

## Business review

## UK

**What we do**

In the UK we are a leading provider of life, pensions, investment, general insurance and health products to more than 20 million customers. We also provide roadside assistance through the RAC. Products are distributed via a number of channels including IFAs, brokers, corporate partners and direct to customers via the internet. Currently trading as Norwich Union, we are rebranding to Aviva during 2009.

**Employees and locations****28,424**

2007: 32,872

Our life and general insurance businesses are based in York and Norwich respectively, with operations spread across the UK. We also have overseas operations in India and Sri Lanka

**Operating brands**


## Case study:

**Back in the driving seat**

Imagine spending a year painstakingly restoring a car – only to have it stolen.

That's what happened recently to a policyholder. We settled the claim, but it wasn't the end of the story...

Our policyholder continued searching car websites for his beloved Land Rover. After two years, he finally discovered it for sale on-line (despite significant modifications) and notified the police.

After the car was recovered, we made sure it was returned free of charge without any claims settlement to repay. In fact, we even arranged delivery back to an understandably delighted customer:

"Finally getting the 'Old Girl' back was a dream come true – hopefully she'll be back on the road soon."

"Delighting our customers"

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[www.norwichunion.com](http://www.norwichunion.com)

## What's happened?

### Economic downturn

- Global economic crisis, a dramatic slowdown in the housing market and the onset of a recession
- Savings ratio at its lowest level since the 1940s as disposable incomes decline and cost of living increase
- Significant decline in consumers confidence as value of investments fall

### Regulatory changes

- Capital gains tax and value added tax (VAT) changes
- Level of creditor business impacted by the Financial Services Authority's reviews of payment protection insurance
- Review by FSA of retail distribution

## What action have we taken?

### UK – Life

#### Maintained market share

- Life and Pensions market share increased to 11.3% along with our top three ranking in key savings, protection, pensions and annuities markets

#### Operational excellence

- Outsourced administration of 1 million policies to Swiss Re
- Achieved four stars in the Financial Adviser Service awards
- Launched financial adviser academy in advance of Retail Distribution Review recommendations
- 1,037 employees graduated from the Service Academy
- Helped 7,500 of our customers to unlock more value from their homes in these tough times

### UK – General insurance and health

#### Operational excellence

- Made significant progress on our transformation change programme designed to deliver true operational excellence

#### Focus on profit

- Great strides in reshaping our book
- Rate increases achieved across all commercial lines
- Improved our price competitiveness and introduced sophisticated pricing techniques
- Delivery on the promise of scale – £265 million of cost savings in the year

## What have we achieved?

Total sales	MCEV operating profit	IFRS operating profit	
<b>£18,756m</b>	<b>£1,509m</b>	<b>£1,377m</b>	
2007 restated: £20,445m	2007 restated: £1,225m	2007: £1,126m	
PVNB	£11,858m	Long-term savings	£883m
Investment sales	£1,485m	Fund management	£(18)m
Net written premiums	£5,413m	General insurance	£656m
	<b>£18,756m</b>	Other operations	£(12)m
			<b>£1,509m</b>

## What's next?

### Our medium-term targets are to:

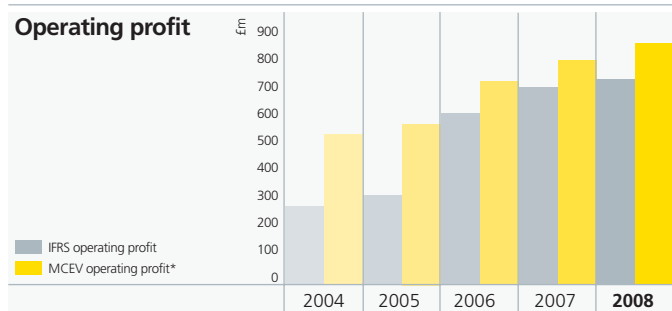
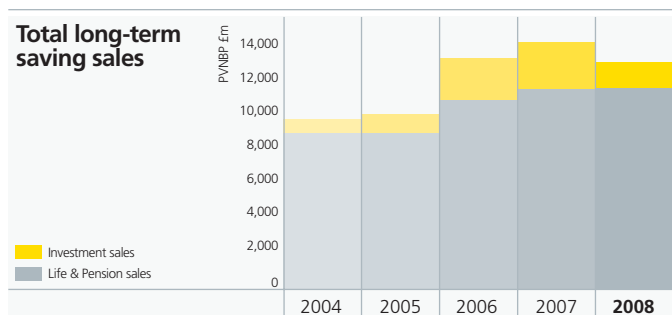
- Continue to transform our business model
- Exploit the synergies of our separate UK businesses
- Generate capital for the group

## Business review

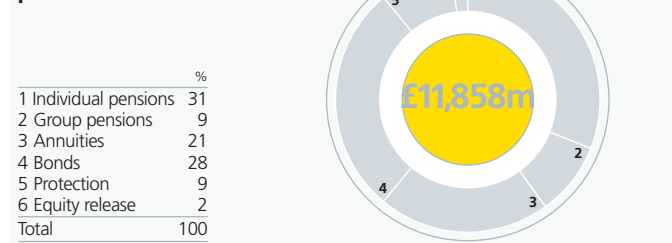
## UK – Life

## Long-term savings

	IFRS operating profit £m	MCEV operating profit £m	PVNBP £m	Value of new business £m	New business margin %
2008	751	883	11,858	204	1.7
2007	723	822	11,797	278	2.4



## Split of life and pension sales



## Profile and strategy

As Norwich Union we are one of the leading providers of life, pensions and investment products in the UK with a total market share of 11% and a top three position in our key markets of savings, protection, pensions and annuities. Our ambition is to offer products and services that provide financial security and peace of mind for our existing 7 million customers, while attracting new customers and delivering profitable growth for our shareholders.

Norwich Union has a compelling combination of balanced distribution and broad product choice. We have significant reach into the Independent Financial Adviser (IFA) sector where we transact with over 3,500 registered advisers and conduct significant volumes of business through all the leading networks and service providers. We have successful strategic partnerships with the Royal Bank of Scotland Group (RBSG) and many leading UK financial services brands including Post Office Financial Services and 18 building societies.

Our product range includes life assurance and healthcare products which protect our customers and their families in times of difficulty as well as our pension and savings products which provide prosperity and help secure a more comfortable retirement for our customers.

Our main operations are based in York though we have a significant presence in Norwich, Eastleigh, Bristol and Sheffield. We also have outsourcing relationships with a number of partners including Swiss Re in the UK, WNS in India, Scottish Friendly and International Financial Data Services (IFDS).

Our ambition is to create value for our customers and protect what is important to them. We also aim to improve financial literacy and engage with our customers to provide support and advice whenever it is needed. In 2008, we received over £8 billion in premiums from our customers, settled 6,500 death claims equating to £319 million, paid over £1 billion in annuities, £500 million to pension customers, helped in excess of 14,500 customers make a claim and received 2 million calls from our customers, supported by the commitment of more than 8,500 staff.

Our people have continued to perform with dedication throughout 2008. In our latest survey, the percentage of our people who are personally committed to achieving our organisational goals has increased to 89% (2007: 86%), a significant achievement given the current economic climate and the degree of change within the organisation.

To enhance our approach of offering straightforward, easy to access products and services tailored to individual customer needs, we will continue with our current strategy of:

simplifying the business through addressing the legacy system issues built up through past mergers and acquisitions;

transforming our business model;

realising synergies and operational efficiencies across the UK; and

generating capital for the group.

The strategy we embarked on in 2006 has already seen us extract greater value from our business. Our major simplification and operational initiatives will complete during 2009, and through our investment in technology and customer propositions, will accelerate our transformation into an e-commerce business. In addition, we will seize the opportunity of our re-brand to Aviva to improve customer experience, deliver first class service and build customer loyalty.

## The marketplace

The UK long-term savings market declined by 7% in 2008 after five consecutive years of growth. In 2008 we have seen an unprecedented series of events affect our market including the global economic crisis, a dramatic slowdown in the housing market and regulatory impacts such as capital gains tax changes and the ongoing reviews into the payment protection insurance market and advice-remuneration models.

The combination of lower disposable income, cost of living increases, investment market falls and the onset of an economic recession have seen the savings ratio decline to its lowest level since the 1940s, resulting in an increase in the savings gap and the percentage of the population that are financially unprotected. Overall, people have invested less than in previous years and have already experienced a significant decline in the value of their retirement savings and investments.

In 2008, we saw falls in all the major investments markets including a 31% decline in the FTSE 100 index, a 20% decline in commercial property values and a sharp fall in the value of corporate bonds. These conditions have resulted in industry wide reductions to with-profits bonus levels, the introduction of market value reductions for early withdrawals and, in relation to some specialised forms of investment, deferral of settlement of withdrawals.

Norwich Union customers have not been immune to these measures. We recognise that this has caused disappointment to many of our customers but these actions reflect our prudent management of our funds in these conditions.

They also ensure that all customers are treated fairly by striking a balance between those wishing to access their capital and those remaining in the affected funds.

All of these events have had an adverse effect on the life insurance sector as a whole and we expect further slowdown in new business sales in 2009 across the majority of product lines. Opportunities for growth remain in some market segments, particularly within the corporate sector as companies remove pension risk from their balance sheets. In the medium to longer term we expect to see the market return to growth as there remains a significant savings and protection gap. The current economic conditions have left a number of smaller and less well diversified companies in a weaker capital position. This will drive better capital discipline and may encourage further market consolidation.

## Operational performance

In 2008 we worked across the business towards making a real difference to our customers. Actions ranged from simplifying our direct debit forms to improvements in our service promises by supporting our ambition to make it easier for customers. We improved the accessibility of our offering through e-commerce propositions such as the Simplified Life, introduced new rating factors for our annuity business and helped 7,500 of our customers unlock more value from their homes through our equity release products.

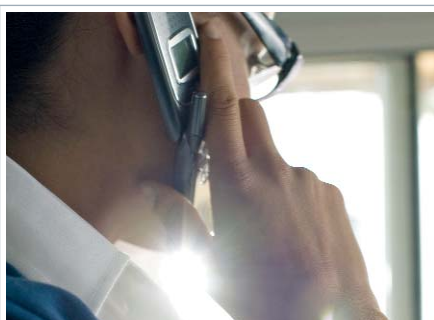
We continue to provide our staff with the tools to meet customer needs by developing their knowledge of our industry, products and customers. In 2008 over 1,000 of our colleagues graduated from the Service Academy, a joint venture with the Chartered Insurance Institute (CII) which provides an accredited qualification for Customer Experience employees. A further 2,722 employees are currently enrolled in the programme.

We recognise that service levels in 2008 have fallen below our aspirations in some areas and we have taken the appropriate action to remedy this situation. We continue to look for ways of improving service and are prepared to partner with third parties where they have greater expertise. One such example is our wrap offering where, despite our best endeavours to address service and operational issues, we concluded that the proposition was better delivered through a third party and have outsourced the administration to Scottish Friendly.

Throughout the second half of 2008 we have experienced an increase in both the number and frequency of customer calls driven by the ongoing market volatility and the media coverage of the global financial crisis. The majority of customers enquired about the value of their policies, as consumer confidence was impacted by market turbulence. The focus of our service teams was to provide the necessary help and support to customers and re-assure them that their savings are safe. Furthermore, our dedicated retention team has concentrated its efforts on reminding our customers of the features of their policies and associated benefits. In addition the team's proactive customer service engagement led to the retention of over 9,000 policyholders contemplating early surrender of their policies.

For the third successive year we improved our rating in the Financial Adviser Service Awards and our four-star rating reflects our highest position since 2000 demonstrating that financial advisers are acknowledging the improvements we are making to our customer service. In advance of the publication of the Retail Distribution Review recommendations, which will change the way advice is given to customers buying retail investment products, we have launched our Financial Adviser Academy which is currently supporting over 2,000 advisers in achieving their CII Diploma in Financial Planning.

## “More than I'd expect”



Case study:

### Well-spotted!

A UK customer contacted our tele-advice team to discuss a new mortgage protection policy. She was concerned about the potential cost of her premiums as she had been treated for breast cancer. However, our adviser, Jason, noticed that she still had some existing policies, including critical illness cover – but she had assumed she couldn't claim because her treatment was successful. So Jason took responsibility for investigating the situation and engaged with the claims team on the customer's behalf. The result? We paid her almost £100,000. And that virtually paid off the mortgage she had originally wanted to cover!

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\* The savings ratio is the proportion of household income which is saved as a percentage of total disposable household income.

\*\*Read more about the Retail Distribution Review on the FSA website at [www.fsa.gov.uk](http://www.fsa.gov.uk)

## Business review

## UK – Life continued

We recognise that it will be a real challenge for advisory businesses to transform their business models and are fully committed to supporting advisers through these changes.

In July 2008 following extensive discussions with the Policyholder Advocate, Norwich Union announced a £1 billion offer to one million eligible policy holders in return for giving up the right to the £2.1 billion inherited estate of CGNU Life Assurance Ltd and Commercial Union Life Assurance Company Ltd. Since then, investment market performance has caused the value of the estate to reduce to £1.4 billion meaning that the offer made in July no longer meets our criteria of being fair to both policyholders and shareholders. As a consequence, we are working closely with the Policyholder Advocate to see how we can restructure our offer and expect to be in a position to provide an update to policyholders in the next few months. These developments do not affect the entitlement to receive a £2.1 billion special distribution that we announced in early 2008.

Throughout 2008 we continued to be customer centric and diversify and improve our product offering and distribution footprint. We successfully launched our Norwich Union Income drawdown product and enhanced our annuities ratings factors to include postcode, smoking and marital status, enabling us to satisfy customer needs with products that are designed to meet their individual requirements throughout their lives.

Our simplification strategy has proceeded at pace throughout 2008. We have made significant progress in our partnership with Swiss Re with over one million policies now administered on their systems. This in turn has allowed us to switch off over 200 systems and we remain on track to meet our £100 million annualised cost savings target by the end of 2009, £60 million of which has already been achieved.

## Financial commentary

In 2008 we delivered our highest life and pension sales, up 1% to £11,858 million (*2007 restated: £11,797 million*) increasing our market share to 11.3% (*2007: 10.4%*). This performance was underpinned by; the success of our pensions strategy, growth in annuities and higher sales through our joint venture with RBSG whose sales were £1,639 million (*restated 2007: £1,615 million*).

Sales of collective investments were lower by 46% in 2008 at £1,485 million (*2007: £2,751 million*), as a result of the down-turn in the property, equity and fixed income markets.

Our operating profit for the year on an MCEV basis was up 7% to £883 million (*2007 restated: £822 million*) as we improved performance from our in-force book, maintained our focus on our control of persistency variances and continued to deliver on our efficiency saving commitments.

Our continued focus on retention initiatives have enabled us to contain our lapse experience to a loss of £23 million, against a backdrop of changes to capital gains tax rules for bonds and the prevailing economic climate. In addition, we have taken the prudent step of establishing an additional provision of £50 million in anticipation of higher short-term recessionary related withdrawals and a further provision of £20 million in relation to likely increases in mortgage and income protection related claims as unemployment rises.

The adverse expense experience variance has halved in 2008 to approximately £40 million, leaving us on track to achieve our commitment of a zero cost overrun in 2009 as we deliver the full benefit of the £100 million annualised cost savings announced in October 2007.

The value of new business declined in 2008 to £204 million (*2007: restated £278 million*) leading to a new business margin of 1.7% (*2007: restated 2.4%*). The reduction in margin in 2008 is attributable to annuity business and reflects non recognition of asset yield (net of credit default allowances) which we have secured above risk-free rate. In 2008 an estimated 0.5% of additional asset yield has been achieved (net of default allowances) but not recognised. This is equivalent to a value £130 million (pre-tax) and this will emerge in future years through the expected return. The effect in 2007 is less pronounced. Excluding this effect new business contribution has improved reflecting pricing changes, management of business mix and the benefit of operational efficiencies.

The new business internal rate of return has increased for the third successive year and now stands at 14% for business written in 2008 (*2007: 13%*).

On an IFRS basis, life operating profit increased by 4% to £751 million (*2007: £723 million*), driven by the with-profits business and supported by £124 million of profit relating to the shareholder proportion of the special distribution announced in February 2008.

The non-profit result was £462 million (*2007: £545 million*). The prior year result included a £167 million one-off benefit from the implementation of the reserving changes introduced by PS06/14. Underlying earnings were up £84 million reflecting the cumulative benefits of the efficiency programme (£65 million) and lower new business strain.

In 2008 we have strengthened our allowances for credit defaults on commercial mortgages and corporate bonds held by shareholders by £550 million bringing total allowances at 31 December 2008 to £1.13 billion, equating to 85 bps over the lifetime of these securities. Despite the effects of falling investment markets and the increases in default allowances, the solvency position of our funds remain healthy.

Finally, on an MCEV basis the embedded value of our life business has fallen to £4.9 billion (*2007: £6.9 billion*) reflecting the impact on net worth and future profits of adverse investment market movements.

## Outlook

The outlook for 2009 is very uncertain as the impact of the global financial crises continues to affect customers' ability to save and plan effectively. We expect the trends experienced in 2008 to continue throughout 2009. In the current environment we will maintain our focus on rigorous capital discipline and on driving higher returns through operational efficiency, product innovation and targeted commission changes. We are optimistic that we can continue to deliver profitable growth in these turbulent times.

We are confident that through our strong brand, extensive product range and distribution reach we will emerge from these economic conditions in a strong position. We also expect that our strategy of simplifying and transforming our business, coupled with the resilience of our compelling business model will provide us with the opportunity to capitalise on our leading position in the market place and create further shareholder value.

# UK – General insurance and health

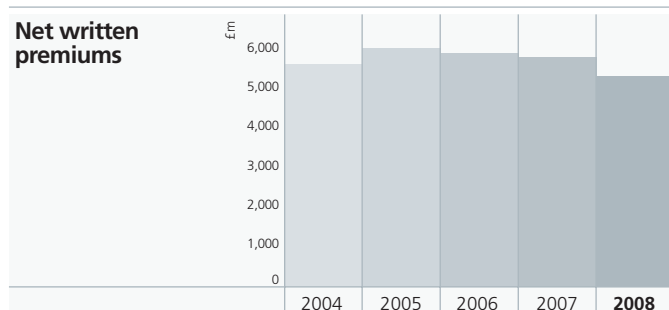
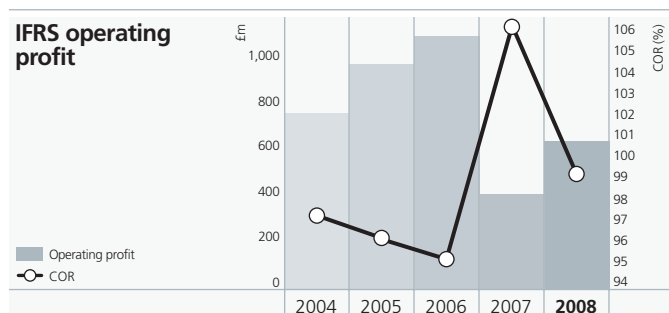
## General insurance and health

	IFRS operating profit £m	Combined operating ratio* %	Net written premium £m	Underwriting result £m	Long-term investment return £m
<b>2008</b>	<b>656</b>	<b>99</b>	<b>5,413</b>	<b>71</b>	<b>585</b>
2007	421	106	5,896	(226)	647

\* Norwich Union Insurance only.

## Analysis of UK general insurance and health results

	IFRS operating profit		Net written premiums	
	2008	2007	2008	2007
Norwich Union Insurance	<b>566</b>	368	<b>4,981</b>	5,440
Aviva Re	<b>97</b>	53	<b>43</b>	50
Agency run-off	<b>(21)</b>	–	–	–
Norwich Union Healthcare	<b>14</b>	–	<b>389</b>	406
United Kingdom	<b>656</b>	421	<b>5,413</b>	5,896



## Profile and strategy

As Norwich Union Insurance (NUI) we are the leading general insurer in the UK, with 14% of the total market. We focus on personal and SME (small to medium enterprise) insurance and are also a leading provider of roadside assistance through the RAC.

We have unparalleled distribution reach. Our personal products are sold directly to customers over the phone and through our website [www.norwichunion.com](http://www.norwichunion.com), via brokers and through over 100 corporate partnerships. For commercial insurance we focus on broker distribution and believe that independent brokers remain the best source of the advice SME customers require.

We contribute to the “one Aviva, twice the value” vision by sharing our experience as market leader in the UK general insurance market with the group’s general insurance businesses across the world, providing peace of mind to our customers and generating cash and capital overtime to support group expansion. Our strategy to maintain market leadership is to focus on insurance excellence through:

being outstanding in the core general insurance skills of underwriting, pricing and claims handling that will allow us to create the conditions for profitable growth;

reshaping our book of business to maximise our access to customers whilst delivering a sustainable distribution ratio;

delivering the promise of scale by addressing legacy issues;

providing products and services that meet the varying needs of our customers;

supporting independent brokers and working with our partners to present a natural synergy for the benefit of our customers; and

inspiring a genuine passion for our business in our people.

To underpin these key themes we are executing a series of major initiatives across the business.

## The marketplace

The UK general insurance market continues to be characterised by over-capacity, high competition and falling prices. However, after a lengthy period of these soft market conditions in commercial lines, we are seeing tentative signs of hardening although rate increases remain below the level of claims inflation. There are also early signs that personal lines rates are also starting to harden.

The UK market remains one of the most dynamic in the world both in terms of products and distribution. In 2008 the proportion of customers buying insurance on-line has continued to increase and this is now a major distribution channel. In particular, internet price comparison sites have again grown their market share as customers seek price transparency, with sales for personal motor insurance via these sites increasing from 16% to 52% over the last three years.

Two developments have been increasing insurance companies’ costs in recent years:

An increase in the unregulated practice of “claims farming” – This is a major emerging issue for the industry and involves claims being referred to third party companies who generate referral fees which inflate claims settlement costs and drive up the overall cost of insurance for customers without delivering commensurate value.

The growth of broker consolidators

– This has directly impacted costs through demands for higher commissions from the consolidated broker businesses. Lately, however, this growth has slowed as capital to fund acquisitions has been increasingly difficult to raise and insurers seek to reduce commissions in an effort to drive down costs.

**Business review****UK – General insurance and health continued**

The level of creditor business within the market has fallen as a result of reduced lending due to the economic environment and the response of distributors to the Financial Services Authority's review into the sale of payment protection insurance. Looking forward, the payment protection insurance market will undergo further significant change when the final remedies\* of the Competition Commission are fully implemented but the protection provided to customers by this product continues to be of vital importance particularly in this time of economic instability. We are actively working with the distributors to ensure our products are designed to provide this protection in a manner that also addresses the Competition Commission's concerns.

**Operational performance**

In 2008 we were delighted to be voted "General Insurer of the Year" at the *Insurance Times Awards* for the sixth successive year, demonstrating the confidence and trust that independent brokers have in us. In addition, RAC was voted by JD Power as the best Roadside Assistance provider for the third year running.

We made significant progress on our transformational change programme designed to enable us to maintain our market-leading position. This programme, first announced in October 2007, will deliver our core objective of insurance excellence and is underpinned by our focus on building a world class underwriting capability that uses the data and expertise we have to ensure that we write the right risks at the right price.

During the year we have continued to implement initiatives to improve the efficiency of our organisation. In addition to our ongoing activity to minimise claims inflation, work is well advanced on the second phase of the programme announced in June 2008 to improve service and enable growth. This phase is delivering the promise of scale by addressing legacy issues built up through past mergers and acquisitions and is being undertaken with the customer in mind so that we can deliver a much better service once the phase has been completed. It involves the redesign of the operations function, simplifying our processes and products, delivering improvements in customer services and completing the consolidation of our business from 27 sites into nine modern insurance "centres of excellence". Excellent progress has already been made with over 50 systems decommissioned and 14 properties (where NUI or RAC was the main occupier) vacated by the end of 2008.

The focus we place on profit has led to a number of key decisions being made to reshape our book of business. Within personal lines:

- We have a clear strategy to distinguish between our direct offerings.
  - NU Direct (soon to be Aviva UK Direct Insurance) has been repositioned away from the aggregators to provide direct customers with our best price service. Initiatives implemented in 2008 to support this include the 'Happy's back' advertising campaign and providing price transparency by including competitors' prices alongside our website quotes.
  - We are leveraging the trusted RAC brand to provide the motorist with access to an even wider range of insurance options through the RAC panel, which has now been launched to serve those customers who wish to select their insurance provider through a trusted aggregator.
  - We have improved price competitiveness through the introduction of sophisticated pricing techniques.

We are committed to supporting independent brokers and have established broker networks as well as working on delivering our trading platform directly into the offices of 3,000 independent brokers

We are focusing our partner business on where there is both a genuine "moment of truth" and the right return.

- A "moment of truth" occurs when there is a clear point in the buying process where purchasing insurance has a logical position at front of mind for the customer.

**"Going the extra mile"**

Case study:

**A perfect start**

A colleague had just started working in our claims department, when a customer called. He'd left his chip pan on, fallen asleep, and was upset that he and his wife would have died if their dog hadn't raised the alarm. He was also confused about his cover – his wife usually dealt with insurance, but now suffered from Alzheimer's. Unfortunately, the customer only possessed contents insurance with us – so most fire damage wasn't covered. That's when our new colleague decided to track down the buildings insurance policy for him. And make sure they helped this distressed customer. She even came into work early to do so. That's a fantastic show of customer care. Not to mention the quality of our recruits.

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[www.norwichunion.com](http://www.norwichunion.com)

\* Read more about the Competition Commission remedies for the payment protection insurance market on their website at: [www.competition-commission.org.uk](http://www.competition-commission.org.uk)

For the transformation to be successful we must have the full commitment of our staff as they are ultimately tasked with its delivery. As such, one of our priorities is to ensure we create an environment which recognises and fosters the contribution and the needs of individuals. To enable this we have initiated the roll-out of a new talent management framework in 2008, a process that will continue during 2009.

As discussed on page 16, Norwich Union will be rebranding to Aviva in 2009. However, we will be retaining the iconic RAC brand which continues to command an exceptional level of loyalty and we are developing strategies and propositions (eg the re-launch of RAC Insurance as a panel offering) to build upon the position of trust engendered by this brand.

## Financial performance

### General Insurance

Total general insurance operating profit was £642 million (2007: £421 million). This includes a contribution from Aviva Re, the group's captive reinsurer, of £97 million (2007: £53 million), which benefited from a one-off commutation of £30 million in the year. Losses of £21 million (2007: £nil) relate to agency business in run-off. The following commentary relates only to NUI.

Our financial performance in 2008 reflects the continuing tough market conditions and our focus on sustainable profitability rather than volumes. We have seen net written premiums fall 8% to £4,981 million in 2008 (2007: £5,440 million). While all business lines have been affected the decline was most notable in creditor, where volumes have fallen by around 30% reflecting distributor response to the issues with payment protection insurance and the decline in lending.

In personal lines we have achieved motor rating increases of 5% (2007: 6%). Following our initiatives to improve the price competitiveness of our direct channel we have focused on better quality risks resulting in a reduction in our average premium levels. Homeowner rates have increased by 9% (2007: 7%). While overall rating in personal lines has been marginally better than headline claims inflation, the impact of claims farming and an increase in bodily injury claims have adversely impacted profitability.

The commercial market has remained particularly price competitive. Against this backdrop we have reversed the trend of declining rates seen in the past four years, achieving an overall rate increase in 2008 of 3% (a 5% improvement on the 2% reduction in 2007). Our stance on commercial pricing is underlined by the implementation of the second phase of rating action in the final quarter of the year. While this represents a significant improvement on recent trends, the rating achieved in the year remained below the level of claims inflation and has also contributed to a reduction in volumes.

Operating profit in 2008 was £566 million (2007 restated: £368 million), which mainly reflected an improvement in weather-related claims for the year which were in line with normal expectations (2007: £475 million adverse). This benefit was partly offset by a reduction in the savings on prior year claims development to £285 million (2007 restated: £430 million, including £215 million of a non-recurring nature), together with a reduction in investment returns to £549 million (2007 restated: £613 million).

While the income we have received from our investments has remained relatively stable, the unprecedented economic volatility experienced in 2008 had a significant adverse impact on our profitability as a result of unrealised losses on our investment portfolio. The decision we took last year to de-risk our balance sheet by disposing of our equity holdings has given greater stability to long-term capital returns; however, we remain a major investor in the market principally through our gilt and corporate bond holdings. Looking forward, the market volatility and declining interest rates are likely to continue to influence profitability in the near future.

Our combined operating ratio has improved to 99% (2007 restated: 106%). 2008 saw a step change in our operational efficiency, with the expense ratio improving to 12.1% (2007 restated: 13.9%) despite the significant reduction in business volumes. This has been achieved by £265 million of cost savings in the year, including £200 million from the first phase of our programme announced in October 2007, together with the excellent progress already made on phase 2 with over 50 systems decommissioned and 14 properties (where NUI or RAC was the main occupier) vacated by the end of 2008.

In line with group policy as set out in note 2(b) on page 146, we have moved to a more transparent reserving policy including the discounting of latent claims. We have also reviewed our latent claims reserves to ensure we are in line with externally benchmarked levels. Accordingly we have strengthened gross undiscounted provisions by £623 million in the year. The net discounted strengthening of £279 million in our latent claims reserves has been included as an exceptional item below operating profit.

### Health

Total health insurance operating profit increased to £14 million (2007: nil) resulting from pricing decisions throughout the year to improve margins, tighter expense controls and exiting unprofitable international markets.

### Outlook

Following several years of profitable growth, we anticipate that the challenging market conditions we have seen in 2007 and 2008 will continue into 2009, both in the UK general insurance market specifically and the wider economy generally. In particular we would expect:

In a mature market such as UK general insurance, trends in gross domestic product to be reflected in premium levels leading to a contraction in volumes

An increase in the frequency and severity of claims driven by the economic climate and moral hazard issues (such as theft and fraud), offset in part by lower levels of activity

Offsetting this it is possible that a global shortage of capital and lower investment returns will be catalysts for the market to harden, leading to an improvement in underwriting profitability, and may also prompt customers to turn to trusted brands such as ours.

We are confident that the actions we are undertaking to deliver true operational excellence are the right ones. We have already seen tangible impacts from this programme, most notably in the improvement in efficiency within our organisation, although it will take time for all of the benefits to be reflected in our financial results. In addition, we will continue to move personal lines rates up generally and consistently with the trends we expect in the market, as well as applying targeted increases to specific segments within our book.

In 2009 we will continue with the second phase of the programme to improve service and drive growth. As announced in October 2008 we expect this phase, together with additional actions being taken in other areas (most notably in the IT function), to deliver further cost savings of £150 million per annum by 2010. The actions taken to reduce distribution costs and impact of claims ratio improvements arising from rating and risk selection will result in a real improvement in current year profitability. All this gives us confidence in delivering a UKGI COR in 2009 in line with our worldwide target of 98% or better, without the benefit of historical levels of prior year support.