Chinese insurance market.

Joint ventures

Both our major joint ventures made good progress during 2007. India continued to deliver double digit growth and we have appointed a new CEO and continue to focus on accelerating the growth of this business. Our joint venture in Central and Eastern Europe employs a direct model in an intermediated world. It owns Link4, the leading direct writer in Poland, and in May successfully launched a similar operation in the Czech Republic. In 2007, Link4 grew premiums by 38% to £47m, well ahead of the market. We look to build on this experience as we roll out our direct proposition in Russia in 2008.

Market conditions

Emerging Markets covers a large number of countries with diverse economic and regulatory environments. Common themes include the continued growth in demand for insurance products in Personal lines, driven by increasing affluence, and in Commercial lines as strong GDP growth continues.

Strong GDP growth and low insurance penetration continue to present exciting market opportunities, and at the same time, attract new entrants and bring increased competition.

2008 priorities and outlook

We anticipate 2008 will be an exciting year for Emerging Markets as we continue to implement our organic growth strategy. In addition, we are building a pipeline of targeted bolt on acquisitions to accelerate delivery of our growth objectives. We are committed to underwriting discipline and continuous operational improvement to drive sustainable profitable performance.

'Strong GDP growth and low insurance penetration continue to present exciting market opportunities.'

Financial review

ANOTHER STRONG YEAR

George Culmer
Chief Financial Officer

Analysis of result – management basis[1]

	2007 £m	2006 £m	Movement %
Net written premiums	**5,837**	5,484	**6**
Underwriting result	**278**	310	**(10)**
Investment result	**629**	556	**13**
Insurance result	**907**	866	**5**
Other activities	**(93)**	(86)	**(8)**
Operating result[2]	**814**	780	**4**
Interest, amortisation and reorganisation costs	**(122)**	(130)	**6**
Loss on disposals	**(22)**	(1)	**–**
Profit before tax	**670**	649	**3**
Taxation	**(29)**	(170)	**83**
Profit after tax from continuing operations	**641**	479	**34**
Loss after tax from discontinued operations	**(13)**	(499)	**97**
Profit/(loss) after tax	**628**	(20)	**–**
Combined operating ratio (%)	**94.9**	93.3	**(1.6) pts**
Shareholders' funds	**3,077**	2,561	**20**

(1) The result is shown on a management basis. The result on a statutory basis is shown on page 58.
(2) A reconciliation between operating result on a management basis and results of operating activities on a statutory basis is shown on pages 84 to 85. The key components of the operating result are described on page 84.

Results overview

In challenging market conditions, the Group has again delivered a strong result. In 2007, we delivered profitable growth in each of our regions and achieved a strong bottom line performance. The results have been delivered against the backdrop of a competitive rating environment, adverse large losses and weather, including the UK floods, and volatile investment markets. Our continued delivery of strong results clearly demonstrates the benefit of the strong and diversified portfolio and our tight financial management.

Net written premiums

Net written premiums are up 6% to £5.8bn (2006: £5.5bn), demonstrating the strength of our portfolio, with above market growth in International, strong double digit growth in Emerging Markets, and targeted growth in the UK.

Operating result

The operating result is £814m (2006: £780m), with an improved investment result offset by the lower underwriting result.

Underwriting result

The underwriting result of £278m (2006: £310m) reflects a strong performance in challenging conditions and the benefit of management actions, including our prudent reinsurance programme, positive action on rating, and the strong and diversified portfolio. The current year underwriting loss is £70m (2006: underwriting profit of £179m) and includes the impact of the UK floods of £120m, as well as adverse weather (£73m worse than 2006) and large loss experience (£88m worse than 2006) across the Group.

Financial review continued

As in 2006, the prior year underwriting profit has been particularly strong and totalled £348m in 2007. This reflects a continuation of the trend seen in the first six months of the year with strong positive emergence from our UK specialist claims unit, as well as the cumulative impact of actions taken to reduce claims leakage in Other Europe. This compares with a prior year underwriting profit of £131m in 2006, which as reported, was after £164m of reserve strengthening for Scandinavian PA and UK asbestos reserves. The Group continues to adopt a prudent reserving policy for both current year and overall reserves, and reserves at 31 December 2007 were stronger than at the start of the year, with particular strength in International.

Investment result

The Group maintains a low risk asset strategy with the portfolio dominated by high quality fixed income and cash assets. During 2007, we undertook a number of actions to enhance the defensive position of the portfolio, including selling a net £220m of equities in the second and fourth quarters, reducing our limited CDO exposure through selective disposals and extending bond duration to improve liability matching and lock in higher yields.

The quality of our portfolio and the benefit of these management actions are clearly demonstrated in the strength of our investment result. The 2007 investment result is up 13% to £629m, and reflects increased investment income as well as a 45% increase in total gains. The increase in total gains has driven the investment result ahead of our 2007 guidance and follows action taken to reduce equity exposure.

Investment income is up 15% to £591m, reflecting an increase in bond and cash yields, with the average underlying yield on the portfolio increasing from 4% to 4.4%. Investment income also includes £26m on the funds withheld account on the Adverse Development Cover provided to Arrowpoint Capital, which is included in the 2007 consolidated accounts for the first time. This is offset by £28m of discount unwind on the related liabilities, which is included in the total unwind of discount of £81m.

Total gains were £119m (2006: £82m). Within this, realised gains total £174m, reflecting gains on equity sales of £185m, offset by losses on bond disposals.

Unrealised losses total £55m and predominantly comprise the mark to market movement in the commercial property portfolio of £42m. This compares with a £42m increase in 2006 and represents a 9.4% fall in the portfolio value, which is broadly in line with the fall in the IPD index of 10%. Unrealised losses also includes charges for vacant investment property costs of £8m, impairments of £3m and other market movements of £5m offset by a £3m gain on exchange.

In 2008, total gains are expected to be in line with the 2006 total of £82m.

Other activities

Other activities of £93m are £7m higher than in 2006, which reflects a 19% reduction in central expenses to £60m (2006: £74m), offset by the movement in other operating activities. Other operating activities include net gains on non insurance derivatives which benefited from a £12m gain in 2006, other non insurance activities, share of results of associates, and other costs principally relating to business development in Emerging Markets.

Interest, amortisation and reorganisation costs

Interest costs are £104m, up from £92m, reflecting the financing costs for the Codan buyout, and the buy back of the residual Yankee bond.

Amortisation of £18m was charged in respect of intangible assets and goodwill on acquired claims provisions, compared with £15m in 2006.

With the completion of the Group's operational improvement programme in 2006, no reorganisation costs have been charged to the income statement in 2007 (2006: £23m).

Loss on disposals

Loss on disposals are £22m and include a £13m loss on the disposal of Venezuela and a £6m loss on the disposal of the UK Guildhall legacy book. The loss on Venezuela comprises a £5m loss on the net assets of the Company and £8m of foreign exchange, which is recycled from reserves and does not impact Group net assets. The disposal of Guildhall removes £58m of mostly asbestos and environmental liabilities from our balance sheet. We received £32m consideration for net assets of £30m, and after the unwind of the discount of the reserves of £8m, this resulted in a loss of £6m.

Taxation

The tax charge is £29m and includes the release of £103m of the deferred tax liabilities that had been held in respect of Codan's Danish Security Fund and Swedish Safety Reserve. These

Analysis of investment result – management basis

	2007 £m	2006 £m	Movement %
Bonds	**391**	372	5
Equities	**48**	56	(14)
Cash and cash equivalents	**83**	63	32
Land and buildings	**17**	13	31
Other	**52**	12	–
Investment income	**591**	516	15
Realised gains	**174**	46	278
Unrealised gains/(losses), impairments and foreign exchange	**(55)**	36	(253)
Total gains	**119**	82	45
Unwind of discount	**(81)**	(42)	(93)
Investment result	**629**	556	13

reserves are held in shareholders' equity and following the minority buyout, we have determined that no future tax liability will arise in respect of them. Accordingly, we have released these deferred tax provisions.

Profit after tax

Profit after tax is £628m and benefits from the strong operating result as well as the release of deferred tax reserves in Codan following completion of the minority buyout.

The underlying return on equity remains very strong at 21.3% for the year.

Dividend

The directors will recommend at the Annual General Meeting, to be held on 19 May 2008, a final dividend of 4.53p (2006: 4.12p) per share. This, together with the interim dividend of 2.48p, will make a total distribution for the year of 7.01p (2006: 5.87p), an increase of 19% for the year.

Cashflow

The Group's operating cashflow was £652m in 2007, a decrease of 23% on 2006 which reflects the impact of the UK floods as well as adverse weather and large loss experience across the Group. The £22m increase in the dividend to minorities to £31m, reflects the minorities' share of an exceptional dividend paid by the Group's non-wholly owned UK subsidiary British Aviation Insurance Company. The issued share capital of £304m and £223m net movement in debt both primarily relate to the Codan minority buyout. Corporate activity of £888m includes the buyout of the Codan minorities of £590m, the disposal of the US operation and a number of acquisitions in International and Emerging Markets.

The 2006 cashflow has been reanalysed to show tax paid and issue of share capital separately and to reclassify a £78m investment sale from operating cashflow to sale of other investments.

Balance sheet

Our balance sheet and capital position are strong. In 2007, Group shareholders' funds increased by 20%, to £3.1bn (2006: £2.6bn) primarily reflecting the strong retained profits for the year.

Investment portfolio – management basis

	2007 £m	2006 £m
Debt and fixed income securities	**9,581**	8,568
Cash and cash equivalents	**1,509**	1,831
Equity securities	**1,487**	1,620
Investment property	**429**	454
Other	**272**	269
Total financial assets	**13,278**	12,742

Investment portfolio

The investment portfolio totalled £13.3bn at the year end compared with £12.7bn at the start of the year and 83% of the portfolio is invested in high quality fixed income and cash assets. The fixed interest portfolio remains concentrated on high quality short dated assets, with an average duration of 3.1 years. At the end of the year, 99% of the bond portfolio was investment grade, with 86% rated AA or above, a marginal increase over the prior year.

The Group has no holdings in monoline insurers and no exposure to credit insured bonds, US municipal bonds or US subprime Residential Mortgage Backed Securities. The Group's CDO exposure was £130m at the year end and comprised over £115m of CLOs, which have experienced no downgrades. Since year end, we have disposed of £27m of CDOs.

At the year end, equities (excluding preference shares and Collective Investment Vehicles backed by fixed income and cash assets) comprised 8% of the portfolio compared with 10% in 2006. Although the size of the equity portfolio has been reduced, we have maintained our equity protection strategy, covering up to £800m of our portfolio. These derivatives are a rolling programme of put and call options, with the quantum and strike levels of coverage adjusted quarterly. Since year end, we have taken out an additional £50m of protection on our European equities.

The commercial property portfolio represents only 3% of investment assets and comprises high quality commercial properties, generating strong and sustainable rental income and does not include any development properties.

Cashflow – management basis

	2007 £m	2006 £m
Operating cashflow	**652**	851
Tax paid	**(127)**	(118)
Interest paid	**(92)**	(82)
Group dividends	**(111)**	(87)
Dividend to minorities	**(31)**	(9)
Net cashflow	**291**	555
Issue of share capital	**304**	6
Pension deficit funding	**(86)**	(86)
Net movement of debt	**223**	(169)
Corporate activity	**(888)**	(355)
Cash movement	**(156)**	(49)
Represented by:		
(Decrease)/increase in cash and cash equivalents	**(352)**	443
Purchase/(sale) of other investments	**196**	(492)
	(156)	(49)

Financial review continued

As at 31 December 2007 unrealised gains in the balance sheet were £461m (2006: £575m).

Capital position

As at 31 December 2007, the Group had an Insurance Group's Directive (IGD) surplus of approximately £1.5bn, an increase of £0.2bn from 2006. The coverage ratio has improved from 1.9 times the IGD requirement at the end of 2006 to a very strong 2.5 times the requirement at the end of 2007.

At 31 December 2007, the Group had surplus economic capital of around £2.2bn, up from £2bn at the start of the year, based on a risk tolerance consistent with Standard & Poor's (S&P) long term A rated bond default curve. This is equivalent to a probability of solvency over one year of 99.94%.

The Group calculates its economic capital position using a global multi year stochastic economic capital model. The model is a key decision making tool and is used for a range of strategic, operational and financial management purposes throughout the Group, and has also been the basis for the Group's Individual Capital Assessment (ICA) submissions to the FSA since the 2004 year end.

The ICA is a forward looking, economic assessment of the capital requirements of the Group based on our assessment of the risks to which we are exposed. The Group has received its Individual Capital Guidance from the FSA, which at the request of the FSA remains confidential.

Rating agencies

S&P, AM Best and Moody's Investor Service provide insurance financial strength ratings for the Group and its principal subsidiaries.

In December 2007, S&P upgraded the Group to A (stable), the Group's target rating. The Group was upgraded to A3 positive outlook by Moody's in February 2008 and is rated A- positive outlook by AM Best. Details of the Group's ratings can be found in the Investor Relations section under Bond Investor Information on the Group's website **www.rsagroup.com**.

Pension fund

The surplus on the pension scheme as at 31 December 2007 is £116m net of tax compared with £24m at the start of the year. The scheme has benefited from positive market movements and funding payments made during the year. The Group has strengthened the pension scheme assumptions during the year for both mortality and inflation.

We sold around £900m of equities in the second quarter, reducing the equity holding in the pension fund from 46% to 24% at the end of the year. At the same time, we extended the interest rate and inflation swap programme over the scheme liabilities.

The reduction in the equity exposure has significantly benefited the scheme, with the change in asset mix contributing over £75m to the year end surplus position.

Summary

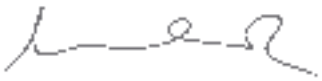
Our objective is to deliver sustainable profitable performance, and this is clearly evident in the Group's continued delivery of strong results.

Our tight management of the business, including our relentless action on rate and expenses, conservative reinsurance approach and low risk investment strategy ensured that the Group was well positioned to manage 2007's competitive rating environment, adverse weather losses, including the UK floods and volatile investment markets.

We remain confident of the Group continuing to deliver sustainable profitable performance, and this is reflected in the 10% increase in the 2007 final dividend and our expectation of delivering a COR of around 95% in 2008.

The table below shows the main movements in the pension fund surplus net of tax during 2007

	UK £m	Other £m	Group £m
Pension fund at 1 January 2007	72	(48)	24
Actuarial (losses)/gains	(22)	6	(16)
Deficit funding	62	–	62
Other movements	42	4	46
Pension fund at 31 December 2007	154	(38)	116



George Culmer
Chief Financial Officer

RISK FRAMEWORK

Overall risk framework

The Group operates under an enterprise risk management framework that is designed to identify, assess, measure and manage exposure to risk including environmental, social and governance matters. This process is subject to continuous review and development and further work was undertaken in 2007 to enhance the framework.

Risk management

The Board is responsible for the Group's systems of risk management.

Executive management has the responsibility for establishing and implementing appropriate systems and controls in their own areas of remit. The Group Risk Management Framework provides the mechanism through which risk management and control is embedded throughout the Group. Each Group business is required to follow a consistent process to identify, assess, manage and monitor their key risks.

Group risk appetite

The Group has a process for setting risk appetite and for monitoring compliance with this. The Group risk appetite sets business volumes for certain higher risk insurance classes, stipulates loss retention limits, reinsurance protection, targets for credit rating and solvency margins, and other appropriate measures.

There is a formal escalation process for potential or emerging risks that are outside the risk appetite.

Risk framework

The Group has continued to adopt the 'three lines of defence' governance model. The framework for the oversight and management of risk is as follows:

- Management – the first line of defence in setting strategy, performance measurement, establishment and maintenance of internal control and risk management in the business
- Risk assessment – the second line, operating a formal risk management framework within which, the Group policies and minimum standards are set, and objective oversight and challenge of risk management across the Group is achieved. This is provided by the Board Risk Committee, supported by the Group Risk functions, and a Groupwide network of regional risk committees
- Independent assurance – the third line of defence, providing independent and objective assurance of the effectiveness of the Group's systems of internal control established by the first and second lines of defence. This is provided by the Group Audit Committee, supported by Group Internal Audit.

Group risk policy statements

Group risk policy statements set out the minimum standards to be maintained by the Group's operations in order to manage their risks in a way that is consistent with the risk appetite. Business managers are responsible for complying with Group and local risk policies and for managing risk by taking mitigating actions where risks are outside the appetite. The Board Risk Committee's oversight and challenge role includes consideration of risk mitigation.

Compliance with policy statements is mandatory. Policies are subject to regular review in order to reflect changes in circumstances and the risk appetite.

Risk categories

The Group views risks according to the categories outlined below. Additional information is provided in the risk management section of the financial statements. Details of some of the key current practices, tools and other arrangements for each risk category are set out below.

Insurance risk

The Group's general insurance activities are primarily concerned with the pricing, acceptance and management of risks arising from our contracts with customers. The management of the underwriting and claims risks uses a number of key tools, including the review of the performance and management of all the individual insurance portfolios throughout the Group, and the investigation of potential emerging insurance risks.

Further work has been undertaken in 2007 to refine and improve the Portfolio Classification process, designed to provide a more effective method of evaluating individual and overall portfolio performance.

Claims development and reserving levels are closely monitored by Reserve Committees. Each region's Reserve Committee determines a recommended level of outstanding claims reserves, in accordance with the Group Reserving Policy. The Group Reserving

Risk framework continued

Committee considers the reasonableness of these recommendations. It then determines the level of aggregate outstanding claims reserves to be carried by the Group.

Reinsurance risk

The Group's reinsurance strategy and appetite are set and agreed by the Board and published and disseminated via the Group reinsurance policy statement. The Group Reinsurance Credit Committee oversees the implementation of the counterparty credit aspects of this strategy. The reinsurance team monitors and controls reinsurance activity throughout the Group and has responsibility for the purchase of the Group's worldwide programme of treaties. All major treaty purchases are analysed using various sophisticated modelling tools to ensure that the level of cover purchased is capital efficient and aligned with Group risk appetite and strategy.

Operational risk

Operational risk exists in every facet of the organisation, including those areas that are not viewed as 'operating units'. As such, all areas of the Group and its major outsourcing providers are involved in addressing and controlling operational risk.

The Group uses a suite of risk tools to help manage operational risk using a common categorisation of risk. These tools include Risk and Control Self Assessments, Key Risk Indicators, Scenario Analyses, Incident Management and Loss Data.

A series of forward looking key risk indicators is used to assess potential future trends in operational risks, whilst data collected on actual operational risk incidents and 'near misses' captures past experiences. In addition, the use of scenario analyses enables the Group to assess whether certain operational events that have occurred elsewhere could manifest themselves within the Group. When taken together, the tools provide a complementary set of indicators of the Group's operational risk profile.

Credit, market and liquidity risks

The primary sources of credit risk within the Group are investment and treasury activities and reinsurance counterparty risk. Within the investment management and treasury activities, a range of bank counterparty concentration and credit quality limits, together with other controls, are in place to ensure that exposure is managed within the Group risk appetite. New reinsurance cover is placed with reinsurers that are authorised as Approved Reinsurance Counterparties recommended by the Group Reinsurance Credit Committee under criteria approved by the Board Risk Committee.

Market risk arises from the Group's investment portfolios. The Global Asset Management Committee is the management committee that oversees the Group's investment strategy under the oversight of the Investment Committee, and operating within risk limits set by the Board Risk Committee.

The primary source of liquidity risk is the Group's treasury activities. Liquidity risk is considered to be a low risk category. Group liquidity is managed by Group Treasury and each operation is required to maintain a minimum level of cash or cash equivalents or highly liquid assets that can be liquidated within a maximum stated period of time. Contingency funding plans are prepared and monitored to ensure that these minimum levels are met even in stressed conditions.

Regulatory risk

The Group operates in a number of geographical locations with diverse regulatory requirements. The regulatory environment has become more complex and demanding. The Group continues to respond to these developments through its arrangements for regulatory compliance and by ensuring that it maintains open and cooperative relationships with its regulators.

Principal risks and uncertainties

In this section we set out the principal risks and uncertainties to delivering our strategy, together with the actions we are taking to minimise the likelihood that these will occur and any potential impact on the future performance of the business.

1. Rating environment softens significantly in key markets

The Group's overriding objective is to deliver sustainable profitable performance. Our strong and diverse portfolio provides exposure to markets at different stages of development at different points in the insurance cycle. We actively use the portfolio to shift capacity to where we see the best returns.

We are committed to underwriting discipline, with a relentless focus on profitability over volume.

We continue to invest in our technical skills and our sales and marketing capabilities. We target growth where it is profitable through specialist segmentation and focus on expanding in target trades and segments where our technical expertise gives us competitive advantage.

2. Insurance risks are accepted outside the Group's risk appetite or below technical price

The Group has strict underwriting limits in place to ensure that risk selection is within the Group's risk appetite. The Group's underwriters are licensed to only write risks within specified limits, based on the experience of each individual underwriter.

Portfolio reviews are carried out across the business to assess the performance of each portfolio against key performance indicators. Key risk indicators are used to monitor emerging trends, opportunities and risks. Any portfolio that triggers a key risk indicator is flagged and investigated, with corrective measures implemented if required.

Audits of business won and lost ensure that risks accepted are priced to achieve target returns and that underwriting discipline is maintained.

3. Adverse loss experience through catastrophic losses arising from an insurance event or series of events, increasing frequency and severity of large losses or deterioration in long tail reserves

The Group's underwriting strategy is set centrally using risk aggregation models and limits to ensure that risks written are well diversified and are within the Group's risk appetite.

Portfolio reviews monitor underwriting performance, ensuring that risks accepted are within the Group's risk appetite and priced to achieve target returns. Emerging trends in large losses, frequency and severity are flagged and investigated.

The Group maintains a conservative reinsurance programme, which limits net losses to a specified amount each year.

In addition, the Group maintains a conservative reserving policy and claims reserves are set with the aim that, over the longer term, they will be more likely than not to result in positive prior year development.

4. Adverse financial markets impact the investment portfolio and the pension fund

The Group operates a low risk investment policy, with the investment portfolio dominated by short dated, high quality fixed income and cash assets.

In 2007, we have taken steps to further reduce the Group's exposure to market risk, including:

- Reducing equity exposure in the pension fund from 46% to 24% at the year end
- Selling a net £220m of shareholder equities and hedging up to £800m of the remaining equity portfolio with derivatives to mitigate the impact of equity market falls
- Ongoing reduction of CDO exposure through selective disposals
- Extending bond duration to improve liability matching and lock in higher yields

While the value of the Group's general insurance bond holdings will be impacted by interest rate movements, the short dated average term of these holdings mitigates their sensitivity to such movements.

The investment portfolio is routinely monitored to ensure compliance with counterparty concentration and credit limits and that all exposures are within the Group's risk appetite.

The prudent nature of the Group's investment strategy has been evidenced by the resilience of the portfolio during 2007. In spite of market turbulence, the portfolio performed strongly and did not experience any material impairments.

CORPORATE RESPONSIBILITY

Climate change continued to be a major focus in 2007, generating both risks and opportunities for insurers. RSA has been at the forefront of the debate, helping customers and preparing our business.

Our approach to corporate responsibility is based on our Business Principles, which underpin everything we do and outline how we interact with stakeholders, both as a company and as individuals. These principles link to our Group policies and form part of our broader risk and governance framework which, together with our latest Corporate Responsibility Report can be found at **www.rsagroup.com**.

Customers

As an insurer, we play a vital role in helping people recover and getting their lives back on track. This was demonstrated by our response to weather related events during 2007, including Cyclone Gonu in Oman and the summer flooding in the UK. In response to the UK floods, we were one of the first insurers on the ground, providing emergency payments and alternative accommodation, proactively contacting our customers within 48 hours.

We remain committed to clear and open communication with customers, and resolving their complaints promptly. This was reflected by our upper quartile position in all categories in the UK in the 2007 benchmark by the ABI. Throughout our businesses we continue to improve our customer service. This year we rolled out our Personal Customer Manager programme, which was pioneered in our Canadian business, to over 170,000 customers in the UK, assigning people with their own dedicated customer services manager. This demonstrates our focus on improving the customer experience.

Product innovation is key to our success and across the business we adopt clear segmentation methods to create tailored and relevant products for specific customer groups. Social and environmental changes are always generating new insurance demands, and we have continued to develop insurance solutions that provide additional social or environmental benefits:

- In the UK, we launched the pilot of 'Green Telematics' using satellite technology, aimed at reducing the environmental impact of driving, through advising on driving behaviour
- We're expanding our global commercial renewable energy insurance propositions and continue to be a leading provider of both off-shore and on-shore wind cover
- In Italy and Canada, based on our successful 50 plus products in Scandinavia, we have launched similar propositions targeting the over 50s, tailoring our insurance to the needs of this important and growing demographic.

Business partners

We work closely with our business partners and intermediaries to grow a successful business at the same time as reducing our social and environmental impact. We demand high standards from them.

During 2007, we have been active in working towards a common approach for responsible procurement in the financial services sector. This approach will help drive environmental and social improvements throughout the supply chain without jeopardising cost or quality.

Responsible investment

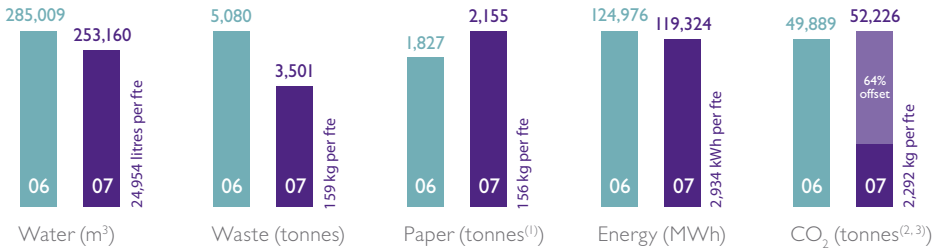
Our UK assets continue to be managed by F&C Asset Management who apply their responsible engagement overlay across our equity portfolios to encourage companies to manage social, ethical and environmental risks. We receive regular feedback on the companies in which F&C Asset Management have invested in on our behalf.

Employees

A sustainable business needs to attract, develop and reward talented people, as well as giving people responsibility and making them accountable for their actions. At RSA we are continuing to build and enhance our high performance culture. This year we have continued to focus on the ongoing development of our employees throughout our businesses and at all levels. Some of the major initiatives we focused on in 2007 were:

- The launch of our Technical Academy global graduate programme in our core disciplines of claims, actuarial and underwriting

Group impacts



(1) Inclusion of marketing materials in 50% of operations
(2) Revised in CR report 2006
(3) Includes expansion of Canadian reporting, inclusion of Italy and Colombia for first year
Note: Data covers 85% of RSA

- Our Executive Development Programme is now in its fourth year, focusing on key strategic projects
- The FastTrack programme is a two year development programme for high potential early career candidates. We plan to continue the programme in 2008 with another 45 participants.

Scores recorded in our annual global employee survey continued to improve, with overall satisfaction improving by 2%. A key part of this survey is using the feedback we get from employees as a means of generating ideas and actions to make operational improvements in all our businesses. We turn the results into clear action plans. Last year we also started to run 'World Café' engagement events across the Group. These events have played a key part in developing the new RSA brand and beliefs and empowering regional businesses to play their role in making major improvements to the business.

Environment

During 2007 we have been focusing on integrating environmental management and our climate change strategy throughout our business.

As a Group:

- We have stretching environmental targets in place. This year we have made excellent progress and achieved over 79% of the original targets. We have set new challenging targets for 2008
- We continue to be 'Carbon Neutral' in the UK, and only use offsetting, in renewable energy projects of the highest quality, as a last resort
- We have integrated best practice environmental design into the new Irish HQ and two major site refurbishments in the UK, all due for occupation in 2008.

As an insurer:

- We are committed to engaging in the climate change debate and work closely with forums such as the United Nations, FORGE group and 'We're in this Together' initiative
- We remain vocal in the UK on key environmental issues and continue to lobby on increased funding for flood defences and action on climate change
- Our technology to assess risk for customers is constantly improving and evolving through applications such as Eurotempest and our Flood Risk Assessment tool
- We aim to make it more affordable for customers to make environmental choices though products and services such as our commercial energy surveys, discounted insurance for hybrid cars and fuel efficient vehicles.

Community

Over the last few years we have been developing a more targeted and proactive community engagement programme. As a Group, we are focusing on three main areas that are relevant to our business and our interaction with local communities. These are safety, social inclusion and the environment.

Road accidents are a major cause of death and injury, which as a leading motor insurer, we are committed to reducing. Our programmes on road safety education continue; in Chile teaching 27,000 children, while in Sweden we donated 180,000 reflective safety vests. In Dubai, in association with the Government, we have started a road safety training and stress reduction campaign for drivers.

Addressing social inclusion continues to be an issue across all our regions and we tackle this in different ways. In the UK, financial inclusion is a major issue and alongside our provision of social housing insurance, Bridget McIntyre is a member of the UK Government's Financial Inclusion Taskforce and chairs the Insurance Working Group.

Our overall charitable donation rose by 13% to £2.3 million in 2007, with 8,850 volunteer hours donated. In 2008, we look forward to our first ever Groupwide volunteer event helping local great causes identified by our employees, and building on the success of the RSA UK National Volunteer Week.

Targets for 2008

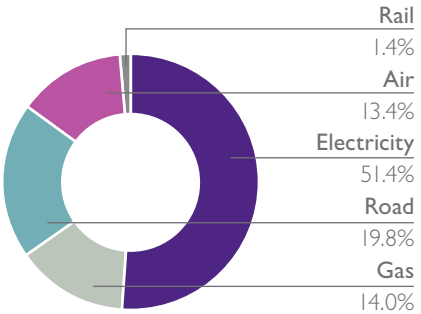
We met 79% of our 2007 environmental targets. For full details of the progress please see the full Corporate Responsibility Report.

The following targets are for completion by the end of 2008, set against a 2006 baseline.

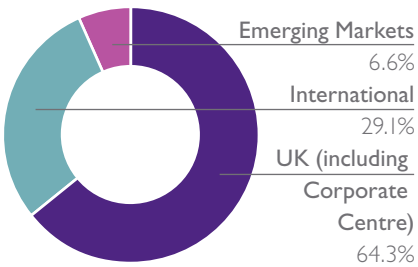
Environmental Targets 2008	% reduction
Energy	
UK (electricity)	10
Ireland	10
Canada	5
Waste	
UK	10
Denmark (paper)	5
Ireland (paper)	10
CO_2	
Group	2.5
UK	5
Ireland (travel)	5
Travel (Air)	
UK	5
Sweden	1
Denmark	1
Ireland	10
Canada	10[1]
Travel (Car)	
Sweden	5
Denmark	2
Paper	
Sweden	5
Denmark	5

Note
All Canadian targets refer to RSA Canada only
[1] Canadian air target for international air travel with 5% domestic air travel reduction set

CO_2 impact



CO_2 emissions by region



EXECUTIVE TEAM

Andy Haste
Group Chief Executive
Andy was appointed Group Chief Executive in April 2003, following previous roles as Chief Executive of AXA Sun Life plc and Director of AXA UK plc (life and pensions). He is the former President and Chief Executive Officer of Global Consumer Finance Europe at GE Capital UK, Western Europe and Eastern Europe (financial services), and is the former President of National Westminster Bank's US Consumer Credit Business.

Mark Chambers
General Counsel and Group Company Secretary
Mark was appointed General Counsel and Group Company Secretary in October 2004. He was previously head of the legal team at American Express for EMEA. Before that he worked for GE, holding a number of senior positions with the consumer finance and insurance businesses. Earlier in his career, Mark worked for the international law firm Slaughter and May in London and New York. Mark is a non-executive director of the University of Westminster.

George Culmer
Chief Financial Officer
George was appointed Chief Financial Officer and Group Director in May 2004. He was previously Head of Capital Management at Zurich Financial Services and Chief Financial Officer of its UK operation. Before that George spent ten years with Prudential.

Orlagh Hunt
Group Human Resources Director
Orlagh joined the Group as HR Director for International in September 2003 and was appointed Group Human Resources Director in October 2006. She was previously Head of Human Resources for AXA Sun Life plc and has previously worked at Walkers and Tesco in a variety of HR management roles.

Simon Lee
Chief Executive, International Businesses
Simon has been Chief Executive of RSA's International business since April 2003. Previously he spent 17 years with the National Westminster Bank Group, in the UK and US including time as Chief Executive, NatWest Offshore and Head of US Retail Banking.

Neil Macmillan
Group Director, Audit, Risk and Compliance
Neil joined the Group as UK Director for Internal Audit in June 2003 and was appointed Group Director, Audit, Risk and Compliance in July 2006. Before joining RSA, Neil was Head of Internal Audit for the Royal Bank of Scotland Group's Wealth Management and Retail Direct Divisions.

Bridget McIntyre
UK Chief Executive
Bridget joined as UK CEO at RSA in November 2005. Previously, Bridget worked for Norwich Union for 13 years in roles including Finance Director of the general insurance business, Managing Director of London & Edinburgh, Finance Director of UK Long Term Savings and, most recently, Sales, Marketing & Underwriting Director of Norwich Union's general insurance business. As a qualified Chartered Management Accountant, in her earlier career Bridget worked at Volvo UK, HarperCollins, Marconi Radar Systems and Willis Faber.

Timothy Mitchell
Group Underwriting and Claims Director
Tim was appointed Group Underwriting and Claims Director in November 2007 when he joined the Group. Tim has over 30 years experience in the insurance industry. He joined RSA from Zurich Financial Services where he held senior underwriting roles including three years as Global Chief Underwriting Officer for General Insurance. Tim has also held senior management roles at AIG and Continental Insurance.

Clare Salmon
Group Strategy, Marketing and Customer Director
Clare joined as Group Strategy, Marketing and Customer Director in June 2007. Previously she was Director of Marketing & Commercial Strategy at ITV plc and a member of the Executive Management Board. Clare is also the former Managing Director of AA Financial Services and has held senior commercial roles at Prudential and British Gas. She is also a non-executive director of Alliance Trust plc.

Left to right:
Standing: Bridget McIntyre, David Weymouth, Timothy Mitchell, Simon Lee, Paul Whittaker.
Seated: George Culmer, Mark Chambers, Andy Haste, Neil Macmillan, Clare Salmon, Orlagh Hunt.

David Weymouth
Group Operations and IT Director

David joined as Group Operations and IT Director in June 2007. He spent 27 years with the Barclays Group, where senior positions included Chief Operating Officer for Corporate Banking and Group Chief Information Officer and was part of the Group Executive Committee. He most recently spent two years consulting to a portfolio of blue chip and government organisations and acting as an independent board member at the DTI and for Chordiant Inc, the US Nasdaq quoted software business.

Paul Whittaker
CEO of Emerging Markets

Paul was appointed CEO of Emerging Markets in 2006, having been RSA's Group HR Director since April 2003. He has over 15 years senior management experience in the financial services sector including three years at AXA and 10 years at GE Capital, including work in Asia and Eastern Europe on acquisition integration and business development.

BOARD OF DIRECTORS

John Napier
Age 65. Director of the Group from January 2003 and Chairman of the Group from March 2003. Chairman of the Nomination Committee from March 2003. Non-executive Chairman of Kelda Group plc (water utility). Former Executive Chairman and Chief Executive of Kelda Group plc. Former Chairman of Booker plc (cash and carry). Former Managing Director of Hays plc (business services) from 1991 to 1998. Former Managing Director of AGB plc (international market research and information services). ●●

Andy Haste
Age 46. Director and Group Chief Executive from April 2003. Former Chief Executive of AXA Sun Life plc and Director of AXA UK plc (life and pensions). Former President and Chief Executive Officer of Global Consumer Finance Europe at GE Capital UK, Western Europe and Eastern Europe (financial services). Former President of National Westminster Bank's US Consumer Credit Business (retail banking). ●●

George Culmer
Age 45. Chief Financial Officer and Director of the Group from May 2004. Previously Head of Capital Management Zurich Financial Services (insurance) and Chief Financial Officer of its UK operation. ●●

Noel Harwerth
Age 60. Director of the Group from March 2004. Director of Logica CMG, Corporate Services Group plc, Anglo Irish Bank and Partnership Director, London Underground. Deputy Chairman of Sumitomo Mitsui Banking Corporation Europe Limited (finance). Former Chief Operating Officer of Citibank International plc (finance). ●●

Edward Lea
Age 66. Director of the Group from July 2003. Chairman of the Group Audit Committee from October 2003. Director Redbourn Group plc (property management and investment). Director of IDC Plugs Limited (electrical services). Director of MacIntyre Care (charity). Previously a director of The British United Provident Association (BUPA). ●●●

Simon Lee
Age 47. Director of the Group from January 2007 having been Chief Executive of the International business since April 2003. Former Chief Executive, Natwest Offshore and Head of US Retail Banking at National Westminster Group. ●

Malcolm Le May
Age 50. Director of the Group from March 2004 and Chairman of the Investment Committee. President Europe JER Partners Limited (Europe) (property investment). Non-Executive Director of Pendragon plc. Former Deputy Chief Executive Morley Fund Management (Investment Fund Manager). Former Deputy CEO of ING-Barings (finance). ●●●

John Maxwell
Age 63. Director of the Group from July 2003. Chairman of the Remuneration Committee from October 2003. Director of Provident Financial plc (financial services). Director of Homeserve plc (support services). Director of the Royal Automobile Club Limited. Director of London Finance and Investment Group plc. Previously an executive director of Prudential Group plc. Former Chairman of DX Services plc (mail). Previously Director General (Chief Executive Officer) of The Automobile Association Limited. ●●●●

Bridget McIntyre
Age 46. UK Chief Executive and Director of the Group from November 2005. Former Executive Director of Norwich Union (insurance). ●

● Member of the Group Audit Committee
● Executive director
● Member of the Investment Committee
● Member of the Nomination Committee
● Member of the Remuneration Committee









Left to right:

Top row: John Napier, Andy Haste, George Culmer
Middle row: Noel Harwerth, Edward Lea, Malcolm Le May
Bottom row: John Maxwell, Simon Lee, Bridget McIntyre

Directors' report

The directors of Royal & Sun Alliance Insurance Group plc ('RSA') present their report and the audited financial statements of the Company for the year ended 31 December 2007.

Principal activity

The Company is the holding company of the RSA group of companies (the 'Group') whose principal activity is the transaction of personal and commercial general insurance business. The Group writes business in over 130 countries.

Business review

The Company is required by the Companies Act to include a business review in this report. The information that fulfils the requirements of the business review can be found within the Group CEO's review on pages 6 to 10, the Group strategy on pages 11 to 13 and the regional business reviews on pages 14 to 22 which are incorporated in this report by reference. An overview of the Group's business performance during the year along with an analysis of its financial position is set out in the financial review on pages 23 to 26. The future developments of the business can be found in the Group CEO's review on pages 6 to 10 and in the regional business reviews on pages 14 to 22. The principal risks and uncertainties facing the Group are set out in the estimation techniques, uncertainties and contingencies on pages 70 to 72 and in the risk framework on pages 27 to 29.

The Group uses Key Performance Indicators ('KPIs') to provide a well balanced and comprehensive review of the Group's overall performance. KPIs are monitored in a number of areas including financial, employee, customer and the environment and community. Financial KPIs include the Group's combined operating ratio, expense ratio, operating result and net written premium growth. Employee KPIs include the percentage of staff that have performance related pay, the percentage of staff taking part in the employee survey and the increase in overall employee satisfaction as measured by the survey. Customer KPIs include the levels of customer retention and the Group's position in the annual benchmarking survey on complaints handling by the Association of British Insurers. Environment and community KPIs include the levels of CO_2 emissions and the amount of the Group's charitable donations. Financial KPIs are detailed in the Group CEO's review on pages 6 to 10, the Group strategy on pages 11 to 13 and the regional business reviews on pages 14 to 22. The employee, customer and the environment and community KPIs are detailed in the regional business reviews on pages 14 to 22, the corporate responsibility report on pages 30 to 31 and in this report.

Dividends

The directors recommend a final dividend of 4.53p per ordinary share in respect of the year ended 31 December 2007 to be paid on 6 June 2008 to holders of ordinary shares on the register at the close of business on 7 March 2008, subject to shareholder approval. This, together with the interim dividend of 2.48p per ordinary share, will make a total dividend for the year of 7.01p per ordinary share.

The preferential dividend at the rate of 3.6875% for the period from 1 October 2007 to 31 March 2008 will be paid on 1 April 2008 to holders of preference shares on the register at the close of business on 7 March 2008.

Employment policy

The Group's employment policy reflects our belief that motivated and skilled employees are critical to our success.

We encourage equal opportunities and diversity across the Group. This involves recruiting, engaging, retaining, rewarding and developing people solely on the grounds of ability to do the job, and establishing and promoting a working environment which is free from discrimination.

The Group is committed to the promotion of equal opportunities for all employees including those with a disability. In order to do this, we will ensure that any reasonable adjustment is made, where it is appropriate to do so, to provide equal opportunities to all in respect of recruitment, terms and conditions of employment, promotions, transfers, grievances, redundancies and vocational training. The Group is committed wherever possible, to supporting the rehabilitation and return to work of employees who become disabled during their career with us.

In 2007 the Group entered the Where Women Want To Work Top 50 produced by The Times for the first time. We were one of only three insurers who made it on to the list.

The Group is committed to fostering a constructive dialogue with recognised independent trade unions, ensuring a regular and constructive dialogue on business issues and early consultation on changes affecting the workforce. In the UK, Unite is formally recognised through a partnership agreement which covers collective consultation and bargaining on behalf of non management employees. The Management Association (TMA) represents managerial employees under a separate consultative agreement. The European Consultative Forum (ECF) is a cross European body created to enable information sharing and consultation on transnational issues with the European workforce. Since 2005, an amended constitution has been in place for the European workforce which enables streamlined consultation arrangements.

The Group continues to focus on the development of employees in order to ensure they can deliver high levels of performance. We believe we can create real competitive advantage by building and maintaining a high performance culture across the Group. In 2007, the focus has been on developing leadership talent and capability for today's business needs and those of the future. We have continued to accelerate the development of our in house executive talent, through the Executive Development Programme which enters its fourth year in 2008. We have also introduced robust strategies to build capability and performance in the areas of sales, underwriting, claims and actuarial.

A Groupwide programme was introduced during 2006 looking at sales effectiveness, with the aim of equipping our salesforce with the tools, skills, career pathways, training, reward and recognition that an effective salesforce would expect. This programme has now been rolled out in the UK, Scandinavia, Canada, Ireland, Italy and a number of countries in the

Directors' report continued

Emerging Markets region. The programme will be rolled out in the remaining countries during 2008.

During 2007 a new Graduate Programme was launched. In this first year it focused on technical roles within claims, underwriting and actuarial. The Graduate Programme is aimed at filling the talent pipeline within our technical roles to support the Group's growth objectives. The programme is run as part of the Technical Academy.

A second year of our accelerated career programme, FastTrack, resulted in us hiring 45 individuals who show potential to swiftly build capability to fulfil leadership positions in the Group. Typically three or four years post graduate, these individuals follow a structured career acceleration programme involving a six month overseas assignment to help bring increased exposure to cultural and organisational differences.

Our fourth annual web based Global Employee Survey was run in 2007. 91% of eligible employees took the opportunity to contribute. Our aim is to consistently seek feedback on the environment we are creating as an employer and to work constructively towards our objective of becoming an employer of choice. Our intention is to continue to conduct an annual survey to ensure we have a current picture of employees' views and to track year on year movement in particular areas of priority. In this way we measure how the culture of our business is changing. For example, in 2007 72% of staff felt that 'My job provides the opportunity to learn new skills and develop new talents', an increase of 2% on 2006. As in previous years, we have used the 2007 results to build a Groupwide action plan which requires every manager to identify and work on areas of particular importance to his or her team.

Our policy is to encourage employee share ownership. Employees from a number of our global businesses are encouraged to participate in Sharesave which is an Employee Sharesave Scheme (HM Revenue and Customs approved). This year 44% of UK based eligible employees participated while overseas the average take up rate was 28%, which was a significant increase on previous years.

Employees are kept well informed of the overall performance and objectives of the Group.

The Group actively encourages employees to become involved in supporting their local communities. Further details are provided in the corporate responsibility report on pages 30 to 31.

Environmental programme

Details of our environmental programme can be found on our website at **www.rsagroup.com**.

Supplier payment policy

It is the Company's policy to agree appropriate terms and conditions in advance with its suppliers and to make payment in accordance with those terms and conditions, provided the supplier has complied with them. In most cases, agreements for the supply of goods or services are made under the Group's standard terms of contract that lay down payment terms. In the UK these are available on request from UK Procurement, Leadenhall Court, 1 Leadenhall Street, London EC3V 1PP.

The Company's outstanding indebtedness to trade creditors on 31 December 2007 amounted to £5.6m corresponding to 20 days' payment when averaged over the year.

Share capital

During the year, 12,448,823 ordinary shares of 27.5p each were issued in satisfaction of the exercise of employee share options for a total consideration of £9m, and 66,632,200 ordinary shares of 27.5p each were issued under the Company's scrip dividend scheme for a total consideration of £100m. On 24 May 2007 the Company placed 186,350,000 ordinary shares of 27.5p each, raising gross proceeds of approximately £300m. The placing was part of the financing in respect of the recommended offer to purchase the shares in Codan A/S not already held by the Group.

The Company can increase its share capital and authorise the directors to allot further securities by ordinary resolution. As at 31 December 2007, the directors had authority to allot securities up to a nominal amount of £432,165,676.

The Company may purchase any of its own shares (including any redeemable shares). An authority from shareholders for the Company to purchase up to 298,848,845 of its own ordinary shares (representing 10% of its issued share capital as at 22 March 2007) remained in force at 31 December 2007.

Rights and obligations attaching to shares

The rights attaching to the ordinary shares and preference shares are set out in the Company's Articles of Association (the 'Articles'). Details of the rights and obligations attaching to shares as at 31 December 2007 are incorporated into this report by reference and are set out in note 18 on pages 96 to 97.

The Articles may be amended subject to shareholder approval by special resolution at a general meeting of the Company. We are proposing to amend the Articles at the 2008 AGM, further details of which are set out in the Notice of AGM.

Employee Benefit Trusts

The Company operates the Royal & SunAlliance ESOP Trust, the Royal & SunAlliance ESOP Trust No. 2 and the Royal & SunAlliance ESOP Trust No. 3 (the 'Trusts'). In each case, the trustee is Lloyds TSB Offshore Trust Company Limited. In respect of any shares held in the Trusts, the trustee may vote in respect of those shares, but is not obliged to. In respect of the Royal & SunAlliance ESOP Trust No.3, the trustee may have regard to the financial interests of the beneficiaries in exercising its voting rights over the Company's shares.

Substantial share interests

At the date of this report we have been notified, in accordance with the Disclosure and Transparency Rules, of the following interests in the ordinary share capital of the Company:

	Number of shares in which there is a direct interest	Number of shares in which there is an indirect interest	Interest in issued share capital
AXA S.A.	24,458,659	214,735,733	7.35%
Goldman Sachs Asset Management	–	192,491,038	5.92%
Legal & General Group plc	159,445,835	–	4.90%
Schroders plc	–	147,476,133	4.53%
Standard Life Investments	108,621,140	17,201,130	3.87%

Directors

The names of the directors, together with biographical details are set out on page 34.

Details of the directors' service contracts and terms of appointment, together with their interests in the Company's shares are shown in the remuneration report on pages 45 to 56.

Details of directors' powers are set out in the corporate governance report on page 40 and are incorporated into this report by reference.

Directors' indemnity

Article 154 of the Company's Articles provides that, among other things and insofar as permitted by law, every director shall be indemnified by the Company against all costs, charges, expenses, losses or liabilities incurred in the execution and discharge of the director's duties, power or office.

Since 12 July 2006, the Company has granted an indemnity to each of the directors pursuant to the power conferred by Article 154. The indemnities granted constitute qualifying third party indemnity provisions (as defined by section 234 of the Companies Act 2006). The Board of Directors (the 'Board') believes that it promotes the success of the Company to provide this indemnity to its directors in order to ensure that the Group attracts and retains high calibre directors through competitive terms of employment in line with market standards.

Directors and officers of the Company and its subsidiaries also have the benefit of an insurance policy which provides suitable cover in respect of legal actions brought against the directors.

None of the directors had any interest in any other contract with the Company or any of its subsidiaries during 2007.

Related party transactions

Related party transactions are set out in note 32 on page 115.

Charitable and political contributions

The Company and its subsidiaries worldwide made charitable donations of £2,370,003 during the year. The largest contribution of £251,935 was made for the Danish life buoy programme promoting safety around water.

The Group did not make any donations to European Union (EU) political parties nor to political parties outside the EU during 2007, and it is not the Group's policy to do so.

Annual General Meeting

The AGM will be held at the Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE on Monday, 19 May 2008 at 11.00 am.

Enclosed with this report is a letter from the Chairman to shareholders. Attached to the letter is the Notice convening the AGM which will include items of ordinary and special business as detailed in the Notice.

Change of name

It is proposed that a resolution be put to the shareholders of the Company at the 2008 AGM that the name of the Company be changed to RSA Insurance Group plc.

Auditors

So far as each director is aware, there is no relevant audit information (as defined in section 234ZA(3) of the Companies Act 1985) of which the Company's auditors are unaware, and each director has taken all steps that he or she ought to have taken as a director in order to make himself or herself aware of, and to establish that the auditors are aware of, any relevant audit information.

Deloitte & Touche LLP have confirmed their willingness to continue in office as auditors of the Company for the year ending 31 December 2008. A resolution for their reappointment will be proposed at the 2008 AGM.

Going concern

The directors have satisfied themselves that the Group has adequate resources to continue in operation for the foreseeable future having given consideration to the uncertainties and contingencies disclosed in the financial statements and have therefore prepared the financial statements on a going concern basis.

By order of the Board
Mark R Chambers
General Counsel and Group Company Secretary
26 February 2008

Corporate governance

This report sets out the Company's approach to corporate governance in 2007. The report has been prepared in accordance with the Code of Best Practice set out in section 1 of the 2006 FRC Combined Code on Corporate Governance (the 'Combined Code') and sets out the extent of our compliance with the Code.

Compliance with the Combined Code

Throughout 2007 the Group has complied with the Principles and Provisions of the Combined Code except that the Group has not appointed a senior independent director. The non-executive directors have a unanimous view that the appointment of a senior independent director is not appropriate at this time. All non-executive directors are encouraged to communicate directly with executive directors and senior management outside of formal meetings and an active dialogue is maintained by the Board.

The Board

The Board is accountable to shareholders for the creation and delivery of strong sustainable performance and the creation of long term shareholder value. The Board meets regularly and is responsible for organising and directing the affairs of the Company and the Group in a manner that will promote the success of the Company and is consistent with good corporate governance practice, and for ensuring that in carrying out its duties the Company and the Group meet legal and regulatory requirements. The Board is also responsible to the Financial Services Authority (FSA) for ensuring compliance with the Group's UK regulatory obligations.

The business of the Company is managed by the directors, who may exercise all the power of the Company subject to the Articles of Association (the 'Articles'), relevant law and any directions as may be given by the Company in general meeting by shareholder resolution. The directors may delegate any of their powers or discretions to committees.

A director must not vote in respect of any contract or other proposal in which he (or any person connected with him) has a material interest otherwise than by virtue of his interests in securities of the Company. However, a director shall be entitled to vote in certain limited circumstances which are set out in full in the Articles. Amendments are being proposed to the Articles at the 2008 AGM regarding directors' conflicts of interest in line with the Companies Act 2006. Further details are set out in the notice of AGM.

The directors restrict the borrowings of the Company so that the aggregate amount, for the time being, remaining borrowed by the Group is not, without the previous sanction of an ordinary resolution of the Company, more than one and a half times the aggregate of:

- The amount paid up on the issued share capital of the Company
- The total of the capital and revenue reserves of the Group (subject to certain adjustments).

The specific duties of the Board are clearly set out as a formal schedule of matters specifically reserved to it, which can only be amended by the Board itself and which is reviewed annually. Matters reserved to the Board include:

- Approval of the Group's long term objectives and commercial strategy
- Approval of changes to the Group's senior management structure
- Approval of the Group's overall risk appetite
- Annual review of the effectiveness of internal control arrangements
- Approval of the annual operating and capital budgets
- Changes to the Group's capital structure
- Approval of the Group's financial results and any significant changes to accounting practices or policies.

The Board met 13 times during the year ended 31 December 2007. The attendance of directors at meetings of the Board and at Board Committees of which they were members during the year is set out below:

	Notes	Board meetings	Board Committee	Group Audit Committee	Nomination Committee	Remuneration Committee	Investment Committee	Board Risk Committee
Total number of meetings in the year	1	13	6	7	4	5	2	5
George Culmer		13	6				2	5*
Noel Harwerth		12		6			2	
Andy Haste		13	6				2	5
Edward Lea		11		7*		5	2	
Simon Lee	2	12						
Malcolm Le May		11				4	2*	
John Maxwell		13		6	4	5*	2	
Bridget McIntyre		13						
John Napier		13*			4*		2	

*Chairman of the Board or board committee

Notes

1. In addition to attendance as above, Andy Haste and George Culmer regularly attend, by invitation, meetings of the Group Audit Committee (GAC) and Andy Haste regularly attends meetings of the Remuneration Committee.
2. Simon Lee agreed not to attend the Board meeting on 21 May 2007 due to the business of the meeting creating a potential conflict with his interests as a director of Codan A/S.

Board balance and independence

Details of the directors who served during the year can be found on page 34.

At all times during the year, at least half of the Board, excluding the Chairman, comprised non-executive directors. All non-executive directors have been determined by the Board to be independent. The Chairman meets regularly with the non-executive directors both individually and collectively without the executive directors being present. The Chairman met the independence criteria of the Combined Code on his appointment in 2003 and continues to meet the criteria set out in the Code. There have been no changes to his external commitments since then which might affect his responsibilities to the Group. None of the executive directors serve on the board of another FTSE 100 company.

Directors have access to the services and advice of the General Counsel and Group Company Secretary and in addition may take independent professional advice at the expense of the Company in furtherance of their duties.

Appointments to the Board

The directors and the Company (by ordinary resolution) may appoint a person who is willing to be a director either to fill a casual vacancy or as an additional director. A director who is appointed by the directors shall retire at the following AGM and will put himself forward to be elected by the shareholders. In accordance with the Company's Articles and the Combined Code, the directors submit themselves for reappointment at the first AGM after their appointment and for re-election every three years thereafter. There are no directors retiring by rotation at the 2008 AGM. The Company may (by ordinary resolution of which special notice has been given) remove any director before the expiration of his period of office.

Nomination Committee

During the year the Nomination Committee was chaired by John Napier. The other member of the Committee was John Maxwell. Malcolm Le May was appointed to the Committee on 19 December 2007. The attendance record of directors during 2007 is shown in the table above. The Committee met four times during 2007.

The Nomination Committee's principal duties are to review the structure, size and composition of the Board and to evaluate the directors' skills, knowledge and experience. When appointing new directors, regard is given to the size of the Board and the balance of executive and non-executive directors as well as the skills and experience already represented by the existing Board members, and those which would be desirable on the Board going forward. The Committee has access to external recruitment consultants in order to help fill any vacancies. The Committee considers the leadership needs and succession planning of the Board when making decisions on new appointments. Resolutions to re-appoint directors at the AGM are subject to the approval of the Board, taking into account the recommendations of the Nomination Committee.

Corporate governance continued

Induction and professional development

Directors undertake an induction programme and will receive a range of information about the Company when they join the Board. This includes background information on the Group and details of board procedures, governance issues and directors' responsibilities. The induction programme also includes a series of meetings with members of the Board and various briefings and presentations regarding the business from executives.

Development and training for the directors is an ongoing process which includes briefings on legislative changes and on corporate governance issues. Directors also receive regular presentations about the Company's operations and there are regular discussions on strategy, customer marketing and employee satisfaction. Opportunity is also created for non-executive directors to make informal visits to different parts of the Group and to meet with local management.

Performance evaluation

In 2007 the Board undertook an annual evaluation of its performance to assess how well the Board, its committees and the directors were performing. The review included the use of a comprehensive questionnaire. Responses from the questionnaire were collated and subsequently discussed by the Board. Strong positive feedback on the workings of the Board was received and potential improvements identified through the evaluation process will be implemented.
The non-executive directors are responsible for the evaluation of the Chairman's performance and take into account the views of the executive directors in their evaluation. As part of the ongoing performance evaluation process the Chairman has regular one to one meetings with all the non-executive directors.

Chairman and Chief Executive Officer (CEO)

The roles of the Chairman and the Group CEO are separate, with responsibilities clearly divided between them. This separation of responsibilities is formalised in role statements which have been approved by the Board.

The Chairman is responsible for leading the Board, liaising as necessary with the Group CEO on developments between Board meetings and ensuring that both the Group CEO and his executive management team have appropriate objectives and that their performance against those objectives is reviewed. The Group CEO is responsible to the Board for the executive management of the Group and for liaising with the Chairman and keeping him informed on all material matters.

Remuneration

Details of the directors' remuneration and the Group's policies on remuneration are set out in the remuneration report on pages 45 to 56.

Financial reporting

The directors are required to ensure that adequate accounting records are maintained so as to disclose at any time, and with reasonable accuracy, the financial position of the Group. They are also responsible for taking reasonable steps to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The directors must present financial statements for each financial year, in accordance with applicable law, accounting standards and regulations, which give a true and fair view of the state of affairs of the Group and of the profit or loss and cashflows for that period. Financial statements for the Group are prepared in accordance with International Financial Reporting Standards (IFRS), the Companies Acts 1985 and 2006 and Article 4 of the IAS Regulations.

In preparing such financial statements the directors are required to:

- Select suitable accounting policies and apply them on a consistent basis using reasonable and prudent judgement
- State whether or not applicable accounting standards have been followed and explain any material departures
- State whether the Group financial statements have been prepared in accordance with IFRS
- Use the going concern basis unless it is inappropriate to do so.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

Internal control

The Board has overall responsibility for the Group's internal control systems and for monitoring effectiveness. Implementation and maintenance of the internal control systems are the responsibility of the executive directors and senior management. The performance of internal control systems is reviewed regularly by the Group Audit Committee (GAC).

The Board reviews annually the effectiveness of the Group's systems of internal control in order to safeguard the Group's assets and shareholders' investment. This system includes governance, financial controls, the risk management framework and operational, regulatory and compliance requirements. The systems are designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material financial misstatement or loss. Following the review of the internal control systems, the Board confirms that the actions it considers necessary to rectify any significant failings or weaknesses identified as a result of the review have been, or are being, taken.

The Board, through the GAC, receives reports from the Group Director, Audit, Risk and Compliance and his team on the integrity of the control environment and also receives reports from the external auditors based upon their audit work. The GAC also receives reports on the Group's arrangements for ensuring regulatory compliance. The Board, through the Board Risk Committee (BRC), considers reports from risk specialists (both internal and external) to the Group, and reviews Group level risk management information.

Each quarter there is a self certification process completed by business managers across the Group to confirm the adequacy of controls and their compliance with Company policies, laws, rules and regulations.

The Board considers that the current reporting framework delivers sufficient information to monitor the systems of internal control and to review their effectiveness as required by the Combined Code. The Board therefore considers that an ongoing process for identifying, evaluating and managing the significant risks faced by the Group has been in place during 2007 and up to the date of approval of the Annual Report and Accounts. This process is regularly reviewed by the Board and accords with the Turnbull Guidance on the Combined Code.

Further detail on the overall risk framework is set out on pages 27 to 29.

Group Audit Committee

The GAC is chaired by Edward Lea who has been Chairman of the Committee since October 2003. The other members of the Committee are Noel Harwerth and John Maxwell. In 2007, the Committee met seven times. The attendance record of directors in 2007 is shown in the table on page 41. The Committee is comprised of independent non-executive directors who have recent and relevant financial experience. The Group CEO, Chief Financial Officer, Group Director, Enterprise Risk Management and the Group Director, Audit, Risk and Compliance are regular attendees. The Chairman and other members of executive management are also invited to attend from time to time. The outcomes of meetings are reported to the Board and the Board receives the minutes of all GAC meetings.

The GAC's principal duties are as follows:

- To coordinate and have oversight of the Group's financial reporting process
- To monitor compliance
- To have oversight of internal and external audit functions
- To manage the systems of internal controls
- To review all matters relating to the legal integrity of the Group
- To provide assurance on the effectiveness of the Group's risk management.

The GAC has unrestricted access to Company documents and information, as well as to employees of the Company and the external auditors.

The GAC meets regularly with internal and external auditors without management present. The partner of the Group's external auditors, who is responsible for the external audit, attends meetings regularly. Each year, the GAC considers the performance of the external auditors prior to a resolution on their reappointment and remuneration at the AGM.

External auditors

During the year, Deloitte & Touche LLP were, on a number of occasions, engaged as advisors. In order to maintain their independence, such appointments are only made in accordance with a protocol developed by the GAC. This gives guidance to businesses within the Group on the appropriateness of engaging the Group's external auditors as advisors and sets down the procedures to be followed to authorise such an engagement. The GAC is satisfied that this protocol has been followed and there are no matters that would compromise the independence of the auditors or affect the performance of their statutory duties.

The Board has accepted the GAC's recommendation that a resolution be put to the 2008 AGM for the reappointment of Deloitte & Touche LLP as external auditors.

It is the GAC's responsibility to keep the procedures laid out in the Group whistleblowing policy under review. This policy deals with employees who wish to raise serious concerns in good faith, and either do not feel comfortable raising the matter with local management or are not satisfied with the local management response. They can raise their concerns with the Group Director, Audit, Risk and Compliance, who will either investigate or arrange for an investigation of the matter. Employees are offered such safeguards and support as may be necessary to protect their personal integrity and, where possible, identity.

Key features of the current internal control systems of the Group include:

Internal audit

The Group has an internal audit function, whose activities and effectiveness are monitored and reviewed by the GAC. The GAC is responsible for ensuring that adequate access to information and resource is given to the Group Director, Audit, Risk and Compliance and for approving the appointment to, and removal of the holder from, that position.

The Board Risk Committee

The BRC, which meets at least quarterly, is chaired by George Culmer, Chief Financial Officer. The BRC also comprises the Group CEO and other members of executive management. The Committee is authorised by the Board under its terms of reference to manage all risks faced by the Group. The Board approved Group risk appetite is set by reference to policies, control limits and other mechanisms. The Committee's principal duties include:

- Defining the Group's risk appetite prior to approval by the Board
- Approval of policy and minimum standards that are consistent with the risk appetite
- Ensuring that risks that are outside the appetite are mitigated in an appropriate manner
- Overseeing and challenging the Group's risk management processes.

Corporate governance continued

Investment Committee

The Investment Committee is chaired by Malcolm Le May, meets twice a year and comprises all of the non-executive directors, the Group CEO and the Chief Financial Officer. The Committee assists the Board in setting the Group's investment strategy and monitors the execution of that strategy and the Group's investment performance.

Financial control framework

In 2006 the Company voluntarily delisted from the New York Stock Exchange and terminated its American Depository Receipt (ADR) programme. In January 2007 the Company suspended its US SEC registration and its reporting obligations to the SEC also ceased at that time. The registration was permanently terminated on 31 December 2007. As a result of the SEC deregistration, the Company is no longer required to be compliant with the US Sarbanes Oxley Act 2002. However, the elements of Sarbanes Oxley compliance which have added value have been carried forward in the Group's financial control framework.

Corporate governance framework

The Group's corporate governance framework describes and prescribes how the Group is directed and managed by setting out the matters reserved for the Board, the terms of reference of the Board and management committees, role statements, policies, systems, procedures and controls.

The terms of reference for key committees of the Board explaining their role and the authority delegated to them are available on the Company's website **www.rsagroup.com** or on request from the General Counsel and Group Company Secretary.

Delegated authorities

The Group operates a Delegated Authority Policy which specifies how executive authority is delegated from the Board to the Group CEO and on to other executives in the Group. Individual executive licences set out specific limits of authority in terms of entering into financial, underwriting and other business commitments. Each executive is responsible for ensuring a similar process of delegation is in place within their area of responsibility.

Dialogue with institutional shareholders

The Board attaches considerable importance to its relationships and communication with shareholders. Senior management meet principal institutional shareholders on a regular basis and small shareholder groups on request and non-executive directors are available to meet with institutional shareholders as required. In addition, investor relations events are held during the year to increase shareholders' understanding of the business.

Constructive use of the Annual General Meeting

All shareholders are invited to attend the Company's AGM. The AGM Notice is despatched to shareholders at least 20 working days before the meeting and contains separate resolutions on each substantive issue including a resolution to adopt the Annual Report and Accounts. All directors are requested to attend each AGM. The Chairman and the chairmen of the Group Audit, Nomination and Remuneration Committees make themselves available to take questions from shareholders at and after the AGM.

Any form of proxy sent by the Company to shareholders in relation to any general meeting must be delivered to the Company, whether in written form or in electronic form, not less than 48 hours before the time for holding the meeting (or in the case of a poll taken otherwise than at or on the same day as the meeting, not less than 24 hours before the time appointed for the taking of the poll).

At any general meeting every shareholder present shall have one vote on a show of hands, and on a poll every shareholder present in person or by proxy shall have one vote for each share of which he is the holder. In the case of an equality of votes, whether on a show of hands or on a poll, the chairman of the meeting shall be entitled to a casting vote. All resolutions were put to a poll at the AGM in 2007. Voting at the AGM is conducted electronically, with the results being announced to the London Stock Exchange and on the Company's website.

By order of the Board
Mark R Chambers
General Counsel and Group Company Secretary
26 February 2008

Remuneration report

The following report by the Remuneration Committee has been approved by the Board for submission to the shareholders at the 2008 AGM.

Deloitte & Touche LLP have audited the following items stipulated in law for their review:

- The table of directors' remuneration and associated footnotes on page 52 and the disclosure of the items comprising benefits in kind
- The tables of defined benefit and defined contribution pensions on pages 52 to 53 and associated footnotes
- The table of disclosure of directors' share options and share awards on pages 53 to 56 and associated footnotes.

In constitution and operation the Committee complies fully with the Combined Code as appended to the Listing Rules of the UK Listing Authority and as described in the corporate governance section of this report, on page 40.

Principal duties of the Remuneration Committee

The Committee is a formal committee of the Board and is accountable to shareholders through its annual remuneration report, which is voted on at the AGM, and remains committed to reflecting the best interests of shareholders and to the pursuit of best practice in remuneration policy.

The Committee's principal duties are as follows:

- The determination of the terms and conditions and remuneration of the Chairman of the Board and the executive directors
- Overseeing the operation of the Company's share based long term incentive schemes, including approving the value and timing of awards and overseeing the operation of performance conditions
- Consideration of, and advice to the Board on, the Group's broader remuneration policy in relation to senior executives reporting to the Group CEO (the 'Executive Team').

The Committee presents a summary of its principal activities to shareholders through this report, and the Committee Chairman attends the AGM to answer questions from shareholders on the activities of the Committee and its remuneration policies.

The Committee's responsibilities are set out in its terms of reference which are available to shareholders on request and on our website at **www.rsagroup.com**. The Committee welcomes ongoing dialogue with shareholders on remuneration policy.

Membership of the Remuneration Committee

During the year the directors who served on the Committee were John Maxwell (Chairman), Edward Lea and Malcolm Le May. All of the non-executive directors on the Committee were determined by the Board to be independent. The attendance of members in 2007 is shown in the table on page 41.

Members of the Committee have no personal financial interest, other than as shareholders, in the Committee's decisions and they have no conflict of interest arising from cross directorships. Fees for serving as a committee member and chairing committees of the Board are described in the non-executive directors section of this report on page 52.

Advisors to the Remuneration Committee

In developing remuneration strategy during the year, the Committee obtained its principal advice from New Bridge Street Consultants LLP, who were appointed by the Committee and provided no other services to the Company during 2007.

The terms of engagement for the remuneration consultants are available to shareholders on request and on our website at **www.rsagroup.com**.

The Group CEO is invited to attend all meetings of the Committee to provide context and advice to the Committee on Group strategy and performance and senior executive pay strategy. The Group Human Resources Director normally attends meetings to provide information on wider remuneration strategy and practice within the Group. The Chairman is invited to attend meetings as appropriate. The General Counsel and Group Company Secretary acts as secretary to the Committee. None of the non Committee attendees are present as of right, and do not attend when their own remuneration is discussed.

Activities of the Remuneration Committee

The continuing focus of the Committee is the maintenance of a strong link between performance and reward. It is the Committee's view that the interests of shareholders are best served by ensuring a remuneration structure which has a significant element of performance related pay, and reinforces the culture of high performance and accountability that applies at all levels throughout the Group.

The Committee meets as often as necessary throughout the year to ensure that it is able to fully report to the Board and shareholders on all relevant matters. In 2007, the Committee met five times and the principal business of those meetings included the following activities:

- The determination of performance conditions, and approval of awards, under the Long Term Incentive Plan (LTIP)
- Conducting the annual review of base salaries for executive directors and the Group CEO's recommendations for his Executive Team, and making appropriate recommendations to the Board
- The consideration and approval of annual bonus payments for 2006
- The review of actual performance of the executive directors in 2006 against agreed goals and objectives
- The review of proposed annual objectives and performance goals of executive directors for 2007
- The ongoing review and monitoring of performance conditions and reports on performance for awards under the Share Matching Plan and various share option grants
- The ongoing review of share incentives generally, including the approval of changes of an administrative or regulatory nature

Remuneration report continued

- The determination of initial remuneration arrangements for Executive Team members who joined the Group in 2007
- The determination of termination arrangements for those members of the global 'Top 100' (the Top 100) who left the Group in 2007
- A review of the Committee's terms of reference
- The drafting of the remuneration report for the Annual Report and Accounts 2007.

Remuneration policy principles

The Committee's remuneration policy is consistent with the high performance culture across the Group. The key principles which underpin the remuneration policy are:

- Total remuneration is set at a level which enables the recruitment, retention and motivation of high quality executive talent
- There is a strong and visible link between remuneration and performance
- Executive remuneration and shareholder interests are strongly aligned. This is reflected in the design of the LTIP, which provides a co-investment opportunity
- The observation of existing share ownership guidelines to further enhance the alignment of shareholder interests with those of executive directors
- Incentive arrangements are leveraged so that only exceptional performance attracts the highest levels of award
- A balance of short and long term performance is used, incorporating measures of financial performance, delivery of shareholder value and a robust assessment of personal contribution
- Remuneration policy and practice is transparent to shareholders
- That, where relevant, there is consideration of environmental, social and governance risks when determining remuneration for executive directors and senior managers to ensure that positive behaviours are reinforced.

Elements of remuneration

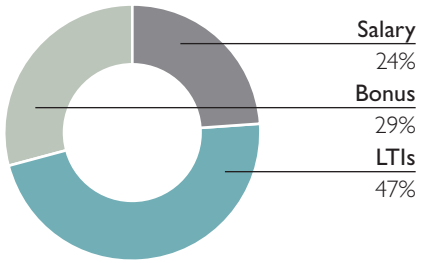
Remuneration for executive directors in 2008 will consist of the four principal elements described in the table below, of which only base salary is pensionable:

Remuneration	Purpose	Delivery	Policy detail
Base salary	To reflect the market value of the role and the skills and experience of the individual	• Cash • Monthly • Pensionable	• Reviewed annually, changes effective from 1 April • Benchmarked against a selected group of FTSE 100 financial services companies • Positioned appropriately against similar roles, with reference to the median position of similar roles in the comparator companies
Annual performance bonus	To incentivise the delivery of annual goals at Group, business area and individual levels	• Maximum opportunity of 133% of base salary • Up to 100% of annual base salary is paid as cash • Up to 33% of base salary is awarded in the form of compulsorily Deferred Shares under the LTIP • Annual • Non pensionable	• Financial targets are measured against combined operating ratio for Group and business areas • Individual targets are approved by the Remuneration Committee • Up to 33% of cash bonus paid may be reinvested in voluntarily Deferred Shares under the LTIP
LTIP	To reward the creation of sustained growth in shareholder value	• Performance shares subject to stretching performance conditions • Matching shares awarded linked to Deferred Shares, also subject to performance conditions • Annual awards that may vest after three years • Non pensionable	• Discretionary awards • Participation reviewed annually • TSR performance measured against a peer group of companies, together with an ROE measure • Full details of performance measures and vesting described on page 56
Pension	To provide appropriate and competitive post retirement benefits	• Deferred income • Paid monthly	• Defined benefit scheme or defined contribution scheme, and/or cash allowance in lieu of pension contributions

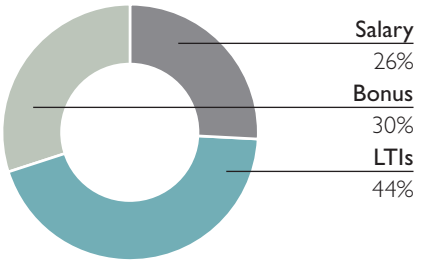
This structure is replicated for other members of the Executive Team.

As an indication of the balance of remuneration, including long term incentives (LTIs), the following charts illustrate the remuneration attributable to the executive directors over the year (excluding allowances and pension provision):

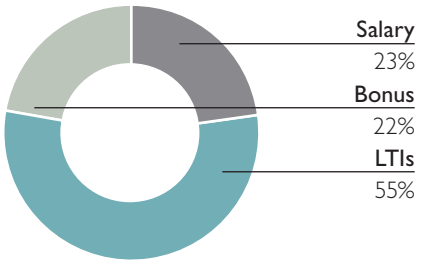
Andy Haste



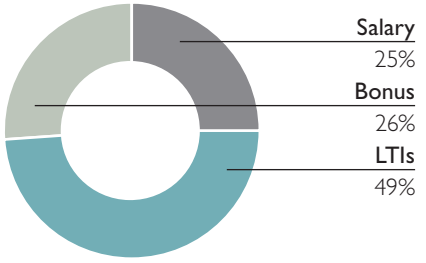
George Culmer



Simon Lee



Bridget McIntyre



For the purposes of the charts, the bonus value is based on the cash bonus plus the fair value of the compulsory Deferred Shares. The LTI value is based on the fair value of awards of Performance Shares and half of the maximum potential number of Matching Shares that may vest (subject to performance) relating to voluntary and compulsory Deferred Shares under the LTIP. Details of how the fair values have been calculated are set out in note 27 on page 111.

Base salary

Policy: Base salary is set with reference to the median level for equivalent roles in similar companies.

Base salaries for executive directors and members of the Executive Team are set on appointment with reference to market data. To enable the Group to compete for the most talented executives, the Committee relates base salary levels to the median level for equivalent roles in similar companies facing similar levels of complexity and challenge in the UK and internationally. In the UK, the comparator group most frequently used is a selected group of financial services companies within the FTSE 100.

The Committee is alert to market concerns surrounding base pay increases and closely monitors basic pay (and total remuneration) for executive directors in the light of both the market and individual and corporate performance. The Committee is confident that the structures and processes in place for reviewing annual salary increases are robust.

Base salaries are primarily reviewed on the basis of market movements. The Committee analyses the remuneration details of a comparator group comprising 14 FTSE 100 financial services companies and awards salary increases with reference to the median position for equivalent roles in that group.

The 2007 salary review process resulted in the following increases, effective from 1 April 2007, for the executive directors (as at 31 December 2007):

	Position	Increase	Base salary
Andy Haste	Group CEO	6.2%	£855,000
George Culmer	Chief Financial Officer	8.6%	£480,000
Simon Lee	International CEO	6.0%	£371,000
Bridget McIntyre	UK CEO	6.1%	£390,000

The following table sets out the base salaries of UK based executives below Board level on a banded basis as at 31 December 2007. No such executive received a base salary in excess of £350,000.

Base salary range	Number of employees
£250,001 and over	8
£200,001 – £250,000	9
£150,001 – £200,000	34

Remuneration report continued

Annual performance bonus

Policy: Bonus payments are related to stretching performance targets and are capped at 133% of base salary. For maximum bonuses to be achieved outstanding performance must be demonstrated.

The executive directors and the Executive Team participate in an annual bonus plan. If stretching targets are achieved, participants receive a cash bonus of up to 50% of base salary and Deferred Shares worth up to 16.5% of base salary. For outstanding performance, a cash bonus of up to 100% of base salary and Deferred Shares worth up to 33% of base salary are achievable. Deferred Shares are described in the section headed share based long term incentive awards below.

The targets used for determining the amount of bonus payable are a combination of stretching business performance targets and the results of a structured assessment of each executive's performance against detailed and specific personal objectives.

Financial targets are measured against combined operating ratio (COR) targets which are the preferred measures for the Group. COR is the single indicator which most fully captures the underlying strength and performance of an insurance business. To achieve focused incentivisation, for each executive director financial targets are weighted towards the area of the business for which they have primary responsibility.

The financial targets that apply to the annual performance bonus for Andy Haste and George Culmer are a combination of targets relating to the overall Group COR result and the COR results of the regional operating businesses. The financial targets for Bridget McIntyre's and Simon Lee's annual performance bonus are weighted towards the UK and International businesses respectively while also retaining a target for the Group COR result as a whole.

Personal targets are reviewed and approved by the Committee early in the financial year. The Group CEO's performance is assessed annually by the Chairman of the Board and members of the Committee. The Group CEO carries out a similar assessment for each of his direct reports, subject to review and sign off by the Committee in the case of executive directors. Assessments also take account of appropriate leadership style and each executive receives a performance rating against the standard scale used at all levels in the business.

Bonuses paid to executive directors in respect of the performance year 2007 are included in the table of directors' emoluments on page 52. The Remuneration Committee is satisfied that the bonus payments made in respect of 2007 reflect the consistently strong COR results across the Group throughout 2007, and the contribution made by each executive director.

UK based executives who are members of the Top 100 participate in a bonus plan which is structured in the same way and measured using the same metrics as the plan described above. For outstanding performance a cash bonus of up to 65% of base salary and Deferred Shares worth up to 33% of the cash bonus are achievable.

Executives are also offered the opportunity to voluntarily invest up to 33% of the cash element of their bonus into Deferred Shares. In 2007 (under the LTIP), an award of Matching Shares was made on a pro rata basis to the Deferred Shares. Matching Shares may vest subject to the performance conditions described on page 56 of this report.

The Committee reserves the right to reduce the permissible investment below this level. However, the LTIP will continue to operate on the same terms in 2008.

Share based long term incentive awards

Policy: To provide annual share awards to executives to ensure alignment with shareholder interests solely through the LTIP. Except in exceptional circumstances, no other discretionary share plan will be used to make awards.

Prior to the approval of the LTIP, two share incentive plans were operated:

- The 2004 Share Matching Plan, which was designed to operate for two years. The final awards under this plan were made in 2005
- The Executive Share Option Scheme (ESOS). Regular awards under the ESOS were discontinued from 2006, but the ESOS remains available for use in exceptional circumstances, such as executive recruitment.

The primary long term incentive is the LTIP, the key features of which (and associated policies) are summarised in the sections below.

Awards under the LTIP will be funded through a combination of new issues and shares purchased in the market.

Conditional awards of Performance Shares

Participants may receive a conditional award of shares with the grant level and performance condition determined by the Committee prior to each grant. Executive directors, members of the Executive Team and the Top 100 will be eligible for awards of Performance Shares.

It is intended that, in 2008, awards of Performance Shares to executive directors will be limited to a maximum face value of 100% of base salary, other than in exceptional circumstances. Awards of Performance Shares to members of the Executive Team in 2008 will be limited to a maximum face value of 80% of base salary, other than in exceptional circumstances. Account will be taken of personal performance in determining the scale of the award to each executive. For executives below this level, awards are made based on a formula which relates the size of award to performance and potential, as measured through the annual performance appraisal process.

In any year, the face value of Performance Shares granted to any individual will be limited to 150% of base salary in normal circumstances subject to an overriding cap of 250% of base salary in exceptional circumstances such as an executive recruitment.

Performance Shares will vest after three years subject to the performance condition (see below) and provided the individual remains in employment with the Group (other than in exceptional circumstances such as death or retirement at normal retirement age).

Deferred Shares

As described in the annual performance bonus section on page 48, executive directors, members of the Executive Team and the Top 100 may be granted Deferred Shares as part of the annual bonus. These Deferred Shares may not be withdrawn and will normally vest three years from the date of grant subject to continued employment with the Group.

In addition executives may invest an additional portion of bonus in Deferred Shares on a voluntary basis. Voluntary Deferred Shares are not at risk of forfeiture and may be withdrawn at any time (but the right to Matching Shares would lapse on those Deferred Shares withdrawn).

Conditional awards of Matching Shares

Executives may receive a conditional award of Matching Shares pro rata to the number of Deferred Shares held. At threshold performance the matching ratio will be 0.625:1. The maximum matching ratio for Matching Shares: Deferred Shares will be 2.5:1, calculated on the gross value of the bonus invested in Deferred Shares. Details of the performance condition used are described below.

Executive directors, members of the Executive Team and the Top 100 will be eligible for awards of Matching Shares.

Matching Shares will vest after three years subject to the performance condition (see below) and provided the individual remains in employment with the Group (other than in exceptional circumstances such as death or retirement at normal retirement age).

Performance conditions

The Committee will determine the performance condition for each grant of Performance Shares and Matching Shares, with performance measured over a single period of three years with no provision to retest. In 2008 grants of Performance Shares and Matching Shares related to non voluntarily Deferred Shares will be subject to a performance condition consisting of a combination of return on equity (ROE) and total shareholder return (TSR) targets. These are set out below:

- 50% of the shares comprising the award will vest according to ROE performance. In line with the positive outlook on the future prospects of the Group, the Remuneration Committee has approved an increase in the ROE performance targets for awards made in 2008. If underlying average annual ROE over three years commencing with the financial year of grant is below 12% (10% for awards made in 2006 and 2007), no part of the award subject to the ROE performance condition will vest. If underlying average annual ROE over three years is 12% (10% for awards made in 2006 and 2007), 25% of the award will vest. If underlying average annual ROE over three years is 18% (16% for awards made in 2006 and 2007), 100% of the award will vest. Vesting will be on a straight line basis in between. Underlying ROE will exclude items of an exceptional nature which in the view of the Committee do not reflect the underlying performance of the business
- 50% of the shares comprising the award will vest according to TSR performance against a comparator group of UK and International financial services companies. Below median performance, no part of the award subject to the TSR performance condition will vest. At median performance, 25% of the award will vest. At upper quintile (top 20%), 100% of the award will vest. Vesting will be on a straight line basis in between
- Additionally, before any shares subject to the TSR condition vests, the Committee must be satisfied that the Company's TSR performance is reflective of underlying financial performance.

The TSR comparator group will consist of the following companies:

Comparator companies:	
Aegon	AXA
Alleanza	Allianz
AVIVA	Baloise
Fortis	Generali
Legal & General	Munich Re
QBE	Swiss Re
Zurich Financial Services	

During 2007, AGF ceased to be listed and will be removed from the comparator group for the purpose of measuring TSR performance for awards made in 2006 and 2007. The Committee reviews, on an ongoing basis, the composition of the comparator group and will consider adding companies for future awards in the event that the number of constituent companies drops below an acceptable level.

The Group's TSR will be independently calculated and verified by the Committee for the purposes of awards made in 2008 under the LTIP.

The vesting of Matching Shares related to voluntarily Deferred Shares will be determined solely by the ROE performance condition.

ROE has been selected as the measure of financial performance as it is one of the key measures of overall business performance and is visible externally to shareholders.

The TSR performance condition has been designed to provide alignment between executive remuneration and shareholder interests and to ensure that an element of the package is linked directly to share price performance. The comparator group has been selected to ensure that performance is compared fairly against a group of similar companies operating in a similar competitive environment. The use of ROE and TSR in combination provides a balanced approach to the measurement of Company performance over the longer term.

Remuneration report continued

Dilution

Dilution levels for all schemes are held strictly within the Association of British Insurers (ABI) limits (10% over 10 years for all schemes and 5% for discretionary schemes). The dilution levels compared to ABI limits as at 31 December 2007 were:

ABI limit	RSA dilution
10% over 10 years for all share schemes:	5.47%
5% over 10 years for discretionary schemes:	3.22%

Share ownership guidelines

Strengthened share ownership guidelines were introduced in 2004 for executive directors and members of the Executive Team.

The Group CEO is required to build and maintain a minimum shareholding in the Company equivalent to 150% of base salary. The other executive directors have a target of 100% of base salary and other members of the executive team have a target of 50% of base salary. In order to ensure that progress is made towards this target, executives are required to retain shares to a value of 50% of the net of tax gain under all executive schemes until the relevant guideline is attained. This requirement will apply to awards under the LTIP, and will continue to apply to awards under all existing long term incentive plans.

The following table shows the number of shares (including voluntary Deferred Shares held under the LTIP) held by each executive director at 31 December 2007 and the increase in shareholding over the year.

	Shares held	Increase	% salary*
Andy Haste	1,070,829	33%	186%
George Culmer	244,407	52%	75%
Simon Lee	177,136	609%	71%
Bridget McIntyre	121,767	388%	46%

*Assuming share price of 148.2p (the closing middle market price on the last dealing day of the year).

Pension provision and other benefits

Policy: Reasonable provision in line with arrangements made in similar companies will be made to allow executives to plan effectively for their retirement but the Committee will not compensate executives affected by the tax limits effective 6 April 2006.

Andy Haste is a member of the SAL Pension Scheme (SAL), a contributory defined benefit occupational pension scheme. In common with all other members of the Group's defined benefit occupational pension schemes, from 1 January 2006 Andy Haste's future benefits within SAL will accrue on a career average revalued earnings basis rather than on a final salary basis. The Group has decided to retain a cap within its defined benefits after 'A Day' and, accordingly, Andy Haste's benefit accrual will continue to be calculated by reference to a 'capped' salary (£112,800 for the tax year commencing 6 April 2007). In addition to his benefits within SAL, Andy Haste receives an age related taxable cash allowance to enable him to make his own provision for retirement above the cap. In 2008 he will be paid an allowance of 28% of base salary for this purpose.

Until 31 December 2005, George Culmer participated in a contributory defined contribution occupational pension scheme (the Royal & SunAlliance UK Pension Scheme 2002). From 1 January 2006 this scheme was replaced by the Royal & SunAlliance Stakeholder Pension Plan (the Stakeholder Plan), a contributory defined contribution stakeholder pension scheme. George Culmer became a member of the Stakeholder Plan from 1 January 2006. In 2008, as in 2007, he will receive employer contributions worth 15% of base salary, subject to an employee contribution of 5% of base salary up to the HM Revenue and Customs annual allowance as applicable. Additionally, George Culmer receives a taxable cash allowance of 15% of base salary, in order to bring his overall pension provision closer to the market median.

Simon Lee elected not to join a Group pension plan on appointment, and receives a taxable cash allowance of 17.5% of base salary instead.

Bridget McIntyre was enrolled in the Stakeholder Plan as from 1 January 2006. In 2008, as in 2007, she will receive employer contributions worth 15% of base salary, subject to an employee contribution of 5% of base salary up to the HM Revenue and Customs annual allowance as applicable. Additionally, Bridget McIntyre receives a taxable cash allowance of 15% of base salary, in order to bring her overall pension provision closer to the market median.

In addition, the executive directors participate in a number of benefits available to other senior managers including life assurance at the rate of four times base salary together with a spouse/dependant annuity, sickness and ill health early retirement benefits and private medical insurance. They also have a choice between a company car and a monthly cash car allowance. In common with other employees, the executive directors are eligible to participate in the Royal & SunAlliance Sharesave plan.

Service contracts

The Committee's policy on service contracts is that they should be subject to a maximum notice period of one year. Generally in the event of termination and in all cases of termination on performance grounds the Committee's policy would be to seek and apply mitigation. None of the executive directors have current terms in their service contracts which allow them additional rights or payment in the event of a reconstruction or amalgamation of the Group.

Director	Effective date of contract	Notice period
Andy Haste	2 April 2003	12 months
George Culmer	1 May 2004	12 months
Simon Lee*	30 April 2003	12 months
Bridget McIntyre	1 November 2005	12 months

*Simon Lee was appointed to the Board effective 1 January 2007. His contractual notice period was extended to 12 months on that date, in line with other executive directors.

Andy Haste's service contract expires under normal circumstances in January 2024. The service contracts for George Culmer, Bridget McIntyre and Simon Lee terminate under normal circumstances in October 2024, July 2023 and March 2023 respectively. These service

contracts may all be terminated earlier by the Company, or the individual, on 12 months notice.

External directorships

Where appropriate, the Group encourages directors and other senior managers to accept, subject to the approval of the Chairman and the Group CEO, an invitation to join the Board of another company in a non-executive capacity, recognising the value of such wider experience. In these circumstances, they are permitted to retain any remuneration from the non-executive appointment. For executive directors and other members of the executive team, external appointments are limited to one . At the date of this report Bridget McIntyre, Simon Lee and Mark R Chambers all held directorships in not for profit organisations.

Non-executive directors

Under the Company's Articles, the remuneration paid to non-executive directors is determined by the Board, within limits set by shareholders. The fee structure for non-executive directors was last reviewed in 2005, and is shown below:

	£
Base fee	45,000
Plus:	
Chairman of Group Audit Committee	20,000
Chairman of Remuneration Committee	12,500
Chairman of Investment Committee	12,500
Additional fee for sitting on more than one committee but not acting as chair of any committee	5,000

Non-executive directors are not entitled to bonus payments or pension arrangements, nor do they participate in the Group's long term incentive plans.

The Committee determines the Chairman's remuneration. The fee payable to John Napier in respect of his appointment as Chairman of the Board is £325,000p.a. until the end of his current term of appointment. The appointment may be terminated by the Chairman on three months' notice to the Company.

Non-executive directors do not have service contracts but each has a letter of appointment. The letters of appointment all request a period of one month's notice should the non-executive director wish to resign.

Non-executive director	Effective date of letter of appointment
Edward Lea	10 July 2003
John Maxwell	10 July 2003
Noel Harwerth	30 March 2004
Malcolm Le May	30 March 2004

All non-executive directors (including the Chairman) are subject to a three year rolling period of appointment in accordance with the Company's Articles.

John Napier's letter of appointment was effective 9 January 2003 and the term of his appointment was initially three years; at the beginning of 2006 it was extended until 31 December 2008.

Historical TSR performance

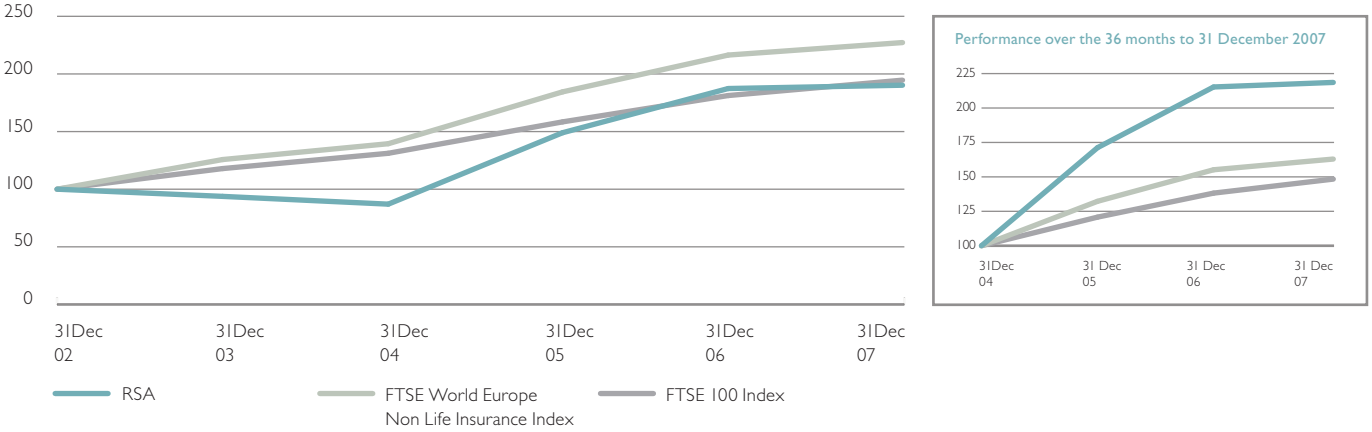
The main graph below is included in the report of the Committee as a requirement of Schedule 7A to the Companies Act 1985.

The graph shows the TSR of the Group with reference to the FTSE World Europe Non Life Insurance Index and the FTSE 100 Index. The FTSE World Europe Non Life Insurance Index comprises the range of European insurance businesses which most closely match our competitor group, and the TSR comparator group selected for 2006 and 2007 awards under the Long Term Incentive Plan. The FTSE 100 Index comprises the 100 most highly capitalised companies, representing approximately 80% of the UK market. TSR performance relative to the indices is shown over the five years from 31 December 2002 to 31 December 2007.

The inset graph shows the TSR of the Group with reference to the same index over the 36 month period ending 31 December 2007.

TSR reflects the change in value of ordinary shares in a company over time, as represented by the evolution of a notional initial investment of £100 in the shares and including any distribution of dividends.

Total shareholder return for RSA and FTSE World Europe Non Life Insurance Index and FTSE 100 Index



Directors' emoluments and interests

Directors' emoluments (audited part)

Remuneration for the year ended 31 December was as follows:

	Notes	Base salary and fees £000	Allowances and benefits £000	Bonuses £000	Total 2007 £000	Total 2006 £000
Executive directors	1					
George Culmer	2	**470**	**98**	**442**	**1,010**	915
Andy Haste	3	**842**	**283**	**787**	**1,912**	1,834
Simon Lee	4	**366**	**82**	**352**	**800**	681
Bridget McIntyre	5	**384**	**80**	**293**	**757**	794
Non-executive directors						
Noel Harwerth		**50**	–	–	**50**	50
Edward Lea		**65**	–	–	**65**	65
Malcolm Le May		**58**	–	–	**58**	58
John Maxwell		**58**	–	–	**58**	58
John Napier		**325**	–	–	**325**	325

Notes

1. 2007 bonuses were calculated as described in the remuneration report on page 48. In 2007 a maximum cash bonus of 100% of salary was achievable.
2. George Culmer received an annual performance bonus of £441,600 in respect of performance year 2007. His allowances include 15% of base salary as a retirement allowance, paid monthly. During 2007 the amount paid was £71,000. He also received car benefits worth £26,000 and medical benefits worth £1,000.
3. Andy Haste received an annual performance bonus of £786,600 in respect of performance year 2007. His allowances include an age related percentage of base salary as a retirement allowance, paid monthly. During 2007 the allowance was 27% and the amount paid was £228,000. He also received car benefits and additional taxable travel benefits worth £45,000 and medical and life assurance benefits worth £10,000.
4. Simon Lee was appointed to the Board effective from 1 January 2007. He received an annual performance bonus of £352,450 in respect of performance year 2007. His allowances also included 17.5% of base salary as a retirement allowance, paid monthly. During 2007, the amount paid was £64,000. He also received car benefits and additional taxable travel benefits worth £17,000 and medical benefits worth £1,000.
5. Bridget McIntyre received an annual performance bonus of £292,500 in respect of performance year 2007. Her allowances include 15% of base salary as a retirement allowance, paid monthly. During 2007 the amount paid was £58,000. She also received car benefits and additional taxable travel benefits worth £21,000 and medical benefits worth £1,000.
6. David Paige resigned as an executive director on 31 December 2006. During 2006 he received total emoluments of £714,000.

Pension benefits (audited part)

Non-executive directors are not entitled to any pension benefits. The pension benefits earned by the executive directors, as members of Group defined benefit schemes, were as follows:

	Change in accrued pension in year £	Total accrued pension at 31 December 2007 £	Transfer value of total accrued pension at 31 December 2007 £	Transfer value of total accrued pension at 31 December 2006 £	Difference in transfer values less member contribution (note 1) £
Andy Haste	**2,043**	**8,811**	**94,190**	68,403	14,871

Notes

1. The difference in transfer values reflects the difference between the two transfer values calculated using relevant information on the respective dates and is not necessarily the actuarial increase of the underlying pension.
2. The figures set out in the table above provide information as required by the Directors' Remuneration Report Regulations 2002. The Listing Rules require the change in accrued pension to be shown excluding the effects of inflation and the transfer value of this increase. These figures are shown in the notes below.
3. The accrued pension figures shown are the annual amounts of member's pension payable from normal retirement age. Increases to pensions when in payment are applied in accordance with the relevant scheme rules. On the death of the member leaving a surviving spouse and/or children, spouse's and/or children's pensions are payable in accordance with scheme rules.
4. The benefits shown above in respect of Andy Haste relate to his membership of a defined benefit pension scheme up to the earnings cap.
5. For Andy Haste the increase in his accrued pension during the year, excluding the effects of inflation, was £1,862p.a. and the transfer value in respect of this less his contributions was £14,323 at 31 December 2007.
6. Andy Haste is required to contribute to the scheme and also has the option of paying Additional Voluntary Contributions (AVCs). Neither voluntary contributions nor the resulting benefits are included in the table.
7. Transfer values have been calculated in accordance with the guidance note GN11 published by the UK Institute of Actuaries and Faculty of Actuaries.
8. The transfer value of the accrued benefits represents the value of assets that the pension scheme would need to transfer to another pension provider on transferring the scheme's liability in respect of Andy Haste's pension benefits. The transfer values do not represent sums payable or due to Andy Haste.

The Company contributions paid in respect of executive directors who are members of Group defined contribution schemes, were as follows:

	Company contributions paid in 2007 £	Company contributions paid in 2006 £
George Culmer	**70,575**	65,504
Bridget McIntyre	**57,656**	63,219

Simon Lee elected not to join a Group pension plan on appointment, and receives a taxable cash allowance of 17.5% of base salary instead.

Shareholdings (non audited part)

The interests of directors in ordinary shares of 27.5p each of the Company, as declared and recorded in accordance with the UKLA Listing Rules, are as follows:

	Notes	Shares held at 31 December 2007	Shares held at 1 January 2007
Executive directors			
George Culmer	1,2	**144,344**	105,138
Andy Haste	1,2	**866,634**	691,274
Simon Lee	1,2	**100,528**	24,983
Bridget McIntyre	1,2	**63,126**	14,937
Non-executive directors			
Noel Harwerth		**10,000**	–
Edward Lea		**416,467**	302,003
Malcolm Le May		**15,360**	–
John Maxwell		**304,251**	261,011
John Napier		**314,265**	300,945

Notes

1. In addition to the interests shown above, the directors indicated, in common with the employees, had a beneficial interest as at 31 December 2007 in 4,938,894 (2006: 4,938,894) ordinary shares of 27.5p each held in the Royal & SunAlliance ESOP Trust No 2.
2. The directors had a beneficial interest as at 31 December 2007 in the voluntary Deferred Shares of 27.5p each held under the Long Term Incentive Plan which are not included in the above table.
3. On 26 February 2008, the directors' interests remained unchanged.

Options (audited part)

Movements in option holdings during 2007 were as follows:

		Options held at 1 January 2007	Options granted during the year	Options exercised during the year	Options lapsed during the year	Options held at 31 December 2007
George Culmer	ESOS	1,994,318	–	–	–	**1,994,318**
	SAYE	12,466	–	–	–	**12,466**
Andy Haste	ESOS	7,573,433	–	–	–	**7,573,433**
	SAYE	23,858	–	–	–	**23,858**
Simon Lee	ESOS	1,355,496	–	–	–	**1,355,496**
	SAYE	23,858	–	–	–	**23,858**
Bridget McIntyre	ESOS	301,724	–	–	–	**301,724**
	SAYE	15,448	–	–	–	**15,448**

Directors' emoluments and interests continued

Options granted following the AGM in May 2003 are potentially exercisable if, at the end of the period of three business years starting with the business year in which the options were granted, the Group has achieved a return on capital (ROC) of at least 6% per annum (after inflation and excluding items of an exceptional nature which in the view of the Committee do not reflect the underlying performance of the business) when averaged over the period. One retest is allowed at the end of the fourth business year, but if the performance criterion has not been met over the full four year period, the options lapse. Options granted between September 1998 and May 2003 are also subject to a performance condition that the Group must achieve a ROC of at least 6% when averaged over a consecutive three year period, but if the measure is not satisfied at the end of the third business year following the date of grant, the test can be repeated on an annual basis over the 10 year life of the option. Options granted between April 1997 and September 1998 were subject to a different performance condition linked to TSR. For options to be eligible for exercise, the Group's TSR has to be at or above the median of companies in the FTSE 100 Index over a consecutive period of three years, between the year of grant and the completion of the 10 year life of the option. The test is conducted twice per year, at the end of March and September, by independent external specialists. None of the terms or conditions of any of the existing options over shares of the Group were varied during the year. Full details of all directors' shareholdings and options to subscribe for shares are recorded in the Group's Register of Directors' Interests which is open to inspection in accordance with the provisions of the UKLA Listing Rules.

The official closing middle market price at its highest during the year was 172.1p per share and at its lowest was 128.3p per share; on the last dealing day of the year it was 148.2p per share.

Options held during 2007 in respect of the ordinary shares of the Company as a result of executive and SAYE share option schemes are as follows:

	Number of options at 1 January 2007	**Number of options at 31 December 2007**	Exercise price (pence)	Dates exercisable from	Dates exercisable to
George Culmer	481,012	**481,012**	79.0	14.06.07	13.06.14
	500,000	**500,000**	76.0	18.11.07	17.11.14
	787,500	**787,500**	80.0	08.04.08	07.04.15
	225,806	**225,806**	93.0	18.08.08	17.08.15
	12,466	**12,466**	75.0	01.12.08	31.05.09
Andy Haste	3,052,915	**3,052,915**	59.0	02.04.06	01.04.13
	1,298,701	**1,298,701**	92.4	16.10.06	15.10.13
	5,917	**5,917**	75.0	01.12.08	31.05.09
	443,037	**443,037**	79.0	14.06.07	13.06.14
	10,643	**10,643**	59.0	01.12.09	31.05.10
	921,052	**921,052**	76.0	18.11.07	17.11.14
	1,443,750	**1,443,750**	80.0	08.04.08	07.04.15
	413,978	**413,978**	93.0	18.08.08	17.08.15
	7,298	**7,298**	75.0	01.12.10	31.05.11
Simon Lee	206,049	**206,049**	114.05	04.06.06	03.06.13
	125,000	**125,000**	92.4	16.10.06	15.10.13
	161,392	**161,392**	79.0	14.06.07	13.06.14
	167,763	**167,763**	76.0	18.11.07	17.11.14
	525,937	**525,937**	80.0	08.04.08	07.04.15
	169,355	**169,355**	93.0	18.08.08	17.08.15
	5,917	**5,917**	75.0	01.12.08	31.05.09
	10,643	**10,643**	59.0	01.12.07	31.05.08
	7,298	**7,298**	75.0	01.12.10	31.05.11
Bridget McIntyre	301,724	**301,724**	116.0	13.12.08	12.12.15
	15,448	**15,448**	106.0	01.12.11	31.05.12

Notes
All of the above options were granted for nil consideration.

Long term incentive schemes (audited part)

Long term incentive scheme interests held during 2007 in respect of the ordinary shares of the Company are as follows:

Share Matching Plan

	Notes		Share awards held at 1 January 2007	Share awards granted during the year	Share awards vested and exercised during the year	Share awards vested but not exercised during the year	Share awards lapsed during the year	Share awards held at 31 December 2007	Dates by which qualifying conditions must be fulfilled
George Culmer	1,3,4	Deferred Share awards	128,938	–	–	–	–	**128,938**	08.04.08
		Matching Share awards	386,814	–	–	–	–	**386,814**	08.04.08
Andy Haste	1,3,4	Deferred Share awards	462,182	–	–	**197,046**	–	**462,182**	08.04.08
		Matching Share awards	1,017,281	–	–	**221,873**	–	**1,017,281**	08.04.08
Simon Lee	1,3,4	Deferred Share awards	139,409	–	**43,327**	–	–	**96,082**	08.04.08
		Matching Share awards	337,042	–	**48,786**	–	–	**288,246**	08.04.08
Bridget McIntyre	1,2,4	Deferred Share awards	150,000	–	–	–	–	**150,000**	01.11.08
		Matching Share awards	450,000	–	–	–	–	**450,000**	01.11.08

Notes

1. The market price of ordinary shares on 14 June 2004, 8 April 2005 and 1 November 2005, the dates on which the above long term incentive scheme interests were granted, was 79.25p, 81.25p and 100p respectively.
2. Bridget McIntyre's award of Deferred and Matching shares was approved prior to her appointment on 1 November 2005. Due to dealing restrictions in accordance with the Model Code, these awards could not be granted until 12 June 2006. The number of shares was calculated with reference to the share price on 1 November 2005. Subject to performance as described below, these awards may vest on the third anniversary of her appointment. In all other respects these awards are subject to the same rules as other awards granted in 2005.
3. Matching Share awards are capable of vesting in respect of a maximum of three times the number of Deferred Shares awarded, subject to the achievement of TSR targets over a single two year period. TSR performance is measured relative to other companies specified by the Remuneration Committee. For awards granted in 2004 and 2005, TSR was measured partly relative to FTSE 100 companies and partly relative to the following financial services comparator group companies: Aegon, Legal & General Group, Allianz Group, Old Mutual, AXA, Prudential, AVIVA, RAS, Generali and Zurich Financial Services Group. For 50% of the Matching Share awards, where TSR is measured against the FTSE 100, full vesting will only occur at upper decile performance, vesting will occur in the ratio of shares under Matching Share awards to shares under Deferred Share awards of 2:1 at upper quartile performance and vesting in the ratio 1:1 will occur at median performance. For the other 50% of the Matching Share awards, where TSR is measured against the financial services comparator group, full vesting will occur if TSR is highest in the comparator group, vesting in the ratio 2:1 will occur at upper quartile performance and vesting in the ratio 1:1 will occur at median performance. Matching Share awards will not vest at below median performance. For awards granted in 2004, the targets were measured over the period from 1 April 2004 to 31 March 2006. For awards granted in 2005, the targets were measured over the period from 1 April 2005 to 31 March 2007. The relevant TSR figures were averaged over the three months before the beginning and end of this performance period. Additionally, no Matching Shares vest unless the Committee is satisfied that there has been a sustained improvement in the underlying performance of the Company over the performance period.
4. Awards made in 2004 vested on 14 June 2007. Andy Haste's 2004 awards were shown in the Annual Report and Accounts 2006 as having vested in that year in order to clarify the lapse of the proportion of the Matching Share awards that failed to meet performance targets. Simon Lee was the only executive director to have exercised awards made in 2004 during the year. The performance condition attaching to Matching Share awards granted in 2005 was met to the extent that three Matching Shares vested for each Deferred Share. Awards made in 2005 are due to vest in 2008.

Directors' emoluments and interests continued

Long Term Incentive Plan

	Notes		Share awards held at 1 January 2007	Share awards granted during the year	Share awards held at 31 December 2007	Date by which qualifying conditions must be fulfilled
George Culmer	1,2,5	Deferred Shares	149,098	**120,905**	**270,003**	16.04.10
	3,5	Matching Shares	469,036	**379,807**	**848,843**	16.04.10
	4,5	Performance Shares	347,347	**241,588**	**588,935**	16.04.10
Andy Haste	1,2,5	Deferred Shares	305,129	**245,852**	**550,981**	16.04.10
	3,5	Matching Shares	959,884	**772,313**	**1,732,197**	16.04.10
	4,5	Performance Shares	632,612	**488,886**	**1,121,498**	16.04.10
Simon Lee	1,2,5	Deferred Shares	114,422	**92,291**	**206,713**	16.04.10
	3,5	Matching Shares	359,952	**289,919**	**649,871**	16.04.10
	4,5	Performance Shares	208,471	**191,303**	**399,774**	16.04.10
Bridget McIntyre	1,2,5	Deferred Shares	44,116	**114,419**	**158,535**	16.04.10
	3,5	Matching Shares	138,781	**359,432**	**498,213**	16.04.10
	4,5	Performance Shares	288,801	**223,187**	**511,988**	16.04.10

Notes

1. The market price of ordinary shares on 16 April 2007, the date on which long term incentive scheme interests were granted during the year, was 164.66p.
2. Deferred Shares are inclusive of voluntary Deferred Shares and compulsory Deferred Shares. Voluntary Deferred Shares are purchased by Lloyds TSB Offshore Trust Company Limited on behalf of each participant using part of the net annual bonus paid to them and are held in trust for three years. These Deferred Shares are not at risk of forfeiture and may be withdrawn from the trust at any time, but the related Matching Share awards would lapse if the voluntary Deferred Shares are withdrawn within three years of acquisition. Compulsory Deferred Shares are awarded as part of the annual bonus. These Deferred Shares will normally vest in three years from the date of grant subject to continuous employment with the Group.
3. Matching Shares are capable of vesting in respect of a maximum of 2.5 times the number of Deferred Shares awarded, subject to the achievement of performance conditions over a three year period. One half of the Matching Shares relating to compulsory Deferred Shares (and all of the Matching Shares relating to voluntary Deferred Shares) are subject to TSR performance relative to other companies specified by the Remuneration Committee. For awards granted in 2006 and 2007 TSR will be measured relative to the following comparator group companies: Aegon, Alleanza, Allianz, AVIVA, AXA, Baloise, Fortis, Generali, Legal & General, Munich Re, QBE, Swiss Re, and Zurich Financial Services. Full vesting will only occur at upper quintile performance; at median performance 25% of the Matching Shares will vest. Vesting will be on a straight line basis in between. The remaining half of the Matching Shares relating to compulsory Deferred Shares are subject to a ROE performance condition. If underlying ROE over three years commencing on the year of grant is below 10%, no part of the award subject to ROE performance will vest. If underlying ROE over three years is 10%, 25% of the award will vest. If underlying average annual ROE over three years is 16% or higher, 100% of the awards will vest. Vesting will be on a straight line basis in between. For the purpose of establishing the number of Matching Shares relating to voluntary Deferred Shares that may be awarded, the gross value of that part of the annual bonus payment that a participant elects to voluntarily defer is used.
4. Performance conditions relating to awards of Performance Shares are the same as those relating to compulsory Deferred Shares as described above. One half of an award of Performance Shares may vest subject to the TSR performance condition and one half may vest subject to the ROE performance condition.
5. The above table shows the date by which qualifying conditions for awards made on 16 April 2007 must be fulfilled. For awards made on 12 June 2006, the date by which qualifying conditions must be fulfilled is 12 June 2009.
6. No other directors of the Company held long term incentive scheme interests during 2007.

John Maxwell
Chairman of the Remuneration Committee, on behalf of the Board
26 February 2008

Independent auditors' report to the members of Royal & Sun Alliance Insurance Group plc

We have audited the consolidated financial statements of Royal & Sun Alliance Insurance Group plc for the year ended 31 December 2007 which comprise the consolidated income statement, the consolidated statement of recognised income and expense, the consolidated balance sheet, the consolidated cashflow statement, significant accounting policies, estimation techniques, uncertainties and contingencies, risk management and related notes 1 to 34. These consolidated financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the remuneration report that is described as having been audited.

We have reported separately on the Parent Company financial statements of Royal & Sun Alliance Insurance Group plc for the year ended 31 December 2007.

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 auditors' 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' responsibilities for preparing the Annual Report, the remuneration report and the consolidated financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union are set out in the directors' report.

Our responsibility is to audit the consolidated financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the consolidated financial statements give a true and fair view, whether the consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation and whether the part of the remuneration report described as having been audited has been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the directors' report is consistent with the consolidated financial statements. The information given in the directors' report includes that specific information presented in the Group CEO's business review, the regional business reviews and the estimation techniques, uncertainties and contingencies that are cross referred from the business review section of the directors' report.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding director's remuneration and other transactions is not disclosed.

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the 2006 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited consolidated financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the consolidated financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the consolidated financial statements and the part of the remuneration report to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the consolidated financial statements, and of whether the accounting policies are appropriate to the Group'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 consolidated financial statements and the part of the remuneration report to be audited 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 consolidated financial statements and the part of the remuneration report to be audited.

Opinion

In our opinion:

- The consolidated financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the Group's affairs as at 31 December 2007 and of its profit for the year then ended
- The consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation
- The part of the remuneration report described as having been audited has been properly prepared in accordance with the Companies Act 1985 and
- The information given in the directors' report is consistent with the consolidated financial statements.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London
26 February 2008

Consolidated income statement

for the year ended 31 December 2007

	Notes	2007 £m	2006 £m
Continuing operations			
Income			
Gross written premiums		**6,596**	6,264
Less: reinsurance premiums		**(759)**	(780)
Net written premiums		**5,837**	5,484
Change in the gross provision for unearned premiums		**(235)**	(108)
Less: change in provision for unearned premiums, reinsurers' share		**5**	(84)
Change in provision for unearned premiums		**(230)**	(192)
Net earned premiums		**5,607**	5,292
Net investment return	2	**709**	600
Other operating income	4	**113**	121
Total income		**6,429**	6,013
Expenses			
Gross claims incurred		**(4,044)**	(3,758)
Less: claims recoveries from reinsurers		**387**	305
Net claims and benefits	3	**(3,657)**	(3,453)
Underwriting and policy acquisition costs		**(1,776)**	(1,626)
Unwind of discount		**(81)**	(42)
Other operating expenses	4	**(119)**	(151)
Total expenses		**(5,633)**	(5,272)
Results of operating activities		**796**	741
Finance costs	4	**(104)**	(92)
Loss on disposal of subsidiaries		**(22)**	(1)
Net share of profit after tax of associates	11	**–**	1
Profit before tax from continuing operations		**670**	649
Income tax expense	5	**(29)**	(170)
Profit for the year from continuing operations		**641**	479
Discontinued operations			
Loss for the year from discontinued operations	34	**(13)**	(499)
Profit/(loss) for the year		**628**	(20)
Attributable to:			
Equity holders of the Parent Company		**596**	(52)
Minority interests		**32**	32
		628	(20)
Earnings per share on profit from continuing operations attributable to the ordinary shareholders of the Parent Company			
Basic	6	**19.3p**	15.0p
Diluted	6	**19.0p**	14.8p
Earnings per share on profit/(loss) attributable to the ordinary shareholders of the Parent Company			
Basic	6	**18.9p**	(2.1)p
Diluted	6	**18.6p**	(2.1)p
Ordinary dividends paid and proposed for the year			
Interim dividend paid (per share)	7	**2.48p**	1.75p
Final dividend proposed (per share)	7	**4.53p**	4.12p

The attached notes form an integral part of these consolidated financial statements.

Consolidated statement of recognised income and expense

for the year ended 31 December 2007

	2007 £m	2006 £m
Exchange gains/(losses) net of tax	**140**	(151)
Fair value (losses)/gains net of tax	**(67)**	32
Pension fund actuarial (losses)/gains net of tax	**(16)**	153
Net gains recognised in equity	**57**	34
Profit/(loss) for the year	**628**	(20)
Total recognised income for the year	**685**	14
Attributable to:		
Equity holders of the Parent Company	**670**	(10)
Minority interests	**15**	24
	685	14

The attached notes form an integral part of these consolidated financial statements.

Consolidated balance sheet

as at 31 December 2007

	Notes	2007 £m	2006 £m
Assets			
Goodwill and other intangible assets	8	**663**	552
Property and equipment	9	**377**	385
Investment property	10	**429**	454
Investments in associates	11	**105**	27
Financial assets	12	**11,340**	10,457
Total investments		**11,874**	10,938
Reinsurers' share of insurance contract liabilities	13	**1,872**	1,927
Insurance and reinsurance debtors	14	**2,579**	2,225
Deferred acquisition costs	15	**542**	453
Current tax assets	23	**19**	17
Deferred tax assets	23	**87**	29
Other debtors and other assets	16	**963**	806
		1,069	852
Cash and cash equivalents	17	**1,509**	1,831
		20,485	19,163
Non current and disposal group assets held for sale	34	**108**	3,485
Total assets		**20,593**	22,648
Equity, reserves and liabilities			
Equity and reserves			
Shareholders' equity		**3,077**	2,561
Minority interests		**67**	331
Total equity and reserves	18	**3,144**	2,892
Liabilities			
Loan capital	19	**1,194**	1,192
Insurance contract liabilities	20	**13,727**	12,790
Insurance and reinsurance liabilities	21	**426**	391
Borrowings	22	**303**	8
Current tax liabilities	23	**92**	56
Deferred tax liabilities	23	**224**	319
Provisions	24	**331**	380
Other liabilities	25	**1,087**	1, 026
Provisions and other liabilities		**1,734**	1,781
		17,384	16,162
Non current and disposal group liabilities held for sale	34	**65**	3,594
Total liabilities		**17,449**	19,756
Total equity, reserves and liabilities		**20,593**	22,648

The attached notes form an integral part of these consolidated financial statements.

The financial statements were approved on 26 February 2008 by the Board of Directors and are signed on its behalf by:

George Culmer
Chief Financial Officer

Consolidated cashflow statement

for the year ended 31 December 2007

	Notes	2007 £m	2006 £m
Cash generated from continuing operations	31	**66**	406
Tax paid		**(127)**	(118)
Interest received		**587**	527
Interest paid		**(101)**	(82)
Dividends received		**1**	1
Pension deficit funding		**(86)**	(86)
Cashflows from discontinued operations		**(37)**	(531)
Net cashflows from operating activities		**303**	117
Proceeds from sales or maturities of:			
Investment contracts		**8,672**	8,166
Investment property		**18**	55
Property and equipment		**26**	43
Intangible assets		**1**	1
Investments in subsidiaries (net of cash disposed of)	30	**(407)**	–
Investments in associates		**22**	–
Purchase or settlement of:			
Investment contracts		**(8,878)**	(7,840)
Investment property		**(8)**	(17)
Property and equipment		**(28)**	(37)
Intangible assets		**(66)**	(127)
Investments in subsidiaries (net of cash acquired)	30	**(52)**	(69)
Investments in associates		**(64)**	–
Cashflows from discontinued operations		**83**	606
Net cashflows from investing activities		**(681)**	781
Proceeds from issue of share capital		**304**	6
Purchase of shares from minorities		**(616)**	(121)
Dividends paid to ordinary shareholders		**(102)**	(78)
Dividends paid to preference shareholders		**(9)**	(9)
Dividends paid to minority interests		**(31)**	(9)
Net movement in long term borrowings		**(25)**	74
Net movement in other borrowings		**293**	(243)
Cashflows from discontinued operations		**–**	(9)
Net cashflows from financing activities		**(186)**	(389)
Net (decrease)/increase in cash and cash equivalents and bank overdrafts		**(564)**	509
Cash and cash equivalents and bank overdrafts at beginning of the year		**2,040**	1,612
Effect of exchange rate changes on cash and cash equivalents		**62**	(81)
Cash and cash equivalents and bank overdrafts at end of the year	17	**1,538**	2,040

The attached notes form an integral part of these consolidated financial statements.

Significant accounting policies

The principal accounting policies applied in the preparation of the consolidated financial statements are set out below.

Consolidated financial statements

The consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). The consolidated financial statements are prepared under the historical cost convention as modified by the revaluation of available for sale financial assets, investment property, Group occupied property and financial assets and financial liabilities held for trading (which include all derivative contracts).

Except where otherwise stated, all figures included in the consolidated financial statements are presented in millions of British Pounds Sterling ('Sterling'), shown as '£m', rounded to the nearest million.

Changes in presentation and comparative information

- The Group has adopted IFRS 7 'Financial Instruments: Disclosures' and a complementary amendment to IAS 1 'Presentation of Financial Statements – Capital Disclosures'. This results in additional disclosures of the Group's risk management policies and the extent to which the Group is exposed to risk.
- The Group has adopted IFRS 8 'Operating Segments'. This results in the disclosure of financial information about the Group based upon the information used internally to evaluate the performance of the operating divisions and the allocation of resources to those divisions. The Group has chosen to adopt IFRS 8 for a period earlier than the period for which adoption is mandatory. The directors believe that the information provided is more useful to users of the Group's financial statements than that required under the previous standard IAS 14 'Segment Reporting' because the new standard aligns with the performance measures of the operating divisions used for internal performance measurement.

Comparative information has been provided for each of these disclosures. These changes have no impact on the result or the earnings per share for the period, the comparative period or earlier periods, and the Group's financial position at the end of each such period.

Selection of accounting policies

The Group exercises judgement in selecting each Group accounting policy. The accounting policies of the Group are selected by the directors to present financial statements that they consider provide the most relevant information. For certain accounting policies there are different accounting treatments that could be adopted, each of which would be in compliance with IFRS and would have a significant influence upon the basis on which the financial statements are presented. The bases of selection of the accounting policies for the accounting for financial assets and for the recognition of actuarial gains and losses related to pension obligations are set out below:

- The Group designates financial assets that are held as investments on the basis on which the investment return is managed and the performance is evaluated internally. Where the investment return is managed on the basis of the periodic cashflows arising from the investment, a financial asset is designated as an available for sale financial asset with unrealised gains recognised in the statement of recognised income and expense. Where the investment return is managed on the basis of the total return on the investment (including unrealised investment gains), the financial asset is designated as at fair value through the income statement.
- The Group accounting policy is to recognise actuarial gains and losses arising from the recognition and funding of the Group's pension obligations in the statement of recognised income and expense during the period in which they arise. This policy has been adopted as it provides the most relevant basis of recognition of such gains and losses.

Consolidation

Subsidiaries

Subsidiaries are entities over which the Group has the power to govern the financial and operating policies so as to obtain benefits from their activities, generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group.

The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, including costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recognised as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Changes in the ownership interests of a subsidiary between shareholders of the Group and minority shareholders are accounted for as transactions between equity holders of the Group. Any difference between the fair value of the consideration given by the transferee and the carrying value of the ownership interest transferred is recognised directly in equity.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries are changed where necessary to ensure consistency with the policies adopted by the Group.

Associates

Associates are entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and

50% of the voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost.

The Group's shares of its associates' post acquisition profits or losses are recognised in the income statement, and its shares of post acquisition movements in reserves is recognised in reserves. The cumulative post acquisition movements are adjusted in the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Adjustments are made, where necessary, to conform the accounting policies of associates to ensure consistency with the policies adopted by the Group.

Translation of foreign currencies

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency).

The results and financial position of those Group entities whose functional currency is not Sterling are translated into Sterling as follows:

- Assets and liabilities for each balance sheet presented are translated at the closing exchange rate at the date of that balance sheet
- Income and expenses for each income statement are translated at average exchange rates during each period
- All resulting exchange differences are recognised as a component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to equity. When a foreign entity is sold, the cumulative exchange differences relating to that foreign entity are recognised in the income statement as part of the gain or loss on sale.

Goodwill arising on the acquisition of a foreign entity is treated as an asset of the foreign entity and the carrying value is translated at the closing exchange rate.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Translation differences on non monetary items, such as equities classified as available for sale financial assets, are included in the fair value reserve in equity.

Goodwill and other intangible assets

Goodwill, being the difference between the cost of a business acquisition and the Group's interest in the net fair value of the identifiable assets and liabilities acquired, is initially capitalised in the balance sheet at cost and is subsequently recognised at cost less accumulated impairment losses. The cost of the acquisition is the amount of cash paid and the fair value of other purchase consideration given together with associated expenses. Goodwill is allocated to cash generating units for the purpose of impairment testing. Each of those cash generating units represents the Group's investment in each country of operation. Goodwill is subject to an impairment review at least annually. An impairment review is also carried out whenever there is an indication that goodwill or other intangible assets are impaired. Where the carrying amount is more than the recoverable amount, an impairment is recognised.

When calculating the goodwill arising on an acquisition, claims provisions are discounted to present value. Immediately following the acquisition, the claims provisions are valued at full nominal value. This increase in liabilities is matched by the recognition of an intangible asset arising from acquired claims provisions, representing the present value of future investment income implicit in the claims discount. The intangible asset is amortised over the expected run off period and is tested in the context of the liability adequacy test of insurance liabilities where the balances of intangible assets associated with insurance contracts is deducted from the carrying amount of the insurance liabilities. The run off period is normally between five and 11 years.

Expenditure that increases the future economic benefits arising from computer software in excess of its standard of performance assessed immediately before the expenditure was made, is recognised as an intangible asset.

Other intangible assets comprise renewal rights, customer lists, brands and other acquired identifiable non monetary assets without physical form.

Computer software and other intangible assets are carried at cost less accumulated amortisation. Amortisation on computer software and other intangible assets is calculated using the straight line method to allocate the cost over their estimated useful lives, which is normally estimated to be between three and 12 years.

Property and equipment

Property and equipment comprise Group occupied land and buildings, fixtures, fittings and equipment (including computer hardware and motor vehicles). These assets are depreciated over their estimated useful life after taking into account residual values.

Group occupied property is stated at fair value, less subsequent depreciation for buildings. All other assets are stated at depreciated cost. Fair value movements are recorded in equity.

Significant accounting policies continued

Fair value is based on current prices in an active market for similar property in the same location and condition and subject to similar contractual terms of ownership. Valuations are performed by external professionally qualified valuation surveyors on at least an annual basis, with reference to current market conditions.

All other classes are stated at cost less accumulated depreciation. Cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset only when it is probable that future economic benefits associated to the item will flow to the Group and the cost can be measured reliably.

Land is not depreciated. Depreciation on all other items is calculated on the straight line method to write down the cost of such assets to their residual value over their estimated useful lives as follows:

Group occupied buildings	normally 30 years
Fixtures and fittings	10 years
Motor vehicles	4 years
Equipment	3-5 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the balance sheet date.

An impairment review is carried out whenever there is an indication that the assets are impaired. An asset's carrying amount is written down to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Increases in the carrying amount arising on the revaluation of Group occupied property are credited to revaluation surplus in equity. Decreases that offset the previous increases of the same asset are charged against revaluation surplus directly in equity, other decreases are charged to the income statement. Each year the difference between depreciation based on the fair value of the asset charged to the income statement and depreciation based on the assets original cost is transferred from revaluation surplus to retained earnings.

Investment property

Investment property, comprising freehold and leasehold land and buildings, is held for long term rental yields and is not occupied by the Group.

Investment property is recorded at fair value, measured by independent professionally qualified valuers, who hold a recognised and relevant professional qualification and have recent experience in the location and category of the investment property being valued, on an annual basis or more frequently and by internal valuers for interim periods, with reference to current market conditions. Related unrealised gains and unrealised losses or changes thereof are recognised in net investment return.

Financial assets

A financial asset is initially recognised, on the date the Group commits to purchase the asset, at fair value plus, in the case of all financial assets not classified as at fair value through the income statement, transaction costs that are directly attributable to its acquisition. A financial asset is derecognised when the rights to receive cashflows from the investment have expired or have been transferred and when the Group has transferred substantially the risks and rewards of ownership of the asset.

On initial recognition, the financial assets may be categorised into the following categories: financial assets at fair value through the income statement, loans and receivables, held to maturity financial assets and available for sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition.

The Group designates investments in accordance with its investment strategy on the basis on which the investment return is managed and the performance is evaluated internally. Where the investment return is managed on the basis of the periodic cashflows arising from the investment, a financial asset is designated as an available for sale financial asset. Where the investment return is managed on the basis of the total return on the investment (including unrealised investment gains), the financial asset is designated as at fair value through the income statement.

Financial assets arising from non investment activities are not classified on initial recognition as available for sale assets and are therefore categorised as loans and receivables.

Where the cumulative changes recognised in equity represent an unrealised loss the individual asset or group of assets is reviewed to test whether an indication of impairment exists.

For securities whose fair values are readily determined and where there is objective evidence that such an asset is impaired, including a significant or prolonged decline in the fair value below cost, the unrealised loss charged to equity is reclassified to the income statement.

If the fair value of a previously impaired debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, the impairment loss is reversed and the reversal recognised in the income statement. Impairment losses on equity investments are not reversed.

For other loans and receivables, where there is evidence that the contracted cashflows will not be received in full, an impairment charge is recognised in the income statement to reduce the carrying value of the financial asset to its recoverable amount.

Investment income is recognised in the income statement. Dividends on equity investments are recognised on the date at which the investment is priced 'ex dividend'. Interest income is recognised using the effective interest method. Unrealised gains and losses on available for sale investments are recognised directly in equity, except for impairment

losses and foreign exchange gains and losses on monetary items (which are recognised in the income statement). On derecognition of an investment classified as available for sale, the cumulative gain or loss previously recognised in equity is recognised in the income statement.

Derivative financial instruments

Derivatives are recognised in the balance sheet on a trade date basis and are carried at fair value. Derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and the nature of the item being hedged. Where a derivative is not designated as a hedging instrument, changes in its fair value are recognised in the income statement.

Hedging

Transactions are classified as hedging transactions when the following conditions for hedge accounting are met:

- There is a formal designation and documentation of the hedging relationship and the Group's risk management objective and strategy for undertaking the hedge
- The hedge is expected to be highly effective in achieving offsetting changes in fair value or cashflows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship
- The effectiveness of the hedge can be reliably measured
- For cashflow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cashflows that could ultimately affect profit or loss
- The hedge is assessed on an ongoing basis and determined to have been highly effective.

Where loan capital or a forward foreign exchange contract is designated as a hedging instrument against the net investment in foreign entities, the effective portion of the hedge is recognised in equity; the gain or loss relating to the ineffective portion is recognised immediately in the income statement. Gains and losses accumulated in equity are included in the income statement when the underlying hedged item is derecognised.

Estimation of the fair value of financial assets and liabilities

The methods and assumptions used by the Group in estimating the fair value of financial assets and liabilities are:

- For fixed maturity securities, fair values are generally based upon quoted market prices. Where market prices are not readily available, fair values are estimated using either values obtained from quoted market prices of comparable securities or estimated by discounting expected future cashflows using a current market rate applicable to the yield, credit quality and maturity of the investment
- For equity securities fair values are based upon quoted market prices
- If the market for a financial asset is not active, the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cashflow analysis and option pricing models
- For mortgage loans on real estate and collateral loans, fair values are estimated using discounted cashflow calculations based upon prevailing market rates
- For cash, short term investments, commercial paper, other assets, liabilities and accruals, carrying amounts approximate to fair values
- For notes, bonds, loans payable and loan capital, fair values are determined by reference to quoted market prices or estimated using discounted cashflow calculations based upon prevailing market rates. Loan capital is carried at amortised cost and, when different, fair value is shown in the relevant note. For borrowings that carry a variable rate of interest (other than loan capital), carrying values approximate to fair values
- For derivatives, fair values are generally based upon quoted market prices.

Insurance contracts

Product classification

Insurance contracts are those contracts that transfer significant insurance risk at the inception of the contract. Insurance risk is transferred when the Group agrees to compensate a policyholder if a specified uncertain future event (other than a change in a financial variable) adversely affects the policyholder. Any contracts not meeting the definition of an insurance contract under IFRS are classified as investment contracts or derivative contracts, as appropriate.

Recognition of income

Premiums written are accounted for in the period in which the contract is entered into and include estimates where the amounts are not determined at the balance sheet date. Premiums written exclude taxes and duties levied on premiums and directly related expenses, e.g. commissions. Premiums are earned as revenue over the period of the contract and are calculated principally on a daily pro rata basis.

Acquisition costs

Acquisition costs comprise the direct and indirect costs of obtaining and processing new insurance business. These costs are recognised as a deferred acquisition cost asset and amortised on the same basis as the related premiums are earned.

Insurance liabilities

The provision for unearned premium represents the portion of the premiums written relating to periods of insurance coverage subsequent to the balance sheet date.

The provisions for claims outstanding, whether reported or not, comprise the estimated cost of claims incurred but not settled at the balance sheet date. It includes related expenses and a deduction for the expected value of salvage and other recoveries. The provision is determined using the best information available of claims settlement patterns, forecast inflation and settlement of claims. The provisions for claims outstanding relating to long

Significant accounting policies continued

term permanent disability claims in Canada and Scandinavia are also determined using recognised actuarial methods.

The provisions for claims outstanding, and related reinsurance recoveries, are discounted where there is a particularly long period from incident to claims settlement and where there exists a suitable claims payment pattern from which to calculate the discount. In defining those claims with a long period from incident to claims settlement, those categories of claims where the average period of settlement is six years or more from the balance sheet date, has been used as a guide. The discount rate used is based upon an investment return expected to be earned by assets, which are appropriate in magnitude and nature to cover the provisions for claims outstanding being discounted, during the period necessary for the payment of such claims.

Differences between the estimated cost and subsequent settlement of claims are recognised in the income statement in the year in which they are settled or in which the provisions for claims outstanding are re-estimated.

At each balance sheet date an assessment is made of whether the provisions for unearned premiums are adequate. A separate provision is made, based on information available at the balance sheet date, for any estimated future underwriting losses relating to unexpired risks. The provision is calculated after taking into account future investment income that is expected to be earned from the assets backing the provisions for unearned premiums (net of deferred acquisition costs). The unexpired risk provision is assessed in aggregate for business classes which, in the opinion of the directors, are managed together.

Reinsurance ceded

Premiums payable in respect of reinsurance ceded, are recognised in the period in which the reinsurance contract is entered into and include estimates where the amounts are not determined at the balance sheet date. Premiums are expensed over the period of the reinsurance contract, calculated principally on a daily pro rata basis.

A reinsurance asset (reinsurers' share of insurance liabilities) is recognised to reflect the amount estimated to be recoverable under the reinsurance contracts in respect of the outstanding claims reported under insurance liabilities. The amount recoverable from reinsurers is initially valued on the same basis as the underlying claims provision. The amount recoverable is reduced when there is an event arising after the initial recognition that provides objective evidence that the Group may not receive all amounts due under the contract and the event has a reliably measurable impact on the expected amount that will be recovered from the reinsurer.

The reinsurers' share of each unexpired risk provision is recognised on the same basis.

Annuities purchased by the Group to make payments under structured settlement arrangements are accounted for as reinsurance ceded if the Group remains liable for the settlement in the event of default by the annuity provider. Any gain or loss arising on the purchase of an annuity is recognised in the income statement at the date of purchase.

Cash and cash equivalents

Cash and cash equivalents are short term, highly liquid investments that are subject to insignificant changes in value and are readily convertible into known amounts of cash. Cash equivalents comprise financial assets with less than three months maturity from the date of acquisition.

Treasury shares

Treasury shares are deducted from equity. No gain or loss is recognised on the purchase, sale, issue or cancellation of the treasury shares. Any consideration paid or received is recognised directly in equity.

Loan capital

Loan capital comprises subordinated bonds which are initially measured at the consideration received less transaction costs. Subsequently, loan capital is measured at amortised cost using the effective interest rate method.

An exchange with an existing lender of loan capital with substantially different terms is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are substantially different if the discounted present value of the cashflows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10% different from the discounted present value of the remaining cashflows of the original financial liability. An exchange where the terms are not substantially different is accounted for as an exchange.

If an exchange of loan capital or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If it is accounted for as an exchange, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability and no adjustment is made to the carrying value of the liability to reflect its fair value at the date of exchange.

Taxation

Taxation in the income statement is based on profits and income for the year as determined in accordance with the relevant tax legislation, together with adjustments to provisions for prior years. UK tax in respect of overseas subsidiaries and principal associated undertakings is recognised as an expense in the year in which the profits arise, except where the remittance of earnings can be controlled and it is probable that remittance will not take place in the foreseeable future, in which case UK tax is based on dividends received.

Deferred tax is provided in full using the liability method on temporary differences arising between the tax bases of assets and liabilities and the carrying amounts in the financial statements. However, if the deferred tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting, nor taxable profit or loss, it is not accounted for. Deferred tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

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

Employee benefits

Pension obligations

Group companies operate various pension schemes. The schemes are generally funded through payments to trustee administered funds, determined by periodic actuarial calculations. The Group has both defined contribution and defined benefit schemes. A defined contribution scheme is a pension scheme under which the Group pays fixed contributions into a separate entity. A defined benefit scheme is a pension scheme that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and salary.

Post retirement benefits (including pension schemes and post retirement health schemes)

Contributions to defined contribution pension schemes are charged in the period in which the employment services qualifying for the benefit are provided. The Group has no further payment obligations once the contributions have been paid.

The amounts charged (or credited where relevant) in the income statement relating to post retirement benefits in respect of defined benefit schemes are as follows:

- The current service cost
- The past service costs for additional benefits granted in the current or earlier periods
- The interest cost for the period
- The impact of any curtailments or settlements during the period
- The expected return on scheme assets (where relevant).

The current service cost in respect of defined benefit schemes comprises the present value of the additional benefits attributable to employees' services provided during the period.

The present value of defined benefit obligations and the present values of additional benefits accruing during the period are calculated using the Projected Unit Credit Method.

Past service costs arise where additional benefits are granted. The cost of providing additional benefits is recognised on a straight line basis over the remaining period of service until such benefits vest. The cost of providing additional benefits that vest on their introduction are recognised immediately.

The calculation of the present value of accrued benefits includes an actuarial assumption of future interest rates, which is used to discount the expected ultimate cost of providing the benefits. The discount rate is determined at each balance sheet date by reference to current market yields on high quality corporate bonds identified to match the currency and estimated term of the obligations. The interest cost for the period is calculated by multiplying the discount rate determined at the start of the period by the defined benefit obligations during the period.

The change in the present value of the defined benefit obligation and the changes in the fair value of scheme assets resulting from any curtailments and settlements of scheme liabilities during the period are recognised in the income statement. Additionally, any previously unrecognised past service costs related to these liabilities are recognised in the gains or losses on settlement and curtailment.

The expected returns on scheme assets are determined for each asset class, at the beginning of the period, as the expected investment returns on scheme assets over the entire life of the related obligations. All returns are net of investment expenses.

Actuarial gains and losses arise from changes to actuarial assumptions when revaluing future benefits and from actual experience in respect of scheme liabilities and investment performance of scheme assets being different from previous assumptions. Actuarial gains and losses are recognised in the statement of recognised income and expense.

The value recognised in the balance sheet for each individual post retirement scheme is calculated as follows:

- The present value of defined benefit obligation of the scheme at the balance sheet date
- Minus any past service cost not yet recognised
- Minus the fair value at the balance sheet date of the scheme assets out of which the obligations are to be settled directly.

Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the balance sheet date are discounted to present value.

Significant accounting policies continued

Share based payment

The value of the employee share options and other equity settled share based payments is calculated at fair value at the grant date using appropriate and recognised option pricing models. The value of liabilities in respect of cash settled share based payment transactions is based upon the fair value of the awards at the balance sheet date.

Vesting conditions, which comprise service conditions and performance conditions, other than those based upon market conditions, are not taken into account when estimating the fair value of such awards but are taken into account by adjusting the number of equity instruments included in the ultimate measurement of the transaction amount. The value of the awards is recognised as an expense on a systematic basis over the period during which the employment services are provided. Where an award of options is cancelled by an employee, the full value of the award (less any value previously recognised) is recognised at the cancellation date.

The proceeds received net of any transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Dividends to equity holders

The final dividend is recognised as a liability when approved at the Annual General Meeting. The interim dividend is recognised as a liability when paid.

Leases

Rental income from operating leases is recognised on a straight line basis over the term of the lease. Payments made under operating leases are charged on a straight line basis over the term of the lease.

Operating segments

Operating segments are identified on the basis of the regional structure of the Group. Internal reports about these segments are regularly reviewed by the Group Chief Executive Officer and by the Board of Directors to assess their performance and to allocate capital and resources.

Non current and disposal group assets and liabilities held for sale and discontinued operations

Non current and disposal group assets are classified as held for sale if their carrying amount is to be recovered principally through a sale transaction, that is highly probable to complete within one year from the date of classification, rather than through continuing use. Such assets are measured at the lower of carrying amount and fair value less costs to sell and are classified separately from other assets in the balance sheet. Assets and liabilities of a disposal group are not netted. In the period where a non current asset or disposal group is recognised for the first time the balance sheet for the comparative prior period presented is not restated.

Discontinued operations are presented on the face of the income statement as a single amount comprising the total of the net profit or loss of discontinued operations and the after tax gain or loss recognised on the sale or the measurement to fair value less costs to sell of the net assets constituting the discontinued operations. In the period where an operation is presented for the first time as discontinued, the income statement for the comparative prior period presented is restated to present that operation as discontinued.

Unless otherwise stated, in the period where an operation is presented as discontinued, the notes to the financial statements contain amounts attributable to continuing operations only. The comparatives for the notes to the income statement are restated.

Current and non current distinction

Assets are classified as current when expected to be realised within the Group's normal operating cycle of one year. Liabilities are classified as current when expected to be settled within the Group's normal operating cycle of one year. All other assets and liabilities are classified as non current.

The Group's consolidated balance sheet is not presented using current and non current classifications. However, the following balances are generally classified as current: cash and cash equivalents; deferred acquisition costs; and insurance and reinsurance debtors.

The following balances are generally classified as non current: goodwill and other intangible assets; property and equipment; investment property; investment in associates; financial assets; deferred tax assets; loan capital; and deferred tax liabilities.

The remaining balances are of a mixed nature. The current and non current portions of such balances are set out in the respective notes or in the risk management section.

Recently issued accounting pronouncements

Below are listed the developments that are relevant to the Group's future financial reporting.

a) Published standards and amendments to published standards that are not yet effective and have not been early adopted by the Group

- On 6 September 2007 the International Accounting Standards Board (IASB) issued a revised version of IAS 1 'Presentation of Financial Statements'.

  The revised standard changes certain aspects of the presentation of financial statements including the mandatory introduction of a statement of comprehensive income. The revised standard gives preparers of financial statements the option of presenting items of income and expense and components of other comprehensive income either in a single statement of comprehensive income with subtotals, or in two separate statements (a separate income statement followed by a statement of comprehensive income). In addition, the revisions include changes in the titles of some of the financial statements to standardise accounting terminology (for example, the balance sheet is renamed a statement of financial position). The new titles will be used in accounting standards, but are not mandatory for use in financial statements.

  The revised standard will come into effect for the annual periods beginning on or after 1 January 2009, but early adoption is permitted. The revised standard has not yet been adopted by the EU. The revisions will result in changes to the presentation of the financial statements but are not expected to change the results or the earnings per share of the current period, the comparative period or earlier periods, and the Group's financial position at the end of each such period.

- On 10 January 2008 the IASB issued a revised version of IFRS 3 'Business Combinations' and an amended version of IAS 27 'Consolidated and Separate Financial Statements'. The revisions include the following changes to existing accounting practice:
  - An equity interest in a subsidiary entity that is not held by the reporting and controlling entity is now described as a non controlling interest (currently described as a minority interest)
  - Total comprehensive income is attributed to a non controlling interest even if this results in the non controlling interest having a deficit balance
  - A change in a controlling interest arising from a transaction between a controlling interest and a non controlling interest that does not result in a loss of control, is accounted for as an equity transaction
  - In a business combination, the acquiring company must measure the non controlling interest at either fair value or as the non controlling interest's proportionate share of the identifiable net assets. Currently only the second basis is permitted
  - Costs incurred by the acquirer in connection with a business combination must be accounted for separately from the business combination. This will result in such costs being expensed and not being included in goodwill
  - All consideration (including contingent consideration) transferred in a business combination is measured at fair value at the acquisition date. Changes in the value of contingent consideration are measured in accordance with the relevant accounting treatment under IFRS
  - Pre existing equity interests in an acquiree are remeasured to fair value at the date of, and immediately before, the business combination and any resulting gain or loss is recognised in profit or loss.

  The revised standards will come into effect for the annual periods beginning on or after 1 July 2009, but early adoption is permitted. The revised standards have not yet been adopted by the EU. The new standards will be applied prospectively and so will have no impact on the results and the earnings per share of the current period, the comparative period or earlier periods, and on the Group's financial position at the end of each such period. It is not possible to assess the impact the changes will have on future periods.

b) Other Standards and Interpretations to published standards issued that are not relevant for the Group's operations or not expected to change accounting policies

- On 29 March 2007 the IASB issued an amendment to IAS 23 'Borrowing Costs' that removed the option to recognise specific borrowing costs, that relate to assets that take a substantial period of time to get ready for use or sale, as expenses. The Group does not incur borrowing costs that relate to the specific categories of assets in IAS 23.
- On 28 June 2007 the IFRIC published Interpretation IFRIC 13 'Customer Loyalty Programmes'. This interpretation clarifies the accounting treatment for customer loyalty award credits granted by an entity when providing goods or services.
- On 4 July 2007 the IFRIC published Interpretation IFRIC 14, IAS 19 'The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction'. This interpretation clarifies the value that may be placed upon an asset arising from the surplus within a pension fund sponsored by the reporting entity and also the impact of its commitments to provide funding to its pension funds.
- On 17 January 2008 the IASB issued an amendment to IFRS 2 'Share Based Payment'. The amendment clarifies the accounting treatment of the cancellation of share option arrangements by the option holder.
- On 14 February 2008 the IASB issued Amendments to IAS 32 'Financial Instruments: Presentation' and IAS 1 'Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation'. The amendment requires certain financial instruments with particular features and meeting specific conditions, which previously would be classified as debt instruments, to be classified as equity instruments. The Group does not issue such instruments.

None of the above are anticipated to have a material impact on the Group financial statements.

Estimation techniques, uncertainties and contingencies

Introduction

One of the purposes of insurance is to enable policyholders to protect themselves against uncertain future events. Insurance companies accept the transfer of uncertainty from policyholders and seek to add value through the aggregation and management of these risks.

The uncertainty inherent in insurance is inevitably reflected in the financial statements of insurance companies. The uncertainty in the financial statements principally arises in respect of the insurance liabilities of the company.

The insurance liabilities of an insurance company include the provision for unearned premiums and unexpired risks and the provision for outstanding claims. Unearned premiums and unexpired risks represent the amount of income set aside by the company to cover the cost of claims that may arise during the unexpired period of risk of insurance policies in force at the balance sheet date. Outstanding claims represents the company's estimate of the cost of settlement of claims that have occurred by the balance sheet date but have not yet been finally settled.

In addition to the inherent uncertainty of having to make provision for future events, there is also considerable uncertainty as regards the eventual outcome of the claims that have occurred by the balance sheet date but remain unsettled. This includes claims that may have occurred but have not yet been notified to the company and those that are not yet apparent to the insured.

As a consequence of this uncertainty, the insurance company needs to apply sophisticated estimation techniques to determine the appropriate provisions.

Estimation techniques

Claims and unexpired risks provisions are determined based upon previous claims experience, knowledge of events and the terms and conditions of the relevant policies and on interpretation of circumstances. Particularly relevant is experience with similar cases and historical claims payment trends. The approach also includes the consideration of the development of loss payment trends, the potential longer term significance of large events, the levels of unpaid claims, legislative changes, judicial decisions and economic and political conditions.

Where possible the Group adopts multiple techniques to estimate the required level of provisions. This assists in giving greater understanding of the trends inherent in the data being projected. The Group's estimates of losses and loss expenses are reached after a review of several commonly accepted actuarial projection methodologies and a number of different bases to determine these provisions. These include methods based upon the following:

- The development of previously settled claims, where payments to date are extrapolated for each prior year
- Estimates based upon a projection of claims numbers and average cost
- Notified claims development, where notified claims to date for each year are extrapolated based upon observed development of earlier years
- Expected loss ratios.

In addition, the Group uses other methods such as the Bornhuetter-Ferguson method, which combines features of the above methods. The Group also uses bespoke methods for specialist classes of business. In selecting its best estimate, the Group considers the appropriateness of the methods and bases to the individual circumstances of the provision class and underwriting year. The process is designed to select the most appropriate best estimate.

Large claims impacting each relevant business class are generally assessed separately, being measured either at the face value of the loss adjusters' estimates or projected separately in order to allow for the future development of large claims.

Provisions are calculated gross of any reinsurance recoveries. A separate estimate is made of the amounts that will be recoverable from reinsurers based upon the gross provisions and having due regard to collectability.

The claims provisions are subject to close scrutiny both within the Group's business units and at Group Corporate Centre. In addition, for major classes where the risks and uncertainties inherent in the provisions are greatest, regular and ad hoc detailed reviews are undertaken by advisers who are able to draw upon their specialist expertise and a broader knowledge of current industry trends in claims development. As an example, the Group's exposure to asbestos and environmental pollution is examined on this basis. The results of these reviews are considered when establishing the appropriate levels of provisions for outstanding claims and unexpired periods of risk.

It should be emphasised that the estimation techniques for the determination of insurance liabilities involve obtaining corroborative evidence from as wide a range of sources as possible and combining these to form the overall estimate. This technique means that the estimate is inevitably deterministic rather than stochastic. A stochastic valuation approach, whereby a range of possible outcomes is estimated and probabilities assigned thereto, is only possible in a limited number of situations.

The pension assets and pension and post retirement liabilities are calculated in accordance with International Accounting Standard 19 (IAS 19). The assets, liabilities and income statement charge, calculated in accordance with IAS 19, are sensitive to the assumptions made from time to time, including inflation, interest rate, investment return and mortality. IAS 19 compares, at a given date, the current market value of a pension fund's assets with its long term liabilities, which are calculated using a discount rate in line with yields on 'AA' rated bonds of suitable duration and currency. As such, the financial position of a pension fund on this basis is highly sensitive to changes in bond rates and will also be impacted by changes in equity markets.

Uncertainties and contingencies

The uncertainty arising under insurance contracts may be characterised under a number of specific headings, such as:

- Uncertainty as to whether an event has occurred which would give rise to a policyholder suffering an insured loss
- Uncertainty as to the extent of policy coverage and limits applicable
- Uncertainty as to the amount of insured loss suffered by a policyholder as a result of the event occurring
- Uncertainty over the timing of a settlement to a policyholder for a loss suffered.

The degree of uncertainty will vary by policy class according to the characteristics of the insured risks and the cost of a claim will be determined by the actual loss suffered by the policyholder.

There may be significant reporting lags between the occurrence of the insured event and the time it is actually reported to the Group. Following the identification and notification of an insured loss, there may still be uncertainty as to the magnitude and timing of the settlement of the claim. There are many factors that will determine the level of uncertainty such as inflation, inconsistent judicial interpretations and court judgments that broaden policy coverage beyond the intent of the original insurance, legislative changes and claims handling procedures.

The establishment of insurance liabilities is an inherently uncertain process and, as a consequence of this uncertainty, the eventual cost of settlement of outstanding claims and unexpired risks can vary substantially from the initial estimates, particularly for the Group's long tail lines of business. The Group seeks to provide appropriate levels of claims provision and provision for unexpired risks taking the known facts and experience into account.

The Group has exposures to risks in each class of business within each operating segment that may develop and that could have a material impact upon the Group's financial position. The geographical and insurance risk diversity within the Group's portfolio of issued insurance policies make it not possible to predict whether material development will occur and, if it does occur, the location and the timing of such an occurrence. The estimation of insurance liabilities involves the use of judgments and assumptions that are specific to the insurance risks within each territory and the particular type of insurance risk covered. The diversity of the insurance risks results in it not being possible to identify individual judgments and assumptions that are more likely than others to have a material impact on the future development of the insurance liabilities.

The sections below identify a number of specific risks relating to asbestos and environmental claims. There may be other classes of risk which could develop in the future and that could have a material impact on the Group's financial position.

The Group evaluates the concentration of exposures to individual and cumulative insurance risk and establishes its reinsurance policy to reduce such exposure to levels acceptable to the Group.

Asbestos and environmental claims

The estimation of the provisions for the ultimate cost of claims for asbestos and environmental pollution is subject to a range of uncertainties that is generally greater than those encountered for other classes of insurance business. As a result it is not possible to determine the future development of asbestos and environmental claims with the same degree of reliability as with other types of claims, particularly in periods when theories of law are in flux. Consequently, traditional techniques for estimating claims provisions cannot wholly be relied upon and the Group employs specialised techniques to determine provisions using the extensive knowledge of both internal asbestos and environmental pollution experts and external legal and professional advisors.

Factors contributing to this higher degree of uncertainty include:

- The long delay in reporting claims from the date of exposure (for example, cases of mesothelioma can have a latent period of up to 40 years). This makes estimating the ultimate number of claims we will receive particularly difficult
- Issues of allocation of responsibility among potentially responsible parties and insurers
- Emerging court decisions increasing or decreasing insurer liability
- The tendency for social trends and factors to influence court awards
- Developments pertaining to the Group's ability to recover reinsurance for claims of this nature
- For US liabilities from our London market business, developments in the tactics of US plaintiff lawyers and court decisions and awards.

Acquisitions and disposals

The Group makes acquisitions and disposals of businesses as part of its normal operations. All acquisitions are made after due diligence, which will include, amongst other matters, assessment of the adequacy of claims reserves, assessment of the recoverability of reinsurance balances, inquiries with regard to outstanding litigation and inquiries of local regulators and taxation authorities. Consideration is also given to potential costs, risks and issues in relation to the integration of any proposed acquisitions with existing RSA operations. The Group will seek to receive the benefit of appropriate contractual representations and warranties in connection with any acquisition and, where necessary, additional indemnifications in relation to specific risks although there can be no guarantee that such protection will be adequate in all circumstances. The Group may also provide relevant representations, warranties and indemnities to counterparties on any disposal. While such representations, warranties and indemnities are essential components of many contractual relationships, they do not represent the underlying purpose of the transaction. These clauses are customary in such contracts and may from time to time lead to us receiving claims from counterparties.

Estimation techniques, uncertainties and contingencies continued

Contracts with third parties

The Group enters into joint ventures, outsourcing contracts and distribution arrangements with third parties in the normal course of its business and is reliant upon those third parties performing their obligations in accordance with the terms and conditions of the contracts.

Litigation, mediation and arbitration

The Group, in common with the insurance industry in general, is subject to litigation, mediation and arbitration, and regulatory, governmental and other sectoral inquiries in the normal course of its business. In addition the Group is subject to litigation in connection with its former ownership of the US operation. The directors do not believe that any current mediation, arbitration, regulatory, governmental or sectoral inquiries and pending or threatened litigation or dispute will have a material adverse effect on the Group's financial position, although there can be no assurance that losses resulting from any current mediation, arbitration, regulatory, governmental or sectoral inquiries and pending or threatened litigation or dispute will not materially affect the Group's financial position or cashflows for any period.

Reinsurance

The Group is exposed to disputes on, and defects in, contracts with its reinsurers and the possibility of default by its reinsurers. The Group is also exposed to the credit risk assumed in fronting arrangements and to potential reinsurance capacity constraints. In selecting the reinsurers with whom we do business our strategy is to seek reinsurers with the best combination of credit rating, price and capacity. We publish internally a list of authorised reinsurers who pass our selection process and which our operations may use for new transactions.

The Group monitors the financial strength of its reinsurers, including those to whom risks are no longer ceded. Allowance is made in the financial position for non recoverability due to reinsurer default by requiring operations to provide, in line with Group standards, having regard to companies on the Group's 'Watch List'. The 'Watch List' is the list of companies whom the directors believe will not be able to pay amounts due to the Group in full.

Changes in foreign exchange rates may impact our results

We publish our consolidated financial statements in Pounds Sterling. Therefore, fluctuations in exchange rates used to translate other currencies, particularly other European currencies and the US Dollar, into Pounds Sterling will impact our reported consolidated financial condition, results of operations and cashflows from period to period. These fluctuations in exchange rates will also impact the Pound Sterling value of our investments and the return on our investments.

Income and expenses for each income statement item are translated at average exchange rates. Balance sheet assets and liabilities are translated at the closing exchange rates at the balance sheet date.

Investment risk

The Group is exposed to credit risk on its invested assets. Credit risk includes the non performance of contractual payment obligations on invested assets and adverse changes in the credit worthiness of invested assets including exposures to issuers or counterparties for bonds, equities, deposits and derivatives. Our insurance investment portfolios are concentrated in listed securities with very low levels of exposure to assets without quoted market prices. We use model based analysis to verify asset values when market values are not readily available.

We use derivative financial instruments to reduce our exposure to adverse fluctuations in interest rates, foreign exchange rates and equity markets. We have strict controls over the use of derivative instruments.

Rating agencies

The ability of the Group to write certain types of insurance business is dependent on the maintenance of the appropriate credit ratings from the rating agencies. The Group has the objective of maintaining single 'A' ratings. At the present time the ratings are 'A' (stable) from S&P upgraded from 'A-' in December 2007, 'A-' (positive outlook) from AM Best and 'A3' stable from Moodys. Any worsening in the ratings could have an adverse impact on the ability of the Group to write certain types of general insurance business.

Regulatory environment

The legal, regulatory and accounting environment is subject to significant change in many of the jurisdictions in which we operate. We continue to monitor the developments and react accordingly.

In particular the Group is continuing to monitor and respond to ongoing consultation following publication of the Solvency II Framework Directive, which is intended, in the medium term, to achieve greater harmonisation of approach across European member states to assessing capital resources and requirements. The directors are confident that the Group will continue to meet all future regulatory capital requirements.

Risk management

As an insurance company, the Group is fundamentally concerned with the management of risks. This note summarises the key risks to the Group and the steps taken to manage them.

As set out in the corporate governance report, the Group's Board of Directors (the 'Board') defines the risk appetite of the organisation.

The Group employs a comprehensive risk management framework to identify, assess, manage and monitor the risks arising as a result of operating the business. The framework includes a comprehensive suite of risk policies, procedures, measurement, reporting and monitoring techniques and a series of stress tests and scenario analyses to ensure that the Group's risk exposures are managed appropriately.

The Group is exposed to financial risk through its financial assets, financial liabilities (investment contracts and borrowings), reinsurance assets and insurance liabilities. In particular the key financial risk is that the proceeds from the realisation of its financial assets are not sufficient to fund the obligations arising from its insurance and investment contracts.

The Group manages its financial assets within a framework that has been developed to seek to ensure the ability to meet its obligations under insurance and investment contracts. A key principle behind this process is to hold assets of sufficient credit quality and currency that provide a broad match against the liabilities arising from insurance and investment contracts.

The components of insurance, reinsurance, credit, market and liquidity risk management are addressed below:

Insurance risk

The Group's insurance activities are primarily concerned with the pricing, acceptance and management of risks from its customers. In accepting risk the Group is committing to the payment of claims and therefore these risks must be understood and controlled. Disciplined underwriting, encompassing risk assessment, risk management, pricing and exposure control is critical to the Group's success.

Property and casualty insurance risks

The Group manages these risks through its underwriting strategy, adequate reinsurance arrangements and proactive claims handling. The underwriting strategy aims to ensure that the underwritten risks are well diversified in terms of type and amount of risk, industry and geography.

Pricing for property and casualty products is generally based upon historical claims frequencies and claims severity averages, adjusted for inflation and trended forward to recognise anticipated changes in claims patterns. While claims remain the Group's principal cost, the Group also makes allowance in the pricing procedures for acquisition expenses, administration expenses, investment income, the cost of reinsurance and for a profit loading that adequately covers the cost of the capital the Group exposes to risk.

Underwriting limits are in place to enforce appropriate risk selection criteria. For example, the Group has the right not to renew individual policies, it can impose deductibles and it has the right to reject the payment of a fraudulent claim. In certain territories, legislation requires that the maximum loss under each employers' liability contract is never lower than a prescribed amount. All the Group employers' liability contracts offer maximum cover in compliance with such minimums.

All of the Group's underwriters have specific licences that set clear parameters for the business they can underwrite, based on the experience of the individual underwriter. Additionally the Group has a centrally managed forum looking at Group underwriting issues, reviewing and agreeing underwriting direction and setting policy and directives where appropriate. The Group has a quarterly portfolio management process across all its business units, which provides a consistent assessment of each portfolio performance against a set of key performance indicators. Under the portfolio management system, key risk indicators are tracked to monitor emerging trends, opportunities and risks and, on an annual basis, a review forum of business and underwriting leaders undertakes a detailed review of each portfolio utilising data from the quarterly reviews.

Reinsurance arrangements in place include excess, stop loss and catastrophe coverage. The effect of such reinsurance arrangements is that the Group should not suffer total net insurance losses beyond the Group's risk appetite in any one year.

Reserves – an overview

The Group establishes property and casualty loss reserves to account for the anticipated ultimate costs of all losses and related loss adjustment expenses (LAE) on losses that have already occurred. The Group establishes reserves for reported losses and LAE, as well as for incurred but not yet reported (IBNR) losses and unallocated loss adjustment expenses (ULAE). Loss reserve estimates are based on known facts and on interpretation of circumstances including the Group's experience with similar cases and historical claims payment trends. The Group also considers the development of loss payment trends, levels of unpaid claims, judicial decisions and economic conditions.

Risk management continued

The Group uses a variety of statistical techniques and a number of different bases to set reserves, depending on the business unit and line of business in question. The Group's reserving managers consider claims developments separately for each line of business and subdivide certain lines of business by major claim types or sub classifications of business. Large claims impacting each relevant account are also generally assessed separately, either being reserved at the face value of the loss adjusters' estimates or projected separately in order to allow for the future development of large claims.

The Group has a Group Reserving Committee consisting of the Group Chief Executive Officer, Chief Financial Officer, Group Underwriting and Claims Director and Group Chief Actuary. A similar committee has been established in each of the Group's major operating segments. The Group Reserving Committee monitors the decisions and judgments made by the business units as to the level of reserves recommended and makes the final decision on the reserves to be included within the consolidated financial statements ('Management Best Estimate'). In making its judgment, the Group Reserving Committee's aim is that, over the longer term, reserves should be more likely to run off favourably than adversely. However, there can be no assurance that reserves will not develop adversely and exceed the Management Best Estimate. In making its judgment of the Management Best Estimate of reserves to include in the consolidated financial statements, the Group Reserving Committee adopts the following approach:

- The Group's actuaries provide an indication of ultimate losses together with an assessment of risks and possible favourable or adverse developments that may not have been fully considered in calculating these indications. At the end of 2007 these risks and developments include: the possibility of future legislative change having retrospective effect on open claims; changes in claims settlement procedures potentially leading to future claims payment patterns differing from historical experience; the possibility of new types of claim, such as disease claims, emerging from business written several years ago; general uncertainty in the claims environment; the emergence of latent exposures such as asbestos; the outcome of litigation on claims received; failure to recover reinsurance and unanticipated changes in claims inflation
- Consideration is also made of the views of internal peer reviewers of the reserves and of third parties including actuaries, legal counsel, risk directors, underwriters and claims managers
- Consideration is made of how previous actuarial indications have developed.

In forming its collective judgment, the Committee considers this information as a whole.

Emerging and legal risks

These are risks that have been identified as potentially affecting the Group but for which the extent of risk has not yet been identified. Existing or potential future risk exposures are investigated in a structured way, using internal and external resources, and actions to mitigate, contain or remove these risks are taken.

In addition, to the extent that legal decisions in any of the jurisdictions in which the Group operates worldwide may increase court awards, and that the impact may be applied prospectively or retrospectively, claims and benefits reserves may prove insufficient to cover actual losses, LAE or future policy benefits. In such an event, or where it has been previously estimated that no liability would apply, the Group would add to its reserves and incur a charge to earnings. Such insufficiencies could have a material adverse effect on the Group's future consolidated financial condition, financial results and cashflows.

In the ordinary course of its insurance activities, the Group is routinely involved in legal or arbitration proceedings with respect to liabilities, which are the subject of policy claims.

As insurance industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues can have a negative effect on the Group's financial results by either extending coverage beyond its underwriting intent or by increasing the number and size of claims.

Reinsurance risk

The Group is exposed to multiple insured losses arising out of a single occurrence, whether a natural peril event such as a hurricane, flood or an earthquake, or man made catastrophes such as an explosion or fire at a major industrial facility. Any such catastrophic event could generate insured losses under one or more of its policies.

The ability of the business units in each territory to assess the aggregation risk of a single event impacting on thousands of policyholders is vital. The Group employs proprietary exposure measurement systems to assess these risks. In some markets, particularly in the UK, the Group has in addition developed its own expertise in catastrophe modelling that is used in conjunction with outside consultants. The accurate estimation of the potential expected maximum loss for a catastrophe is critical and is the primary factor considered in designing the Group's catastrophe reinsurance programme.

The expertise within the Group on catastrophe modelling is shared through the Worldwide Reinsurance Practice Group, which also provides an overview of the Groupwide catastrophe exposures and reinsurance adequacy. A reinsurance programme is considered to be 'adequate' only if it covers at least 199 out of 200 possible events by loss size. This is referred to as the '1 in 200 year expected maximum loss'. Since 1999, the Group has set its total retention for a single catastrophic event based on geographic location.

All of the Group's operations are required to purchase reinsurance within agreed local reinsurance appetite parameters. The Group Corporate Centre reviews the operations' proposed catastrophe purchases to check that they at least meet the Group's '1 in 200 year' standard. Group Corporate Centre also checks to see that total Group exposures are within the limits set out above and also are consistent with the required risk based capital. As a result the Group may decide to purchase further catastrophe coverage at the Group level.

In addition to local reinsurance arrangements, the Group reinsures a portion of the risks underwritten to control exposure to losses, to reduce volatility and protect capital. The Group's reinsurance strategy is to purchase reinsurance in the most effective manner from reinsurers who meet its security standards.

The Group uses financial analysis models to assess the risk and reward effects of different reinsurance structures and prices.

The Group remains primarily liable as the direct insurer on all risks reinsured, although the reinsurer is liable to the Group to the extent of the insurance risk ceded.

Credit risk

Credit risk is the risk of loss of value of the financial assets due to counterparties failing to meet all or part of their obligations. The Board Risk Committee (BRC) is responsible for ensuring that the Board approved Group credit risk appetite is not exceeded, through the setting and imposition of Group policies, procedures and limits. In defining its risk appetite for credit risk the Group looks at exposures at both an aggregate and business unit level distinguishing between credit risks incurred as a result of offsetting insurance risks or operating in the insurance market (e.g. reinsurance credit risks and insurance operations credit risks) and credit risks incurred for the purposes of generating a return (e.g. invested assets credit risk).

Limits are set at both a portfolio and counterparty level based on likelihood of default, derived from the rating of the counterparty, to ensure that the Group's overall credit profile and specific concentrations are managed and controlled within risk appetite. Financial assets are graded according to current credit ratings issued. AAA is the highest possible rating. Investment grade financial assets are classified within the range of AAA to BBB ratings. For invested assets, restrictions are placed on each of the Group's investment managers as to the level of exposure to not rated securities.

The following table provides information regarding the aggregated credit risk exposure for financial assets of the Group as at 31 December 2007.

	Credit rating relating to financial assets that are neither past due nor impaired						Total of financial assets that are neither past due nor impaired
	AAA £m	AA £m	A £m	BBB £m	<BBB £m	Not rated £m	£m
Debt securities	6,635	1,528	1,010	201	70	134	9,578
Other financial assets	55	3	8	2	1	82	151
Short term investments	7	26	53	2	1	32	121
Reinsurers' share of insurance contract liabilities	63	702	714	191	115	74	1,859
Insurance and reinsurance debtors [1]	2	75	71	43	8	2,200	2,399
Derivative assets	–	–	33	–	–	–	33
Other debtors	–	–	–	–	1	288	289
Cash and cash equivalents	334	822	191	–	3	159	1,509

Notes

1. The insurance and reinsurance debtors classified as not rated comprise personal policyholders and small corporate customers that do not have individual credit ratings. The overall credit risk to the Group is deemed to be low as the cover could be cancelled if payment were not received on a timely basis.

Risk management continued

As at 31 December 2006

	Credit rating relating to financial assets that are neither past due nor impaired						Total of financial assets that are neither past due nor impaired
	AAA £m	AA £m	A £m	BBB £m	<BBB £m	Not rated £m	£m
Debt securities	5,723	1,322	1,242	133	91	53	8,564
Other financial assets	49	5	2	3	4	91	154
Short term investments	4	11	57	7	4	31	114
Reinsurers' share of insurance contract liabilities	91	579	703	276	85	158	1,892
Insurance and reinsurance debtors [1]	2	18	49	38	6	1,840	1,953
Derivative assets	–	–	13	–	–	4	17
Other debtors	–	–	–	–	–	325	325
Cash and cash equivalents	494	1,006	249	14	7	61	1,831

With the exception of AAA rated government debt securities, the largest aggregate credit exposure does not exceed **2%** of the Group's total financial assets.

The Group is exposed to concentrations of risk with individual reinsurers, due to the nature of the reinsurance market and the restricted range of reinsurers that have acceptable credit ratings. Reinsurance counterparties are subject to a rigorous internal assessment process on an ongoing basis to ensure that their creditworthiness continues to be satisfactory and the potential impact from reinsurer default is measured regularly and managed accordingly. The Group Reinsurance Credit Committee oversees the management of these risks. Group standards are set such that reinsurers that have a financial strength rating of less than 'A-' with Standard & Poor's, or a comparable rating with AM Best, are removed from the Group's authorised list unless the Group's internal review discovers exceptional circumstances in favour of the reinsurer. Collateral is taken to mitigate exposures where appropriate to acceptable levels or the size or credit quality of the exposure. At 31 December 2007 the Group held collateral against **£65m** (2006: £87m) of reinsurers' share of insurance contract liabilities.

The Group's largest reinsurance exposures to active reinsurance groups are Munich Re, Swiss Re and Lloyds of London. At 31 December 2007 the reinsurance asset recoverable from these groups does not exceed **4.5%** of the Group's total financial assets. Stress tests are regularly performed on the Group's reinsurance assets and the limits are set such that in a catastrophic event, the exposure to a single reinsurer is estimated not to exceed **3%** of the Group's total financial assets. Certain of the Group's subsidiaries are members of government mandated pools in various parts of the world. As of 31 December 2007 the largest pool (by premium volume) was Pool Re operated by the UK Government to provide terrorism cover.

There were no material financial assets that would have been past due or impaired had the terms not been renegotiated.

The following table provides information regarding the carrying value of financial assets that have been impaired and the ageing of financial assets that are past due but not impaired as at 31 December 2007.

		Financial assets that are past due but not impaired						
	Neither past due nor impaired £m	Up to three months £m	Three to six months £m	Six months to one year £m	Greater than one year £m	Financial assets that have been impaired £m	Carrying value in the balance sheet £m	Impairment losses charged to the income statement £m
Debt securities	9,578	–	–	–	–	3	9,581	2
Other financial assets	151	–	–	–	–	–	151	–
Short term investments	121	–	–	–	–	–	121	–
Reinsurers' share of insurance contract liabilities	1,859	–	–	–	–	13	1,872	(3)
Insurance and reinsurance debtors	2,399	90	33	11	26	20	2,579	3
Derivative assets	33	–	–	–	–	–	33	–
Other debtors	289	27	32	5	2	–	355	–
Cash and cash equivalents	1,509	–	–	–	–	–	1,509	–

As at 31 December 2006

	Neither past due nor impaired £m	Financial assets that are past due but not impaired				Financial assets that have been impaired £m	Carrying value in the balance sheet £m	Impairment losses charged to the income statement £m
		Up to three months £m	Three to six months £m	Six months to one year £m	Greater than one year £m			
Debt securities	8,564	–	–	–	–	4	8,568	–
Other financial assets	154	–	–	–	1	–	155	–
Short term investments	114	–	–	–	–	–	114	–
Reinsurers' share of insurance contract liabilities	1,892	–	–	–	–	35	1,927	(2)
Insurance and reinsurance debtors	1,953	147	23	17	39	46	2,225	–
Derivative assets	17	–	–	–	–	–	17	–
Other debtors	325	8	–	–	5	1	339	–
Cash and cash equivalents	1,831	–	–	–	–	–	1,831	–

Regional operations are responsible for assessing and monitoring the creditworthiness of their counterparties (e.g. brokers and policyholders). Local credit committees are responsible for ensuring these exposures are within the risk appetite of the local operations within the overall financial control framework. Exposure monitoring and reporting is embedded throughout the organisation with aggregate credit positions reported and monitored at Group level. Invested assets credit risk is discussed in more detail below.

The Group's investments comprise a broad range of financial investments issued principally in the UK, Canada and Scandinavia.

At 31 December 2007, the Group had pledged **£954m** (2006: £651m) of financial assets as collateral for liabilities or contingent liabilities and had accepted **£1,536m** (2006: £1,025m) collateral that could be sold or pledged. The nature of the assets pledged as collateral comprises primarily government securities. The terms and conditions of the collateral pledged are market standard in relation to letter of credit facilities. The Group is permitted to sell or repledge collateral held in the event of default by the owner, the fair value of which has been noted above at **£1,536m**. The terms and conditions of the collateral held are market standard. The assets held as collateral are readily convertible into cash.

At 31 December 2007, the Group had entered into short term sale and repurchase agreements for UK government securities (repos). The Group continues to recognise the debt securities on the balance sheet as the Group remains exposed to the risks and rewards of ownership. The carrying value of these debt securities recognised on the balance sheet is **£295m** (2006: £nil) and the carrying value of the associated liabilities is **£295m** (2006: £nil).

In 2006 in addition to the above, the Group's discontinued US operation had pledged £1,356m of financial assets as collateral for liabilities or contingent liabilities and had accepted £948m of collateral that could be sold or pledged.

Certain of the Group's equities and debt securities that are held at fair value are unlisted (2007: **£577m**; 2006: £686m). These primarily comprise cash instruments which are highly liquid and redeemable at short notice at carrying value. The amount also includes a number of other unlisted investments which are valued either by reference to industry pricing sources or model based calculations.

Market risk

The Group is exposed to the risk of potential losses from adverse movements in market rates and prices as follows:

- Interest rate risk
- Equity price risk
- Property price risk
- Foreign currency exchange risk
- Derivatives.

The investment risk policy governs the Group's exposure to market risks. Exposures are controlled by the setting of investment limits in line with the Group's risk appetite.

The Group Investment Committee (GIC), on behalf of the Group Board, is responsible for reviewing and approving the investment strategy for the Group's investment portfolios. It provides approval for all major changes of the Group's investment strategy and, in particular, approves any substantive

Risk management continued

changes to the balance of the Group's funds between the major asset classes. Importantly the GIC also approves the terms of reference of the Group's main operational investment committee, the Group Asset Management Committee (GAMC). The BRC issues GAMC with investment risk limits.

Interest rate risk

The fair value of the Group's portfolio of fixed income securities is inversely correlated to changes in the market interest rates. Thus if interest rates fall, the fair value of the portfolio would tend to rise and vice versa as set out in the sensitivity analysis on page 80.

Equity price risk

The Group's portfolio of equity securities is subject to equity risk arising from changes in market price. Thus if the value of equities rise so will the fair value of its portfolio and vice versa as set out in the sensitivity analysis on page 80.

The Group sets appropriate risk limits to ensure that no significant concentrations to individual companies or sectors arise. The Group takes a long term view in selecting shares and looks to build value over a sustained period of time rather than churning the portfolio looking for short term gains from its equity holdings.

The Group makes use of derivative products as appropriate to protect the portfolio from losses outside of its risk appetite.

The Group does not have material holdings of unquoted equities.

Property price risk

The Group's portfolio of properties is subject to property price risk arising from changes in the market value of properties. Thus if the value of property falls so will the fair value of the portfolio as set out in the sensitivity analysis on page 80.

A number of the Group's property holdings are Group occupied and therefore are reported within property and equipment. The Group's investment in investment property is recorded as such and is invested in as part of an efficient portfolio management strategy.

Foreign currency exchange risk

The Group operates in 28 countries. Accordingly, its net assets are subject to foreign currency exchange rate movements. The Group's primary foreign currency exposures are to the Danish Kroner, Canadian Dollar, Swedish Krona and the Euro. If the value of Sterling strengthens then the value of non Sterling net assets will decline when translated into Sterling and consolidated.

The Group incurs exposure to foreign currency exchange risk in two ways:

- Operational foreign currency exchange risk – by underwriting liabilities in currencies other than the currency of the primary environment in which the business units operate (non functional currencies)
- Structural foreign currency exchange risk – by investing in overseas subsidiaries and operating an international insurance group.

Operational foreign currency exchange risk is managed within the Group's individual operations by broadly matching assets and liabilities by currency.

Structural foreign currency exchange risk is managed at a Group level through forward foreign exchange contracts. Derivatives are used to manage exposures within the limits that have been set. In managing structural foreign currency exchange risk, net assets maintained by the Group's subsidiaries in local currencies are taken into account to satisfy local regulatory solvency and internal risk based capital requirements. These assets should prove adequate to support local insurance activities irrespective of foreign currency exchange rate movements. Consequently, this may affect the value of the consolidated shareholders' equity expressed in Sterling.

At 31 December 2007, the Group's total shareholders' equity, analysed by currency is:

	Sterling £m	Danish Kroner £m	Canadian $ £m	Swedish Krona £m	Euro £m	Other £m	Total £m
Shareholders' equity – 31 December 2007	**482**	**690**	**798**	**441**	**349**	**317**	**3,077**
Shareholders' equity – 31 December 2006	626	556	655	203	(9)	530	2,561

Shareholders' equity is stated before taking account of the effect of forward foreign exchange contracts. After taking account of the effect of forward foreign exchange contracts, a 10% change in Sterling against Danish Kroner or Canadian Dollar would have the following impact on shareholders' equity:

	10% strengthening in Sterling against Danish Kroner £m	10% weakening in Sterling against Danish Kroner £m	10% strengthening in Sterling against Canadian $ £m	10% weakening in Sterling against Canadian $ £m
Movement in shareholders' equity at 31 December 2007	**(15)**	**19**	**(38)**	**47**
Movement in shareholders' equity at 31 December 2006	(20)	25	(60)	73

Apart from the impact on derivative financial instruments covered below, the changes arise from retranslation of foreign subsidiaries' balance sheets from their functional currencies into Sterling, with movements being taken through the currency translation reserve. These movements in exchange rates therefore have no impact on profit.

Derivatives

The Group may use derivative financial instruments for the purpose of reducing its exposure to adverse fluctuations in interest rates, foreign exchange rates and equity price risk. The Group does not use derivatives to leverage its exposure to markets and does not hold or issue derivative financial instruments for speculative purposes. Forward contracts are used to reduce the risk of adverse currency movements on certain forecast future cash transactions and for structural hedging. The policy on use of derivatives is approved by the BRC.

	Remaining life			Fair value		Notional principal amounts	
	Less than one year £m	**One to five years £m**	**More than five years £m**	**2007 £m**	2006 £m	**2007 £m**	2006 £m
Cross currency							
Asset	**1**	**–**	**–**	**1**	–	**4**	4
Liability	**29**	**–**	**2**	**31**	–	**1,247**	170
Credit							
Asset	**–**	**–**	**–**	**–**	4	**–**	37
Liability	**–**	**–**	**–**	**–**	7	**–**	46
Equity/index							
Asset	**32**	**–**	**–**	**32**	12	**see below**	see below
Liability	**31**	**–**	**–**	**31**	21	**see below**	see below

At 31 December 2007 there were derivative contracts in place to protect the value of the UK equity portfolios of the Group. These provided limited protection against declines in market levels whilst also capping participation in any appreciation of the market. In total, this strategy covered an underlying equity value up to approximately **£800m**. If UK equity markets decreased by 15%, the impact of these derivatives as of 31 December 2007, would be to decrease the impact of the decline by **£47m** (2006: £41m).

At 31 December 2007 the Group holds forward foreign exchange contracts that are designated as hedging instruments to reduce structural foreign exchange risk. The derivatives are included in the above. Further information on designated hedges can be found in note 28.

Risk management continued

Sensitivity analysis

The Group uses a number of sensitivity or stress test based risk management tools to understand the impact on earnings and capital in both normal and stressed conditions. These stress tests combine deterministic shocks, analysis of historical scenarios and stochastic modelling using the Individual Capital Assessment (ICA) models to inform the Group's decision making and planning process and also for identification and management of risks within the business units.

The following table provides an indication of some of the single factor changes adopted within the Group:

Changes in the income statement and equity:

	Increase/(decrease) in income statement		Decrease in equity	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Interest rate markets (note 2):				
Impact on fixed interest securities of increase in interest rates of 100bps	**–**	–	**(264)**	(198)
Impact on loan capital of increase in interest rates of 100bps (note 3)	**–**	–	**–**	–
Decrease of equity markets (note 4):				
Direct impact on equities of a 15% fall in equity markets	**–**	–	**(223)**	(243)
Mitigating impact arising from derivatives held	**47**	41	**–**	–
Property markets (note 4):				
Decrease of property markets of 15%	**(64)**	(68)	**(44)**	(45)

Notes

1. This analysis assumes that there is no correlation between equity price, interest rate and property market rate risks. It also assumes that all other assets and liabilities remain unchanged and that no management action is taken. This analysis does not represent management's view of future market change, but reflects management's view of key sensitivities.
2. The sensitivity of the fixed interest securities of the Group has been modelled by reference to a reasonable approximation of the average interest rate sensitivity of the investments held within each of the portfolios.
3. The impact on the fair value of the loan capital is an increase of **£124m** (2006: £85m).
4. The effect of movements in equity and property markets is reflected as a one time decrease of worldwide equity and property markets on 1 January 2008 and 1 January 2007 which results in a 15% decline in the value of the Group's assets in these investment categories.
5. This analysis has not considered the impact of the above market changes on the valuation of the Group's insurance liabilities.

With reference to sensitivity analysis within insurance risk, the Group has exposures to risks in each class of business within each operating segment that may develop and that could have a material impact upon the Group's financial position. The geographical and insurance risk diversity within the Group's portfolio of issued insurance policies makes it not possible to predict whether material development will occur and, if it does occur, the location and timing of such an occurrence.

The Group evaluates the concentration of exposures to individual and cumulative insurance risk and establishes its reinsurance policy to reduce such exposures to levels acceptable to the Group.

Liquidity risk

Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The Group has no tolerance for liquidity risk and is committed to meeting all liabilities as they fall due. The investment risk limits set by the BRC ensure that the Group's portfolio is kept in highly liquid marketable securities sufficient to meet its liabilities as they come due based on actuarial assessment. The Group maintains a level of liquid assets consistent with the expectations of the Financial Services Authority (FSA) and the investment community.

The limits are monitored at a Group level as part of the Group Risk exposure monitoring and BRC reporting process.

In addition the Group has committed credit facilities available as set out in note 22.

Maturity periods or contractual repricing

The following table summarises the contractual repricing or maturity dates (whichever is earlier) for financial assets and financial liabilities, that are subject to fixed and variable interest rates. Equity instruments are not subject to interest rate risk. Insurance assets and liabilities are also presented and are analysed by remaining duration.

As at 31 December 2007

	Less than one year £m	One to two years £m	Two to three years £m	Three to four years £m	Four to five years £m	Five to ten years £m	Greater than ten years £m	Total £m
Financial assets								
Debt securities	1,626	2,006	1,478	1,149	1,021	1,439	862	9,581
Other financial assets	94	18	11	15	–	6	7	151
Short term investments	121	–	–	–	–	–	–	121
Reinsurers' share of provision for unearned premiums	201	7	3	1	1	2	–	215
Reinsurers' share of provision for losses and loss adjustment expenses	522	344	236	159	111	172	113	1,657
Insurance and reinsurance debtors	2,565	5	3	2	3	1	–	2,579
Derivative assets	33	–	–	–	–	–	–	33
Cash and cash equivalents	1,509	–	–	–	–	–	–	1,509
Total	6,671	2,380	1,731	1,326	1,136	1,620	982	15,846

	Less than one year £m	One to two years £m	Two to three years £m	Three to four years £m	Four to five years £m	Five to ten years £m	Greater than ten years £m	Total £m
Financial liabilities								
Subordinated guaranteed US$ bonds	–	–	–	–	–	–	11	11
Subordinated guaranteed Euro bonds	–	365	–	–	–	–	–	365
Subordinated Sterling perpetual guaranteed bonds	–	–	–	–	–	305	–	305
Subordinated guaranteed perpetual notes	–	–	–	–	–	513	–	513
Provision for unearned premiums	3,134	152	59	8	5	9	16	3,383
Provision for losses and loss adjustment expenses	3,392	1,847	1,322	921	641	1,363	858	10,344
Direct insurance creditors	165	1	–	–	–	–	–	166
Reinsurance creditors	250	10	–	–	–	–	–	260
Borrowings	302	1	–	–	–	–	–	303
Deposits due to reinsurers	47	16	1	–	–	–	–	64
Derivative trading liabilities	60	–	–	–	–	–	2	62
Total	7,350	2,392	1,382	929	646	2,190	887	15,776

Risk management continued

As at 31 December 2006

	Less than one year £m	One to two years £m	Two to three years £m	Three to four years £m	Four to five years £m	Five to ten years £m	Greater than ten years £m	Total £m
Financial assets								
Debt securities	2,416	1,610	1,285	947	535	1,138	637	8,568
Other financial assets	91	14	16	13	11	8	2	155
Short term investments	114	–	–	–	–	–	–	114
Reinsurers' share of provision for unearned premiums	166	12	4	2	1	4	–	189
Reinsurers' share of provision for losses and loss adjustment expenses	538	374	238	165	104	184	135	1,738
Insurance and reinsurance debtors	2,225	–	–	–	–	–	–	2,225
Derivative assets	12	–	–	–	–	–	5	17
Cash and cash equivalents	1,831	–	–	–	–	–	–	1,831
Total	7,393	2,010	1,543	1,127	651	1,334	779	14,837

	Less than one year £m	One to two years £m	Two to three years £m	Three to four years £m	Four to five years £m	Five to ten years £m	Greater than ten years £m	Total £m
Financial liabilities								
Subordinated guaranteed US$ bonds	–	–	–	–	–	–	37	37
Subordinated guaranteed Euro bonds	–	–	335	–	–	–	–	335
Subordinated Sterling perpetual guaranteed bonds	–	–	–	–	–	301	–	301
Subordinated guaranteed perpetual notes	–	–	–	–	–	519	–	519
Provision for unearned premiums	2,734	159	52	6	3	6	9	2,969
Provision for losses and loss adjustment expenses	3,206	1,764	1,265	893	608	1,286	799	9,821
Direct insurance creditors	139	1	–	–	–	–	–	140
Reinsurance creditors	236	6	9	–	–	–	–	251
Borrowings	6	1	1	–	–	–	–	8
Deposits due to reinsurers	39	12	9	1	–	–	–	61
Derivative trading liabilities	21	–	–	–	–	–	7	28
Total	6,381	1,943	1,671	900	611	2,112	852	14,470

The analysis above is based upon the contractual terms of the financial assets within the Group's investment portfolios. The financial assets are mainly highly liquid marketable securities which would normally be readily realisable before maturity.

Capital management

The maintenance of a strong capital position of the Group is critical to its ability to conduct business.

The Group maintains sufficient capital, which comprises shareholders' equity and subordinated loan capital, to meet its plan and objectives. This represents sufficient surpluses for both regulatory and economic capital, as well as sufficient capital to support the Group's aim of maintaining single 'A' ratings.

To provide protection against material events or shocks, the Group would normally expect to hold sufficient capital to maintain significant economic and regulatory surpluses.

The maintenance of a capital position in excess of regulatory requirements is an absolute requirement for all of the Group's regulated entities. There is no tolerance for breaching capital requirements for any regulated entity.

Economic capital

Economic capital is the Group's preferred measure of capital sufficiency. It is the Group's own assessment of the amount of capital it needs to hold to meet its obligations given the Group's risk appetite. Assets and liabilities are valued on an economic basis providing the most realistic representation of the Group's financial condition.

The economic capital analysis compares the economic value of the Group's assets with the total resources required in a range of adverse scenarios, calibrated to a defined risk tolerance consistent with the Group's 'A' rating which is in line with target. The economic capital surplus is the amount by which the economic assets exceed the total resources required. The total resources required is the amount of assets the Group needs today to meet its liabilities under the defined risk tolerance. The Group defines the economic capital required as the difference between the total resource requirement and the accounting value of liabilities. The Group's capital surplus has increased during the year. At 31 December 2007, the Group's surplus economic capital is approximately **£2.2bn** (2006: £2.0bn).

The economic capital model is used to support, inform and improve the Group's decision making across the Group. It is used to determine the Group's optimum capital structure, its investment strategy, its reinsurance programme and to determine the pricing and target returns for each portfolio. The economic capital model is also used for the Group's ICA. The only adjustment made is to use the FSA's required calibration.

Regulatory solvency position

The Group remains fully compliant with both the FSA's risk based ICA methodology and Solvency I, which is used to calculate the Insurance Groups Directive (IGD) requirement.

For the Group's senior regulated insurance company, Royal & Sun Alliance Insurance plc, the capital position continues to be reported under Solvency I.

As at 31 December 2007 the Group had an IGD surplus of approximately **£1.5bn** (2006: £1.3bn). The improvement in IGD surplus is mainly attributable to the profits for the year, continuing actions to enhance capital efficiency including agreement with the FSA to adopt the accounting consolidation method as a basis for preparing the IGD return and the issue of equity shares, offset by the dividend and by the purchase of the minority interest in Codan. The coverage ratio stood at **2.5** times at 31 December 2007 (2006: 1.9 times).

The Group received its Individual Capital Guidance (based on its ICA submission) from the FSA in late 2007, which at the request of the FSA remains confidential. The ICA is a forward looking, economic assessment of the capital requirements of the Group based on its assessment of the risks to which it is exposed. The models used to determine the ICA have been integrated into the Group's business processes and are used to enhance the management of the Group.

The Group is also continuing to implement a number of capital management initiatives, including optimising its regulatory structure and improving the capital efficiency of its discontinued lines of business.

Notes to the financial statements

1. Operating segments

On 1 January 2007, the Group was reorganised into three operating segments – International, Emerging Markets and the UK. The UK is the Group's country of domicile and principal market (based on value of premium written in a single country). International comprises operations in Scandinavia, Canada, Ireland and Italy and Emerging Markets comprises the Group's operations in Latin America, Asia and the Middle East, the Baltics and the Group's new joint venture in Central and Eastern Europe. All operations are engaged in providing personal and commercial general insurance services. Central functions include the Group's internal reinsurance function and Group Corporate Centre.

In the previous Group structure the Group's non UK businesses were organised into Scandinavia (including the Baltics) and International (Canada, Ireland, Italy, Latin America and Asia and the Middle East). The new structure brings together operations with similar challenges and opportunities in order to give due focus to achieving the Group's objective of profitable growth across the business. Each operating segment is managed by a Chief Executive Officer (CEO) who is directly accountable to the Group CEO and the Board of Directors.

The Group uses the following key measures to assess the performance of its operating segments:

- Net written premiums
- Underwriting result
- Combined operating ratio (COR).

Net written premiums is the key measure of revenue used in internal reporting. Underwriting result and COR are the key internal measures of profitability of the operating segments. The COR reflects the ratio of claims costs and expenses (including commission) to premiums, expressed as a percentage.

All of these items are measured in accordance with the Group's accounting policies. Certain items included within the Group's investment result are allocated to the operating segments based on economic capital requirements.

Transfers or transactions between segments are entered into under normal commercial terms and conditions that would also be available to unrelated third parties.

Amounts reported for the prior year have been restated to reflect the revised operating segments.

Management basis

The management basis reflects the way management monitor the business. Operating result on a management basis comprises the underwriting result, the investment result and other activities.

Major components of underwriting result are net earned premiums, other operating income, net claims and benefits and underwriting and policy acquisition costs.

The investment result, excluding unwind of discount and foreign exchange, is disclosed as net investment return on the statutory basis. Investment income on the statutory basis includes an adjustment for depreciation on Group occupied properties.

Other activities primarily comprise administration and other expenses and investment expenses and charges.

Segment revenue and results

Year ended 31 December 2007

	UK £m	International £m	Emerging Markets £m	Central functions £m	Total Group £m
Net written premiums	2,688	2,513	615	21	5,837
Underwriting result	65	206	18	(11)	278
Investment result	372	212	42	3	629
Insurance result	437	418	60	(8)	907
Other activities	(1)	(8)	(6)	(78)	(93)
Operating result (management basis)	436	410	54	(86)	814
Amortisation					(18)
Results of operating activities (per income statement)					796
Combined operating ratio (%)	97.6	91.3	95.3	–	94.9
Other segment items included in the income statement:					
Investment income	328	198	35	30	591
Interest expense	–	(6)	(6)	(9)	(21)
Depreciation and amortisation	(38)	(39)	(6)	(5)	(88)

Year ended 31 December 2006

	UK £m	International £m	Emerging Markets £m	Central functions £m	Total Group £m
Net written premiums	2,618	2,334	531	1	5,484
Underwriting result	160	149	11	(10)	310
Investment result	321	199	35	1	556
Insurance result	481	348	46	(9)	866
Other activities	9	(11)	(7)	(77)	(86)
Operating result (management basis)	490	337	39	(86)	780
Amortisation					(15)
Reorganisation costs					(23)
Less: net share of profit after tax of associates					(1)
Results of operating activities (per income statement)					741
Combined operating ratio (%)	92.3	93.1	97.3	–	93.3
Other segment items included in the income statement:					
Investment income	295	190	30	1	516
Interest expense	–	(7)	(6)	(12)	(25)
Depreciation and amortisation	(50)	(33)	(9)	(4)	(96)

No other material non cash expenses are reported internally by segment.

Segment assets and capital expenditure

Year ended 31 December 2007

	UK £m	International £m	Emerging Markets £m	Central functions £m	Total Group £m
Segment assets	**8,716**	**8,977**	**1,474**	**1,213**	**20,380**
Investment in associates	**–**	**4**	**101**	**–**	**105**
Total assets of continuing operations	**8,716**	**8,981**	**1,575**	**1,213**	**20,485**
Non current and disposal group assets held for sale					**108**
Total assets					**20,593**
Capital expenditure:					
Property and equipment	**3**	**18**	**7**	**–**	**28**
Goodwill	**–**	**35**	**–**	**–**	**35**
Intangible assets	**42**	**60**	**2**	**–**	**104**

Year ended 31 December 2006

	UK £m	International £m	Emerging Markets £m	Central functions £m	Total Group £m
Segment assets	9,033	7,816	1,229	1,058	19,136
Investment in associates	–	–	27	–	27
Total assets of continuing operations	9,033	7,816	1,256	1,058	19,163
Non current and disposal group assets held for sale					3,485
Total assets					22,648
Capital expenditure:					
Property and equipment	14	13	8	2	37
Goodwill	40	28	2	–	70
Intangible assets	93	33	1	–	127

Notes to the financial statements continued

1. Operating segments continued

Net written premiums by major geographical territories

	2007 £m	2006 £m
UK	**2,688**	2,618
Scandinavia	**1,379**	1,280
Canada	**703**	662
Other Europe	**431**	392
Other	**636**	532
Total net written premiums	**5,837**	5,484

Net written premiums are allocated to the countries in which the business is underwritten or managed.

Other Europe principally comprises the Group's businesses in Ireland and Italy.

2. Net investment return

A summary of the gross investment income, net realised and net unrealised gains/(losses) included in the income statement is given below.

	Investment income		Net realised gains/(losses)		Net unrealised gains/(losses)		Impairments		Total investment return	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Investment property	**19**	13	**12**	12	**(42)**	42	**–**	–	**(11)**	67
Equity securities	**48**	56	**185**	52	**(2)**	–	**(1)**	(3)	**230**	105
Debt securities	**391**	372	**(29)**	(27)	**–**	–	**(2)**	–	**360**	345
Other investments:										
Loans secured by mortgages	**1**	1	**1**	–	**–**	–	**–**	–	**2**	1
Other loans	**5**	3	**–**	16	**–**	–	**–**	–	**5**	19
Other	**31**	8	**(4)**	7	**(8)**	–	**–**	–	**19**	15
Deposits, cash and cash equivalents	**83**	63	**1**	–	**–**	–	**–**	–	**84**	63
Derivatives	**15**	1	**8**	(14)	**(3)**	(2)	**–**	–	**20**	(15)
Net investment return	**593**	517	**174**	46	**(55)**	40	**(3)**	(3)	**709**	600

The net investment return arising on assets categorised as at fair value through the income statement includes the net return arising on derivatives. There are no other material amounts of net investment return arising from financial assets that do not relate to financial assets designated as available for sale financial assets.

Direct operating expenses (including repairs and maintenance) arising from investment properties were not material in 2007 and 2006.

Unrealised capital gains and losses recognised directly in equity for available for sale assets are as follows:

	Net unrealised gains/(losses)		Net realised gains/(losses) transferred to income statement		Impairments transferred to income statement		Net movement recognised in equity	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Equity securities	**49**	158	**(194)**	(39)	**1**	3	**(144)**	122
Debt securities	**1**	(132)	**27**	16	**2**	–	**30**	(116)
Other	**1**	2	**(1)**	(4)	**–**	–	**–**	(2)
Total	**51**	28	**(168)**	(27)	**3**	3	**(114)**	4

3. Net claims and benefits

	2007 £m	2006 £m
Gross claims paid	**4,145**	3,910
Gross changes in insurance contract liabilities for claims	**(101)**	(152)
Reinsurance recoveries on losses and loss expenses paid	**(519)**	(603)
Reinsurers' share of change in insurance contract liabilities for claims	**132**	298
Net claims and benefits	**3,657**	3,453

4. Profit before tax

The following items have been included in arriving at the profit before tax on continuing operations:

Other operating income

	2007 £m	2006 £m
Other income	114	109
Net (losses)/gains on derivatives	(1)	12
Other operating income	**113**	121

Other operating expenses

	2007 £m	2006 £m
Administration and other expenses	83	87
Reorganisation expenses	–	23
Investment expenses and charges	21	25
Amortisation of intangible assets	18	15
Foreign exchange (gains)/losses	(3)	1
Other operating expenses	**119**	151

Other lease payments

The operating lease payments recognised as an expense during the year were **£48m** (2006: £75m). The Group has no significant lease agreements that include contingent rents.

Finance costs

	2007 £m	2006 £m
Interest expense on loan capital	90	80
Other loan interest	14	12
Finance costs	**104**	92

Auditors' remuneration

	PricewaterhouseCoopers LLP		Deloitte & Touche LLP		Total	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Fees payable to the Company's auditors for audit of the Company's annual accounts	–	0.9	0.9	–	0.9	0.9
Fees payable to the Company's auditors and its associates for other services:						
The audit of the Company's subsidiaries, pursuant to legislation	0.3	5.3	2.6	–	2.9	5.3
Other services pursuant to legislation	0.1	0.5	0.1	–	0.2	0.5
Tax services	0.8	0.5	0.1	–	0.9	0.5
Services relating to corporate finance activities	0.3	0.2	1.1	–	1.4	0.2
Other	0.2	0.1	0.4	–	0.6	0.1
Fees in respect to pension scheme:						
Audit	0.1	0.1	–	–	0.1	0.1
	1.8	7.6	5.2	–	7.0	7.6

During 2007 PricewaterhouseCoopers LLP resigned as auditors and Deloitte & Touche LLP were appointed.

Auditors' remuneration in 2006 included amounts relating to the requirements of section 404 of the Sarbanes Oxley Act.

Notes to the financial statements continued

4. Profit before tax continued

Directors' emoluments

The aggregate emoluments of the directors, including amounts received from subsidiaries, were as follows:

	2007 £000	2006 £000
Emoluments of executive directors	**4,479**	4,257
Fees and other payments to non-executive directors	**556**	556
	5,035	4,813

A pension payment of **£25,302** (2006: £24,423) was paid by a subsidiary to a former director in respect of services other than as a director. Details of directors' remuneration and pension benefits, including that of the highest paid director (Andy Haste), are included in the directors' emoluments. Details of directors' interests in the Parent Company are shown in the directors' emoluments and interests.

Employee information

Staff costs for all employees comprise:

	2007 £m	2006 £m
Wages and salaries	**657**	590
Social security costs	**74**	69
Pension costs	**43**	64
Share based payments to directors and employees	**19**	12
	793	735

The average number of employees of the continuing operations during the year was as follows:

	2007 Number	2006 Number
UK	**9,626**	10,377
International	**7,418**	7,279
Emerging Markets	**5,509**	5,521
	22,553	23,177

Discontinued operations

The loss before tax from discontinued operations includes the following:

	2007 £m	2006 £m
Reorganisation expenses	**1**	11
Investment expenses and charges	**–**	23
Amortisation and impairment of intangible assets	**1**	5

Staff costs for employees of discontinued operations comprise:

	2007 £m	2006 £m
Wages and salaries	**5**	38
Social security costs	**1**	3
Pension costs	**1**	3
Share based payments to directors and employees	**–**	1
	7	45

Auditors' remuneration of **£nil** was paid in 2007. In 2006 £1m was paid to PricewaterhouseCoopers LLP in respect of the audit services for the discontinued operation.

5. Income tax expense

The tax amounts charged in the income statement are as follows:

	2007 £m	2006 £m
Current tax	**168**	156
Deferred tax	**(139)**	14
Taxation attributable to the continuing operations	**29**	170

UK corporation tax is calculated at **30%** (2006: 30%) of the estimated assessable profit for the year. Since the Group operates around the world, it is subject to income taxes in many different jurisdictions. Taxation for jurisdictions other than the UK is calculated at the rates prevailing in those jurisdictions. Of the above taxation attributable to the Group **£37m** (2006: £74m) relates to UK corporation tax and **£(8)m** (2006: £96m) to overseas taxation.

	2007 £m	2006 £m
Profit before tax on continuing operations	**670**	649
Tax at the UK rate of **30%** (2006: 30%)	**201**	195
Tax effect of:		
Income/gains not taxable	**(26)**	(35)
Expenses not deductible for tax purposes	**10**	14
Tax losses not recognised	**–**	4
Release of tax held in respect of Security Fund/Safety Reserve	**(103)**	–
Release of tax provided in respect of prior periods	**(15)**	(5)
Different tax rates of subsidiaries operating in other jurisdictions	**(32)**	(3)
Other	**(6)**	–
Income tax expense	**29**	170

6. Earnings per share attributable to the ordinary shareholders of the Parent Company

The earnings per ordinary share is calculated by reference to the profit/(loss) attributable to the ordinary shareholders and the weighted average of shares in issue during the year.

Basic

Basic earnings per share is calculated by dividing the profit/(loss) attributable to the ordinary shareholders of the Parent Company by the weighted average number of ordinary shares in issue during the period, excluding ordinary shares purchased by the ESOP Trusts and held as treasury shares.

	Continuing operations		Total Group	
	2007 £m	2006 £m	2007 £m	2006 £m
Profit/(loss) attributable to the ordinary shareholders of the Parent Company	**609**	447	**596**	(52)
Less: cumulative preference dividends	**(9)**	(9)	**(9)**	(9)
Profit/(loss) for the calculation of earnings per share	**600**	438	**587**	(61)
Weighted average number of ordinary shares in issue (thousands)	**3,106,017**	2,929,453	**3,106,017**	2,929,453
Basic earnings per share (p)	**19.3**	15.0	**18.9**	(2.1)

Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. The Parent Company has only one category, share options, of dilutive potential ordinary shares.

Notes to the financial statements continued

6. Earnings per share attributable to the ordinary shareholders of the Parent Company continued

The calculation is performed for the share options to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Parent Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options.

	Continuing operations		Total Group	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Profit/(loss) for the calculation of earnings per share	**600**	438	**587**	(61)
Weighted average number of ordinary shares in issue (thousands)	**3,106,017**	2,929,453	**3,106,017**	2,929,453
Adjustments for share options (thousands)	**43,869**	29,835	**43,869**	29,835
Weighted average number of ordinary shares for diluted earnings per share (thousands)	**3,149,886**	2,959,288	**3,149,886**	2,959,288
Diluted earnings per share (p)	**19.0**	14.8	**18.6**	(2.1)

Earnings per share attributable to discontinued operations

The loss for the year from discontinued operations is **£13m** (2006: £499m). The basic earnings per share from discontinued operations is **(0.4)p** (2006: (17.1)p) and the diluted earnings per share from discontinued operations is **(0.4)p** (2006: (16.9)p).

7. Dividends

	2007 p	2006 p	**2007 £m**	2006 £m
Ordinary dividend:				
Final paid in respect of prior year	**4.12**	3.05	**123**	89
Interim paid in respect of current year	**2.48**	1.75	**79**	51
			202	140
Preference dividend			**9**	9
			211	149

At the Annual General Meeting (AGM) on 19 May 2008, a dividend in respect of 2007 of **4.53p** per share amounting to a total dividend of **£146m** is to be proposed. The proposed dividend will be paid and accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31 December 2008.

The trustees of the Royal & SunAlliance ESOP Trust and the Royal & SunAlliance ESOP Trust No 2 waived their entitlement to dividends which reduced the total dividend paid by **£1m** (2006: £1m).

8. Goodwill and other intangible assets

	Goodwill £m	Intangible asset arising from acquired claims provisions £m	Software development £m	Other £m	Total £m
Cost					
At 1 January 2007	213	89	399	106	807
Additions and transfers	35	6	51	47	139
Disposals and transfers	–	–	(9)	(20)	(29)
Exchange adjustment	15	7	7	17	46
At 31 December 2007	263	102	448	150	963
Accumulated amortisation					
At 1 January 2007	–	65	145	45	255
Amortisation charge	–	6	38	12	56
Amortisation on disposals	–	–	(8)	(20)	(28)
Exchange adjustment	–	6	4	7	17
At 31 December 2007	–	77	179	44	300
Net book amount at 31 December 2007	263	25	269	106	663

No goodwill and other intangible assets as at 31 December 2007 have been impaired.

	Goodwill £m	Intangible asset arising from acquired claims provisions £m	Software development £m	Other £m	Total £m
Cost					
At 1 January 2006	769	218	325	88	1,400
Additions and transfers	70	–	94	33	197
Disposals and transfers	–	–	(3)	–	(3)
Exchange adjustment	(83)	(19)	(5)	(15)	(122)
Transfer to non current and disposal group assets held for sale	(543)	(110)	(12)	–	(665)
At 31 December 2006	213	89	399	106	807
Accumulated amortisation					
At 1 January 2006	–	171	117	45	333
Amortisation charge	–	11	46	9	66
Amortisation on disposals	–	–	(1)	–	(1)
Exchange adjustment	–	(17)	(5)	(9)	(31)
Transfer to non current and disposal group assets held for sale	–	(100)	(12)	–	(112)
At 31 December 2006	–	65	145	45	255
Accumulated impairment					
At 1 January 2006	617	–	–	–	617
Exchange adjustment	(74)	–	–	–	(74)
Transfer to non current and disposal group assets held for sale	(543)	–	–	–	(543)
At 31 December 2006	–	–	–	–	–
Net book amount at 31 December 2006	213	24	254	61	552

Amortisation expense of **£38m** (2006: £46m) has been charged to underwriting and policy acquisition costs.

Additions of software development comprise **£17m** (2006: £82m) of external software and **£34m** (2006: £12m) of internally developed software.

Impairment tests for goodwill

Goodwill is allocated to the Group's cash generating units (CGUs) as follows:

	2007 £m	2006 £m
UK	**43**	43
International	**175**	126
Emerging Markets	**45**	44

When testing for impairment, the recoverable amount of a CGU is determined based on value in use calculations. These calculations use cashflow projections based on financial budgets approved by management covering a five year period. Cashflows beyond the five year period are extrapolated using the estimated growth rates which do not exceed the long term average past growth rate for the insurance business in which the CGU operates.

A number of other assumptions and estimates are involved in the application of a cashflow model to forecast operating cashflows, premium volumes, expenses and working capital requirements. Forecasts of future cashflows are based on the best estimates of future premiums, operating expenses using historical trends, general geographical market conditions, industry trends and forecasts and other available information. These assumptions are subject to review by management and the Group Audit Committee. The cashflow forecasts are adjusted by an appropriate discount rate. The discount rates used are pre tax and reflect specific risks relating to the relevant segments at the date of evaluation. The weighted average growth rates used are consistent with the forecasts included in industry reports.

Notes to the financial statements continued

9. Property and equipment

	Group occupied property – land and buildings £m	Other £m	Total £m
Cost/valuation			
At 1 January 2007	298	320	618
Additions	7	21	28
Disposal of subsidiaries	(4)	–	(4)
Disposals	(19)	(8)	(27)
Revaluation adjustments	17	–	17
Exchange adjustment	17	14	31
Transfer to investment property	(10)	–	(10)
Transfer to non current and disposal group assets held for sale	(13)	–	(13)
At 31 December 2007	293	347	640
Accumulated depreciation			
At 1 January 2007	–	227	227
Depreciation charge	4	28	32
Depreciation on disposals	–	(5)	(5)
Revaluation adjustment	(4)	–	(4)
Exchange adjustment	–	8	8
At 31 December 2007	–	258	258
Accumulated impairment			
At 1 January 2007	–	6	6
Exchange adjustment	–	(1)	(1)
At 31 December 2007	–	5	5
Net book amount at 31 December 2007	293	84	377

	Group occupied property – land and buildings £m	Other £m	Total £m
Cost/valuation			
At 1 January 2006	301	329	630
Additions	7	30	37
Acquisition of subsidiaries	1	2	3
Disposals	(4)	(21)	(25)
Revaluation adjustments	16	–	16
Exchange adjustment	(7)	(13)	(20)
Transfer to non current and disposal group assets held for sale	(16)	(7)	(23)
At 31 December 2006	298	320	618
Accumulated depreciation			
At 1 January 2006	–	220	220
Depreciation charge	4	32	36
Depreciation on disposals	–	(13)	(13)
Revaluation adjustment	(4)	–	(4)
Exchange adjustment	–	(7)	(7)
Transfer to non current and disposal group assets held for sale	–	(5)	(5)
At 31 December 2006	–	227	227
Accumulated impairment			
Impairment charge	–	6	6
At 31 December 2006	–	6	6
Net book amount at 31 December 2006	298	87	385

The Group occupied property was revalued on 31 December 2007 by independent valuers.

Depreciation and impairment expense of **£32m** (2006: £42m) has been charged to underwriting and policy acquisition costs.

The carrying amount of Group occupied property that would have been recognised had the assets been carried under the cost model at 31 December 2007 is **£189m** (2006: £218m).

10. Investment property

Investment property consists of the following:

	2007 £m	2006 £m
Land and buildings:		
Freehold and long leasehold	**426**	451
Short leasehold	**3**	3
Total land and buildings	**429**	454

Movement in the carrying value of investment property is detailed below:

	2007 £m	2006 £m
Investment property at 1 January	**454**	435
Additions from subsequent expenditure	**9**	1
Transfer from property and equipment	**10**	–
Sales and purchases	**1**	(21)
Fair value (losses)/gains	**(50)**	40
Exchange adjustment	**5**	(1)
Investment property at 31 December	**429**	454

Investment properties are included in the Group's investment portfolio to provide investment returns over the longer term in accordance with the Group's investment strategy. Investment properties are managed by external managers.

The lease agreements are normally drawn up in line with local practice and the Group has no significant exposure to leases that include contingent rents.

11. Investments in associates

The Group has the following investments in associates:

	Country	Ordinary shareholding
Global Direct Insurance Investments BV	Netherlands	50.0%
Royal Sundaram Alliance Insurance Company Ltd	India	26.0%
Syn Mun Kong Public Limited Company	Thailand	20.0%

Syn Mun Kong Public Limited Company is listed on the Stock Exchange of Thailand. The fair value of the Group's holding at 31 December was **£3m**.

Summarised below are the assets, liabilities, revenue and profit and loss of the companies above, subject to the following:

- During 2007 the Group disposed of its 45% interest in Royal & Sun Alliance Insurance (Malaysia) Bhd. The comparatives below have not been restated
- Comparatives are not provided for Global Direct Insurance Investments BV, which was acquired during 2007.

	2007 £m	2006 £m
Total assets	**251**	207
Total liabilities	**173**	135
Total revenue	**116**	147
Goodwill on acquisition	**56**	5
Profit for the year after tax	**2**	8

The Group's share of net assets and profit and loss are accounted for under the equity method.

Some associates that do not materially affect the results or assets of the Group have been omitted from this statement.

12. Financial assets

	2007 £m	2006 £m
Equity securities	**1,487**	1,620
Debt securities	**9,581**	8,568
Other financial assets	**151**	155
Short term investments	**121**	114
Total financial assets – available for sale	**11,340**	10,457

The Group does not hold significant financial assets classified as fair value through the income statement.

The Group's portfolio of equity securities comprises ordinary shares and unit trusts of **£1,132m** (2006: £1,309m) and other equity instruments of **£355m** (2006: £311m). Other equity instruments include preference shares and collective investment vehicles primarily invested in cash and bond assets. The performance of these assets is typically not expected to correlate strongly to the performance of ordinary shareholdings.

The Group does not hold significant financial assets that are valued using a valuation technique.

Notes to the financial statements continued

13. Reinsurers' share of insurance contract liabilities

	2007 £m	2006 £m
Reinsurers' share of provision for unearned premiums	215	189
Reinsurers' share of provision for losses and loss adjustment expenses	1,657	1,738
Total reinsurers' share of insurance contract liabilities	**1,872**	1,927

The following changes have occurred in the reinsurers' share of the provision for unearned premiums during the year:

	2007 £m	2006 £m
Reinsurers' share of provision for unearned premiums at 1 January	189	298
Premiums ceded to reinsurers	759	790
Reinsurers' share of premiums earned	(754)	(885)
Changes in reinsurance asset	5	(95)
Reinsurers' share of portfolio transfers and acquisitions/(disposals) of subsidiaries	12	1
Exchange adjustment	9	(15)
Reinsurers' share of provision for unearned premiums at 31 December	**215**	189

The following changes have occurred in the reinsurers' share of the provision for losses and loss adjustment expenses during the year:

	2007 £m	2006 £m
Reinsurers' share of provision for losses and loss adjustment expenses at 1 January	1,738	4,108
Reinsurers' share of total claims incurred	387	353
Total reinsurance recoveries received	(519)	(998)
Reinsurers' share of portfolio transfers and acquisitions/(disposals) of subsidiaries	50	(13)
Exchange adjustment	57	(341)
Other movements	2	6
Transfer to non current and disposal group assets held for sale	(58)	(1,377)
Reinsurers' share of provision for losses and loss adjustment expenses at 31 December	**1,657**	1,738

14. Insurance and reinsurance debtors

	2007 £m	2006 £m
Insurance debtors comprise:		
Due from policyholders	1,086	950
Due from intermediaries	1,254	1,046
Total insurance debtors	2,340	1,996
Reinsurance debtors	239	229
Total insurance and reinsurance debtors	**2,579**	2,225

15. Deferred acquisition costs

	2007 £m	2006 £m
Deferred acquisition costs at 1 January	453	465
Exchange adjustment	20	(18)
Acquisition costs deferred during the year	766	771
Amortisation charged during the year	(705)	(761)
Credit to income statement in the year	61	10
Acquisition of subsidiaries	8	1
Transfer to non current and disposal group assets held for sale	–	(5)
Deferred acquisition costs at 31 December	**542**	453

The Group records acquisition costs recovered from reinsurers as a deduction from deferred acquisition costs.

16. Other debtors and other assets

	2007 £m	2006 £m
Derivative assets	33	17
Other debtors	355	339
Pension scheme surplus	263	188
Accrued interest and rent	150	128
Prepayments	162	134
Total other debtors and other assets	**963**	806
To be settled within 12 months	643	545
To be settled after 12 months	320	261

17. Cash and cash equivalents

	2007 £m	2006 £m
Cash and cash equivalents and bank overdrafts (as reported within the cashflow statement)	1,538	2,040
Add: bank overdrafts	3	4
Less: transfer to non current and disposal group assets held for sale	(32)	(213)
Total cash and cash equivalents	**1,509**	1,831

The interest bearing financial assets and financial liabilities included in cash and cash equivalents and bank overdrafts had an effective interest rate of **4.85%** (2006: 4.45%) and had an average maturity of **23 days** (2006: 34 days).

18. Equity and reserves

Changes in equity

Changes in equity for the year ended 31 December 2007

	Ordinary share capital £m	Ordinary share premium £m	Treasury shares £m	Preference shares £m	Revaluation reserves £m	Capital redemption reserve £m	Translation reserve £m	Retained earnings £m	Share-holders' funds £m	Minority interests £m	Total equity £m
Balance at 1 January	821	857	(57)	125	456	8	(81)	432	2,561	331	2,892
Total recognised (expense)/income for the year	–	–	–	–	(43)	–	136	577	670	15	685
Dividends – paid (note 7)	–	–	–	–	–	–	–	(211)	(211)	(31)	(242)
Issued by scrip	19	81	–	–	–	–	–	–	100	–	100
Issued for cash	55	5	–	–	–	–	–	244	304	–	304
Treasury shares utilised	–	–	19	–	–	–	–	(19)	–	–	–
Changes in shareholders' interests in subsidiaries	–	–	–	–	11	–	(8)	(371)	(368)	(248)	(616)
Depreciation transfer	–	–	–	–	(2)	–	–	2	–	–	–
Share options	–	–	–	–	–	–	–	21	21	–	21
Balance at 31 December	895	943	(38)	125	422	8	47	675	3,077	67	3,144

The above amounts are presented net of deferred tax. The deferred tax charged or credited directly to equity is set out in note 23.

During the year, Codan A/S purchased **£24m** of its own shares on the market. In addition, the Group launched a voluntary conditional public tender offer for the acquisition of all the outstanding issued shares and voting rights in Codan A/S. As a result the Group acquired sufficient shareholding to effect a compulsory acquisition of the remaining shares and, as the transaction is not reversible, to account for 100% of the subsidiary. The total consideration was **£590m**. At 31 December 2007, the Group owned 99.5% of Codan A/S and completed the compulsory acquisition process to acquire the remaining 0.5% in January 2008. The two transactions reduced minority interests by **£246m** and shareholders' funds by **£368m**.

Notes to the financial statements continued

18. Equity and reserves continued

Changes in equity for the year ended 31 December 2006

	Ordinary share capital £m	Ordinary share premium £m	Treasury shares £m	Preference shares £m	Revaluation reserves £m	Capital redemption reserve £m	Translation reserve £m	Retained earnings £m	Share-holders' funds £m	Minority interests £m	Total equity £m
Balance at 1 January	807	804	(57)	125	432	8	50	517	2,686	391	3,077
Total recognised income/(expense) for the year	–	–	–	–	14	–	(131)	107	(10)	24	14
Dividends – paid (note 7)	–	–	–	–	–	–	–	(149)	(149)	(9)	(158)
Issued by scrip	12	49	–	–	–	–	–	–	61	–	61
Issued for cash	2	4	–	–	–	–	–	–	6	–	6
Changes in shareholders' interests in subsidiaries	–	–	–	–	–	–	–	(46)	(46)	(75)	(121)
Depreciation transfer	–	–	–	–	10	–	–	(10)	–	–	–
Share options	–	–	–	–	–	–	–	13	13	–	13
Balance at 31 December	821	857	(57)	125	456	8	(81)	432	2,561	331	2,892
Continuing operations	821	857	(57)	125	455	8	(69)	530	2,670	331	3,001
Discontinued operations	–	–	–	–	1	–	(12)	(98)	(109)	–	(109)
	821	857	(57)	125	456	8	(81)	432	2,561	331	2,892

The above amounts are presented net of deferred tax. The deferred tax charged or credited directly to equity is set out in note 23.

During 2006, the Group purchased the minority interest of its subsidiaries in Latvia and Lithuania for £55m. Codan A/S purchased £66m of its own shares on the market. This increased the Group's ownership of Codan A/S from 71.1% to 74.5%.

Ordinary and preference shares

During the year **12,448,823** (2006: 6,804,499) ordinary shares were issued on the exercise of employee share options for a cash consideration of **£9m** (2006: £6m). The Parent Company also issued **66,632,200** (2006: 45,604,849) ordinary shares during the year under the scrip scheme as approved by shareholders. To fund the acquisition of Codan A/S the Parent Company issued **186,350,000** ordinary shares in a placing raising gross proceeds of approximately **£300m**. The total nominal value of ordinary shares issued during the year was **£74m** (2006: £14m).

	2007 £m	2006 £m
Authorised		
3,923,636,364 ordinary shares of 27.5p each (2006: 3,923,636,364 ordinary shares of 27.5p each)	**1,079**	1,079
300,000,000 preference shares of £1 each (2006: 300,000,000 preference shares of £1 each)	**300**	300
Issued and fully paid		
3,252,957,665 ordinary shares of 27.5p each (2006: 2,987,526,642 ordinary shares of 27.5p each)	**895**	821
125,000,000 preference shares of £1 each (2006: 125,000,000 preference shares of £1 each)	**125**	125
	1,020	946

The Royal & SunAlliance ESOP Trust holds ordinary shares in the Parent Company, which may subsequently be transferred to employees (other than the executive directors). At 31 December 2007 the Trust held **15,102,896** ordinary shares (2006: 17,751,097) in the Parent Company with a nominal value of **£4m** (2006: £5m) and a mid market value, based on the market value of the Parent Company's shares at the close of business on 31 December 2007 as shown in the Official List of the London Stock Exchange, of **£22m** (2006: £27m).

The Royal & SunAlliance ESOP Trust No 2 holds ordinary shares in the Parent Company, which may subsequently be transferred to employees including executive directors. At 31 December 2007 the Trust held **4,938,894** ordinary shares (2006: 4,938,894) in the Parent Company with a nominal value of **£1m** (2006: £1m) and a mid market value, based on the market value of the Parent Company's shares at the close of business on 31 December 2007 as shown in the Official List of the London Stock Exchange, of **£7m** (2006: £8m).

Rights attaching to the shares

The rights attaching to each class of share may be varied with the consent of the holders of 75% of the issued shares of that class.

Preference shareholders shall not have any right to receive notice of, attend, speak or vote at any general meeting of the Parent Company unless:

- The preferential dividend on such shares for the dividend payment period immediately prior to the issue of the notice is in arrears or if any arrears of deficiency of dividend in respect of any preceding period has not been paid in full
- A resolution is proposed varying the rights attached to preference shares, for the winding up of the Parent Company or for a reduction of capital in the Parent Company (in which case preference shareholders may only vote on such resolution)

• In such other circumstances as the directors may determine prior to the allotment of any preference shares.

The Parent Company in general meeting may by ordinary resolution declare dividends, but no dividend shall exceed the amount recommended by the directors or permitted by law. The directors may also pay such interim dividends as they think fit and pay the fixed dividends payable on any shares of the Parent Company half yearly or otherwise on fixed dates. Subject to shareholder approval, the directors may allow shareholders to receive new ordinary shares in lieu of dividends paid in cash.

In priority to any payment of dividend to other shareholders (other than any dividend not exceeding 0.1p per share), holders of preference shares are entitled to a cumulative preferential dividend of 7.375% per annum, payable out of the profits available for distribution and resolved to be distributed in half yearly instalments and the shares are not redeemable. Preference shareholders have no further right to participate in the profits of the Parent Company. In addition, preference shares do not confer:

• Any right to participate in any offer by way of rights or otherwise to subscribe for additional shares in the Parent Company (except where required by law)

• Any rights of conversion

• Any right to participate in any issue of bonus shares.

The directors may deduct from any dividend or other monies payable to any shareholder all sums of money presently payable by him to the Parent Company on account of calls or otherwise in relation to his shares in the Parent Company.

If the Parent Company is wound up, the liquidator may, with the sanction of an extraordinary resolution of the Parent Company divide among the shareholders the whole or any part of the assets of the Parent Company and may, for such purpose, set such value as he deems fair upon any property to be divided. The liquidator may also, with like sanction, vest the whole of any part of the Parent Company's assets in trustees upon such trusts for the benefit of the contributories as the liquidator shall think fit. No shareholder shall be compelled to accept any shares or other securities or other assets that are subject to any liability.

On a return of capital on a winding up (liquidation), preference shareholders are entitled, in priority to holders of ordinary shares of the Parent Company, to receive out of the surplus assets of the Parent Company any arrears and accruals of the dividend together with the greater of the price at which the gross yield on each preference share is equal to the mean gross yield on 3.5% War Loan or such Government Stock as may be agreed (but not exceeding twice the nominal amount of the preference share) and the nominal amount of the share together with any premium paid on issue.

The directors may make calls on shareholders in respect of monies unpaid on their shares. If any call is not complied with the directors may serve a notice on such shareholder requiring him to pay the call together with any interest and expenses incurred by the Parent Company. Failure to comply with a notice may result in forfeiture of any share which is the subject of the notice (including any dividends declared and other monies payable in respect of the shares so forfeited).

The Parent Company has a first and paramount lien on every share that is not fully paid for all monies called or payable in respect of such share. The Parent Company may sell any share on which the Parent Company has a lien passed following service of a notice on the shareholder demanding payment of the sum and giving notice of the Parent Company's intention to sell in default of such payment.

The Parent Company shall be entitled to sell any share of a shareholder if no cheque, warrant or order sent by the Parent Company in respect of the share in question has been cashed and no communication has been received by the Parent Company from the shareholder for a period of 12 years.

No shareholder is, unless the directors otherwise determine, entitled to attend or vote either personally or by proxy at any general meeting if:

• Any call or any sum presently payable by him to the Parent Company in respect of such share remains unpaid or

• The shareholder has failed to comply with a notice under section 793 of the Companies Act 2006 and is in default for a period of 14 days from the date of service of such notice.

Further, if a shareholder who holds 0.25% or more (in nominal value) of the issued shares is in default of a section 793 notice then the directors may also withhold the payment of any dividend and restrict the transfer of shares held by such shareholder.

Save with the consent of preference shareholders, the directors shall not increase the amount of any shares of any class (or any securities convertible into any shares of any class), ranking as regards participation in the profits or assets of the Parent Company (otherwise than on a redemption or purchase by the Parent Company of any such share) in priority to the preference shares.

The directors may refuse to register any transfer of any share which is not a fully paid up share provided that such refusal does not prevent dealing in the shares from taking place on an open and proper basis. The directors may likewise refuse to register any transfer in favour of more than four persons jointly.

The directors may also refuse to register any transfer of any certificated share unless:

• A duly stamped instrument of transfer is delivered to the Parent Company's registered office together with the certificates of the shares to which it relates and any other evidence that the directors may reasonably require to show the right of the transferor to make the transfer and

• The instrument of transfer is in respect of only one class of share.

The directors can require a shareholder to provide evidence that shares held by such shareholder are not held by or on behalf of a US Holder (as defined in the Articles of Association). The directors may require a US Holder to sell its shares to a non US resident, failing which the Parent Company may effect a sale of such shares on such US Holder's behalf. The directors may refuse to register a transfer by a US Holder where it is made to a US resident.

Notes to the financial statements continued

19. Loan capital

	2007 £m	2006 £m
Subordinated guaranteed US$ bonds	**11**	37
Subordinated guaranteed Euro bonds	**365**	335
Total dated loan capital	**376**	372
Subordinated Sterling perpetual guaranteed bonds	**305**	301
Subordinated guaranteed perpetual notes	**513**	519
Total loan capital	**1,194**	1,192

The subordinated guaranteed US Dollar bonds ('Yankee Bonds') have a redemption date of 15 October 2029. The rate of interest payable on the Yankee Bonds is 8.95%.

On 22 February 2007, the Group repurchased Yankee Bonds with nominal value of $49,500,000 for a total consideration of $68m (including accrued interest of $1.5m). Yankee Bonds with nominal value of $23,679,000 remain.

The subordinated guaranteed Euro bonds (€500m) have a redemption date of 15 October 2019. €200m of the Euro bonds bear interest at a fixed rate of 6.875% until 15 October 2009 and a floating rate thereafter. €300m of the Euro bonds bear interest at a floating rate from the date of issue of EURIBOR +1.25%. The Parent Company has the option to repay the Euro bonds on specific dates from 15 October 2009. If the bonds are not repaid on that date, the rate of interest payable would be LIBOR plus 2.25%.

The subordinated Sterling perpetual guaranteed bonds have a nominal value of £375m and the rate of interest payable is 6.701% of the nominal value. The Group has the option to repay the bonds on specific dates starting 12 July 2017. If the bonds are not repaid, from that date, the interest rate payable would be LIBOR plus 2.51%.

The subordinated guaranteed perpetual notes have a nominal value of £450m and pay an annual coupon of 8.50% with an option to call the notes, or if not called for the coupon rate to be reset, on 8 December 2014 and every five years thereafter.

The bonds and the notes are contractually subordinated to all other creditors of the Parent Company such that in the event of a winding up or of bankruptcy, they are to be repaid only after the claims of all other creditors have been met.

The aggregate fair value of the dated loan capital, subordinated Sterling perpetual guaranteed bonds, and subordinated guaranteed perpetual notes at 31 December 2007 is **£1,234m** (2006: £1,291m).

20. Insurance contract liabilities

	2007 £m	2006 £m
Provision for unearned premiums	**3,383**	2,969
Provision for losses and loss adjustment expenses	**10,344**	9,821
Total insurance contract liabilities	**13,727**	12,790

Provision for unearned premiums

The following changes have occurred in the provision for unearned premiums during the year:

	2007 £m	2006 £m
Provision for unearned premiums at 1 January	**2,969**	3,001
Premiums written	**6,596**	6,270
Less: premiums earned	**(6,361)**	(6,191)
Changes in provision for unearned premiums	**235**	79
Gross portfolio transfers and acquisitions	**37**	10
Exchange adjustment	**142**	(96)
Transfer to non current and disposal group assets held for sale	**–**	(25)
Provision for unearned premiums at 31 December	**3,383**	2,969

Provision for losses and loss adjustment expenses

	2007 £m	2006 £m
Provision for losses and loss adjustment expenses at 1 January	**9,821**	14,203
Claims losses and expenses incurred	**4,044**	3,877
Total claims payments made in the year, net of recoveries	**(4,145)**	(4,748)
Gross portfolio transfers and acquisitions	**204**	4
Exchange adjustment	**421**	(773)
Other movements	**57**	67
Transfer to non current and disposal group assets held for sale	**(58)**	(2,809)
Provision for losses and loss adjustment expenses at 31 December	**10,344**	9,821

Assumptions

The total value of outstanding claims provisions less related reinsurance recoveries before discounting amounted to **£9,288m** (2006: £8,655m).

Claims on certain classes of business have been discounted as follows:

		Discount rate		Average number of years to settlement	
	Category	2007 %	2006 %	2007 Years	2006 Years
UK	Asbestos and environmental	**5.00**	5.00	**15**	15
Scandinavia	Disability	**3.66**	3.58	**12**	12
Canada	Asbestos and environmental	**5.00**	5.00	**6**	6

In determining the average number of years to ultimate claims settlement, estimates have been made based on the underlying claims settlement patterns.

Claims development tables

The tables below present changes in the historical provision for losses and loss adjustment expenses that were established in 2001 and the provision for losses and loss adjustment expenses arising in each subsequent accident year. The tables are presented at current year cumulative average exchange rates and have been adjusted for operations that have been disposed of.

The top triangle of the tables presents the estimated provision for ultimate incurred losses and loss adjustment expenses at the end of each accident year as at each balance sheet date.

The lower (paid) triangle of the tables presents the amounts paid against those provisions in each subsequent accounting period.

The estimated provision for ultimate incurred losses changes as more information becomes known about the actual losses for which the initial provisions were set up and as the rate of exchange changes. The 2007 redundancy/(deficiency) represents the claims development of earlier accident years in the current accounting period.

Notes to the financial statements continued

20. Insurance contract liabilities continued

Consolidated claims development table gross of reinsurance

	2001 and prior £m	2002 £m	2003 £m	2004 £m	2005 £m	2006 £m	**2007 £m**	Total £m
Estimate of cumulative claims								
At end of accident year	8,865	3,021	2,951	2,458	2,588	2,288	**2,591**	
One year later	9,408	2,801	2,798	2,263	2,533	2,313		
Two years later	9,595	2,878	2,699	2,101	2,432			
Three years later	9,906	2,852	2,593	2,030				
Four years later	10,222	2,784	2,516					
Five years later	10,649	2,735						
Six years later	10,536							
Claims paid								
One year later	2,909	1,197	1,082	835	1,115	941		
Two years later	1,464	431	334	279	324			
Three years later	1,191	295	229	197				
Four years later	738	194	164					
Five years later	488	105						
Six years later	377							
Cumulative claims paid	7,167	2,222	1,809	1,311	1,439	941		
2007 redundancy/(deficiency)	113	49	77	71	101	(25)		386
Reconciliation to the balance sheet								
Current year provision before discounting	3,369	513	707	719	993	1,372	**2,591**	10,264
Exchange adjustment to closing rates								355
Discounting								(646)
Annuities								371
Present value recognised in the balance sheet								**10,344**

Consolidated claims development table net of reinsurance

	2001 and prior £m	2002 £m	2003 £m	2004 £m	2005 £m	2006 £m	**2007 £m**	Total £m
Estimate of cumulative claims								
At end of accident year	7,090	2,359	2,147	2,016	2,152	2,169	**2,214**	
One year later	7,345	2,310	2,154	1,885	2,032	2,139		
Two years later	7,465	2,316	2,083	1,719	1,946			
Three years later	7,803	2,298	1,981	1,653				
Four years later	7,859	2,223	1,924					
Five years later	8,284	2,175						
Six years later	8,235							
Claims paid								
One year later	2,247	963	771	630	821	861		
Two years later	1,149	324	270	231	260			
Three years later	1,008	240	189	169				
Four years later	523	158	98					
Five years later	392	83						
Six years later	250							
Cumulative claims paid	5,569	1,768	1,328	1,030	1,081	861		
2007 redundancy	49	48	57	66	86	30		336
Reconciliation to the balance sheet								
Current year provision before discounting	2,666	407	596	623	865	1,278	**2,214**	8,649
Exchange adjustment to closing rates								312
Discounting								(601)
Annuities								327
Present value recognised in the balance sheet								**8,687**

The loss development tables above are presented on an undiscounted basis. Prior year development in 2007 showed favourable experience across all accident years and totalled £336m, net of reinsurance, which primarily comprises favourable development from the Group's UK specialist claims unit, as well as the cumulative impact of actions taken to reduce claims leakage in Other Europe. In 2006 adverse run off was £26m. On a discounted basis, prior year underwriting profit in 2007 was £348m, compared with £131m in 2006, which included £164m of reserve strengthening for Scandinavia personal accident and UK asbestos reserves. The total discounting at the end of 2007 was £601m representing an increase of £29m in the year, due mostly to the impact of including the Adverse Development Cover (ADC) following the disposal of the US operation. In Scandinavia certain long tail liabilities are settled by an annuity and the discounted value of these annuities is shown separately. At the year end the annuity reserves were £327m (2006: £308m).

21. Insurance and reinsurance liabilities

	2007 £m	2006 £m
Direct insurance creditors	**166**	140
Reinsurance creditors	**260**	251
Total insurance and reinsurance liabilities	**426**	391

22. Borrowings

The Group's borrowings of **£303m** (2006: £8m) relate to loans from credit institutions. In 2007 the Group utilised these funds partly to finance the purchase of the minority interest in Codan A/S.

At 31 December 2007 total unsecured loans from credit institutions under committed credit facilities of **£500m** (2006: £500m) were available to the Group. There were no amounts outstanding at 31 December 2007 (2006: £nil). The facility expires in 2012.

At 31 December 2007 and 2006 the Group had in place a one billion US Dollar Euro commercial paper program. There were no amounts outstanding at 31 December 2007 (2006: £nil).

23. Current and deferred tax

Current tax

	Asset		Liability	
	2007 £m	2006 £m	2007 £m	2006 £m
To be settled within 12 months	**13**	–	**15**	34
To be settled after 12 months	**6**	17	**77**	22
	19	17	**92**	56

Deferred tax

	2007 £m	2006 £m
Deferred tax assets	**87**	29
Deferred tax liabilities	**(224)**	(319)
Net deferred tax position at 31 December	**(137)**	(290)

The movement for the year in the Group's net deferred tax position is as follows:

	2007 £m	2006 £m
Net deferred tax position at 1 January	**(290)**	(179)
Credit/(charge) to the income statement for the year	**138**	(29)
Credit/(charge) to equity for the year	**24**	(75)
Net liability on acquisition/disposal of subsidiaries	**(13)**	(5)
Exchange adjustment	**(5)**	(2)
Effect of change in tax rates		
– income statement	**1**	–
– equity	**8**	–
Net deferred tax position at 31 December	**(137)**	(290)

Notes to the financial statements continued

23. Current and deferred tax continued

The following are the major deferred tax liabilities and assets recognised by the Group and their movements during the year:

	Reclassification of debt £m	Retirement benefit obligations £m	Net insurance contract liabilities £m	Revaluation of investments £m	Security Fund/ Safety Reserve £m	Other temporary differences £m	Total £m
Deferred tax at 1 January 2006	24	103	94	(118)	(103)	(179)	(179)
(Charge)/credit to the income statement for the year	–	(37)	(59)	11	–	56	(29)
(Charge)/credit to equity for the year	(2)	(74)	–	(2)	–	3	(75)
Disposals of subsidiaries	–	–	–	–	–	(5)	(5)
Exchange adjustment	–	–	–	–	2	(4)	(2)
Deferred tax at 31 December 2006	22	(8)	35	(109)	(101)	(129)	(290)
(Charge)/credit to the income statement for the year	**–**	**(48)**	**31**	**3**	**103**	**49**	**138**
(Charge)/credit to equity for the year	**(2)**	**9**	**–**	**24**	**–**	**(7)**	**24**
Acquisition/disposal of subsidiaries	**–**	**–**	**1**	**1**	**–**	**(15)**	**(13)**
Exchange adjustment	**–**	**1**	**4**	**(2)**	**(2)**	**(6)**	**(5)**
Effect of change in tax rate							
– income statement	**–**	**–**	**(3)**	**(1)**	**–**	**5**	**1**
– equity	**(2)**	**4**	**–**	**6**	**–**	**–**	**8**
Deferred tax at 31 December 2007	**18**	**(42)**	**68**	**(78)**	**–**	**(103)**	**(137)**

International Financial Reporting Standards require the Danish Security Fund and Swedish Safety Reserve in Codan A/S to be recognised within shareholders' equity rather than as liabilities. At 31 December 2006 the Group held £101m of deferred tax liability (adjusted for £2m foreign exchange movement in 2007) in respect of these reserves. During 2007 the Group acquired the minority interest in Codan A/S. In light of this change in circumstance the Group has concluded that no tax base and associated temporary tax difference exists in respect of these reserves. The deferred tax liability held at 31 December 2006 in respect of the Danish Security Fund and Swedish Safety Reserve has therefore been released in the period.

The deferred income tax credited/(charged) to equity is as follows:

	2007 £m	2006 £m
Fair value reserves in shareholders' equity		
Available for sale financial assets	**30**	(2)
Group occupied property	**(4)**	(2)
Retirement benefit obligations	**13**	(74)
Share options	**(3)**	5
Reclassification of debt	**(4)**	(2)
Total credited/(charged) to equity for the year	**32**	(75)

The aggregate current tax relating to items that were credited or charged to equity is **£3m** (2006: £8m).

At the balance sheet date, the Group had unused tax losses of **£1,244m** (2006: £653m) and unused tax credits of **£33m** (2006: £30m) available for offset against future profits. A deferred tax asset of **£2m** (2006: £14m) has been recognised in respect of losses included within other temporary differences at 31 December 2007. No deferred tax asset has been recognised in respect of **£1,237m** (2006: £639m) tax losses and unused tax credits of **£33m** (2006: £30m) due to the unpredictability of future profit streams. Included in unrecognised tax losses are losses of **£51m** (2006: £39m) which will expire by 2016. Other tax losses and unused credits may be carried forward indefinitely.

24. Provisions

Carrying amount

	2007 £m	2006 £m
Pensions and post retirement obligations	**105**	156
Reorganisation provisions	**37**	27
Other provisions	**189**	197
Total provisions at 31 December	**331**	380

Of the above, **£139m** is due to be settled outside of 12 months (2006: £173m).

Reorganisation provisions comprise costs relating to reorganisations mainly within the UK business. These provisions primarily comprise severance and property costs and are part of an ongoing programme to achieve business improvement and expense savings.

Other provisions includes **£nil** (2006: £51m) of provisions relating to the disposal of the discontinued US operation. In addition, there are provisions of **£65m** (2006: £52m) held relating to vacant property leases, dilapidations and refurbishments, the costs relating to which will be borne across the period over which the leases expire, which is up to 20 years. Other provisions also includes various litigation provisions of **£10m** (2006: £9m), the payment of which is dependent upon legal processes and Motor Insurance Bureau provision of **£33m** (2006: £33m).

See note 26 for further information regarding the pensions and post retirement benefit obligations.

Movements during the year on reorganisation and other provisions

	Reorganisation provisions £m	Other provisions £m
Provisions at 1 January 2007	**27**	**197**
Exchange adjustment	**–**	**1**
Credited	**19**	**73**
Utilised	**(9)**	**(94)**
Released	**–**	**2**
Acquisition of subsidiary	**–**	**10**
Provisions at 31 December 2007	**37**	**189**

25. Other liabilities

	2007 £m	2006 £m
Deposits received from reinsurers	**64**	61
Derivative trading liabilities	**62**	28
Other creditors	**614**	560
Accruals and deferred income	**347**	377
Total other liabilities	**1,087**	1,026
To be settled within 12 months	**1,016**	935
To be settled after 12 months	**71**	91

In 2003 a subsidiary of the Group wrote an Adverse Development Cover (ADC) contract with its former US subsidiary. Prior to the disposal of the US operation, the assets and liabilities arising from the ADC eliminated on consolidation. As part of the disposal of the US operation, and as publicly disclosed in 2006, the original contract was amended and restated.

The liabilities arising under the ADC contract comprise an insurance component and a deposit component. The liability arising under the insurance component of £0.1bn represents the timing risk on the settlement of those liabilities. The financial liability arising under the deposit component is offset by the value of funds held in a trust fund whose trust deed only permits the trust fund assets to be used to settle amounts due under the ADC. The value of the funds held in trust at 31 December 2007 is £0.4bn and the value of the liability of the deposit component is £0.4bn.

Following the signing of the amended and restated contract the accounting treatment has been reviewed; the insurance component is accounted for within insurance liabilities and the deposit component, offset by the value of the funds held in the trust account, is recognised under other liabilities.

26. Retirement benefit obligations

The Group operates defined contribution pension schemes, funded and unfunded defined benefit pension schemes, and has other post retirement obligations.

Defined contribution pension schemes

Costs of **£34m** (2006: £30m) were recognised in respect of defined contribution schemes by the Group. The Group's Swedish subsidiaries are part of a multi employer defined benefit scheme along with other financial institutions in Sweden. As it is not possible to determine the assets and liabilities in respect of any one employer under this scheme, it is included in these accounts as a defined contribution scheme. Contributions of **£23m** were paid to this scheme during 2007 and are included in the costs shown above. The latest information regarding the funding of this scheme is taken from the interim report for the first half of 2007, when the scheme funding rate was **132%**. The Group's Swedish subsidiaries' share of the total multi employer scheme was less than **15%**.

Defined benefit pension schemes and other post retirement benefits

The major defined benefit pension schemes are located in the UK. The assets of these schemes are held mainly in separate trustee administered funds.

In April 2002, the primary UK defined benefit schemes were effectively closed to new entrants and in 2005, following discussions with the Trustees and consultation with the members, the UK defined benefit schemes were altered from providing benefits on a final salary basis to benefits on a revalued average salary basis with effect from 1 January 2006. Under the new benefit formula, the accrued benefits of current active members are based on salaries at the date of change and will increase in line with inflation each year (limited to 5% in any year) up to their retirement date. Benefits earned in each year from 1 January 2006 are based on salaries in that year and are revalued up to retirement.

Notes to the financial statements continued

26. Retirement benefit obligations continued

In addition to these changes, the 2002 Scheme (which was the scheme to which new UK employees had been admitted following the closure of the defined benefit schemes to new members) has been closed to further accrual from 1 January 2006. It has been replaced by a stakeholder arrangement and members of the 2002 Scheme and future new employees in the UK accrue future benefits on a defined contribution basis under the stakeholder scheme.

For the two main UK defined benefit schemes, the level of contributions in 2007 were **23%** and **22%** of pensionable salaries (2006: 23% and 21%). Additional contributions totalling **£86m** (2006: £86m) were made to the schemes, in accordance with the plan to reduce their funding deficits. Expected contributions to pension and post retirement benefit schemes for the year ending 31 December 2008 are approximately **£70m**, including a further **£37m** of additional contributions.

The major defined benefit schemes are subject to regular valuation using the projected unit method which is the basis used to determine the pension cost in the consolidated income statement. Independent, qualified actuaries carry out valuations of the major defined benefit schemes for the purposes of assessing pension costs.

The Group also provides post retirement healthcare benefits to certain current and retired Canadian employees. The benefits are not prefunded. Life insurance benefits, which provide varying levels of coverage, are provided at no cost to retirees. Healthcare benefits, which also provide varying levels of coverage, require retiree contributions in certain instances. Benefits are generally payable for life. The estimated discounted present values of the unfunded accumulated obligations are calculated in accordance with the advice of independent, qualified actuaries.

Movement in the surplus/(deficit) during the year:

	2007 £m	2006 £m
Surplus/(deficit) at 1 January	32	(472)
Total pension expense	(9)	(34)
Employer contribution	168	203
Actuarial (losses)/gains	(28)	226
Acquisition of subsidiary	1	–
Exchange adjustment	(6)	18
Transfer to non current and disposal group assets and liabilities held for sale	–	91
Pension and post retirement surplus	158	32
Deferred tax in respect of net pension and post retirement asset	(42)	(8)
Net pension surplus at 31 December	116	24

The amounts recognised in the income statement are as follows:

	2007			2006
	UK £m	Other £m	Total £m	Total £m
Current service cost	40	12	52	60
Interest cost	229	14	243	255
Expected return on scheme assets	(279)	(15)	(294)	(288)
Past service cost	9	3	12	15
Gains on curtailment	(1)	(3)	(4)	(8)
Total (included in staff costs)	(2)	11	9	34

The 2006 total includes discontinued operations

The actuarial (losses)/gains recognised in equity are as follows:

	2007			2006
	UK £m	Other £m	Total £m	Total £m
Actual return on scheme assets	375	8	383	280
Less: expected return on scheme assets	(279)	(15)	(294)	(288)
Actual return on assets in excess of/(below) expectations	96	(7)	89	(8)
Experience (losses)/gains on liabilities	(72)	(6)	(78)	41
Change in actuarial assumptions	(61)	22	(39)	193
Actuarial (losses)/gains	(37)	9	(28)	226

The 2006 total includes discontinued operations

The accumulated actuarial gains since 1 January 2004 are **£62m** (2006: £90m, restated to exclude discontinued operations).

	2007 UK £m	2007 Other £m	2007 Total £m	2006 Total £m
Present value of funded obligations	4,764	248	5,012	4,767
Present value of unfunded obligations	5	69	74	71
Present value of obligations	4,769	317	5,086	4,838
Equities	1,193	121	1,314	2,191
Bonds	3,410	117	3,527	2,260
Cash	154	23	177	171
Property	226	–	226	248
Total assets in the schemes	4,983	261	5,244	4,870
Surplus/(deficit) on continuing operations	214	(56)	158	32
Deficit on discontinued operations	–	–	–	(91)
Continuing operations analysed:				
Defined benefit pension schemes	214	(30)	184	56
Other post retirement benefits	–	(26)	(26)	(24)
Schemes in surplus (note 16)	232	31	263	188
Schemes in deficit (note 24)	(18)	(87)	(105)	(156)

The following is a reconciliation of the Group's retirement benefit obligations:

	2007 £m	2006 £m
Retirement benefit obligations at 1 January	4,838	5,439
Current service costs	52	60
Past service costs	12	15
Interest costs	243	255
Contributions by scheme participants	2	3
Actuarial loss/(gains) on obligations	117	(234)
Gain on curtailments	(4)	(9)
Benefits paid	(226)	(248)
Acquisition of subsidiary	13	–
Exchange rate adjustment	39	(82)
Transfer to non current and disposal group assets and liabilities held for sale	–	(361)
Retirement benefit obligations at 31 December	5,086	4,838

The following is a reconciliation of the Group's pension schemes' assets:

	2007 £m	2006 £m
Pension schemes' assets at 1 January	4,870	4,967
Return on schemes' assets	383	280
Contributions by the employer	168	203
Contributions by schemes' participants	2	3
Benefits paid	(226)	(248)
Loss on settlement	–	(1)
Acquisition of subsidiary	14	–
Exchange rate adjustment	33	(64)
Transfer to non current and disposal group assets and liabilities held for sale	–	(270)
Pension schemes' assets at 31 December	5,244	4,870

Notes to the financial statements continued

26. Retirement benefit obligations continued

Additional information for the current annual period and previous three annual periods:

	2007 £m	2006 £m	2005 £m	2004 £m
At 31 December				
Present value of defined benefit obligation	**5,086**	4,838	5,439	4,939
Fair value of schemes assets	**5,244**	4,870	4,967	4,226
Surplus/(deficit)	**158**	32	(472)	(713)
Experience adjustments on schemes liabilities	**(78)**	42	(50)	87
Experience adjustments on schemes assets	**89**	(14)	434	145

Assumptions

The principal actuarial assumptions used were as follows:

	UK		Other	
	2007 %	2006 %	2007 %	2006 %
Assumptions used in calculation of retirement benefit obligation:				
Discount rate	**5.6**	5.1	**5.4**	4.9
Annual rate of general inflation	**3.2**	2.7	**2.5**	2.5
Annual rate of increase in salaries	**4.7**	4.2	**4.4**	4.4
Annual rate of increase in pensions	**3.2**	2.7	**2.5**	2.5
Assumptions used in calculation of income statement credit/charge in year:				
Discount rate	**5.1**	4.7	**4.9**	5.0
Expected return on:				
Equities	**7.5**	7.5	**8.3**	8.3
Bonds	**4.4**	4.1	**5.3**	5.3
Other	**6.1**	6.0	**3.5**	3.5

Expected return on schemes' assets

The weighted average expected return on schemes' assets across the Group for 2007 was **6%** (2006: 6%). The expected return on schemes' assets are determined for each asset class by considering both market conditions at the opening balance sheet date and any expectations for longer term changes in current returns. All returns are net of investment expenses.

Mortality rate

The mortality assumptions are set following investigations of the main schemes' recent experience by the schemes' actuaries for the funding valuations. The mortality assumptions adopted for the main UK schemes used the PMA92 and PFA92 mortality tables for males and females respectively, with age ratings to reflect the schemes' recent experience compared with that expected under these tables.

Reductions in future mortality rates are allowed for using the 'medium cohort' projection and using the projected mortality rates applicable to calendar year 2014 for current pensioners and 2032 for future pensioners. The weighted average assumptions imply that a current pensioner aged 60 has an expected future lifetime of **25.8** years (males) and **27.0** years (females) and a future pensioner aged 60 has a future lifetime of **27.2** years (males) and **28.2** years (females).

Commutation

Each of the UK defined benefit pension schemes has changed its rules to allow for increased commutation following 'A day' in April 2006. The commutation factors are broadly cost neutral (i.e. when valued on the IAS 19 basis, the amount of cash taken is approximately equal to the value of the pension being given up). For this reason there is no change made to previous practice whereby the accounting valuation makes no allowance for commutations.

Post retirement medical benefits

The valuation of liabilities for post retirement liabilities in Canada assumes **10%** decreasing to **5%** in 10 years for drugs (2006: 9% decreasing to 5% in eight years), **4%** (2006: 4%) for hospitals and **3%** (2006: 3%) for other.

Sensitivity analysis

The discount rate, the assumed inflation rate and the mortality assumptions all have a significant effect on the IAS 19 accounting valuation. A 0.1% increase in the discount rate would reduce the defined benefit obligations in the UK by £79m. A 0.1% increase in the inflation rate assumption would increase the defined benefit obligations in the UK by £69m. An increase of one year in life expectancy would increase the defined benefit obligations by approximately £151m.

The effect of an increase of one percentage point and the effect of a decrease of one percentage point in the assumed medical cost trend rates in Canada on the following is set out below:

	1% increase		1% decrease	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Aggregate of the current service cost and interest components of net periodic post employment medical costs	**0.4**	0.4	**0.3**	0.3
Accumulated post employment benefit obligation for medical costs	**3.9**	2.8	**3.1**	2.3

27. Share based compensation

The Group has four types of share based payment plans which are settled in the form of ordinary shares: the Executive Share Option Scheme; the Sharesave Plan; the Share Matching Plan; and the Long Term Incentive Plan. Dilution levels for all schemes are held strictly within Association of British Insurers limits.

The total employment cost recorded in the income statement for all plans was **£19m** in 2007 (2006: £13m). These costs include the costs associated with plans which are settled in the form of ordinary shares for awards that have been granted after 7 November 2002. The value of equity settled awards granted prior to this date has been excluded in accordance with the transitional provisions contained in IFRS 2 'Share Based Payment'.

Executive Share Option Scheme

The Group operates an Executive Share Option Scheme, which provides options to purchase ordinary shares to officers and other key employees at prices not less than the fair value of the ordinary shares at the date of grant.

The performance conditions in respect of awards under the Executive Share Option Scheme are described on page 54. The exercise price of all options is the fair value of the ordinary shares on the date of grant. All options expire 10 years after the date of the grant.

Additional information with respect to the Executive Share Option Scheme at 31 December is as follows:

	2007		2006	
Range of exercise prices	**Number of shares**	**Weighted average exercise price***	Number of shares	Weighted average exercise price*
Options outstanding at 1 January	**73,839,962**	**142.71**	80,629,852	148.58
Exercised	**(3,865,688)**	**86.09**	(2,576,629)	101.56
Forfeited	**(1,890,835)**	**139.84**	(3,985,252)	276.47
Expired	**(1,890,782)**	**287.22**	(228,009)	342.46
Cancelled	**(12,559,525)**	**154.63**	–	–
Options outstanding at 31 December	**53,633,132**	**139.01**	73,839,962	142.71

*Sterling (pence)

Notes to the financial statements continued

27. Share based compensation continued

The following share options under the Executive Share Option Scheme are outstanding or exercisable at 31 December:

Options outstanding

	2007			2006		
Range of exercise prices	Number of shares	Weighted average remaining contractual life (years)	Weighted average exercise price*	Number of shares	Weighted average remaining contractual life (years)	Weighted average exercise price*
50.1 – 100.0	**39,860,028**	**6.89**	**81.04**	53,147,605	7.85	81.74
100.1 – 150.0	**2,235,290**	**5.76**	**114.31**	4,057,015	6.61	114.20
200.1 – 250.0	**2,705,104**	**4.19**	**234.23**	4,131,321	5.19	234.23
250.1 – 300.0	**1,648,006**	**2.23**	**278.65**	1,737,924	3.23	278.65
300.1 – 350.0	**61,819**	**3.88**	**312.58**	61,819	4.88	312.58
350.1 – 400.0	**2,666,029**	**3.18**	**380.15**	5,422,956	3.95	381.26
400.1 – 450.0	**4,456,856**	**1.69**	**413.81**	5,281,322	2.49	415.01
	53,633,132	**5.95**	**139.01**	73,839,962	6.85	142.71

*Sterling (pence)

Options exercisable

	2007		2006	
Range of exercise prices	Number of shares	Weighted average exercise price*	Number of shares	Weighted average exercise price*
50.1 – 100.0	**17,549,796**	**77.06**	3,052,915	58.96
100.1 – 150.0	**1,933,566**	**114.05**	2,808,296	114.05
200.1 – 250.0	**2,705,104**	**234.23**	2,937,591	234.23
250.1 – 300.0	**1,648,006**	**278.65**	1,737,924	278.65
300.1 – 350.0	**61,819**	**312.58**	61,819	312.58
350.1 – 400.0	**2,666,029**	**380.15**	2,841,849	380.20
400.1 – 450.0	**4,456,856**	**413.81**	4,737,385	413.90
	31,021,176	**178.68**	18,177,779	260.39

*Sterling (pence)

Under the scheme, there were no awards during 2006 or 2007. The value of the awards is charged in the income statement over the vesting period. The weighted average share price on the dates the options were exercised in 2007 was **152.06p** (2006: 149.14p).

Sharesave Plan

Under the Group's Sharesave Plan (savings related) eligible employees can receive options to purchase ordinary shares at a price equal to 80% of the fair value of the ordinary shares on the date of grant. All options vest either three or five years from the grant date and expire six months after vesting. The number of shares available for purchase from the plan by each participant is limited to the whole number of shares purchasable from the aggregate value of the individual's savings contract upon maturity. An individual's maximum monthly contribution to all current savings contracts is £250.

Additional information with respect to the Sharesave Plan at 31 December is as follows:

	2007		2006	
	Number of shares	Weighted average exercise price*	Number of shares	Weighted average exercise price*
Options outstanding at 1 January	**59,964,593**	**77.16**	60,137,543	74.98
Granted	**17,174,075**	**105.00**	9,550,434	108.36
Exercised	**(9,889,250)**	**64.72**	(5,559,918)	71.65
Forfeited	**(3,614,970)**	**79.70**	(2,782,453)	77.90
Expired	**(1,327,293)**	**173.94**	(1,381,013)	218.64
Options outstanding at 31 December	**62,307,155**	**84.59**	59,964,593	77.16

*Sterling (pence)

The following share options under the Sharesave Plan are outstanding or exercisable as of 31 December:

Options outstanding

	2007			2006		
Range of exercise prices	Number of shares	Weighted average remaining contractual life (years)	Weighted average exercise price*	Number of shares	Weighted average remaining contractual life (years)	Weighted average exercise price*
50.1 – 100.0	**36,716,673**	**1.29**	**69.54**	49,934,125	1.98	68.55
100.1 – 150.0	**25,590,482**	**3.25**	**106.20**	9,421,988	3.67	108.39
200.1 – 250.0	–	–	–	104,201	0.09	250.00
300.1 – 350.0	–	–	–	504,279	–	310.00
	62,307,155	**2.09**	**84.59**	59,964,593	2.22	77.16

*Sterling (pence)

Options exercisable

	2007		2006	
Range of exercise prices	Number of shares	Weighted average exercise price*	Number of shares	Weighted average exercise price*
50.1 – 100.0	**8,649,491**	**71.63**	1,413,783	75.00
300.1 – 350.0	–	–	504,279	310.00
	8,649,491	**71.63**	1,918,062	136.78

*Sterling (pence)

Under the Sharesave Plan, the weighted average estimated fair value per option granted by the Parent Company during 2007 was **45.84p** (2006: 46.66p). The fair value of share options granted under the Sharesave Plan during 2007 was **£8m** (2006: £4m). The value of the awards is charged in the income statement over the vesting period. The weighted average share price on the dates the options were exercised in 2007 was **150.57p** (2006: 143.42p).

Fair values for the options granted under the Sharesave Plan were estimated as of the date of grant using the Black Scholes pricing model with the following weighted average assumptions: dividend yields of **4.0%** (2006: 3.5%); expected volatilities of **30%** (2006: 35%); ordinary share price of **142.90p** (2006: 138.51p); risk free interest rates of **5.0%** (2006: 4.8%); and expected terms equal to the vesting terms of three or five years. An estimate based on past experience is made of the number of forfeitures during the vesting period due to employees leaving the Group. The actual share price at 31 December 2007 was **148.2p** (2006: 152.5p). The expected volatility is determined by reference to the actual volatility of the share price over the appropriate term ending on the grant date.

Share Matching Plan

The Group's Share Matching Plan for executive directors and other selected executives was adopted following approval obtained at the 2004 AGM. Awards were made during 2004 and 2005.

The performance conditions in respect of awards under the Share Matching Plan are described in the footnote to the long term incentive schemes table (audited part) on page 55. Under the plan, Deferred Share awards granted are held in trust for three years and are normally forfeited upon an employee leaving the Group. No further performance conditions apply.

Participants may also receive Matching Share awards up to a maximum of three times the number of Deferred Shares awarded. Matching Share awards are subject to the achievement of total shareholder return targets over a single two year period, with performance measured by comparison against other UK listed companies. Matching Share awards vest with the Deferred Share awards on the third anniversary of the date of grant to the extent that the performance conditions have been met.

Further information on the Share Matching Plan may be found in the footnote to the long term incentive schemes table (audited part) on page 55.

Notes to the financial statements continued

27. Share based compensation continued

Additional information with respect to Deferred and Matching Share awards at 31 December is as follows:

	2007 Number of shares	2006 Number of shares
Outstanding Deferred Share awards at 1 January	**3,433,720**	4,075,168
Granted*	**–**	150,000
Exercised	**(327,775)**	(310,847)
Forfeited	**(113,832)**	(480,601)
Outstanding Deferred Share awards at 31 December	**2,992,113**	3,433,720
Potential Matching Share awards	**7,326,649**	8,230,850
Total potential share awards outstanding at 31 December	**10,318,762**	11,664,570

*The award shown in 2006 was approved in 2005, but could not be granted until 2006. It is subject to the same criteria as all the other grants made in 2005.

Under the Share Matching Plan there were no awards granted in 2007. In 2006 the fair value of each Deferred Share award granted by the Parent Company was 114.40p and the fair value of each potential Matching Share award was 38.10p. The total fair value of the awards granted under the plan during 2006 was £nil.

The fair value of the Deferred Share awards was calculated based upon the ordinary share price at grant date after deducting from it the estimated value of the dividends that will not be received during the vesting period. The fair value of the potential Matching Share awards was estimated by calculating the expected value arising from modelling the awards that would arise under different performance scenarios.

Long Term Incentive Plan

The Long Term Incentive Plan for executive directors and other selected executives was adopted following approval obtained at the 2006 AGM. Awards were made during 2006 and 2007 following shareholder approval.

The structure of the plan allows for a number of different types of awards to be made. Voluntary Deferred Shares are purchased by participants from net bonus payable (limited to a maximum value of 33% of net bonus); in addition, for senior executives, the Remuneration Committee may defer a portion of an individual's bonus (limited to 33% of that bonus) into an award over shares referred to for the purpose of the plan as Compulsory Deferred Shares. Voluntary Deferred Shares are held in trust for three years and Compulsory Deferred Shares are normally forfeited on an employee leaving the Group. No further performance conditions apply. The Remuneration Committee may make a conditional award of shares on a 'matched' basis to Voluntary and Compulsory Deferred Shares ('Matching Shares') up to a maximum of 2.5:1.

Additionally, the Remuneration Committee may make conditional awards of Performance Shares to senior executives, and conditional awards of Restricted Shares to other executives and senior managers.

Awards of Performance Shares and Matching Shares related to Compulsory Deferred Shares are subject to a performance condition consisting of a combination of a return on equity target and a total shareholder return target (with performance measured by comparison against other European insurance companies) over a single three year performance period. Matching Shares related to Voluntary Deferred Shares are subject only to the return on equity performance condition. Restricted Shares are not subject to performance conditions. All awards vest on the third anniversary of the date of grant to the extent that the performance conditions have been met.

Further information on the Long Term Incentive Plan may be found outside these financial statements in the remuneration report.

	2007				
	Restricted Shares	Voluntary Deferred Shares	Compulsory Deferred Shares	Performance Shares	Total
Share awards outstanding at 1 January	**4,208,357**	**667,002**	**1,622,178**	**4,829,205**	**11,326,742**
Granted	**4,007,328**	**749,048**	**1,675,482**	**4,901,428**	**11,333,286**
Exercised	**–**	**(25,906)**	**–**	**–**	**(25,906)**
Forfeited	**(152,424)**	**(17,711)**	**(194,704)**	**(456,485)**	**(821,324)**
Share awards outstanding at 31 December	**8,063,261**	**1,372,433**	**3,102,956**	**9,274,148**	**21,812,798**
Potential Matching Shares awards	**–**	**5,932,206**	**7,757,355**	**–**	**13,689,561**
Total potential share awards outstanding at 31 December	**8,063,261**	**7,304,639**	**10,860,311**	**9,274,148**	**35,502,359**

	2006				
	Restricted Shares	Voluntary Deferred Shares	Compulsory Deferred Shares	Performance Shares	Total
Granted	4,277,904	667,002	1,622,178	4,829,205	11,396,289
Forfeited	(69,547)	–	–	–	(69,547)
Share awards outstanding 31 December	4,208,357	667,002	1,622,178	4,829,205	11,326,742
Potential Matching Shares awards	–	2,871,739	4,055,422	–	6,927,161
Total potential share awards outstanding at 31 December	4,208,357	3,538,741	5,677,600	4,829,205	18,253,903

Under the Long Term Incentive Plan, the weighted average estimated fair value of each Restricted Share award granted by the Parent Company in 2007 was **140.68p** (2006: 114.81p). The fair value of each Voluntary Deferred Share award was **£nil** (2006: £nil) and the fair value of each potential associated Matching Share was **164.00p** (2006: 126.00p). The fair value of each Compulsory Deferred Share award was **164.00p** (2006: 127.00p) and the fair value of each potential associated Matching Share was **113.50p** (2006: 87.85p). The fair value of each Performance Share award granted was **112.07p** (2006: 88.71p). The total fair value of the awards granted under the plan in 2007 was **£24m** (2006: £18m).

Fair values of the awards granted under the Long Term Incentive Plan scheme during 2007 are taken to be the share price on the day preceding the grant date, except for the Restricted Shares where the share price is reduced by an estimate of the value of dividends that will not be received. A dividend yield of **4.0%** (2006: 3.5%) was assumed. Market related performance criteria were based on an arithmetic mean estimate of performance against a specified group of 13 competitors and it is assumed that all non market related performance criteria would be met such that all awards would be exercisable. An estimate based on past experience is made of the number of forfeitures during the vesting period due to employees leaving the Group.

Other share based payments

Certain employees of the Group's former US operation held entitlements under the Equity Incentive Scheme for US Employees prior to the disposal of the operation. On disposal of the US operation the options under the scheme became cash settled and the majority of the options vested. There are also other plans under which awards have been granted to certain employees in the form of cash settled share based awards. Under these plans, if the vesting conditions are satisfied, cash awards are made based upon the underlying performance of the Parent Company's ordinary shares. Awards were made in 1999 and 2001 under old schemes and during 2004 and 2005 on terms that provide the same potential benefits as the Share Matching Plan. The liability in respect of these plans at 31 December 2007 was **£4m** (2006: £2m). The intrinsic value of awards that had vested at 31 December 2007 was **£4m** (2006: £nil).

28. Hedge accounting

At 1 January 2005 the Group designated the loan capital denominated in Euros as a hedging instrument against the net investment in designated subsidiaries to reduce the foreign currency exchange risk exposure. The book value of the hedging instrument at 31 December 2007 was **£365m** (2006: £335m). The fair value of the hedging instrument at 31 December 2007 was **£377m** (2006: £353m). The hedge ineffectiveness recognised in the income statement during 2007 is **£nil** (2006: £nil).

During 2007 the Group designated certain forward exchange contracts as hedging instruments against the net investment in designated subsidiaries to reduce further the foreign currency exchange risk exposure. On designation, the interest element is separated from the forward exchange rate and is excluded from the hedge relationship. Effectiveness of the hedge is then measured using the spot rate, which is also the exchange rate used when measuring net investment in the designated subsidiaries. The fair value of the hedging instruments at 31 December 2007 is a liability of **£26m** (2006: £nil). The hedge ineffectiveness recognised in the income statement during 2007 is **£nil** (2006: £nil).

Further information on derivatives, including those designated as hedging instruments, can be found in the risk management section.

Notes to the financial statements continued

29. Subsidiaries

Country of incorporation		Principal activity
United Kingdom	Royal Insurance Holdings plc (note 1)	Holding company
	Royal & Sun Alliance Insurance plc	General insurance
	British Aviation Insurance Company Limited (57.1%)	General insurance
	The Globe Insurance Company Limited	General insurance
	The Marine Insurance Company Limited	General insurance
	Martello Underwriting Limited	General insurance
	Royal International Insurance Holdings Limited	General insurance
	Royal & Sun Alliance Reinsurance Limited	General insurance
	Sun Alliance and London Insurance plc	General insurance
	Sun Insurance Office Limited	General insurance
Argentina	Royal & Sun Alliance Seguros (Argentina) SA	General insurance
Bahrain	Royal & Sun Alliance Insurance (Middle East) Limited E.C. (50.01%)	General insurance
Brazil	Royal & Sun Alliance Seguros (Brasil) SA	General insurance
Canada	Roins Financial Services Limited	Holding company
	Quebec Assurance Company	General insurance
	The Johnson Corporation	Holding company
	Royal & Sun Alliance Insurance Company of Canada	General insurance
	Western Assurance Company	General insurance
	Canadian Northern Shield Insurance Company	General insurance
Chile	Royal & Sun Alliance Seguros (Chile) SA (99.4%)	General insurance
Colombia	Royal & Sun Alliance Seguros (Colombia) SA (86.7%)	General insurance
Denmark	Codan A/S (note 2)	Holding company
	Codan Forsikring A/S (note 2)	General insurance
Guernsey	Insurance Corporation of the Channel Islands Limited	General insurance
Isle of Man	Tower Insurance Company Limited	General insurance
Mexico	Royal & Sun Alliance Seguros (Mexico) SA de C.V.	General insurance
Netherlands Antilles	Royal & Sun Alliance Insurance (Antilles) NV (51.0%)	General insurance
Norway	Duborgh Skadeforsikring AS (note 2)	Insurance brokerage
	White Label Holding AS Group (note 2)	Holding company
Republic of Ireland	EGI Holdings Limited	General insurance
Sweden	Trygg-Hansa Försäkrings AB, Publikt (note 2)	General insurance
Uruguay	Royal & Sun Alliance Seguros (Uruguay) SA	General insurance

Notes

1. 100% direct subsidiary of Royal & Sun Alliance Insurance Group plc.
2. During the year, Codan A/S purchased £24m of its own shares on the market. In addition the Group launched a voluntary conditional public tender offer for the acquisition of all the outstanding issued shares and voting rights in Codan A/S. As a result the Group acquired sufficient shareholding to effect a compulsory acquisition of the remaining shares and, as the transaction is not reversible, to account for 100% of the subsidiary. At 31 December 2007 the Group owned 99.5% of Codan A/S and completed the compulsory acquisition process to acquire the remaining 0.5% in January 2008.
3. Except where indicated all holdings are of equity shares and represent 100% of the nominal issued capital. In all cases the proportion of voting power held equals the proportion of ownership interest.
4. Some subsidiaries have been omitted from this statement to avoid providing particulars of excessive length but none materially affects the results or assets of the Group.

30. Business combinations

Acquisition of subsidiaries

On 10 April 2007 the Group acquired an additional 40% of the share capital of Stevenson and Hunt Insurance Brokers Limited to bring its total holding to 58%. On 31 October 2007 the Group acquired 100% of the share capital of Thomson Jemmett Vogelzang. On 31 December 2007 the Group acquired 100% of the share capital of Canadian Northern Shield Insurance Company ('CNS'). All acquisitions were in Canada. The total consideration was **£61m** and goodwill of **£23m** arose on acquisitions.

	£m
Intangible assets (excluding goodwill)	45
Investments	60
Reinsurers' share of insurance contract liabilities	25
Other assets	25
Cash and cash equivalents	9
Insurance contract liabilities	(90)
Other liabilities	(36)
Net assets	38
Cash consideration including acquisition costs	61
Goodwill on acquisitions	23

If the acquisitions had occurred on 1 January 2007, Group net written premiums for the year would have increased by **£52m** and the Group's profit after tax would have increased by **£4m**. The total profit after tax of the acquired entities since the acquisition dates included in the Group's profit for the period is **£1m**.

Goodwill is individually assessed on each acquisition. The goodwill shown above arose from the premium paid for strengthening the Group's market position in targeted business segments and acquiring the skilled workforce to drive future profitability in those segments. Goodwill also represents the future cost saving from expected synergies and economies of scale.

The valuation of CNS is provisional as the purchase completed at the end of the financial year.

Disposal of subsidiaries

During the year disposals of subsidiary undertakings and books of business were made for total proceeds of **£8m**, giving rise to a pre tax loss of **£35m**. Group disposals during the year comprise:

- The disposal of its US operation on 4 March 2007. The net cost of the transaction was **£nil** and generated a pre tax loss of **£19m**. This represents foreign exchange, which is recycled from shareholders' funds and does not impact total equity. In 2006 the loss recognised as a result of remeasurement to fair value less costs to sell was £399m.
- The disposal of its Venezuelan business on 14 December 2007. The transaction generated proceeds, net of costs, of **£nil** and generated a pre tax loss of **£13m** which comprises a £5m loss on net asset value and £8m of foreign exchange, which is recycled from shareholders' funds and does not impact total equity.
- Other disposals in the year generated proceeds, net of costs, of **£8m** and generated a pre tax loss of **£3m**.

Notes to the financial statements continued

30. Business combinations continued

The carrying value of assets and liabilities disposed of were as follows:

	£m
Investments	1,729
Reinsurers' share of insurance contract liabilities	1,409
Other assets	328
Cash and cash equivalents	415
Insurance contract liabilities	(2,809)
Other liabilities	(1,056)
Net assets	16
Cumulative translation differences	27
Loss on disposal	(35)
Total consideration	**8**

The loss on disposal recognised in the income statement in continuing operations of **£22m** comprises the disposals above, excluding the US operation, of **£16m** and **£6m** in respect of a provision on reclassification of a disposal group, as described in note 34.

31. Cash generated from continuing operations

	2007 £m	2006 £m
Net profit for the year before tax on continuing operations	670	649
Adjustments for:		
Depreciation	32	35
Amortisation	56	61
Fair value (gains)/losses (including (gain)/loss on disposal) on property and equipment	(4)	1
Fair value gains (including gain on disposal) on investments	(159)	(38)
Fair value losses/(gains) (including loss/(gain) on disposal) on investment property	30	(53)
Impairment charge on available for sale financial assets	3	3
Share of profit from associates	–	(1)
Loss on disposal of subsidiaries	22	1
Foreign exchange gain	(53)	(34)
Amortisation of available for sale investments	7	78
Other non cash movements	312	193
Changes in operating assets/liabilities:		
Movement in technical provisions		
Unearned premiums	230	191
Losses and loss adjustment expenses	94	176
Movement in working capital	(624)	(419)
Movement in deferred acquisition costs	(61)	(14)
Reclassification of interest received	(489)	(423)
Cash generated from continuing operations	**66**	406

32. Related party transactions

The ultimate Parent Company of the Group is Royal & Sun Alliance Insurance Group plc which is incorporated in Great Britain and registered in England and Wales.

The following transactions were carried out with related parties:

Key management compensation

	2007 £m	2006 £m
Salaries and other short term employee benefits	**4**	4
Bonus awards	**3**	4
Pension benefits	**1**	1
Share based awards	**4**	3
Total	**12**	12

A number of the directors, other key managers, their close families and entities under their control have general insurance policies with subsidiary companies of the Group. Such policies are on normal commercial terms except that executive directors and key managers are entitled to special rates which are also available to other members of staff.

Investments in associates

Included within liabilities in the balance sheet at 31 December 2007 is **£25m** (2006: £nil) payable as a capital injection to an associated company Global Direct Insurance Investments BV.

Discontinued operations

The Group disposed of its US operation to Arrowpoint Capital Corp., a company set up by the Group's former US management team. This transaction was undertaken on normal commercial terms and conditions.

33. Commitments

Capital commitments

The Group's significant capital commitments in respect of property and equipment and intangible assets are detailed in the table below:

	2007 £m	2006 £m
Property and equipment	**27**	2
Intangible assets	**18**	–
Total	**45**	2

Financial instrument commitments

The Group has a number of guarantees and commitments.

Bank loan guarantees

In Canada, the Group guarantees outstanding loan repayments in the event of bank loan default by broker subsidiaries and special relationship brokers. The bank loan guarantees amount in total to **£8m** (2006: £7m) and have a term of up to 10 years. It is not anticipated that any of the brokers will default, and full recourse is available on any default. In 2006 the Group had financial and performance guarantees of £2m in Scandinavia.

Notes to the financial statements continued

33. Commitments continued

Operating lease commitments

The Group leases various outlets and offices under non cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

Operating lease commitments where the Group is the lessee

The future aggregate minimum lease payments under non cancellable operating leases are as follows:

	Land and buildings		Other	
	2007 £m	2006 £m	**2007 £m**	2006 £m
One year or less	**58**	55	**2**	2
Between one and five years	**192**	184	**2**	2
After five years	**134**	158	**–**	–
	384	397	**4**	4
Recoveries under sub tenancies	**(67)**	(94)	**–**	–
Total	**317**	303	**4**	4

Operating lease commitments where the Group is the lessor

The future aggregate minimum lease payments under non cancellable operating leases are as follows:

	Land and buildings	
	2007 £m	2006 £m
One year or less	**25**	23
Between one and five years	**83**	82
After five years	**125**	149
Total	**233**	254

34. Discontinued operations and non current and disposal group assets and liabilities held for sale

Discontinued operations

On 4 March 2007 the Group announced the completion of the disposal of its US operation to Arrowpoint Capital Corp. The losses arising on the writedown of the carrying value of the US operation to fair value less costs to sell were recognised in the 2006 result. The loss recognised on completion in 2007 includes the cumulative amount of the exchange gains and losses deferred in equity relating to the US operation and to the cumulative exchange gains and losses recorded on a US Dollar denominated loan made by a UK subsidiary company to the US operation.

An analysis of the result of discontinued operations is as follows:

	2007 £m	2006 £m
Total income	**26**	124
Total expenses	**(26)**	(209)
Loss before tax and losses recognised on completion/writedown	**–**	(85)
Loss recognised on completion/writedown	**(19)**	(399)
Loss before tax of discontinued operations	**(19)**	(484)
Tax on loss on disposal and writedown	**6**	(15)
Loss for the year from discontinued operations	**(13)**	(499)

Non current and disposal group assets and liabilities held for sale

During 2007 the Group has classified an office property within the UK operating segment as a non current asset held for sale. The Group currently occupies, but is in the process of vacating, the property. The Group is actively marketing the property and expects to complete a sale within one year. No gain or loss has been recognised in the income statement since the reclassification.

During 2007 the Group has classified one of its subsidiaries within the UK operating segment, Guildhall Insurance Company Limited, as a disposal group. The sale of the company has been agreed, subject to regulatory approval and the Group expects to complete the sale within one year. A provision for a pre tax loss of **£6m** has been recognised on reclassification. No gain or loss has been recognised in the income statement since the reclassification.

During 2006 the Group reclassified the assets and liabilities of its US operation as a disposal group.

The analysis of the non current and disposal group assets and liabilities held for sale is as follows:

	2007 £m	2006 £m
Assets		
Goodwill and other intangibles	–	10
Property and equipment	**13**	2
Total investments	–	1,591
Reinsurers' share of insurance contract liabilities	**58**	1,377
Insurance and reinsurance debtors	**5**	250
Deferred acquisition costs	–	5
Other debtors and other assets	–	37
Cash and cash equivalents	**32**	213
Total assets	**108**	3,485
Liabilities		
Insurance contract liabilities	**58**	2,834
Insurance and reinsurance liabilities	**5**	41
Other liabilities	**2**	719
Total liabilities	**65**	3,594

Independent auditors' report to the members of Royal & Sun Alliance Insurance Group plc

We have audited the Parent Company financial statements of Royal & Sun Alliance Insurance Group plc for the year ended 31 December 2007 which comprise the Parent Company balance sheet, statement of changes in equity of the Parent Company, Parent Company cashflow statement and the related notes 1 to 10. These Parent Company financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the Group financial statements of Royal & Sun Alliance Insurance Group plc for the year ended 31 December 2007 and on the information in the remuneration report that is described as having been audited.

This report is made solely to the Parent 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 Parent Company's members those matters we are required to state to them in an auditors' 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 Parent Company and the Parent 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' responsibilities for preparing the Annual Report and the Parent Company financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union are set out in the directors' report.

Our responsibility is to audit the Parent Company financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Parent Company financial statements give a true and fair view and whether the Parent Company financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the directors' report is consistent with the Parent Company financial statements. The information given in the directors' report includes that specific information presented in the financial review, the Group CEO's business review, the regional business reviews and in the estimation techniques, uncertainties and contingencies that is cross referred from the business review section of the directors' report.

In addition we report to you if, in our opinion, the Parent 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 other transactions is not disclosed.

We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited Parent Company financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Parent Company financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Parent Company financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the Parent Company financial statements, and of whether the accounting policies are appropriate to the Parent 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 Parent Company 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 Parent Company financial statements.

Opinion

In our opinion:

- The Parent Company financial statements give a true and fair view, in accordance with IFRS as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the Parent Company's affairs as at 31 December 2007
- The Parent Company financial statements have been properly prepared in accordance with the Companies Act 1985
- The information given in the directors' report is consistent with the Parent Company financial statements.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London
26 February 2008

Parent Company balance sheet

as at 31 December 2007

	Notes	2007 £m	2006 £m
Assets			
Fixtures and fittings		**2**	2
Investments	2	**5,587**	5,811
Amounts owed by subsidiaries	9	**1,273**	1,212
Current tax assets	6	**26**	57
Deferred tax assets	6	**21**	28
Other debtors and other assets	3	**4**	6
		1,324	1,303
Cash and cash equivalents		**1**	2
Total assets		**6,914**	7,118
Equity, reserves and liabilities			
Equity and reserves			
Share capital	4	**1,020**	946
Reserves		**3,976**	4,090
Retained earnings		**422**	288
Total equity and reserves		**5,418**	5,324
Liabilities			
Amounts owed to subsidiaries	9	**232**	540
Loan capital	5	**1,194**	1,192
Accruals and other liabilities		**70**	62
Total liabilities		**1,496**	1,794
Total equity, reserves and liabilities		**6,914**	7,118

The attached notes form an integral part of these separate financial statements.

The separate financial statements were approved on 26 February 2008 by the Board of Directors and are signed on its behalf by:

George Culmer
Chief Financial Officer

Statement of changes in equity of the Parent Company

for the year ended 31 December 2007

Changes in equity for the year ended 31 December 2007

	Ordinary share capital £m	Ordinary share premium £m	Preference shares £m	Revaluation reserves £m	Capital redemption reserve £m	Retained earnings £m	Total equity £m
Balance at 1 January	821	857	125	3,225	8	288	5,324
Profit for the year	–	–	–	–	–	82	82
Dividends – paid (note 7)	–	–	–	–	–	(211)	(211)
Issued by scrip	19	81	–	–	–	–	100
Issued for cash	55	5	–	–	–	244	304
Share options	–	–	–	–	–	19	19
Fair value losses net of tax	–	–	–	(200)	–	–	(200)
Balance at 31 December	**895**	**943**	**125**	**3,025**	**8**	**422**	**5,418**

Changes in equity for the year ended 31 December 2006

	Ordinary share capital £m	Ordinary share premium £m	Preference shares £m	Revaluation reserves £m	Capital redemption reserve £m	Retained earnings £m	Total equity £m
Balance at 1 January	807	804	125	2,362	8	281	4,387
Profit for the year	–	–	–	–	–	143	143
Dividends – paid (note 7)	–	–	–	–	–	(149)	(149)
Issued by scrip	12	49	–	–	–	–	61
Issued for cash	2	4	–	–	–	–	6
Share options	–	–	–	–	–	13	13
Fair value gains net of tax	–	–	–	863	–	–	863
Balance at 31 December	821	857	125	3,225	8	288	5,324

The attached notes form an integral part of these separate financial statements.

Parent Company cashflow statement

for the year ended 31 December 2007

	Note	2007 £m	2006 £m
Cash generated from operations	8	**70**	63
Net movement in amounts owed to/by subsidiaries		**(239)**	(52)
Investments in subsidiaries		**–**	(2)
Net cashflows from investing activities		**(239)**	(54)
Proceeds from issue of share capital		**304**	6
Dividends paid		**(111)**	(87)
(Repayment)/proceeds from issuance of long term borrowings		**(25)**	74
Net cashflows from financing activities		**168**	(7)
Net (decrease)/increase in cash and cash equivalents		**(1)**	2
Cash and cash equivalents at beginning of the year		**2**	–
Cash and cash equivalents at end of the year		**1**	2

The attached notes form an integral part of these separate financial statements.

Notes to the separate financial statements

1. Significant accounting policies

Royal & Sun Alliance Insurance Group plc, domiciled in the United Kingdom, is the ultimate Parent Company (the 'Company') of the RSA group of companies. The principal activity of the Company is to hold investments in its subsidiaries and the receipt and payment of dividends.

These separate financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

Except where otherwise stated, all figures included in the separate financial statements are presented in millions of Pounds Sterling ('Sterling'), shown as £m, rounded to the nearest million.

In accordance with section 230 of Companies Act 1985, the Company's income statement and related notes have not been presented in these separate financial statements.

The accounting policies that are used in preparation of these separate financial statements are consistent with the accounting policies used in preparation of the consolidated financial statements of Royal & Sun Alliance Insurance Group plc as set out in those financial statements.

The additional accounting policies that are specific to the separate financial statements of the Company are set out below.

Investment in subsidiaries

The Company accounts for its investments in directly owned subsidiaries as available for sale financial assets, which are included in the accounts at fair value.

Changes in the fair value of the investments in subsidiaries are recognised directly in equity in the statement of changes in equity. Where there is a decline in the fair value of a directly owned subsidiary below cost, and there is objective evidence that the investment is impaired, the cumulative loss that has been recognised in equity is removed from equity and recognised in the income statement.

Dividend income

Dividend income from investments in subsidiaries is recognised when the right to receive payment is established.

2. Investments

	2007 £m	2006 £m
Investments at 1 January – at valuation	**5,811**	4,870
(Disposals)/additions during the year	**(24)**	78
Fair value adjustments	**(200)**	863
Investments at 31 December – at valuation	**5,587**	5,811

The balance at 31 December comprises:

	2007 £m	2006 £m
Investment in subsidiaries	**5,208**	5,410
Loans to subsidiaries	**379**	401
	5,587	5,811

The investments in subsidiaries are recognised in the balance sheet at fair value measured in accordance with the Company's accounting policies. Fair value of the Company's significant subsidiary is determined by reference to the market value (derived from relevant indices) of the Company's ordinary shares and loan capital instruments at the balance sheet date, being the most transparent independent available indicator. The market value is adjusted for the fair value of the Company's preference shares, assets and liabilities, excluding directly owned subsidiaries. The adjusting items have been fair valued by determining the present value of future cashflow projections, using an appropriate arms length discount rate. The remaining subsidiaries are held at fair value which has been determined to be net asset value.

The directors believe that the methodology used supports the inclusion of the investments in subsidiaries on the balance sheet, at the fair values ascribed to them. The market value of the Company's ordinary shares at 31 December 2007 was **148.2p**. A movement of 1% in the share price would have an impact of **£48m** on the fair value.

Full details of the principal subsidiaries of the Company are set out in note 29 to the consolidated financial statements.

3. Other debtors and other assets – to be settled within 12 months

	2007 £m	2006 £m
Other prepayments and accrued income	**2**	3
Other debtors	**2**	3
Total other debtors and other assets	**4**	6

4. Share capital

Full details of the share capital of the Company are set out in note 18 to the consolidated financial statements.

5. Loan capital

Full details of the loan capital of the Company are set out in note 19 to the consolidated financial statements.

6. Current and deferred tax

Current tax

	2007 £m	2006 £m
To be settled within 12 months	**26**	57
To be settled after 12 months	**–**	–
	26	57

Deferred tax

	2007 £m	2006 £m
Deferred tax assets	**21**	28
Deferred tax liabilities	**–**	–
Net deferred tax position at 31 December	**21**	28

Deferred tax assets

The following are the major deferred tax assets recognised by the Company and movements during the year:

	Other temporary differences £m	Reclassification of bonds £m	Accelerated capital allowances £m	Total £m
Deferred tax assets at 1 January	–	24	2	26
Charge to equity for the year	–	(2)	–	(2)
Credited/(charged) to income for the year	5	–	(1)	4
Deferred tax assets at 31 December 2006	5	22	1	28
Effect of change of rate in deferred tax	**–**	**(2)**	**–**	**(2)**
Charge to equity for the year	**–**	**(2)**	**–**	**(2)**
Charge to income for the year	**(3)**	**–**	**–**	**(3)**
Deferred tax assets at 31 December 2007	**2**	**18**	**1**	**21**

At the balance sheet date, the Company has unused tax losses of **£7m** (2006: £4m) available for offset against future profits. No deferred tax asset has been recognised in respect of the tax losses of **£7m** (2006: £4m) due to the unpredictability of future profit streams. The losses may be carried forward indefinitely.

The aggregate current tax relating to items that are credited to equity is **£4m** (2006: £2m).

7. Dividends

Full details of the dividends paid and proposed by the Company are set out in note 7 to the consolidated financial statements.

8. Cash generated from operations

	2007 £m	2006 £m
Net profit for the year before tax	**63**	111
Realised losses	**21**	–
Foreign exchange loss/(profit)	**20**	(29)
Changes in operating assets/liabilities	**(34)**	(19)
Cash generated from operations	**70**	63

Notes to the separate financial statements continued

9. Related party transactions

Royal & Sun Alliance Insurance Group plc (incorporated in Great Britain and registered in England and Wales) is the ultimate Parent Company of the RSA group of companies.

The following transactions were carried out with related parties:

Provision of services and benefits

Royal & Sun Alliance Insurance Group plc provides services and benefits to its subsidiary companies operating within the UK and overseas as follows:

- Provision of technical support in relation to risk management, information technology and reinsurance services. Services are charged for annually on a cost plus basis, allowing for a margin of **5%** (2006: 5%)

- Issue of share options and share awards to employees of subsidiaries. Costs are charged for annually based on the underlying value of the awards granted calculated in accordance with the guidance set out within IFRS 2.

Key management compensation

	2007 £m	2006 £m
Salaries and other short term employee benefits	**4**	4
Bonus awards	**3**	4
Pension benefits	**1**	1
Share based awards	**4**	3
Total	**12**	12

There are no employees with employment contracts with the Company. All employees are employed by subsidiary companies.

A number of the directors, other key managers, their close families and entities under their control have general insurance policies with subsidiary companies of the Group. Such policies are on normal commercial terms except that executive directors and key managers are entitled to special rates which are also available to other members of staff.

Other transactions

Year end balances with related parties are set out below:

	2007 £m	2006 £m
Receivable from related parties:		
Receivable from subsidiaries, interest bearing loans	**995**	1,009
Receivable from subsidiaries, non interest bearing	**278**	203
Total receivable from related parties	**1,273**	1,212
Payable to related parties:		
Payable to subsidiaries, interest bearing loans	**131**	427
Payable to subsidiaries, non interest bearing	**101**	113
Total payable to related parties	**232**	540

Interest is charged on interest bearing loans, which are repayable on 24 hours written notice, at three months LIBOR + 0.6%.

Additional loans to subsidiaries of **£379m** (2006: £401m) as disclosed within note 2 have been made. Of this, **£294m** (2006: £294m) and **£78m** (2006: £78m) are subordinated loans on which interest is charged at 8.5% and 6.701% respectively with the remaining loan balance interest free with no specified repayment date.

Royal & Sun Alliance Insurance plc (RSAI), a subsidiary of the Company, has provided guarantees to the Company's creditors for amounts arising from its loan capital agreements (as set out in note 19 to the consolidated financial statements) and for amounts arising from its committed credit facilities (as set out in note 22 to the consolidated financial statements). The guarantees relating to the loan capital agreements are subordinated to all other creditors of RSAI.

10. Share based payments

Full details of share based payment plans are provided in note 27 to the consolidated financial statements.

Shareholder information

Registered Office and Group Corporate Centre

9th Floor, One Plantation Place, 30 Fenchurch Street, London EC3M 3BD. Telephone: +44 (0)20 7111 7000. Registered in England No. 2339826.

Company website

The Annual Report and Accounts, interim results and other useful information about the Company, such as the current share price, is available on the website **www.rsagroup.com**. Frequently asked questions and answers in respect of shareholding matters are detailed on the Company's website.

Registrar

The Company's share register is maintained by Equiniti Limited. Queries regarding your shareholding should be addressed to Equiniti at the following address:

Equiniti Limited
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA
Telephone: +44 (0)871 384 2048

Overseas callers should use +44 (0)121 415 7064.
Shareholders with a text phone facility should use +44 (0)871 384 2255.

Please quote the company reference number 0059 and your shareholder account number (on your share certificate and dividend tax vouchers) when contacting or corresponding with Equiniti.

Annual General Meeting

Ordinary shareholders are invited to attend the Company's Annual General Meeting (AGM), which will be held in The Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE at 11.00am on 19 May 2008. Ordinary shareholders who are unable to attend the AGM to ask a question in person are invited to send the Chairman an email via the Company's website or to write to the Chairman at the Registered Office address above.

Share ownership

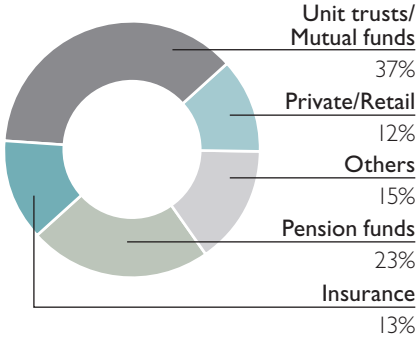
RSA is listed on the London Stock Exchange under the code RSA. The average total daily trading volume during 2007 was approximately 28m ordinary shares. The opening market price of an ordinary share on 2 January 2007 was 152.50p and closing market price on 31 December 2007 was 148.20p. The highest daily closing price of an ordinary share was 172.10p on 18 May 2007 and lowest daily closing price was 128.30p on 30 July 2007. Further details of the ordinary and preference shares are found in note 18 on pages 96 to 97.

Shareholdings by size

No of shares	Shareholders	%	Shares	%
1 – 24,999	48,134	97.38	112.5m	3.46
25,000 – 99,999	701	1.42	31.1m	0.96
100,000 – 499,999	265	0.54	54.6m	1.68
500,000 – 999,999	105	0.21	65.4m	2.01
1,000,000 – 1,999,999	75	0.15	120.7m	3.71
2,000,000 and above	148	0.30	2,868.6m	88.18
Total	**49,428**	**100.00**	**3,252.9m**	**100.00**

Distribution of shares by geography

Analysis of investors



Shareholder information continued

Managing your shareholding

Share Register Fraud: protecting your investment

It is required by law that our shareholder register is available for public inspection and we are unable to control the use of information obtained by persons inspecting the register. Please treat any approaches purporting to originate from RSA with caution. RSA will never contact its shareholders directly to provide recommendation or advice regarding your shareholding and neither does it appoint third parties to do so.

Tips on protecting your shares

- Keep any documentation that contains your shareholder reference number in a safe place and destroy any documentation which you no longer need by shredding it
- Inform Equiniti promptly when you change your address
- Be aware of dividend payment dates and contact the registrars if you do not receive your dividend cheque, or better still, make arrangements to have the dividend paid directly into your bank account
- Consider holding your shares electronically in a CREST account via a nominee.

Amalgamation of accounts

Shareholders who receive duplicate sets of Company mailings owing to multiple accounts in their name should write to Equiniti to request that their accounts be amalgamated.

Low cost share dealing facilities

A telephone and internet dealing service is available through Equiniti which provides a simple way of buying and selling RSA shares. Commission is 1% with a minimum charge of £25 for telephone dealing and 0.5% with a minimum charge of £15 for internet dealing. For telephone sales call +44 (0)845 6037 037 between 8.30am and 4.30pm, Monday to Friday, and for internet sales log on to **www.shareview.co.uk/dealing**. You will need your shareholder reference number as shown on your share certificate. Share dealing services are also widely provided by other organisations.

ShareGift

Shareholders with a small number of shares, the value of which makes it uneconomic to sell them, may wish to consider donating them to charity through ShareGift, a registered charity administered by The Orr Mackintosh Foundation, registered charity number 1052686. The relevant share transfer form can be obtained from Equiniti. Further details can be obtained from:

ShareGift
17 Carlton House Terrace,
London SW1Y 5AH
Telephone: +44 (0)20 7930 3737
www.sharegift.org

Capital gains tax

The market value at 31 March 1982 of each post consolidation ordinary share of 27.5p in the Company, for capital gains tax purposes after relevant adjustments, was 146.41p (25p shares 133.1p) for former Royal Insurance shareholders and 57.97p (25p shares 52.7p) for former Sun Alliance shareholders. An adjustment to tax cost is required to take account of the 2003 rights issue, according to whether the rights were taken up or sold. Similarly, for former Royal Insurance shareholders an adjustment to tax cost is required to take account of the 1993 rights issue, according to whether the rights were taken up or sold.

Disabled shareholders

RSA is committed to providing a quality service to all of its shareholders. An induction loop is installed at the AGM venue. Please contact the Company Secretary's department at the address above if you require particular assistance.

The Unclaimed Assets Register

RSA supplies unclaimed dividend data to The Unclaimed Assets Register (UAR), which provides investors who have lost track of shareholdings with the opportunity to search the UAR's database of unclaimed financial assets on payment of a small, fixed fee. The UAR donates part of the search fee to charity. Further details can be obtained from: The Unclaimed Assets Register, 6th Floor, Cardinal Place, 80 Victoria Street, London SW1E 5JL. Telephone: +44 (0)870 241 1713. The website address is **www.uar.co.uk**.

American Depositary Receipts

The Company terminated its listing, in the form of American Depositary Shares, on the New York Stock Exchange on 30 October 2006.

Should you have an enquiry relating to the above please contact the Investor Relations department at Royal & Sun Alliance Insurance Group plc, 9th Floor, One Plantation Place, 30 Fenchurch Street, London EC3M 3BD. Telephone: +44 (0)20 7111 7136.

Financial calendar

27 February 2008
Announcement of the full year results for 2007, the ordinary final dividend for 2007 and the first preference dividend for 2008

5 March 2008
Ex dividend date for the ordinary final dividend for 2007 and the first preference dividend for 2008

7 March 2008
Record date for the ordinary final dividend for 2007 and the first preference dividend for 2008

13 March 2008
Announcement of the scrip dividend price for the ordinary final dividend for 2007

1 April 2008
Payment date for the first preference dividend for 2008

8 May 2008
Deadline for the receipt of scrip dividend mandates by Equiniti Limited in relation to the ordinary final dividend for 2007

19 May 2008
Annual General Meeting

6 June 2008
Payment date for the ordinary final dividend for 2007 (subject to shareholder approval at the AGM)

7 August 2008*
Announcement of the half year results for the six months ended 30 June 2008, the ordinary interim dividend for 2008 and the second preference dividend for 2008

13 August 2008*
Ex dividend date for the ordinary interim dividend for 2008

15 August 2008*
Record date for the ordinary interim dividend for 2008

21 August 2008*
Announcement of the scrip dividend price for the ordinary interim dividend for 2008

27 August 2008*
Ex dividend date for the second preference dividend for 2008

29 August 2008*
Record date for the second preference dividend for 2008

1 October 2008*
Payment date for the second preference dividend for 2008

31 October 2008*
Deadline for the receipt of scrip dividend mandates by Equiniti Limited in relation to the ordinary interim dividend for 2008

28 November 2008*
Payment of the ordinary interim dividend for 2008

*provisional date

Important disclaimer

This document contains 'forward looking statements' (as defined in the US Private Securities Litigation Reform Act of 1995) with respect to certain of the Company's plans and its current goals and expectations relating to its future financial condition, performance and results. These statements are often, but not always, made through use of words or phrases such as 'will likely result', 'are expected to', 'will continue', 'believe', 'is anticipated', 'estimated', 'intends', 'plans', 'seeks', 'projection', 'outlook' and 'aims'. By their nature, all forward looking statements involve risk and uncertainty because they relate to future events and circumstances which are beyond the Company's control, including amongst other things, UK domestic and global economic business conditions, market related risks such as fluctuations in interest rates and exchange rates, the policies and actions of regulatory authorities (including changes related to capital and solvency requirements), the impact of competition, inflation, deflation, the timing impact and other uncertainties of future acquisitions or combinations within relevant industries, as well as the impact of tax and other legislation and other regulations in the jurisdictions in which the Company and its affiliates operate. As a result, the Company's actual future financial condition, performance and results may differ materially from the plans, goals and expectations set forth in the Company's forward looking statements. The Company undertakes no obligation to update any forward looking statements save in respect of any requirement under applicable law or regulation.

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