

Information on the achieved profit basis

Basis of preparation – achieved profit basis

The achieved profit statement on page 12 includes the results of the Group's life operations reported under the achieved profit basis combined with the modified statutory basis results of the Group's non-life operations. In the directors' opinion, the achieved profit basis provides a more accurate reflection of the performance of the Group's life operations year on year than results under the modified statutory basis. The achieved profit methodology used is in accordance with the guidance on "Supplementary reporting for long-term insurance business (the achieved profit method)" circulated by the Association of British Insurers in December 2001. Further details on the methodology and assumptions are set out on pages 18 to 20.

The results of the Group's life operations under the modified statutory basis, which is the basis used in the annual statutory accounts, can be found on pages 21 to 30.

The contribution from the Group's share of the alliance with The Royal Bank of Scotland (RBSG) is incorporated within the achieved operating profit. Goodwill amortised in the period in respect of the Group's holding in the associated company, RBS Life Investments Limited, is included within the "Amortisation of goodwill" on page 12.

The results for the six month periods to 30 June 2004 and 30 June 2003 are unaudited but have been reviewed by the auditors, Ernst & Young LLP. Their report in respect of 30 June 2004 is included on page 31. The interim accounts do not constitute statutory accounts as defined by Section 240 of the Companies Act 1985. The results for the full year 2003 have been taken from the Group's 2003 annual Report and Accounts.

Components of total life achieved profit

Total life achieved profit, including the Group's share from the alliance with RBSG, comprises the following components, the first three of which in aggregate are referred to as life achieved operating profit:

- new business contribution written during the period including value added between the point of sale and end of the period;
- the profit from existing business equal to:
 - the expected return on the value of the in-force business at the beginning of the period,
 - experience variances caused by the differences between the actual experience during the period and expected experience based on the operating assumptions used to calculate the start of year value,
 - the impact of changes in operating assumptions including risk margins;
- the expected investment return on the shareholders' net worth, based upon assumptions applying at the start of the year;
- investment return variances caused by differences between the actual return in the period and the expected experience based on economic assumptions used to calculate the start of year value; and
- the impact of changes in economic assumptions in the period.

	6 months 2004 £m	6 months 2003 £m	Full year 2003 £m
New business contribution (after the effect of solvency margin)	246	211	472
Profit from existing business – expected return	406	376	757
– experience variances	(13)	(19)	(12)
– operating assumption changes*	(4)	(10)	38
Expected return on shareholders' net worth	165	147	300
Life achieved operating profit before tax	800	705	1,555
Investment return variances	(214)	208	683
Effect of economic assumption changes	205	(217)	11
Total life achieved profit before tax	791	696	2,249
Tax on operating profit	(243)	(213)	(473)
Tax on other ordinary activities	–	9	(191)
Total life achieved profit after tax	548	492	1,585

* In 2003, operating assumption changes included the impact of reducing risk margins in Poland, the US and Australia in line with the directors' views of the risks associated with this in-force portfolio. The impact of this change was nil for the six months to 30 June 2003 and £24 million in the full year 2003.

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New business contribution

The following table sets out the contribution from new business written by the long-term business operations. The contribution generated by new business written during the period is the present value of the projected stream of after tax distributable profit from that business. Contribution before tax is calculated by grossing up the contribution after tax at the full corporation tax rate for UK business and at appropriate rates of tax for other countries.

	Annual premium equivalent*			New business contribution before solvency margin†		New business contribution after solvency margin‡	
	6 months 2004 £m	6 months 2003 £m	Local currency growth %	6 months 2004 £m	6 months 2003 £m	6 months 2004 £m	6 months 2003 £m
United Kingdom	547	531	3	126	117	112	102
Europe (excluding UK)							
France	145	120	21	44	35	22	14
Ireland	44	39	13	10	11	8	9
Italy	89	117	(24)	21	27	13	15
Netherlands (including Belgium and Luxembourg)	119	102	17	38	22	26	3
Poland	18	20	4	3	–	2	(1)
Spain	130	139	(7)	66	68	53	58
Other	58	44	38	(1)	(4)	(3)	(4)
International	74	100	(21)	17	21	13	15
Total annualised premiums	1,224	1,212	2				
Total new business contribution before effect of solvency margin†				324	297		
Effect of solvency margin				(78)	(86)		
Total new business contribution including effect of solvency margin				246	211	246	211

* Annual premium equivalent represents regular premiums plus 10% of single premiums.

† New business contribution before effect of solvency margin includes minority interests in 2004 of £54 million (six months to 30 June 2003: £54 million). This comprises minority interests in France of £3 million (six months to 30 June 2003: £2 million), Italy £12 million (six months to 30 June 2003: £14 million), Netherlands £5 million (six months to 30 June 2003: £3 million), Poland £1 million (six months to 30 June 2003: nil) and Spain £33 million (six months to 30 June 2003: £35 million).

‡ New business contribution after the effect of solvency margin includes minority interests of £40 million (six months to 30 June 2003: £40 million). This comprises minority interests in France nil (six months to 30 June 2003: nil), Italy £8 million (six months to 30 June 2003: £8 million), Netherlands £4 million (six months to 30 June 2003: £2 million), Poland £1 million (six months to 30 June 2003: nil) and Spain £27 million (six months to 30 June 2003: £30 million).

New business contributions have been calculated using the same economic assumptions as those used to determine the embedded values as at the beginning of each year and operating assumptions used to determine the embedded values as at the end of the period. The effect of solvency margin represents the impact of holding the minimum European Union (EU) solvency margin (or equivalent for non-EU operations) and discounting to present value the projected future releases from the solvency margin to shareholders.

Experience variances

Experience variances include the impact of the difference between expense, demographic and persistency assumptions, and actual experience incurred in the period. Also included are variances arising from tax, where such variances are due to management action. The source of profit is included in the table below.

30 June 2004	Exceptional expenses* £m	Mortality/morbidity† £m	Lapses‡ £m	Other# £m	Total £m
United Kingdom	(35)	20	(14)	11	(18)
France	(1)	8	1	1	9
Netherlands (including Belgium and Luxembourg)	(9)	3	–	3	(3)
Europe	–	4	(5)	7	6
International	(3)	1	1	(6)	(7)
	(48)	36	(17)	16	(13)

* Exceptional expenses reflect project spend, including costs associated with the pace of regulatory change in the UK.

† Mortality experience has typically been better than anticipated in many of the Group businesses in particular in the UK on annuity and PHI contracts.

‡ Lapse experience has been adverse in a number of businesses including on savings businesses in the UK, and on some classes of business in Ireland.

In the UK, other experience profits include exceptional profits arising from better than assumed default experience on corporate bonds and commercial mortgages.

Operating assumption changes

Changes in operating assumptions are made when the assumed future levels of expenses, mortality or other operating assumptions are expected to change permanently. The impact of operating assumption changes in the period was a loss of £4 million (2003: loss of £10 million) and arose primarily in Ireland where the persistency assumptions with respect to certain classes of business were lowered reflecting the recent actual experience. This has been partially offset by the beneficial impact of changes in asset mix in the Netherlands.

Analysis of life achieved operating profit

Life achieved operating profit is calculated on an after-tax basis and then grossed up at the full rate of corporation tax for UK business and at appropriate rates of tax for other countries.

	6 months 2004 £m	6 months 2003 £m	Full year 2003 £m
United Kingdom	356	339	659
Europe (excluding UK)			
France	114	90	220
Ireland	18	31	65
Italy	34	33	70
Netherlands (including Belgium and Luxembourg)	129	69	189
Poland	33	40	104
Spain	78	71	158
Other	7	2	9
International	31	30	81
Total life achieved operating profit before tax*	800	705	1,555

* Life achieved operating profit includes minority interests in the six months to 30 June 2004 of £79 million (six months to 30 June 2003: £65 million; full year 2003: £154 million). This comprises minority interests in France of £5 million (six months to 30 June 2003: £4 million; full year 2003: £6 million), Italy £18 million (six months to 30 June 2003: £17 million; full year 2003: £37 million), Netherlands £13 million (six months to 30 June 2003: £3 million; full year 2003: £14 million), Poland £5 million (six months to 30 June 2003: £6 million; full year 2003: £20 million), Spain £37 million (six months to 30 June 2003: £35 million; full year 2003: £76 million) and Other Europe £1 million (six months to 30 June 2003: nil; full year 2003: £1 million).

Embedded value of life business

	6 months 2004 £m	6 months 2003 £m	Full year 2003 £m
Embedded value at the beginning of the period	12,155	10,148	10,148
Total life achieved profit after tax	548	492	1,585
Exchange rate movements	(317)	307	342
Embedded value of businesses acquired*	–	64	64
Amounts injected into life operations	13	88	221
Amounts released from life operations	(458)	(38)	(205)
Embedded value at the end of the period†	11,941	11,061	12,155

* Embedded value of businesses acquired in 2003 represents the embedded value of Delta Lloyd ABN AMRO Verzekeringen Holding BV, the insurance company acquired as part of the bancassurance agreement entered into with ABN AMRO NV in the Netherlands, of £64 million.

† Embedded value at the end of the period includes minority interests in 2004 of £575 million (30 June 2003: £504 million; 31 December 2003: £559 million). This comprises minority interests in France of £52 million (30 June 2003: £49 million; 31 December 2003: £46 million), Italy £223 million (30 June 2003: £204 million; 31 December 2003: £230 million), Netherlands £53 million (30 June 2003: £37 million; 31 December 2003: £43 million), Poland £56 million (30 June 2003: £50 million; 31 December 2003: £63 million), Spain £187 million (30 June 2003: £161 million; 31 December 2003: £174 million) and Other Europe £4 million (30 June 2003: £3 million; 31 December 2003: £3 million).

Segmental analysis of embedded value of life business

	Net worth at 30 June*		Value of in-force at 30 June†		Embedded value at 30 June	
	2004 £m	2003 £m	2004 £m	2003 £m	2004 £m	2003 £m
United Kingdom	1,769	1,913	3,744	3,443	5,513	5,356
Europe (excluding UK)						
France	1,049	961	451	408	1,500	1,369
Ireland	262	247	274	284	536	531
Italy	319	291	109	102	428	393
Netherlands (including Belgium and Luxembourg)	1,222	967	1,131	1,021	2,353	1,988
Poland	121	120	226	216	347	336
Spain	194	182	284	226	478	408
Other	137	138	67	47	204	185
International	453	369	129	126	582	495
	5,526	5,188	6,415	5,873	11,941	11,061

* The shareholders' net worth comprises the market value of the shareholders' funds and the shareholders' interest in the surplus held in the non-profit component of the long-term business funds determined on a statutory solvency basis and adjusted to add back any non-admissible assets.

† The value of in-force includes the effect of holding shareholders' capital to support the minimum statutory solvency margin requirements and allowing for projected future releases. This impact reduces the value of in-force by £920 million (30 June 2003: £840 million). The minimum statutory solvency margin requirements supported by shareholders' capital of £3,200 million (30 June 2003: £3,000 million) is included within the net worth.

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Minority interest in life achieved profit

			6 months 2004	6 months 2003	Full year 2003
	Shareholders' interest £m	Minority interest £m	Group £m	Group £m	Group £m
New business contribution before effect of solvency margin	270	54	324	297	621
Effect of solvency margin	(64)	(14)	(78)	(86)	(149)
New business contribution including effect of solvency margin	206	40	246	211	472
Life achieved operating profit before tax and exceptional items	721	79	800	705	1,555
Total life achieved profit before tax	707	84	791	696	2,249
Attributed tax	(213)	(30)	(243)	(204)	(664)
Total life achieved profit after tax	494	54	548	492	1,585
Closing life embedded value	11,366	575	11,941	11,061	12,155

Methodology

(a) Life achieved profit

The achieved profit method of financial reporting is designed to recognise the present value of profits to be earned over the life of an insurance policy. The total profit recognised over the lifetime of a policy is the same as under the modified statutory basis of reporting, but the timing of recognition is different.

Distributable profits from long-term businesses arise when they are released to shareholders following actuarial valuations. These are carried out in accordance with statutory requirements designed to ensure and demonstrate solvency in long-term business funds.

Future distributable profits will depend on experience in a number of areas such as investment return, discontinuance rates, mortality and administration costs. Using realistic assumptions of future experience, we can project releases to shareholders arising in future years from the business in-force and associated minimum statutory solvency margin.

The life achieved profit reflects current performance by measuring the movement, from the beginning to the end of the period, in the present value of projected releases to shareholders from the business in-force and associated minimum statutory solvency margin, together with the movement in the net assets of the long-term operations, adjusted for any amounts released from or invested in life operations.

The present value of the projected releases to shareholders is calculated by discounting back to the current time using a risk discount rate. The risk discount rate is a combination of a discount rate to reflect the time value of money and a risk margin to make prudent allowance for the risk that experience in future years may differ from the assumptions referred to above.

Achieved profit reporting takes account of the cost of maintaining local provisions. In addition, a significant allowance for the expected cost of guarantees is implicitly allowed for in the risk margin inherent in the risk discount rate consistent with the principles of the achieved profit guidance.

The calculations are carried out on an after-tax basis and the profits are then grossed up for tax at the full rate of corporation tax for the United Kingdom and at an appropriate rate for each of the other countries.

(b) Embedded value

The shareholders' interest in the long-term business operations is represented by the embedded value. The embedded value is the total of the net assets of the long-term operations and the present value at risk discount rates (which incorporate a risk margin) of the projected releases to shareholders arising from the business in-force, less a deduction for the effect of holding the minimum statutory solvency margin. This effect of solvency margin is the difference between the nominal value of the solvency margin and the present value at risk discount rates of the projected release of the solvency margin and investment earnings on the assets deemed to back the solvency margin.

For with-profit funds in the United Kingdom and Ireland, for the purpose of recognising the value of the estate, it is assumed that terminal bonuses are increased to exhaust all of the free assets over the future lifetime of the in-force with-profit policies.

Principal economic assumptions

Economic assumptions are derived actively, based on market yields on risk-free fixed interest assets at each period end. Margins are applied on a consistent basis to risk-free yields to obtain investment return assumptions for ordinary shares and property and risk discount rates. The change in assumptions in 2004 reflects the actual movements in risk-free yields in each territory.

The principal economic assumptions used are as follows:

	United Kingdom				France			
	30 June 2004 %	31 December 2003 %	30 June 2003 %	31 December 2002 %	30 June 2004 %	31 December 2003 %	30 June 2003 %	31 December 2002 %
Risk discount rate	7.7	7.5	7.3	7.3	8.1	8.1	7.8	8.1
Pre-tax investment returns:								
Base government fixed interest	5.1	4.8	4.5	4.5	4.3	4.3	3.9	4.3
Ordinary shares	7.6	7.3	7.0	7.0	6.3	6.3	5.9	6.3
Property	6.6	6.3	6.0	6.0	5.8	5.8	5.4	5.8
Future expense inflation	4.2	4.1	3.6	3.6	2.5	2.5	2.5	2.5
Tax rate	30.0	30.0	30.0	30.0	35.4	35.4	35.4	35.4

	Ireland				Italy			
	30 June 2004 %	31 December 2003 %	30 June 2003 %	31 December 2002 %	30 June 2004 %	31 December 2003 %	30 June 2003 %	31 December 2002 %
Risk discount rate	8.6	8.6	8.3	8.7	7.4	7.4	7.0	7.3
Pre-tax investment returns:								
Base government fixed interest	4.5	4.5	4.1	4.6	4.4	4.4	3.9	4.4
Ordinary shares	7.5	7.5	7.1	7.6	7.4	7.4	6.9	7.4
Property	6.0	6.0	5.6	6.1	5.9	5.9	5.4	5.9
Future expense inflation	4.0	4.0	4.0	4.0	3.3	3.3	3.3	3.3
Tax rate	12.5	12.5	12.5	12.5	38.3	38.3	39.3	39.8

	Netherlands				Poland*			
	30 June 2004 %	31 December 2003 %	30 June 2003 %	31 December 2002 %	30 June 2004 %	31 December 2003 %	30 June 2003 %	31 December 2002 %
Risk discount rate	7.5	7.4	7.1	7.4	14.8	13.5	15.4	15.4
Pre-tax investment returns:								
Base government fixed interest	4.4	4.2	3.9	4.2	7.5	6.0	8.0	8.0
Ordinary shares	7.4	7.2	6.8	7.2	7.5	6.0	8.0	8.0
Property	5.9	5.7	5.3	5.7	n/a	n/a	n/a	n/a
Future expense inflation	2.5	2.5	2.5	2.5	4.9	3.4	5.4	5.4
Tax rate	25.0	25.0	25.0	25.0	19.0	19.0	27.0	27.0

	Spain			
	30 June 2004 %	31 December 2003 %	30 June 2003 %	31 December 2002 %
Risk discount rate	7.7	7.7	7.4	7.7
Pre-tax investment returns:				
Base government fixed interest	4.6	4.6	4.2	4.6
Ordinary shares	7.6	7.6	7.2	7.6
Property	6.1	6.1	5.7	6.1
Future expense inflation	3.0	3.0	3.0	3.0
Tax rate	35.0	35.0	35.0	35.0

* The economic assumptions shown above are those in the calculations for the life business. The economic assumptions for the pension business are identical with the exception of the risk discount rate which is 14.0% (30 June 2003: 13.8%; full year 2003: 12.7%; full year 2002: 13.8%).

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Other assumptions

- Current tax legislation and rates have been assumed to continue unaltered, except where changes in future tax rates have been announced.
- Assumed future mortality, morbidity and lapse rates have been derived from an analysis of Aviva's recent operating experience.
- The management expenses of Aviva attributable to long-term business operations have been split between expenses relating to the acquisition of new business and to the maintenance of business in-force. Certain expenses of an exceptional nature have been identified separately and the discounted value of projected exceptional costs has been deducted from the value of in-force business. A realistic estimate of future fund management expenses that will be charged to long-term businesses by Group companies not included in the long-term business covered by the achieved profit method has been included within the value of in-force business.
- It has been assumed that there will be no changes to the methods and bases used to calculate the statutory technical provisions and current surrender values.
- The value of in-force business allows for future premiums under recurring single premium business where collection of future single premiums is expected and where the receipt of further single premiums is not regarded as new business at the point of receipt. It does not allow for future premiums under non-contractual increments, or for future Department of Work and Pensions (DWP) rebate premiums, and the value arising therefrom is included in the value of new business when the premiums are received.
- The value of the in-force business has been determined after allowing for the effect of holding solvency margins equal to the minimum EU solvency requirement (or equivalent for non-EU operations). Solvency margins relating to with-profit business are assumed to be covered by the surplus within the with-profit funds and no effect has been attributed to shareholders.
- Bonus rates on with-profit business have been set at levels consistent with the economic assumptions and Aviva's medium-term bonus plans. The distribution of profit between policyholders and shareholders within the with-profit funds assumes that the shareholder interest in conventional with-profit business in the United Kingdom and Ireland continues at the current rate of one-ninth of the cost of bonus.

Alternative assumptions

Economic assumptions

The table below shows the sensitivity to a one percentage point increase in the assumed investment returns for equity and property investments and in the discount rate for new business contribution for the half year and embedded value.

	New business contribution*		Embedded value†	
	Equity/property returns £m	Discount rates £m	Equity/property returns £m	Discount rates £m
United Kingdom	8	(21)	150	(275)
Europe (excluding UK)				
France	2	(4)	40	(80)
Ireland	1	(2)	10	(15)
Italy	–	(1)	10	(10)
Netherlands (including Belgium and Luxembourg)	6	(7)	200	(150)
Poland	–	–	10	(15)
Spain	–	(5)	5	(20)
Other	–	(1)	5	(5)
International	–	(3)	–	(20)
	17	(44)	430	(590)

* Calculated before effect of solvency margin, tax and minority interest.

† Calculated after effect of solvency margin and tax but before minority interest.

The impact of an increase of one percentage point in the discount rate is calculated with all other assumptions remaining unchanged.

Non-economic assumptions

Sensitivity calculations have been performed to identify the non-economic assumptions to which new business contribution and the value of in-force business within embedded value are particularly sensitive. The calculations have been based on similar percentage movements in each assumption from the base assumption used to calculate the published new business contribution and value of in-force business. Based on this, the Group's new business contribution and value of in-force are most sensitive to changes in future maintenance expenses.