Business review

Group performance

What we do

Aviva is the world's fifth largest insurance group, serving 50 million customers across Europe, North America and Asia Pacific. Our main business activities are long-term savings, fund management and general insurance. We are the largest insurance services provider in the UK and one of the leading providers of life and pension products in Europe.

Employees and locations

54,758

2007: 57,011

Australia	Hong Kong	Netherlands	South Korea
Belgium	Hungary	Malaysia	Spain
Canada	India	Poland	Sri Lanka
China	Ireland	Romania	Taiwan
Czech Republic	Italy	Russia	Turkey
France	Lithuania	Singapore	United Kingdom
Germany	Luxembourg	Slovakia	United States

What's happened?

- We are in one of the most turbulent periods for financial markets since records began
- No one can accurately forecast when the current situation will start to improve
- As a result the market is demanding more transparency in our results and the disclosures we make, reassurance in the quality of our assets and continued focus on cost management

What action have we taken?

Performance

- Maintained our focus on profitable growth
- Adopted interim reporting in line with the FSA's Disclosure and Transparency rules
- Implemented our Financial Reporting Controls Framework (FRCF) across most of the group
- Early adoption of market consistent embedded value (MCEV) methodology for our long-term savings business

Capital

- Proactively managed our financial and IGD solvency position
- Kept the market and regulator informed of our position
- Continued to be heavily involved with the development of Solvency II
- Efficient raising of external debt

Risk

- We improved our risk management framework
- Further developed a robust process for gathering and reviewing information on the quality of our assets
- We took action to reduce the risks on our balance sheet

What have we achieved?

Performance

- We increased our operating profit on both MCEV and IFRS bases
- FRCF has been rolled out across most of the group. This control framework, similar to Sarbannes-Oxley, is designed to mitigate the risk of material financial misstatement in our external announcements and publications
- We have produced our results on an MCEV basis. This is an important step forward in increasing the transparency of our business

Capital

- We have achieved an estimated IGD surplus of £2.0 billion at 31 December 2008, demonstrating the resilience of our capital position and the benefits of our proactive capital management approach
- We maintained our Group Standard & Poor's and Moody's ratings

Risk

- We have taken out additional hedging against our equity exposure
- We have included detailed asset quality analysis, for our analyst presentation responding to the demand for more information and transparency in our disclosures
- We have made provision for potential default experience on our balance sheet

What's next?

- Continue the proactive management of our capital base to ensure that we have a strong foundation for future years and that capital is allocated where it can generate the best returns
- Ensure that we remain at the front of industry changes through continued involvement in development of Solvency II and IFRS Phase II
- Explore a possible US listing which will give us a platform to broaden our investor base in North America

Business review

Group performance continued

Operating profit

Group operating profit – IFRS basis

	12 months 2008 £m	Restated* 12 months 2007 £m
Long-term business	**1,694**	1,610
Fund Management	**123**	179
General insurance and health	**1,198**	1,021
Other operations and regional costs**	**(198)**	(74)
Regional operating profit before tax	**2,817**	2,736
Corporate centre	**(141)**	(157)
Group debt costs and other interest	**(379)**	(363)
IFRS operating profit before tax	**2,297**	2,216

Group operating profit – MCEV basis

	12 months 2008 £m	Restated* 12 months 2007 £m
Long-term business	**2,801**	2,544
Fund Management	**42**	90
General insurance and health	**1,198**	1,021
Other operations and regional costs**	**(163)**	(70)
Regional operating profit before tax	**3,878**	3,585
Corporate centre	**(141)**	(157)
Group debt costs and other interest	**(379)**	(363)
MCEV operating profit before tax	**3,358**	3,065

* We have changed our approach to reserving for latent claims this year and restated our 2007 comparatives. In addition, the creation of Aviva Investors has resulted in a restatement of 2007 long-term business and fund management operating profit. Details are shown in note 2 to the financial statements

**The results of the group's asset management and other operations that arise from providing fund management and other services to the life business have been included in the long-term business operating return on an MCEV basis. On an IFRS basis, they are included in fund management and other operations.

As announced in February 2009 the Group has adopted a market consistent embedded value methodology (MCEV) for supplementary life reporting.This replaces the European Embedded Value basis (EEV) we have previously used. We have restated the 2007 balance sheet and results accordingly. There is no change to the underlying fundamentals or economics of our business as a result of adopting MCEV; it merely provides a further perspective on the business, particularly for internal capital allocation purposes. Full details of our methodology can be found in the Financial Statements MCEV section in this report.

Operating profit before tax on an IFRS basis grew 4% to £2,297 million *(2007 restated: £2,216 million)*. Improved results from our long-term savings and general insurance businesses were offset by lower profits from fund management operations, impacted by the poor conditions in financial markets, and increased losses from non-insurance operations and regional costs.

On an MCEV basis, operating profit increased by 10% to £3,358 million *(2007 restated: £3,065 million)*. The operating results of our long-term savings, fund management, general insurance and other operations are discussed in detail in the regional sections of this report. Our results on both bases have benefited from the impact of currency movements, particularly the appreciation of the euro and US dollar.

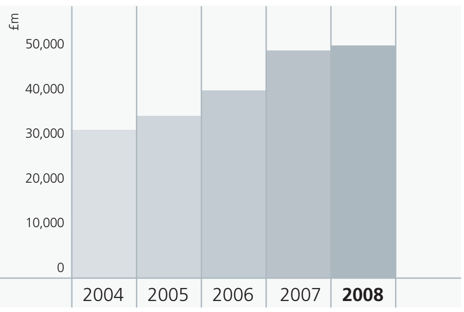
Corporate centre

Corporate centre costs for the year improved to £141 million (*2007: £157 million*) due to lower central spend and staff incentive costs. Within this total, project spend was £34 million *(2007: £26 million)*, driven by the corporate centre's share of the ongoing implementation of the global finance strategy. This project has allowed us to deliver new reporting requirements under MCEV and will enable us to meet future requirements under Solvency II. It will also deliver compliance with Sarbanes-Oxley (which would support a potential US listing). Further expenditure to deliver this project is also included in each region's operating profit.

Group debt costs and other interest

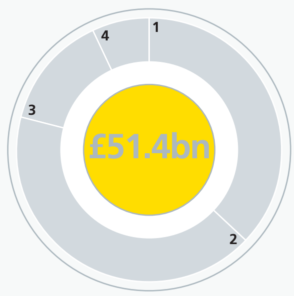
Group debt costs and other interest of £379 million (*2007: £363 million)* comprise internal and external interest on borrowings, subordinated debt and intra-group loans not allocated to local business operations. External interest costs increased to £286 million *(2007: £259 million)* reflecting higher interest on subordinated debt, due to the hybrid debt issues in May and August 2008 offset by lower commercial paper interest as proceeds from the hybrid debt raising were used to repay some commercial paper. Internal interest costs increased to £197 million *(2007: £179 million)* driven by changes in our internal loan balances.

Total sales
£51,415m
2007: £50,274m



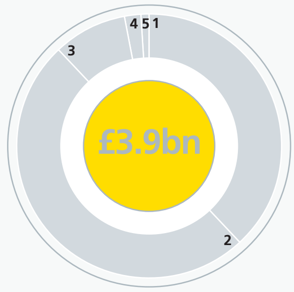
Regional analysis of total sales

Region	%
1 UK	37
2 Europe	42
3 N. America	14
4 Asia Pacific	7
Total	100



Regional analysis of MCEV operating profit†

Region	%
1 UK	38
2 Europe	50
3 N. America	9
4 Asia Pacific	2
5 Aviva Investors	1
Total	100



† Before corporate centre and group debt costs.

Also included is UK net pension income which represents the expected return on pension scheme assets less the interest charge on pension scheme liabilities. Net pension income increased to £104 million *(2007: £75 million)* reflecting higher expected rates of return on assets partly offset by higher discount rate on the liabilities.

Interest on the £990 million direct capital instrument issued in 2004 is not included within unallocated interest as it is instead treated as an appropriation of profits retained in the period.

(Loss)/profit before tax

Reconciliation of group operating profit to profit before tax – IFRS basis

	12 months 2008 £m	Restated* 12 months 2007 £m
IFRS operating profit before adjusting items and tax attributable to shareholders' profits	**2,297**	2,216
Adjusted for the following:		
Investment return variances and economic assumption changes on long-term business	**(1,631)**	15
Short-term fluctuation in return on investments backing non-long-term business	**(819)**	(184)
Economic assumption changes on general insurance and health business	**(94)**	2
Impairment of goodwill	**(66)**	(10)
Amortisation and impairment of intangibles	**(117)**	(103)
Profit on the disposal of subsidiaries and associates	**7**	49
Integration and restructuring costs	**(326)**	(153)
Exceptional items	**(551)**	–
IFRS (loss)/profit before tax attributable shareholders' profits	**(1,300)**	1,832
Tax	**415**	(334)
IFRS (loss)/profit for the financial year	**(885)**	1,498
Attributable to:		
Equity shareholders	**(915)**	1,320
Minority interests	**30**	178

Reconciliation of group operating profit to profit before tax – MCEV basis

	12 months 2008 £m	Restated* 12 months 2007 £m
MCEV operating profit before adjusting items and tax attributable to shareholders' profits	**3,358**	3,065
Adjusted for the following:		
Economic variances on long-term business	**(12,422)**	(19)
Short-term fluctuation in return of investments backing non-long-term business	**(819)**	(184)
Economic assumption changes on general insurance and health business	**(94)**	2
Impairment of goodwill	**(66)**	(10)
Amortisation and impairment of intangibles	**(108)**	(89)
Profit on the disposal of subsidiaries and associates	**7**	20
Integration and restructuring costs	**(326)**	(153)
Exceptional items	**(754)**	–
MCEV (loss)/profit before tax attributable to shareholders' profits	**(11,224)**	2,632
Tax	**3,514**	(686)
MCEV (loss)/profit for the period	**(7,710)**	1,946
Attributable to:		
Equity shareholders	**(7,632)**	1,704
Minority interests	**(78)**	242

* We have changed our approach to reserving for latent claims this year and restated our 2007 comparatives. Details are in note 2 to the financial statements.

(Loss)/profit before tax

We have reported a loss before tax on an IFRS basis in 2008 of £1,300 million *(2007 restated: £1,832 million profit)*. This loss mainly reflects the impact that the financial markets have had during the year with adverse investment variances and economic assumption changes amounting to £2,544 million *(2007 restated: £167 million adverse)*. During the year equity markets fell by between 30% to 50%, bond yields fell by 80 basis points in the UK and 110 basis points in the Eurozone and credit spreads widened, reflecting the increased risk of corporate debt. In addition to market value movements, this line also reflects that we have further increased credit allowance by £550 million for credit defaults on £16 billion of assets in the UK annuity business. Adverse economic assumption changes on general insurance and health business of £94 million relate to the discounted latent claims provisions

Impairment of goodwill of £66 million *(2007: £10 million)* is mainly driven by impairments in the Netherlands and on an Italian associate.

Amortisation and impairment of intangibles of £117 million *(2007: £103 million)* reflected amortisation of acquired additional value of in force business. The increase since last year mainly relates to the new acquisition in Spain of Cajamurcia.

Profit on the disposal of subsidiaries of £7 million *(2007: £49 million)* reflects £45 million profit on sale of our offshore operations and sundry small businesses offset by a loss of £38 million on the sale of certain UK non-core operations.

Integration and restructuring costs incurred in the year amounted to £326 million *(2007: £153 million)*. This includes £287 million for the cost savings initiatives in the UK life and general insurance businesses and Europe, which have delivered £340 million annualised cost savings in the year. Also included are integration costs of £39 million which mainly relate to the work to set up our global asset management operation, Aviva Investors.

We have reported exceptional items of £551 million *(2007: £nil)* in the year. These include £142 million for the transfer of the lifetime wrap platform the write down in preparation for the sale of the British School of Motoring in the UK and the closure of the structured settlement business in the US. The costs also include £304 million after reinsurance for the discounted cost of strengthening our latent claims provisions, mainly in the UK, and £126 million for the settlement agreed by our Netherlands life business for its unit-linked policyholders, following an industry-wide challenge on the level of fees. The remaining balance relates to brand migration costs of £37 million offset by £58 million benefit from settlement of a disputed Australian tax liability and the consequent release of a provision for interest charges.

Under MCEV exceptional items were £754 million, reflecting the higher cost of the Netherlands unit-linked settlement on an MCEV basis.

Tax

The taxation credit was £415 million *(2007 restated: £334 million charge)* on an IFRS basis and includes a charge of £487 million *(2007 restated: £604 million)* on operating profit, equivalent to an effective rate of 21.2% *(2007 restated: 27.3%)*. On an MCEV basis the effective rate of tax on operating profit was 25.0% *(2007 restated: 30.1%)*.

Business review

Group performance continued

Financial highlights

	12 months 2008 £m	Restated* 12 months 2007 £m
Worldwide sales*	**51,415**	50,274
Life and pensions value of new business before tax and minority interests	**780**	897
Life and pensions value of new business net of tax and minority interests	**409**	504
Life and pensions margin before tax and minority interests	**2.1%**	2.7%
Life and pensions margin net of tax and minority interests	**1.3%**	1.8%
General insurance combined operating ratio	**98%**	100%
Return on equity shareholders' funds	**11.0%**	10.4%
Earnings per share		
Basic – MCEV operating profit	**83.4p**	70.4p
Basic – IFRS total return after tax	**(36.8)p**	48.9p
Dividend per share	**33.0p**	33.0p

* Based on worldwide long-term savings new business sales, plus general insurance and health business net written premiums.

Worldwide sales

In 2008 we achieved total worldwide sales of £51,415 million *(2007 restated: £50,274 million)* reflecting growth in both life and pension sales and general insurance and health net written premiums. Sales of investment products fell reflecting the volatility experienced in financial markets during the year.

Long-term new business sales were up 1% to £40,278 million *(2007 restated: £39,705 million)*. Within this, life and pension sales increased 11% to £36,283 million *(2007 restated: £32,722 million)*, reflecting excellent growth in the US, where we have doubled the scale of our business in two years, and the benefit of the euro on sales in our European businesses. Sales of investment products decreased 43% to £3,995 million *(2007: £6,983 million)*.

Net written premiums from our general insurance and health business were £11,137 million *(2007: £10,569 million)*.
Good growth in Europe, particularly in the Netherlands, was partly offset by reduced premiums in our UK general insurance business, reflecting both the tough market conditions and our focus on profit rather than volumes.

Details of our sales performance can be found in the regional sections of this report.

Value of new business and margins

Total value of new business for 2008 was £780 million (*2007: £897 million)* resulting in a new business margin of 2.1% *(2007: 2.7%)*. The reduction in margin in 2008 reflects the volatility inherent in MCEV profit methods at times of economic and financial stress. Annuity new business margins reduced in 2008 as risk free return rates fell relative to asset yields, the effect of which is expected to reverse in future years as the benefit of asset yields emerge in operating earnings "expected returns". After removing tax and minority interests, the margin was 1.3% *(2007: 1.8%)*.

Combined operating ratio

The worldwide general insurance combined operating ratio (COR) improved to 98% *(2007: 100%)* in line with our "meet or beat" target. The improvement reflected lower adverse weather related claims offset by reduced levels of prior year claims releases.
The general insurance markets are increasingly competitive and our businesses in the Netherlands, Ireland and Canada all reported a deterioration in their CORs. In the UK, the COR improved due to the absence of adverse weather and the benefit derived from initiatives to deliver cost savings and control claims inflation but these were partly offset by lower prior year claims releases and difficult market conditions.

The group aims to maintain strong reserves in respect of general insurance and health business to protect against adverse future claims development. In 2008 we continued to benefit from favourable prior year claims development, although at a lower level than in 2007. Going forward we expect the size of these prior year releases to reduce as we have improved our reserving policy to set more stringent guidelines across the group.

During the year we revised our estimation of latent claims to reflect increasing market trends observed in mesothelioma claims The Institute of Actuaries' Asbestos working party report in 2008 contributed to our view that there has been a real worsening of expected ultimate claims experience for mesothelioma, even though current claims are only running at about £25 million a year. Therefore we have made a one-off provision after discounting for £304 million. As this relates to business no longer written by the group, this has been treated as an exceptional item and is therefore not included in the calculation of COR.

Return on equity shareholders' funds

Our post tax return on equity shareholders' funds was 11.0% *(2007 restated: 10.4%)*. This reflects the increased operating profit and reduced tax charge largely offset by £2.6 billion increase in opening shareholders' funds.

Earnings per share

Our IFRS earnings per share for 2008 was a loss of 36.8 pence *(2007 restated: 48.9 pence)*. This reflects an increase in operating earnings offset by the investment variances and exceptional items discussed above. We remain committed to our target to double earnings per share as set at 2007 by 2012.

Dividend

The Board has recommended a final dividend of 19.91 pence per share *(2007: 21.10 pence)*, payable on 15 May 2009 to shareholders on the register at 27 March 2009. This equates to a total dividend for the year of 33.00 pence *(2007: 33.00 pence)*. Our IFRS operating profits cover this dividend 1.9 times *(2007 restated: 1.6 times*) in line with our dividend cover target of 1.5 – 2.0 times.

Following a review by the Board of the operation of the current dividend reinvestment plan (DRIP) the company intends to propose a resolution at the forthcoming AGM to reintroduce a Scrip dividend scheme. Subject to shareholder approval, the Scrip Scheme will commence with the 2008 final dividend. The DRIP has been withdrawn.

Balance sheet and cash flow

Summarised group consolidated balance sheet
As at 31 December 2008

	IFRS basis		MCEV basis	
	2008 £m	Restated 2007 £m	**2008 £m**	Restated 2007 £m
Assets				
Goodwill	**3,578**	3,082	**3,578**	3,082
Acquired value of in-force business and intangible assets	**4,038**	3,197	**4,038**	3,197
Additional value of in-force long-term business	**–**	–	**2,669**	7,758
Interests in and loans to joint ventures and associates	**2,983**	3,782	**2,983**	3,782
Investment properties, property and equipment	**15,390**	16,333	**15,390**	16,333
Loans	**42,237**	36,193	**42,237**	36,193
Financial investments	**229,722**	216,410	**229,722**	216,410
Other assets	**32,433**	62,433	**32,433**	26,240
Cash and cash equivalents	**24,181**	16,089	**24,181**	16,089
Total assets	**354,562**	321,326	**357,231**	329,084
Equity				
Capital and reserves	**11,052**	12,946	**12,481**	12,656
Additional retained profit on an MCEV basis	**–**	–	**431**	7,342
Equity attributable to shareholders of Aviva plc	**11,052**	12,946	**12,912**	19,998
Preference shares and direct capital instrument	**1,190**	1,190	**1,190**	1,190
Minority interests	**2,204**	1,795	**3,013**	2,501
Total equity	**14,446**	15,931	**17,115**	23,689
Liabilities				
Gross liability for insurance and investment contracts	**282,409**	251,083	**282,409**	251,083
Unallocated divisible surplus	**2,325**	6,785	**2,325**	6,785
Net asset value attributable to unitholders	**6,918**	6,409	**6,918**	6,409
Borrowings	**15,201**	12,657	**15,201**	12,657
Other liabilities	**33,263**	28,461	**33,263**	28,461
Total liabilities	**340,116**	305,395	**340,116**	305,395
Total equity and liabilities	**354,562**	321,326	**357,231**	329,084

Equity attributable to our ordinary shareholders on an IFRS basis reduced by 15% to £11,052 million *(2007 restated: £12,946 million)* reflecting the impact of falling investment values partly offset by increased operating profit and the increase in the net assets of our non-UK businesses due to the strengthening of the euro and the dollar against sterling. On an MCEV basis, the equity attributable to ordinary shareholders was £12,912 million *(2007 restated: £19,998 million)*, giving a net asset value per share of 486 pence *(2007 restated: 763 pence)*.

At 31 December 2008, our total assets on an IFRS basis were £354,562 million *(2007 restated: £321,326 million)*. On the MCEV basis our total assets were £357,231 million *(2007 restated: £329,084 million)*. The difference relates to the recognition of internally generated additional value of in-force business (AVIF) under MCEV. The growth in assets reflects the strengthening of the euro and dollar against sterling, which offset the fall in market values, and an increase in holdings of cash and cash equivalents.

Summarised consolidated cash flow statement
IFRS basis

	Long-term business operations £m	**Non long-term business operations £m**	**12 months 2008 £m**	Restated* 12 months 2007 £m
Net cash from operating activities	**7,526**	**627**	**8,153**	4,143
Net cash from investing activities	**(164)**	**(231)**	**(395)**	(635)
Net cash flow from financing activities	**(878)**	**(1,259)**	**(2,137)**	(1,184)
Net increase in cash and cash equivalents	**6,484**	**(863)**	**5,621**	2,324
Cash and cash equivalents at 1 January	**11,132**	**4,432**	**15,564**	12,635
Effect of exchange rates	**2,525**	**359**	**2,884**	605
Cash and cash equivalents at 31 December	**20,141**	**3,928**	**24,069**	15,564
Cash and cash equivalents at 31 December comprised:				
Cash at bank and in hand			**11,249**	4,004
Cash equivalents			**13,425**	12,181
			24,674	16,185
Bank overdrafts			**(605)**	(621)
			24,069	15,564

Of the cash and cash requirements shown above £493 million has been classified as held for sale *(2007: £96 million)*

Cash flows from operating activities were £8,153 million *(2007 restated: £4,143 million)* reflecting higher levels of premium income partly offset by higher levels of paid claims. Investing activities used a lower amount of cash at £395 million *(2007: £635 million)*, due to lower acquisition expenditure. Financing activities used higher levels of cash at £2,137 million *(2007 £1,184 million)*, reflecting increased interest paid on borrowings and higher dividend payments due to the removal of the scrip dividend.