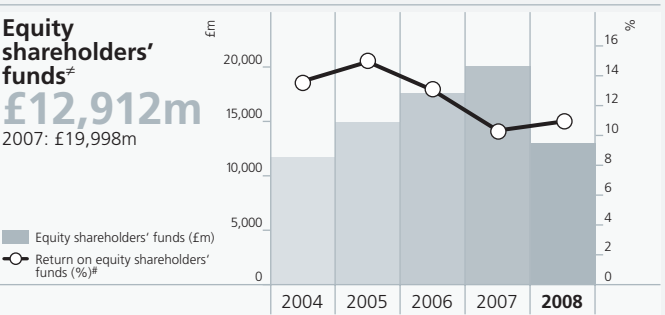
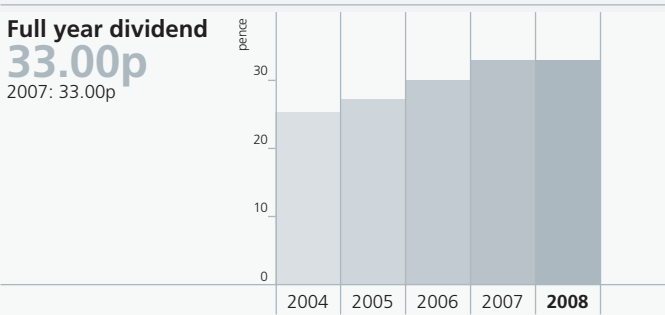
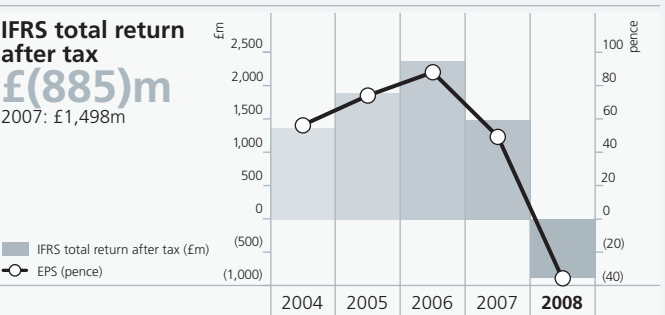
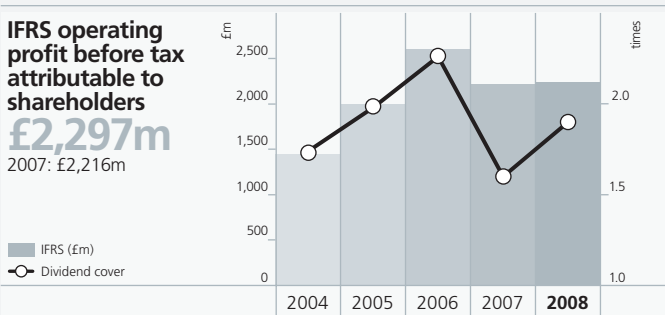
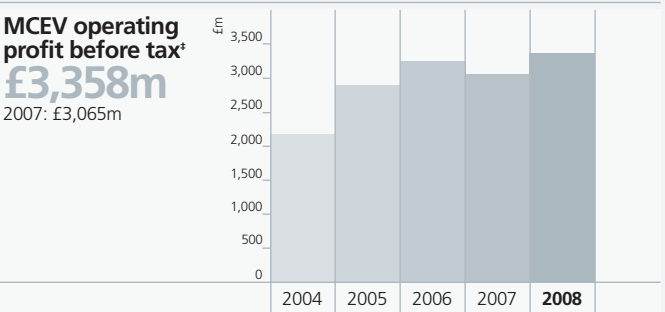
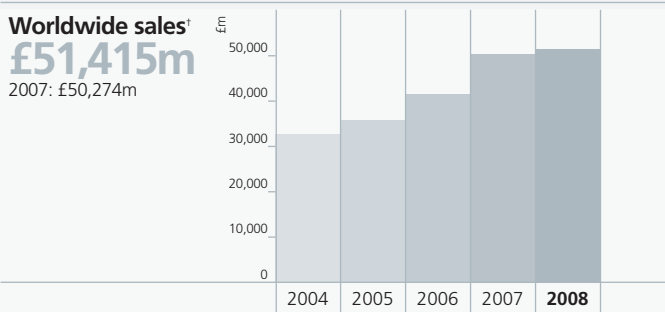




# Our business

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.

## Group



\* Based on gross worldwide premiums at 31 December 2007.  
\*\* Typically includes motor, household, creditor, health, commercial motor, commercial property and commercial liability insurance.  
† From continuing operations, including share of associates' premiums.  
‡ From continuing operations, long-term savings results are included on an MCEV basis before adjusting items for 2008 and 2007. Prior years are presented on an EEV basis.  
# On an MCEV basis for 2008, 2007 and 2006. Prior years are presented on an EEV basis.  
# Return based on opening equity shareholders' funds presented on an MCEV basis for 2008 and 2007. Prior years on an EEV basis.



By recognising who people are and what they want, and doing something about it, we aim to set ourselves apart from other companies.

This year's report features examples of the new and different ways in which we are working in order to make this happen.

# This is Aviva.

View the annual report and accounts online:  
[aviva.com/2008annualreport](http://aviva.com/2008annualreport)



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## Chairman's introduction



Lord Sharman of Redlynch OBE  
Chairman

### Dear Shareholder,

In my experience, the situation in which we find ourselves as we enter 2009 is unprecedented. The recent period will long be remembered as one of the most turbulent for financial markets, and indeed the world economy, since records began. Banks have been nationalised, global insurance businesses have failed, interest rates and share prices have plunged, mortgage lending has been reduced to a trickle, and no one can accurately forecast where and when the current situation will be resolved.

Aviva is well placed to weather this crisis, and for both our life and general insurance operations it is business as usual. We have made sensible decisions in the past, greatly reducing our exposure to equities and introducing a robust risk management strategy. We have good liquidity and a strong balance sheet. Our vision, "one Aviva, twice the value", is proving its worth and during the past year we have continued to attract and retain customers wherever we do business.

We are not immune to the effects of the current situation. No one is. Our 2008 results demonstrate our resilience and our ability to focus on what we are good at, namely providing prosperity and peace of mind for our customers, as well as maintaining the strength of our balance sheet.

### Dividend

Our dividend policy remains unchanged. As a guide we use dividend cover in the 1.5 to 2.0 times range, based on IFRS operating earnings after tax and I am pleased to announce that our recommended final ordinary dividend for 2008 is 19.91 pence per share, bringing the total dividend for the year to 33.00 pence, in line with last year (2007: 33.00 pence).

### Board developments

Our thanks are due to Guillermo de la Dehesa who retired from the board at the end of 2008 after a long period of service. His experience of international financial and economic matters has been invaluable to us and we wish him well.

Mark Hodges, chief executive officer of Norwich Union Life, joined the board in June 2008 and brings with him a rare mix of operational and strategic expertise. We also welcome Euleen Goh who joined us in January 2009. Most recently chief executive of Standard Chartered Bank in Singapore (2001-2006), Euleen has a wealth of experience both as an executive and non-executive and will bring fresh insight into important areas of activity in South East Asia.

I would also like to thank all our Aviva people, led by Andrew Moss and his team, for their skill and dedication during what has undoubtedly been a challenging year for everyone.

Lord Sharman of Redlynch OBE  
Chairman

➤ 04 – 11 More on the events of 2008

➤ 84 – 85 More on our Board

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## Group chief executive's review

**Andrew Moss**  
Group chief executive



### Dear Shareholder,

Last year I outlined our vision to unlock value and drive growth from our existing business – “one Aviva, twice the value”. Events in 2008 have certainly made it harder to achieve our medium term objectives but we remain 100% committed to their delivery. I'm confident that we can deliver our vision for our customers, our shareholders and our people.

When times are tough people want to protect what they have. They look for reassurance from brands they can trust – and our long experience of managing risk gives Aviva the strength and stability they need.

In a challenging year, the most difficult that I or any of my colleagues have had to encounter, we've remained true to our core purpose of bringing prosperity and peace of mind to our customers. We are not immune to the financial crisis, but we are confident that we have the right strategy for a successful future. I'm pleased to report that this is reflected in sound trading performance, with growth in both our life and pensions and general insurance businesses. In addition we have undertaken a thorough review of the value of our assets and liabilities and provided prudently for possible future losses so that we can withstand future volatility and uncertainty.

Today we're the fifth-largest insurance group in the world. We have over 50 million customers, 54,000 employees, global sales of £51.4 billion and £381 billion of funds under management.

### Financial results

We have reported our results for the first time on a market consistent embedded value (MCEV) basis. MCEV is an improvement in many ways on European embedded value (EEV) reporting, which we have previously used, and Aviva is one of the first to adopt this basis in the UK. It leads to a more conservative view of our business which is appropriate in the current economic environment.

As a global group with 63% of our total sales coming from outside the UK we have benefited from currency movements in the year, mainly the appreciation of the euro and US dollar. However, our results also reflect the impact of the financial volatility that we've seen in 2008. On an IFRS basis shareholder funds have fallen to £11,052 million (2007: £12,946 million). However, using the MCEV methodology, the impact of market movements is significantly greater and shareholder funds are reduced to £12,912 million (2007 restated: £19,998 million). The great majority of this reduction in shareholders' funds is due to prudent marking to market of our assets rather than realised cash losses. As markets recover, as they will to some degree, at some point, our shareholders' funds will also increase.

On an IFRS basis, the group operating profit before tax was £2,297 million (2007 restated: £2,216 million) and total IFRS return was a loss of £885 million (2007 restated: £1,498 million profit) which again reflected the significant impact of investment market volatility during the period. This resulted in IFRS earnings per share being a loss of 36.8 pence (2007 restated: 48.9 pence profit).

Meanwhile our underlying business has shown great resilience. Pre-tax operating profit on an MCEV basis was £3,358 million (2007 restated: £3,065 million) with strong results in both our long-term savings and general insurance business lines. Return on equity shareholders' funds on an MCEV basis was 11.0% (2007: 10.4%) and the net asset value of the group at 31 December was 486 pence (31 December 2007: 763 pence).

## A strategy to deliver our vision

The Aviva triangle has been developed to explain the purpose, vision, strategy and regional performance of the group. Our strategic priorities are:

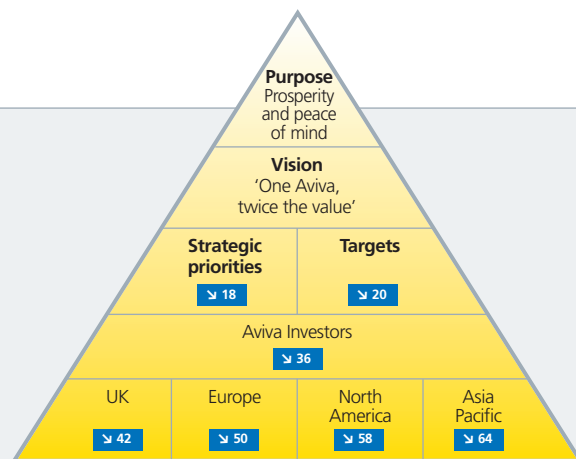
**Manage composite portfolio**

**Build global asset management**

**Allocate capital rigorously**

**Increase customer reach**

**Boost productivity**



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The enormous financial volatility of 2008 has led to a reduction in the capital that we hold in excess of regulatory requirements. We remain in a strong position with an IGD capital surplus of £2.0 billion at the end of 2008. Maintaining this capital strength has been a priority in 2008 and will remain so in 2009.

## Maintaining our dividend

Our group dividend policy remains unchanged. With savings rates at a record low, this is good news for our shareholders as well as a mark of our financial strength. Our recommended final ordinary dividend is 19.91 pence per share, bringing the total dividend for the year to 33.00 pence, unchanged from 2007.

## Strength of our business

In 2008 we benefited more than ever from the diversity of our business model, as the spread of our businesses and geographical reach helped to mitigate risk.

Despite the downturn, we achieved our highest ever life and pensions sales in our UK Life market. In the United States we met our target of doubling new business sales, a year earlier than expected. In our general insurance business, profits improved despite continuing tough market conditions and our focus now is on sustainable profitability rather than volumes.

In the Asia Pacific markets we saw life and pensions business growing on the back of our Chinese joint venture and our new ventures in South Korea and Taiwan. Some European markets suffered in 2008 but we performed well in central and eastern Europe. With over 65% of sales coming from outside the UK, we've also benefited from currency movements such as the appreciation of the euro.

In September we launched Aviva Investors, pooling our asset management skills into a single company. With £236 billion currently under management, working in 15 countries around the world, we fully expect to see Aviva Investors become a powerhouse in global investment.

## Managing our risk

Sound risk management has always been at the heart of our business. This discipline has served us well in 2008.

Whether it's financial risk as a result of changes in the values of our investments and insurance liability or credit risk from our investment in bonds and other securities, we are monitoring and managing our risk continuously.

There are many examples of our prudent approach to risk. Expectations of credit default increased dramatically in 2008 and within our UK annuity company we have made provisions at a level which assumes credit default will be worse than at any time in modern business history, worse even than the 1930's. We have experienced some credit default losses during the year, but these have been acceptable within the overall scale of our business.

Back in 2007 we made a sound decision to manage our equity risk when we sold £3.4 billion of equities and we've also taken steps to safeguard ourselves against further falls in equity markets through the derivatives markets.

Financial volatility has also meant that we have had to reassess the policyholder and shareholder elements of the reattribution of the inherited estate in the UK to ensure fairness between shareholders and policyholders. This negotiation continues in a constructive way.

## Delivering for our customers

Our purpose is to provide prosperity and peace of mind to our 50 million customers around the world. I am pleased with the progress we are making towards measuring customer advocacy across our group. It will help us measure and improve customer experience and build customer loyalty. Currently over two thirds of our businesses are at or better than the external benchmark and we aim to be world-class. In the end the number of customers that stay with us and recommend us to others is the ultimate measure of our success. It has been pleasing to see the strong growth in our customer numbers, particularly in China and central and eastern Europe.

When I talk to customers, I am always struck how good it is when we are delivering first class service. Our challenge is to do this consistently, day in, day out and this is what we aim to deliver through our new brand promise.

## Building the Aviva brand

Through the year we've moved several steps closer to our goal of a global brand. We already operate as Aviva in 21 markets and by June 2009, Norwich Union will have been renamed as Aviva. Hibernian in Ireland and Commercial Union in Poland move fully to the Aviva name in 2010. You can read more about our brand on page 16.

## Pride in our people

If our 54,000 people around the world feel valued and that their contribution matters, they will in turn provide excellent service for our customers. I'm particularly pleased that in this difficult year, our global employee climate survey shows improvements in almost every area of activity. Our staff have weathered an unsettling year with enormous professionalism and dedication, and I am grateful to them.

We want this to be a great organisation to work for, and I believe that our people show all the signs of being proud to belong to the global family that is Aviva. As a result of our cost cutting exercise, there were some redundancies in 2008; a difficult decision, but necessary to ensure the future development of the business.

In 2008, I appointed the final members of my leadership team. I now have the support of a ten strong executive team; talented and dedicated individuals who are working together to achieve our vision.

As a company, we take our obligations to the world around us seriously. We're a leader in the field of corporate responsibility and many of our people play an active part in the communities in which we operate. In 2008 we continued to be recognised by a wide range of external benchmarks for the work we do across a range of activities.

## Committed to our vision

We remain committed to our vision of "one Aviva, twice the value". It has given us the focus to remain on course during one of the most difficult years in financial memory. Providing prosperity and peace of mind for our customers is a long term enterprise. This long term view of our business has meant that we've managed our resources carefully and avoided excessive risk. That gives me real confidence as I look to the future.

**In the following pages you'll find more about the general trading conditions and our business activities over the last year, plus our plans for the year ahead. I hope you'll take the time to read on.**



**Andrew Moss**  
Group chief executive



## Group chief executive's perspective

# What's happened?

### The global economy

2008 was one of the most turbulent years in economic history as a wide range of assets posted record or near record falls. What began in 2007 as a crisis in US sub-prime mortgages spread first through the global banking system and then the broader economy as credit markets froze and equity markets fell.

Governments introduced a series of measures aimed at restarting lending and supporting economies. By year-end a large part of the global banking system was effectively under government control. In a further step, huge stimulus packages were launched to limit the damage, as economies slipped into recession. However, by the end of the year most of the world's equity markets had fallen by between 30% and 50%.

In the UK, the pound has weakened dramatically against the dollar and the euro. The UK economy continues to shrink after 16 years of growth – total government debt is now projected to grow by 50% to well over £1 trillion, which is nearly 60% of GDP. UK interest rates are at an all-time low and unemployment is rising fast, with some forecasters predicting three million out of work by the end of 2009.

Our own industry is not unscathed. In September 2008 we saw AIG, once the world's largest insurer, being bailed out with \$150 billion from the US government largely due to its non-insurance activities.

At Aviva, we have seen a fall in the value of the investments we hold. The majority of our investments are measured at fair value according to International Financial Reporting Standards (IFRS) and our balance sheet, and consequently our net asset value, reflects substantial unrealised losses on these investments. However, we hold these instruments for the long term and as markets return to normal behaviour patterns we expect to see these valuations recover.



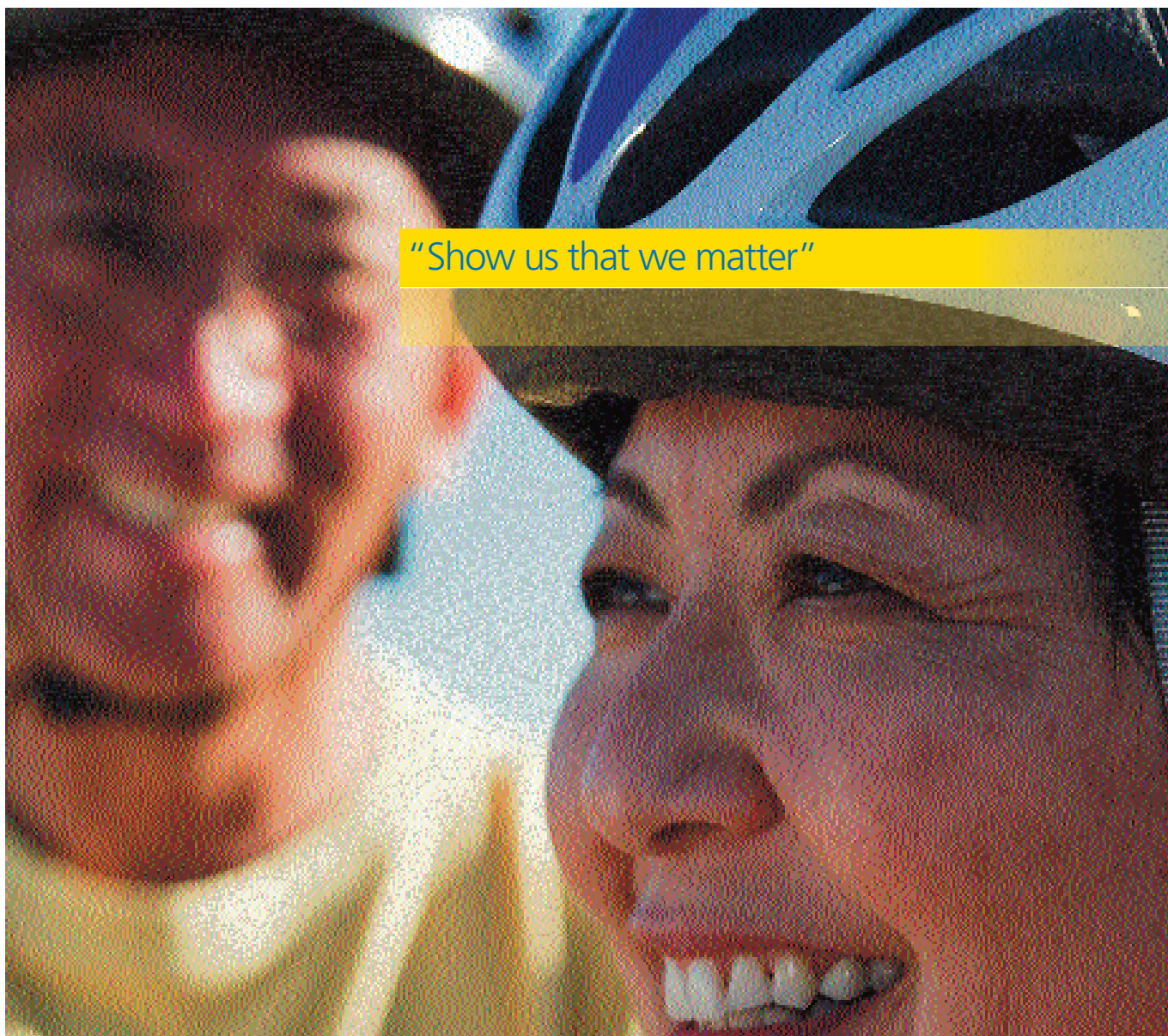
"I wasn't born yesterday"

We recognise that our customers have their own busy schedules and need to be informed of the progress of their claims in an intelligent and proactive way.

We aim to make it easier for them by contacting them first and take the steps to keep them up to date so they don't need to chase us.

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In the current economic climate customers need as much help and support from their providers as possible.

By listening to, and recognising our customers we are able to develop and tailor our products to suit their requirements and provide help right now, when they need it the most.

### Our share price

Our share price has fallen significantly during the year and we ended 2008 down 42.1%, against a backdrop of dramatic falls in markets. In 2008 we have outperformed FTSE 350-life, down 43.3% and FTSE Euro 300-Life, down 62.5%. Whilst we underperformed the FTSE 100 which ended 2008 down 31.3%, we fared better than most of our European counterparts.

There is no doubt that there is a disconnect between our current share price and the underlying value of the business. This is true of many sectors, and while investors remain nervous it is likely to persist. But customers continue to buy insurance, invest and save, with trusted brands like Aviva. As a result our operating performance has improved in 2008. You can read full details of our operating performance on pages 22 to 27.

Group chief executive's perspective continued

## What action have we taken towards achieving "one Aviva, twice the value?"

➤ 18 – 19 [More on our strategy](#)

➤ 32 – 35 [More on managing risk](#)

"I'm more than just a customer reference number"

### Managing our risk

At Aviva, sound risk management is a key component of our business. We had already made sensible investment decisions before the credit crunch took hold. While we had some default losses in the second half of the year on our exposure to AIG, Lehman, Bradford and Bingley, Freddie Mac, Fannie Mae and Washington Mutual, these were within our limits of acceptable risk. Since then we've taken further steps to provide against default risk.

In September 2007 we sold £3.4 billion of equities when the FTSE Index was standing at 6,400. Since then we've introduced safeguards to protect ourselves from further significant falls on the equity markets. We continuously assess our overall exposure and define the risks that we're prepared to accept across the group.

Aviva's capital management philosophy is focused on capital efficiency and effective risk management to support our dividend policy and earnings per share growth. Rigorous capital allocation is one of our primary strategic priorities and is ultimately governed by the Group Executive Committee.

We moved into 2009 with £2.0 billion of regulatory surplus capital and even if the markets fell a further 40%, our IGD surplus would still be around £1.2 billion. We're constantly looking to improve our capital structure and efficiency.

We have a strong balance sheet and strong liquidity. Our current Standard & Poors group rating is AA-, or 'very strong'. These ratings reflect our strong liquidity, competitive position, capital base, increasing underlying earnings and strategic and operational management.

### Valuing our customers

We are building a culture that puts customers at the heart of our business. By really understanding what they need we can give them the best possible service and experience of Aviva and earn their long-term loyalty to the brand.

We're in the sixth year of a survey into customer attitudes to saving. In 2008 we surveyed 28,500 people across 25 markets, bringing the total to over 100,000 responses since we started. We also launched a challenge, the Customer Cup, in which we invite teams from Aviva's offices around the world to identify and implement ways of making a difference to customers and help build customer loyalty.

Our regional structure is helping us to get closer to markets and be more responsive to local opportunities and conditions. We want Aviva customers to have all the benefits of a global organisation that shapes products to their varying needs and lifestyles, wherever they live.





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Valuing our customers means giving them products and services that they need and there are many successful examples throughout the company. This year in the UK for example, we've launched a ground-breaking new website. We'll tell customers our competitors' prices for motor insurance against our own, even if the alternatives are cheaper. They can also check their existing cover with other insurers against comparable cover from Norwich Union. In the savings market we are giving customers a fairer deal with a new pricing system for annuities which uses postcodes to reflect their lifestyles and circumstances more accurately.

In the Asia Pacific region, where both incomes and life expectancy are on the rise, people are also looking for safe savings opportunities. Our new joint venture in South Korea takes us into the second largest life insurance market in Asia.

To stay ahead in growth markets, we must be inventive. Bancassurance, which offers people the convenience of buying insurance at local bank branches, is one of the foundations of our business in western Europe. We're now successfully introducing the concept of bancassurance to customers across eastern Europe and the Far East. Today we have more than 90 bancassurance partnerships around the world, generating nearly one quarter of Aviva's long-term savings sales.

This mix of activities is one of the key drivers of our success. We see life insurance, general insurance and asset management as complementary parts of a business that can balance cash flow, returns and long-term value for our shareholders, while bringing prosperity and peace of mind to our customers.

### **Making our business more transparent**

We have always been committed to improving the transparency of our business and so we became one of the early adopters of a new way of reporting in 2008 – Market Consistent Embedded Value (MCEV).

MCEV aims to improve transparency and comparability in embedded value reporting across Europe.

We believe that it gives useful insight into the financial performance of the group's life and related businesses. You can read more about MCEV reporting and how it affects our results on pages 286-327.

### **Building a more efficient organisation**

"One Aviva, twice the value" also means a leaner, more efficient organisation. One of the benefits of being a truly global organisation is that we can simplify systems, share services and IT, and streamline the running of all our businesses.

In 2007 we announced a total cost reduction programme of £500 million. The UK life business is on track to deliver £100 million of savings by the end of 2009. In the UK general insurance business, we have completed the first phase to deliver cost savings of £200 million in 2008. Phase two of the transformation, announced in June 2008, is the creation of nine modern customer facing centres of insurance expertise to deliver consistent first-class service. This, and associated initiatives, will deliver an extra £150 million in savings a year by the end of 2010. A further £50 million cost savings will come from our European businesses.

We are also simplifying our legacy systems. In 2007, we announced a deal with Swiss Re to outsource the administration of nearly three million Norwich Union Life policies. This has already allowed us to decommission over 200 systems, and improve our service both to IFAs and policyholders.

However, cutting costs is not without impact, sadly and most notably on our people. There have been some redundancies this year, but these decisions have been made to ensure the ongoing development of the business.

Our customers are at the heart of what we do, we understand that they want to be recognised and treated as individuals.

By really getting to know our customers we are able to offer them the service and products that they want. In this way we can provide the best possible experience and earn their long-term loyalty.

## Group chief executive's perspective continued

## What have we achieved?

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**Highlights of the year**

Delivered life and pension new business sales ahead of analyst expectations with a second consecutive record year in the UK

Improved our Financial Adviser Service awards rating to four stars in UK life and pensions business

Achieved target of doubling sales in our US life business a year ahead of plan

Worldwide general insurance combined operating ratio improved to 98% (2007: 100%)

Voted "General Insurer of the Year" in the UK at the Insurance Times Awards for the sixth year running

RAC was voted by JD Power as the best Roadside Assistance provider in the UK for the third year running

Won "Life Company of the Year" at the AFA Plan for Life awards in Australia

Maintained our number one ranking in both fixed indexed annuities and fixed indexed life insurance markets in the US Life business

Completed the acquisition of VIVAS Health in Ireland.

Signed new bancassurance deals in Spain, Poland, Turkey and Italy.

Maintained good growth in China with a 66% increase following significant expansion of our distribution network

Expanded our distribution footprint through new joint ventures in South Korea and Taiwan coming on-line

Successfully launched Aviva Investors, our global asset management business

Maintained a strong capital and liquidity position. IGD surplus of £2.0 billion and direct access to £1.4 billion of liquid assets with further £2.1 billion of undrawn committed credit facilities

Embarked on the global rebranding programme with Norwich Union to become Aviva in 2009. Poland and Ireland to complete rebrand in 2010

Early adoption of market consistent embedded value (MCEV) methodology for our long-term savings business



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"Remember whose money it is"

£3,358m

**MCEV operating profit before tax**

Turbulent financial markets have had an impact on our profit before tax but operating profit, over which we have more direct control, is 10% up on 2007.

£2.0bn

**IGD solvency surplus**

Aviva has a strong capital position. Insurers are required to hold a financial buffer over and above statutory solvency levels, known as the capital resource requirement. The IGD surplus is the amount of capital held in addition to this regulatory requirement.

50m

**Number of customers**

Despite the tough economic climate in 2008 our overall customer base has grown. In Asia Pacific we launched joint ventures in South Korea and Taiwan and we expanded our distribution network in China. We've also seen an increase in customers in central and eastern Europe where our businesses have performed well.

33.00p

**Dividend per share**

In an environment of low interest rates, dividends are important to shareholders. We've maintained our dividend in line with 2007 while balancing the requirements of our investors and the need to maintain capital to develop the business.

£51.4bn

**Worldwide sales**

Sales were up in 2008 with growth in both life and pensions sales and general insurance and health net written premiums. This was offset by lower sales of investment products reflecting the volatility experienced in financial markets during the year.

486p

**Net asset value per share**

NAV is one of the key ratios analysts use for measuring the value of a company and contrasts with our share price which closed at 390p on 31 December.

We're here to bring "prosperity and peace of mind" to our customers – prosperity with our life, savings and asset management business, peace of mind through the security general insurance cover brings.



## Group chief executive's perspective continued

## What's next?

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"I want to be more than just a target market"

Customers more now than ever want peace of mind in these uncertain times. They have genuine concerns and will need help and support.

Despite the difficult economic conditions we are confident that our strategy places us in good shape for the future, with opportunities in many of our markets.

### Economic outlook

We moved into 2009 in the midst of a recession. Industrial production and corporate profits are falling sharply and unemployment rising equally fast. Economic growth is expected to be extremely poor in 2009 but is likely to recover in 2010 led by the US and China. From start to finish the recession is likely to cut western GDP by at least 4%. Looking out beyond 2009, with no return to normal lending and a sustained rise in savings, we expect economic growth to be very subdued over the next cycle.

### What's next for our markets?

Looking ahead we expect the UK and European markets to remain subdued in 2009. In North America, sales of indexed annuity products will not grow as fast as they did in 2008, but this is set against very strong growth over the past two years. In the Asia Pacific markets we anticipate steady growth in the major economies, although investors are likely to be more cautious.

We do expect to see growth returning to our bancassurance business as the banks concentrate on their retail operations and bancassurance becomes even more important to them. At a time when some banks are facing huge difficulties, we continue to do business in this area.



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## Our strategy

Although the outlook is challenging, our strategic objectives remain clear and relevant. Some of these objectives have already been met. North America is a great example where we have already reached our target a year ahead of schedule. In these areas we'll be setting new and challenging targets for the year to come.

In the current economic climate, performing in line with the market is a realistic aim. Our priority will be to maintain our capital strength by making the most efficient and profitable investment choices. By doing this we expect to emerge from the current climate even stronger.

We'll place less emphasis over the coming year on top-line sales targets, though we will maintain a strong presence in each of our markets. In our general insurance business we remain committed to meeting or beating our target of 98% COR for the group.

We are confident that by adhering to our strategy and our vision to create "one Aviva, twice the value", we have the greatest opportunity for success in the present climate.

It is not surprising that in difficult times customers can be neglected and forgotten.

We're taking great care to stay in touch with all our customers and partners as we become Aviva around the world and to remind them how central they are to the continued success of our business.

"Don't forget me"




















“Recognise me  
for who I am”

## Business review

## Group structure

## Executive management team

					
<b>Andrew Moss</b> Group chief executive	<b>Philip Scott</b> Chief financial officer	<b>Mark Hodges</b> Executive director, Chief executive Norwich Union Life	<b>John Ainley</b> Group human resources director	<b>Amanda Mackenzie</b> Chief marketing officer	<b>Anupam Sahay</b> Group strategy and development director
					
<b>Igal Mayer</b> Chief executive, Norwich Union General Insurance	<b>Alain Dromer</b> Chief executive, Aviva Investors	<b>Andrea Moneta</b> Chief executive, Aviva Europe	<b>Tom Godlasky</b> Chief executive, Aviva North America	<b>Simon Machell</b> Chief executive, Aviva Asia Pacific	

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	Total sales	Contribution to group sales	MCEV operating profit	IFRS operating profit
UK	£18,756m	1 37%	£1,509m	£1,377m
Europe	£21,844m	2 42%	£1,925m	£1,141m
North America	£7,316m	3 14%	£334m	£149m
Asia Pacific	£3,499m	4 7%	£69m	£36m
Aviva Investors			£41m	£114m



#### 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

#### What we do

We operate in 15 countries across Europe and are the second largest insurer in the region, providing life, general and health insurance products to more than 20 million customers. Customers are served through a diverse set of distribution channels, including banks, brokers, agents, direct sales force, telephone and the internet. Our ability to operate across distribution channels allows us to meet different customer preferences and respond to market developments.

#### Employees and locations

**16,501**

2007: 15,989

Belgium	Italy	Romania
Czech Republic	Ireland	Russia
France	Lithuania	Slovakia
Germany	Netherlands	Spain
Hungary	Poland	Turkey

#### What we do

Our North America region is comprised of two distinct businesses. In Aviva USA we provide a comprehensive portfolio of life insurance and annuity products to more than one million customers in all 50 states through independent agents and brokers. Through Aviva Canada, we market a wide range of conventional personal and commercial lines insurance to more than three million customers using brokers and affinity groups.

#### Employees and locations

**5,627**

2007: 4,634

Canada  
United States

#### What we do

We have been present in Asia Pacific for over 100 years and today operate in nine markets across this region. We are particularly focused on providing long-term savings products through a multi-channel distribution strategy with particular strength in bancassurance and wrap administration. We also sell general insurance products in Sri Lanka and Malaysia and are an established provider of health insurance in Singapore.

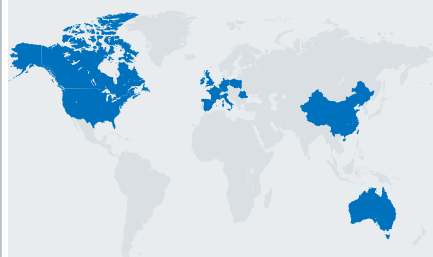
#### Employees and locations

**2,376**

2007: 2,052

Australia	India	South Korea
China	Malaysia	Sri Lanka
Hong Kong	Singapore	Taiwan

## Aviva Investors



#### What we do

Aviva Investors is a global asset management business dedicated to building and providing our clients with focused investment solutions. Our client base ranges from among the largest financial institutions to individuals investing for the future. We operate under a single brand in 15 countries so our clients benefit not only from our unique access to, and experience of, our local markets – but also from our ability to leverage an infrastructure that comes with global representation.

#### Employees and locations

**1,298**

2007: 967

Australia	Ireland	Singapore
Canada	Italy	Spain
China	Luxembourg	Taiwan
France	Poland	United Kingdom
Germany	Romania	United States



## Business review

## Our global brand

The creation of a single global brand is a key part of delivering 'one Aviva, twice the value' and the implications go far beyond changing the name on our brochures or signs. We know that if we are to achieve our objective of being our customers' most recommended brand we will be judged by what we do, not what we say.

### Why we're changing

#### Aviva – already an established and respected brand

Customers in 21 markets across the world already know us as Aviva. We're market leaders in everything from bancassurance in Europe and Asia, to Fixed Indexed Annuities in the USA. And in 2008, our fund management operations around the world came together to form one single, global business, Aviva Investors. We have also traded as Aviva plc since 2001.

#### More impact with customers

The creation of a single brand globally will mean we will be able to improve the effectiveness of our marketing spend across our businesses. This means achieving greater impact for less spend and be better placed to more effectively compete with other strong global brands, such as Axa and Aegon.

In addition, our commercial partners, shareholders, regulators and customers, as well as our people, operate increasingly across national and cultural boundaries that once separated us. Through ensuring that Aviva operates in a consistent and integrated way across our markets will make it easier for people to do business with us.

#### Creating opportunities

A strong global brand helps us to open doors as we enter new markets and secure new business partnerships. This is about doing things once and doing things right by utilising the best expertise from wherever it is across Aviva and applying it once for all our markets. This also means that good ideas – whether for improved service, new products or better ways of doing things – are shared across all parts of the business.

Our people acting as a global team not only means ensuring we leverage our scale, expertise and ideas more effectively but it also opens up more opportunities for our people to develop and grow.

#### RAC and Delta Lloyd

Two major brands will remain unchanged: RAC in the UK is a leader in a specialist market with very high levels of trust and recognition among its members that are specific to its roadside recovery heritage. In the Benelux countries, Delta Lloyd's governance means that it operates more independently than our other businesses and so will not take part in the change.

### Why now?

Our start point was to ensure we had a real understanding of what our customers want from us across the globe so that we could build the brand around meeting their needs. Throughout 2008 we never stopped listening to our customers. They told us (in fact 3/4 of customers) that it was the products and service they received that matters most. To that end we created our brand promise of 'no one recognises you like Aviva' as across the globe customers expressed a strong need to be recognised for who they are, their situation and their needs. Alongside this work, we also developed detailed plans to enable us to manage the name change in those markets that are yet to become Aviva. Although the current market conditions are tough we took the decision to proceed with our plans. We are a long term business and our growth will be achieved more successfully by making the investment in our global brand. As a business we are in a sound capital position so what better time to make the investment when we can benefit from the significant reduction in media costs and greater impact for those remaining advertisers operating in a less cluttered market. Further, it is well documented that those brands that continue to maintain their profile in downturns significantly outperform their rivals when markets recover.

### How we will make the name change

We are managing the change of name in a careful, considered way appropriate for each market and it will take two years to complete in full. Our asset management business completed the change to Aviva Investors in September 2008. And at the end of the year we began to communicate the planned change of Norwich Union to Aviva in the UK, which will complete in June this year. Poland and Ireland have also started their name change process, moving to Commercial Union Aviva and Hibernian Aviva respectively as an initial step before adopting fully the Aviva name.

#### Recognising our customers

Throughout the name change our key priority is to ensure we keep our customers, corporate partners and brokers in all these markets well informed. Moving to Aviva creates an opportunity to give our customers a clear sense of our scale and financial strength and of how they will benefit in the future. But it is also an opportunity to remind them how central we know they are to the continued success of our business.

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So at the heart of moving to a global brand is our commitment to creating a strong, unified business that understands what our customers need and is organised in a way that can deliver consistently. This means using our resources and expertise from across Aviva to create ways of delivering prosperity and peace of mind for all our customers, wherever they are around the globe.

## “Who are Aviva, and what do they stand for?”



Case study:

### UK councils

During 2008 we created advisory councils formed of customers and commercial partners around the UK, in addition to our existing customer research programmes. These councils provided us with a real understanding of what the brand change would mean for them and how we could best communicate the change.

We also consulted the councils on the impact of the credit crunch and onset of recession which informed our final communications plans. We will continue to work with customer councils to help inform future product and service developments – and of course we share the learnings from the councils with colleagues across our markets too.

## “How do the benefits warrant the costs?”

## What the change will mean...

### ...to our customers

This also makes good economic sense: we will be able to remove duplication across a wide range of activities and remove costs from the business, to the benefit of our shareholders and investors. We plan to recoup the cost of the name change in two years and then to deliver significant benefits.

### ...to our shareholders and investors

Our business has its roots in the 300 year old heritage of Norwich Union, Commercial Union and General Accident and we have built our business on helping and supporting our customers, protecting their goods, properties and their families and providing for their futures. We are just as committed now as we have always been. Through the creation of a single global brand we will be better placed to ensure we are using all our resources from across Aviva, in the most effective way, to improve service and develop products that better meet our customers' needs.

### ...to our employees

We make the same promise to our employees as we do to our customers. We respect and value our colleagues and recognise the contribution they make towards meeting the needs of our customers.



Case study:

### Commercial benefits

In the UK we used detailed modelling to increase the efficiency of our media spend. The initial stage of building awareness of Norwich Union moving to Aviva has delivered well against the targets set, putting us ahead of our plan. Acting as a single brand we have been able to minimise the cost of producing high profile, high impact advertising by sharing work across markets.

## Business review

## Group strategy

Our purpose is to deliver prosperity and peace of mind to our customers. We will do this by realising our vision: “one Aviva, twice the value”.

2008 was a very challenging year for the world economy, especially for the financial sector, characterised by slow growth and extreme market volatility, with most major economies contracting towards the end of the year. Throughout this period we have remained focused on our vision and made steady progress against the five strategic priorities we set in 2007 (shown below).

## Manage composite portfolio

We are fully committed to maintaining the composite nature of the group. We firmly believe in the benefits of life insurance, general insurance and asset management as complementary parts of an overall business model that balances cash flow, returns and long-term value creation, and delivers prosperity and peace of mind to customers.

## 2008 progress

The composite model provided us with strength in a challenging economic environment, allowing us to adapt profitably. In 2008 we actively managed the composite portfolio, specifically:

Continued the transformation of our UK and Canadian GI businesses

Realised more value from our life and pensions businesses

– Maintained our leading position in UK and Europe

– Doubled sales in US, a year ahead of plan

– Strengthened our position in Asia and Emerging Europe

Launched Aviva Investors (see below)

## Build global asset management

Launched in September 2008, Aviva Investors is a clear example of the “one Aviva, twice the value” strategy in action. Integrating our global asset management businesses under one umbrella, Aviva Investors is now a leading asset manager, operating in 15 countries with £236 billion of funds under management. We plan to grow Aviva Investors and significantly increase its contribution to group profits.

## 2008 progress

Launched Aviva Investors as a global business under one brand, leveraging the resources of several of Aviva's established asset management businesses

Built an experienced executive team, bringing together talent from our businesses worldwide

Reshaped the investment model, separating investment portfolios that benefit from global scale and reach from those that leverage local market knowledge

Created a scalable infrastructure for launching new products and driving cross-border sales

## Allocate capital rigorously

Capital management will continue to be a key focus. Capital is treated as a scarce resource, and is allocated to provide the highest sustainable returns for shareholders. We continuously seek improvements in capital structure and efficiency.

## 2008 progress

Maintained a strong capital position under tough market conditions

Proactively managed our balance sheet, including reducing and hedging equity exposure

Strengthened our credit management and risk systems

Maintained strong liquidity and cash flow position

Moved to market consistent embedded value (MCEV) to enhance decision making on value and profitability

## Increase customer reach

We sell our products in 28 countries in ways that our customers choose to buy them. We will get closer to our customers through better understanding of their needs and by providing products and services that customers want. We will continue looking for the right distribution in the right markets. Our move to a global brand is key to achieving our goals.

## 2008 progress

Commenced migration to a single Aviva brand and created a global marketing function (see page 16)

Introduced a consistent measure to track customer advocacy and drive improvements in customer experience

Reinforced the FSA's Treating Customers Fairly principles in every aspect of our business

Expanded significantly in our existing markets, particularly the US, China and Poland

Commenced operations in South Korea and Taiwan

## Boost productivity

We constantly look for ways to boost our productivity, to support sustainable growth, increase our competitiveness, improve our services, and deliver higher value to our customers. Working together as “one Aviva”, we deliver operational excellence through shared services, shared knowledge, rationalised systems and effective outsourcing.

## 2008 progress

Achieved £340 million annualised cost savings in UK GI, UK Life and Europe

On track to meet our 2009 cost saving targets

Increased our cost saving target from £350 million to £500 million

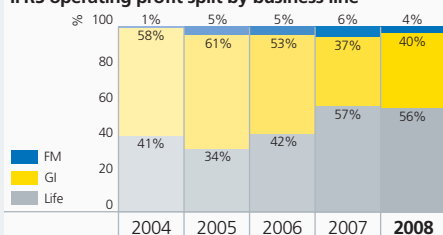
Increased use of shared services, both regionally (expanded Singapore hub, UK cost savings) and functionally (group-wide approach to functions such as procurement and HR)



In 2009, we will continue to drive the group strategy, while adapting our short-term tactics in response to current recessionary conditions. In particular we are focused on capital, profitability and productivity over volume growth and we have strengthened our commitment to understanding and responding to the needs of our customers and partners during these turbulent times.

## 2008 measurement/indicator

### IFRS operating profit split by business line

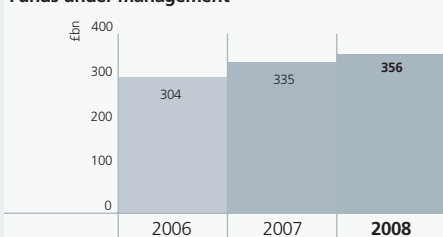


## 2009 priorities

Manage GI for value and cash flow and exercise price discipline and leadership  
Drive profitable growth and long-term value creation from the life and pensions business  
Grow our asset management business (see below)

## 2008 measurement/indicator

### Funds under management\*

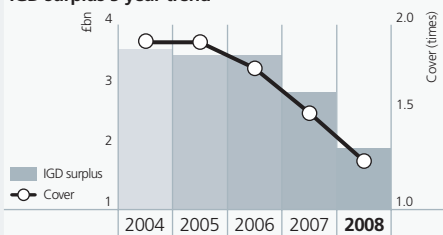


## 2009 priorities

Continue to drive investment performance  
Become a provider of solutions to address individual client requirements by leveraging all internal capabilities  
Increase penetration in existing markets and enter new, high potential growth markets  
Expand our third-party business and increase cross-border sales  
Further develop effective global core business processes and infrastructure

## 2008 measurement/indicator

### IGD surplus 5 year trend

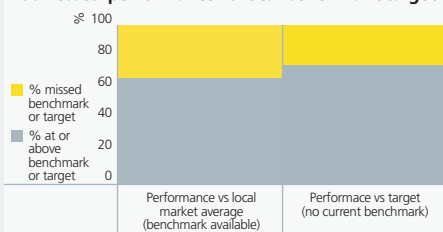


## 2009 priorities

Maintain strong balance sheet  
Monitor and manage market and operational risks in a volatile environment  
Allocate capital to the highest risk-adjusted return opportunities by country, business line and product

## 2008 measurement/indicator

### Businesses' performance vs local benchmark/target

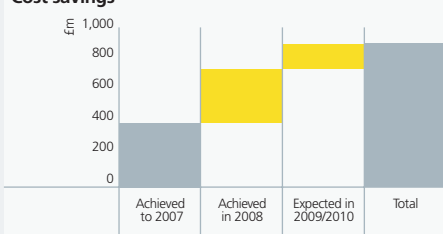


## 2009 priorities

Rebrand to Aviva in the UK by the end of 2009 and in Ireland and Poland by the end of 2010  
Implement a variety of initiatives, to improve customer experience and support the new brand promise  
Continue to build access to customers through our multi-channel approach  
Increase customer retention and overall marketing effectiveness group-wide

## 2008 measurement/indicator

### Cost savings



## 2009 priorities

Execute our shared services strategy, including:  
– Globally consistent operating models for corporate functions eg IT, HR, Finance, Risk and Marketing  
– Tailored use of shared services for regional operations, including UK, Asia and Europe  
– Increased use of outsourcing and offshoring  
Improve productivity across all lines of business  
Actively reduce costs in mature markets, notably the UK

## Summary of regional strategic priorities

### Aviva Investors

- Globally integrated business
- Transform the investment model
- Increase third party business

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### UK

- Market leadership
- Address legacy
- Transform business model
- Exploit UK synergies
- Generate capital

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### Europe

- Scale, growth, capital
- Seize unique growth opportunities
- Leverage scale
- Generate capital

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### North America

- Optimise business mix, growth and margin
- Generate net capital returns
- Contribute to doubling IFRS EPS by 2012

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### Asia Pacific

- Scale, growth
- Prioritised portfolio
- Regional operating model
- Investment required

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\* Total funds managed by Aviva managers.

## Business review

## Key performance indicators

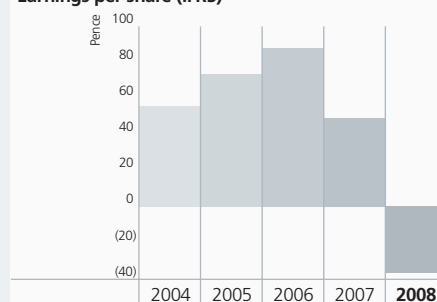
In 2008, the group's strategy was underpinned by focusing on a number of key financial performance measures. The key measures that are used to assess performance at a group level are set out below:

## Earnings per share

To demonstrate our commitment to our vision of "one Aviva, twice the value", we announced our ambition in February 2008 to double IFRS earnings per share by 2012. This ambition is based on total IFRS return, including investment volatility and non-operating items over the weighted average number of shares.

Our IFRS earnings per share for 2008 was a loss of 36.8 pence (*2007 restated: 48.9 profit*). This reflects the net adverse short-term fluctuations and economic assumption changes due to adverse market movement, continued investment in developing the business and strengthening our provisions for latent claims.

Earnings per share (IFRS)

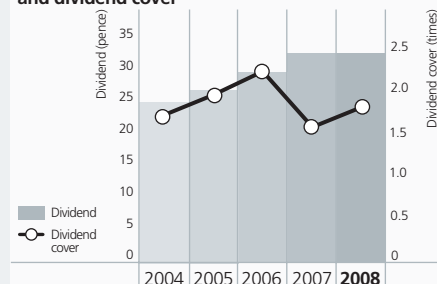


## Proposed ordinary dividend per share and dividend cover\*

Our intention is to increase the total dividend on a basis judged prudent using a dividend cover in the 1.5 to 2.0 times range as a guide, while retaining capital to support future business growth.

Our board has recommended a final dividend of 19.91 pence per share (*2007: 21.10 pence*) bringing the total dividend for the year to 33.00 pence. The total dividend has been maintained in line with 2007. Dividend cover is 1.9 times (*2007: 1.6 times*) within our target range.

Proposed ordinary dividend per share and dividend cover

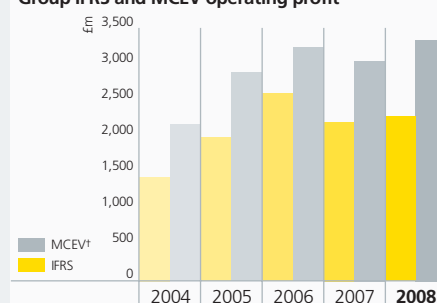


## Group operating profit before tax\*\*

We aim to achieve steady sustainable growth in our operating profit, both on a MCEV and IFRS basis. In seeking to achieve this growth, we continue to adopt strict financial management disciplines underpinned by strong corporate governance.

In 2008 we delivered strong MCEV operating profit at £3,358 million, up 10% against 2007 and IFRS operating profit of £2,297 million, up 4% against the prior year. These results reflect higher life and general insurance results offset by lower fund management returns.

Group IFRS and MCEV operating profit



\* Dividend cover is measured on operating earnings after tax on an IFRS basis, expressed as a multiple of the ordinary dividend in respect of the financial year.

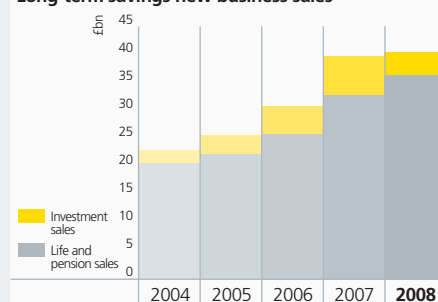
\*\*Group MCEV operating profit is calculated using long-term savings operating profit on a MCEV basis before the impairment of goodwill. Group IFRS operating profit is calculated using long-term savings operating profit on an IFRS basis before the impairment of goodwill.

† On an MCEV basis for 2008 and 2007. Prior years presented on an EEV basis.

## Long-term savings new business sales

Total new business sales, including investment sales, increased by 1% in 2008 to £40,278 million (2007: £39,705 million) with growth in life and pension sales being offset by a fall in the sales of investment products. As a global group with 67% of our long-term savings sales coming from outside the UK we have benefited from currency movements in the year, mainly the appreciation of the euro and US dollar. However, while we have already met the target to double sales in North America a year earlier than planned, in the current economic climate top-line sales growth targets are not our priority. In 2009 we aim to maintain a strong franchise in each of our markets, but with an increased emphasis on capital efficiency. We will aim to perform in line with the market, but will prioritise profitability and efficient use of capital.

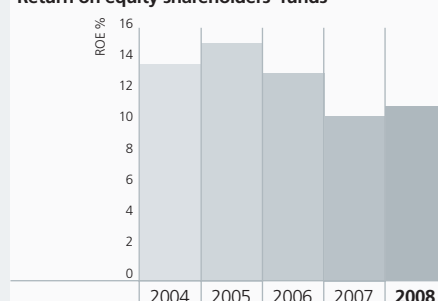
Long-term savings new business sales



## Return on equity shareholders' capital

Return on equity shareholders' capital is calculated as after-tax operating return, before adjusting items, on opening equity shareholders' funds, including life profits on a market consistent embedded value (MCEV) basis\*. The improvement in 2008 to 11.0% (2007 restated: 10.4%) reflects the increase in post-tax MCEV operating return, partly offset by an increase in opening shareholders' funds of £2.6 billion.

Return on equity shareholders' funds



## Employee engagement and leadership

Our global employee climate survey continues to provide measures of employee engagement and leadership. Employee engagement represents the degree to which people believe in Aviva being a great place to work and are contributing to help meet our collective goals and ambitions.

The survey results are used each year to determine and implement actions with the aim of achieving continuous improvement. The climate survey measures employees' perceptions of leadership, verifying alignment with our strategic direction and immediate business plans. Our aim is to improve both measures over time and meet or exceed a global financial services benchmark.

In 2008 we saw improvements in every area of the survey including Aviva's leadership, understanding of company values and levels of engagement. More employees said they felt more customer focused and empowered in the workplace. Awareness of Aviva's diversity policies and practices was also higher and more employees felt that their talents were being managed effectively by their managers.

Aviva climate survey results 2008



## Customer satisfaction

All business units measure and track progress in customer advocacy, and, where feasible, benchmark performance against local competitors.

Aviva is committed to implementing a consistent measure of customer advocacy across the group, Net Promoter Score® (NPS). Overall, 17 businesses carried out an overall NPS survey in 2008. For those that also benchmarked, eight businesses were at or exceeded the market average, with two placed in the upper quartile, and four scored below the market average. For those businesses that unable to conduct a benchmark survey, four businesses' scores met or exceeded their targets and one missed.

Our UK Life, UK GI and Canadian business are transitioning across to NPS in 2009. In the UK, the life business met its broker satisfaction target, UK GI achieved its direct customer satisfaction target (at 94%) and our RAC business continued to receive very high levels of customer satisfaction (98%).



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.

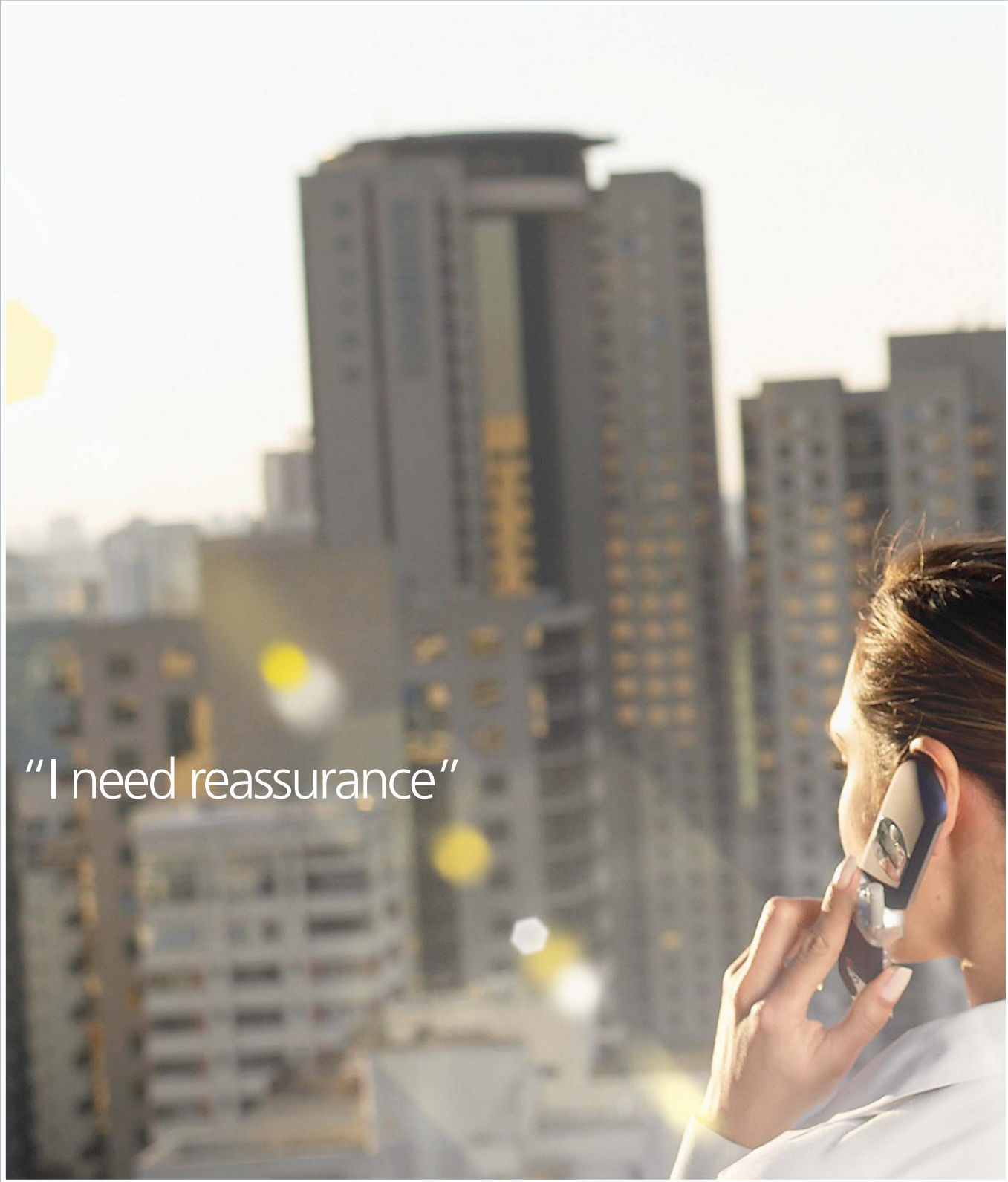
Employees and locations

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

"I need reassurance"



## 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 Sarbanes-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)
<b>IFRS operating profit before tax</b>	<b>2,297</b>	<b>2,216</b>

## 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)
<b>MCEV operating profit before tax</b>	<b>3,358</b>	<b>3,065</b>

\* 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

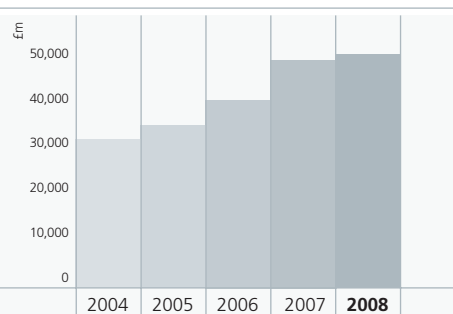
Corporate centre costs for the year improved to £141 million (2007: £157 million) due to lower central spend and staff incentive costs. Within this total, project spend was £34 million (2007: £26 million), driven by the corporate centre's share of the ongoing implementation of the global finance strategy. 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.

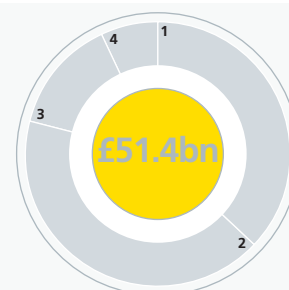
## Total sales

**£51,415m**  
2007: £50,274m



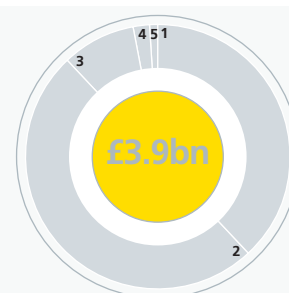
## Regional analysis of total sales

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
<b>IFRS operating profit before adjusting items and tax attributable to shareholders' profits</b>	<b>2,297</b>	<b>2,216</b>
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)	–
<b>IFRS (loss)/profit before tax attributable shareholders' profits</b>	<b>(1,300)</b>	<b>1,832</b>
Tax	415	(334)
<b>IFRS (loss)/profit for the financial year</b>	<b>(885)</b>	<b>1,498</b>
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
<b>MCEV operating profit before adjusting items and tax attributable to shareholders' profits</b>	<b>3,358</b>	<b>3,065</b>
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)	–
<b>MCEV (loss)/profit before tax attributable to shareholders' profits</b>	<b>(11,224)</b>	<b>2,632</b>
Tax	3,514	(686)
<b>MCEV (loss)/profit for the period</b>	<b>(7,710)</b>	<b>1,946</b>
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 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
<b>Assets</b>				
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
<b>Total assets</b>	<b>354,562</b>	<b>321,326</b>	<b>357,231</b>	<b>329,084</b>
<b>Equity</b>				
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
<b>Total equity</b>	<b>14,446</b>	<b>15,931</b>	<b>17,115</b>	<b>23,689</b>
<b>Liabilities</b>				
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
<b>Total liabilities</b>	<b>340,116</b>	<b>305,395</b>	<b>340,116</b>	<b>305,395</b>
<b>Total equity and liabilities</b>	<b>354,562</b>	<b>321,326</b>	<b>357,231</b>	<b>329,084</b>

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.



## Business review

## Capital management

## Capital management

## Capital management objectives

Aviva's capital management philosophy is focused on capital efficiency and effective risk management to support a progressive dividend policy and EPS growth. Rigorous capital allocation is one of our primary strategic priorities and is ultimately governed by the group Executive Committee.

Overall capital risk appetite is set and managed with reference to the requirements of a range of different stakeholders including shareholders, policyholders, regulators and rating agencies. In managing capital we seek to:

maintain sufficient, but not excessive, financial strength to support new business growth and satisfy the requirements of our regulators and other stakeholders, and thus give both our customers and stakeholders assurance of our financial strength;

optimise our overall debt to equity structure to enhance our returns to shareholders, subject to our capital risk appetite and balancing the requirements of the range of stakeholders;

retain financial flexibility by maintaining strong liquidity, including significant unutilised committed credit lines and access to a range of capital markets;

allocate capital rigorously across the group, to drive value adding growth in accordance with risk appetite;

increase the dividend on a basis judged prudent, while retaining capital to support future business growth, using dividend cover on an IFRS operating earnings after tax basis in the 1.5 to 2.0 times range as a guide.

## Capital resources

The primary sources of capital used by the group are equity shareholders' funds, preference shares, subordinated debt and borrowings. We also consider and, where efficient to do so, utilise alternative sources of capital such as reinsurance and securitisation in addition to the more traditional sources of funding. Targets are established in relation to regulatory solvency, ratings, liquidity and dividend capacity and are a key tool in managing capital in accordance with our risk appetite and the requirements of our various stakeholders.

In February, the Standard & Poors (S&P) rating committee downgraded NU Life from AA to AA-, which is now aligned with the other 'core' group subsidiaries. At the same time S&P have changed the outlook on NU Life's ratings from "negative" to "stable". There are no changes to any of the group's other ratings or outlooks. The group's financial strength rating from Moody's is Aa3 ("excellent") with a stable outlook from AM Best.

## Capital allocation

Capital allocation is undertaken based on a rigorous analysis of a range of financial, strategic, risk and capital factors to ensure that capital is allocated efficiently to value adding business opportunities. A clear management decision making framework, incorporating ongoing operational and strategic performance review, periodic longer term strategic and financial planning and robust due diligence over capital allocation is in place, governed by the Group Executive Committee and Group Asset Committee. These processes incorporate various capital profitability metrics, including an assessment of return on capital employed and internal rates of return in relation to hurdle rates to ensure capital is allocated efficiently and that excess business unit capital is repatriated where appropriate.

## Different measures of capital

In recognition of the requirements of different stakeholders, we measure capital on a number of different bases, all of which are taken into account when managing and allocating capital across the group. These include measures which comply with the regulatory regimes within which we operate and those which the directors consider appropriate for the management of the business. The primary measures are:

*(i) Accounting bases*

We report our results on both an IFRS and a Market Consistent Embedded Value (MCEV) basis. The directors consider that the MCEV principles provide a more meaningful measure of the long-term underlying value of the capital employed in our life and related businesses. This basis allows for the impact of uncertainty in the future investment returns more explicitly and is consistent with the way the life business is priced and managed. Accordingly, in addition to IFRS, we analyse and measure the net asset value and total capital employed for the group on this basis. This is the basis on which group return on equity is measured.

*(ii) Regulatory bases*

Individual regulated subsidiaries measure and report solvency based on applicable local regulations, including in the UK the regulations established by the Financial Services Authority (FSA). These measures are also consolidated under the European Insurance Groups Directive (IGD) to calculate regulatory capital adequacy at an aggregate group level. We have fully complied with these regulatory requirements during the year.

*(iii) Rating agency bases*

Agency ratings are an important indicator of financial strength and maintenance of these ratings is one of the key drivers of capital risk appetite. Certain rating agencies have proprietary capital models which they use to assess available capital resources against capital requirements as a component of their overall criteria for assigning ratings. In addition, rating agency measures and targets in respect of gearing and fixed charge cover are also important in evaluating the level of borrowings utilised by the group. While not mandatory external requirements, in practice rating agency capital measures tend to act as one of the primary drivers of capital requirements, reflecting the capital strength required in relation to our target ratings.

*(iv) Economic bases*

We also measure capital using an economic capital model that takes into account a more realistic set of financial and non-financial assumptions. This model continues to be developed and is increasingly relevant in the internal management and external assessment of our capital resources. The economic capital model is used to assess capital strength in accordance with the Individual Capital Assessment (ICA) requirements established by the FSA. Further developments are planned to meet the emerging requirements of the Solvency II framework.

## Accounting basis and capital employed by segment

The table below shows how our capital, on an MCEV basis, is deployed by segment and how that capital is funded.

	2008 £m	2007 £m
Long-term savings	19,250	22,397
General insurance and health	5,516	5,594
Fund management	340	355
Other business	(326)	831
Corporate*	(30)	(31)
<b>Total capital employed</b>	<b>24,750</b>	<b>29,146</b>
Financed by:		
Equity shareholders' funds	12,912	19,998
Minority interests	3,013	2,501
Direct capital instrument	990	990
Preference shares	200	200
Subordinated debt	4,606	3,054
External debt	919	1,257
Net internal debt	2,110	1,146
	<b>24,750</b>	<b>29,146</b>
<b>Net asset value per share – MCEV basis</b>	<b>486p</b>	<b>763p</b>

\* The "Corporate" net liabilities represent the element of the pension scheme deficit held centrally.

At 31 December 2008 we had £24.8 billion (31 December 2007: £29.1 billion) of total capital employed in our trading operations, measured on an MCEV basis. Net asset value per ordinary share, based on equity shareholders' funds, has decreased to 486 pence per share (31 December 2007: 763 pence per share).

Total capital employed is financed by a combination of equity shareholders' funds, preference capital, subordinated debt and borrowings. In addition to our external funding sources, we have certain internal borrowing arrangements in place which allow some of the assets that support technical liabilities to be invested in a pool of central assets for use across the group. These internal debt balances allow for the capital allocated to business operations to exceed the externally sourced capital resources of the group. Although intra-group in nature, they are included as part of the capital base for the purpose of capital management. These arrangements arise in relation to the following:

Certain subsidiaries, subject to continuing to satisfy standalone capital and liquidity requirements, loan funds to corporate and holding entities, these loans satisfy arm's-length criteria and all interest payments are made when due.

Aviva International Insurance (All) Ltd acts as both a UK general insurer and as the primary holding company for our foreign subsidiaries. Internal capital management mechanisms in place allocate a portion of the total capital of the company to the UK general insurance operations. These mechanisms also allow for some of the assets backing technical liabilities to be made available for use across the group. Balances in respect of these arrangements are also treated as internal debt for capital management purposes.

Net internal debt represents the balance of the above amounts due from corporate and holding entities, less the tangible net assets held by these entities.

On 13 May 2008 we issued £0.8 billion equivalent of Lower Tier 2 hybrid in a dual-tranche transaction (£400 million and £500 million). £0.6 billion of the proceeds was used to repay short-term commercial paper borrowings. On 8 August 2008 we issued a further £0.2 billion of Lower Tier 2 hybrid. These transactions had a positive impact on group IGD solvency and economic capital measures.

Financial leverage, the ratio of external senior and subordinated debt to MCEV capital and reserves, was 34.7% (31 December 2007: 19.2%). Fixed charge cover, which measures the extent to which external interest costs, including subordinated debt interest and preference dividends, are covered by MCEV operating profit was 9.2 times (31 December 2007: 9.2 times).

## Regulatory bases

### Regulatory basis – Group: European Insurance Groups Directive

	UK Life funds £bn	Other business £bn	2008 £bn	2007 £bn
Insurance Groups Directive (IGD) capital resources	5.7	9.8	15.5	16.2
Less: capital resource requirement	(5.7)	(7.8)	13.5	13.3
Insurance Group Directive (IGD) excess solvency	–	2.0	2.0	2.9
Cover over EU minimum (calculated excluding UK Life funds)			1.3 times	1.5 times

We have a regulatory obligation to have positive solvency on a regulatory IGD basis at all times. Our risk management processes ensure adequate review of this measure. At 31 December 2008, the estimated excess regulatory capital was £2.0 billion (31 December 2007: £2.9 billion). This measure represents the excess of the aggregate value of regulatory capital employed in our business over the aggregate minimum solvency requirements imposed by local regulators, excluding the surplus held in the UK and Ireland with-profit life funds.

The minimum solvency requirement for our European businesses is based on the Solvency I Directive. In broad terms, for EU operations, this is set at 4% and 1% of non-linked and unit-linked life reserves respectively and for our general insurance portfolio of business is the higher of 18% of gross premiums or 26% of gross claims, in both cases adjusted to reflect the level of reinsurance recoveries. For our major non-European businesses (the US, Australia and Canada) a risk charge on assets and liabilities approach is used. The IGD is a pure aggregation test with no credit given for the considerable diversification benefits of Aviva.

Our excess solvency of £2.0 billion reflects a net decrease of £0.9 billion since 31 December 2007 reflecting the prevailing challenging market and general insurance trading conditions offset by various capital initiatives undertaken during the year including the issue of hybrid debt. Following individual guidance from the FSA we now recognise surpluses in the non-profit funds of our UK life and pensions business which is available for transfer to shareholders of £0.4 billion, the benefit of which is offset by reserve strengthening elsewhere in the group.

In the current economic conditions we are proactively managing balance sheet risk. In addition to the de-risking exercise we undertook in 2007 we have taken out further equity hedges during 2008 and continue to actively manage our equity risk exposures. We expect our IGD surplus would be approximately £1.2 billion in the event of a 40% fall in equity markets from the 31 December 2008 position.

## Business review

## Capital management continued

## Regulatory basis – Long-term businesses

For our non-participating worldwide life assurance businesses, capital requirements, expressed as a percentage of the EU minimum, are set for internal management and embedded value reporting purposes as the higher of:

Target levels set by reference to internal risk assessment and internal objectives, taking account of the level of operational, demographic, market and currency risk.

Minimum capital level (ie level of solvency capital at which local regulator is empowered to take action).

The required capital across our life businesses varies between 100% and 325% of EU minimum or equivalent. The weighted average level of required capital for non-participating life business, expressed as a percentage of the EU minimum (or equivalent) solvency margin has remained stable at 142% (31 December 2007: 141%).

These levels of required capital are used in the calculation of embedded value to evaluate the cost of locked in capital. At 31 December 2008 the aggregate regulatory requirements based on the EU minimum test amounted to £6.0 billion (31 December 2007: £4.6 billion). At this date, the actual net worth held in our long-term business was £9.5 billion (31 December 2007: £9.4 billion) which represents 157% (31 December 2007: 205%) of these minimum requirements.

## Regulatory basis – UK Life with-profit funds

The available capital of the with-profit funds is represented by the realistic inherited estate. The estate represents the assets of the long-term with-profit funds less the realistic liabilities for non-profit policies within the funds, less asset shares aggregated across the with-profit policies and any additional amounts expected at the valuation date to be paid to in-force policyholders in the future in respect of smoothing costs, guarantees and promises. Realistic balance sheet information is shown below for the three main UK with-profit funds; CGNU Life, Commercial Union Life Assurance Company (CULAC) and Norwich Union Life & Pensions (NUL&P). These realistic liabilities have been included within the long-term business provision and the liability for insurance and investment contracts on the consolidated IFRS balance sheet at 31 December 2008 and 31 December 2007.

	2008					2007
	Estimated realistic assets £bn	Estimated realistic liabilities <sup>***</sup> £bn	Estimated realistic inherited estate <sup>†</sup> £bn	Estimated risk capital margin <sup>‡</sup> £bn	Estimated excess £bn	Estimated excess £bn
CGNU Life	12.8	(12.1)	0.7	(0.4)	0.3	1.1
CULAC	12.4	(11.7)	0.7	(0.4)	0.3	0.8
NUL&P <sup>#</sup>	21.4	(20.2)	1.2	(0.7)	0.5	1.3
<b>Aggregate</b>	<b>46.6</b>	<b>(44.0)</b>	<b>2.6</b>	<b>(1.5)</b>	<b>1.1</b>	<b>3.2</b>

\* These realistic liabilities include the shareholders' share of future bonuses of £0.8 billion (31 December 2007: £1.2 billion). Realistic liabilities adjusted to eliminate the shareholders' share of future bonuses are £43.2 billion (31 December 2007: £48.8 billion).

\*\*These realistic liabilities make provision for guarantees, options and promises on a market consistent stochastic basis. The value of the provision net of charges included within realistic liabilities is £1.4 billion, £1.5 billion and £4.1 billion for CGNU Life, CULAC and NUL&P respectively (31 December 2007: £0.7 billion, £0.8 billion and £3.0 billion for CGNU Life, CULAC and NUL&P respectively).

† Estimated realistic inherited estate at 31 December 2007 was £1.4 billion, £1.2 billion and £1.9 billion for CGNU Life, CULAC and NUL&P respectively.

‡ The risk capital margin (RCM) is 1.8 times covered by the inherited estate (31 December 2007: 3.5 times).

# The NUL&P fund includes the Provident Mutual (PM) fund which has realistic assets and liabilities of £1.8 billion and therefore does not impact the realistic inherited estate.

## Investment mix

The aggregate investment mix of the assets in the three main with-profit funds at 31 December 2008 was:

	2008 %	2007 %
Equity	24%	37%
Property	12%	13%
Fixed interest	56%	37%
Other	8%	13%
	<b>100%</b>	<b>100%</b>

The equity backing ratios, including property, supporting with-profit asset shares are 57% in CGNU Life, CULAC and NUL&P. With-profit new business is mainly written through CGNU Life.

## Proposed reattribution of inherited estate

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.

## Regulatory basis – Solvency II

Solvency II represents new EU legislation which totally redefines prudential supervision of EU insurers. It aims to establish a new economic risk sensitive approach to capital and solvency calculation and a new harmonised EU supervisory regime which places importance on effective internal governance and risk management practices. Aviva has already recognised that Solvency II offers a blueprint for industry best practice and is fully prepared to meet the challenge that offers. To that end we are an active participant in the key European industry working groups who provide the voice of industry in ongoing negotiations in Brussels.



It is possible that the first stage of the Solvency II project will reach conclusion by June 2009 if the EU Parliament, Council and Commission are able to reach agreement on the "Level 1 Framework Directive". If this happens, it is envisaged that full implementation of Solvency II requirements could be imposed on EU insurers in the first quarter of 2013.

### Rating agency bases

Agency ratings are important in supporting access to debt capital markets and in providing assurance to business partners and policyholders over the financial strength of the group and our ability to service contractual obligations. In recognition of this, we have solicited rating relationships with a number of rating agencies. Rating agencies generally assign ratings based on an assessment of a range of financial (eg capital strength, gearing and fixed charge cover ratios) and non-financial (eg competitive position and quality of management) factors. Managing our capital and liquidity position in accordance with our target rating levels is a core consideration in all material capital management and capital allocation decisions.

### Economic bases

We use a risk-based capital model to assess economic capital requirements and to aid in risk and capital management across the group. This model is also used to support our Individual Capital Assessments (ICA) which are reported to the FSA for all UK regulated insurance businesses. The model is based on a framework for identifying the risks to which business units, and the group as a whole, are exposed. A mixture of scenario based approaches and stochastic models are used to capture market risk, credit risk, insurance risk and operational risk. Scenarios are specified centrally to provide consistency across businesses and to achieve a minimum standard. Where appropriate, businesses also supplement these with additional risk models specific to their own risk profile. When aggregating capital requirements at business unit and group level, we allow for diversification benefits between risks and between businesses, with restrictions to allow for non-fungibility of capital when appropriate. This means that the aggregate capital requirement is less than the sum of capital required to cover all of the individual risks.

For internal management purposes, our economic capital model is calibrated to our target capital adequacy rating. Financial modelling techniques enhance our practice of active risk and capital management, ensuring sufficient capital is available to protect against unforeseen events and adverse scenarios. Our aim continues to be the optimal usage of capital through appropriate allocation to our businesses. We continue to develop our economic capital modelling capability for all our businesses as part of our development programme to increase the focus on economic capital management.

The FSA uses the results of our ICA process when setting target levels of capital for the UK regulated insurance businesses. In line with FSA requirements, the ICA estimates the capital required to mitigate the risk of insolvency to a 99.5% confidence level over a one year time horizon (equivalent to events occurring in 1 out of 200 years) against financial and non-financial tests.

## Business review

## Risk management

As a global company, we face a large and diverse number of risks. Each of these risks has the potential to harm our financial performance or hinder the achievement of our strategic objectives. If we don't manage risk effectively we could miss potential opportunities to further develop and expand our business.

## What sorts of risks do we face?

We group the type of risks we face into three categories: financial, strategic and operational.

Financial risks cover market and credit risk, insurance risk, liquidity and capital management.

Strategic risks include issues such as customer, products and markets as well as any risks to our business model arising from changes in our market and risks arising from mergers and acquisitions.

Operational risks arise from inadequately controlled internal processes or systems, human error or non-compliance as well as from external events. Operational risks include taxation, reputation and regulatory risks, such as compliance.

Naturally, it's impossible to analyse every single risk we encounter, so instead we set limits to manage our material risks to ensure we stay within our risk appetite (the amount of risk we are willing to accept). To work out how "material" a risk is to our business we assess its size and scale based on how likely it is that it will occur and what potential impact it would have on our business and our stakeholders if it were to occur. Most importantly, when risks are outside of appetite we agree what actions need to be taken to manage the risks (or groups of risks).

Our Risk Management Framework provides the means for us to identify, assess, measure, manage and monitor all of these different types of risk to provide us with a single picture of the threats, uncertainties and opportunities we face. We're then able to make appropriate decisions to limit and control the impact that all of these risks may have on our strategic objectives.

## What risk management activity happens at Aviva?

To ensure that risks are effectively identified and assessed and that appropriate controls and responses are in place, our risk management activity needs to operate through clearly defined and agreed structures and processes.

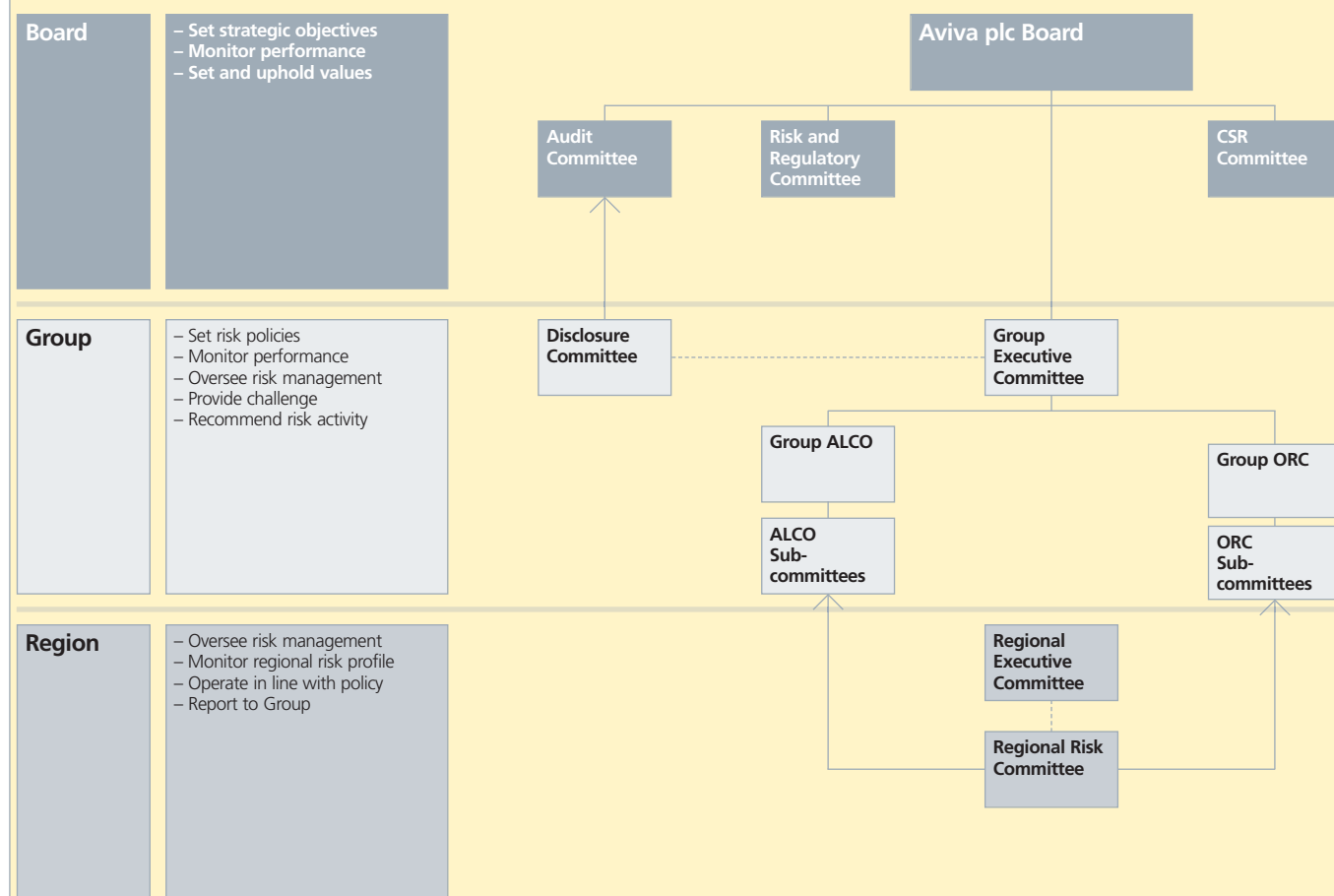
At Aviva, we coordinate all group-wide risk management activities through a central risk team, led by the group chief risk officer. In each of our regions, local chief risk officers ensure that the regional risk profiles remain within the limits set centrally. The local chief risk officers work with business unit management to ensure that our risk management framework is being used consistently across all our businesses. They also work with the group chief risk officer to coordinate and communicate decisions that are taken at a group level.

As well as working with the regions, the central risk team is also responsible for managing group risk governance and oversight.

## Our Risk Management Framework

At group centre, we monitor risks on a regular basis through our Risk Management Framework. The framework includes all our risk management processes, systems and tools and helps set standards for identifying, managing and reporting risks and establishing minimum standards for our control environment.

## Corporate Governance and oversight: Risk committee structure



This process allows us to:

assess the overall risk exposures we face as a group;

identify risk exposures across specific areas of our business or business activities; and

define the risks we're prepared to accept.

The central risk team monitors these risk exposures on a regular basis with a specific focus on financial risks via a fortnightly report, and reports the findings to the Executive Committee and, as part of the performance management process, senior management review risk management information to ensure the successful delivery of our business objectives.

As well as the ongoing monitoring activities the central risk team produces a formal quarterly risk report for the Risk and Regulatory Committee of the board and the various risk oversight committees.

### Corporate governance and oversight

Our Risk Governance Framework allocates responsibility for the oversight of risk management to a number of committees at group centre with the Group Asset Liability Committee ('ALCO') and the Group Operational Risk Committee ('ORC') providing a key focus on financial and operational risk. The Group centre committees are in turn supported by the regions. These relationships are summarised in the diagram on page 32.

These committees monitor the aggregate risk profile, provide challenge and recommend risk management activity and ensure that our risk policies are used to manage risk to agreed standards.

Board oversight is maintained on a regular basis through its Risk and Regulatory Committee. The group chief risk officer has a reporting line to the chief financial officer as well as to the chairman of the Risk & Regulatory Committee assuring independence of the function.

### Policies and procedures

We have 35 policies that deal with the management of all our risks. These policies define our risk appetite and set out risk management and control standards for the group's worldwide operations. The policies also set out the roles and responsibilities of businesses, regions, policy owners, and the risk oversight committees.

As our business needs to change and respond to market conditions and customer needs, we regularly monitor our policies and risk appetite to ensure they remain relevant and up-to-date. This helps to provide assurance to the various governance and risk oversight committees that there are appropriate controls in place for all our core business activities, and that the processes for managing risk are understood and followed consistently across our global businesses.

### Risk and economic capital

We continue to develop our economic capital models to allow us to measure, compare and further understand our risks. The results of the modelling are incorporated into our key decision making processes. These models show us the relative impact to economic capital from the risks we face. In turn this allows us to consider appropriate and effective mitigating strategies where risks are outside of appetite.

The Financial Services Authority (FSA) requires Aviva to assess its economic capital requirements to ensure that it adequately reflects business and control risks. In turn this analysis supports our strategic planning and decision-making processes.

## How are financial, strategic and operational risks managed at Aviva?

### Financial risks

We're exposed to financial risk as a result of changes in the values of our investments and the value of our insurance liabilities. This risk is caused by potential market movements in equity and property prices, the impact of interest rate changes and inflation expectations, credit risk exposures, foreign exchange rate movements and liquidity demands.

### Market risk

Aviva is exposed to market risk from owning a portfolio of international insurance businesses. A decline in markets or an increase in market volatility may also adversely affect sales of our investment products and our fund management business. We recognise that market risk is part of the businesses that we run, and that a certain level of market risk is acceptable in order to deliver benefits to both policyholders and shareholders.

We manage market risk by applying our market risk policy to all of the assets under the group's control. This includes policyholder assets (those assets supporting the technical liabilities) and shareholder assets (the surplus assets held that are not required to meet policyholder benefits and to cover regulatory margins). In practice assets can move between these categories.

To ensure we manage the risks around assets backing technical liabilities, we have set standards for the way businesses should match their liabilities with appropriate assets. Businesses also need to follow a clear decision-making and monitoring process when liabilities cannot be matched or a degree of mismatching is desired. Several of our long-term savings businesses sell products where the majority of the market risk is borne by the policyholder. Any market risk attributable to policyholders is managed to satisfy the policyholders' objectives for risk and reward.

We monitor the financial impact of the changes to market values (including our staff pension schemes) through our measurement of economic capital and sensitivities to our key performance measures and set our risk appetite in respect of the amount to be invested in different types of asset.

### Equity price risk

Falls in equity prices is our largest market risk exposure. We continually monitor our exposures relative to our risk appetite and have reduced our overall exposures to equity risk during 2008 by extending our portfolio of equity hedges. This is in addition to the significant equity de-risking we performed in 2007 within our main staff pension scheme and general insurance businesses. These hedges tend to take the form of a portfolio of options designed to provide protection against falls in equity prices at the lowest cost possible. Over the year we have actively managed our portfolio of equity hedges to ensure our equity risk remains within appetite without any adverse liquidity impacts. "Hedging" is a strategy used to reduce exposures to price risk movements.

A 10% decrease in equity prices would decrease total shareholders' funds net of tax by £1,100 million on an MCEV basis and £600 million on an IFRS basis. Lines of business sensitivities to increases in equity prices are shown in note 55 to the financial statements and in the section on MCEV reporting. These figures are based on an instantaneous shock and include the impact of the hedges in place.

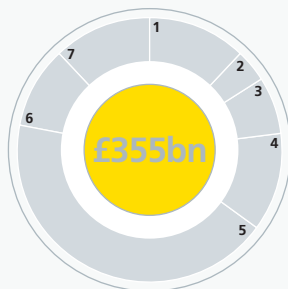


## Business review

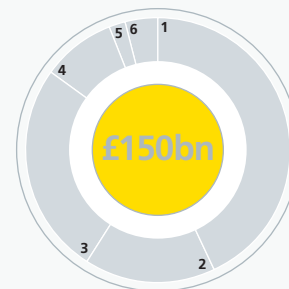
## Risk management continued

## Deployment of assets

	%
1 Equities	12
2 Property	4
3 Cash	7
4 Loans	12
5 Debt securities	43
6 Other investments	10
7 Other net assets	12
Total	100

Credit risk exposures  
– debt securities

	%
1 AAA	44
2 AA	16
3 A	26
4 BBB	9
5 Speculative grade	1
6 Not rated	4
Total	100

**Interest rate risk**

Changes in the level of interest rates affect both the products we sell and the value of our investments. For example, long-term debt and fixed income securities are both exposed to fluctuations in interest rates. We are also exposed to movements in interest rates on business carrying investment return and surrender value guarantees.

A 1% increase in interest rates would decrease total shareholders' funds net of tax by £500 million on an MCEV basis and £600 million on an IFRS basis. Lines of business sensitivities to increase in interest rates are shown in note 55 and in the section on MCEV reporting.

For some categories of our long-term business, we reduce interest rate risk through the close matching of assets and liabilities. For short-term business such as general insurance, we require a close matching of assets and liabilities by duration to minimise this risk. If we can't entirely remove interest rate exposure through matching, then we may use a variety of derivative instruments in order to hedge against unfavourable market movements.

We have implemented a portfolio of hedges in Delta Lloyd to protect against the interest rate guarantees within the business. This strategy protected our position in the light of the rapidly falling interest rates environment we have witnessed.

**Property price risk**

We also invest in property assets in different global locations. These assets are also subject to fluctuations in their value. Property investment is managed locally by our business units, recognising any local regulatory restrictions in respect of asset admissibility or liquidity and with reference to the business units' risk appetite.

A 10% decrease in property values would decrease shareholders' funds by £300 million pre-tax on an IFRS basis and embedded value would decrease by £355 million, net of tax on an MCEV basis. Sensitivities to property values are shown in note 55 and in the section on MCEV reporting.

**Credit risk**

We have significant exposures to credit risk through our investments in corporate bonds, commercial mortgages, and other securities. We hold these investments for the benefit of both our policyholders and shareholders.

We manage the exposure to individual counterparties, by measuring exposure against centrally set limits. These limits take account of credit ratings issued by rating agencies such as Standard & Poor's.

We manage the level of risk we're prepared to take via analysis that helps us define the optimal balance between the risk we take and the returns we can earn on the underlying assets, monitoring the types of investment available to us to achieve our aims. We also actively monitor and consider the risk of a fall in the value of fixed interest securities from changes in the perceived credit worthiness of the issuer.

We're also exposed to credit risk through our use of reinsurance. Reinsurance arrangements are only placed with providers who meet our counterparty credit standards.

**Foreign exchange risk**

As an international business we're exposed to fluctuations in exchange rates in the countries in which we undertake business. Over half of our premium income comes from currencies other than sterling. Generally, we don't hedge these currency risks as profits are retained to support growth in the business units. However significant dividends from overseas business units are hedged as they are declared.

Movements in exchange rates will affect the value of shareholders' funds which are expressed in sterling. This aspect of foreign exchange risk is monitored centrally against limits aimed at aligning capital deployed with capital required. We use currency borrowings and derivatives when necessary to keep currency exposures within these limits. We hedge specific foreign exchange transaction risks when we feel it's appropriate; for example, acquisition or disposal activity.

We're also exposed to some exchange risk from assets held in staff pension schemes, as a part of the investment strategy agreed with the scheme trustees.

**Derivatives risk**

We use derivatives in a number of our businesses to enable efficient investment management or as part of structured retail savings products. In addition we use derivatives to hedge the financial risks discussed above. Derivatives can involve complex financial transactions and, to minimise the risks involved we set minimum standards of control that we require our businesses to adopt when using derivatives.

Activity is overseen by the Derivatives Approvals Committee, which monitors implementation of the policy, exposure levels and approves large or complex transactions proposed by businesses. Speculative activity is prohibited, unless prior approval has been obtained from the Derivatives Approval Committee.

**Liquidity risk**

We need to ensure that we maintain sufficient liquid assets to meet our cash flow obligations as they fall due. All our businesses identify their sources of liquidity risk and monitor the potential exposures.

At group level, we maintain a prudent level of liquidity which meets the expectations of the FSA and the wider investment community. We maintain a buffer of liquid assets to cover unforeseen circumstances, including providing temporary funds to any of our business units that may experience temporary liquidity shortfalls. The group maintains significant committed borrowing facilities from a range of banks.

**Insurance risk management**

As an insurance business, we evaluate exposures to determine whether or not to insure risks and set terms and conditions for any insurance products underwritten.

### Life insurance risk

Our life insurance businesses are exposed to a range of life insurance risks from various products. These risks are, typically, longevity (the risk that people will live longer than we have assumed), mortality (the death of a policyholder), and morbidity (ill health), as well as experience risks to changes in the underlying assumptions made at the start of the insurance policy, for example duration of the policy and expenses.

### Longevity risk

We have a significant exposure to annuity business and our most significant life insurance risk is therefore associated with longevity. We monitor longevity statistics and compare these with emerging industry trends. We use the results of this analysis to decide both the reserving and pricing of annuities.

Inevitably, there remains uncertainty about the development of longevity that cannot be removed. Should our assumptions in respect of annuitant mortality worsen by 5% then shareholders' funds would decrease by £320 million pre-tax on an IFRS basis and decrease embedded value by £415 million on an MCEV basis, net of tax.

### Mortality and morbidity risk

Our business units manage mortality and morbidity risk arising on insurance products through the setting of limits and the use of reinsurance to transfer excessive risk exposures. Sensitivity tests show that mortality risk is relatively low. A 5% worsening in assurance mortality experience reduces shareholder funds by £30 million on an IFRS basis and decreases embedded value by £265 million on an MCEV basis, net of tax.

### Persistency risk

Persistency (or lapse) risk affects all of our life insurance businesses and is managed at a business unit level through frequent monitoring of experience. Where possible, the potential financial impact of lapses is reduced by the product design. Guidelines have been developed on persistency management, sharing best practice in the setting of lapse assumptions, product design requirements, experience monitoring, and required management actions.

### Product Design and Pricing risk

Poorly designed or inadequately priced products can lead to both financial loss and reputational damage for Aviva. Guidelines have been developed to support the businesses through the complete cycle of the product development process, financial analysis and pricing.

### Expense risk

Expenses are managed and monitored at a business unit level, as part of general day-to-day business management. Expense management is a key part of a business' ability to meet financial targets. Expense risk arises not only from any failure to control the overall level of expenses but also from any deviation of actual experience from the assumptions made in pricing our insurance policies. Expense assumptions are regularly monitored to ensure they remain appropriate.

### General insurance risk

Our general insurance businesses are exposed to a variety of risks, including fluctuations in the timing, frequency and severity of claims and claim settlements, inadequate reinsurance protection and inadequate reserves.

### Catastrophe risk

Our largest general insurance risk is claims incurred from catastrophic events, such as flooding and windstorm. We manage this risk through central monitoring of risk aggregations and, where we do not wish to retain the risk within the group, by purchasing catastrophe cover from third-party reinsurers.

We use reinsurance to help reduce the financial impact of a catastrophe and to manage the volatility of our earnings. We use extensive financial modelling and analysis to ensure we understand the catastrophe risk and to ensure we get maximum benefit in terms of cost of providing the catastrophe reinsurance covers.

As catastrophe events become more remote, the amount of risk we retain increases, so that our total potential loss from our most concentrated exposure (northern European wind storm) is approximately £400 million for a one in ten year event, compared to approximately £850 million for a one in a hundred year event.

### Worsening claims ratios

Another material risk is the financial impact of worsening claims ratios. The business units manage this risk through underwriting disciplines, control of claims management and exploring different solutions to the way we measure and price the risks we underwrite. For example, our UK business has developed digital flood mapping to understand better the risk to household insurance from flood damage.

### Strategic risks

We are exposed to a number of strategic risks. Our strategy needs to support our vision, purpose and objectives and be responsive to both the external and internal environment, for example changes in the competitive landscape, regulatory changes, merger and acquisition opportunities and emerging trends (such as climate change, pandemic and improving longevity).

Strategic risk is explicitly considered throughout our strategic review and planning process. Developments are assessed during our quarterly performance management process where all aspects of our risk profile are considered.

We actively engage with external bodies to share the benefit of our expertise in supporting responses to emerging risks as well as challenging developments that could be damaging to our business and the industry as a whole.

### Operational risks

We're exposed to operational risk arising from inadequately controlled internal processes or systems, human error or non-compliance as well as from external events. Operational risks include taxation, reputation and regulatory risks, such as compliance.

Our businesses are primarily responsible for identifying and managing operational risks in line with minimum standards of control set out in our policies. Each operational risk is assessed against financial, operational and reputation criteria.

Business management teams must be satisfied that all material risks falling outside our risk appetite are being mitigated, monitored and reported to an appropriate level. Any risks with a high potential impact level are monitored centrally on a regular basis.

### Supplier risk

Within Aviva, we have robust guidelines on how supplier risk should be assessed, mitigated and monitored through our Purchasing and Outsourcing policies. These policies are promoted and endorsed by Aviva's senior management and our local Procurement and Risk teams have the responsibility to ensure these are fully implemented. Performance against these guidelines is then assessed at both regional and group level on an ongoing quarterly basis. Risk is measured against four areas: financial impact, internal service disruption, customer impact and risk to the Aviva brand.

Where we identify any potential supply risk – detailed actions plans are put in place and local senior management are informed to ensure appropriate focus is applied.

In addition we complete regular assessments of our major suppliers and ensure that we have robust alternative supply options available. We assess the ongoing financial health of our major suppliers globally, coupled with a review of the business contingency plans to ensure an adequate standard of assurance is maintained.

## Business review

## Aviva Investors

**What we do**

Aviva Investors is a global asset management business dedicated to building and providing our clients with focused investment solutions. Our client base ranges from among the largest financial institutions to individuals investing for the future. We operate under a single brand in 15 countries so our clients benefit not only from our unique access to, and experience of, our local markets – but also from our ability to leverage an infrastructure that comes with global representation.

**Employees and locations**

**1,298**

2007: 967

Australia  
Canada  
China  
France  
Germany

Ireland  
Italy  
Luxembourg  
Poland  
Romania

Singapore  
Spain  
Taiwan  
United Kingdom  
United States

**Operating brands**

“What can you  
do for me?”

## Case study:

**Each client has specific needs**

Working in partnership with them, we listen to client requirements, understand their objectives and approach to risk, and then design a bespoke solution.

We have a wide array of investment capabilities to draw on. As a unified provider we can now tap into virtually every type of investment opportunity all over the world, giving our clients access to more products than ever before. Our expertise and global and local knowledge, meanwhile, help us select the right solutions to match each client's needs.

Visit Aviva Investors at

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



## What's happened?

### Global financial markets in turmoil

- Global banking crisis, frozen credit markets and falling equity markets
- Commercial and residential property prices fell sharply
- Commodity prices at record lows

### Investors look for security

- Government bonds and guaranteed products perform well in volatile market conditions

### Stimulus packages provided by governments

- Government made huge sums of money available to banks in an attempt to restart credit markets
- Interest rate cuts and tax incentives to stimulate spending
- Other incentives provided to industries to shore up businesses

### Economies around the world slipping into recession

- US and UK moved into official recession in fourth quarter of 2008

## What action have we taken?

### Consolidated our fund management business under Aviva Investors

- As a global asset management business we can provide our clients with focused investment solutions

### Risk management

- The risk management culture across the group continues to give significant competitive advantages as we grow our external business around the globe

### Protecting our clients

- We took action to improve transparency for our clients in liquidity funds

### Global research

- We launched a global research centre that will allow collaboration and sharing of information worldwide

## What have we achieved?

### Funds under management

**£236bn**

2007: £235bn

### MCEV operating profit

**£41m**

2007: £64m

### IFRS operating profit

**£114m**

2007: £147m

## What's next?

### Our medium-term targets are to:

- Complete the integration of our business across the world
- Transform the business model
- Increase our third party business
- Grow contribution to group profits

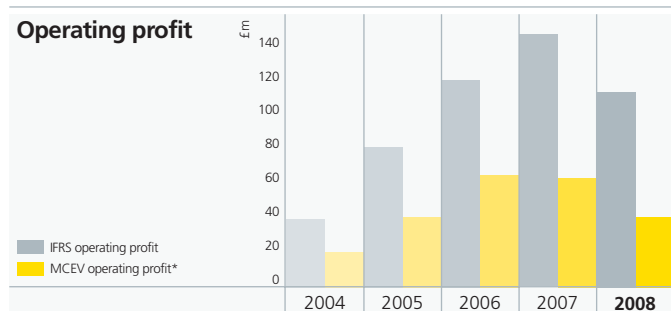
## Business review

## Aviva Investors continued

## Fund management

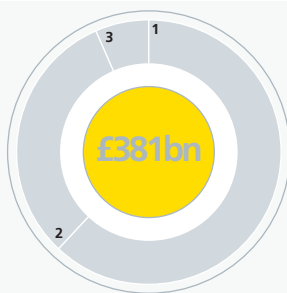
	IFRS operating profit		MCEV operating profit	
	2008	2007	2008	2007
United Kingdom	64	70	34	40
Europe	35	43	9	15
North America	14	27	(3)	3
Asia Pacific	1	7	1	6
<b>Total Aviva Investors</b>	<b>114</b>	<b>147</b>	<b>41</b>	<b>64</b>
Other fund management	9	32	1	26
<b>Total Aviva FM results</b>	<b>123</b>	<b>179</b>	<b>42</b>	<b>90</b>

Note: Full year 2007 has been restated to reflect the new Aviva Investors' management structure. The fund management portion of the US business has been separately identified with a £24 million transfer from the life business result.



## Analysis of 2008 funds under management (£bn)

	£bn
1 Aviva investors	236
2 Other Aviva managers	120
3 External fund managers	25
<b>Total</b>	<b>381</b>



## Profile and strategy

Our global asset management arm, Aviva Investors, is a leading institutional asset management company\*\*. We operate under a single brand in 15 countries across our regions of the United Kingdom, Europe, North America and Asia Pacific.

The business combines the former Aviva operations in the UK (Morley), France (Aviva Gestion d'Actifs), Ireland (Hibernian Investment Managers), Poland (CUIM Polska), Romania (CertInvest), North America (Aviva Capital Management, Aviva Investment Canada) and Australia (Portfolio Partners). In 2008 we also established operations in China, Taiwan and Singapore.

Following our successful rebranding in September we are focusing on investment performance and client solutions and service. Under the leadership of chief executive Alain Dromer, we plan to take advantage of scale and build on our legacy strengths to develop a presence in new and rapidly growing markets.

We aspire to increase operating profits by four times and to double our contribution to the group as we continue to integrate and grow the business around the globe. We are able to leverage the strong awareness of Aviva through our Aviva Investors sub-brand and will contribute to the group vision of "prosperity and peace of mind" while developing a distinctive high performance culture and global reputation as a leading institutional asset management business.

## The marketplace

2008 was one of the most volatile economic periods in history with a wide range of assets posting record or near record falls. What began in 2007 as a crisis in US sub-prime mortgages spread first through the global banking system and then the broader economy. As credit markets froze, investors aggressively cut leverage causing many other asset prices to collapse.

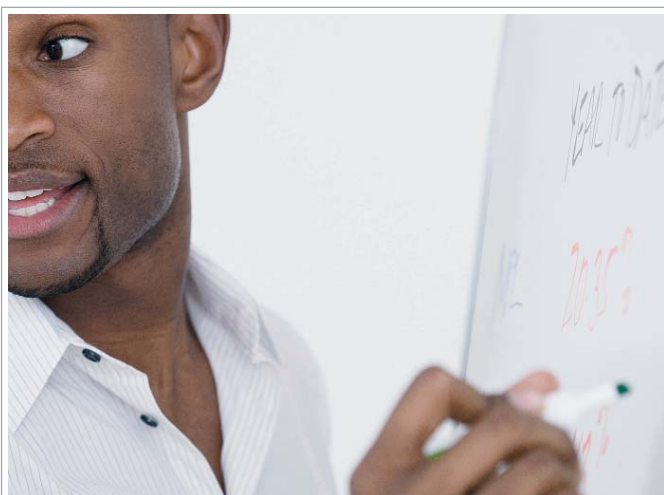
Policymakers coordinated a series of measures aimed at restarting lending and supporting economies and by year-end a large part of the global banking system was effectively under government control. In a further step, huge stimulus packages were announced by governments around the world, designed to limit the damage as their economies slipped into recession. However, by the end of December most of the world's equity markets had fallen by around 40% for the year.

Within equity markets there was nowhere to hide in 2008, with all global markets being dragged down together. UK equities fared better than most despite clear signs of a serious recession. Bond markets were more varied with government bonds performing well as investors sought security. The spread on investment grade corporate bonds widened to unprecedented levels as investors became scarce and default risks increased. Real estate investments generally fared badly with both commercial and residential property prices falling sharply, particularly in the US and the UK. Finally, commodity prices, which had performed very well early in 2008, collapsed along with global growth expectations.

\* On an MCEV basis for 2008 and 2007. Prior years presented on an EEV basis.

\*\*34th globally, 3rd based in the United Kingdom, based on Cerulli Associates' December 2007 ranking of asset managers by assets under management.

## “Award winning education programme”



Case study:

### Top marks for Trustee Tutor

Trustee Tutor is our award-winning education programme. We use it to give trustees the knowledge to challenge and gain the most from their fund managers and consultants. Through various learning and development media, it caters for different knowledge levels and learning styles.

We've already received positive feedback from numerous trustees. "An excellent series of seminars pitched at the right level and well delivered," comments one trustee. Meanwhile, another adds: "Excellent presenters. Very well paced. Good coverage of the topics at an appropriate level." Finally, one trustee concludes: "As a new trustee I've found this an excellent starting point."

Visit Aviva Investors at

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

## Operational performance

Against this economic backdrop, the launch of Aviva Investors in September was well received by clients, industry analysts and the media. The risk management culture and the full support of the group continue to be significant competitive advantages as we grow our external business around the globe.

In 2008, falling asset prices and a global flight to more liquid and transparent investments impacted our business in both negative and positive ways. In line with the broader market we saw significant outflows of cash from the open-ended funds in our UK real estate business. However, we also experienced record month-on-month net inflows into our sterling and euro liquidity funds. As part of an effort to promote transparency and to protect clients' liquidity in extremely volatile markets we moved two of our constant net asset value liquidity funds to a variable net asset value policy in November. This decision was considered to be in the best interest of investors as a variable net asset value provides a more accurate reflection of the underlying value of the funds on a daily basis.

2008 was a busy year for us and key operational developments included:

### Business Development

Alain Dromer built his executive team in 2008. In addition, further key appointments were made in the year, increasing the capacity of our global organisation while shaping a high performance culture that continues to attract, cultivate and retain talent.

We are building a business focused on clients, aiming to generate transferable benefits from partnerships with both internal and external clients and excel at cross-border sales. We delivered significant progress in client services in 2008, with a substantial improvement in the UK institutional business rating by the annual Greenwich survey.

### Investment performance

We have aligned the organisation to long-term investment trends, supporting our focus on investment performance. This includes the separation of our investment offerings into components which enables us to customise and package investment solutions across a range of client segments and needs.

We reshaped our investment portfolios by separating those that benefit from a global scale and reach from those that leverage local market knowledge. We also launched a global research centre that allows investment teams to collaborate and share internal research and information worldwide, strengthened our platform of investment solutions and established a global solutions team.



## Business review

## Aviva Investors continued

**Cross-border sales and third-party sales**

We created a scalable infrastructure in 2008. This included using our Luxembourg SICAV platform to launch the Aviva Investors Australian Resources Fund, Aviva Investors Global High Yield Bond Fund, Global Equity Income Fund and the Aviva Investors Renewable Energy Fund. This platform is expected to generate further transferable benefits from our partnerships with both internal and external clients and to drive cross-border sales.

**Real estate**

Our real estate business is the world's largest manager of European commercial real estate assets\* and is well positioned to build a global business. It has a large and highly experienced team, a reputation for innovation, offices in six locations across the world, a tried-and-tested investment process, exemplary customer service, a strategy team producing quality research and a constant emphasis on improving and expanding its capability. Highlights of 2008 included the launch of the Aviva Investors Asia Pacific Property fund, the first and only daily priced fund focused on the region, and the beginning of the integration of the French real estate team. Additional developments included the acquisition in April of Madison Harbor LLC, a US real estate multi manager.

As a result of these actions, our commitment to excellence and performance during the year, we were recognised by our industry through winning several prestigious awards including:

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Fixed income hedge fund of the year, G7 Fund, Eurohedge Awards

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All Quality Long Convertible Bond Manager, No. 1 for 1-Year Period ended 30 June 2008, eVestment Alliance (North America)

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Silver medal, European Convergence Equity, five-year performance, Investir magazine (France)

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Best Australian equity large-cap share fund, Portfolio Partners Elite Opportunities Trust, Australian Financial Review Smart Investor Blue Ribbon Awards

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Property Manager of the Year, European Pension Awards

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Best Trustee Education Provider, Trustee Tutor, Engaged Investor Trustee Awards

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Case study:

### Trusted to deliver solutions

We're not just investment managers. We also want our key institutional clients to regard us as trusted advisers – offering sound advice and contributing to their strategic planning.

When one of our largest pension fund clients wanted to de-risk their portfolio, we worked with them to devise a solution. The plan utilised derivative instruments and bond purchases to meet risk objectives. Crucially, it was also sufficiently flexible to adapt to current volatile market conditions.

So we're delighted to see its implementation now well underway.

Visit Aviva Investors at

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

"A trusted adviser"

\* Based on findings from Property Funds Research/FT Banker magazine (issued May 2008, data as at December 2007).

## Financial performance

Total funds under management at 31 December 2008 were £236 billion (2007: £235 billion). In common with the asset management industry in general, market factors had an adverse impact on the value of our funds under management. However the fall in equity and property capital values and outflows from some open-ended property funds was more than offset by exchange gains as sterling declined against other major currencies towards the end of the year, increasing the value of our non-sterling investments.

Total operating profit was £116 million (2007: £151 million). Of this, fund management operating profit totalled £114 million (2007: £147 million), principally derived from our UK, French and North American businesses. The pooled pension business, reported in the UK long-term savings segment, contributed a further £2 million (2007: £4 million).

While the decline during the year in funds under management in local currency terms had an adverse impact on management fee income, this was offset by strong results from the UK stock lending business and performance fees recognised. During the year we continued to invest in developing a scalable, cost efficient operating platform, ensuring that cost growth is controlled and focused on adding value for our clients. However, as a result of the decline in underlying management fee income, the cost income ratio increased to 71% (2007: 62%).

## Outlook

The global economy begins 2009 in the midst of a deep recession. Industrial production and corporate profits are falling sharply and unemployment rising equally fast. Economic growth is expected to be significantly negative in 2009 but should benefit from the considerable amount of money injected by governments worldwide and is likely to recover in 2010 led by the US and China. From start to finish the recession is likely to cut western GDP by at least 4%, with the risk to that figure being on the downside. Looking out beyond 2009, we expect that the de-leveraging of the private sector – a rise in savings rate – is likely to remain in place for several years. With no return to normal lending and a sustained rise in savings, we expect economic growth to be very subdued over the next cycle. Chinese growth should be helped by a reversal of the prior objective to cool growth, with increased lending and infrastructure building.

For markets we expect short term interest rates to stay very low and bond yields to be similarly low. Equity valuations now appear cheap globally, providing good return prospects over the very long term, with other assets such as corporate bonds are cheaper still. In the short run however equities will struggle to make progress until closer to the trough in global economic activity. This could allow some recovery in asset prices later in the year, but the risks remain to the downside.

Conditions in real estate markets remain challenging, with most expected to see further capital value decline during the course of this year as the economic contraction feeds through into lower corporate demand for property space and investor sentiment remains weak.

Aviva Investors has a growth plan in place designed to reflect the current environment that is focused on enhancing the delivery of investment performance and third party and cross border sales.

## 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."

Visit Norwich Union at  
[www.norwichunion.com](http://www.norwichunion.com)

"Delighting our customers"



## 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:

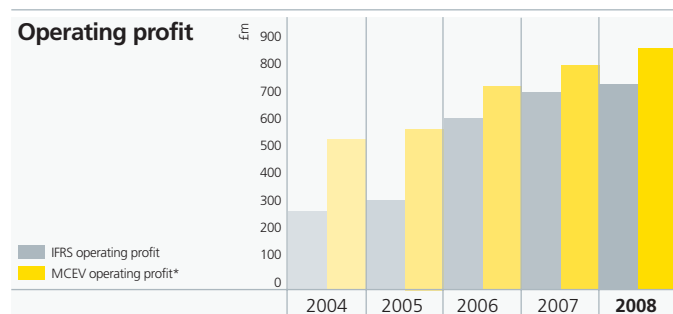
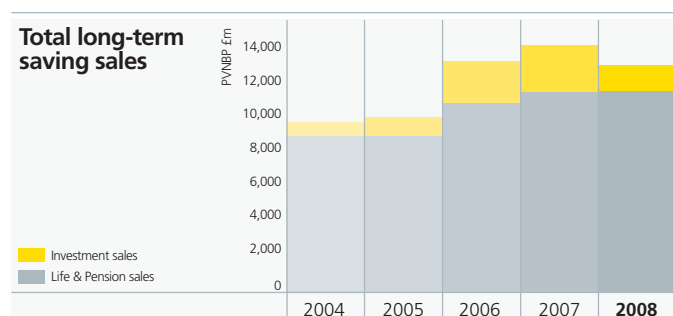
- Continue to transform our business model
- Exploit the synergies of our separate UK businesses
- Generate capital for the group

## Business review

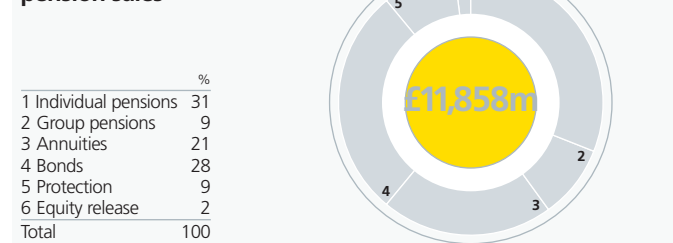
## UK – Life

## 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.

\* On an MCEV basis for 2008 and 2007. Prior years presented on an EEV basis.

## 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.

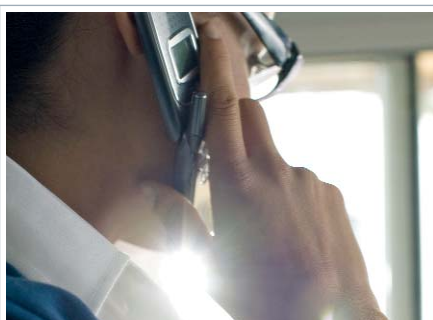
We continue to provide our staff with the tools to meet customer needs by developing their knowledge of our industry, products and customers. In 2008 over 1,000 of our colleagues graduated from the Service Academy, a joint venture with the Chartered Insurance Institute (CII) which provides an accredited 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!

Visit Norwich Union at

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

\* 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

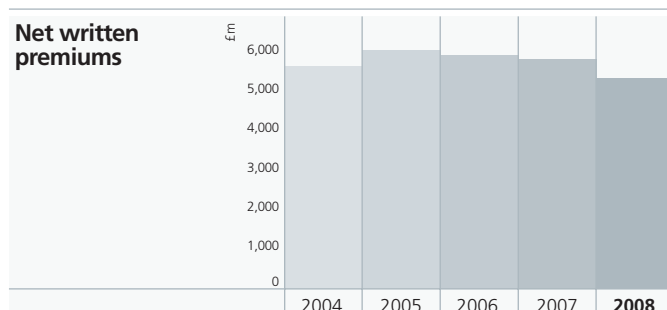
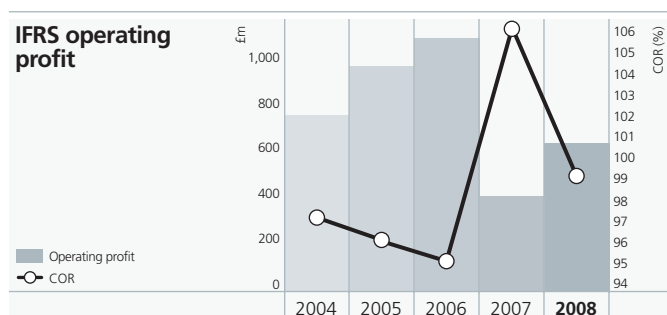
### General insurance and health

	IFRS operating profit £m	Combined operating ratio* %	Net written premium £m	Underwriting result £m	Long-term investment return £m
2008	656	99	5,413	71	585
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	566	368	4,981	5,440
Aviva Re	97	53	43	50
Agency run-off	(21)	–	–	–
Norwich Union Healthcare	14	–	389	406
United Kingdom	656	421	5,413	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.

Visit Norwich Union at

[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.

## Business review

## Europe

**What we do**

We operate in 15 countries across Europe and are the second largest insurer in the region, providing life, general and health insurance products to more than 20 million customers. Customers are served through a diverse set of distribution channels, including banks, brokers, agents, direct sales force, telephone and the internet. Our ability to operate across distribution channels allows us to meet different customer preferences and respond to market developments.

**Employees and locations****16,501**

2007: 15,989

Belgium	Italy	Romania
Czech Republic	Ireland	Russia
France	Lithuania	Slovakia
Germany	Netherlands	Spain
Hungary	Poland	Turkey

**Operating brands****delta lloyd**

## Case study:

**Knowledge is power**

The global economic downturn has hit all parts of the world. And customers everywhere demand up-to-date information and advice. In Romania, for instance, we're issuing a monthly savings and investment bulletin to help our agents understand the implications of the crisis – and ensure their customers make the best financial decisions. We've also updated our marketing materials, created an on-line risk profile detector and revised call centre scripts.

Elsewhere in Eastern Europe, we're providing additional knowledge and training to our Hungarian agents and broker companies – including PR initiatives – to better inform customers.

It's all part of our commitment to keeping both colleagues and customers in the loop.

Visit Aviva Romania at

[www.aviva.ro](http://www.aviva.ro)

"Nu-mi irosiți timpul"  
("Don't waste my time")



## What's happened?

### Aging populations approaching retirement age

- Throughout western Europe the “baby boomer” generations approaching retirement age has increased demand for services that fund retirement and care

### Economic and market turbulence across Europe

- Slowing business volumes as consumers adjust spending
- Bancassurance sales impacted as banks seek to increase liquidity and capital
- Demand for trusted and secure asset classes as consumers reduce their risk appetite

### Market harmonisation across the region

- Converging regulations, cross-border bank and broker consolidation and an increasing global nature of financial markets.

## What action have we taken?

### Focused on our products, distribution and our customers needs

- We have responded to difficult economic conditions by adjusting products to meet our customer's altered needs such as the launch of the “Safe Haven Fund” in Ireland
- Cross border sales from Hungary to Slovakia have increased our geographical coverage
- We have enacted initiatives that support our distributors and policyholders alike. Such as explaining to customers most affected by market volatility what is happening in the market and how it impacts them

### Mergers and Acquisitions

- Acquisition of VIVAS Health in Ireland completes Hibernians product range
- New joint venture arrangements in Poland provides additional distribution coverage
- Increased holding of our profitable Spanish venture in Cajamurcia Vida

### Introduced a new senior management team and pan European structure

## What have we achieved?

Total sales		MCEV operating profit		IFRS operating profit	
<b>£21,844m</b>		<b>£1,925m</b>		<b>£1,141m</b>	
2007 restated: £20,488m		2007 restated: £1,921m		2007 restated: £1,197m	
PVNB	£16,990m	Long-term savings	£1,638m		
Investment sales	£764m	Fund management	£6m		
Net written premiums	£4,090m	General insurance	£397m		
	<b>£21,844m</b>	Other operations	£(116)m		
			<b>£1,925m</b>		

## What's next?

### Our medium-term targets are to:

- Seize unique growth opportunities
- Leverage our scale across the region
- Generate capital



## Business review

## Europe continued

## Long-term savings

	IFRS operating profit £m	MCEV operating profit £m	PVNB £m	Value of new business £m	2008 New business margin %
France	275	692	3,880	135	3.5
Ireland	61	78	1,299	15	1.2
Italy	48	131	2,331	71	3.0
Netherlands	196	187	4,097	(73)	(1.8)
Poland	162	241	1,842	65	3.5
Spain	155	286	2,527	236	9.3
Other Europe	(16)	23	1,014	29	2.9
<b>Europe</b>	<b>881</b>	<b>1,638</b>	<b>16,990</b>	<b>478</b>	<b>2.8</b>

	IFRS operating profit £m	MCEV operating profit £m	PVNB £m	Value of new business £m	2007 New business margin %
France	243	568	3,790	144	3.8
Ireland	73	85	1,780	37	2.1
Italy	78	137	2,975	77	2.6
Netherlands	181	316	3,133	8	0.3
Poland	110	181	1,120	48	4.3
Spain	119	233	2,433	181	7.4
Other Europe	(27)	(17)	453	7	1.5
<b>Europe</b>	<b>777</b>	<b>1,503</b>	<b>15,684</b>	<b>502</b>	<b>3.2</b>

## General insurance and health

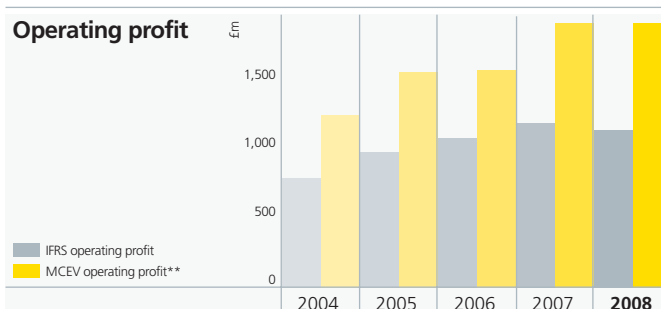
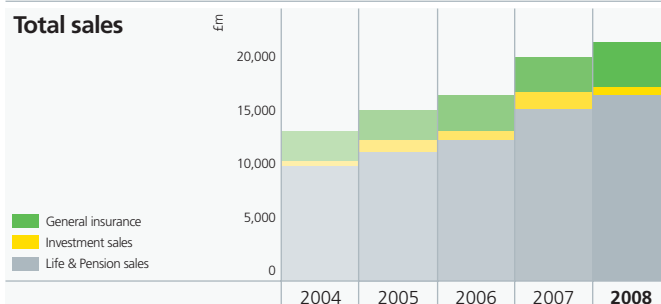
	IFRS operating profit £m	Combined operating ratio* %	Net written premium £m	2008 Under-writing result £m
France	107	96	882	39
Ireland	68	103	513	–
Netherlands	177	94	2,278	43
Other Europe	45	98	417	–
<b>Total</b>	<b>397</b>	<b>97</b>	<b>4,090</b>	<b>82</b>

	IFRS operating profit £m	Combined operating ratio* %	Net written premium £m	2007 Under-writing result £m
France	70	99	733	11
Ireland	162	80	474	101
Netherlands	169	85	1,717	75
Other Europe	41	94	308	10
<b>Total</b>	<b>442</b>	<b>89</b>	<b>3,232</b>	<b>197</b>

\* General insurance business only.

## Fund management

	Investment sales		IFRS operating profit		MCEV operating profit	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
Netherlands	304	811	10	23	2	17
Other Europe	460	761	4	4	4	4
<b>Total</b>	<b>764</b>	<b>1,572</b>	<b>14</b>	<b>27</b>	<b>6</b>	<b>21</b>



## Profile and strategy

Aviva operates in fifteen countries across Europe, providing life, general and health insurance products to more than twenty million customers.

Our core European business comprises the mature markets of France, Spain, Italy and Ireland, together with the central and eastern European, higher growth markets of Poland, Russia, Turkey, Hungary, Romania and the Czech Republic. In addition, we operate in the Netherlands, Belgium and Germany through our Dutch business Delta Lloyd. Delta Lloyd is managed independently from our other operations due to its governance structure and its performance is covered in more detail at the end of this review.

We provide life and pensions products in each of our European markets, where we are recognised for the quality of our products and customer service. In addition we provide general insurance products with operations in France, Italy, Poland and Turkey as well as in Ireland, where we are the market leader. Customers are served through a diverse set of distribution channels, including banks, brokers, agents, direct sales force, telephone and the internet. We are the leading provider of insurance via the bancassurance channel in Europe with 31 bank partners. We have relationships with more than 5,000 brokers and independent agents and in addition we operate a direct sales force of more than 8,500 consultants. Our ability to operate across distribution channels allows us to meet different customer preferences and respond to market developments.

During the course of 2008 we have continued to strengthen our distribution capability across Europe. Our bancassurance channel has benefitted from the addition of agreements in Spain with Cajamurcia, in Poland with Bank Zachodni WBK, Turkey with Citibank and Tekstilbank and our acquisitions of Avipop and UBI Vita in Italy. In our retail channel, principally direct and intermediated business, we have successfully launched a direct motor business in Poland and acquired VIVAS Health in Ireland.

\*\*On an MCEV basis for 2008 and 2007. Prior years presented on an EEV basis.

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## "Produits innovants"

"Innovative products"



Case study:

### Premium safety

'Pay as you drive' insurance is being piloted in greater Paris. Launched throughout France later this year, it will allow young drivers to pay lower premiums – through actual kilometres driven and usage times.

It's an innovative response to younger drivers' needs: 18 to 25-year-olds who haven't previously held insurance and drive less than 9,000km per year. And it's designed to promote responsible driving, too. The pricing system encourages drivers to use the road when accident risks are lowest. Also, we offer a 10% reduction for parents who hold car insurance with us and ensure their offspring drive their own vehicle (rather than more powerful parental cars). The pilot scheme will also test the re-adjusting of premiums to reflect policyholder behaviour.

Visit Aviva France at

[www.aviva.fr](http://www.aviva.fr)

We have also strengthened our leadership team with the appointment of Andrea Moneta as CEO. Andrea has extensive experience in the European financial services arena, having held a number of senior positions in UniCredit and the European Central Bank. Andrea has created a new European leadership team which will lead the transformation of the European business ensuring that our customers, our vision and our values are at the centre of our decision making.

We remain committed to achieving our "one Aviva, twice the value" targets for shareholders and bringing prosperity and peace of mind to our customers.

### The marketplace

Europe is the largest market in the world generating more than 40% of global insurance premiums\* and accounting for over 30% of global personal financial assets\*\*. It has a relatively affluent population of more than 800 million people and encompasses both mature markets, such as France and Ireland, and some of the world's largest emerging markets, such as Russia and Poland. Some of the insurance markets in central and eastern Europe have been among the fastest growing across the globe, a pattern that is likely to resume once global economic conditions improve.

Insurance market development varies considerably across the region from mature and highly-penetrated markets such as Ireland (£4,000+ premiums per capita<sup>†</sup>) to emerging markets such as Russia and Turkey (below £500 per capita). Within this range some western markets, for example Spain and Italy, have low penetration levels compared with other western European countries and therefore have the potential to grow substantially over the next decade.

The impacts of economic turbulence and the credit crunch have been felt across the region. While insurers are far less exposed than banks to the availability of capital, business volumes have slowed as consumers adjust their spending and banks seek to increase liquidity and capital.

This changing environment presents us with opportunities. Insurance products offer a valuable profit stream for banks and can stimulate growth in new bancassurance opportunities. As the leading bancassurer in the region we are well placed to capitalise on this market trend.

We will also benefit from organic growth opportunities, arising from low market consolidation across the region, the migration of customers to brands in which they have confidence.

\* Sigma (2008).

\*\*Aviva/Oliver Wyman research (2007).

† Axco (2008), Comité Européen des Assurances (2008), Central Intelligence Agency (2008).

## Business review

## Europe continued



Case study:

**Web-wise**

Savings and pensions aren't always easy to understand. That's why we've launched two new educational websites to help French customers. Firstly, [www.bonconseil.fr](http://www.bonconseil.fr) offers completely impartial guidance on investment choices. The website includes step-by-step learning materials – so individuals can discover what kind of saver they are and how to improve their capital management. Meanwhile, [www.bienpreparersaretraite.fr](http://www.bienpreparersaretraite.fr) offers a comprehensive collection of practical and objective information on pension issues. Studies have already shown that the French population feel under-prepared for their retirement. That's why this website aims to show how to best prepare a pension. We also offer each client a Personalised Pension Assessment. It all helps to prove that customers remain our main focus.

Visit Aviva France at

[www.aviva.fr](http://www.aviva.fr)**"Assister ses clients"***"Helping customers"*

Over the next decade, Europe will be the region most likely impacted by the effects of an ageing population. Governments will struggle to fund state pensions and healthcare and will increasingly encourage self provision. For consumers this will result in an increased need to save but also in a reduction in risk appetite and a flight to trusted and secure financial services providers.

In western Europe, the "baby boomer" generation's approach to retirement will prompt a flow of investments in more secure asset classes followed by increased demand for services that fund retirement and care. Insurers like Aviva are well positioned to benefit from this market shift.

Market harmonisation continues across the region as a result of converging regulations, cross-border bank and broker consolidation and the increasingly global nature of financial markets. While significant differences remain, such as taxation, customer expectations and demands are increasingly similar across the region. These trends, when combined with technology developments, are creating opportunities to leverage product design, efficient operations and expertise across national borders.

**Operational performance****Customer**

We are committed to providing our customers with prosperity and peace of mind and putting them at the heart of everything we do. Working as a region ensures that we are able to give a consistent response to the challenges created by the credit crunch. A number of initiatives have been enacted to support our distributors and policyholders alike. For example, we contacted the 40,000 French unit-linked customers most affected by market volatility to explain what is happening in the markets and how this will impact them. In Italy, although not contractually obliged, we have signalled our intention to work with our bank partners to support our customers who were impacted by the collapse of Lehman Brothers and the Icelandic banks where customers assets were involved with these organisations. We have also adapted our savings products to provide customers with safer investment options.

**Products and distribution**

Our European business is an excellent example of Aviva's diversity. We meet customers' long-term savings needs in 15 markets, with a broad range of products, through a range of distribution channels. In France and Poland the majority of our sales are through retail channels, while bancassurance channels dominate sales in Spain and Italy. Customers in Ireland are served evenly through both retail and bancassurance.

Our businesses are focused on our customers, developing products and distribution based on their needs and supported by actively sharing knowledge and experience across the region. In 2008 we have adjusted our product and fund offerings to respond to the needs of customers in these difficult economic conditions.

Aviva Europe is also committed to delivering the benefits of "one Aviva" by capitalising on our scale to achieve further growth and to generate capital and in 2008 we have continued to expand our distribution capability across Europe.



## Mergers and acquisitions

The acquisition of VIVAS Health in Ireland completed Hibernian Aviva's product range and we are currently pursuing cross-selling opportunities with our existing life and general insurance operations. In Poland we launched a new joint venture with Bank Zachodni WBK, the Polish subsidiary of AIB, which provides additional distribution coverage following the conclusion of our partnership with Deutsche Bank. We also completed our acquisition of UBI Vita in Italy, increased our holding in our profitable Spanish joint venture Cajamurcia Vida to 50% and entered into new bancassurance opportunities in Turkey with Citibank and Tekstilbank.

## Corporate responsibility

Corporate Responsibility (CR) is fundamental to our vision for Aviva Europe. Gaining admiration and trust, in particular through our interactions with customers, partners, our employees and our communities, are the natural outcomes of a consistent application of Aviva's CR policies and principles. As an evolving region, the levels of awareness of CR and the speed of its implementation, naturally depend on the maturity of each business in each of our markets and its integration with the culture and values of the group.

In 2008 we launched a pan European CR initiative, focusing on raising levels of understanding and engagement to embed our CR approach across the region. Aviva Europe has received several awards for its CR programme including Aviva Lithuania named as "Socially Responsible Company of the year 2007" and Aviva France's diversity programme awarded the "Trophées de la diversité en Entreprise" by the National Agency for Social Cohesion and Equal Opportunities. Our focus in 2009 will be to continue this progression and to share best practices amongst our markets.

## Employees

Operating as one business across 15 European markets offers our employees enhanced development opportunities and the chance to gain experience in different locations, as well as stimulating the sharing of best practice across the region. This helps us to improve the retention of talented staff and gives us a competitive advantage. For example, the development of new life policy administration systems in Romania and Czech Republic has been undertaken by a team drawn from a number of our markets across the region.

Our philosophy is to treat our employees as individuals, recognising the unique contribution they make to the success of our business. One of the mechanisms we use is an annual employee survey, and in 2008 we were pleased that three quarters of our people chose to participate. The results of the survey indicated that we continue to make progress in a number of the areas that matter most to our people. Importantly, it also enabled us to identify those areas where we need to make more progress and close the gap between Aviva in Europe and ISR top performing European companies and thereby become the most admired, trusted, sought-after and financially successful company in our industry and region.

## Delta Lloyd

### Profile and strategy

The Delta Lloyd (DL) group is one of the top-five leading financial services providers based in the Netherlands, with significant operations in Belgium and Germany. The DL group has over £70 billion of assets under management, 4.5 million customers and employs 6,500 staff.

There are three distinct brands in the DL group. In the Netherlands the Delta Lloyd brand works exclusively with independent insurance intermediaries, whilst OHRA focuses on direct channels such as telephone, internet and mail. The third brand comprises a joint venture with ABN AMRO, reaching customers through the extensive distribution networks of ABN AMRO bank.

DL's strategy concentrates on security for its customers and other stakeholders through income protection, wealth creation and risk insurance and is founded on five strategic pillars: reputation, distribution power, efficiency, expertise and core values. The DL group is aiming to secure a position among the top three insurers in the Netherlands by 2010 and, where appropriate, to grow its banking and asset management businesses. Scale and cost effectiveness are essential as customers focus on price and use different distribution channels to buy their financial products.

DL Bank has introduced its own annuity products in response to the challenge from the banking sector, which is now allowed to offer unit-linked savings and pension products on the same terms as insurers. In Belgium the acquisition of Swiss Life Belgium from SNS REAAL on 30 June 2008 further strengthened its position in the Belgian life insurance market. DL has opted for a positioning of its asset management business as a niche player and aims to expand its activities in Belgium and Germany and to increase third party distribution.

DL has actively committed to corporate responsibility ranging from complying with various codes of conduct to realising energy savings. In May 2008 DL teamed up with Rabobank to become co-owners of Econcern, a sustainable energy company which operates in 21 countries, and invests in a number of sustainable energy projects including an off-shore wind-park.

The sale of the health business to OWM CZ Groep Zorgverkeeraar UA ("CZ") was completed on 1 January 2009 and as part of the alliance, DL has exclusive rights to market life, general insurance and income protection products to CZ's 2.6 million customers. This agreement will enable DL to focus on its core life and general insurance businesses while providing access to products from a top-three health provider and continuity of service to customers.

## Business review

## Europe continued

**The Marketplace**

The Dutch insurance market is mature with cost reduction and economies of scale becoming increasingly important. There is a focus from the customer on increasing transparency through value-for-money high performance products. There is also an increase in legislation, for example, in the areas of customer protection and new compensation rules for brokers.

The Dutch savings market is extremely competitive with banks now able to offer retirement products on the same terms as insurers. In addition, the 2007 industry review of charges on unit-linked insurance policies, combined with volatile equity markets, has reduced demand. The general insurance market has seen competition on premium rates, particularly in the key motor account.

Following market-wide challenge in respect of charges, DL has agreed a settlement with its unit-linked policyholders. It is the first insurer in the Dutch market to reach such an agreement which represents a considerable improvement for customers in comparison to the original Financial Services Ombudsman recommendation. The cost to DL is £126 million.

The acquisition of ABN AMRO by the Dutch state and subsequent confirmation of the continuation of DL's long-term joint venture with ABN AMRO has enhanced DL's bancassurance position and ensures that they can continue to provide products to customers through the full range of distribution channels. Both parties have agreed that the joint venture will be the exclusive insurance partner for both the existing and the future Dutch banking operations of ABN AMRO.

DL is well placed due to its distribution strength, market position and investment in its brands to gain advantage from the current market downturns.



Case study:

### Green schemes

Hibernian Aviva is taking steps to reduce Ireland's carbon 'tyreprint' by offering motorists reduced rates for selected lower CO<sub>2</sub> producing cars. Specifically, we offer a discount of 20% to motorists driving eco-friendly cars such as the Toyota Prius, Honda Civic IMA Hybrid, Ford Focus Flexifuel and Saab 9-3 Flexifuel.

These cars are better for the environment as they produce lower carbon emissions and use alternative energy sources such as non-fossil fuels, like hydrogen, and solar power.

Visit Hibernian at

[www.hibernian.ie](http://www.hibernian.ie)

"An environmental approach"

## Financial performance

The financial results of Aviva Europe, including Delta Lloyd, are described below.

### Life businesses

Total life and pensions sales were up 8% at £16,990 million (2007 restated: £15,684 million), buoyed by the strong euro. On a local currency basis our sales were down by 7%. This decline is a direct result of the “credit crunch”, which also affected our investment sales, which dropped to £764 million (2007 restated: £1,572 million). Overall, this is a resilient performance supported by the diversity of our markets and distribution.

Our Aviva Europe new business margin, excluding Delta Lloyd, was 4.3% (2007 restated: 3.9%) reflecting a focus on profitability. In Delta Lloyd the new business margin reduced to (1.8)% (2007 restated: 0.3%) due to the writing of large corporate pension schemes. Overall, the new business margin was 2.8% (2007 restated: 3.2%). This has been supported by increased process efficiency and strong cost management across the region. This will continue to be important in 2009 as new business markets continue to contract across much of the region. In 2009 we will optimise our sales volumes consistent with our focus on prudent capital management and seeking the greatest returns on capital.

IFRS operating profit increased to £881 million (2007 restated: £777 million). The strength of the euro has had a positive impact on these results and, on a local currency basis, IFRS operating profit decreased by 4%, driven by higher new business strain in Delta Lloyd. In Poland we saw increased cost efficiencies and higher returns from existing business and in Spain we benefitted from a new bancassurance joint venture with Cajamurcia. In Turkey we saw the continued successful development of our joint venture AvivaSA.

MCEV operating profit increased by 9% to £1,638 million (2007 restated: £1,503 million). Currency strengthening had a favourable impact on the result which declined 6% on a local currency basis. The underlying decrease mainly reflected a strengthening of allowances for annuitant mortality in Delta Lloyd and negative experience variances due to the worsening economic climate. This was partly offset by good growth across our central and eastern European operations, with increased value of new business and higher expected returns in these growing markets.

### General insurance and health businesses

Net written premiums increased by 27% to £4,090 million (2007: £3,232 million). Against a backdrop of increasing price competition across a number of countries, operating profit decreased to £397 million (2007: £442 million). This result has been favourably impacted by the strengthening of the euro and the development of new distribution channels and product launches in the year. However, these improvements were countered by the current competitive nature of insurance markets, particularly in Ireland and the Netherlands. Our business in Ireland was greatly impacted by a difficult year for the Irish economy and severe floods which led to an increase in weather related claims. A more favourable claims experience for our French business was reflected in a 50% increase in operating profits to £107 million (2007: £70 million).

Although the Europe COR has worsened compared with the prior period, at 97% (2007: 89%) it remains within the group target of “meet or beat” 98% and we expect to continue to achieve this target in the future.

### Other businesses

Regional costs of £28 million (2007: £11 million) reflects the first full year of regional costs.

Other operations losses of £123 million (2007: £38 million) includes holding company costs in a number of our markets, principally France, Italy and Delta Lloyd. Additional costs of £30 million have been incurred this year in relation to the implementation of the global financial strategy and other projects. In addition, Delta Lloyd’s banking and retail mortgage divisions reported an operating loss of £22 million (2007: profit £8 million) as a result of the adverse economic climate, and in Italy we incurred a loss of £6 million in our distribution associate Banca Network Investimenti, acquired in December 2007. The 2007 result benefited from a one-off pension scheme adjustment in France of £17 million.

### Outlook

The outlook for trading in 2009 is difficult to predict with any certainty. We expect new business markets to remain subdued across the region, particularly for life products where the current economic conditions mean that consumers’ propensity to save is relatively low. General insurance markets continue to perform better in terms of volume, although price competition is fierce, particularly in the more mature western European markets.

Our focus in 2009 will be the prudent management of capital, ensuring that we appropriately balance the need to generate current year profits with a desire to invest in business development. Despite difficult economic conditions the European market still presents a number of growth opportunities. We will be alive to these opportunities yet selective in where we choose to invest, maximising our short- and medium-term returns on capital. Within the context of these challenging economic conditions, customer retention will be a particular focus in 2009.



## Business review

## North America

**What we do**

Our North America region is comprised of two distinct businesses. In Aviva USA we provide a comprehensive portfolio of life insurance and annuity products to more than one million customers in all 50 states through independent agents and brokers. Through Aviva Canada, we market a wide range of conventional personal and commercial lines insurance to more than three million customers using brokers and affinity groups.

**Employees and locations****5,627**

2007: 4,634

Canada  
United States**Operating brands**

"Will you go  
the extra mile?"

## Case study:

**...an extra five miles  
on a snowmobile**

In early spring 2008, a customer had his seasonal cottage vandalised. Like most of Canada, the city of Fredericton (New Brunswick) had received lots of snow and the only way to access this particular property was by using snowshoes and a snowmobile. But that didn't stop two field service representatives...

To ensure the customer received immediate service, one of our reps arranged for a snowmobile to get her and her colleague out to the customer's property to assess the damage. The customer was very pleased because Aviva believes in going the extra mile...or even an extra five miles on a snowmobile.

("Irez-vous encore plus loin?")

Visit Aviva Canada at

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

## What's happened?

### Industry changes

- Severe credit exposure experienced in the second half of 2008 by many of the largest financial institutions
- US Security and Exchange Commission (SEC) adopts new rule which classifies equity indexed annuities as securities for federal regulatory purposes
- Steady consolidation of highly fragmented general insurance business in Canada

### Demographic changes

- With 78 million members of the US “baby boom” generation approaching retirement age, demand for household savings and insurance products remain high
- Significant population increases, changing demographic profile and significant economic development in Western Canada drive organic growth opportunity

## What action have we taken?

### Focused on customer needs

- Major change towards customers-centricity resulted in the launch of Aviva Canada's “Let's Change Insurance” brand campaign
- Claims Service Guarantee in Aviva Canada promises great claim experience every step along the experience
- “Wellness for Life” programme in the US

### Optimised regional business model

- Implemented a major change programme in the highly competitive personal lines market that has streamlined and standardised underwriting
- We have initiated efficiency improvements and expense reduction programmes focused on delivering streamlined IT infrastructure outsourcing, regional finance function transformation, consolidation of investment accounting and a structured approach to procurement

### Expanded contribution of asset management

- Exposure to a more diversified range of investment products became available since Aviva Investors became a single centre of excellence in 2008

## What have we achieved?

Total sales		MCEV operating profit		IFRS operating profit	
<b>£7,316m</b>		<b>£334m</b>		<b>£149m</b>	
2007 restated: £5,058m		2007 restated: £274m		2007 restated: £229m	
PVNBP	£5,715m	Long-term savings			£201m
Net written premiums	£1,601m	General insurance			£145m
	<b>£7,316m</b>	Other operations			£(12)m
					<b>£334m</b>

## What's next?

### Our medium-term targets are:

- Optimise business mix, growth and margin
- Generate capital for the group

## Business review

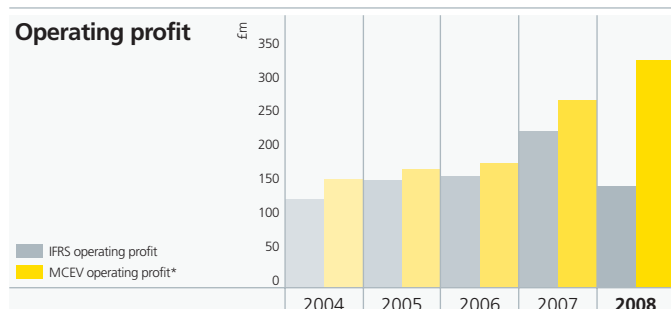
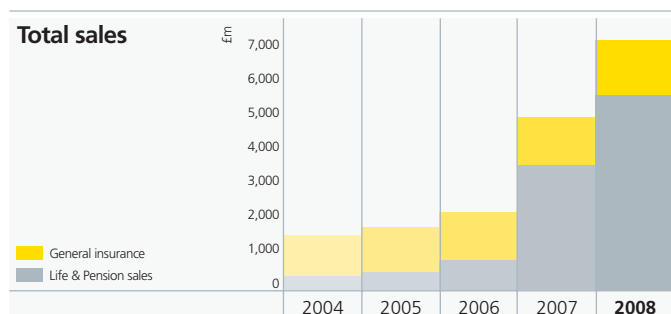
## North America continued

## Long-term savings

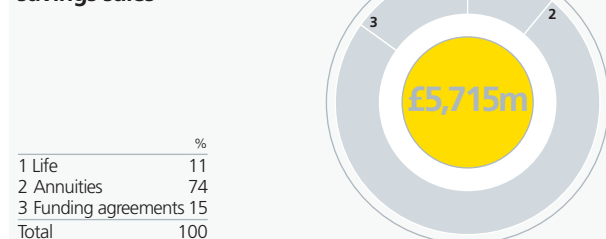
	IFRS operating profit £m	MCEV operating profit £m	PVNB <sup>†</sup> £m	Value of new business £m	New business margin %
<b>2008</b>	<b>16</b>	<b>201</b>	<b>5,715</b>	<b>55</b>	<b>1.0</b>
2007	79	124	3,646	52	1.4

## General insurance

	IFRS operating profit £m	Combined operating ratio %	Net written premium £m	Underwriting result £m
<b>2008</b>	<b>145</b>	<b>99</b>	<b>1,601</b>	<b>21</b>
2007	154	98	1,412	18



## USA – Split of long-term savings sales



## Profile and strategy

Our North America region is comprised of two major lines of business, each of which operates in a distinct geographic market: life insurance and annuities in the United States and general insurance in Canada.

In Aviva USA we provide a comprehensive portfolio of life insurance and annuity products to more than one million customers across all 50 states. We are currently number one in sales of both fixed indexed annuities and fixed indexed life insurance. In response to the evolving requirements of the marketplace, the company's term products were improved and relaunched in 2008. At present, products are primarily distributed through independent agents and brokers, although opportunities may exist to expand our distribution capabilities.

Through Aviva Canada, we market a wide range of conventional personal and commercial lines insurance to more than three million customers using brokers and affinity groups. Aviva Canada is the largest general insurance operation in the Aviva group outside of the UK, with a 9% share of the Canadian market<sup>#</sup>. We have a top five position in all major provinces and are well placed for steady organic growth. Our success is founded on strong fundamentals; strong distribution relationships, underwriting excellence and a balanced portfolio of commercial and personal lines.

The regional executive office is based in Chicago. This office provides governance to the US and Canadian business units, leads business development opportunities and determines the strategic direction of the region. Our four regional strategic priorities in 2008 were:

Grow in existing and new markets;

Expand the contribution of asset management by leveraging the capabilities of Aviva Investors;

Optimise the regional business model to achieve efficiencies and accelerate performance; and

Develop a customer-centric culture that is engaging to employees as well as customers.

## The marketplace

## United States

The US is the world's largest economy<sup>\*\*</sup> as well as its largest insurance market<sup>†</sup>. This is especially true for retirement savings products as 78 million members of the baby boom generation<sup>‡</sup> move into retirement.

The US savings market is undergoing substantial structural changes. This is the result not only of the shifting demographics of an ageing population but also due to a cascading set of crises stemming from US sub-prime mortgage foreclosures, which in turn initiated a massive de-leveraging effect in the capital markets with a profound adverse impact on many financial institutions.

Retirement savings represent 40% of household assets in the US<sup>§</sup> and, despite the uncertainty affecting the financial markets, people are still saving and buying insurance from brands they trust. In Aviva USA we are well positioned to respond to this customer need for safety, having savings and investment products with downside guarantees which are a very attractive offering for retiring customers.

\* On an MCEV basis for 2008 and 2007. Prior years presented on an EEV basis.

\*\*The World Bank, based on 2007 GDP.

† Swiss Re Sigma Report, No.3/2008, "World Insurance in 2007: emerging markets leading the way".

‡ US Census Bureau, July 2005.

§ Investment Company Institute, "Research Fundamentals", October 2008, Vol. 17, No. 3 – Q1.

¶ AXCO Insurance Market Report, 2006.

# "MSA Report, Property and Casualty, Canada, 2008" Published by Market-Security Analysis and Research Inc.



The US Securities and Exchange Commission (SEC) has adopted a new rule (Rule 151A) which classifies equity indexed annuities as securities for federal regulatory purposes on contracts issued on or after 12 January 2011. In addition to creating additional administrative requirements for issuers, the ruling requires agents to be licensed to sell these products. Indexed products meet an important customer need and are a key element of our product suite. We are currently assessing the specific actions needed to position ourselves advantageously with respect to the potential adoption of this or a similar rule.

### Canada

As the seventh largest<sup>™</sup> in the world, Canada's general insurance market is established and stable. The four largest provinces generate around 90% of total premiums with Ontario, the largest, representing 47% on its own<sup>#</sup>. The biggest growth market is western Canada, where economic development has resulted in significant population increases and a changing demographic profile.

The Canadian general insurance industry is highly fragmented with many small players and no dominant consumer brand. Steady consolidation has resulted in the top five companies sharing 35% of the market with the top two companies, ING and Aviva, controlling 20%<sup>#</sup>. The rest of the industry consists of smaller, provincially based models or niche companies. Further consolidation is therefore anticipated.

The trend of insurers purchasing independent brokers through loans and minority equity investments continues. However, the need to preserve capital and the slowing availability of acquisition targets are driving aggressive organic growth activity among the industry's leading insurers. Emerging distribution opportunities and trends in consumer buying habits are resulting in customers of personal lines progressively moving away from the well-established and dominant retail broker model. Direct and affinity marketing are the fast-growing new channels in personal lines, with commercial lines distribution expected to remain firmly broker based.

### Operational performance

We made significant progress in implementing our four regional strategic priorities in 2008 and delivered exceptional growth results.

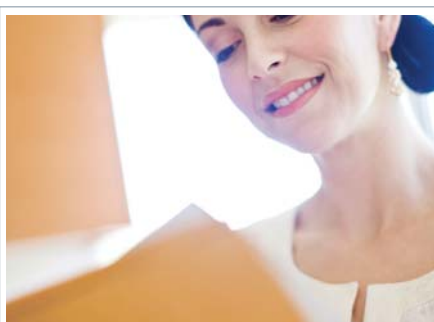
#### Grow in existing markets

In Aviva USA we achieved new business sales of £5,715 million in 2008. In doing so, we have achieved our target of doubling the scale of the US business a year ahead of plan.

Our decision to exit certain markets in late 2007 to focus on selling higher margin products contributed to a slight decrease in the sales of life products in 2008. To pave the way for our future growth, we made changes to our product mix in response to customer needs. This included the introduction of new term insurance products and new fixed universal life products as well as the expansion of our distribution network with focus on larger brokerage general agents.

While we will put greater emphasis on life sales in 2009, we will continue to market indexed annuities and refresh our traditional fixed annuity product set in order to capitalise on the growing savings and retirement demographic.

## "Taking care of our customers"



Case study:

### Taking time

In a recent claim, the insured had passed away and the beneficiary named was his common-law wife. The insured died in a different state and his wife was refused the death certificate as she was not next of kin. She was very upset and worried about how the claim could be paid.

We contacted the office in charge and gave them her authorisation as well as documents naming her as the beneficiary. Shortly afterwards, they agreed to post her a copy of the death certificate.

She got back in touch with us and couldn't express how much she appreciated the extra effort we'd shown her.

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

**Business review****North America continued**

In general insurance, strong performance in commercial lines ensured sustained growth. In the highly competitive personal lines market, we implemented a major change programme that included:

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standardisation, streamlining and automation of personal lines underwriting

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centralisation of broker underwriting support; and

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introduction of more than 100 business development roles combined with culture change initiatives in underwriting and sales

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**Expand contribution of asset management**

As Aviva Investors became a single centre of excellence in 2008, the combined funds under management became larger. This increased scale has given us exposure to a more diversified range of investments.

**Optimise the regional business model**

We have wholeheartedly adopted the group's "one Aviva, twice the value" vision and worked hard to implement efficiency improvements and reduce expenses. This includes ongoing initiatives such as IT infrastructure outsourcing, regional finance function transformation, consolidation of investment accounting and a structured approach to procurement.

**Engage our people and customers**

The launch of Aviva Canada's brand campaign "Let's Change Insurance" was a major step change in the industry, resulting in a substantial increase in consumer awareness of Aviva in our target territories. The brand commitment to earn the trust of Canadians is underpinned by a mission to change insurance for the better by being honest about the things people don't like about insurance and taking steps to change them. A key element of this commitment was the introduction of a unique Claims Service Guarantee in 2008. The guarantee promises customers great claims service at every step of the experience, with a commitment to refund the customer's full premium if they are not completely happy. The Claims Service Guarantee was the first in a series of 'proof points' designed to showcase our leadership in customer-centricity.

In Aviva USA we introduced customers to our "Wellness for Life" programme which provides premium reductions to customers who maintain healthy lifestyles. We provide wellness information services through our affiliation with the world-renowned Mayo Clinic Health Solutions. We have also maintained our industry-leading approach to conducting suitability reviews. These reviews are designed to ensure that customers understand the design and nature of the product they are purchasing, and that it is appropriately matched to their needs.

Employee engagement in the region remained strong, as demonstrated by a 96% overall response rate to the 2008 climate survey and an employee engagement score of 84%, well above the industry norm.

**"Spreading the word"****Case study:****....saves the day**

Stewart Hamilton in Scarborough was chatting to a BMO rep and, when he mentioned Aviva, was told he was hearing good things about us.

Asked what specifically, the rep told how a friend of his was very happy because we'd sent her a disposable camera to keep in her glove box. She ended up getting in an accident and there were disputes over what had happened, but the pictures she had taken at the time made her case clear. She was delighted about how forward thinking we were and has been raving about us ever since.

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## Financial performance

### Long-term savings

In the US, our long-term savings sales increased by 57% to £5,715 million (2007 restated: £3,646 million). This was the second consecutive year of record volumes despite significant challenges in the financial markets which have changed the competitive landscape and shaken consumer confidence. We retained our number one sales position in both the indexed annuity and the indexed life insurance markets and have already doubled sales within two years of the acquisition of the former AmerUs business, one year ahead of the stated target.

Expanded distribution, marketing programmes and new product launches contributed to sales of both our annuity and life products. 63% growth in annuity sales was a significant accomplishment given the challenging economic environment. Sales of life products, which mainly include indexed universal life and term assurance products, were slightly down on the prior year as growth was offset by the impact of our tactical decision to exit certain markets in late 2007 to focus on selling higher margin products.

Funding agreement sales were very strong as the volatile investment markets created a favourable environment for these large institutional transactions.

Long-term business operating profit on an MCEV basis was £201 million (2007 restated: £124 million), an increase of 62% driven by improved value of new business, higher expected return from widening credit spreads and less adverse operating assumption changes.

New business margins of 1.0% (2007 restated: 1.4%) were consistent with 2007. Annuity margins are lower than those of life products but the increases in annuity volumes allowed the value of new business to increase to £55 million (2007 restated: £52 million).

IFRS operating profit was £16 million (2007 restated: £79 million). Core margins are under pressure due to the low interest rate environment in the US, coupled with a volatile investment market. This has resulted in lower account values, higher lapse activity and a higher cost of options to support product guarantees.

### General insurance business

Aviva Canada continues to deliver profitable growth. Net written premiums increased 13% to £1,601 million (2007 restated: £1,412 million) with growth in both personal and commercial business and high retention across all lines of business. In personal lines premiums grew by 10% despite increased competition and challenging pricing in a large part of Ontario. Commercial lines premiums increased 20% due to strong new business coupled with a major broker acquisition in the second half of the year.

We achieved rate increases on all lines of business. Both personal motor and homeowner rates increased by 6% (2007: 3% and 4% respectively) reflecting general claims experience in the market. Commercial motor continues to be a profitable line for us, and we improved rates by 3% during the year (2007: 6% decrease). We were able to increase commercial property rates by 4% (2007: 1%) keeping in line with claims inflation and loss experience felt across the market. Liability rates remain extremely competitive but we are beginning to achieve rate increases that are broadly in line with claims inflation.

Our combined operating ratio was 99% (2007: 98%). The claims ratio was in line with 2007 as good prior year loss development was offset by higher claims following a harsh winter and significant storm activity. However, the expense ratio was slightly higher in 2008 reflecting increased spending to support our corporate change programmes and strategic investment.

Operating profit decreased 6% to £145 million (2007: £154 million). Underlying this was an increase in underwriting result to £21 million (2007: £18 million), offset by lower investment income following the equity de-risking that took place in the latter half of 2007 as well as lower reinvestment rates on our bond portfolio.

### Outlook

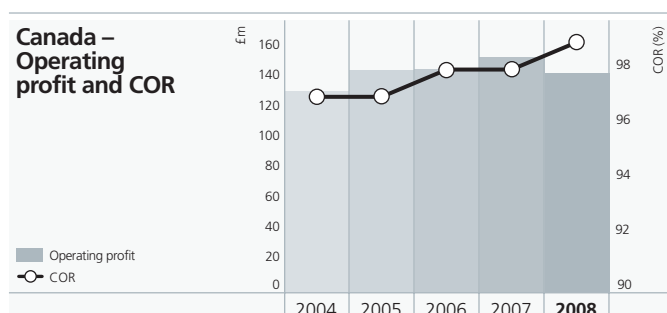
We believe that 2009 will be turbulent as the economy combats the adverse effects of a crisis many believe is only exceeded by the Great Depression of the 1930's.

Despite significant challenges in the financial markets and a weaker economy we also believe that in North America we are in the right place at the right time with the right products. Our established focus on products with downside guarantees and an ongoing commitment to value-adding programmes and features that are important to customers provide a strong foundation for the future.

2008 was focused on achieving our growth agenda. The immense change in our environment caused by the financial crisis in late 2008 requires us to be ever diligent on staying financially healthy and strong. We have adapted our strategic emphasis in 2009 to profitability, productivity and capital efficiency. To conserve capital, we will focus our attention on our existing core businesses in Canada and the US.

Over the long term, Aviva Canada is well placed to benefit from consumers' interest in the purchase of leisure and life style products such as insurance for boats and antique cars, playing to Aviva's strength and enabling us to maintain our dominant market share. We will also continue to address increasing customer demand for choice and simplicity through our multi-distribution model and brand investment in key territories. In commercial lines, we aim to retain our current market position through our expertise in distribution and product innovation.

In addition, we will continue to progress the efficiency and effectiveness of the region's operating model. The North America region was in a start-up position at the beginning of 2008; by the end of the year we had established the regional office in Chicago and staffed all key positions. For 2009, our focus will be on ensuring the region's business concepts and processes continue to progress the group model with clarity of accountabilities and focus across the region.





## Business review

## Asia Pacific

**What we do**

We have been present in Asia Pacific for over 100 years and today operate in nine markets across this region. We are particularly focused on providing long-term savings products through a multi-channel distribution strategy with particular strength in bancassurance and wrap administration. We also sell general insurance products in Sri Lanka and Malaysia and are an established provider of health insurance in Singapore.

**Employees and locations**

**2,376**

2007: 2,052

Australia  
China  
Hong Kong

India  
Malaysia  
Singapore

South Korea  
Sri Lanka  
Taiwan

**Operating brands**

“Committed to meeting customers’ needs”

**Case study:****No freeze at Christmas**

Christmas wasn't forgotten at Aviva Australia. Despite the fund freeze across much of the mortgage sector, we made sure tens of thousands of self-funded retirees received their pension as usual.

Our decision to continue making the payments came just after several major mortgage funders announced they'd be suspending or limiting redemptions.

“Our customers have worked hard to fund their retirement and we're committed to meeting their needs,” explains Frank Lombardo, Aviva group director operations. “There have been lots of discussions about the issues facing retirees but when our customers are worried we need to act now to find solutions.”

Visit Aviva Australia at

[www.aviva.com.au](http://www.aviva.com.au)



## What's happened?

### Investors' confidence has fallen

- Local stock markets in the Asia Pacific region have been significantly affected by the global economic crisis and sales of investment and investment-linked products have been negatively affected

### Prospect for continued growth across the region

- Low insurance penetration, an aging population and high Gross Domestic Product (GDP) growth indicate prospect for continued growth across the region
- Bancassurance is the fast-growing channel in the emerging markets of China and India

## What action have we taken?

### Leveraged bancassurance expertise in new and emerging markets

- New bancassurance partnerships have been formed to consolidate our strong position in the high growth potential markets of India and China
- Focused on developing successful bancassurance partnerships with our JV partners in new markets of Malaysia, Taiwan and South Korea

### Realising synergies across the region

- Substantial investment made to expand our distribution network and optimise our shared service model into high growth potential and new markets

### Developing and retaining talent

- Launched a series of initiatives aimed at building our employee brand and developing our top leaders

### Exceptional performance in developing markets

- We achieved exceptional growth in the developing China market and had a successful first year of operations in Taiwan along with promising sales in new markets such as South Korea

## What have we achieved?

Total sales		MCEV operating profit		IFRS operating profit	
<b>£3,499m</b>		<b>£69m</b>		<b>£36m</b>	
2007 restated: £4,283m		2007 restated: £101m		2007 restated: £37m	
PVNBP	£1,720m	Long-term savings		£79m	
Investment sales	£1,746m	Fund management		£13m	
Net written premiums	£33m	General insurance		–	
	<b>£3,499m</b>	Other operations		£(23)m	
				<b>£69m</b>	

## What's next?

### Our medium term targets are to:

- Prioritise our portfolio
- Develop the regional operating model
- Invest in the markets with the best opportunities

## Business review

## Asia Pacific continued

## Long-term savings

	IFRS operating profit £m	MCEV operating profit £m	PVNB <sup>†</sup> £m	Value of new business £m	2008 New business margin %
Asia	2	31	1,351	30	2.2
Australia	44	48	369	13	3.5
<b>Asia Pacific</b>	<b>46</b>	<b>79</b>	<b>1,720</b>	<b>43</b>	<b>2.5</b>

	IFRS operating profit £m	MCEV operating profit £m	PVNB <sup>†</sup> £m	Value of new business £m	2007 New business margin %
Asia	(6)	45	1,141	49	4.3
Australia	37	50	454	16	3.5
<b>Asia Pacific</b>	<b>31</b>	<b>95</b>	<b>1,595</b>	<b>65</b>	<b>4.1</b>

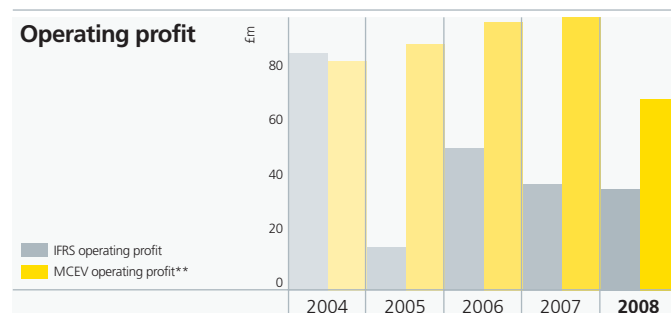
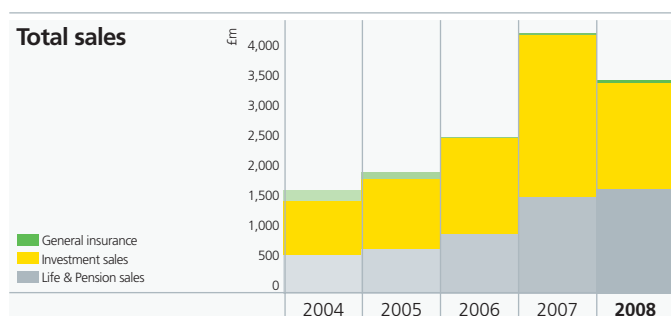
## Fund management

	Investment sales		IFRS operating profit		MCEV operating profit	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
<b>Total</b>	<b>1,746</b>	<b>2,660</b>	<b>13</b>	<b>15</b>	<b>13</b>	<b>15</b>

## General insurance and health

	IFRS operating profit £m	Combined operating ratio %*	Net written premium £m	Underwriting result £m
<b>2008</b>	<b>–</b>	<b>108</b>	<b>33</b>	<b>(1)</b>
2007	4	97	28	3

\* General insurance business only.



## Profile and strategy

We have been present in Asia Pacific for over 100 years and today operate in nine markets across this region. Our footprint spans the markets of Australia, Singapore, Hong Kong, India, China, South Korea, Malaysia, Sri Lanka and Taiwan. We are particularly focused on providing long-term savings products and believe that Asia is still an attractive region for growth due to low insurance penetration in most countries, an ageing population, a fast expanding middle class and high gross domestic product (GDP) growth.

Our ambition in the region is to establish Aviva as a leading international player in Asia Pacific and grow the business to become a meaningful part of the group. During 2008, we made significant efforts and investments to strengthen the Asia Pacific regional team which, under the leadership of Simon Machell, will lead and support the implementation of our strategy in the region.

We serve our customers through a multi-channel distribution strategy with particular strength in bancassurance and wrap administration. We have more than 50 bancassurance partners throughout the region, including major players such as Development Bank of Singapore (DBS) in Singapore and Hong Kong, ABN AMRO in India and Bank of China and ICBC in China. In addition we operate joint ventures with prestigious banks in Taiwan (First Commercial Bank), Malaysia (CIMB), Sri Lanka (National Development Bank) and South Korea (Woori Bank). We are a leading provider in the wrap administration business in both Australia and Singapore with our successful Navigator platform.

We have made important steps towards realising our ambition having achieved rapid growth in most of our markets in recent years. In 2008 we again experienced exceptional growth in China and have had a successful first year of operations in Taiwan. We started operations in South Korea in April and achieved promising sales through the bancassurance channel. Significant progress was also made in delivering our key regional initiatives. For example, the "one Aviva" regional operating model has started providing synergies in IT and product development and is enabling us to share skills and services across the group and within the Asia Pacific region.

Our strong distribution partnerships, wide footprint and regional operational model create a solid platform from which to compete effectively in the region.

## The marketplace

2008 was a difficult trading year for the financial services industry. As a region Asia Pacific is not immune to the global economic crisis and local stock markets were significantly affected.

Investor confidence dropped considerably over the year and sales of investment and investment-linked products were negatively impacted across the region.

Despite this, the Asia Pacific region remains highly attractive with markets ranging from large and mature to emerging powerhouses. The low insurance penetration in most countries, ageing populations and high GDP growth indicate that prospects for continued growth in the life and pensions industry are very good. The latest economic forecasts predict GDP growth for the region of 5.8% in 2009†.

We manage our portfolio of businesses in this region by their stage of development:

**Established:** our operations in Australia, Singapore and Hong Kong are established businesses in advanced markets.

**High potential:** we have fast-growing businesses in India and China which we consider to be the markets with the highest potential for growth in the region.

**New start:** these are relatively new businesses with strong local bank partners, located in South Korea, Malaysia, Sri Lanka and Taiwan.

\*\*On an MCEV basis for 2008 and 2007. Prior years presented on an EEV basis.

† Source: Asia Development Bank, December 2008.

## “快速响应”

“Responding quickly”



Case study:

### Emergency action

On 12 May, 2008 a devastating earthquake hit the Sichuan province of China. Tragically, tens of thousands of lives were lost in the disaster. And the challenge facing colleagues at our Aviva-COFCO Sichuan branch was enormous.

After an emergency meeting, a command centre was set up. Text messages were sent to all Sichuan customers, letting them know how to make a claim or get help. Within three days, the first claim payment of 120,000 yuan was made to a customer in Qingyi town, Mianyang city.

Aviva-COFCO colleagues later donated their bonuses to help those in the worst-affected areas, and colleagues are still working fast to settle claims.

Visit Aviva-COFCO at

[www.aviva-cofco.com.cn](http://www.aviva-cofco.com.cn)

### Established markets (Australia, Singapore, Hong Kong)

The Australian market has moved away from older style retail investment products and today over 90% of retail investments are being channelled through the wrap administration market. While current market volatility and declining investor confidence will clearly have an impact on growth in the short term, we believe that the strong fundamentals in the Australian market will enable double digit growth in both the protection and platform markets over the next decade.

Singapore and Hong Kong are relatively mature markets and are developing as offshore private wealth management hubs in Asia. As a result, demand for retirement planning and wealth management products is increasing.

### High potential markets (India, China)

India is a highly attractive market with its large population, a high gross domestic savings rate creating capital for investment, a large and growing middle class to support long-term growth and the government's commitment to economic reform.

China is also a very attractive market due to its population size and stable, rapid GDP growth. The life insurance market grew by an average of 26% per annum between 2000 and 2007 and grew by 48% in 2008<sup>‡</sup>. We believe that the low insurance penetration and changing demographics (a growing affluent class, an ageing population and the acceleration of urbanisation) will continue to fuel growth in the medium term. We are now the second largest, in terms of total premium income, of the foreign insurance companies in this market with a presence in nine provinces and 39 city branches.

### New start markets (South Korea, Malaysia, Sri Lanka and Taiwan)

We have recently started joint ventures with bank partners in markets at various stages of development. In 2008 we commenced our operations in Taiwan and established market entry in South Korea, both through joint ventures with leading local banks. These are both advanced markets with insurance penetration similar to the UK.

Malaysia is an emerging market where the government initiatives to make the country an international Islamic financing hub are expected to translate into a strong increase in Takaful business.

The life insurance industry in Sri Lanka grew by an average of 19% per annum between 2003 and 2007<sup>~</sup>. It has South Asia's fastest ageing population and the low insurance penetration has the potential to drive continued growth in the future.

<sup>‡</sup> Insurance Regulatory Commission (CIRC).

<sup>~</sup> Insurance Board of Sri Lanka, based on gross written premiums.



## Business review

## Asia Pacific continued

## Operational performance

During 2008 we have made substantial investments to expand our distribution network and optimise our "one Aviva" shared services model. This model enables us to realise synergies across the region and in 2008 we expanded the existing Singapore and Hong Kong services and introduced this into Malaysia. We remain committed to supporting expansion in high potential and new start markets to secure future profitability and growth.

As part of the shared service model we have created a regional propositions team to both anticipate changes in customer needs and to lead and coordinate the development of products and their roll out across the region. Additionally, Navigator, our Australian wrap administration platform, was successfully launched in Singapore in recent years, an example of how we are able to share expertise and provide support to developing businesses. We plan to build on this success by introducing Navigator in Hong Kong in 2009.

During 2008 we have expanded our customer reach in our local markets. In Australia, where we recently won "Life Company of the Year" at the AFA Plan for Life Awards, our strategy of taking strategic stakes in dealer groups has continued to generate additional business. We successfully acquired an interest in a further dealer group this year and now have five such strategic investments in place. In addition we have signed a bancassurance agreement with Wide Bay Australia. The sales of risk products through their branches will commence by the end of the first quarter of 2009.

In India and China bancassurance is a fast-growing channel and in 2008 we signed new bancassurance partnerships to consolidate our strong positions. We are also strengthening our multi-distribution approach by investing in new distribution channels such as direct marketing. In India, we have started up the Aviva Sales Training and Recruitment Academy ("ASTRA") and have already seen the productivity of our agents improving.

In Malaysia, Taiwan and South Korea we are focusing on developing successful bancassurance partnerships with our JV partners, leveraging Aviva's recognised bancassurance expertise.

We have focused on aligning our human resources with the strategic priorities of the business and have initiated programmes to develop our ability to harness adversity and strengthen our leadership.

The goal of making Aviva a great place to work is matched by our ambition to see Aviva recognised as an employer of choice around the region. A common talent management system was introduced across the region in 2008 along with a uniform reward and recognition programme, bringing the Aviva brand to life and taking us one step closer to achieving our "one Aviva" vision.

Finally, our aim to integrate responsible practices with corporate business strategy is now firmly embedded into the core culture of the company. In the past year we have demonstrated a strong belief in our corporate responsibility mission through a variety of social and environmental initiatives from providing aid to victims of the China earthquake to promoting micro-insurance in India. We also found ways to build corporate responsibility into our daily activities through developing energy efficiencies in the workplace, with Australia leading the charge.

## "Berkongsi kepakaran merentas perniagaan"

"Sharing expertise across the business"



Case study:

### Malaysia launches EasyLife range

Insurance ownership is still relatively low in Malaysia and in the 2008 Aviva Consumer Attitudes to Savings study, CIMB Aviva found that 35% of Malaysians said they did not understand insurance and 40% wished that somebody else could help to sort out their financial affairs.

Through sharing expertise across our Asia Pacific region, CIMB Aviva has created EasyLife, combining simple products with needs-based advice services to address the need for education. We'll complement EasyLife with a range of Easy Takaful plans in 2009.

Visit CIMB Aviva at

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

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## Financial performance

### Long-term savings

Total long-term savings sales for Asia Pacific were £3,466 million (2007 restated: £4,255 million). Within this, life and pensions sales grew by 8% to £1,720 million (2007 restated: £1,595 million). On a local currency basis, life and pension sales were 1% below the prior year and total sales down 26%.

Investment sales were down 34% to £1,746 million (2007: £2,660 million) reflecting consumers' reticence to buy investment products in the current volatile market conditions. Further to this, investment sales were adversely impacted by a change to local pension laws in Singapore, which restricts external distributions from the government pension fund, and the one-off impact in 2007 of favourable changes in Australian superannuation legislation.

In Australia, life and pension sales decreased 19% to £369 million (2007 restated: £454 million). In addition to the impact of a difficult economic climate, sales in 2007 were very strong following a one-off group pension transfer and favourable changes to superannuation legislation.

Sales of life and pensions products in Asia grew 18% to £1,351 million (2007 restated: £1,141 million). This was driven by 66% growth in China, following significant expansion of our distribution network, and first-time contributions from our new joint ventures in South Korea and Taiwan. This growth was partly offset by results from our other Asian operations. In India and Singapore regulatory changes had a negative impact on our sales while in Hong Kong our products are mainly investment related and were therefore greatly impacted by the market volatility.

MCEV operating profit for our long-term businesses decreased by 17% to £79 million (2007 restated: £95 million). Lower value of new business of £43 million (2007 restated: £65 million) mainly reflected the lower volumes in Hong Kong, a change in lapse assumptions in India, following regulatory changes to a number of products, and the one-off benefit in 2007 from legislation changes in Australia. These, together with the impact of the start-up businesses in South Korea and Taiwan and changes in business mix to lower margin products in China and India, resulted in a lower new business margin of 2.5% (2007 restated: 4.1%).

On an IFRS basis, operating profit from the long-term businesses improved to £46 million (2007: £31 million) due to lower new business strain from reduced sales and changes in the business mix.

### General insurance and health

Net written premiums in the general insurance and health businesses increased to £33 million (2007: £28 million). This mainly reflected the contribution from Malaysia which commenced operations in July 2007.

Operating profit of £nil (2007: £4 million) included the costs of the closure of the Malaysia motor portfolio.

### Outlook

Despite the global economic and financial turbulence, Asia remains an attractive growth region. In 2009, while we will continue to grow the business in line with the market we will also focus on the efficient use of our capital. We have a sound business in Asia Pacific with successful, established partnerships and a strong financial position and we remain committed to building a strong presence in this region.

"Working together  
in times of crisis"



#### Case study:

#### Facing up to disaster

Colleagues at Aviva Australia pulled together in response to the recent Victoria bushfire disaster.

At Aviva Australia headquarters in Melbourne, Victoria's state capital, determined colleagues immediately assisted with the aid effort. Within days, they'd donated over AUD\$20,000 to the Bushfire Appeal.

Free counselling was also offered to any staff member affected by the disaster. Allan Griffiths chief executive officer of Aviva Australia, was understandably proud of the magnificent response.

This is what Aviva is all about.

Visit Aviva Australia at

[www.aviva.com.au](http://www.aviva.com.au)



## Business review

## People and responsibility

**What we do**

Our People and Corporate Responsibility strategies promote the delivery of the Aviva purpose and vision. We work on getting great people to join Aviva and stay and engaging all 54,000 Aviva employees on corporate responsibility. We help our businesses embed best practice in CR and take a leading role in our industry to share our successes and challenges. Our aim is to make good business a part of everyone's thinking so that together we can make sure Aviva is responsible in everything we do.

A photograph of a woman wearing a straw hat and white gloves, planting flowers in a garden. She is in the foreground, looking down at the plants. In the background, another woman is visible, also working in the garden. The garden is filled with various green plants and flowers, including purple daisies in the foreground. The background shows a dense line of trees.

“Actions, not just words”

**Case study:****67,000 hours – employee volunteering takes off**

Our people are voting with their feet on the benefits of helping local communities. In just two years the number of paid employee volunteering hours has nearly doubled (34,000 hours in 2006). Employees can now take up to three paid days per year to support the causes they care deeply about. With individual and team-based opportunities, it's a great way to engage with charities and bring new skills back to Aviva.

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## What's happened?

### Economic uncertainty

- The credit crunch has undermined consumer confidence in financial services. Building trust and improving the public's understanding in money matters is a societal imperative

### Environmental concern

- Climate change remains one of the biggest risks to our planet. Global businesses are intensifying their efforts to reduce their own impacts and influencing partners and suppliers to take up the challenge

### Employment market changing

- Increasing competition to attract and retain talented employees is joined by the need to equip future leaders with the right skills to excel in tough market conditions

## What action have we taken?

- Published five year, industry-leading research into consumer attitudes to saving
- Continued to reduce our own emissions through innovative initiatives and encouraging other companies as well
- Funded off-setting projects to maintain our carbon neutral status and introduced three new initiatives in our Sustainable and Responsible Investment (SRI) portfolio
- Strengthened our community investment activities to tackle global issues in financial literacy, education and life trauma
- Launched "Summits" for 1,700 senior managers, designed to align, equip and mobilise the group to deliver the "one Aviva, twice the value" vision
- Extended our "Talking Talent" programme to identify, manage and develop talent across the company

## What have we achieved?

- 72% of our employees say that Aviva is a great place to work (Global Survey)
- Retained our membership of the FTSE4Good and Dow Jones Sustainability World indexes
- Won "Building Public Trust" award for clear and transparent reporting of our executive remuneration policy
- Ranked 9th out of all UK companies in the Good Companies Guide for our work to shape policy and promote consistency in climate change issues
- Increased participation by our employees in our Corporate Responsibility (CR) activities

## What's next?

### Our short- and medium-term targets are to:

- Meet or exceed tough global targets to reduce our emissions
- Support and inspire all our employees to be the best they can be
- Continue to embed CR programmes across all our businesses around the world
- Build more innovative ways of engaging employees and customers in our community involvement activities
- Report against our progress and build our programme of engagement with stakeholders on key issues

## Business review

## People and responsibility continued

## Governance and strategy

The Aviva corporate responsibility (CR) programme encompasses our business ethics and values, our customers, our people and suppliers, our community relations and the environment. When conditions are adverse, as in the current economic downturn being experienced by businesses and customers globally, it's more important than ever to maintain our reputation as an employer of choice and a responsible corporate citizen. This means responding appropriately to immediate events. It also means staying focused on important goals that will contribute towards long-term prosperity and peace of mind for our customers.

Combating climate change is just such an issue and therefore an important part of our CR strategy. The actions we've taken over several years have resulted in our carbon emissions falling by a further 6.63% this year. Sustainable commercial growth is equally vital for the future of Aviva, our shareholders, customers and employees. However, operating in new markets, particularly emerging economies, brings with it not only opportunities for Aviva and the prospect of better financial security for our customers but also responsibilities and challenges for the group. Specifically, as an employer and also as a buyer of goods and services, we must apply consistently high standards wherever we operate internationally. We also look to the companies in which we invest to demonstrate their own socially responsible strategies, and this year we announced three new initiatives that further strengthen our sustainable and responsible investment (SRI) portfolio. Among these is the Aviva Investors European Renewable Energy Fund which specialises in developing and financing renewable energy projects in the EU.

Our governance structure is designed for responsiveness to risk as well as opportunity. This enables us to identify issues, mitigate adverse impacts and maximise positive ones. Our CSR committee, chaired by non-executive directors Wim Dik in 2008 and Carole Pivnicka from 1 January 2009, approves our CR strategy, policies and plans, and reports to the board at regular intervals during the year. The committee's report can be found on page 99. Our CR advisory group, reporting to the executive committee, is a forum for dialogue between our regions and our CR specialists at group level. It gathers and analyses perspectives from all around Aviva, helping to ensure that CR strategies are fully informed by insights from the broad spectrum of our business.

In everything we do, we aim to meet the highest standards of conduct and these principles are set out in our business ethics code. This year we implemented a revised code which reinforces the standards expected of all our employees and businesses. Every single employee at Aviva has a part to play in upholding our standards and our success comes from their commitment to translate principles into action, whatever their role or level of seniority. That's why our people strategy is at the heart of our business and why we invest in comprehensive programmes to nurture talent, develop future leaders and enable people to fulfil their potential in line with our values of integrity, performance, progressiveness and teamwork.

The key elements of our people and responsibility strategy are:

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Getting great people to join Aviva and stay

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Matching the right people to the right roles and taking action where there are gaps

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Getting the best out of people while they are here

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For the next three years we are focused on:

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Improving how we identify, develop and use our employees' talents

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Cultivating and inspiring excellent leadership

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Engaging our people and customers with exceptional CR initiatives

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Using rewards to focus senior leaders on our shared goals

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Recognising each of our people – the difference each of us makes

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We will achieve this through:

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Empowering regional HR teams and building strong centres of expertise

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More regional shared services, common processes and benchmarks

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Pursuing the cultural change we started with the Summits programme

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Delivering on our CR agenda

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## Our People

## Employee Promise

To become "one Aviva" and deliver "twice the value" we are reinforcing our external brand of recognising our customers as individuals. To ensure that this is how all our customers experience Aviva we have embarked on a global programme to create a culture where this lives and breathes internally so our employees are truly recognised as individuals and for their contribution to Aviva's success.

This is the overarching aim and promise to our employees which our HR and People practices support. The programme consists of:

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A global intranet "Aviva World" for communicating across Aviva which encourages collaboration and an opportunity to get to know other employees as individuals right across the globe

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Management and leadership programmes which create the environment for employees to be the best they can be, ie Leading People, Talking Talent & Talking Performance

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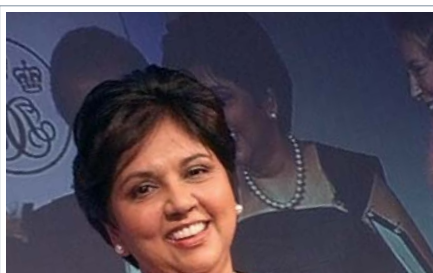
A global climate survey to ensure we are listening to what is important to our employees and a new online "employee promise" poll

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A day when we will celebrate our global status, joining together and sharing in activities which support our strategy

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## "Supporting good causes"



Case study:

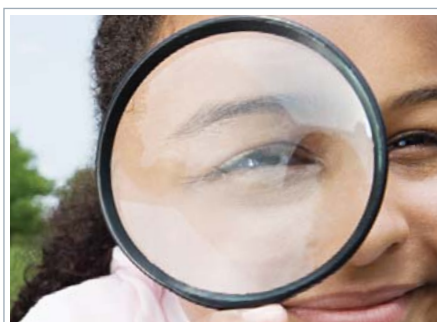
### Women Empowerment award

Aviva sponsored the first ever Global Empowerment Award at the Women of the Future Summit. This was presented to Indra Nooyi, CEO of PepsiCo, by HRH Princess Michael of Kent and Louella Eastman, group CR director at Aviva plc.

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[www.aviva.com/csr](http://www.aviva.com/csr)

## "Great reporting"



Case study:

### Conducting our business openly

Clear and transparent communication about how we conduct our business is a fundamental principle. Aviva's 2007 remuneration report (in the annual report and accounts) was recognised as such, by winning the 2008 "Building Public Trust" award. These prestigious awards celebrate the best of corporate reporting by the UK's leading quoted companies and public sector bodies. The judges found Aviva's approach to be "great reporting" and "innovative", describing the report as "a very clear summary of remuneration policy". The judges believe winners are helping to set the standards of excellence in reporting that all organisations can aim for.

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[www.aviva.com/csr](http://www.aviva.com/csr)

### Mobilising our leaders in adverse conditions

Our Leadership Academy work focused on "Summit" events designed to align, equip and mobilise Aviva's leaders to deliver "one Aviva, twice the value". 1,700 of our senior leaders participated in one of 16 major events around the world. This programme has been the biggest, most concentrated investment in our leadership capability. Each leader was equipped to measure and improve their ability to respond at their best in adverse conditions. Within the 1,700 leaders, 120 were identified as "climbing coaches" – change agents who are equipped with the skills to embed the Summit knowledge across the business. There has been a demonstrable improvement in clarity, engagement and personal commitment to bring "one Aviva, twice the value" to life.

### Talent management

Our Talking Talent programme, initiated in 2007, is a globally consistent approach to identify, manage and develop talent right across the group. Initially introduced to the top 400 leaders in the organisation, we are delighted with the enthusiasm with which it has been received around the world. The programme has been rapidly extended to other levels of the organisation, including all employees in the UK life business.

### Leading people

We believe that developing leadership capability is an investment in our future. This is confirmed by our employees who told us in our 2008 annual global climate survey that the way their immediate managers behave impacts on their own engagement and performance.

Our leadership development programme focuses our people managers on six outcomes which cause sustainable high performance by creating a team environment where people can give of their best. Now in its second year, activity has been focused on managers building relationships based on open and honest two-way feedback. An online feedback tool was introduced and will be freely available to all people managers from January 2009.

Our objectives for 2008 were to create the tools and awareness required to bring about a substantial change in the way we maximise the skills of our people. To this end, an extensive toolkit for HR, guidelines, training plans, handbook and performance management process have been delivered. We are already seeing change, with 87% of our employees agreeing that they "are clear what's expected of them" in their day to day job (2008 global climate survey).

We are continuing to embed this approach as a priority in 2009 with a focus on training and continued measurement.

### Financial crime

The CR policy ensures that all employees are aware of our commitment to integrity through ethical and honest business practices. This is underpinned by our financial crime policy which ensures that the risks of fraud, money laundering and market abuse are adequately controlled and reinforces our zero tolerance approach to financial crime.

We rely on our employees to raise concerns about ethical behaviour and financial crime and have recently implemented "Right Call" – an Aviva-wide malpractice reporting service. This enables all employees to report any suspicions or concerns in a confidential manner for independent investigation.



## Business review

## People and responsibility continued

## "Raising funds for charity"



Case study:

**The Eve Appeal and Aviva Women's Network**

The London group of the Aviva Women's Network hosted a range of events this year, including a unique tea party to raise funds for The Eve Appeal, a UK charity which seeks to cut the number of deaths from gynaecological cancer by 50%. While the event had a very serious purpose, it also gave women from different areas of the business the opportunity to meet and network.

Visit Aviva CSR at

[www.aviva.com/csr](http://www.aviva.com/csr)**Corporate Responsibility****Engaging with our stakeholders**

Dialogue with a wide range of internal and external stakeholders, using a variety of feedback mechanisms from surveys to one-to-one meetings, is an essential part of our business strategy. We also participate in industry-wide forums and work with professional institutions to develop our research and understanding in key subject areas.

**Diversity, equality and human rights**

The Aviva principles and policies embody the key tenets of respect, valuing differences and inclusion and are aligned with the United Nations Universal Declaration of Human Rights (UNUDHR). In fact, our programmes have been recognised as going above and beyond the level of activity of many companies to ensure respect, fairness and equality among our employees.

Representation of female colleagues within the senior management group increased from 22% in 2007 to 28% in 2008. We have appointed the first female member to our executive committee this year, and we now have three women on the board. Amanda Mackenzie joined the executive committee in March 2008 as chief marketing officer. Rita Dhut and Siobhan Boylan from Aviva Investors were named in *Financial News*' "100 Most Influential Women".

Employee networks such as the Global Senior Women's Network and Pride Aviva strengthen our diversity agenda and continue to thrive. This year, Pride Aviva, an employee network for lesbian, gay, bisexual and transgender professionals, launched its first national e-magazine. We also improved our position in *Stonewall's* "Top 100 employers for gay people in Britain" to 78th place.

**Employee survey**

We carried out our global climate survey for the fourth consecutive year, providing our employees with a channel to express their feedback. Our overall participation rate increased to 74% (2007: 70%) with four business units achieving 100% participation.

Our senior management pay is linked to the climate survey results through clear targets on leadership and engagement. We pay special attention to action planning using the results and for the first time held action planning workshops in each region. We also draw up a global action plan to address employee issues worldwide. Progress on these plans is then shared with employees before the next survey cycle.

**Community**

As a responsible business, we are committed to helping address challenges facing people and society. Globally, Aviva invested £9.6 million in community and charitable programmes in 2008. Our community investment is focused on financial literacy, education and life trauma – subjects which are closely aligned with our business and where we can maximise our expertise and resources to make a difference. In addition to this core programme, we also respond to humanitarian crises, as and when they arise, through our partnership with Oxfam. How we invest takes different forms: from directly funding carefully selected initiatives in partnership with charitable organisations, to creating a workplace where employee volunteering and giving is enabled and supported. With this in mind, our colleagues can now apply for up to three paid volunteering days. As a result, our businesses around the world have seen a significant increase in community volunteering among their people.

Here are just a few examples of how we have played our part this year:

#### Responding to global crises

- As a member of the Oxfam 365 Alliance, our funding enables the charity to respond immediately when an emergency occurs, delivering vital services and supplies around the world. Last year our employees in China also gave their time and donated generously to help the earthquake victims in Sichuan – please see page 67

#### Motivating the next generation

- The Climate Change Champions project in the UK is harnessing the energy of Norwich Union volunteers to help schoolchildren to save energy. Twenty nine schools took part in 2007/08, reducing their carbon footprint, securing environmental pledges from the public and celebrating their success at a House of Commons reception

#### Increasing access to education

- Eagle Insurance in Sri Lanka provided its eighth batch of scholarships to support students through their university degrees, bringing the total of student awards made since 1994 to 336

#### Building awareness among our employees

- Aviva SA, our business in Turkey, has designed an online training programme to educate staff about CR, and this is the first of its kind in Turkey. Aviva SA also launched their first volunteering programme, to produce audio books for people in need

## Environment

Our environment strategy focuses on working within our spheres of control, influence and concern. Within our sphere of control we manage our own impact and use of resources including electricity, gas, water and waste. We are also committed to using our influence as an investor to encourage other organisations to adopt responsible strategies. Finally, we aim to promote environmentally aware choices among individuals, including our employees and customers.

Work on reducing our impact on the environment continued at pace this year. We again reduced our carbon emissions by more efficient use of energy and by implementing alternatives to business travel such as our high definition video-conferencing facility. To help us manage our impact we set global targets in 2008 to achieve reductions by 5% in carbon emissions and 2% in water. When we compare our global operations' performance to 2007 on a like-for-like basis, our total emissions fell by 6.6%. Overall, we achieved a group-wide reduction in carbon emissions of 3.3%. This figure includes data from our operations in China for the first time. Our water consumption fell by 1.2%. We review these targets annually and provide new ones based on our performance to date. For 2009 we have set the following targets:

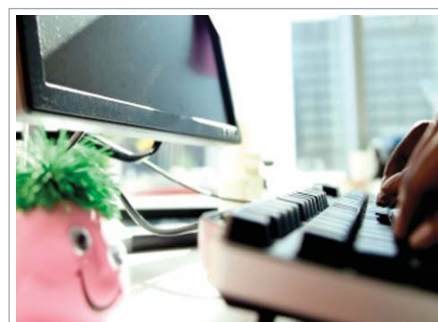
Reduce CO<sub>2</sub> emissions by 5%

Reduce water use by 4%

Reduce waste by 4%

Increase percentage of recycled waste by 2% (until 80% recycled rate is achieved).

“We like it here”



Case study:

### Global participation increased to 74%

72% of employees consider Aviva a great place to work.

Since we introduced our global climate survey four years ago, employee participation levels have risen and we've gathered valuable feedback on all areas of our business. In 2008, we saw an increase in positive attitudes in every area of the survey compared to 2007, including Aviva's leadership, understanding of company values and levels of engagement. More employees said they felt more customer focused and empowered in the workplace. Awareness of Aviva's diversity policies and practices was also higher than 2007 and more employees felt that their talents were being managed effectively by their managers.

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[www.aviva.com/csr](http://www.aviva.com/csr)

## Business review

## People and responsibility continued

Our senior managers view our carbon target to be so significant that it is included in each regional chief executive's personal objectives. To help improve the quality of our data we introduced an online CR data collection and reporting tool.

As the first insurer to be carbon neutral on a global basis we continue to be committed to offsetting activities. This year we have continued to support renewable energy projects in developing countries where Aviva has a presence. Our signature project was in the Sichuan province of China, providing clean and renewable energy by way of a small-scale run of river hydro project. As well as reducing pollution in the area, this project has provided much needed skilled employment for the local region.

We've also been concentrating on water this year as it is a major issue relating to climate change. Our customers are seriously affected when flooding occurs so it is important to us to help people be prepared. To this end we have pioneered a flood planning process to highlight to a whole community ways to deal with a flood and how damage can be limited.

Part of our strategy is to share knowledge with our employees so that they can reduce their environmental impact at home. We have developed an interactive game to show our employees where they can make savings at home, at work and at play and put together an employee engagement action pack to help our businesses. This provides them with the technical information they need to support employees to make a difference, including a list of top tips for reducing carbon emissions.

Our Australian business offers a financial incentive to employees to purchase renewable energy or water saving devices for their home. They will match fund the government's rebate of up to A\$300, which makes these purchases more affordable.

We believe it is important to raise awareness of climate change and influence others. An example of this is the solar powered boat, sponsored by Delta Lloyd, which won the Frisian Solar Challenge race in the Netherlands this year. We also think it's important to research ways to reduce the impact of climate change and this year we have committed to a five year research partnership with Earthwatch. This includes funding a project to research the potential of mangrove trees to provide an economic model for avoiding deforestation and ensure the sustainability of these natural flood defences in Kenya.

## Customers

Satisfied customers are a key measure of success and our purpose, to provide prosperity and peace of mind, guides every interaction, from customer service to responsible selling and marketing. Product innovation, to meet people's changing life needs, is an essential element in all our markets.

In France, we are increasingly integrating CR principles into our products, and offer lower home and car insurance premiums to customers who act more safely, and who make environmentally and socially responsible choices. There are also incentives for our French policyholders to stop smoking and so reduce the risks to their health.

In the Netherlands, Delta Lloyd and ING have launched the first insurance for automatic external defibrillators (AEDs) and this is at cost price. This is in response to the Dutch Heart Foundation's campaign on the importance of immediate resuscitation and the use of an AED in the event of a cardiac arrest.

As a global insurer, we take pride in understanding the specific needs of our customers, wherever they are in the world. In India, we have developed a range of financial products and services to help the underprivileged and combat poverty. The micro-insurance plan, Grameen Suraksha, reduces the burden on its rural policyholders (who now number more than 1.1 million) who pay premiums for just two years and then realise the term benefit for five or ten years. And India's first comprehensive child care plan, Aviva Little Master, is designed to take care of the current and future needs of children should they be orphaned.

## "Putting something back"



Case study:

## Offsetting our carbon emissions

As part of our climate change strategy, we retrospectively offset our outstanding carbon. In rural areas of East Africa we have joined forces with co2balance to replace the use of open fires for cooking with energy efficient stoves. As well as providing 70% more energy efficiency, there are social and economic benefits. More efficient stoves means less wood is burnt, so helping to prevent deforestation. And as the stoves are built within the villages employment is created in local areas.

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Case study:

### Mangrove trees and carbon sequestration

The capture and storage of carbon (or sequestration) is an important area of research in climate change mitigation. We are providing five-year funding for an investigation led by Earthwatch, the international environment charity, into the sequestration potential of mangrove swamps in Kenya. The project will also inform an economic model for avoiding deforestation and ensure the sustainability of these natural flood defences. The research supports our commitment to provide carbon finance in Africa where we believe there is an urgent need. It will demonstrate exactly how much carbon can be stored in mangroves over time, and will lead to the development of carbon credit verification.

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“Helping for the future”

This year also saw the launch of three new SRI initiatives by Aviva Investors:

The inclusion of the UN Principles for Responsible Investment (UN PRI) in our contracts. This enables clients to see the PRI assessment of our performance and hold us to account for delivery on our responsible investment commitments

The introduction of a broader AGM voting remit on corporate responsibility for all global holdings on the MSCI global index

The creation of a new sustainable fund specialising in renewable energy projects including solar photovoltaic, geothermal, biomass, biogas and wind assets

### Suppliers

We understand the importance of responsible business practices within the supply chain and recognise the influence that our organisation can have. This year we have developed our position by chairing the Financial Services Purchasing Forum CSR sub-group which aims to promote a coordinated and standardised approach to managing CR issues in the supply chain. Ethical, social and environmental considerations are already part of our procurement processes: we give each new supplier in the UK a minimum 10% CR weighting when reviewing new tender submissions.

### External benchmarking

Our achievements in 2008 were recognised by our continued inclusion in some of the leading external benchmarks:

Dow Jones Sustainability World Index

2008 SAM (Sustainable Asset Management) Bronze Class / 2009 inclusion in SAM yearbook

FTSE4Good Index Series

ECPI Ethical Index Euro and Ethical Index Global indices, received second highest EE+ rating

Accountability rating – ranked 45th out of the world's 100 largest companies

The Guardian/Observer Good Companies Guide – ranked 9th out of FTSE 350 companies

Carbon Disclosure Project Leadership Index – score of 83 out of 100

### Affiliations and engagements

We engage externally with leading organisations to share good practice, improve our performance and ensure the effectiveness of our CR strategies. Among much other collaboration in 2008, we contributed to and signed our support to the following:

CBI Climate Change Board

Prince of Wales Accounting for Sustainability

ClimateWise – Aviva was one of the leading companies to be recognised in the Forum for the Future ClimateWise programme review

UNEP Finance Initiative

UN Global Compact Caring for Climate

## Business review

## People and responsibility continued

## Accounting for sustainability: climate, waste and resource impact

## Key indicators

## Greenhouse gas emissions

CO<sub>2</sub> emissions

Other significant emissions

## Direct company impacts

## Cash flow performance

CO<sub>2</sub> emissions

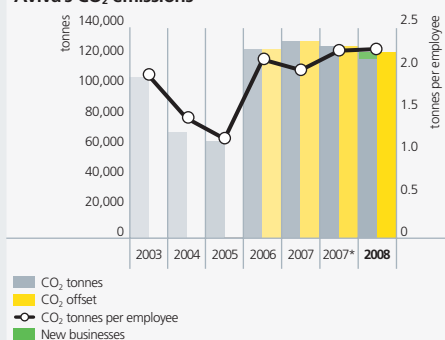
Total cost of offsetting 105% of our global CO<sub>2</sub> emissions – 128,931 tonnes in 2008 – was in the region of £750,000. We incur up to a 2% premium for zero emission/ renewable electricity compared to fossil fuels. Following the publication of the 2008 UK DEFRA carbon reporting guidelines, at the end of our current electricity contract we will no longer pay a premium for zero emission electricity in the UK.

2008 has been a benign year for weather related claims, although we do see a trend in the increased incidents of such events and believe the occurrence of these will rise with climate change.

## Other significant emissions

Our operations do not generate material quantities of any other significant greenhouse gases.

## Non-financial indicators

Aviva's CO<sub>2</sub> emissions

\* The 2007 CO<sub>2</sub> emissions has been restated. Each year the conversion factor for electricity generation varies. We therefore need to restate these figures every four years. We are restating the 2007 figures accordingly.

## Waste

Hazardous and non-hazardous waste

Conservation investment

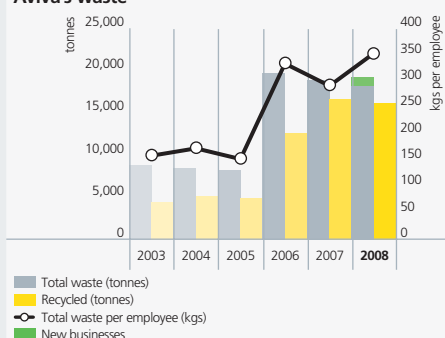
## Hazardous and non-hazardous waste

Total disposal cost for hazardous and non hazardous waste in the UK was £629,000 (2007: £464,000), which includes UK landfill tax.

## Conservation investment

Total capital expenditure for storage and recycling in the UK was minimal (2007: £200,000).

## Aviva's waste



## Resource usage

Water

Energy intensity

Paper usage

Environmental incidents

## Water

The operating cost of water usage was £944,000 in 2008 (2007: £938,000).

## Energy intensity

Total cost of building-related energy in 2008 was £18.2 million (2007: £20.4 million).

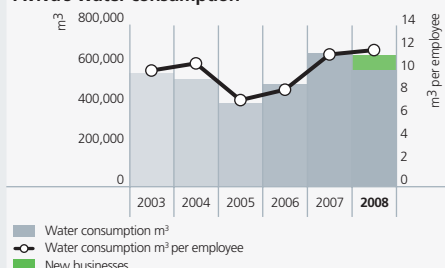
## Paper usage

We currently do not track the cost of paper usage.

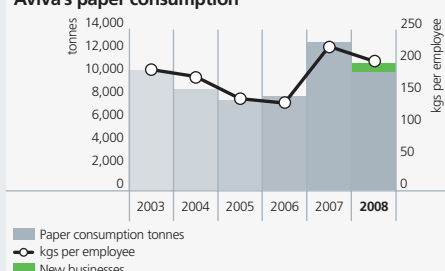
## Environmental incidents

During 2008 there were no environmental incidents as a result of our operations, resulting in fines of £nil (2007: £nil).

## Aviva's water consumption



## Aviva's paper consumption



## Commentary on our performance, strategy and targets

In 2008, our total CO<sub>2</sub> emissions decreased with all businesses reporting consistently on their footprint and applying practices to reduce their emissions. They have achieved this by using technologies, changing behaviours, and by purchasing zero emission and renewable electricity. We anticipate our carbon footprint reducing to 108,000 tonnes in 2009 through our divestment of AutoWindscreens and AGS – 10,000 tonnes – and by reducing business travel. There will be an increase from our new data centre reaching full capacity but expect that this will reduce over time through a programme of virtualisation and consolidation of data.

Our RAC business has fitted speed limiters on its breakdown vehicles providing an anticipated saving on fuel and associated carbon emissions of 7.4% over the year to October 2009. We are trialling retrofitted hybrid drive systems on two of the breakdown vehicles which could save up to another 25% in associated emissions in 2008/09. We will continue to purchase zero emission/ renewable electricity where it is practical to do so. Currently 65% (2007: 61%) of our electricity worldwide is purchased from zero emission sources. Our remaining emissions will continue to be offset on a retrospective basis compensating for the carbon output of our consumption of non-renewable sourced electricity, gas and oil from buildings and business travel.

In 2008, the total volume of waste generated has increased globally by 2% and the proportion of waste recycled has decreased by 4% on 2007 data to 84%. Our waste figures will reduce by some 6,000 tonnes due to the divestment of AutoWindscreens.

The learning from our bin-less office system is being applied to the Canadian business in 2009 and complements their efforts in 2008 around the composting of organic waste.

The rebranding of our businesses in the UK, Ireland and Poland to Aviva in 2009 and 2010 will inevitably generate increased volumes of waste. This however, is being closely monitored to ensure this waste is kept to a minimum.

Our focus on water reduction increased in 2008; the Aviva's businesses in the UK set a target of 10% reduction. Trials of flow straighteners for taps, reduced water consumption urinals, and water saving devices on toilets cisterns have been successful, resulting in a combined reduction to 5.5m<sup>3</sup> per employee per year at the test locations. A group target of 4% has been set for 2009, through the sharing of these good practices around the world.

Our energy strategy is to invest in new energy saving technology and to reduce our energy dependency on fossil fuels. We are prepared to pay up to 2% premium for purchasing electricity from renewable/zero emission sources.

We have trialled the use of boiler optimisation valves fitted to all our boilers. The trial suggested a reduction in gas use of 15% and our investment of £154,000 should see a positive return in just 38 weeks.

Capital expenditure work on energy conservation is proceeding with a payback period of less than 3 years.

Our strategy is to increase the use of recycled content paper, while reducing overall paper use. Cost and quality of recycled papers are now comparable with virgin content paper.

We have introduced self selection options, which enable policyholders to receive and save policy documentation online, thus reducing paper usage, printing and postage cost.

## Indirect impacts

### Products/Suppliers/Investments

We anticipate having a complete UK carbon footprint of the properties we own through our Property Fund managed by Aviva Investors. Under the new UK Government Carbon Reduction Commitment scheme, electricity gas and oil used in the properties will be subject to an additional cost of £12 per tonne.

We regularly review the viability of new products and services which can encourage customers to reduce their own CO<sub>2</sub> emissions. Our Prestige Property Owners Policy includes a free energy assessment, advice and guidance on energy saving technologies and reassessment to demonstrate improvements.

This year the UK general insurance business worked with public bodies to create a best practice template in flood planning, involving local authorities, emergency services and utilities companies. The planning should help improve response times, raise awareness and reduce damage. See [www.floodplanuk.org](http://www.floodplanuk.org). This development complements the work completed earlier in the year. See [www.floodsim.com](http://www.floodsim.com)

Aviva Investors' new European Renewable Energy Fund specialises in developing and financing renewable energy infrastructure projects in the European Union. The Environmental Technology Fund and New Energy Fund managed by Delta Lloyd asset management business and the Renewable Energy and Clean Technologies fund in Aviva Spain focuses on climate change mitigation.

We are working with our upstream partners to eliminate waste from the business through take back of packaging and switching to biodegradable wrapping etc. Environmental clauses are included in contracts with suppliers. Each new supplier has to sign up to Aviva's CR Supplier Code of Conduct – focusing on environmental impact as well as human rights and social issues.

We adhere to all building regulations (insulation, proper disposal of waste material including building waste and white goods) and we are members of a responsible motor repair network which disposes of waste and spare parts in accordance with sustainable environmental practices.

Work is continuing with our marketing departments and suppliers to provide marketing materials with recycled content and remanufactured stationery products.

Shareholders have been asked to make the switch to receive company information electronically including the electronic transfer of dividends.

## Industry

### Benchmark information

Carbon Disclosure Project Leadership Index  
Score 83 out of 100

BREEAM minimum ranking "Good" for new build and refurbishment

200 kgs of waste per employee per year

Recycling rate of 60–70% (BRE Office toolkit)

7.7m<sup>3</sup> per employee per year. (National Water Demand Management Centre)



Business review

Basis of preparation

This business review complies with the recommendations of the European Union (EU) Modernisation Directive, the Companies Act 2006 (Contents of Directors’ report: Business review) and is in line with current best practice. It is addressed to, and written for, the members of Aviva plc with the aim of providing a fair review of our business development, performance and position at the current time. In producing this review, we aim to present a view that is balanced and comprehensive and that is consistent with the size and complexity of our business. The review is written in the context of the risks and uncertainties facing our business. We anticipate that the format and content of the review will evolve over time, along with developments in our business and the external environment.

Key Performance Indicators

The Companies Act requires that a fair review of the business contains financial and, where applicable, non-financial key performance indicators (KPIs). We consider that our financial KPIs are those that communicate to the members the financial performance and strength of the group as a whole. These KPIs comprise:

Earnings per share (International Financial Reporting Standards basis)
Proposed ordinary dividend per share and dividend cover
Operating profit (Market Consistent Embedded Value basis)
Operating profit (IFRS basis)
Long-term new business sales (PVNBP)
Return on equity shareholders’ funds

Management also use a variety of Other Performance Indicators (OPIs) in both running and assessing the performance of individual business segments and units, rather than the group as a whole. OPIs include measures such as new business margins, combined operating ratio and underwriting profit.

In addition to reporting on our financial performance, it is important that as a forward thinking company we are aware of our wider responsibilities and report on the non-financial aspects of our performance. We consider that our employees and customers are fundamental to the success of our business; as such, they form the basis for our non-financial measures, and include:

Leadership and employee engagement
Customer satisfaction

Forward-looking statements

This business review contains “forward-looking statements” about:

Our future plans
Our current goals
Our expectations of our future financial condition, performance and results
By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events that are beyond our control. For example, certain insurance risk disclosures are dependent on our choices about assumptions and models, which by their nature are estimates. As such, actual future gains and losses could differ materially from those that we have estimated. Other factors that could cause actual results to differ materially from those estimated by the forward-looking statement include, but are not limited to:
Global economic business conditions
Monetary and interest rate policies
Foreign currency exchange rates
Equity and property prices
The impact of competition, inflation and deflation
Changes to regulations, taxes and legislation
The timing and impact of acquisitions and business combinations in relevant industries
Natural and other disasters
Changes to consumer saving and spending habits
Our success in managing the above factors

Consequently, our actual future financial condition, performance and results could differ materially from the plans, goals and expectations set out in our forward-looking statements. We undertake no obligation to update the forward-looking statements contained in this review or any other forward-looking statements we make.

Accounting basis of preparation

In addition to presenting our results and financial position on an International Financial Reporting Standards basis, we also use Market Consistent Embedded Value (MCEV) as an alternative performance measure. Details of the accounting basis of preparation are set out on the following page.

## Accounting basis of preparation

### International Financial Reporting Standards (IFRS)

Our consolidated financial statements are prepared under IFRS, using standards issued by the International Accounting Standards Board (IASB) and endorsed by the EU. In addition to fulfilling this legal obligation, the group has also complied with IFRS as issued by the IASB and applicable at 31 December 2008.

The financial data contained in the report and accounts has been prepared using the group's accounting policies set out on pages 125 to 139. Where applicable, the financial statements have also been prepared in accordance with the Statement of Recommended Practice (SORP) on accounting for insurance business issued by the Association of British Insurers (ABI) in December 2005, as amended in December 2006.

Following a review of our general insurance reserving policy, we have restated the 2007 comparative figures to discount our long-term latent claims provisions. We have also reviewed our policy on the consolidation of managed funds and, as a result, have made further restatements for the effect of third party participation. Details are given in note 2 to the financial statements.

### Market Consistent Embedded Value (MCEV) basis of reporting

We present the results and financial position of our life and related businesses on an MCEV basis, in addition to the IFRS basis. MCEV methodology represents a more meaningful basis of reporting the value of the group's life and related businesses and the drivers of performance than IFRS methodology. This basis values cashflow from assets consistently with market prices and is consistent with the way pricing is assessed and the business is managed.

The MCEV methodology adopted is in accordance with the MCEV Principles published by the CFO Forum in June 2008, with the exception of the use of an adjusted risk-free yield due to current market conditions for immediate annuities in the UK and Netherlands and for all US contracts. Under the MCEV methodology, the total profit recognised over the full lifetime of an insurance policy is the same as under the IFRS basis of reporting. However, the MCEV basis gives a fairer indication of the profitability of business on inception. Additionally, shareholders' funds on an MCEV basis incorporate internally generated additional value of in-force business (AVIF), which is excluded for IFRS reporting. Our incentive schemes and internal management reporting are focused broadly evenly between IFRS and MCEV performance. These financial statements include supplementary information on MCEV reporting in the "Alternative method of reporting long-term business" section.

### Longer term investment return

The long-term nature of most of our operations means that short-term realised and unrealised gains and losses are shown as an adjustment to operating profit. We focus instead on operating profit incorporating a longer term investment return (LTIR). Our rates of return that we use for equity and property in our LTIR methodology are aligned with the rates that we use under MCEV principles. For fixed interest securities, we include the amortisation of premiums or discounts arising on purchase, thereby producing an LTIR that is equivalent to the gross redemption yield.

### Critical accounting policies and estimates

The preparation of financial statements requires the group to select accounting policies and make estimates and assumptions that affect items reported in the consolidated income statement, balance sheet, other primary statements and notes to the financial statements. These are set out on pages 125 to 139.

#### Critical accounting policies

The major areas of judgement on policy application are considered to be over whether group entities should be consolidated (set out in policy D), on product classification (set out in policy F) and in the classification of financial investments (set out in policy S).

#### Use of estimates

All estimates are based on management's knowledge of current facts and circumstances, assumptions based on that knowledge and their predictions of future events and actions. Actual results can always differ from those estimates, possibly significantly.

The table below sets out those items that we consider particularly susceptible to changes in estimates and assumptions, and the relevant accounting policy.

Item	Accounting policy
Insurance and participating investment contract liabilities	F & K
Goodwill, AVIF and other intangible assets	N
Fair value of financial investments	S
Impairment of financial investments	S
Fair value of derivative financial instruments	T
Deferred acquisition costs and other assets	W
Provisions and contingent liabilities	Z
Pension obligations	AA
Deferred income taxes	AB

### Future accounting developments

We continue to take an active role in the development of new accounting standards, via industry forums and working parties, and reviewing and providing comment on proposals from the IASB. Phase II of the IASB's project on insurance contracts continues to be the most significant area of development for us. We commented on the IASB discussion paper published in 2007 and continue actively to engage in the debate. We fully support the timely development of a global standard for insurance accounting that reflects the economics of our business, and are working directly and through the CFO Forum of leading European insurers, to achieve this. These developments are still at a relatively early stage, so it is too soon to assess the impact this change in accounting will have. While this standard is under development, we will continue to focus on MCEV as the best measure of value for our long-term business. We continue to monitor other major IASB projects, including financial statement presentation, liabilities, revenue recognition, pensions accounting and fair value measurement.



“We will only succeed  
by meeting  
customers’ needs”





our

## Board of directors

### Lord Sharman of Redlynch OBE

Chairman

Age 66



Appointed to the Board in January 2005 and became chairman in January 2006. Currently an independent non-executive director of BG Group plc (*utility*) and Reed Elsevier plc (*publishing*). Former chairman of Aegis Group plc (*media services*) and KPMG International (*auditors*), former deputy chairman of Group 4 Securicor plc (*security services*), former member of the supervisory board of ABN AMRO N.V. (*banking*) and a former independent non-executive director of Young & Co.'s Brewery plc (*drinks*) and AEA Technology plc (*commercial/technology*).

Chairman of the Board and nomination committee and member of the corporate social responsibility committee

### Andrew Moss

Group chief executive

Age 51



Appointed to the Board in May 2004. Joined as group finance director and became group chief executive in July 2007. Previously director – finance, risk management and operations in Lloyd's (*insurance*) and formerly held a number of senior management positions at HSBC plc (*banking*).

Member of the corporate social responsibility and nomination committees

### Philip Scott FIA

Chief financial officer

Age 55



Appointed to the Board in May 2000 and became chief financial officer in July 2007. Joined Norwich Union in 1973 and held a number of senior positions before joining the Norwich Union board in 1993. Formerly, responsible for the group's insurance businesses outside Europe and Aviva Investors, the group's UK fund management operations. Currently a non-executive director of Diageo plc (*drinks*) and chairman of the European Insurance CFO Forum.

### Nikesh Arora

Independent non-executive director

Age 41



Appointed to the Board in July 2007. Currently Senior Vice President, and President of Europe, Middle East and Africa Operations at Google (*consumer services*). Non-executive director of Bharti Airtel (*telecommunications*). Formerly chief marketing officer and a member of the management board at T-Mobile (*communications*) and held senior management positions at Deutsche Telekom (*telecommunications*), Fidelity Investments (*financial services*) and Putnam Investments (*financial services*).

Member of the nomination and the risk and regulatory committees

### Mark Hodges

Executive director

Age 43

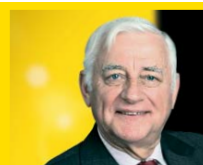


Appointed to the Board in June 2008. Joined Norwich Union in January 1991 and held a number of senior roles within the finance function before becoming finance director of Norwich Union Insurance in 1998 and managing director of Norwich Union Insurance in 2005. Appointed chief executive of Norwich Union Life, the group's long-term savings business in the UK, in April 2006.

### Wim Dik

Non-executive director

Age 70



Appointed to the Board in December 1999. Currently chairman of the supervisory board of Ziggo Holdings B.V. (*telecommunications*), a non-executive director of Unilever N.V. and Unilever plc (*consumer*), of LogicaCMG plc (*computer services*) and vice-chairman of Stage Entertainment B.V. (*entertainment*). Former Minister for Foreign Trade in the Netherlands. A former chairman of Nederlandse Unilever Bedrijven B.V. (*consumer*) and former chairman and chief executive officer of KPN Royal Dutch Telecom (*telecommunications*). A former chairman of the supervisory board of Holland Casino (*gaming*) and of Tele Atlas N.V. (*information systems*), a former member of the supervisory boards of TNT Post Group (*mail services*) and ABN AMRO N.V. (*banking*).

Member of the corporate social responsibility and the risk and regulatory committees

### Mary Francis CBE

Independent non-executive director

Age 60



Appointed to the Board in October 2005. Currently senior independent director of Centrica plc (*utilities*), a non-executive director of St Mowden Properties plc (*property development*) and a director of Almeida Theatre Company Limited. A senior adviser to Chatham House and Governor of the Pensions Policy Institute. Formerly Director General of the Association of British Insurers, non-executive director of the Bank of England, Alliance & Leicester plc (*banking*) and Fund Distribution Limited and a senior civil servant.

**Chairman of the risk and regulatory committee and a member of the audit and remuneration committees**

### Carole Piwnica

Independent non-executive director

Age 51



Appointed to the Board in May 2003. Currently a member of the New York and Paris bars, a director of Naxos UK (*private equity*) and a non-executive director of Toepfer International GmbH (*trading*), Dairy Crest Group plc (*dairy foods*) and a member of the biotech advisory board of Monsanto (*biotechnology*). Former non-executive director and vice-chairman of governmental affairs for Tate & Lyle plc (*agricultural/industrial*) and a non-executive director of S A Spadel N.V. (*food and beverages*) and former chairman of Amylum Group (*agricultural/industrial*).

**Chairman of the corporate social responsibility committee and member of the remuneration committee**

### Richard Karl Goeltz

Senior independent non-executive director

Age 66



Appointed to the Board in May 2004. Currently a non-executive director of the Warnaco Group Inc (*clothing*) and the New Germany Fund (*investment trust*), the Central Europe and Russia Fund (*investment trust*), the European Equity Fund (*investment trust*) and a governor of The London School of Economics and Political Science. Former chief financial officer of American Express Company (*financial services*) and NatWest Group plc (*banking*). Former non-executive director of Delta Air Lines, Inc (*transport*) and Federal Home Loan Mortgage Corporation (Freddie Mac) (*financial services*) and a former member of the Accounting Standards Board (UK).

**Member of the audit and nomination committees**

### Russell Walls

Independent non-executive director

Age 65



Appointed to the Board in May 2004. Currently non-executive director of Signet Jewelers Ltd (*retail*) and chairman of its audit committee, non-executive director of Delphic Diagnostics Limited (*medical*) and treasurer and trustee of The British Red Cross. Former group finance director of BAA plc (*transport*), Wellcome plc (*pharmaceuticals*) and Coats Viyella plc (*textiles*). Former senior independent non-executive director of Stagecoach Group plc (*transport*) and Hilton Group plc (*leisure*) and a former non-executive director of the Mersey Docks and Harbour Company (*transport*).

**Chairman of the audit committee and a member of the nomination and the risk and regulatory committees**

### Eileen Goh

Independent non-executive director

Age 53



Appointed to the Board in January 2009. Currently a non-executive director of Singapore Airlines Limited (*transport*), MediaCorp Pte Ltd (*broadcasting*), DBS Bank Limited, DBS Group Holdings Ltd (*banking*) and the Singapore Exchange Limited. Former Chief Executive Officer of Standard Chartered Bank in Singapore (*banking*).

**Member of the audit and corporate social responsibility committees**

### Scott Wheway

Independent non-executive director

Age 42



Appointed to the Board in December 2007. Former director of The Boots Company plc (now known as The Boots Company Limited) (*pharmacy*) and managing director of Boots the Chemist at Alliance Boots plc. Formerly held a number of senior management positions at Tesco plc (*retail services*).

**Chairman of the remuneration committee and member of the corporate social responsibility committee**

### Graham Jones

Group company secretary



## Executive management

### Andrew Moss

Group chief executive

Age 51

See page 84

### Philip Scott FIA

Chief financial officer

Age 55

See page 84

### Mark Hodges

Executive director and chief executive, Norwich Union Life

Age 43

See page 84

### John Ainley

Group human resources director

Age 52

Joined the Group in 1999. Formerly held senior HR positions with WH Smith plc, ICL plc, Priory Hospitals Group and General Electric plc. Previously also Group HR Director for Norwich Union plc and HR Director for Norwich Union Insurance and Norwich Union Life. Holds a law degree and is a companion of the Chartered Institute of Personnel Development.

### Alain Dromer

Chief executive, Aviva Investors

Age 54

Joined the Group in September 2007. Formerly global head of group investment businesses at HSBC, senior executive vice president and head of asset management and insurance at Credit Commercial de France and director of capital markets at La Compagnie Financière Edmond de Rothschild. Previously at the French Treasury in the Ministry of Finance and the French Institute for Statistics and Economic Studies. Educated at l'École Polytechnique, Paris and l'École Nationale de la Statistique l'Administration Économique, Paris.

### Thomas Godlasky

Chief executive, Aviva North America

Age 53

Joined the Group in 2006. Formerly chairman, president and chief executive officer of AmerUs Group and chief investment officer of AmerUs Capital. Previously with Provident Corporation, Federated Investors, Inc and Mellon Bank. Holds a Bachelor of Science degree in urban and regional planning from Indiana University of Pennsylvania and a master's degree in public administration from the University of Pittsburgh. A graduate of Harvard Business School's Advanced Management Program and a Chartered Financial Analyst.

### Simon Machell

Chief executive, Aviva Asia Pacific

Age 45

Joined the Group in 1994. Formerly chief executive of Norwich Union Insurance in the UK and managing director of the RAC. Previously held positions with Ernst & Young LLP and Legal & General. Holds a BA Honours in Economics from the University of Durham and is a Fellow of the Institute of Chartered Accountants of England and Wales.

### Amanda Mackenzie

Chief marketing officer

Age 45

Joined the Group in 2008. Previously commercial and marketing director for British Gas and has more than 20 years of experience in the marketing and advertising profession. Holds a Bachelor of Science degree in Psychology from the University of London and is a graduate of the INSEAD advanced management programme. She is a fellow of the Royal Society of Arts, a member of the Government Strategic Marketing Advisory Board, a fellow of the Marketing Society and a governor of the National Youth Orchestra.

### Igal Mayer

Chief executive, Norwich Union General Insurance

Age 47

Joined the Group in 1989. Formerly chief executive officer of Aviva Canada, chief financial officer and executive vice-president. Previously finance director for Norwich Union Insurance and managing director for CGU Insurance in London. Holds a BA Honours in Commerce and Economics from the University of Toronto, is a chartered accountant and has received an honorary Chartered Insurance Professional designation from the Insurance Institute of Canada.

### Andrea Moneta

Chief executive, Aviva Europe

Age 43

Joined the Group in 2008. Previously managing director of Dubai Financial Group. Has extensive experience of European financial services, having held senior executive positions at UniCredit, the European Central Bank and Accenture. Holds honours degrees in Political Sciences and Economics and Business Administration. Qualified Dottore Commercialista and Revisore Contabile.

### Anupam Sahay

Group strategy and development director

Age 39

Joined the Group in 2007. Formerly a partner with the global financial services group at McKinsey & Company, advising leading insurers and banks in Europe, USA, Asia and Australia. Holds an engineering degree and an MBA from the Indian Institute of Management.

## Directors' report

The directors submit their report and accounts for Aviva plc, together with the consolidated accounts of the Aviva Group of companies, for the year ended 31 December 2008. The Business review for the Company is contained on pages 14 to 81 and includes a review of the Group's operations, current position and future prospects together with a description of the principal activities of the Group and other information required to be included. Details of material acquisitions and disposals made by the Group during the year are contained in note 3 to the accounts.

### Results

The Group results for the year are shown in the consolidated income statement on page 140.

### Dividends

The directors are recommending a final dividend of 19.91 pence per share (2007: 21.10 pence), which together with the interim dividend of 13.09 pence paid on 17 November 2008 (2007: 11.90 pence), produces a total dividend for the year of 33.00 pence per share (2007: 33.00 pence). The total cost of ordinary dividends paid in 2008, was £902 million (2007: £801 million). The final dividend for 2008 will be paid on 15 May 2009 to all holders of ordinary shares on the Register of Members at the close of business on 27 March 2009.

### Share capital

The issued ordinary share capital of the Company was increased by 35.9 million ordinary shares during the year. 35,908,796 shares were allotted under the Group's employee share and incentive plans and the Aviva Scrip Dividend Scheme for the May 2008 dividend. At 31 December 2008 the issued ordinary share capital totalled 2,658 million shares of 25 pence each and the issued preference share capital totalled 200 million shares of £1 each. Accordingly, the issued ordinary share capital constituted 77% of the Company's total issued share capital and the issued preference share capital constituted 23% of the Company's total issued share capital at 31 December 2008. All the Company's shares are fully paid up and quoted on the London Stock Exchange. Details of the Company's share capital and shares under option at 31 December 2008 and shares issued during the year are given in notes 28 to 31 to the financial statements.

The rights and obligations attaching to the Company's ordinary shares and preference shares as well as the powers of the Company's directors, are set out in the Company's articles of association, copies of which can be obtained from Companies House, or by writing to the Company Secretary and can also be found on the Company's website. With the exception of restrictions on transfer of shares under the Company's share incentive plan while the shares are subject to the plan, there are no restrictions on the voting rights attaching to the Company's ordinary shares or the transfer of securities in the Company.

Where, under an employee share plan operated by the Company, participants are the beneficial owners of shares, but not the registered owners, the voting rights are normally exercised at the discretion of the participants. No person holds securities in the Company carrying special rights with regard to control of the Company. The Company is not aware of any agreements between holders of securities that may result in restrictions in the transfer of securities or voting rights. Unless expressly specified to the contrary in the articles of association of the Company, the Company's articles of association may be amended by special resolution of the Company's shareholders. There are a number of agreements that take effect, alter or terminate upon a change of control of the Company, such as commercial contracts and joint venture agreements. None is considered to be significant in terms of their potential impact on the business of the Group as a whole. All of the Company's share plans contain provisions relating to a change of control. Outstanding awards and options would normally vest and become exercisable on a change of control, subject to the satisfaction of any performance conditions.

At the forthcoming Annual General Meeting, shareholders will be asked to consider an increase in the authorised share capital of the Company, to renew the directors' authority to allot shares and to reintroduce the Scrip Dividend Plan. Details are contained in the Notice of Meeting.

### Authority to purchase own shares

At the Company's Annual General Meeting held on 1 May 2008, shareholders renewed the Company's authorities to make market purchases of up to 262 million ordinary shares, up to 100 million 8¼% preference shares and up to 100 million 8% preference shares. These authorities were not used during the year and, at the forthcoming Annual General Meeting, shareholders will be asked to renew them for another year. Details are contained in the Notice of Meeting. The Company held no Treasury shares during the year.

### Directors

The following persons served as directors of the Company during the year:

Nikesh Arora  
Guillermo de la Dehesa (retired on 31 December 2008)  
Wim Dik  
Mary Francis  
Richard Karl Goeltz  
Mark Hodges (appointed 26 June 2008)  
Andrew Moss  
Carole Piwnica  
Philip Scott  
Lord Sharman of Redlynch  
Russell Walls  
Scott Wheway

The biographical details of the persons currently serving as directors appear on pages 84 and 85.

**Directors' report continued**

The Company's articles of association require one-third of the directors to retire by rotation each year and also require each director to retire at intervals of not more than three years. At the forthcoming Annual General Meeting, Mary Francis, Richard Goeltz, Carole Pwinica and Russell Walls, all non-executive directors, will retire and, being eligible, will offer themselves for re-election. Euleen Goh and Mark Hodges will offer themselves for election by shareholders at this year's Annual General Meeting being the first such meeting after their appointment. Euleen Goh is a non-executive director and was appointed to the Board on 1 January 2009. Mark Hodges is an executive director with a service contract with the Company, details of which can be found in the Directors' remuneration report. Guillermo de la Dehesa retired from the Board on 31 December 2008 and Wim Dik will retire at this year's Annual General Meeting in line with the Board's plans to renew and refresh its composition.

**Directors' interests and indemnity arrangements**

At no time during the year did any director hold a material interest in any contract of significance with the Company or any of its subsidiary undertakings other than an indemnity provision between each director and the Company and service contracts between each executive director and a Group company. The Company has purchased and maintained throughout the year directors' and officers' liability insurance in respect of itself and its directors. The directors also have the benefit of the indemnity provision contained in the Company's articles of association. The Company has executed deeds of indemnity for the benefit of each director of the Company, and each person who was a director of the Company during the year, in respect of liabilities that may attach to them in their capacity as directors of the Company or of associated companies. These indemnities were granted at different times according to the law in place at the time and where relevant are qualifying third-party indemnity provisions as defined by Section 309B of the Companies Act 1985 and Section 234 of the Companies Act 2006. These indemnities were in force throughout the year and are currently in force. Details of directors' remuneration, service contracts and interests in the shares of the Company are set out in the Directors' remuneration report.

**Substantial shareholdings**

As at 27 February 2009 the Company had received the following notification in accordance with the provisions of the Disclosure and Transparency Rules of the Financial Services Authority; the holdings of Legal & General Group plc had fallen below 5% of the total voting rights attaching to the issued ordinary share capital of the Company.

**Financial instruments**

Aviva Group companies use financial instruments to manage certain types of risks including those relating to credit, foreign currency exchange, cash flow, liquidity, interest rates, and equity and property prices. Details of the objectives and management of these instruments are contained on page 32 of the Business review and an indication of the exposure of the Group companies to such risks is contained in note 55 to the accounts.

**Health and safety**

The health and safety of the Group's employees is a priority and is reviewed at regular intervals. Each business within the Group has an appointed health and safety representative, whose role is to bring to the attention of senior management any areas of concern that should be addressed within the health and safety programme. Information on health and safety matters is communicated to staff through the normal communication channels. Under the Group's Health and Safety Policy the Group chief executive is accountable for health and safety.

**Charitable donations**

The Company has continued to support community initiatives and charitable causes worldwide and the total Group commitment during the year was £9.6 million (2007: £6.8 million).

In 2008, the Group's community investment in the United Kingdom totalled £5.6 million (2007: £4 million) of which £2.2 million (2007: £1.4 million) was given in the form of donations to charitable organisations. The Company continues its global partnership with the Oxfam 365 Alliance which ensures that Oxfam can maintain a state of constant preparedness, enabling them to respond immediately to emergencies wherever they occur in the world. The Company promotes a strong volunteering policy and employees are entitled to up to three days annually to support volunteering activities. The Company allocates a part of its budget to matching contributions to charitable causes raised by staff and for providing financial support to charities and communities where members of staff give a personal commitment in terms of their time.

In addition, the Group's businesses are committed to supporting their local communities in line with the Company's strategy which focuses on education, financial literacy and life trauma. For example, in the United Kingdom the business partners with schools to deliver education citizenship modules into schools (for 14 – 19 year olds) with a focus upon economics, as part of the "Paying For It" scheme. Since 2007, Aviva Canada has partnered with ThinkFirst Foundation of Canada. ThinkFirst seeks to prevent brain and spinal cord injuries through education by promoting healthy behaviour in children and youths.

**Political donations**

At the Annual General Meeting held in 2008, shareholders passed a resolution, on a precautionary basis, to authorise the Company to make political donations and/or incur political expenditure (as such terms are defined in Sections 362 to 379 of the Companies Act 2006) in amounts not exceeding £100,000 in aggregate.

The definitions used in the Companies Act 2006 are broad in nature and this authority was sought to ensure that any activities undertaken throughout the Group's businesses which could otherwise be construed to fall within these provisions could be undertaken without inadvertently infringing them. During the year the Company sponsored events in support of the rebranding of Norwich Union to Aviva amounting to a total of £8,627 which could be construed to fall within these provisions. It is not the policy of the Company to make donations to EU political organisations or to incur other political expenditure.

As the authority granted at the 2008 Annual General Meeting will expire on 29 April 2009 renewal of this authority is being sought at this year's Annual General Meeting. Further details are available in the Notice of Meeting.



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## Group employees

The Group's statement on its employees is set out in the Business review.

In summary, the Group's commitment to communication and dialogue with employees continues. The introduction of a truly group-wide intranet has enabled, for the first time, engagement and communication with all employees throughout the Group on a single platform. It also helps management to share information, ideas and opportunities much faster across the entire business. A strong emphasis is placed on the provision of news and information through a range of media. Employees have opportunities to voice their opinions and ask questions through intranet sites, Q&A telecon sessions, opinion surveys and the Group's climate survey which is open to all employees. Face-to-face briefings and team meetings are actively encouraged and are held in all business units across the Group. The Group's businesses in the United Kingdom have established employee consultative forums and a European Consultative Forum convenes annually to discuss matters impacting the business across Europe.

## Employee practice

The Group respects all fundamental human rights and will be guided in the conduct of its business by the provisions of the United Nations Universal Declaration of Human Rights and the International Labour Organisation core labour standards. Aviva also supports the United Nations Global Compact Principles. Aviva Group companies are committed to providing equal opportunities to all employees, irrespective of their gender, sexual orientation, marital status, race, nationality, ethnic origin, disability, age, religion or union membership status. Aviva is an inclusive employer and values diversity in its employees. These commitments extend to recruitment and selection, training, career development, flexible working arrangements, promotion and performance appraisal. In the event of employees becoming disabled, every effort is made to ensure that their employment with the Group continues and to provide specialised training where this is appropriate.

## Creditor payment policy and practice

It is the Group's policy to pay creditors when they fall due for payment. Terms of payment are agreed with suppliers when negotiating each transaction and the policy is to abide by those terms, provided that the suppliers also comply with all relevant terms and conditions. The Company has no trade creditors. In respect of Group activities in the UK, the amounts due to trade creditors at 31 December 2008 represented approximately 37 days of average daily purchases through the year (2007: 23 days).

## Reappointment of the auditor and disclosure of information to the auditor

In accordance with Section 489 of the Companies Act 2006, a resolution is to be proposed at the Annual General Meeting to reappoint Ernst & Young LLP as auditor of the Company. A resolution will also be proposed authorising the directors to determine the auditor's remuneration. The Audit Committee reviews the appointment of the auditor, the auditor's effectiveness and relationship with the Group, including the level of audit and non-audit fees paid. Further details on the work of the auditor and the Audit Committee are set out below in the Audit Committee report.

The directors in office at the date of this report confirm that, so far as they are each aware, there is no relevant audit information of which Ernst & Young LLP are unaware and each director has taken all steps that ought to have been taken as a director to be aware of any relevant audit information and to establish that Ernst & Young are aware of that information.

## Annual General Meeting

The 2009 Annual General Meeting of the Company will be held on 29 April 2009 at The Barbican Centre, Silk Street, London EC2Y 8DS at 11am. A separate document accompanying the Annual Report and Accounts contains the Notice convening the Meeting and a description of the business to be conducted thereat.

By order of the Board.

### Graham Jones

Group company secretary  
4 March 2009

Registered Office: St. Helen's, 1 Undershaft, London EC3P 3DQ Registered in England  
No. 2468686

## Corporate governance report

### The Combined Code on Corporate Governance

The Combined Code on Corporate Governance sets out guidance in the form of principles and provisions on how companies should be directed and controlled to follow good governance practice. The Financial Services Authority requires companies listed in the UK to disclose, in relation to Section 1 of the Combined Code, how they have applied its principles and whether they have complied with its provisions throughout the accounting year. Where the provisions have not been complied with companies must provide an explanation for this.

It is the Board's view that the Company has been fully compliant throughout the accounting period with the provisions set down in Section 1 of the Combined Code, apart from a period of 29 days in 2008 when the majority of the members of the Nomination Committee were not independent non-executive directors. This report sets out details of how the Company has applied the principles and complied with the provisions of the Combined Code during 2008. Further information on the Combined Code can be found on the Financial Reporting Council's website, [www.frc.org.uk](http://www.frc.org.uk)

### The Board

The directors are responsible to shareholders for ensuring that the Company is appropriately managed and that it achieves its objectives. It meets regularly to determine the Company's strategic direction, to review the Company's operating and financial performance and to provide oversight that the Company is adequately resourced and effectively controlled. The specific duties of the Board are clearly set out in its terms of reference that address a wide range of corporate governance issues and list those items that are specifically reserved for decision by the Board. Matters requiring Board approval include:

Group strategy and business plans;
Acquisitions, disposals and other transactions outside delegated limits;
Financial reporting and controls;
Capital structure;
Dividend policy;
Shareholder documentation;
The constitution of Board committees; and
Key business policies, including the remuneration policy.

The full terms of reference for the Board are available from the Group Company Secretary. Matters that are not specifically reserved for the Board and its committees under its terms of reference, or for shareholders in general meeting, are delegated to the Group Chief Executive. The Board's terms of reference also set out those matters that must be reported to the Board, such as significant litigation or material regulatory breaches, and cover how matters requiring consideration by the Board that arise between scheduled meetings should be dealt with.

The Board and its committees operate in line with work plans agreed prior to the start of each year. At Board and committee meetings, directors receive regular reports on the Group's financial position, risk management, regulatory compliance, key business operations and other material issues. Directors are fully briefed in advance of Board and committee meetings on all matters to be discussed. The Group Company Secretary is responsible for following Board procedures and advising the Board, through the Chairman, on governance matters. All directors have access to his advice and services.

The Board has adopted a procedure whereby directors may, in the performance of their duties, seek independent professional advice at the Company's expense if considered appropriate. During the year the members of the Remuneration Committee sought independent advice from New Bridge Street Consultants on a review of senior executive remuneration.

### The Directors

The Board currently comprises the Chairman, seven independent non-executive directors, one non-independent non-executive director and three executive directors. Each non-executive director serves for a fixed term not exceeding three years that may be renewed by mutual agreement. Subject to the Board being satisfied with a director's performance, independence and commitment, there is no specified limit regarding the number of terms a director may serve. Each director is required to be elected by shareholders at the Annual General Meeting following his/her appointment by the Board and to be re-elected at least once every three years. Any non-executive director who has served on the Board for nine years or more is required to submit himself/herself for re-election annually. The Board's policy is to appoint and retain non-executive directors who can apply their wider knowledge and experiences to their understanding of the Aviva Group, and to review and refresh regularly the skills and experience the Board requires through a programme of rotational retirement. In addition to the strengths of experience, diversity and an international perspective, the Board also seeks to comply with the requirements of the Combined Code on the independence of directors. The process for appointing new directors is conducted by the Nomination Committee whose report, including a description of its duties, is set out on page 95.

The Combined Code requires that at least half the Board, excluding the Chairman, should comprise independent non-executive directors as determined by the Board. The Nomination Committee performs an annual review of directors' interests in which all potential or perceived conflicts, including time commitments, length of service and other issues relevant to their independence, are considered. It is the Board's view that an independent non-executive director also needs to be able to present an objective, rigorous and constructive challenge to management, drawing on his/her wider experiences to question assumptions and viewpoints and where necessary defend their beliefs. To be effective, an independent director needs to acquire a sound understanding of the industry and the Company so as to be able to evaluate properly the information provided. Having considered the matter carefully the Board is of the opinion that all of the current non-executive directors are independent and free from any relationship or circumstances that could affect, or appear to affect, their independent judgement, except Wim Dik due to his length of service as a non-executive director of the Company. Accordingly, over half of the directors, excluding the Chairman, are independent non-executive directors. Each of the directors being proposed for re-election at the 2009 Annual General Meeting has been subject to a formal performance evaluation and took part in a peer evaluation review during 2008. Details of the Directors standing for re-election at this year's Annual General Meeting are set out in the Notice of Meeting. Wim Dik will retire at this year's Annual General Meeting. Biographical details of all the directors are set out on pages 84 and 85.

## The Chairman and Group Chief Executive

The respective roles of the Chairman and Group Chief Executive are set out in the Board's terms of reference. The Chairman's priority is the leadership of the Board and the Group Chief Executive's priority is the management of the Company. The Chairman's commitment to the Company is two to three days per week and his main interests outside the Company are set out in his biographical details on page 84. During the year the Chairman retired as the chairman and from the board of Aegis plc.

## Senior Independent Director

Under the Combined Code the Board appoints one of the non-executive directors to act as Senior Independent Director. The main responsibility of the Senior Independent Director is to be available to shareholders should they have concerns that they have been unable to resolve through normal channels, or when such channels would be inappropriate. The Senior Independent Director is also responsible for leading the Board's discussion on the Chairman's performance and the appointment of a new chairman, when appropriate. Wim Dik served as the Senior Independent Director from 2004 to December 2008 and was succeeded in January 2009 by Richard Goeltz.

## Board effectiveness

The effectiveness of the Board is vital to the success of the Group and the Company undertakes a rigorous evaluation each year in order to assess how well the Board, its committees, the directors and the Chairman are performing. The aim is to improve the effectiveness of the Board and its committees and the Group's performance. The process is led by the Chairman and supported by the Group Company Secretary. This year the evaluation was carried out by Boardroom Review, an independent consultancy, and interviews were conducted with each Board member. All directors also completed a questionnaire evaluating the Board and committees' processes, their effectiveness and where improvements may be considered. Boardroom Review prepared a report based on the interviews with the directors and the questionnaire circulated and the overall results of the evaluation were presented to and reviewed by the Board in January 2009.

The performance of the Chairman is also included in the above process and takes into account the views of both the executive and non-executive directors. The Chairman's evaluation is managed by the Senior Independent Director who provides feedback to the Chairman. As part of the Chairman's evaluation the non-executive directors meet separately under the chairmanship of the Senior Independent Director.

The Board evaluation process assesses the executive directors in their capacities as directors of the Company. They are evaluated in respect of their executive duties through a separate process whereby the Chairman and the non-executive directors assess the Group Chief Executive and the Group Chief Executive assesses the executive directors.

Following this comprehensive review, the directors have concluded that the Board and its committees operate effectively and agreed actions in respect of certain processes identified for improvement. Additionally, the Chairman has concluded that each director contributes effectively and demonstrates full commitment to his/her duties.

## Training and development

The Board believes strongly in the development of all its employees and directors and it is a requirement of each director's appointment that they commit to continue their development. The form that this development takes is subject to individual director's requirements and the quality and relevance of the training available.

During the year, directors attended a number of courses ranging from external seminars for members of the Audit and Remuneration Committees and internal seminars on market risk. In addition, members of the Audit and the Risk and Regulatory Committees received tailored training sessions. Training sessions have also been built into the Board's and committees' work plans for 2009. The Board made visits to the Group's businesses located in the United Kingdom and Europe during the year to gain a closer understanding of their operations.

The Board has a comprehensive induction programme consisting of several separate sessions which take place over a number of months at times convenient for the director. The sessions include presentations from key members of senior management, visits to the Group's main operating businesses, and meetings with the external auditor and one of the Company's corporate brokers. Further or follow-up meetings are arranged where a director requires a deeper understanding on a particular item.

## Directors' attendance

The Company requires directors to attend all meetings of the Board and the committees on which they serve and to devote sufficient time to the Company in order to perform their duties. The attendance of the directors at the Board and committee meetings held in 2008 was as follows:

## Board and Board committee attendance 2008

	Board	Audit Committee	Corporate Social Responsibility Committee	Nomination Committee	Risk and Regulatory Committee	Remuneration Committee
Number of meetings held	12	7	4	2	5	9
Nikesh Arora	10	—	—	1#	4	—
Mary Francis	12	6	—	—	5	9
Richard Goeltz	12	7	—	1#	—	9
Eileen Goh (appointed 1 January 2009)	n/a	n/a	n/a	n/a	n/a	n/a
Mark Hodges (appointed 26 June 2008)	7	—	—	—	—	—
Andrew Moss	11	—	3	2	—	—
Carole Piwnica	12	6	3	—	—	9
Philip Scott	11	—	—	—	—	—
Lord Sharman	12	—	3	2	—	—
Russell Walls	11	6	—	2	5	—
Scott Wheway	11	—	4	—	—	9
Wim Dik (will retire on 29 April 2009)	9	—	3	1*	5	—
<b>Former directors</b>						
Guillermo de la Dehesa (retired 31 December 2008)	10	—	3	1*	—	—

— Indicates not a member of that committee.

\* Ceased to be a member of the Nomination Committee on 29 July 2008.

# Became a member of the Nomination Committee on 29 July 2008

During 2008 the Chairman and the non-executive directors met in the absence of the executive directors and there was one meeting of the non-executive directors chaired by the Senior Independent Director at which the Chairman was not present in order to appraise the Chairman's performance.



**Corporate governance report continued****Board committees**

The Board has established the following standing committees to oversee and debate important issues of policy and oversight outside the main Board meetings.

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Audit Committee;

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Corporate Social Responsibility Committee;

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Nomination Committee;

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Risk and Regulatory Committee; and

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Remuneration Committee.

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Throughout the year the chairman of each committee provided the Board with a summary of the key issues considered at the meetings of the committees and the minutes of the meetings were circulated to the Board. The committees operate within defined terms of reference which are available from the Group Company Secretary upon request. Board committees are authorised to engage the services of external advisers as they deem necessary in the furtherance of their duties at the Company's expense.

Reports of the committee chairmen are set out on pages 95 to 119.

**Conflicts of interest**

In line with the Companies Act 2006, the articles of association were amended at the 2008 Annual General Meeting to allow the Board to authorise potential conflicts of interest that may arise and to impose such limits or conditions as it thinks fit. The decision to authorise a conflict of interest can only be made by non-conflicted directors (those who have no interest in the matter being considered) and in making such decision the directors must act in a way they consider in good faith will be most likely to promote the Company's success. The Company has established a procedure whereby actual and potential conflicts of interest are regularly reviewed and for the appropriate authorisation to be sought prior to the appointment of any new director or if a new conflict arises. During 2008 this procedure operated effectively.

**Internal controls**

The Combined Code requires directors to review and report annually to shareholders on the effectiveness of the Company's systems of internal control which include financial, operational and compliance controls and risk management. The Board has the overall responsibility for maintaining the systems of internal control of the Company and for monitoring their effectiveness; while the implementation of internal control systems is the responsibility of management. The Group's systems of internal control are designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material financial misstatement or loss.

The systems are designed to:

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Safeguard assets;

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Maintain proper accounting records;

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Provide reliable financial information;

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Identify and manage business risks;

---

Maintain compliance with appropriate legislation and regulation; and

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Identify and adopt best practice.

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The principal features of the control framework and the methods by which the Board satisfies itself that it is operating effectively are detailed below.

**Control environment**

The Group has an established risk management and governance framework, the key features of which include:

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Terms of reference for the Board and each of its committees;

---

A clear organisational structure, with documented delegation of authority from the Board to executive management;

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A Group policy framework, which sets out risk management and control standards for the Group's operations worldwide;

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Defined procedures for the approval of major transactions and capital allocation; and

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Committees of senior executives responsible for reviewing the Group's financial risks (Asset and Liability Management Committee) and non-financial, ie strategic and operational risks (Group Operational Risk Committee).

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The Group's risk management and governance framework is consistent with the requirements of the Financial Services Authority's risk-based framework for integrating the embedding risk and capital management (Prudential Sourcebook).

**Risk identification, assessment and management**

There is in place an ongoing process for identifying, evaluating and managing the significant risks faced by the Group which has operated throughout 2008 and up to the date of signing this report. The Group's risk management and governance framework is designed to support the identification, assessment, monitoring, management and control of risks that are significant to the achievement of the Group's business objectives. The Group has a set of formal policies which govern the management and control of both financial and non-financial risks. The adoption of these policies throughout the Group enables a consistent approach to the management of risk at regional and business unit level. At Group level, policy owners maintain policy content and guidance material and are responsible for the definition of the management information requirements from the businesses to support the risk oversight committees in the discharge of their responsibilities. Policy owners are also responsible for the Group-wide aggregation and oversight of their specific risks. During 2008 the Group policy set has been embedded, the risk management framework has been reviewed and a new Chief Risk Officer appointed.

Management monitors the completeness of the Group's risk profile on a regular basis. Each quarter, businesses report risk profiles and the adequacy of the mitigating action programmes, where risks are outside of the Group's risk appetite. These assessments are based on financial, reputational and operational criteria. This enables the Group risk function to assess the overall risk exposure and to develop a Group-wide risk profile that is refreshed quarterly. Material items in the Group risk report are reported to the committee of the Group's senior executives (Executive Committee), the Risk and Regulatory Committee and in respect of social, environmental and ethical risks, the Board's Corporate Social Responsibility Committee. The Executive Committee considers whether the residual risks are within the Group's risk appetite, and the adequacy of the mitigating actions. In addition the Executive Committee receives a fortnightly Group-wide risk update report.

The Boards, audit committees and management of the operational businesses also consider local risk reports in a similar way. Regular reports are supplemented by escalation procedures for new or deteriorating risks. In addition, business units provide a certificate every six months to confirm compliance with the Group's risk management framework and governance, and the terms of their delegated authority. Any risk or control issues not already reported through the regular risk management processes must be specifically highlighted.

## Control procedures and monitoring systems

The Group has a well-developed system of planning, incorporating Board approval of a rolling three-year Group plan. Performance against the plan is subsequently monitored and reported to the Board each time it meets. This report also includes updates on relevant measures of solvency and liquidity. Performance is reported through the half-yearly publication of the Company's results based on accounting policies that are applied consistently throughout the Group. Operational management reports quarterly to the Executive Committee on a wide range of key performance and other significant matters and the Board receives regular representations from the senior executives responsible for each region and business function.

The Risk and Regulatory Committee has the overall responsibility of monitoring the Group's internal control and risk management systems on behalf of the Board. In addition, the Audit Committee performs an annual review of the effectiveness of the internal audit function and the framework for the Group's internal financial controls and financial reporting. Throughout 2008, the Audit Committee and the Risk and Regulatory Committee received quarterly reports from the Chief Audit Officer on issues arising and updates on previously reported items. More detailed reports on the work of these committees during 2008 are set out on pages 96 and 98.

The Board has conducted a review of the effectiveness of the Group's systems of internal control. This annual review has been supplemented by a major review of the adequacy and effectiveness of financial reporting controls across the Group. This additional review is being undertaken so that the Group will be able to meet the financial reporting requirements of the Sarbanes-Oxley Act 2002 in the event of a possible listing of the Company on the New York Stock Exchange. The necessary actions have been or are being taken to remedy significant failings or weaknesses identified from these reviews. These actions are being monitored by the Risk and Regulatory Committee or the Audit Committee as appropriate on behalf of the Board.

## Internal audit

The Group's internal audit function advises management on the effectiveness of its internal control systems, the adequacy of these systems to manage business risk and to safeguard the Group's assets and resources. Through the Chief Audit Officer, the internal audit function provides objective assurance on risk and control to both the Audit Committee and the Risk and Regulatory Committee. The effectiveness of the Group's internal audit function is reviewed each year by the Audit Committee.

## Communication with shareholders

The Company places considerable importance on communication with shareholders and engages with them on a wide range of issues.

The Group has an ongoing programme of dialogue and meetings between the executive directors and institutional investors, fund managers and analysts. At these meetings a wide range of relevant issues including strategy, performance, management and governance are discussed within the constraints of information already made public.

The Company's Investor Relations department is dedicated to facilitating communication with institutional investors. The directors consider it important to understand the views of shareholders and, in particular, any issues which concern them. The Board receives reports on matters that have been raised with management at the regular meetings held with the large investors. During the year the Chairman held a meeting with the major institutional investors and attended investor meetings with management. In addition, the Senior Independent Director is available to meet with major shareholders to discuss any areas of concern that cannot be resolved through normal channels of investor communication and arrangements can be made to meet with the Senior Independent Director through the Group Company Secretary. Similarly, arrangements can be made for major shareholders to meet with newly appointed directors. In addition, the Board consults with shareholders in connection with specific issues where it considers appropriate. For example, the chairman of the Remuneration Committee consulted with investors in 2008 regarding the introduction of the One Aviva, Twice the Value Bonus Plan which is outlined in the Remuneration Committee report on page 103.

The Board is equally interested in the concerns of private shareholders and, on its behalf the Group Company Secretary oversees communication with these investors. It is the practice of the Company to issue a postage paid reply form with its Annual General Meeting documentation to enable shareholders to put relevant questions to the directors. This is considered to be particularly helpful for those shareholders who are unable to attend the meeting. Written responses are provided through a brochure containing answers to the most frequently asked questions which is also placed on the Company's website. All material information reported to the regulatory news services is simultaneously published on the Company's website affording all shareholders full access to Company announcements.

The Company has taken full advantage of the provisions within the Companies Act 2006 allowing communications to be made electronically to shareholders where they have not requested hard copy documentation. As a result the Company's website has become the primary method of communication for the majority of its shareholders. Details of the information available for shareholders on the website can be found on the Shareholder information pages 330 to 332.

**Corporate governance report continued**

The Company's Annual General Meeting provides a valuable opportunity for the Board to communicate with private investors. At the meeting, the Company complies with the Combined Code as it relates to voting, the separation of resolutions and the attendance of committee chairmen. Whenever possible, all directors attend the Annual General Meeting and shareholders are invited to ask questions during the meeting and have an opportunity to meet with the directors following the conclusion of the formal part of the meeting. In line with the Combined Code, details of proxy voting by shareholders, including votes withheld, are made available on request and are placed on the Company's website following the meeting.

The Company's annual report and accounts and annual review, together with the Company's interim reports, interim management statements and other public announcements are designed to present a balanced and understandable view of the Group's activities and prospects and are available on the Company's website. The Chairman's statement, Group Chief Executive's review, and Business review provide an assessment of the Group's affairs and they will be supported by a presentation to be made at the Annual General Meeting.

**Institutional investor**

Aviva Investors, the Group's core asset management company, believes that good governance plays an important role in protecting and enhancing shareholder value. In keeping with the Group's values, Aviva Investors looks to act as a responsible investor, monitors the governance of the companies in which it invests and seeks to maintain an effective dialogue and engagement with companies on matters which may affect the future performance of those companies.

Aviva Investors maintains a detailed Corporate Governance and Voting Policy as part of its investment strategy, which underpins its approach to engaging and voting at company general meetings. The policy encompasses social, environmental and ethical issues and is applied pragmatically after careful consideration of all relevant information. In addition, Aviva Investors makes detailed voting reports available to clients, as well as providing some summary reporting on its website [www.avivainvestors.com](http://www.avivainvestors.com).

**Directors' responsibilities**

The directors are required to prepare accounts for each accounting period that comply with the relevant provisions of the Companies Act 1985, the Companies Act 2006 (where applicable) and International Financial Reporting Standards (IFRS) as adopted by the European Union, and which present fairly the financial position, financial performance and cash flows of the Company and the Group at the end of the accounting period. A fair presentation of the financial statements in accordance with IFRS requires the directors to:

select suitable accounting policies and verify that they are applied consistently in preparing the accounts, on a going concern basis unless it is inappropriate to presume that the Company and the Group will continue in business;

present information, including accounting policies, in a manner that is relevant, reliable, comparable and understandable;

provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company and the Group's financial position and financial performance; and

state that the Company and the Group have complied with applicable IFRS, subject to any material departures disclosed and explained in the accounts.

The directors are responsible for maintaining proper accounting records which are intended to disclose with reasonable accuracy, at any time, the financial position of the Company and the Group. They are also ultimately responsible for the systems of internal control maintained by the Group for safeguarding the assets of the Company and the Group and for the prevention and detection of fraud and other irregularities. Further details of the systems of internal controls maintained by the Group are more fully described on page 92.

**Directors' responsibility statement pursuant to the Disclosure and Transparency Rule 4**

The directors confirm that, to the best of each person's knowledge:

(a) the Group and Company financial statements in this report, which have been prepared in accordance with IFRS as adopted by the EU, International Financial Reporting Interpretations Committee's interpretation and those parts of the Companies Act 1985 applicable to companies reporting under IFRS, give a true and fair view of the assets, liabilities, financial position and results of the Company and of the Group taken as a whole; and

(b) the management report contained in this report includes a fair review of the development and performance of the business and the position of the Company and the Group taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board

**Andrew Moss**  
Group Chief Executive

**Philip Scott**  
Chief Financial Officer

**Going concern**

The group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Overview on pages 1 to 11 and the Business Review on pages 12 to 81. The business review includes sections on Group Performance (pages 22 to 27), Capital Management (pages 28 to 31), and Risk Management (pages 32 to 35). In addition the financial statements include notes on the group's borrowings (note 47); its contingent liabilities and other risk factors (note 50); its capital structure and position (notes 53 and 54); management of its major risks including market, credit and liquidity risk (note 55); and derivative financial instruments (note 56).

The group has considerable financial resources together with a diversified business model, with a spread of businesses and geographical reach. As a consequence, the directors believe that the group is well placed to manage its business risks successfully despite the current uncertain economic outlook.

After making enquiries, the directors have a reasonable expectation that the Company and the Group as a whole have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.



## Nomination Committee report

This report provides details of the role of the Nomination Committee and the work it has undertaken during the year.

The main purpose of the Committee is to assist the Board by keeping the composition of the Board under review and conducting a rigorous and transparent process when making or renewing appointments of directors to the Board. It also advises the Board on issues of directors' conflicts of interest and independence. The full terms of reference for the Committee can be found on the Company's website, [www.aviva.com](http://www.aviva.com), and are also available from the Group Company Secretary.

The following directors served on the Committee during the year:

Member	Period	
	From	To
Lord Sharman (Chairman)	25 January 2006	To date
Nikesh Arora	29 July 2008	To date
Guillermo de la Dehesa	21 June 2000	29 July 2008
Wim Dik	26 April 2004	29 July 2008
Richard Goeltz	29 July 2008	To date
Andrew Moss	12 July 2007	To date
Russell Walls	23 January 2007	To date

The Committee met on two occasions in 2008 and the members' attendance record is set out in the Corporate Governance report on page 91. Nikesh Arora and Richard Goeltz were appointed as members of the Committee on 29 July 2008 and Guillermo de la Dehesa and Wim Dik ceased to be members from that date. The Group Company Secretary acts as the secretary to the Committee.

The Committee keeps under review the balance of skills on the Board and the knowledge, experience, length of service and performance of the directors. It also reviews their external interests with a view to identifying any actual, perceived or potential conflicts of interests, including the time available to commit to their duties to the Company. The Committee monitors the independence of each non-executive director and makes recommendations concerning such to the Board. The results of these reviews are important when the Board considers succession planning and the re-election and reappointment of directors and members of the Committee take no part in any discussions concerning their own circumstances.

During the year the Board accepted the Committee's recommendations that Mark Hodges and Euleen Goh join the Board. Mark Hodges was appointed as an executive director of the Board, increasing the number of executive directors to three. The appointment of Euleen Goh as a new non-executive director from 1 January 2009 also helps to maintain the balance of the Board in the context of the retirement of Wim Dik during 2009. In respect of Ms Goh's appointment the Committee engaged a search agency to help it identify suitable candidates with the skills and capabilities required and to assist with the preparation of an interview list.

In line with the Combined Code requirement the Board undertook a review of the effectiveness of all its committees during the year, including the Nomination Committee.

This report was reviewed and approved by the Board on 4 March 2009.

**Lord Sharman of Redlynch**  
Chairman, Nomination Committee

## Audit Committee report

This report provides details of the role of the Audit Committee and the work it has undertaken during the year. The purpose of the Committee is to assist the Board in discharging its responsibilities for the integrity of the Company's financial statements, the assessment of the effectiveness of the systems of internal financial controls and monitoring the effectiveness and objectivity of the internal and external auditors. The full terms of reference for the Committee can be found on the Company's website, [www.aviva.com](http://www.aviva.com), and are also available from the Group Company Secretary.

The following independent non-executive directors, served on the Committee during the year:

Member	Period	
	From	To
Russell Walls (Chairman)	1 July 2004	To date
Mary Francis	1 January 2007	To date
Richard Karl Goeltz	1 July 2004	To date
Euleen Goh	1 January 2009	To date
Carole Piwnica	24 September 2003	31 December 2008

The Committee met on seven occasions in 2008 and the members' attendance record is set out in the Corporate Governance report on page 91. In addition, the Committee held separate meetings with members of senior management for the purpose of induction and training. The Group Company Secretary acts as the secretary to the Committee. Russell Walls, a Fellow Chartered Certified Accountant, is a former Group Finance Director of BAA plc, Wellcome plc and Coats Viyella plc. Richard Karl Goeltz is a former Chief Financial Officer of American Express Company and NatWest Group plc. Euleen Goh, a Chartered Accountant and member of the Chartered Institute of Taxation, is a former Financial Controller of Pontiac Land and Chief Executive of Standard Chartered Bank, Singapore. The Board is satisfied that these directors have recent and relevant financial experience.

The Group Chief Executive, Chief Financial Officer, Chief Audit Officer, Group Chief Accountant, Chief Risk Officer and the external auditor normally attend, by invitation, all meetings of the Committee. Other members of senior management are also invited to attend as appropriate to present reports. It is the Committee's practice at each meeting to meet separately with the Chief Audit Officer and the external auditor without any members of management being present. In performing its duties, the Committee has access to the services of the Chief Audit Officer, the Group Company Secretary and external professional advisers.

The Committee follows an agreed annual work plan. It reviews, with members of management and the internal and external auditors, the Company's financial announcements including the annual report and accounts to shareholders and associated documentation. It places particular emphasis on their fair presentation and the reasonableness of the judgemental factors and appropriateness of significant accounting policies used in their preparation. At each meeting, the Committee receives a report from the Chief Audit Officer concerning the Company's systems of internal financial control, including any significant new issues and actions taken on previously reported issues. Twice each year, the Committee receives reports on the adequacy of the Group's life assurance and general insurance reserves. The Committee also reviews the annual work plan for the Group's internal audit function. The Committee reports to the Board regarding the effectiveness of the Group's overall systems of internal financial control including the risk management systems in relation to the financial reporting process. The Committee works closely with the Risk and Regulatory Committee, which reviews the Company's overall internal controls and risk management systems.

During the year the Committee and the Risk and Regulatory Committee held a joint meeting in Paris with the chairman of the Aviva France audit committee. This meeting allowed the Committee to gain a deeper understanding of the relevant local issues and assess the effectiveness of the systems of internal financial controls and the effectiveness and objectivity of the internal and external auditors in that business.

Each of the Group's major business units has an audit committee that provides an oversight role for its business. The Chief Audit Officer reviews the papers and minutes from these committees and brings all significant matters to the Committee's attention. In addition during 2008 the members of the Committee attended several local audit committee meetings including those in Aviva USA, Norwich Union Life, Norwich Union Insurance, Aviva Canada, Aviva France, Hibernian and Aviva Italy. This programme of attendance at local audit committee meetings will continue during 2009.

The Committee receives reports from the external auditor and regularly holds discussions with both the internal and external auditors in the absence of management. The chairman of the Committee reports to the subsequent meeting of the Board on the Committee's work and the Board receives a copy of the minutes of each meeting of the Committee.

### Internal audit

The Group's internal audit function reports to management on the effectiveness of the Company's systems of internal controls, the adequacy of these systems to manage business risk and to safeguard the Group's assets and resources. The internal audit function is fully centralised and each country/region head has a full reporting line to the Chief Audit Officer (with the exception of Delta Lloyd). Through the Chief Audit Officer, the internal audit function provides objective assurance on risks and controls to the Committee. The plans, the level of resources and the budget of the internal audit function are reviewed at least annually by the Committee, which also undertakes an annual review of the effectiveness of the Group's internal audit function against guidance criteria provided by the Institute of Chartered Accountants in England and Wales and by the Institute of Internal Auditors (IIA). This year the review has been undertaken by PricewaterhouseCoopers to meet the IIA standards requiring that an independent review of internal audit effectiveness be undertaken at least every five years. The results of the review confirmed that Group Internal Audit generally conformed with the International Standards for the Professional Practice of Internal Auditing. In addition, the Group Audit Committee is consulted in determining the objectives and remuneration of the Chief Audit Officer.

The deteriorating economic and market environment required even greater attention to internal financial controls in 2008. During 2008 the Group internal audit function carried out an assurance review of the Group's management of the economic crisis conditions and the management actions put in place to maintain business as usual activities.

### External auditor

Ernst & Young LLP (Ernst & Young) was appointed auditor of the Company in 2001 having previously been the auditor of Norwich Union plc. Following the annual external audit effectiveness review the Committee concluded that the audit was fit for purpose and recommended that a re-tender process should not be undertaken in 2008 but that the relationship and the effectiveness of the auditor be kept under review. The audit signing partner changed as part of a rotation process in 2007. Ernst & Young audits all significant subsidiaries of the Group.

The Company introduced a revised external auditor policy on 1 January 2008 aimed at safeguarding and supporting the independence and objectivity of the external auditors. The policy was updated to reflect current global best practice on auditor independence, and is in full compliance with all UK, US and International Federation of Accountants (IFAC) rules. The revised policy aims to be simpler to interpret, providing greater clarity on what services may and may not be provided by the Group's external auditors.

The policy regulates the appointment of former audit employees to senior finance positions in the Group and sets out the approach to be taken by the Group when using the services of the external auditor, including requiring that all services provided by the external auditor are pre-approved by the Aviva plc Audit Committee. It distinguishes between those services where an independent view is required and that should be performed by the external auditor (such as statutory and non-statutory audit and assurance work), prohibited services where the independence of the external auditor could be threatened and they must not be used, and other non-audit services where the external auditor may be used. Non-audit services where the external auditor may be used include: non-recurring internal controls and risk management reviews (i.e. excluding outsourcing of internal audit work), advice on financial reporting and regulatory matters, due diligence on acquisitions and disposals, project assurance and advice, tax compliance services, and employee tax services.

Annually, the Committee reviews a formal letter provided by the external auditor confirming its independence and objectivity within the context of applicable regulatory requirements and professional standards.

The Group paid £12.1 million to Ernst & Young for audit services in 2008, relating to the statutory audit of the Group and Company financial statements and the audit of Group subsidiaries and associates pursuant to legislation (2007: £10.2 million). The fees for other services which included advice on accounting and regulatory matters, reporting on internal controls, corporate governance matters, and due diligence work were £12.9 million giving a total fee to Ernst & Young of £25.0 million (2007: £19.1 million). Further details are provided in note 12 to the accounts. In addition, the Group engaged the Corporate Citizenship in relation to certain assurance work including verification of its Corporate Social Responsibility report.

During the year, the Committee performed its annual review of the independence, effectiveness and objectivity of the external auditor; assessing the audit firm, the audit partner and audit teams. The process was conducted by means of a questionnaire, completed Group-wide by members of senior management and members of the Group's finance community. The questionnaire sought opinions on the importance of certain criteria and the performance of the external auditor against those criteria. Based on this review, the Committee concluded that the audit service of Ernst & Young was fit for purpose and provided a robust overall examination of the Group's business and the risks involved.

In line with the Combined Code requirement the Board undertook a review of the effectiveness of all its committees during the year, including the Audit Committee. In addition, the Committee also carried out a self-evaluation of its effectiveness.

This report was reviewed and approved by the Board on 4 March 2009.

**Russell Walls**  
Chairman, Audit Committee



## Risk and Regulatory Committee report

This report provides details of the role of the Risk and Regulatory Committee and the work it has undertaken during the year, and should be read in conjunction with the report on the Group's approach to risk and capital management on pages 28 to 35.

The purpose of the Committee is to assist the Board in providing leadership, direction and oversight with regard to the Group's risk and regulatory policies and procedures, including those related to compliance, risk management, financial malpractice and internal controls. The Committee also monitors the Group's risk exposures relative to appetite. The full terms of reference for the Committee can be found on the Company's website, [www.aviva.com](http://www.aviva.com), and are also available from the Group Company Secretary.

The following independent non-executive directors served on the Committee during the year:

Member	Period	
	From	To
Mary Francis (Chairman)	14 January 2006	To date
Nikesh Arora	1 July 2007	To date
Wim Dik	14 January 2006	To date
Russell Walls	14 January 2006	To date

The Committee met on five occasions in 2008 and the members' attendance record is set out in the Corporate Governance report on page 91. In addition the Committee held separate meetings with members of senior management and Ernst & Young for the purposes of induction and training. The Group Company Secretary acts as the secretary to the Committee.

The Group Chief Executive, Chief Financial Officer, Chief Audit Officer, Chief Risk Officer, Group Regulatory Director and the external auditor normally attend, by invitation, all meetings of the Committee. Other members of senior management are also invited to attend as appropriate to present reports. It is the Committee's practice at each meeting to meet separately with the Chief Audit Officer and the external auditor without any members of management being present. In performing its duties, the Committee has access to the services of the Chief Audit Officer, the Chief Risk Officer, the Group Regulatory Director, the Group Company Secretary and external professional advisers.

During the year the work of the Committee fell into the following broad areas:

### Risk management

The deteriorating economic and market environment required even greater attention to risk management in 2008, and heightened the interest of external stakeholders in the Company's processes and controls. The Committee's oversight focused on: continuing to improve the framework for identifying, monitoring and mitigating risks across the Group; ensuring that key financial risks – especially market and credit risks – were being identified and managed effectively; ensuring that operational risks, especially in IT and business protection and continuity, were well monitored and controlled; and monitoring how risk is managed at local and regional level within the Group through presentations from business unit leaders and risk teams. Between its formal meetings, the Committee received regular information from management on the Group's risk exposures and mitigating actions. Financial risk and capital management issues occupied the largest part of the Committee's time during the year, and are likely to continue to do so for the foreseeable future.

### Regulation and compliance

The Committee works with management to ensure that the Group has a constructive relationship with its lead regulator, the FSA, and with the local regulators who oversee its businesses worldwide.

During the year the Committee received regular reports on ongoing compliance issues and regulatory and other public policy initiatives. In particular, the Committee monitored the actions being taken by management in relation to the Risk Mitigation Programme agreed with the FSA; encouraged measures to strengthen oversight of the Group's compliance functions outside the UK; and received presentations on the Group's Treating Customers Fairly Programme in the UK and global customer centricity initiative.

### Internal Audit

The Group's internal audit function provides the Committee with independent and objective assurance over the appropriateness, effectiveness and sustainability of the Company's system of internal controls in place to mitigate significant risks. The Group Internal Audit plan is based on a robust and structured planning process using a risk based methodology that allows for quarterly updates to reflect changes to the Company's risk profile. Key control issues reported by Group Internal Audit to management and to the Committee members are monitored on a quarterly basis until the risk exposure has been properly mitigated. Reports on financial malpractice are also presented to the Committee including incidence of fraud, anti-money laundering procedures and, at least on an annual basis, arrangements whereby persons can report in confidence any concerns about lack of probity (whistleblowing).

During the year the Committee and the Audit Committee held a joint meeting in Paris with the chairman of the Aviva France audit committee. This meeting allowed the Committee to gain a deeper understanding of the relevant local issues and assess how the Group's risk management framework, and regulatory policies and procedures were being embedded in the business.

The chairman of the Committee reports at the subsequent meeting of the Board on the Committee's work and the Board receives a copy of the minutes of each meeting of the Committee.

In line with the Combined Code requirement the Board undertook a review of the effectiveness of all its committees during the year, including the Risk and Regulatory Committee.

This report was reviewed and approved by the Board on 4 March 2009.

**Mary Francis**  
Chairman, Risk and Regulatory Committee

## Corporate Social Responsibility Committee report

This report provides details of the role of the Corporate Social Responsibility Committee and the work it has undertaken during the year.

The purpose of the Committee is to provide guidance and direction to the Group's corporate social responsibility (CSR) programme, review the key CSR risks and opportunities and to monitor progress. The full terms of reference for the Committee can be found on the Company's website, [www.aviva.com](http://www.aviva.com), and are also available from the Group Company Secretary.

The following directors served on the Committee during the year:

Member	Period	
	From	To
Wim Dik (Chairman)	14 January 2006	31 December 2008
Guillermo de la Dehesa	14 January 2006	31 December 2008
Eileen Goh	1 January 2009	To date
Andrew Moss	12 July 2007	To date
Carole Pivnicka	14 January 2006	To date
Lord Sharman	14 January 2006	To date
Scott Wheway	5 December 2007	To date

The Committee met on four occasions in 2008 and the members' attendance record is set out in the Corporate Governance report on page 91. The Group Company Secretary acts as the secretary to the Committee.

During the year the Committee reviewed and approved the content and scope of the Company's 2008 CSR Report, monitored the management of the CSR risks affecting the Group and helped establish a process by which regions could report performance and progress to the Committee.

The Committee reviewed each region's performance and progress during the year. During the Board's visit to the Group's French operations in September 2008 the Committee held a meeting with the senior managers responsible for CSR. The meeting allowed the Committee to gain a deeper understanding of the relevant local issues and assess how CSR was being embedded in the business.

The Committee received ongoing updates on the Group's key CSR programme activities, including climate change, community investment, diversity and external benchmarking. The Committee also reviewed the Group's carbon offset projects as part of management's commitment to be carbon neutral on a global basis.

Aviva's Chairman, the Chairman of the Committee and a non-executive director committee member participated in the Group's Annual CSR Conference that took place in September 2008. Members of the Committee are interviewed as part of the external assurance process of the CSR programme and the subsequent management report, including Aviva's action plan, is reviewed by the Committee to assist the strengthening and future direction of the programme.

In line with the Combined Code requirement the Board undertook a review of the effectiveness of all its committees during the year, including the Corporate Social Responsibility Committee.

This report was reviewed and approved by the Board on 4 March 2009.

**Wim Dik**  
Chairman, Corporate Social Responsibility Committee

## Directors' remuneration report

### Highlights

- In 2008 the Committee agreed and implemented, with shareholder approval, the One Aviva Twice the Value Bonus Plan. It also decided to maintain the 2008 financial targets set in December 2007 despite the unprecedented shocks to the macro-economic system and volatility in markets.
- The Committee approved the Executive Directors' request to freeze their basic salaries for 2009. It is not proposing any major adjustments to Aviva's executive remuneration structure in the coming year. It has further approved stretching financial targets for 2009 and agreed to review in mid 2009 their continued appropriateness
- The demanding financial and non-financial targets set for the 2008 annual bonus were met in-part during the year. The combination of financial outcomes, along with those targets relating to employees, customers, and personal objectives mean the Chief Executive received a 2008 bonus of 54.2% of his maximum opportunity (2007: 65%).
- The Committee entered the 2009 reward review conscious of the economic background and widespread comment on over-generous executive remuneration. The Committee believes Aviva's 2008 business results are strong and that Aviva's remuneration practices already closely link pay to performance. The Committee has, however, looked to ensure prudent and proportionate reward outcomes.
- The Committee has decided to defer for one year Aviva's five-yearly comprehensive compensation review. The existing authorities and approvals, granted by shareholders in 2005, will allow the current schemes to continue to operate up until the Annual General Meeting in 2010.
- Mark Hodges, Chief Executive, Norwich Union Life, was appointed an Executive Director of Aviva plc in June 2008. Information on his remuneration therefore appears in this report for the first time.

### Introduction

This report sets out the remuneration policy for the Company's directors, describes its implementation and discloses the amounts paid in 2008. In addition to meeting statutory requirements, particularly the Companies Act 1985, Schedule 7A, the Remuneration Committee (the "Committee") has aimed to comply with best practice guidelines, including guidance produced by the Association of British Insurers (ABI) and the National Association of Pension Funds, in producing this report. Relevant sections of this report have been audited in accordance with Corporate Governance best practice and legislation

This report covers the following:

- The Committee's objectives, membership and main activities in 2008;
- A review of Aviva's remuneration policy and practice;
- Commentary on the alignment between remuneration and Aviva's business strategy and objectives;
- Details of the terms of executive directors' (EDs) service contracts;
- Aviva's share ownership policy with respect to EDs;
- Aviva's policy on external board appointments;
- Aviva's UK all employee share plans and Share Incentive plans;
- Aviva's position against dilution limits;
- Non-executive directors (NEDs), and;
- Tables summarising the 2008 position on:
  - Directors' remuneration
  - EDs' pension arrangements
  - Share incentive plans
  - Directors' interests in shares

### The Committee's objectives

The Committee is a committee of the Board. Its terms of reference are available from the Group Company Secretary and can be found on the Company's website [www.aviva.com](http://www.aviva.com). The Committee's key objectives are to:

- Establish a competitive remuneration package to attract, retain and motivate scarce, high quality leaders;
- Promote the achievement of both the Company's annual plans and its strategic objectives by providing a remuneration package that contains appropriately motivating targets; and
- Align senior executives' remuneration with the interests of shareholders and other stakeholders, including customers and employees.

The Committee's main responsibilities are to:

- Recommend to the Board the Group's remuneration policy for the EDs and members of senior management, covering basic salary, bonus, long term incentives, retirement provision, long term wealth creation and other benefits;
- Strike an appropriate balance between (i) the fixed and variable and (ii) the cash, equity and equity related components of the total remuneration package;
- Ensure the remuneration package is congruent with, and provides the incentives to realise, short and long term goals;
- Review and determine the terms of employment and remuneration of the individual EDs, including any specific recruitment or severance terms;
- Assess and, within the broad policy from time to time approved by the Board, determine the remuneration terms of the Chairman of the Board;
- Recommend to the Board the establishment of any employee share plans and exercise all the Board's powers in relation to the operation of all share and incentive plans, including the granting of awards, the setting and testing of performance conditions (where appropriate), and any discretion on behalf of the Board regarding any material amendments to the plans' rules not requiring the approval of shareholders; and
- Select, appoint and determine terms of reference for independent remuneration consultants to advise the Committee on remuneration policy and levels of remuneration.

## Committee membership

Table 1 below shows the independent NEDs who served on the Committee during the year:

**Table 1: Members of the Committee during 2008**

Member	From	To
Richard Karl Goeltz (Chairman from January 2006)	3 May 2004	1 January 2009
Mary Francis	25 January 2006	To date
Carole Piwnica	25 January 2006	To date
Scott Whewey (Chairman from 1 January 2009)	5 December 2007	To date

Aviva announced on 4 December 2008 the appointment of Mr Goeltz as its Senior Independent Director with effect from 1 January 2009. From the same date Mr Goeltz ceased to be a member of the Committee and Mr Whewey succeeded him as Chairman.

The Committee met on nine occasions in 2008 and the meeting attendance record is set out in the Corporate Governance report on page 91.

Committee meetings are attended by the Chief Executive (other than when his own remuneration is being discussed) and John Ainley, the Group Human Resources Director. The Group Company Secretary acts as secretary to the Committee. The Chairman attends when discussing the remuneration of the Chief Executive.

The Committee was advised in 2008 by David Hope, the Group Human Resources Strategy Director, on market practice and the alignment of reward arrangements to business strategy and by the Group Chief Accountant on matters relating to the performance measures and targets for the Group's incentive plans. Tim Harris held that role for part of 2008 and was succeeded by David Rogers.

In addition, the Committee appointed New Bridge Street Consultants (NBSC) to advise them on a review of senior executive remuneration (see below). NBSC provided no other material assistance to the Company in 2008. Deloitte LLP, which provided other services to the Group in 2008, advised the Committee on the calculation of Total Shareholder Return (TSR) in respect of the Long Term Incentive Plan (LTIP) vesting. The Group Company Secretary and Linklaters LLP (Linklaters) advised the Committee in relation to the operation of the Company's share plans. Linklaters provided other legal services to the Company during 2008.

In line with Combined Code requirements, the Board undertook a review of the effectiveness of the Committee during the year. Additionally, the Committee reviewed its own performance and agreed steps to enhance its effectiveness.



**Directors' remuneration report continued****Committee activities during 2008**

The Committee is required by its Terms of Reference to meet at least three times per year and has a standing calendar of items within its remit. In addition to these standing items, the Committee discusses matters relating to the operation of the remuneration policy and emerging market practices. In 2008 the Committee met nine times and discussed, amongst others, the issues set out in Table 2 below:

**Table 2: Matters discussed by the Committee during its 2008 meetings**

Meeting	Standing agenda items	Other agenda items
January	– None	– Consideration of proposals for the creation of a "One Aviva, Twice the Value" Bonus Plan (OATTV)
February (Twice)	<ul style="list-style-type: none"> <li>– A review of EDs' basic salaries and benefits in kind</li> <li>– Consideration and approval of EDs' bonus awards for 2007 and approval of share awards under the Annual Bonus Plan (ABP)</li> <li>– A review and approval of LTIP grants to the EDs and approval of the performance conditions for the 2008 grants</li> <li>– A performance test of subsisting LTIP grants</li> <li>– A decision on the operation of the UK's All Employee Share Ownership Plan and the Hibernian's All Employee Share Scheme</li> <li>– A review of dilution limits</li> <li>– A review and approval of recommendations on contributions into the Aviva Capital Accumulation Plan (ACAP)</li> <li>– Approval of the 2007 Directors' Remuneration Report</li> </ul>	– Approval of revised proposals for the OATTV plan
April	– None	– A review and approval of grants under the OATTV plan
June	– None	– Approval of Mark Hodges' appointment terms as an ED
July	<ul style="list-style-type: none"> <li>– Approval of the performance targets for the US Long-Term Incentive Plan</li> <li>– A review of EDs' bonus targets following a rebase for exchange rates and capital assumptions</li> <li>– Approval of an invitation to UK employees to participate in a Save As You Earn scheme</li> </ul>	<ul style="list-style-type: none"> <li>– A review of the proposed Aviva Investors' reward strategy</li> <li>– Consideration of EDs' 2008 bonus targets</li> </ul>
August	– None	– Further consideration of EDs' 2008 bonus targets
September	– None	<ul style="list-style-type: none"> <li>– Review of a paper on the proposed approach to future targets given Aviva's move from an EEV to an MCEV basis for reporting results</li> <li>– A review of market practice on NED shareholding requirements</li> <li>– A review of Aviva's remuneration for its senior management below ED level</li> </ul>
December	<ul style="list-style-type: none"> <li>– Approval of the proposed 2009 financial and employee targets for the operation of the Annual Bonus Plan</li> <li>– Comment upon and noting of the EDs' personal objectives for 2009</li> <li>– A review of the proposed approach to the 2008 Directors' Remuneration report</li> <li>– An update on progress with the Committee's 2008 and proposed 2009 work plans</li> </ul>	<ul style="list-style-type: none"> <li>– Note the final Aviva Investors' Reward Strategy</li> <li>– Consideration of the findings of a review of remuneration in Aviva's US business.</li> <li>– A review of the Executive Remuneration regulatory environment</li> </ul>

The Company's EDs elected to take a basic pay freeze in 2009 and the Committee endorsed that proposal. A further 45 members of senior management have similarly accepted a 2009 basic pay freeze. The EDs will receive 2008 bonuses below (as a percentage of basic salary) those awarded in 2007 against the background of the overall performance of the Group, as set out in pages 22 to 27. This is due to some of the demanding targets originally set in December 2007 not being met in full.

The Committee is conscious of the shareholders' loss of value over the last year. This loss was also felt by the EDs directly through the significantly lower value of the deferred ABP shares and LTIP shares granted in 2006, both of which will vest in March 2009. This is a direct consequence of our reward strategy that seeks alignment between the shareholder and Executives' interests.

### Financial targets for the 2008 bonus

Despite the unprecedented changes in the economic position over the year no changes were made to the targets for Executive Directors for 2008 which were set in December 2007.

### The introduction of a "One Aviva, Twice the Value" (OATTV) Bonus Plan

Details of how the OATTV plan operates are provided later in this report. This plan is designed to align senior management firmly behind the Chief Executive's aim of doubling Earnings per Share (EPS) from its end 2007 baseline by the end of 2012. After significant debate the Committee satisfied itself that this additional element of remuneration would assist the delivery of a key part of the Group's strategy. It was also satisfied that all or part of the bonus will vest only if stretching performance conditions are met. Furthermore, grants under the plan are only expected to be made in 2009 and 2010 in addition to the grants made in 2008. The plan was subject to extensive formal consultation with institutional shareholders and other stakeholders in advance of being put to Aviva's Annual General Meeting (AGM) in 2008 where it was approved.

### Planned Future Changes

The Company does not anticipate any significant changes to the structure of EDs' compensation packages in 2009, compared with that outlined below. There are, however, two points to note:-

- Aviva is changing its financial reporting from a European Embedded Value (EEV) to a Market Consistent Embedded Value (MCEV) approach. This required the Committee to consider how financial targets should be stated on the new MCEV basis. In particular, the Committee has discussed how to treat the Return on Capital Employed (ROCE) element of new and subsisting LTIP grants on an MCEV basis. It is comfortable that a move to MCEV ROCE will not make targets materially easier or more difficult to achieve.
- The external economic climate against which financial targets for 2009 have been set is unprecedentedly volatile. The level of stretch in the targets is very sensitive to the depth and duration of the economic downturn, which is currently highly uncertain. The Committee have therefore decided to review mid year the financial targets used for bonus purposes for EDs and other senior managers. Only in exceptional circumstances would the Committee consider amending financial targets, either up or down, and any significant change would be the subject of appropriate consultation. Any changes would be fully disclosed and explained in the 2009 Annual Report issued in 2010.

The Company is required every five years to seek shareholder approval for the operation of its share based incentive plans. The Committee has, in the past, carried out a comprehensive review of senior executive remuneration to coincide with this. This has allowed the Company to put to shareholders proposals that reflect a thorough review of the Company's remuneration package taking into account changing market and regulatory practice and the requirement to ensure that the package remains competitive. It had been the Committee's intention to carry out such a review in 2009 with a view to putting proposals to the AGM in 2010. Following due consideration, the Committee has determined that this review should be deferred until 2010. Given the current turbulence in the economy, significant developments in relation to shareholder attitudes on executive pay, and emerging regulatory involvement from the Financial Services Authority (FSA), the Committee considers that a more durable outcome will be obtained from a review carried out in 2010, when a number of these factors will be more settled.

**Directors' remuneration report continued**

The permission from shareholders given in 2005 will allow grants to be made under current arrangements up until the AGM in 2010. New proposals will therefore be put to shareholders in 2011.

Notwithstanding this deferral of the full review, the Committee has undertaken a high level review of Aviva's remuneration practices against the preliminary good practice criteria issued by the FSA. The initial assessment identified generally strong alignment of the Company's current practices with the FSA criteria. However, this is an area that will be kept under closer review during the year as the FSA develops its guidance both generally and specifically in relation to the insurance sector.

**Remuneration policy****Alignment with Group Strategy**

The Committee considers alignment between Group strategy and the remuneration of its senior executives, including EDs, to be critical. It believes that senior executives should be highly rewarded (on a market competitive basis) for the delivery of stretching goals but should receive reduced rewards when the business performs poorly. To achieve this alignment Aviva's remuneration package is leveraged, with a high percentage of pay "at risk" against the achievement of stretching goals. Furthermore two-thirds of any bonus and any LTIP grant are delivered in the form of Aviva shares. The element of deferred bonus that is matched under the OATTV bonus plan only vests if very demanding EPS targets are met. The requirements to defer bonus, participation in the LTIP and the OATTV bonus plan closely tie the long term value of executive remuneration to the Company's share price performance.

Senior executives thus have high exposure to the same benefits and drawbacks of share price movement as all shareholders. The belief that senior executives should be shareholders is reinforced through formal guidelines requiring EDs to build up and maintain a significant holding of shares in the Company.

The Group's strategic priorities and targets are set out elsewhere in this report. Those priorities are reflected closely in the remuneration package:

- Basic Salary: Internal and external equity in basic salary positioning is an important contributor to a motivational remuneration package. A range of market data is used to inform decision making taking into account the Company's policy with regard to the FTSE 30 and FTSE 50.
- Annual Bonus Plan (ABP): Bonus structures are effective only if they drive, through the targets, the maintenance of the Company on a sound financial footing and sustained profitable growth. In addition, the targets must not provide an incentive to promote behaviours which could be detrimental to the Company's long term interests. Management must justify the targets it recommends. The Committee assures itself that the targets, first, provide appropriate incentives and, second, are challenging.

The Committee also considers how, given changing economic circumstances, the Group's priorities and consequently the targets underpinning its bonus structures need to change. Given the challenging current environment the Committee has agreed that financial targets for 2009 should focus more on capital conservation and strengthening the Group's liquidity than in previous years. Financial targets sit alongside targets on customer advocacy and employee engagement introduced in 2005 that the Committee believes are critical to long-term organisational health. The personal objectives of executive committee members are reviewed by the Committee to ensure they adequately reflect the strategic aims of the Group, good governance and best practice.

- The One Aviva Twice the Value Bonus Plan (OATTV): This plan was introduced to emphasise the Chief Executive's clear strategic imperative for the Group to deliver growth in Earnings Per Share (EPS), with a target of doubling EPS in five years from an end 2007 baseline. No other element of executive remuneration was focused on EPS growth, and this bonus scheme directly aligns a portion of executive remuneration to this key strategic goal.
- Long Term Incentive Plan (LTIP): The LTIP encourages a longer-term management focus on ROCE and relative Total Shareholder Return (TSR). These metrics measure how the Company is performing in both absolute and relative terms.

The Committee considers all these elements, plus pension and other benefits, as a whole. It looks to ensure that an appropriate balance is maintained between them so that the need for both short-term success and long-term sustainable growth is recognised. The Committee also ensures that the non-financial business measures and individual objectives reflect adequately the Company's environmental, social and governance responsibilities.

### Constituent elements of reward as a percentage of total remuneration

Tables 3a and 3b below shows how the Group's remuneration policy translates in practice into the Chief Executive's remuneration package. It shows the contribution each element makes to overall compensation at both "target" and "stretch" levels of performance. More than half of EDs' total remuneration is performance related.

**Table 3a and 3b: Breakdown of Remuneration for the Chief Executive**

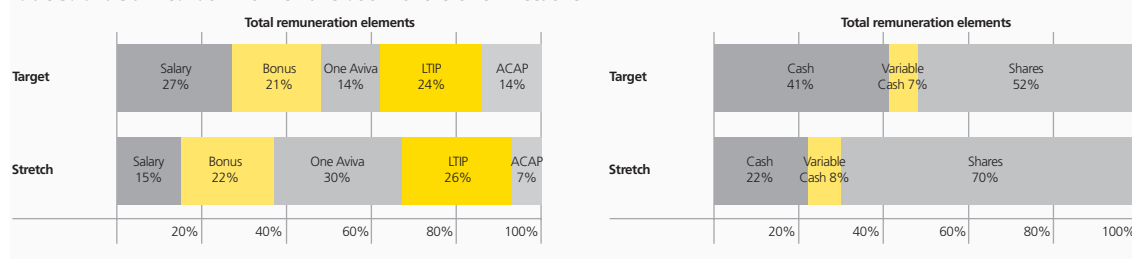


Table 3a shows the breakdown of the package into its main constituent elements. Table 3b gives the proportions of fixed cash, variable cash and shares. For the purposes of Table 3b, fixed cash includes basic salary and the discretionary Aviva Capital Accumulation Plan (ACAP) payment. Variable cash is the one-third of bonus paid in cash annually. The share element includes the two-thirds of bonus deferred into shares, the OATTV match and the LTIP.

- "Target" performance means a target ABP outcome (75% of basic salary), a 50% vesting of the LTIP (87.5% of basic salary) and 1:1 match from the OATTV bonus plan (50% of basic salary).
- "Stretch" performance means a stretch ABP outcome (150% of basic salary), 100% vesting of the LTIP (175% of basic salary) and a 2:1 match from the OATTV bonus plan (200% of basic salary).

The breakdown does not include any share price growth, the dividends on the ABP deferred shares or other benefits (eg. cash car allowance, value of Private Medical Insurance (PMI) and all-employee share ownership plans).



## Directors' remuneration report continued

## Remuneration policy in practice for executive directors

Table 4, below, summarises Aviva's remuneration policy as it is applied in practice to EDs.

Table 4: Remuneration policy in practice

Policy	How delivered
<b>Total remuneration</b>	
<ul style="list-style-type: none"> <li>– Total remuneration package levels are informed by relevant pay data, in particular the lower quartile to median range of the FTSE 30 and the median to upper quartile range of the FTSE 50.</li> <li>– These reference points are chosen to reflect Aviva's market capitalisation and comparability to other large, sophisticated multinational companies and the positioning that is appropriate to Aviva in those different comparator groups.</li> </ul>	<ul style="list-style-type: none"> <li>– Basic salary</li> <li>– ABP</li> <li>– OATTV plan</li> <li>– LTIP</li> <li>– Long-term savings</li> <li>– Aviva Staff Pension Scheme (ASPS)</li> <li>– Benefits</li> <li>– All-employee schemes.</li> </ul>
<b>Basic salary</b>	
<ul style="list-style-type: none"> <li>– Benchmarked as for total remuneration but with positioning and progression taking account of individual and business performance and the levels of increase provided for the broader UK employee population (basic salaries of the UK staff increased by 3.5% on average in 2008).</li> <li>– The Committee takes seriously institutional investors' concerns on the ratcheting of basic salaries and does not unquestioningly accept a particular market position or salary.</li> </ul>	<ul style="list-style-type: none"> <li>– Monthly in cash</li> <li>– Reviewed annually in February, with changes taking effect from 1 April.</li> </ul>
<b>Discretionary Annual Bonus Plan (ABP)</b>	
<ul style="list-style-type: none"> <li>– The ABP is intended to motivate executives to achieve the annual business plan, based on a series of key financial, employee and customer performance indicators (KPIs), which make up 70% of the bonus opportunity, and personal objectives (30%).</li> <li>– 75% of basic salary is payable for "on target" performance and up to 150% for "stretch" performance.</li> <li>– Deferred shares vest on the third anniversary of the date of grant, subject to the recipient remaining in service. On resignation during the three-year deferral period all or part of the grant is forfeited (100% in year of grant, 50% in following year and 25% in year after that). Additional shares are awarded in lieu of the dividends paid on the deferred shares during the deferral period.</li> </ul>	<ul style="list-style-type: none"> <li>– Annually, one-third is paid in cash and two-thirds in deferred shares.</li> </ul>
<b>"One Aviva, Twice the Value" (OATTV) Bonus Plan</b>	
<ul style="list-style-type: none"> <li>– The OATTV bonus aligns senior executives with the Chief Executive's clear strategic imperative of doubling EPS by the end of 2012.</li> <li>– The plan matches 100% of the deferred ABP shares for the Chief Executive (75% for the other EDs).</li> <li>– For the 2008 awards, the vesting of these matched shares is dependent on the average annual growth in EPS during the three-year performance period, thus: <ul style="list-style-type: none"> <li>– Less than 10% growth pa Nil</li> <li>– 10% growth pa 0.1 for 1</li> <li>– 26% growth pa 2 for 1</li> </ul> </li> <li>– Matching is on a straight-line basis for performance from 10% to 26%. No additional shares are awarded for the dividends paid during the three year performance period on those shares that vest.</li> </ul>	<ul style="list-style-type: none"> <li>– Annually, a proportion of the deferred element of the ABP is matched in shares</li> <li>– Shares vest based on demanding EPS growth targets.</li> </ul>
<b>Long-Term Incentive Plan (LTIP)</b>	
<ul style="list-style-type: none"> <li>– The LTIP is intended to motivate achievement of the Company's longer term objectives, to aid the retention of key personnel and to align executive interests to those of shareholders.</li> <li>– The Chief Executive is eligible to receive an annual award of shares equal to 175% of basic salary. Other EDs are eligible to receive an annual award of shares equal to 150% of basic salary.</li> <li>– No share-based award may exceed 200% of basic salary. However, in 2008 6 grants were made in Aviva's US business above 200% to a maximum of 300% of basic salary through a phantom scheme. The levels of grant made took into account US market practice. No additional shares are awarded for the dividends paid during the three year performance period on those shares that vest.</li> </ul>	<ul style="list-style-type: none"> <li>– Annual awards in restricted shares that vest, subject to ROCE and relative TSR performance conditions being met at the end of a three-year performance period</li> <li>– Awards that do not vest lapse.</li> </ul>

Policy	How delivered
<b>Long-term savings</b> <ul style="list-style-type: none"> <li>– The Aviva Capital Accumulation Plan (ACAP) is a long-term savings vehicle which aids retention whilst recognising a need for flexibility in long-term wealth planning.</li> <li>– Company contributions are discretionary and vary year-on-year, but would not normally exceed 50% of basic salary. Contributions for the executive directors are shown in the table on page 116.</li> <li>– No one who participates in the ACAP is currently accruing benefits in the ASPS. A resignation or departure for breach of contract generally results in forfeiture of contribution for the relevant year.</li> </ul>	<ul style="list-style-type: none"> <li>– Discretionary payments into a trust where they are held for a minimum of five years.</li> </ul>
<b>Aviva Staff Pension Scheme (ASPS)</b> <ul style="list-style-type: none"> <li>– The UK ASPS provides a competitive post retirement package. No ED is currently accruing service based benefits in the ASPS.</li> <li>– The scheme provides accrual at <math>\frac{1}{60}</math>, <math>\frac{1}{45}</math> or <math>\frac{1}{60}</math> of annual basic salary depending on seniority and the date of joining the scheme.</li> <li>– Lump sum death in service benefit of four times basic salary is provided, as is a spouse's or partner's pension equal to two-thirds of actual or, on death in service and in certain other circumstances, prospective pension. Post retirement increases are equivalent to RPI up to a maximum of 10%. Retirement benefits can be accessed from age 60.</li> </ul>	<ul style="list-style-type: none"> <li>– Deferred cash payable on retirement in the form of a lump sum/monthly payment.</li> </ul>
<b>Other benefits</b> <ul style="list-style-type: none"> <li>– Other benefits are provided on a market competitive basis.</li> </ul>	<ul style="list-style-type: none"> <li>– Cash car allowance</li> <li>– Private Medical Insurance (PMI)</li> <li>– All-employee share ownership plans.</li> </ul>

### Overview of the effect on current Executive Directors

The effect of these policies in 2008 for current EDs is set out below. It should be emphasised that the figures shown for both the LTIP grant and OATTV bonus plan grant represent the face value of those grants, which would only be realised if very stretching performance conditions were to be met. Details on pension benefits are set out later in this report.

**Table 5: Overview of current Executive Directors' remuneration**

#### Andrew Moss, Chief Executive

Element	Amount	Commentary
Basic salary	£913,750 during the year As at 1 January £880,000 As at 31 December £925,000	Mr Moss received a basic salary increase from 1 April of £45,000 (5.1%). His basic salary is frozen for 2009
ABP	£752,164 (81.3% of basic salary) (£250,721 delivered in cash and £501,443 deferred into shares for three years)	Bonus is a function of the degree of achievement of 2008 targets as follows: Financial 22.9% (maximum 50%) Employee 5.6% (maximum 10%) Customer 2.9% (maximum 10%) Personal 22.8% (maximum 30%).
OATTV bonus plan	£568,891	The face value of 100% of the two-thirds deferred element of 2007 annual bonus.
LTIP – face value of grant	£1,540,000	The face value of the grant represented 175% of basic salary on 29 February 2008.
ACAP	£462,500	The Trustee of the Plan accepted Aviva's recommendation and made an award into the plan equivalent to 50% of Mr Moss' basic salary as at 1 April.
Other benefits	£18,280 cash car allowance 2% basic salary cash supplement Private medical insurance	Mr Moss receives 2% of basic salary as a non-pensionable cash supplement provided in consideration of his surrendering his Unapproved Unfunded Retirement Benefit (UURB) promise at the point when accrual in the ASPS ceased.

**Directors' remuneration report continued****Philip Scott, Chief Financial Officer**

Element	Amount	Commentary
Basic salary	£592,500 during the year As at 1 January £570,000 As at 31 December £600,000	Mr Scott received a basic salary increase from 1 April of £30,000 (5.3%). His basic salary has been frozen for 2009
ABP	£487,890 (81.3% of basic salary) (£162,630 delivered in cash and £325,260 deferred into shares for three years)	Bonus is a function of the degree of achievement of 2008 targets as follows: Financial 22.9% (maximum 50%) Employee 5.6% (maximum 10%) Customer 2.9% (maximum 10%) Personal 22.8% (maximum 30%).
OATTV bonus plan	£320,625	The face value of 75% of the two-thirds deferred element of 2007 annual bonus.
LTIP – face value of grant	£855,000	The face value of the grant represented 150% of Mr Scott's basic salary on 29 February 2008.
ASPS	Membership of the Aviva Staff Pension Scheme	Mr Scott has a fully accrued pension equivalent to two thirds of his pensionable salary at retirement. He therefore no longer accrues service related benefits but does continue to accrue additional benefits as a result of pensionable salary increases.
Other Benefits	£16,120 cash car allowance Private Medical Insurance	

**Mark Hodges, Chief Executive, Norwich Union Life**

Element	Amount	Commentary
Basic salary	£462,500 during the year As at 1 January £395,000 As at 31 December £520,000	Mr Hodges was appointed an executive director of Aviva plc on 26 June 2008 and received an increase in basic salary from that date. His basic salary is frozen for 2009.
ABP	£532,077 (102.3% of basic salary) (£177,359 delivered in cash and £354,718 deferred into shares for three years)	Mr Hodges' bonus is a function of the degree of achievement of 2008 targets as follows: Financial 35.4% (maximum 50%) Employee 8.3% (maximum 10%) Customer 1.7% (maximum 10%) Personal 22.8% (maximum 30%).
OATTV bonus plan	£254,380	The face value of 75% of the two-thirds deferred element of 2007 annual bonus.
LTIP – face value of grant	£592,500	The face value of the grant represented 150% of Mr Hodges' basic salary on 29 February 2008.
ACAP	£207,500	The Trustee of the Plan accepted Aviva's recommendation and made an award into the plan equivalent to 50% of Mr Hodges' basic salary as at 1 April.
Other benefits	£14,710 cash car allowance Private medical insurance	

### Annual Bonus Plan (ABP) – target setting

The financial targets which underpinned the ABP (accounting for 50% of annual bonus) in 2008 were derived from Aviva's return, growth and capital efficiency/capital generation goals. Three of the financial targets (operating profit, volume and new business contribution) were "stretched" (as set out in Table 6) due to their importance in achieving these aspirations.

Employee and customer targets (each accounting for up to 10% of annual bonus) are set taking into account performance to date and aspirations for the future. The employee targets on leadership and engagement are derived from the Group's employee climate survey in which all business units participate and which over 42,000 staff completed in 2008. This survey is delivered through an independent third party able to provide extensive external benchmark data. Our aspiration is to reach the upper quartile positions compared to the relevant global and national norms on leadership and engagement over time.

Customer metrics do not yet have the same degree of consistency and external comparability in all business units as our employee climate survey. During 2008 we moved towards a more consistent metric to measure customer advocacy. Although there is still not complete alignment, all business units do have customer satisfaction and/or advocacy targets from which we can derive suitable performance targets. We expect our new measure to be used in most business units during 2009 and in all business units in 2010.

Internal assurance that the outcomes on employee and customer targets were accurately calculated and reported was provided to the Committee by Group Audit.

Personal objectives based on delivery of key strategic priorities, personal leadership and operating performance of the relevant portion of the business account for up to 30% of annual bonus.

The Group's performance against its financial, employee and customer KPIs in 2008, as they affected the bonus of the Chief Executive, is shown in Table 6 below.

**Table 6: Group performance in 2008 against its KPIs**

	Key performance indicators	Weighting (% of total bonus opportunity)		
		On target (%)	Stretch (%)	Actual payment (%)
Business measures (70%)	Operating profit (EEV/IFRS)	4.2	16.7	6.2
	Volume	4.2	10.4	–
	New Business Contribution	4.2	10.4	8.8
	Costs	4.2	4.2	4.2
	Operating Profit (IFRS basis)	4.2	4.2	3.8
	Combined Operating Ratio (COR) – General Insurance only	4.2	4.2	–
	Customer	5	10	2.9
	Employee	5	10	5.6
Personal measures (30%)	Personal – individual strategic	15	30	22.8
	Total*	50	100	54.2

\* Totals in columns do not add up due to rounding.

The Committee is sensitive to the current environment in relation to executive pay, and particularly relating to the payment of bonuses in circumstances where financial targets have not been met and share prices have fallen. However, the combination of financial and non-financial measures is central to the structure of the ABP. The Committee wants to ensure a balanced focus on both short-term financial performance and on the objective non-financial measures that are leading indicators of future financial success. This balance is, in the Committee's view, reflective of good practice in incentive design and is consistent with the FSA's guidance on creating incentive schemes that have a focus on long-term sustainable performance.

As described above, the Committee took the view that it was important to maintain the integrity of the financial targets for the EDs, and so these were not adjusted during the year. In the same way, the Committee believes that it is appropriate to pay bonus based on pre-agreed rigorous targets when these have been met. As outlined earlier in this report, given the overall 2008 performance against the demanding targets set, the bonuses of the EDs fell in 2008 compared with 2007 as a percentage of basic salary.

To align with the business priorities for 2009, the financial measures at Group level for 2009 are operating profit, volume, new business margin, the Combined Operating Ratio (COR) of our general insurance businesses, net capital returns and cost savings.



**Directors' remuneration report continued****One Aviva Twice the Value (OATTV) Bonus Plan**

The OATTV bonus plan aligns senior executives with the Chief Executive's clear strategic imperative of doubling EPS by the end of 2012. The plan matches 100% of the deferred ABP shares for the Chief Executive (75% for other EDs). For the grant made in 2008 the vesting of these matched shares is dependent on the average annual growth in EPS during the three year performance period, thus:

– Less than 10% growth pa	Nil
– 10% growth pa	0.1 for 1
– 26% growth pa	2 for 1

Matching is on a straight-line basis for performance between 10% and 26%. The maximum match of 2 shares for each deferred share is paid for delivering a doubling of EPS by the end of 2010. The threshold matching of 0.1 of a share for each share deferred is equivalent to doubling EPS by 2014. The Committee reviews the performance conditions of this plan annually.

**Long-Term Incentive Plan – target setting**

The LTIP vests subject to the degree of achievement of two equally weighted performance measures chosen to reflect shareholders' long-term interest in absolute ROCE and relative TSR performance.

**Return on Capital Employed (ROCE) targets**

ROCE targets are set annually within the context of the Company's three year business plan and have to date been set on an EEV basis. Vesting depends upon performance over the three year period against a target return. The Company's external auditor provides a formal opinion on the ROCE vesting calculation. The 2008 LTIP award ROCE targets are set out in Table 7 below:

**Table 7: 2008 LTIP ROCE targets**

ROCE over the three year performance period	Percentage of shares in award that vests based on achievement of ROCE targets
Less than 31.5%	0%
31.5%	15%
Between 31.5% and 37.5%	Pro rata between 15% and 50% on a straight-line basis
37.5% and above	50%

The same performance targets will apply for the 2009 LTIP, except that the measure will be calculated using an MCEV reporting basis and not EEV.

**Total Shareholder Return (TSR) targets**

Relative TSR determines the vesting of the other 50% of any LTIP award. The comparator group for the assessment of relative TSR performance at the time of the 2008 grant comprised Aegon, Allianz, Axa, Fortis, Friends Provident, Generali, HBOS, ING, Legal and General, Lloyds TSB, Prudential, Royal Bank of Scotland, Royal and Sun Alliance, Standard Life and Zurich. HBOS has since been delisted. The 2006 and 2007 LTIP grants are based on the same comparator group, with the exception of Standard Life which was not included in 2006.

TSR vesting operates as set out in Table 8 below:

**Table 8: TSR vesting schedule for the 2008 award**

TSR position over the three year performance period	Percentage of shares in award that vests based on achievement of TSR targets
Below median	0%
Median	15%
Between median and upper quintile	Pro rata between 15% and 50% on a straight-line basis
Upper quintile and above	50%

The same targets will apply for the 2009 LTIP awards. The comparator group will remain unchanged other than the removal of HBOS. The Committee has agreed a shortlist of companies that would be considered for inclusion in the comparator group, subject to final review, should any further member of the group be delisted.

Details of subsisting LTIP awards are provided on page 112 and Table 9 below shows the vesting projections (non-audited) of those awards as at 31 December 2008. For subsisting grants where HBOS was a member of the comparator group the Committee has determined that HBOS TSR performance to the end of 2008 should be used and thereafter replaced by a "synthetic" TSR based on the average TSR performance of the remaining constituents of the comparator group for the remainder of the performance period.

**Table 9: Projections of vesting of subsisting LTIP awards**

LTIP award	31 December 2008 vesting projection (% of award)
Aviva LTIP 2008	59.8%
Aviva LTIP 2007	37.8%
Aviva LTIP 2006	56.3%

Details of the assumptions used in valuing the LTIP for accounting purposes can be found on page 206 of this report. The vesting assumption made in respect of the 2009 award for accounting purposes is 50%.

Since the LTIP has performance conditions attached to it, then one potential outcome is that neither performance condition is met and the whole of the LTIP lapses. Table 10 below has been drawn up to assist in understanding the potential value of the LTIP awards made to executive directors in 2008 should the performance conditions be met in part or in whole.

**Table 10: Potential value of 2008 LTIP awards (rounded to nearest £100)**

LTIP	Andrew Moss	Philip Scott	Mark Hodges
Face value of grant	£1,540,000	£855,000	£592,500
Threshold vesting	£462,000	£256,500	£177,800
Expected value	£891,400	£494,900	£342,900
Maximum vesting	£2,049,700	£1,138,000	£788,600

Assumptions are as follows:

- Threshold vesting assumes TSR and ROCE elements vest at the minimum level, producing a 30% vesting of the total award. No share price growth is assumed;
- Expected value, based on the vesting assumption made for accounting purposes, assumes TSR and ROCE elements vest at a combined rate of 50% of the total award. Share price growth of 5% per annum is assumed over the three year performance period;
- Maximum vesting assumes both TSR and ROCE elements vest in full, producing a 100% vesting. Share price growth of 10% per annum is assumed over the three year performance period.

At the end of the performance period for the 2005 LTIP grant, which vested in 2008, the Company was ranked 12th out of the 15 companies in the TSR comparator group (0% vesting) and ROCE was 39.4% (50% vesting). The total vesting was therefore 50%. The 50% of the award which did not vest lapsed.

The LTIP vesting history is set out in Table 11 below. Prior to the 2005 award vesting history is based on an earlier LTIP plan, the last award under which was made in 2004.

**Table 11: Vesting history of LTIP awards**

Year of grant	Performance period	Percentage of award vesting		
		ROCE	TSR	Total
2002	January 2002 to December 2004	23.3	23.0	46.3
2003	January 2003 to December 2005	30.0	34.9	64.9
2004	January 2004 to December 2006	30.0	34.9	64.9
2005	January 2005 to December 2007	50.0	0.0	50.0

Aviva does not award additional shares for the dividends that were paid during the three year performance period on those shares that vest.

## Directors' remuneration report continued

## Share awards

Table 12 below sets out the current position of those share based awards made to EDs under current remuneration arrangements.

Table 12: ABP, OATTV Bonus Plan and LTIP Awards

	At 1 January 2008 Number	Awards granted during year Number	Awards vesting during year Number	Awards lapsing during year Number	At 31 December 2008 Number	Market price at date awards granted <sup>1</sup> Pence	Market price at date awards vested Pence	Vesting date
<b>Andrew Moss</b>								
<i>Aviva Long-Term Incentive Plan 2005</i>								
– 2005	102,803	–	51,401	51,402	–	633.5	635.5	March 2008
– 2006	87,804	–	–	–	<b>87,804</b>	814.0	–	March 2009
– 2007	136,540	–	–	–	<b>136,540</b>	778.5	–	March 2010
– 2008	–	253,289	–	–	<b>253,289</b>	617.5	–	March 2011
<i>Aviva Deferred Bonus Plan</i>								
– 2005	61,408	–	61,408	–	–	633.5	635.5	March 2008
<i>Aviva Annual Bonus Plan</i>								
– 2006	47,648	–	–	–	<b>47,648</b>	814.0	–	March 2009
– 2007	64,273	–	–	–	<b>64,273</b>	778.5	–	March 2010
– 2008	–	93,567	–	–	<b>93,567</b>	617.5	–	March 2011
<i>"One Aviva, twice the value" Bonus Plan</i>								
– 2008	–	93,567	–	–	<b>93,567</b>	598.0	–	March 2011
<b>Philip Scott</b>								
<i>Aviva Long-Term Incentive Plan 2005</i>								
– 2005	116,822	–	58,411	58,411	–	633.5	635.5	March 2008
– 2006	95,121	–	–	–	<b>95,121</b>	814.0	–	March 2009
– 2007	107,282	–	–	–	<b>107,282</b>	778.5	–	March 2010
– 2008	–	140,625	–	–	<b>140,625</b>	617.5	–	March 2011
<i>Aviva Deferred Bonus Plan</i>								
– 2005	68,690	–	68,690	–	–	633.5	635.5	March 2008
<i>Aviva Annual Bonus Plan</i>								
– 2006	47,138	–	–	–	<b>47,138</b>	814.0	–	March 2009
– 2007	58,647	–	–	–	<b>58,647</b>	778.5	–	March 2010
– 2008	–	70,312	–	–	<b>70,312</b>	617.5	–	March 2011
<i>"One Aviva, twice the value" Bonus Plan</i>								
– 2008	–	52,734	–	–	<b>52,734</b>	598.0	–	March 2011
<b>Mark Hodges</b>								
<i>Aviva Long-Term Incentive Plan 2005</i>								
– 2005	35,046 <sup>7</sup>	–	17,523	17,523	–	633.5	635.5	March 2008
– 2006	44,207	–	–	–	<b>44,207</b>	814.0	–	March 2009
– 2007	56,892	–	–	–	<b>56,892</b>	778.5	–	March 2010
– 2008	–	97,450 <sup>6</sup>	–	–	<b>97,450</b>	617.5	–	March 2011
<i>Aviva Deferred Bonus Plan</i>								
– 2005	34,344 <sup>7</sup>	–	34,344	–	–	633.5	635.5	March 2008
<i>Aviva Annual Bonus Plan</i>								
– 2006	32,725	–	–	–	<b>32,725</b>	814.0	–	March 2009
– 2007	37,366	–	–	–	<b>37,366</b>	778.5	–	March 2010
– 2008	–	55,785 <sup>6</sup>	–	–	<b>55,785</b>	617.5	–	March 2011
<i>"One Aviva, twice the value" Bonus Plan</i>								
– 2008	–	41,838 <sup>6</sup>	–	–	<b>41,838</b>	598.0	–	March 2011

## Notes

1. The actual price used to calculate the ABP and LTIP awards is based on a three-day average price. These were in 2005: 642p; 2006: 820p; 2007: 769p; 2008: 608p. The three-day average price used to grant the 2008 One Aviva twice the value award was 617p.

2. The performance period for all awards begins at the commencement of the financial year in which the award is granted.

3. The performance conditions for awards granted and vested during 2008 are explained elsewhere in this report.

4. The money value of awards will be calculated by multiplying the relevant number of shares by the market price at the date of vesting.

5. The award date for the awards which vested in 2008 was 24th March 2005.

6. These awards were granted to Mark Hodges before he was appointed to the board, and were held at the date of his appointment.

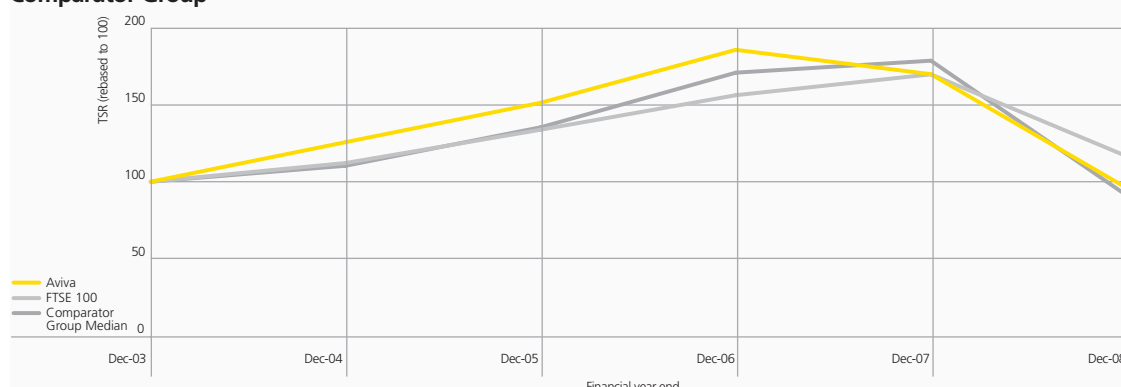
7. These awards were released to Mark Hodges before he was appointed to the board, and were not held at the date of his appointment.

## Performance graph

Table 13 below compares the TSR performance of the Company over the past five years with the TSR of the FTSE 100 Return Index. This index has been chosen because it is a recognised equity market index, of which Aviva is a member.

The companies which comprise the current LTIP comparator group for TSR purposes were chosen on the basis of product and geographic match to Aviva and are listed above. The TSR graph for the comparator group has been plotted using the 20 companies (including Aviva) in the comparator group for pre-2005 grants, the 15 companies (including Aviva) in the comparator group for 2005-07 grants and the 16 companies (including Aviva) in the comparator group for the 2008 grant.

**Table 13: Aviva plc 5-year TSR performance against the FTSE 100 Index and median of the Comparator Group**



## Executive Directors' service contracts

Service contracts agreed with each ED incorporate their terms and conditions of employment. Contracts were reviewed during 2006 and new contracts issued, bringing them into line with good market practice, particularly in respect of mitigation and phased payments. The aim is to strike a fair balance between the Company's and the employee's interests taking into account good market practice. The key terms are set out in Table 14 below.

**Table 14: Executive Directors' key terms and conditions of employment**

Provision	Policy								
Notice period									
By the director	– 6 months.								
By the Company	– 12 months, rolling. No notice or payment in lieu to be paid where the Company terminates for cause.								
Termination payment	– Pay in lieu of notice up to a maximum of 12 months' basic salary. This may be increased by a discretionary redundancy payment (where appropriate) but any such further termination payment is capped at 12 months' basic salary. – Any amount is subject to phased payment and mitigation requirements.								
Remuneration and benefits	– As described in this report. The operation of the ABP, the OATTV bonus plan, and LTIP plans is at the Company's discretion and in the case of the long-term savings plans at the trustees' discretion.								
Expenses	– Reimbursement reasonably incurred in accordance with their duties.								
Holiday entitlement	– 30 working days plus public holidays.								
Sickness	– In line with senior management terms ie 100% basic salary for 52 weeks, and 75% thereafter.								
Non-compete	– During employment and for six months after leaving.								
Contract dates	<table> <tr> <td>Director</td><td>Date current contract commenced</td></tr> <tr> <td>Andrew Moss</td><td>1 January 2007</td></tr> <tr> <td>Philip Scott</td><td>15 November 2006</td></tr> <tr> <td>Mark Hodges</td><td>26 June 2008</td></tr> </table>	Director	Date current contract commenced	Andrew Moss	1 January 2007	Philip Scott	15 November 2006	Mark Hodges	26 June 2008
Director	Date current contract commenced								
Andrew Moss	1 January 2007								
Philip Scott	15 November 2006								
Mark Hodges	26 June 2008								



**Directors' remuneration report continued****Share ownership requirements**

A requirement was introduced in 2005 that the Chief Executive and any EDs should build, over a five year period, a shareholding in the Company equivalent to 175% of basic salary and 150% of basic salary respectively. Shares held in compulsory bonus deferrals and performance shares held in unvested LTIPs are not taken into account in applying this test.

As at 31 December 2008, based on that day's closing share price of 390p, Mr Moss' shareholding of 176,067 shares represented 74% of his basic salary of £925,000 (his holding of 73,208 shares at 1 January 2008 represented 30.8% of his basic salary of £925,000 using the 31 December 2008 share price). Mr Scott's shareholding of 400,973 shares represented 261% of his basic salary of £600,000 (his holding of 291,106 shares at 1 January 2008 represented 189%) and Mr Hodges' shareholding of 100,086 shares represented 75% of his basic salary of £520,000 (his holding of 79,873 shares at 26 June 2008 represented 59.9%).

**External Board appointments**

Aviva recognises its senior executives can benefit from serving in a personal capacity as a non-executive director (NED) of non-Aviva Group companies. It is, at the same time, conscious of the corporate governance recommendations that EDs should take account of the time commitment required by a NED position and ensure any such role does not impact their ability to carry out fully their executive duties. The Company therefore has a policy of normally allowing senior executives to serve as a NED of one external company, subject to approval by the Board, and to retain any board fees.

The only ED who held an external NED appointment during 2008 was Philip Scott who was appointed to the Board of Diageo plc on 17 October 2007. As an NED of Diageo plc Mr Scott received fees totalling £90,000 in 2008.

**All-employee share plans**

EDs are eligible to participate in a number of HM Revenue & Customs (HMRC) approved all-employee share plans on the same basis as other eligible employees.

These plans include a share element of the Aviva All-Employee Share Ownership Plan (AESOP). Under this plan, eligible employees can receive up to a maximum of £3,000 per annum in shares based upon the profits of the Company's UK businesses. The shares are free of tax subject to a retention period. In addition, the partnership element of the AESOP, which the Company also operates, allows participants to invest up to £125 per month out of their gross salary in the Company's shares. There is no matching to this investment by the Company.

The Aviva Savings Related Share Option Scheme (SAYE) allows eligible employees to acquire options over the Company's shares at a discount of up to 20% of their market value at the date of grant. In order to exercise these options, participants must have saved through a three, five or seven-year HMRC approved savings contract, subject to a maximum savings limit of £250 per month.

Details of holdings under these plans can be found on page 119.

**Dilution**

Awards granted under the Aviva employee shares plans are met by the funding of an employee trust administered by an external trustee that acquires shares in the market. New issue shares will only be used where it is not possible to use trust shares and the funding policy is kept under review by the Committee and the Board. Details of the shares currently held in the employee trusts are set out in note 30 to the accounts.

During November 2008 a loan of £32 million was made to RBC Trustees (CI) Limited to ensure sufficient shares were available to meet its ongoing liabilities.

### Non-executive directors (NEDs)

The NEDs, including the Chairman, have letters of appointment which set out their duties and responsibilities. The key terms of the appointments are set out in Table 15 below.

**Table 15: NED key terms of appointment**

Provision	Policy		
Period	– Three year term which can be extended by mutual consent.		
Termination	– By the director or the Company giving the other one month's written notice without compensation.		
Fees	– As described below.		
Expenses	– Reimbursement of travel and other expenses reasonably incurred in the performance of their duties.		
Time commitment	– Between 25 and 50 days per annum depending upon Board and committee requirements and corporate activity.		
Non-compete	– During term of directorship and for six months after leaving.		
Appointment dates	Director	Date of last appointment	Date appointment ends
	Guillermo de la Dehesa	30 May 2006	31 December 2008
	Wim Dik	7 December 2008	AGM 2009
	Mary Francis	1 October 2008	AGM 2009
	Richard Karl Goeltz	3 May 2007	31 May 2010
	Carole Pivnicka	8 May 2006	31 May 2009
	Lord Sharman	14 January 2008	AGM 2011
	Russell Walls	3 May 2007	31 May 2010
	Nikesh Arora	1 July 2007	AGM 2010
	Scott Whewey	5 December 2007	AGM 2010

It is the Company's policy to set the fees paid to its Chairman and NEDs taking account of the median market payments in international companies of similar size and complexity. NEDs receive a basic annual fee in respect of their Board duties. A further fee is paid to NEDs (other than the Chairman) in respect of membership and, where appropriate, chairmanship of Board Committees.

Fees are reviewed annually and are set by the Board to attract individuals with the required range of skills and experience. In determining the level of fees paid to the NEDs the Board receives recommendations from the EDs, who consider the NEDs duties and responsibilities, together with the time commitment required in preparing for and attending meetings, and the amounts paid by competitors and similar-sized companies.

The Chairman and NEDs do not participate in any incentive or performance plans or pension arrangements.

The Company's Articles of Association provide that the total aggregate remuneration paid to the Chairman and NEDs will be determined by the Board within the limits set by shareholders. The current aggregate limit of £1.5 million was approved by shareholders at the Company's 2005 Annual General Meeting. The amount paid in 2008 was £1.23 million. EDs are remunerated under their service contracts and receive no additional fee for serving as directors.

**Directors' remuneration report continued**

NED fees payable from 1 April 2008 are set out in Table 16 below.

**Table 16: NED fees from 1 April 2008**

Chairman	£495,000
Board membership fee	£63,000
Additional fees are paid as follows:	
Senior independent director	£20,000
Committee Chairman	
– Audit	£35,000 (inclusive of committee membership fee)
– Remuneration	£20,000 (inclusive of committee membership fee)
– Risk and Regulatory	£17,500 (inclusive of committee membership fee)
Committee Membership	
– Audit	£10,000
– Remuneration	£10,000
– Nomination	£5,000
– Risk and Regulatory	£5,000
– Corporate Social Responsibility	£5,000

Directors' service contracts and letters of appointment are available for inspection at the Company's registered office during normal hours of business.

**Directors' remuneration in 2008**

Table 17 below sets out the remuneration paid or payable to the directors in respect of the year to 31 December 2008. This section (Directors' remuneration in 2008) and those sections headed "Executive directors' pension arrangements" and "Share incentive plans" along with their associated footnotes have been subject to audit.

**Table 17: Directors' remuneration in 2008**

	Basic salary/fees		Bonuses <sup>1</sup>		ACAP <sup>2</sup>		Benefits <sup>3</sup>		Total	
	2008 £'000	2007 £'000	2008 £'000	2007 £'000	2008 £'000	2007 £'000	2008 £'000	2007 £'000	2008 £'000	2007 £'000
<b>Chairman</b>										
Lord Sharmar	490	450	–	–	–	–	15	–	505	450
<b>Executive directors</b>										
Andrew Moss	914	790	752	853	463	398	91	56	2,220	2,097
Philip Scott	593	565	488	641	–	–	35	55	1,116	1,261
Mark Hodges <sup>4</sup>	463	–	532	–	208	–	99	–	1,302	–
<b>Non-executive directors</b>										
Guillermo de la Dehesa	109	95	–	–	–	–	–	–	109	95
Wim Dik	95	90	–	–	–	–	–	–	95	90
Mary Francis	99	90	–	–	–	–	–	–	99	90
Richard Karl Goeltz	94	87	–	–	–	–	–	–	94	87
Carole Piwnica	87	82	–	–	–	–	–	–	87	82
Russell Walls	107	102	–	–	–	–	–	–	107	102
Nikesh Arora	69	32	–	–	–	–	–	–	69	32
Scott Wheway	77	5	–	–	–	–	–	–	77	5
<b>Total emoluments of directors</b>	<b>3,197</b>	<b>2,388</b>	<b>1,772</b>	<b>1,494</b>	<b>671</b>	<b>398</b>	<b>240</b>	<b>111</b>	<b>5,880</b>	<b>4,391</b>

**Notes**

- Bonuses show the value at the date of award inclusive of the two thirds of bonus which Aviva requires its EDs to defer into Aviva shares for three years.
- During the year, shares granted to certain former EDs under the Company's incentive plans vested. Details of these awards were fully disclosed in the year of grant.
- "Benefits". All the EDs received life assurance benefits during the year that relate to the cost incurred by the Company of insuring the directors' life and relevant spouses' benefits which, had the director died during the year, could not have been wholly paid by the pension scheme and would therefore have been met by the Company had the insurance not been in place. The disclosure also includes the cost of private medical insurance and, where appropriate, accompanied travel, accommodation and car benefits. All the numbers disclosed include the tax charged on the benefits. No directors received an expense allowance during the year.
- Mark Hodges' 2007 data is not disclosed as he was not an ED during the year. Mark Hodges' 2008 data shown above includes all sums paid to him during 2008, not just those paid in respect of his services as a director.
- For the purposes of the disclosure required by Schedule 6 to the Companies Act 1985 the total aggregate emoluments of the directors in respect of 2008 was £5.2 million (2007: £6.6 million, which included three Executive Directors who left in 2007). This reflects the total aggregate emoluments of Mark Hodges in respect of the period that he served as a director during the year, comprising basic salary of £269,000, bonus of £275,000 and benefits of £53,000.
- No compensation payment for loss of office was made to any director, or former director, during the year.
- Annual bonuses are one-third paid in cash and two-thirds deferred into shares for three years.

Fees earned in 2008 by the non-executive directors are set out in Table 18 below.

**Table 18: Non-Executive Directors' fees paid in 2008**

	Board membership fees	Senior independent director	Fees as non-executive Chairman of the Group's operations in Spain	Committee chairman/Membership					Total fees
				Remuneration	Audit	Nomination	Corporate Social Responsibility	Risk and Regulatory	
Colin Sharman, Chairman	£490,000	—	—	—	—	—	—	—	£490,000
Nikesh Arora	£62,250	—	—	—	—	£2,126	—	£5,000	£69,376
Guillermo de la Dehesa	£62,250	—	£38,941	—	—	£2,897	£5,000	—	£109,088
Wim Dik	£62,250	£20,000	—	—	—	£2,897	£5,000	£5,000	£95,147
Mary Francis	£62,250	—	—	£10,000	£10,000	—	—	£16,875	£99,125
Richard Goeltz	£62,250	—	—	£20,000	£10,000	£2,126	—	—	£94,376
Carole Piwnica	£62,250	—	—	£10,000	£10,000	—	£5,000	—	£87,250
Russell Walls	£62,250	—	—	—	£35,000	£5,000	—	£5,000	£107,250
Scott Wheway	£62,250	—	—	£10,000	—	—	£5,000	—	£77,250

**Notes**

Following a review in March 2008 of Aviva's fees against market benchmarks the following changes in NEDs' emoluments were made with effect from 1 April 2008:

- The Chairman's fee was increased from £475,000 pa to £495,000 pa (an increase of 4.2%).
- Board membership fees were increased from £60,000 pa to £63,000 pa (an increase of 5%).
- The fee for chairing the Risk and Regulatory Committee (inclusive of membership fee) was increased from £15,000 pa to £17,500 pa (an increase of 16.7%).
- Other fees remained unchanged.

The following changes to NED responsibilities took place during the year:

- Guillermo de la Dehesa ceased to be a member of the Nomination Committee from 29 July 2008 and retired from the Board and Corporate Social Responsibility Committee from 31 December 2008.
- Wim Dik ceased to be a member of the Nomination Committee from 29 July 2008 and retired as Senior Independent Director on 31 December 2008. He remains a member of the Corporate Social Responsibility and Risk Regulatory Committees
- Richard Goeltz joined the Nomination Committee from 29 July 2008.
- Nikesh Arora joined the Nomination Committee from 29 July 2008.

**Senior executives' remuneration**

The total compensation paid during the year to key management personnel, being those having authority and responsibility for planning, directing and controlling the activities of the Company, including the Company's EDs and NEDs (as required to be disclosed by International Accounting Standard 24) was £53 million (2007 restated: £60 million) and is set out below in note 58 to the Accounts.



**Directors' remuneration report continued****Executive directors' pension arrangements**

The positions of the EDs with respect to accumulated pension benefits under the defined benefits section of the ASPS is set out in Table 19 below.

**Table 19: Executive Directors' pension benefits**

	Andrew Moss <sup>1</sup> £'000	Philip Scott <sup>2</sup> £'000	Mark Hodges <sup>3</sup> £'000
Accrued annual pension at 1 January 2008	20	376	81
Increase in accrued annual pension during the year as a result of inflation	1	19	–
Accrued annual pension at 31 December 2008 <sup>4</sup>	21	395	81
Employee contributions during the year <sup>5</sup>	–	30	–
Transfer value of accrued pension at 31 December 2007	248	5,609	549
Transfer value of accrued pension at 31 December 2008	231	6,300	660
Change in transfer value during the period less employee contributions <sup>6</sup>	(17)	661	111
Age at 31 December 2008 (years)	50	54	43

**Notes**

1. Mr Moss ceased accrual in the ASPS with effect from 31 March 2006, and as a result, his post March 2006 Pension Benefit was £19,556 pa. This will increase in line with deferred pensions (the lower of the increase in RPI or 5%) subject to the life time allowance. At 31 December 2008 it had increased to £21,042 pa.
2. Mr Scott has been accruing benefits in the ASPS since before June 1989, so was not therefore subject to the HMRC's Earnings Cap. Following pensions' simplification Mr Scott registered with HMRC for enhanced protection. He remains a member of the scheme and continues to accrue benefits as a result of salary increases. However, he is not accruing benefits as a result of additional service. Mr Scott's pension will be based upon his final pensionable salary and years of service at retirement, subject to an overriding limit of two-thirds of final pensionable salary. Mr Scott has a pre-existing commitment that were he to retire up to two years before his normal retirement age of 60, then he would receive a non-discounted pension. This commitment was entered into prior to the publication of ABI Guidelines issued in December 2006, which made reference to early retirement terms for directors.
3. Mr Hodges ceased accrual in the ASPS with effect from 31 March 2006, and as a result, his post March 2006 Pension Benefit was £75,000 pa. This will increase in line with deferred pensions (the lower of the increase in RPI or 5%). Mr Hodges was appointed as an ED from 26 June 2008. His benefits shown above are therefore as at that date (not 1 January 2008) and as at 31 December 2008. At 31 December 2008 his "accrued pension" was £80,700 pa.
4. The "accrued pension" is the amount of annual pension to which the Directors would have been entitled to at age 60, had they left service at 31 December 2008.
5. Members of the Defined Benefit section of the ASPS made a contribution of 5% of their pensionable salary.
6. The change in transfer values over the year include the effect of changes made by the Trustee of the ASPS to the assumptions used in respect of changes to market values and expected future investment returns. The Trustees changed the long term financial and mortality assumptions for transfer values with an effective date of 1 July 2008. Transfer values represent the estimated liability on the Scheme to pay the stated level of benefits. They are not sums paid or due to a Director, and do not represent the true cost of providing the pension benefit.
7. No former Directors received any increase in retirement benefits in excess of the amount to which they were entitled, on the later of the date when the Benefits first became payable, or 31 March 1997.

**Share incentive plans**

Details of the directors who held executive office for any part of the financial year, and hold or held options to subscribe for ordinary shares of the Company or hold or held awards over shares in the Company, pursuant to the Company's share-based incentive plans, are set out in Table 20 below.

Savings related share options in Table 20 refer to options granted under the HMRC approved SAYE. Options are normally exercisable during the six month period following the end of the relevant (three, five or seven year) savings contract.

**Table 20: Directors' options to subscribe for, or awards over, Company shares**

	At 1 January 2008 Number	Options granted during year Number	Options exercised during year Number	Options lapsing during year Number	At 31 December 2008 Number	Exercise price Pence	Exercise period
<b>Andrew Moss</b> Savings related options 2005	3,279	–	–	–	<b>3,279</b>	491.0	December 2010 – May 2011
<b>Philip Scott</b> Savings related options 2008	–	2,341	–	–	<b>2,341</b>	410.0	December 2011 – May 2012
<b>Mark Hodges</b> Savings related options 2007	1,705	–	–	–	<b>1,705</b>	563.0	December 2010 – May 2011

**Notes**

The mid-market price of an ordinary share in the Company on 31 December 2008, being the last business day of the year, was 390.0 pence, and the mid-market prices during the year ranged from 670.0 pence to 245.3 pence. During the year, no share options were exercised by directors.

## Directors' interests in Aviva shares

The interests held by each person who was a director at the end of the financial year in the ordinary shares of 25 pence each in the Company are shown in Table 21 below. All the disclosed interests are beneficial. The table also summarises the interests in shares held through the Company's various all-employee and executive share schemes. Details of the options and long term incentive awards are shown above.

**Table 21: Directors' interests in Aviva shares**

	Shares <sup>1</sup>		Bonus Plan Awards <sup>2</sup>		Long-term Incentive Awards <sup>3</sup>		OATTV <sup>4</sup>		Options <sup>5</sup>	
	1 January 2008	31 December 2008	1 January 2008	31 December 2008	1 January 2008	31 December 2008	1 January 2008	31 December 2008	1 January 2008	31 December 2008
Nikesh Arora	–	–	–	–	–	–	–	–	–	–
Guillermo de la Dehesa	144	<b>144</b>	–	–	–	–	–	–	–	–
Wim Dik	200	<b>214</b>	–	–	–	–	–	–	–	–
Mary Francis	1,800	<b>1,800</b>	–	–	–	–	–	–	–	–
Richard Karl Goeltz	2,500	<b>2,500</b>	–	–	–	–	–	–	–	–
Mark Hodges <sup>7</sup>	46,507	<b>100,086</b>	104,435	<b>125,876</b>	136,145	<b>198,549</b>	–	<b>41,838</b>	1,705	<b>1,705</b>
Andrew Moss	73,208	<b>176,067</b>	173,329	<b>205,488</b>	327,147	<b>477,633</b>	–	<b>93,567</b>	3,279	<b>3,279</b>
Carole Pivnicka	2,500	<b>2,500</b>	–	–	–	–	–	–	–	–
Philip Scott	291,106	<b>400,973</b>	174,475	<b>176,097</b>	319,225	<b>343,028</b>	–	<b>52,734</b>	–	<b>2,341</b>
Lord Sharman	5,000	<b>20,000</b>	–	–	–	–	–	–	–	–
Russell Walls	4,000	<b>4,000</b>	–	–	–	–	–	–	–	–
Scott Wheway	–	<b>1,677</b>	–	–	–	–	–	–	–	–

### Notes

- "Shares" are the directors' beneficial holdings in the ordinary shares of the Company and in respect of the EDs include shares held in trust under the Company's All-Employee Share Ownership Plan (AESOP) being shares purchased by them under the partnership element and shares granted under the free share element of the AESOP.
- "Bonus Plan Awards" relates to entitlements to shares arising through the current, or former, Aviva Bonus Plans. Under these plans some of the earned bonuses are paid in the form of shares and deferred for three years. The transfer of the shares to the director at the end of the period is not subject to the attainment of performance conditions but a proportion of the shares can be forfeited if the executive leaves service before the end of the period.
- "Long Term Incentive Awards" are awards granted under the LTIP which vest only if the performance conditions are achieved.
- OATTV awards are granted as a match to the bonus plan awards under the ABP and vest only if the performance conditions are achieved.
- "Options" are options over shares granted under the SAYE
- The interests of connected persons to the Directors are included in the Directors' interests above.
- Mark Hodges was appointed as a director on 26 June 2008. On this date he held 79,873 shares, 125,876 bonus plan awards, 198,549 long term incentive awards, 41,838 OATTV awards and 1,705 options.

The following changes to directors' interests which relate to shares acquired each month under the partnership element of the AESOP during the period 1 January 2009 to 27 February 2009 have been reported to the Company.

	Number of shares
Philip Scott	81
Mark Hodges	81

This report was reviewed and approved by the Board on 4 March 2009.

**Scott Wheway**  
Chairman, Remuneration Committee



“Don’t make it  
hard work for me”



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# Independent auditor's report to the shareholders of Aviva plc

We have audited the Group and Parent Company financial statements (the "financial statements") of Aviva plc for the year ended 31 December 2008 which comprise the Accounting Policies, the Consolidated and Parent Company Income Statements, the pro forma reconciliation of Group operating profit to profit before tax, the Consolidated and Parent Company statement of recognised income and expense the Consolidated and Parent Company reconciliation of movements in shareholders' equity, the Consolidated and Parent Company balance sheets, the Consolidated and Parent Company cash flow statements and the related notes 1 to 58 and A to H. We have also audited the information in the Directors' remuneration report that is described as having been audited.

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 Directors' remuneration report and the financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of directors' responsibilities.

Our responsibility is to audit the financial statements and the part of the Directors' remuneration report to be audited 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 financial statements give a true and fair view and whether the financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' report is consistent with the financial statements. The information given in the Directors' report includes that specific information presented in the Business review that is cross referred from the Directors' report.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate governance report 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 other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Overview, the Business review, the Board of directors, Executive management, the Directors' report, the Corporate governance report, the Audit committee report, the Nomination committee report, the Risk and regulatory committee report, the Corporate social responsibility committee report, Other information, Aviva MCEV Financial statements and the unaudited part of the Directors' remuneration report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

## 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 financial statements and the part of the Directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' 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 financial statements and the part of the Directors' remuneration report to be audited.

**Independent auditor's report to the shareholders of Aviva plc continued****Opinion**

In our opinion:

The financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's and the Parent Company's affairs as at 31 December 2008 and of the Group's loss and the Parent Company's profit for the year then ended;

The financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985, as regards the Group financial statements, Article 4 of the IAS Regulation; and

The information given in the Directors' report is consistent with the financial statements.

**Separate opinion in relation to IFRSs**

As explained in the Accounting Policies to the Group financial statements, the Group, in addition to complying with its legal obligation to comply with IFRSs as adopted by the European Union, has also complied with the IFRSs as issued by the International Accounting Standards Board.

In our opinion, the Group financial statements give a true and fair view, in accordance with IFRSs, of the state of the Group's affairs as at 31 December 2008 and of its loss for the year then ended.

**Ernst & Young LLP**  
Registered Auditor  
London  
4 March 2009

## Accounting policies

Aviva plc (the “Company”), a public limited company incorporated and domiciled in the United Kingdom (UK), together with its subsidiaries (collectively, the “Group” or “Aviva”) transacts life assurance and long-term savings business, fund management, and most classes of general insurance and health business through its subsidiaries, associates and branches in the UK, Ireland, continental Europe, United States (US), Canada, Asia, Australia and other countries throughout the world.

The Group is managed on a regional basis, reflecting the management structure whereby a member of the Executive Management team is accountable to the Group Chief Executive for the operating segment for which he is responsible. Further details of the reportable segments are given in note 4.

The principal accounting policies adopted in the preparation of these financial statements are set out below.

### (A) Basis of presentation

Since 2005, all European Union listed companies have been required to prepare consolidated financial statements using International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) and endorsed by the European Union (EU). The date of transition to IFRS was 1 January 2004. In addition to fulfilling their legal obligation to comply with IFRS as adopted by the European Union, the Group and Company have also complied with IFRS as issued by the International Accounting Standards Board and applicable at 31 December 2008.

In November 2006, the IASB issued IFRS 8, *Operating Segments*. Although its requirements are applicable for accounting periods beginning on or after 1 January 2009, the Group has decided to adopt IFRS 8 early and reflect its impact in these financial statements. As noted above, details of the reportable segments are given in note 4.

During 2007 and 2008, the IASB issued IAS 1, *Presentation of Financial Statements : A Revised Presentation*, and amendments to IFRS 1, *First Time Adoption of IFRS*, IFRS 2, *Share-Based Payment*, IAS 1, IAS 23, *Borrowing Costs*, IAS 27, *Consolidated and Separate Financial Statements*, IAS 32, *Financial Instruments: Presentation*, and IAS 39, *Financial Instruments: Recognition and Measurement*, and the results of its annual improvements project. It also issued revised versions of IFRS 1, and IFRS 3, *Business Combinations*, as well as further amendments to IAS 27 and IAS 39, none of which has yet been endorsed by the EU. These are not applicable for the current accounting period and, on adoption, they will not have any material impact on the Group’s financial reporting.

IFRIC interpretation 13, *Customer Loyalty Programmes*, was issued during 2007 but is not applicable for the current accounting period. In addition, IFRIC interpretation 15, *Agreements for the Construction of Real Estate*, interpretation 16, *Hedges of a Net Investment in a Foreign Operation*, and interpretation 17, *Distributions of Non-cash Assets to Owners*, were issued during 2008. They have not yet been endorsed by the EU but none of them is applicable for the current accounting period. On adoption, none of these interpretations will have any impact on the Group’s financial reporting.

In accordance with IFRS 4, *Insurance Contracts*, the Group has applied existing accounting practices for insurance and participating investment contracts, modified as appropriate to comply with the IFRS framework and applicable standards. Further details are given in policy F below.

Items included in the financial statements of each of the Group’s entities are measured in the currency of the primary economic environment in which that entity operates (the functional currency). The consolidated financial statements are stated in sterling, which is the Company’s functional and presentation currency. Unless otherwise noted, the amounts shown in these financial statements are in millions of pounds sterling (£m). As supplementary information, consolidated financial information is also presented in euros.

The separate financial statements of the Company are on pages 278 to 285.

### FRS 27

Financial Reporting Standard 27, *Life Assurance*, (FRS 27) was issued by the UK’s Accounting Standards Board (ASB) in December 2004. Aviva, along with other major insurance companies and the Association of British Insurers (ABI), signed a Memorandum of Understanding (MoU) with the ASB relating to FRS 27. Under this MoU, Aviva voluntarily agreed to adopt in full the standard from 2005 in the Group’s IFRS financial statements.



**Accounting policies continued****(B) Operating profit**

The long-term nature of much of the Group's operations means that, for management's decision-making and internal performance management, short-term realised and unrealised investment gains and losses are treated as non-operating items. The Group focuses instead on an operating profit measure that incorporates an expected return on investments supporting its long-term and non long-term businesses. Operating profit for long-term business is based on expected investment returns on financial investments backing shareholder and policyholder funds over the reporting period, with allowance for the corresponding expected movements in liabilities. Variances between actual and expected investment returns, and the impact of changes in economic assumptions on liabilities, are disclosed separately outside operating profit. For non-long-term business, the total investment income, including realised and unrealised gains, is analysed between that calculated using a longer term return and short-term fluctuations from that level. Further details of this analysis and the assumptions used are given in notes 8 and 9.

**(C) Critical accounting policies and the use of estimates**

The preparation of financial statements requires the Group to select accounting policies and make estimates and assumptions that affect items reported in the consolidated income statement, balance sheet, other primary statements and notes to the financial statements.

**Critical accounting policies**

The major areas of judgement on policy application are considered to be over whether Group entities should be consolidated (set out in policy D), on product classification (set out in policy F) and in the classification of financial investments (set out in policy S).

**Use of estimates**

All estimates are based on management's knowledge of current facts and circumstances, assumptions based on that knowledge and their predictions of future events and actions. Actual results may differ from those estimates, possibly significantly.

The table below sets out those items we consider particularly susceptible to changes in estimates and assumptions, and the relevant accounting policy.

Item	Accounting policy
Insurance and participating investment contract liabilities	F & K
Goodwill, AVIF and other intangible assets	N
Fair values of financial investments	S
Impairment of financial investments	S
Fair value of derivative financial instruments	T
Deferred acquisition costs and other assets	W
Provisions and contingent liabilities	Z
Pension obligations	AA
Deferred income taxes	AB

Further details on the fair value hierarchy used in assessing the values of our financial investments are given in note 24(b) to these financial statements.

Further details on the estimation of amounts for insurance and participating investment contract liabilities are given in notes 38, 39 and 50 to these financial statements.

**(D) Consolidation principles****Subsidiaries**

Subsidiaries are those entities (including special purpose entities) in which the Group, directly or indirectly, has power to exercise control over financial and operating policies in order to gain economic benefits. Subsidiaries are consolidated from the date on which effective control is transferred to the Group and are excluded from consolidation from the date of disposal. All inter-company transactions, balances and unrealised surpluses and deficits on transactions between Group companies have been eliminated.

From 1 January 2004, the date of first time adoption of IFRS, the Group is required to use the purchase method of accounting to account for the acquisition of subsidiaries. Under this method, the cost of an acquisition is measured as the fair value of assets given up, shares issued or liabilities undertaken at the date of acquisition, plus costs directly attributable to the acquisition. The excess of the cost of acquisition over the fair value of the net assets of the subsidiary acquired is recorded as goodwill (see policy N below). Any surplus of the acquirer's interest in the subsidiary's net assets over the cost of acquisition is credited to the income statement.

### Merger accounting and the merger reserve

Prior to 1 January 2004, certain significant business combinations were accounted for using the “pooling of interests method” (or merger accounting), which treats the merged groups as if they had been combined throughout the current and comparative accounting periods. Merger accounting principles for these combinations gave rise to a merger reserve in the consolidated balance sheet, being the difference between the nominal value of new shares issued by the Parent Company for the acquisition of the shares of the subsidiary and the subsidiary’s own share capital and share premium account. These transactions have not been restated, as permitted by the IFRS 1 transitional arrangements.

The merger reserve is also used where more than 90% of the shares in a subsidiary are acquired and the consideration includes the issue of new shares by the Company, thereby attracting merger relief under the Companies Act 1985.

### Investment vehicles

In several countries, the Group has invested in a number of specialised investment vehicles such as Open-ended Investment Companies (OEICs) and unit trusts. These invest mainly in equities, bonds, cash and cash equivalents, and properties, and distribute most of their income. The Group’s percentage ownership in these vehicles can fluctuate from day-to-day according to the Group’s and third-party participation in them. Where Group companies are deemed to control such vehicles, with control determined based on an analysis of the guidance in IAS 27 and SIC 12, they are consolidated, with the interests of parties other than Aviva being classified as liabilities. These appear as “Net asset value attributable to unitholders” in the consolidated balance sheet. Where the Group does not control such vehicles, and these investments are held by its insurance or investment funds, they do not meet the definition of associates (see below) and are, instead, carried at fair value through profit and loss within financial investments in the consolidated balance sheet, in accordance with IAS 39, *Financial Instruments: Recognition and Measurement*.

As part of their investment strategy, the UK and certain European long-term business policyholder funds have invested in a number of property limited partnerships (PLPs), either directly or via property unit trusts (PUTs), through a mix of capital and loans. The PLPs are managed by general partners (GPs), in which the long-term business shareholder companies hold equity stakes and which themselves hold nominal stakes in the PLPs. The PUTs are managed by a Group subsidiary.

Accounting for the PUTs and PLPs as subsidiaries, joint ventures or other financial investments depends on the shareholdings in the GPs and the terms of each partnership agreement. Where the Group exerts control over a PLP, it has been treated as a subsidiary and its results, assets and liabilities have been consolidated. Where the partnership is managed by a contractual agreement such that no party exerts control, notwithstanding that the Group’s partnership share in the PLP (including its indirect stake via the relevant PUT and GP) may be greater than 50%, such PUTs and PLPs have been classified as joint ventures. Where the Group holds minority stakes in PLPs, with no disproportionate influence, the relevant investments are carried at fair value through profit and loss within financial investments.

### Associates and joint ventures

Associates are entities over which the Group has significant influence, but which it does not control. Generally, it is presumed that the Group has significant influence if it has between 20% and 50% of voting rights. Joint ventures are entities whereby the Group and other parties undertake an economic activity which is subject to joint control arising from a contractual agreement. In a number of these, the Group’s share of the underlying assets and liabilities may be greater than 50% but the terms of the relevant agreements make it clear that control is not exercised. Such jointly-controlled entities are referred to as joint ventures in these financial statements.

Gains on transactions between the Group and its associates and joint ventures are eliminated to the extent of the Group’s interest in the associates and joint ventures. Losses are also eliminated, unless the transaction provides evidence of an impairment of the asset transferred between entities.

Investments in associates and joint ventures are accounted for using the equity method of accounting. Under this method, the cost of the investment in a given associate or joint venture, together with the Group’s share of that entity’s post-acquisition changes to shareholders’ funds, is included as an asset in the consolidated balance sheet. As explained in policy N, the cost includes goodwill identified on acquisition. The Group’s share of their post-acquisition profits or losses is recognised in the income statement and its share of post-acquisition movements in reserves is recognised in reserves. Equity accounting is discontinued when the Group no longer has significant influence over the investment.

If the Group’s share of losses in an associate or joint venture equals or exceeds its interest in the undertaking, the Group does not recognise further losses unless it has incurred obligations or made payments on behalf of the entity.

### The Company’s investments

In the Company balance sheet, subsidiaries and joint ventures are stated at their fair values, estimated using applicable valuation models underpinned by the Company’s market capitalisation. These investments are classified as available for sale (AFS) financial assets, with changes in their fair value being recorded in a separate investment valuation reserve within equity.

**Accounting policies continued****(E) Foreign currency translation**

Income statements and cash flows of foreign entities are translated into the Group's presentation currency at average exchange rates for the year while their balance sheets are translated at the year end exchange rates. Exchange differences arising from the translation of the net investment in foreign subsidiaries, associates and joint ventures, and of borrowings and other currency instruments designated as hedges of such investments, are taken to the currency translation reserve within equity. On disposal of a foreign entity, such exchange differences are transferred out of this reserve and are recognised in the income statement as part of the gain or loss on sale. The cumulative translation differences were deemed to be zero at the transition date to IFRS.

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Gains and losses resulting from the settlement of such transactions, and from the translation of monetary assets and liabilities denominated in foreign currencies, are recognised in the income statement.

Translation differences on debt securities and other monetary financial assets measured at fair value and designated as held at fair value through profit or loss (FV) (see policy S) are included in foreign exchange gains and losses in the income statement. For monetary financial assets designated as AFS, translation differences are calculated as if they were carried at amortised cost and so are recognised in the income statement, whilst foreign exchange differences arising from fair value gains and losses are included in the investment valuation reserve within equity. Translation differences on non-monetary items, such as equities which are designated as FV, are reported as part of the fair value gain or loss, whereas such differences on AFS equities are included in the investment valuation reserve.

**(F) Product classification**

Insurance contracts are defined as those containing significant insurance risk if, and only if, an insured event could cause an insurer to make significant additional payments in any scenario, excluding scenarios that lack commercial substance, at the inception of the contract. Such contracts remain insurance contracts until all rights and obligations are extinguished or expire. Contracts can be reclassified as insurance contracts after inception if insurance risk becomes significant. Any contracts not considered to be insurance contracts under IFRS are classified as investment contracts.

Some insurance and investment contracts contain a discretionary participating feature, which is a contractual right to receive additional benefits as a supplement to guaranteed benefits. These are referred to as participating contracts.

As noted in policy A above, insurance contracts and participating investment contracts in general continue to be measured and accounted for under existing accounting practices at the later of the date of transition to IFRS or the date of the acquisition of the entity. Accounting for insurance contracts is determined in accordance with the Statement of Recommended Practice issued by the Association of British Insurers in December 2005, as amended in December 2006. However, in certain businesses, the accounting policies or accounting estimates have been changed, as permitted by IFRS 4 and IAS 8 respectively, to remeasure designated insurance liabilities to reflect current market interest rates and changes to regulatory capital requirements. When accounting policies or accounting estimates have been changed and adjustments to the measurement basis have occurred then the financial statements of that year will have disclosed the impacts accordingly.

**(G) Premiums earned**

Premiums on long-term insurance contracts and participating investment contracts are recognised as income when receivable, except for investment-linked premiums which are accounted for when the corresponding liabilities are recognised. For single premium business, this is the date from which the policy is effective. For regular premium contracts, receivables are taken at the date when payments are due. Premiums are shown before deduction of commission and before any sales-based taxes or duties. Where policies lapse due to non-receipt of premiums, then all the related premium income accrued but not received from the date they are deemed to have lapsed is offset against premiums.

General insurance and health premiums written reflect business incepted during the year, and exclude any sales-based taxes or duties. Unearned premiums are those proportions of the premiums written in a year that relate to periods of risk after the balance sheet date. Unearned premiums are calculated on either a daily or monthly pro rata basis. Premiums collected by intermediaries, but not yet received, are assessed based on estimates from underwriting or past experience, and are included in premiums written.

Deposits collected under investment contracts without a discretionary participating feature (non-participating contracts) are not accounted for through the income statement, except for the fee income (covered in policy H) and the investment income attributable to those contracts, but are accounted for directly through the balance sheet as an adjustment to the investment contract liability.

## (H) Other investment contract fee revenue

Investment contract policyholders are charged fees for policy administration, investment management, surrenders or other contract services. The fees may be for fixed amounts or vary with the amounts being managed, and will generally be charged as an adjustment to the policyholder's balance. The fees are recognised as revenue in the period in which they are collected unless they relate to services to be provided in future periods, in which case they are deferred and recognised as the service is provided.

Initiation and other "front-end" fees (fees that are assessed against the policyholder balance as consideration for origination of the contract) are charged on some non-participating investment and investment fund management contracts. Where the investment contract is recorded at amortised cost, these fees are deferred and recognised over the expected term of the policy by an adjustment to the effective yield. Where the investment contract is measured at fair value, the front-end fees that relate to the provision of investment management services are deferred and recognised as the services are provided.

## (I) Other fee and commission income

Other fee and commission income consists primarily of fund management fees, income from the RAC's non-insurance activities, distribution fees from mutual funds, commissions on reinsurance ceded, commission revenue from the sale of mutual fund shares, and transfer agent fees for shareholder record keeping. Reinsurance commissions receivable are deferred in the same way as acquisition costs, as described in policy W. All other fee and commission income is recognised as the services are provided.

## (J) Net investment income

Investment income consists of dividends, interest and rents receivable for the year, movements in amortised cost on debt securities, realised gains and losses, and unrealised gains and losses on FV investments (as defined in policy S). Dividends on equity securities are recorded as revenue on the ex-dividend date. Interest income is recognised as it accrues, taking into account the effective yield on the investment. It includes the interest rate differential on forward foreign exchange contracts. Rental income is recognised on an accruals basis.

The realised gain or loss on disposal of an investment is the difference between the proceeds received, net of transaction costs, and its original cost or amortised cost as appropriate. Unrealised gains and losses represent the difference between the carrying value at the year end and the carrying value at the previous year end or purchase value during the year, less the reversal of previously recognised unrealised gains and losses in respect of disposals made during the year.

## (K) Insurance and participating investment contract liabilities

### Claims

Long-term business claims reflect the cost of all claims arising during the year, including claims handling costs, as well as policyholder bonuses accrued in anticipation of bonus declarations.

General insurance and health claims incurred include all losses occurring during the year, whether reported or not, related handling costs, a reduction for the value of salvage and other recoveries, and any adjustments to claims outstanding from previous years.

Claims handling costs include internal and external costs incurred in connection with the negotiation and settlement of claims. Internal costs include all direct expenses of the claims department and any part of the general administrative costs directly attributable to the claims function.

### Long-term business provisions

Under current IFRS requirements, insurance and participating investment contract liabilities are measured using accounting policies consistent with those adopted previously under existing accounting practices, with the exception of liabilities remeasured to reflect current market interest rates and those relating to UK with-profit and non-profit contracts, to be consistent with the value of the backing assets. For liabilities relating to UK with-profit contracts, the Group has adopted FRS 27, *Life Assurance*, which adds to the requirements of IFRS but does not vary them in any way. Further details are given in policy A above.

In the United States, shadow adjustments are made to the liabilities or related deferred acquisition costs and are recognised directly in equity. This means that the measurement of these items is adjusted for unrealised gains or losses on the backing assets such as AFS financial investments (see policy S), that are recognised directly in equity, in the same way as if those gains or losses had been realised.



**Accounting policies continued**

The long-term business provisions are calculated separately for each life operation, based either on local regulatory requirements or existing local GAAP at the later of the date of transition to IFRS or the date of the acquisition of the entity, and actuarial principles consistent with those applied in the UK. Each calculation represents a determination within a range of possible outcomes, where the assumptions used in the calculations depend on the circumstances prevailing in each life operation. The principal assumptions are disclosed in note 38(b). For liabilities of the UK with-profit fund, FRS 27 requires liabilities to be calculated as the realistic basis liabilities as set out by the UK's Financial Services Authority, adjusted to remove the shareholders' share of future bonuses. For UK non-profit insurance contracts, the Group applies the realistic regulatory basis as set out in the FSA Policy Statement 06/14, *Prudential Changes for Insurers*, where applicable.

**Present value of future profits (PVFP) on non-participating business written in a with-profit fund**

For UK with-profit life funds falling within the scope of the FSA realistic capital regime, and hence FRS 27, an amount may be recognised for the present value of future profits on non-participating business written in a with-profit fund where the determination of the realistic value of liabilities in that with-profit fund takes account, directly or indirectly, of this value. This amount is recognised as a reduction in the liability rather than as an asset on the balance sheet, and is then apportioned between the amounts that have been taken into account in the measurement of liabilities and other amounts which are shown as an adjustment to the unallocated divisible surplus.

**Unallocated divisible surplus**

In certain participating long-term insurance and investment business, the nature of the policy benefits is such that the division between shareholder reserves and policyholder liabilities is uncertain. Amounts whose allocation to either policyholders or shareholders has not been determined by the end of the financial year are held within liabilities as an unallocated divisible surplus.

If the aggregate carrying value of liabilities for a particular participating business fund is in excess of the aggregate carrying value of its assets, then the difference is held as a negative unallocated divisible surplus balance, subject to recoverability from margins in that fund's participating business. Any excess of this difference over the recoverable amount is charged to net income in the reporting period.

**Embedded derivatives**

Embedded derivatives that meet the definition of an insurance contract or correspond to options to surrender insurance contracts for a set amount (or based on a fixed amount and an interest rate) are not separately measured. All other embedded derivatives are separated and measured at fair value, if they are not considered as closely related to the host insurance contract or do not meet the definition of an insurance contract. Fair value reflects own credit risk to the extent the embedded derivative is not fully collateralised.

**Liability adequacy**

At each reporting date, an assessment is made of whether the recognised long-term business provisions are adequate, using current estimates of future cash flows. If that assessment shows that the carrying amount of the liabilities (less related assets) is insufficient in light of the estimated future cash flows, the deficiency is recognised in the income statement by setting up an additional provision in the balance sheet.

**General insurance and health provisions****(i) Outstanding claims provisions**

General insurance and health outstanding claims provisions are based on the estimated ultimate cost of all claims incurred but not settled at the balance sheet date, whether reported or not, together with related claims handling costs. Significant delays are experienced in the notification and settlement of certain types of general insurance claims, particularly in respect of liability business, including environmental and pollution exposures, the ultimate cost of which cannot be known with certainty at the balance sheet date. Any estimate represents a determination within a range of possible outcomes. Further details of estimation techniques are given in note 38(c).

Provisions for latent claims are discounted, using rates based on the relevant swap curve, in the relevant currency at the reporting date, having regard to the expected settlement dates of the claims. The discount rate is set at the start of the accounting period with any change in rates between the start and end of the accounting period being reflected below operating profit as an economic assumption change. The range of discount rates used is described in note 38(c). This is a change in accounting policy, the effects of which are given in note 2(b)(i).

Outstanding claims provisions are valued net of an allowance for expected future recoveries. Recoveries include non-insurance assets that have been acquired by exercising rights to salvage and subrogation under the terms of insurance contracts.

**(ii) Provision for unearned premiums**

The proportion of written premiums, gross of commission payable to intermediaries, attributable to subsequent periods is deferred as a provision for unearned premiums. The change in this provision is taken to the income statement as recognition of revenue over the period of risk.

### **(iii) Liability adequacy**

At each reporting date, the Group reviews its unexpired risks and carries out a liability adequacy test for any overall excess of expected claims and deferred acquisition costs over unearned premiums, using the current estimates of future cash flows under its contracts after taking account of the investment return expected to arise on assets relating to the relevant general business provisions. If these estimates show that the carrying amount of its insurance liabilities (less related deferred acquisition costs) is insufficient in light of the estimated future cash flows, the deficiency is recognised in the income statement by setting up a provision in the balance sheet.

### **Other assessments and levies**

The Group is subject to various periodic insurance-related assessments or guarantee fund levies. Related provisions are established where there is a present obligation (legal or constructive) as a result of a past event. Such amounts are not included in insurance liabilities but are included under "Provisions" in the balance sheet.

## **(L) Non-participating investment contract liabilities**

### **Claims**

For non-participating investment contracts with an account balance, claims reflect the excess of amounts paid over the account balance released.

### **Contract liabilities**

Deposits collected under non-participating investment contracts are not accounted for through the income statement, except for the investment income attributable to those contracts, but are accounted for directly through the balance sheet as an adjustment to the investment contract liability.

The majority of the Group's contracts classified as non-participating investment contracts are unit-linked contracts and are measured at fair value. Certain liabilities for non-linked non-participating contracts are measured at amortised cost.

The fair value liability is in principle established through the use of prospective discounted cash-flow techniques. For unit-linked contracts, the fair value liability is equal to the current unit fund value, plus additional non-unit reserves if required on a fair value basis. For non-linked contracts, the fair value liability is equal to the present value of expected cash flows on a market-consistent basis.

Amortised cost is calculated as the fair value of consideration received at the date of initial recognition, less the net effect of principal payments such as transaction costs and front-end fees, plus or minus the cumulative amortisation (using the effective interest rate method) of any difference between that initial amount and the maturity value, and less any write-down for surrender payments. The effective interest rate is the one that equates the discounted cash payments to the initial amount. At each reporting date, the amortised cost liability is determined as the value of future best estimate cash flows discounted at the effective interest rate.

## **(M) Reinsurance**

The Group assumes and cedes reinsurance in the normal course of business, with retention limits varying by line of business. Premiums on reinsurance assumed are recognised as revenue in the same manner as they would be if the reinsurance were considered direct business, taking into account the product classification of the reinsured business. The cost of reinsurance related to long-duration contracts is accounted for over the life of the underlying reinsured policies, using assumptions consistent with those used to account for these policies.

Where general insurance liabilities are discounted, any corresponding reinsurance assets are also discounted using consistent assumptions.

Gains or losses on buying retroactive reinsurance are recognised in the income statement immediately at the date of purchase and are not amortised. Premiums ceded and claims reimbursed are presented on a gross basis in the consolidated income statement and balance sheet as appropriate.

Reinsurance assets primarily include balances due from both insurance and reinsurance companies for ceded insurance liabilities. Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provisions or settled claims associated with the reinsured policies and in accordance with the relevant reinsurance contract.

Reinsurance contracts that principally transfer financial risk are accounted for directly through the balance sheet and are not included in reinsurance assets or liabilities. A deposit asset or liability is recognised, based on the consideration paid or received less any explicitly identified premiums or fees to be retained by the reinsured.

If a reinsurance asset is impaired, the Group reduces the carrying amount accordingly and recognises that impairment loss in the income statement. A reinsurance asset is impaired if there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the Group may not receive all amounts due to it under the terms of the contract, and the event has a reliably measurable impact on the amounts that the Group will receive from the reinsurer.

**Accounting policies continued****(N) Goodwill, AVIF and intangible assets****Goodwill**

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired subsidiary, associate or joint venture at the date of acquisition. Goodwill on acquisitions prior to 1 January 2004 (the date of transition to IFRS) is carried at its book value (original cost less cumulative amortisation) on that date, less any impairment subsequently incurred. Goodwill arising before 1 January 1998 was eliminated against reserves and has not been reinstated. Goodwill arising on the Group's investments in subsidiaries since that date is shown as a separate asset, whilst that on associates and joint ventures is included within the carrying value of those investments.

**Acquired value of in-force business (AVIF)**

The present value of future profits on a portfolio of long-term insurance and investment contracts, acquired either directly or through the purchase of a subsidiary, is recognised as an asset. If the AVIF results from the acquisition of an investment in a joint venture or an associate, it is held within the carrying amount of that investment. In all cases, the AVIF is amortised over the useful lifetime of the related contracts in the portfolio on a systematic basis. The rate of amortisation is chosen by considering the profile of the additional value of in-force business acquired and the expected depletion in its value. The value of the acquired in-force long-term business is reviewed annually for any impairment in value and any reductions are charged as expenses in the income statement.

**Intangible assets**

Intangibles consist primarily of brands, certain of which have been assessed as having indefinite useful lives, and contractual relationships such as access to distribution networks and customer lists. The economic lives of the latter are determined by considering relevant factors such as usage of the asset, typical product life cycles, potential obsolescence, maintenance costs, the stability of the industry, competitive position, and the period of control over the assets. These intangibles are amortised over their useful lives, which range from five to 22 years, using the straight-line method.

The amortisation charge for the year is included in the income statement under "Other operating expenses". For intangibles with finite lives, a provision for impairment will be charged where evidence of such impairment is observed. Intangibles with indefinite lives are subject to regular impairment testing, as described below.

**Impairment testing**

For impairment testing, goodwill and intangibles with indefinite useful lives have been allocated to cash-generating units by geographical reporting unit and business segment. The carrying amount of goodwill and intangible assets with indefinite useful lives is reviewed at least annually or when circumstances or events indicate there may be uncertainty over this value. Goodwill and indefinite life intangibles are written down for impairment where the recoverable amount is insufficient to support its carrying value. Further details on goodwill allocation and impairment testing are given in note 16(b).

**(O) Property and equipment**

Owner-occupied properties are carried at their revalued amounts, which are supported by market evidence, and movements are taken to a separate reserve within equity. When such properties are sold, the accumulated revaluation surpluses are transferred from this reserve to retained earnings. These properties are depreciated down to their estimated residual values over their useful lives. All other items classed as property and equipment within the balance sheet are carried at historical cost less accumulated depreciation.

Investment properties under construction are included within property and equipment until completion, and are stated at cost less any provision for impairment in their values.

Depreciation is calculated on the straight-line method to write-down the cost of other assets to their residual values over their estimated useful lives as follows:

– Land	No depreciation
– Properties under construction	No depreciation
– Owner-occupied properties, and related mechanical and electrical equipment	25 years
– Motor vehicles	Three-years, or lease term if longer
– Computer equipment	Three to five years
– Other assets	Three to five years

The assets' residual values, useful lives and method of depreciation are reviewed regularly, and at least at each financial year end, and adjusted if appropriate. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount. Gains and losses on disposal of property and equipment are determined by reference to their carrying amount.

All borrowing costs and repairs and maintenance costs are charged to the income statement during the financial period in which they are incurred. The cost of major renovations is included in the carrying amount of the asset when it is probable that future economic benefits in excess of the most recently assessed standard of performance of the existing asset will flow to the Group and the renovation replaces an identifiable part of the asset. Major renovations are depreciated over the remaining useful life of the related asset.

### **(P) Investment property**

Investment property is held for long-term rental yields and is not occupied by the Group. Completed investment property is stated at its fair value, which is supported by market evidence, as assessed by qualified external valuers or by local qualified staff of the Group in overseas operations. Changes in fair values are recorded in the income statement in net investment income.

### **(Q) Impairment of non-financial assets**

Property and equipment and other non-financial assets are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's net selling price and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows.

### **(R) Derecognition and offset of financial assets and financial liabilities**

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- The rights to receive cash flows from the asset have expired;
- The Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third-party under a "pass-through" arrangement; or
- The Group has transferred its rights to receive cash flows from the asset and has either transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.



**Accounting policies continued****(S) Financial investments**

The Group classifies its investments as either financial assets at fair value through profit or loss (FV) or financial assets available for sale (AFS). The classification depends on the purpose for which the investments were acquired, and is determined by local management at initial recognition. The FV category has two subcategories – those that meet the definition as being held for trading and those the Group chooses to designate as FV (referred to in this accounting policy as “other than trading”).

In general, the FV category is used as, in most cases, the Group’s investment or risk management strategy is to manage its financial investments on a fair value basis. Debt securities and equity securities, which the Group buys with the intention to resell in the short term, are classified as trading, as are non-hedge derivatives (see policy T below). All other securities in the FV category are classified as other than trading. The AFS category is used where the relevant long-term business liability (including shareholders’ funds) is passively managed, as well as in certain fund management and non-insurance operations.

Purchases and sales of investments are recognised on the trade date, which is the date that the Group commits to purchase or sell the assets, at their fair values. Debt securities are initially recorded at their fair value, which is taken to be amortised cost, with amortisation credited or charged to the income statement. Investments classified as trading, other than trading and AFS are subsequently carried at fair value. Changes in the fair value of trading and other than trading investments are included in the income statement in the period in which they arise. Changes in the fair value of securities classified as AFS, except for impairment losses and relevant foreign exchange gains and losses, are recorded in a separate investment valuation reserve within equity.

Investments carried at fair value are measured using a fair value hierarchy, described in note 24(b), with values based on quoted bid prices or amounts derived from cash flow models. Fair values for unlisted equity securities are estimated using applicable price/earnings or price/cash flow ratios refined to reflect the specific circumstances of the issuer. Equity securities for which fair values cannot be measured reliably are recognised at cost less impairment.

When securities classified as AFS are sold or impaired, the accumulated fair value adjustments are transferred out of the investment valuation reserve to the income statement.

Financial guarantees are recognised initially at their fair value. They are subsequently measured at the higher of either the expected asset or liability under the guarantee, or the amount initially recognised less any cumulative amortisation.

**Impairment**

The Group reviews the carrying value of its investments on a regular basis. If the carrying value of an investment is greater than the recoverable amount, the carrying value is reduced through a charge to the income statement in the period of impairment. The following policies are used to determine the level of any impairment:

**AFS securities:** The Group performs an objective review of the current financial position and prospects of the issuer on a regular basis, to identify whether any impairment provision is required. For listed AFS securities, this review takes into account the likelihood of the current market price recovering to former levels.

For AFS securities identified as being impaired, the cumulative unrealised net loss previously recognised within the investment valuation reserve is transferred to realised losses for the year.

**Mortgages, investment property and securitised loans:** Impairment is measured based on the present value of expected future cash flows discounted at the effective rate of interest of the loan, subject to the fair value of the underlying collateral. When a loan is considered to be impaired, the income statement is charged with the difference between the carrying value and the estimated recoverable amount. Interest income on impaired loans is recognised based on the estimated recoverable amount.

Reversals of impairments are only recognised where the decrease in the impairment can be objectively related to an event occurring after the write-down (such as an improvement in the debtor’s credit rating), and are not recognised in respect of equity instruments.

**(T) Derivative financial instruments and hedging**

Derivative financial instruments include foreign exchange contracts, interest rate futures, currency and interest rate swaps, currency and interest rate options (both written and purchased) and other financial instruments that derive their value mainly from underlying interest rates, foreign exchange rates, commodity values or equity instruments. All derivatives are initially recognised in the balance sheet at their fair value, which usually represents their cost. They are subsequently remeasured at their fair value, with the method of recognising movements in this value depending on whether they are designated as hedging instruments and, if so, the nature of the item being hedged. Fair values are obtained from quoted market prices or, if these are not available, by using valuation techniques such as discounted cash flow models or option pricing models. All derivatives are carried as assets when the fair values are positive and as liabilities when the fair values are negative. Premiums paid for derivatives are recorded as an asset on the balance sheet at the date of purchase, representing their fair value at that date.

Derivative contracts may be traded on an exchange or over-the-counter (OTC). Exchange-traded derivatives are standardised and include certain futures and option contracts. OTC derivative contracts are individually negotiated between contracting parties and include forwards, swaps, caps and floors. Derivatives are subject to various risks including market, liquidity and credit risk, similar to those related to the underlying financial instruments.

The notional or contractual amounts associated with derivative financial instruments are not recorded as assets or liabilities on the balance sheet as they do not represent the fair value of these transactions. These amounts are disclosed in note 56.

#### **Interest rate and currency swaps**

Interest rate swaps are contractual agreements between two parties to exchange periodic payments in the same currency, each of which is computed on a different interest rate basis, on a specified notional amount. Most interest rate swaps involve the net exchange of payments calculated as the difference between the fixed and floating rate interest payments. Currency swaps, in their simplest form, are contractual agreements that involve the exchange of both periodic and final amounts in two different currencies. Exposure to gain or loss on both types of swap contracts will increase or decrease over their respective lives as a function of maturity dates, interest and foreign exchange rates, and the timing of payments.

#### **Interest rate futures, forwards and options contracts**

Interest rate futures are exchange-traded instruments and represent commitments to purchase or sell a designated security or money market instrument at a specified future date and price. Interest rate forward agreements are OTC contracts in which two parties agree on an interest rate and other terms that will become a reference point in determining, in concert with an agreed notional principal amount, a net payment to be made by one party to the other, depending what rate in fact prevails at a future point in time. Interest rate options, which consist primarily of caps and floors, are interest rate protection instruments that involve the potential obligation of the seller to pay the buyer an interest rate differential in exchange for a premium paid by the buyer. This differential represents the difference between current rate and an agreed rate applied to a notional amount. Exposure to gain or loss on all interest rate contracts will increase or decrease over their respective lives as interest rates fluctuate.

#### **Foreign exchange contracts**

Foreign exchange contracts, which include spot, forward and futures contracts, represent agreements to exchange the currency of one country for the currency of another country at an agreed price and settlement date. Foreign exchange option contracts are similar to interest rate option contracts, except that they are based on currencies, rather than interest rates.

Exposure to gain or loss on these contracts will increase or decrease over their respective lives as currency exchange and interest rates fluctuate.

#### **Derivative instruments for hedging**

On the date a derivative contract is entered into, the Group designates certain derivatives as either:

- (i) a hedge of the fair value of a recognised asset or liability (fair value hedge);
- (ii) a hedge of a future cash flow attributable to a recognised asset or liability, a highly probable forecast transaction or a firm commitment (cash flow hedge); or
- (iii) a hedge of a net investment in a foreign operation (net investment hedge)

Hedge accounting is used for derivatives designated in this way, provided certain criteria are met. At the inception of the transaction, the Group documents the relationship between the hedging instrument and the hedged item, as well as the risk management objective and the strategy for undertaking the hedge transaction. The Group also documents its assessment of whether the hedge is expected to be, and has been, highly effective in offsetting the risk in the hedged item, both at inception and on an ongoing basis.

Changes in the fair value of derivatives that are designated and qualify as net investment or cash flow hedges, and that prove to be highly effective in relation to the hedged risk, are recognised in a separate reserve within equity. Gains and losses accumulated in this reserve are included in the income statement on disposal of the relevant investment or occurrence of the cash flow as appropriate.

For a variety of reasons, certain derivative transactions, while providing effective economic hedges under the Group's risk management positions, do not qualify for hedge accounting under the specific IFRS rules and are therefore treated as derivatives held for trading. Their fair value gains and losses are recognised immediately in other trading income.

**Accounting policies continued****(U) Loans**

Loans with fixed maturities, including policyholder loans, mortgage loans on investment property, securitised mortgages and collateral loans, are recognised when cash is advanced to borrowers. The majority of these loans are carried at their unpaid principal balances and adjusted for amortisation of premium or discount, non-refundable loan fees and related direct costs. These amounts are deferred and amortised over the life of the loan as an adjustment to loan yield using the effective interest rate method. Loans with indefinite future lives are carried at unpaid principal balances or cost.

For certain mortgage loans, the Group has taken advantage of the revised fair value option under IAS 39 to present the mortgages, associated borrowings and derivative financial instruments at fair value, since they are managed as a portfolio on a fair value basis. This presentation provides more relevant information and eliminates any accounting mismatch that would otherwise arise from using different measurement bases for these three items. The fair values of mortgages classified as FV are estimated using discounted cash flow forecasts, based on a risk-adjusted discount rate which reflects the risks associated with these products. They are revalued at each period end, with movements in their fair values being taken to the income statement.

To the extent that a loan is uncollectable, it is written-off as impaired. Subsequent recoveries are credited to the income statement.

**(V) Collateral**

The Group receives and pledges collateral in the form of cash or non-cash assets in respect of stock lending transactions, as well as certain derivative contracts and loans in order to reduce the credit risk of these transactions. Collateral is also pledged as security for bank letters of credit. The amount and type of collateral required depends on an assessment of the credit risk of the counterparty.

Collateral received in the form of cash, which is not legally segregated from the Group, is recognised as an asset on the balance sheet with a corresponding liability for the repayment. Non-cash collateral received is not recognised on the balance sheet unless the Group either sells or repurchases these assets in the absence of default, at which point the obligation to return this collateral is recognised as a liability.

Collateral pledged in the form of cash, which is legally segregated from the Group, is derecognised from the balance sheet with a corresponding receivable for its return. Non-cash collateral pledged is not derecognised from the balance sheet unless the Group defaults on its obligations under the relevant agreement, and therefore continues to be recognised on the balance sheet within the appropriate asset classification.

**(W) Deferred acquisition costs and other assets**

The costs directly attributable to the acquisition of new business for insurance and participating investment contracts (excluding those written in the UK) are deferred to the extent that they are expected to be recoverable out of future margins in revenues on these contracts. For participating contracts written in the UK, acquisition costs are generally not deferred as the liability for these contracts is calculated in accordance with the FSA's realistic capital regime and FRS 27. For non-participating investment and investment fund management contracts, incremental acquisition costs and sales enhancements that are directly attributable to securing an investment management service are also deferred.

Where such business is reinsured, an appropriate proportion of the deferred acquisition costs is attributed to the reinsurer, and is treated as a separate liability.

Long-term business deferred acquisition costs are amortised systematically over a period no longer than that in which they are expected to be recoverable out of these future margins. Deferrable acquisition costs for non-participating investment and investment fund management contracts are amortised over the period in which the service is provided. General insurance and health deferred acquisition costs are amortised over the period in which the related revenues are earned. The reinsurers' share of deferred acquisition costs is amortised in the same manner as the underlying asset.

Deferred acquisition costs are reviewed by category of business at the end of each reporting period and are written-off where they are no longer considered to be recoverable.

Other assets include vehicles which are subject to repurchase agreements and inventories of vehicle parts. The former are carried at the lower of their agreed repurchase price or net realisable value, whilst the latter are carried at the lower of cost and net realisable value, where cost is arrived at on the weighted average cost formula or "first in first out" (FIFO) basis. Provision is made against inventories which are obsolete or surplus to requirements.

## (X) Cash flow statement

### Cash and cash equivalents

Cash and cash equivalents consist of cash at banks and in hand, deposits held at call with banks, treasury bills and other short-term highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition, and include certificates of deposit.

For the purposes of the cash flow statement, cash and cash equivalents also include bank overdrafts, which are included in payables and other financial liabilities on the balance sheet.

### Operating cash flows

Purchases and sales of investment property, loans and financial investments are included within operating cash flows as the purchases are funded from cash flows associated with the origination of insurance and investment contracts, net of payments of related benefits and claims.

## (Y) Leases

Leases, where a significant portion of the risks and rewards of ownership is retained by the lessor, are classified as operating leases. Assets held for use in such leases are included in property and equipment, and are depreciated to their residual values over their estimated useful lives. Rentals from such leases are credited to the income statement on a straight-line basis over the period of the relevant leases. Payments made as lessee under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the relevant leases.

## (Z) Provisions and contingent liabilities

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. Where the Group expects a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is more probable than not.

The Group recognises a provision for onerous contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract. Contingent liabilities are disclosed if there is a possible future obligation as a result of a past event, or if there is a present obligation as a result of a past event but either a payment is not probable or the amount cannot be reasonably estimated.

## (AA) Employee benefits

### Annual leave and long service leave

Employee entitlements to annual leave and long service leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave and long service leave as a result of services rendered by employees up to the balance sheet date.

### Pension obligations

The Group operates a large number of pension schemes around the world, whose members receive benefits on either a defined benefit basis (generally related to a member's final salary and length of service) or a defined contribution basis (generally related to the amount invested, investment return and annuity rates), the assets of which are generally held in separate trustee-administered funds. The pension plans are generally funded by payments from employees and the relevant Group companies, taking account of the recommendations of qualified actuaries.

For defined benefit plans, the pension costs are assessed using the projected unit credit method. Under this method, the cost of providing pensions is charged to the income statement so as to spread the regular cost over the service lives of employees, in accordance with the advice of qualified actuaries. The pension obligation is measured as the present value of the estimated future cash outflows, using a discount rate based on market yields for high quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related pension liability. The resulting pension scheme surplus or deficit appears as an asset or liability in the consolidated balance sheet.

Costs charged to the income statement comprise the current service cost (the increase in pension obligation resulting from employees' service in the current period, together with the schemes' administration expenses), past service cost (resulting from changes to benefits with respect to previous years' service), and gains or losses on curtailment (when the employer materially reduces the number of employees covered by the scheme) or on settlements (when a scheme's obligations are transferred outside the Group). In addition, the difference between the expected return on scheme assets, less investment expenses, and the interest cost of unwinding the discount on the scheme liabilities (to reflect the benefits being one period closer to being paid out) is credited to investment income. All actuarial gains and losses, being the difference between the actual and expected returns on scheme assets, changes in assumptions underlying the liability calculations and experience gains or losses on the assumptions



**Accounting policies continued**

made at the beginning of the period, are recognised immediately in equity through the Statement of recognised income and expense.

For defined contribution plans, the Group pays contributions to publicly or privately administered pension plans. Once the contributions have been paid, the Group, as employer, has no further payment obligations. The Group's contributions are charged to the income statement in the year to which they relate and are included in staff costs.

**Other post-employment obligations**

Some Group companies provide post-employment healthcare or other benefits to their retirees. The entitlement to these benefits is usually based on the employee remaining in service up to retirement age and the completion of a minimum service period. Unlike the pension schemes, no assets are set aside in separate funds to provide for the future liability but none of these schemes is material to the Group. The costs of the Canadian scheme are included within those for the defined benefit pension schemes in that country. For such schemes in other countries, provisions are calculated in line with local regulations, with movements being charged to the income statement within staff costs.

**Equity compensation plans**

The Group offers share award and option plans over the Company's ordinary shares for certain employees, including a Save As You Earn plan (SAYE plan), details of which are given in the Directors' remuneration report and in note 29.

The Group accounts for options and awards under equity compensation plans, which were granted after 7 November 2002, until such time as they are fully vested, using the fair value based method of accounting (the "fair value method"). Under this method, the cost of providing equity compensation plans is based on the fair value of the share awards or option plans at date of grant, which is recognised in the income statement over the expected vesting period of the related employees and credited to the equity compensation reserve, part of shareholders' funds.

Shares purchased by employee share trusts to fund these awards are shown as a deduction from shareholders' funds at their original cost.

When the options are exercised and new shares are issued, the proceeds received, net of any transaction costs, are credited to share capital (par value) and the balance to share premium. Where the shares are already held by employee trusts, the net proceeds are credited against the cost of these shares, with the difference between cost and proceeds being taken to retained earnings. In both cases, the relevant amount in the equity compensation reserve is then credited to retained earnings.

**(AB) Income taxes**

The current tax expense is based on the taxable profits for the year, after any adjustments in respect of prior years. Tax, including tax relief for losses if applicable, is allocated over profits before taxation and amounts charged or credited to reserves as appropriate.

Provision is made for deferred tax liabilities, or credit taken for deferred tax assets, using the liability method, on all material temporary differences between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements.

The principal temporary differences arise from depreciation of property and equipment, revaluation of certain financial assets and liabilities including derivative contracts, provisions for pensions and other post-retirement benefits and tax losses carried forward; and, in relation to acquisitions, on the difference between the fair values of the net assets acquired and their tax base. The rates enacted or substantively enacted at the balance sheet date are used to determine the deferred tax.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. In countries where there is a history of tax losses, deferred tax assets are only recognised in excess of deferred tax liabilities if there is convincing evidence that future profits will be available.

Deferred tax is provided on temporary differences arising from investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the difference will not reverse in the foreseeable future.

Deferred taxes are not provided in respect of temporary differences arising from the initial recognition of goodwill, or from goodwill for which amortisation is not deductible for tax purposes, or from the initial recognition of an asset or liability in a transaction which is not a business combination and affects neither accounting profit nor taxable profit or loss at the time of the transaction.

Deferred tax related to fair value re-measurement of available for sale investments, owner-occupied properties and other amounts taken directly to equity is recognised in the balance sheet as a deferred tax asset or liability.

In addition to paying tax on shareholders' profits, the Group's life businesses in the UK, Ireland, Singapore and Australia pay tax on policyholders' investment returns ("policyholder tax") on certain products at policyholder tax rates. Policyholder tax is accounted for as an income tax and is included in the total tax expense. The Group has decided to show separately the amounts of policyholder tax to provide a more meaningful measure of the tax the

Group pays on its profits. In the pro forma reconciliations, operating profit has been calculated after charging policyholder tax.

## (AC) Borrowings

Borrowings are recognised initially at their issue proceeds less transaction costs incurred. Subsequently, most borrowings are stated at amortised cost, and any difference between net proceeds and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest rate method. All borrowing costs are expensed as they are incurred.

Where loan notes have been issued in connection with certain securitised mortgage loans, the Group has taken advantage of the revised fair value option under IAS 39 to present the mortgages, associated liabilities and derivative financial instruments at fair value, since they are managed as a portfolio on a fair value basis. This presentation provides more relevant information and eliminates any accounting mismatch which would otherwise arise from using different measurement bases for these three items.

## (AD) Share capital and treasury shares

### Equity instruments

An equity instrument is a contract that evidences a residual interest in the assets of an entity after deducting all its liabilities. Accordingly, a financial instrument is treated as equity if:

- (i) there is no contractual obligation to deliver cash or other financial assets or to exchange financial assets or liabilities on terms that may be unfavourable; and
- (ii) the instrument is a non-derivative that contains no contractual obligation to deliver a variable number of shares or is a derivative that will be settled only by the Group exchanging a fixed amount of cash or other assets for a fixed number of the Group's own equity instruments.

### Share issue costs

Incremental external costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds of the issue and disclosed where material.

### Dividends

Interim dividends on ordinary shares are recognised in equity in the period in which they are paid. Final dividends on these shares are recognised when they have been approved by shareholders. Dividends on preference shares are recognised in the period in which they are declared and appropriately approved.

### Treasury shares

Where the Company or its subsidiaries purchase the Company's share capital or obtain rights to purchase its share capital, the consideration paid (including any attributable transaction costs net of income taxes) is shown as a deduction from total shareholders' equity. Gains and losses on sales of own shares are charged or credited to the treasury share account in equity.

## (AE) Fiduciary activities

Assets and income arising from fiduciary activities, together with related undertakings to return such assets to customers, are excluded from these financial statements where the Group has no contractual rights in the assets and acts in a fiduciary capacity such as nominee, trustee or agent.

## (AF) Earnings per share

Basic earnings per share is calculated by dividing net income available to ordinary shareholders by the weighted average number of ordinary shares in issue during the year, excluding the weighted average number of ordinary shares purchased by the Group and held as Treasury shares.

Earnings per share has also been calculated on the operating profit before impairment of goodwill and other adjusting items, after tax, attributable to ordinary shareholders, as the directors believe this figure provides a better indication of operating performance. Details are given in note 14.

For the diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares, such as convertible debt and share options granted to employees.

Potential or contingent share issuances are treated as dilutive when their conversion to shares would decrease net earnings per share.

## (AG) Operations held for sale

Assets and liabilities held for disposal as part of operations which are held for sale are shown separately in the consolidated balance sheet. The relevant assets are recorded at the lower of their carrying amount and their fair value, less the estimated selling costs.

# Consolidated income statement

For the year ended 31 December 2008

2008 €m	Note	2008 €m	Restated 2007 €m
<b>Income</b>			
<b>45,258</b>	5	<b>36,206</b>	30,991
<b>(2,301)</b>		<b>(1,841)</b>	(1,658)
<b>42,957</b>		<b>34,365</b>	29,333
<b>346</b>		<b>277</b>	(21)
<b>43,303</b>		<b>34,642</b>	29,312
<b>2,356</b>	G	<b>1,885</b>	1,760
<b>(20,054)</b>	H & I	<b>(16,043)</b>	9,689
<b>(1,410)</b>	J	<b>(1,128)</b>	(304)
<b>9</b>		<b>7</b>	49
<b>24,204</b>		<b>19,363</b>	40,506
<b>Expenses</b>			
<b>(36,691)</b>	6	<b>(29,353)</b>	(27,121)
<b>4,856</b>		<b>3,885</b>	(3,508)
<b>13,286</b>		<b>10,629</b>	(2,018)
<b>5,603</b>		<b>4,482</b>	2,922
<b>(5,514)</b>		<b>(4,411)</b>	(4,244)
<b>(6,770)</b>		<b>(5,416)</b>	(3,473)
<b>(1,934)</b>	7	<b>(1,547)</b>	(1,217)
<b>(27,164)</b>		<b>(21,731)</b>	(38,659)
<b>(2,960)</b>		<b>(2,368)</b>	1,847
<b>1,335</b>	13	<b>1,068</b>	(15)
<b>(1,625)</b>		<b>(1,300)</b>	1,832
<b>1,854</b>	AB & 13	<b>1,483</b>	(349)
<b>(1,335)</b>	13	<b>(1,068)</b>	15
<b>519</b>		<b>415</b>	(334)
<b>(1,106)</b>		<b>(885)</b>	1,498
Attributable to:			
<b>(1,144)</b>		<b>(915)</b>	1,320
<b>38</b>	36b	<b>30</b>	178
<b>(1,106)</b>		<b>(885)</b>	1,498
<b>Earnings per share</b>			
<b>(46.0)c</b>	AF & 14	<b>(36.8)p</b>	48.9p
<b>(46.0)c</b>		<b>(36.8)p</b>	48.5p

# Pro forma reconciliation of Group operating profit to profit before tax

For the year ended 31 December 2008

2008 €m	Note	2008 £m	Restated 2007 £m
<b>Operating profit before tax attributable to shareholders' profits</b>			
<b>2,118</b>		<b>1,694</b>	1,610
<b>154</b>		<b>123</b>	179
<b>1,498</b>		<b>1,198</b>	1,021
<b>(248)</b>		<b>(198)</b>	(74)
<b>(176)</b>		<b>(141)</b>	(157)
<b>(474)</b>		<b>(379)</b>	(363)
<b>2,872</b>		<b>2,297</b>	2,216
<b>Adjusted for the following:</b>			
<b>(2,038)</b>	8	<b>(1,631)</b>	15
<b>(1,024)</b>	9a	<b>(819)</b>	(184)
<b>(118)</b>	9a	<b>(94)</b>	2
<b>(83)</b>	16	<b>(66)</b>	(10)
<b>(146)</b>	17	<b>(117)</b>	(103)
<b>9</b>	3b	<b>7</b>	49
<b>(408)</b>	6	<b>(326)</b>	(153)
<b>(689)</b>	6	<b>(551)</b>	–
<b>(1,625)</b>		<b>(1,300)</b>	1,832
<b>(Loss)/profit before tax attributable to shareholders' profits</b>			
<b>(609)</b>	14a(i)	<b>(487)</b>	(604)
<b>1,128</b>	14a(i)	<b>902</b>	270
<b>519</b>		<b>415</b>	(334)
<b>(1,106)</b>		<b>(885)</b>	1,498
<b>(Loss)/profit for the year</b>			



**Pro forma reconciliation of Group operating profit  
to profit before tax continued**

Operating profit can be further analysed into the following segments:

Year ended 31 December 2008	Long-term business £m	Fund management £m	General insurance and health £m	Other operations £m	Total £m
UK	751	(18)	656	(12)	1,377
Europe	881	14	397	(151)	1,141
North America	16	–	145	(12)	149
Asia Pacific	46	13	–	(23)	36
Aviva Investors	–	114	–	–	114
	<b>1,694</b>	<b>123</b>	<b>1,198</b>	<b>(198)</b>	<b>2,817</b>
Corporate centre					(141)
Group debt costs and other interest					(379)
					<b>2,297</b>

Year ended 31 December 2007	Long-term business £m	Fund management £m	General insurance and health £m	Other operations £m	Restated Total £m
UK	723	(10)	421	(8)	1,126
Europe	777	27	442	(49)	1,197
North America	79	–	154	(4)	229
Asia Pacific	31	15	4	(13)	37
Aviva Investors	–	147	–	–	147
	<b>1,610</b>	<b>179</b>	<b>1,021</b>	<b>(74)</b>	<b>2,736</b>
Corporate centre					(157)
Group debt costs and other interest					(363)
					<b>2,216</b>

# Consolidated statement of recognised income and expense

For the year ended 31 December 2008

2008 €m		Note	2008 £m	Restated 2007 £m
(2,976)	Fair value (losses)/gains on AFS securities, owner-occupied properties and hedging instruments	34	(2,381)	172
(158)	Fair value gains transferred to profit	34	(126)	(391)
1,036	Impairment losses on revalued assets	34	830	–
(116)	Share of fair value changes in joint ventures and associates taken to equity	34	(93)	9
(1,161)	Actuarial (losses)/gains on pension schemes	46e(iv)	(929)	648
98	Actuarial losses/(gains) on pension schemes transferred to unallocated divisible surplus	46c(i)	78	(61)
3,316	Foreign exchange rate movements	34 & 36b	2,653	723
294	Aggregate tax effect – shareholder tax	13b	235	(179)
333	<b>Net income recognised directly in equity</b>		267	921
(1,106)	(Loss)/profit for the year		(885)	1,498
(773)	<b>Total recognised income and expense for the year</b>		(618)	2,419
	Attributable to:			
(1,399)	Equity shareholders of Aviva plc		(1,119)	2,140
626	Minority interests	36b	501	279
(773)			(618)	2,419

# Reconciliation of movements in consolidated shareholders' equity

For the year ended 31 December 2008

2008 €m		Note	2008 £m	Restated 2007 £m
16,424	<b>Balance at 1 January as published</b>		15,931	14,064
–	Prior year adjustment	2b	–	(319)
16,424	<b>Balance at 1 January restated</b>		15,931	13,745
(637)	Total recognised (expense) and income for the year		(618)	2,419
(1,005)	Dividends and appropriations	15	(975)	(871)
21	Issues of share capital	28	20	48
175	Shares issued in lieu of dividends	35	170	301
37	Capital contributions from minority shareholders	36b	36	–
(109)	Minority share of dividends declared in the year	36b	(106)	(66)
44	Minority interest in acquired subsidiaries	36b	43	315
(67)	Changes in minority interest in existing subsidiaries	36b	(65)	–
(30)	Shares acquired by employee trusts	30	(29)	(10)
40	Reserves credit for equity compensation plans	34	39	50
14,893	<b>Balance at 31 December</b>		14,446	15,931

# Consolidated balance sheet

As at 31 December 2008

2008 €m		Note	2008 €m	Restated 2007 €m
<b>Assets</b>				
3,689	Goodwill	N & 16	3,578	3,082
4,163	Acquired value of in-force business and intangible assets	N & 17	4,038	3,197
1,791	Interests in, and loans to, joint ventures	C & 18	1,737	2,576
1,285	Interests in, and loans to, associates	C & 19	1,246	1,206
994	Property and equipment	O & 20	964	942
14,872	Investment property	P & 21	14,426	15,391
43,543	Loans	U & 22	42,237	36,193
	Financial investments	R, S & 24		
154,902	Debt securities		150,255	121,312
44,692	Equity securities		43,351	58,829
37,233	Other investments		36,116	36,269
236,827			229,722	216,410
8,138	Reinsurance assets	M & 41	7,894	8,054
2,724	Deferred tax assets	AB & 44b	2,642	590
641	Current tax assets	44a	622	376
10,119	Receivables and other financial assets	25	9,816	8,619
6,337	Deferred acquisition costs and other assets	W & 26	6,147	4,487
3,878	Prepayments and accrued income	26d	3,762	2,986
24,929	Cash and cash equivalents	X & 52d	24,181	16,089
1,598	Assets of operations classified as held for sale	AG & 3c	1,550	1,128
365,528	<b>Total assets</b>		354,562	321,326
<b>Equity</b>				
	Capital	AD		
685	Ordinary share capital	28	664	655
206	Preference share capital	31	200	200
891			864	855
	Capital reserves			
1,272	Share premium	28b	1,234	1,223
3,372	Merger reserve	D & 33	3,271	3,271
4,644			4,505	4,494
(34)	Shares held by employee trusts	30	(33)	(10)
2,175	Other reserves	34	2,110	1,469
3,924	Retained earnings	35	3,806	6,338
11,600	<b>Equity attributable to shareholders of Aviva plc</b>		11,252	13,146
1,021	Direct capital instrument	32	990	990
2,272	Minority interests	36	2,204	1,795
14,893	<b>Total equity</b>		14,446	15,931
<b>Liabilities</b>				
180,258	Gross insurance liabilities	K & 38	174,850	152,839
110,886	Gross liabilities for investment contracts	L & 39	107,559	98,244
2,397	Unallocated divisible surplus	K & 43	2,325	6,785
7,132	Net asset value attributable to unitholders	D	6,918	6,409
3,076	Provisions	Z, AA & 45	2,984	1,937
3,113	Deferred tax liabilities	AB & 44b	3,020	2,532
662	Current tax liabilities	44a	642	1,225
15,671	Borrowings	AC & 47	15,201	12,657
21,485	Payables and other financial liabilities	R & 48	20,840	18,060
4,696	Other liabilities	49	4,556	3,765
1,259	Liabilities of operations classified as held for sale	AG & 3c	1,221	942
350,635	<b>Total liabilities</b>		340,116	305,395
365,528	<b>Total equity and liabilities</b>		354,562	321,326

Approved by the Board on 4 March 2009.

Philip Scott  
Chief Financial Officer

The accounting policies (identified alphabetically) on pages 125 to 139 and notes (identified numerically) on pages 146 to 277 are an integral part of these financial statements.

# Consolidated cash flow statement

For the year ended 31 December 2008

The cash flows presented in this statement cover all the Group's activities and include flows from both policyholder and shareholder activities.

	Note	Long-term business operations £m	Non-long- term business operations £m	Total 2008 £m	Restated Total 2007 £m
<b>Cash flows from operating activities</b>	52a				
Cash-generated from operations		7,920	875	8,795	4,944
Tax paid		(394)	(248)	(642)	(801)
<b>Net cash from operating activities</b>		<b>7,526</b>	<b>627</b>	<b>8,153</b>	<b>4,143</b>
<b>Cash flows from investing activities</b>					
Acquisitions of subsidiaries, joint ventures and associates, net of cash acquired	52b	(93)	(243)	(336)	(769)
Disposals of subsidiaries, joint ventures and associates, net of cash transferred	52c	180	173	353	283
Purchase of minority interest in subsidiary		(65)	–	(65)	–
New loans to joint ventures and associates		(182)	–	(182)	(126)
Repayment of loans to joint ventures and associates		52	–	52	159
Net repayment loans to joint ventures and associates	18a & 19a	(130)	–	(130)	33
Purchases of property and equipment	20	(57)	(159)	(216)	(227)
Proceeds on sale of property and equipment		35	24	59	93
Purchases of intangible assets	17	(34)	(26)	(60)	(48)
<b>Net cash used in investing activities</b>		<b>(164)</b>	<b>(231)</b>	<b>(395)</b>	<b>(635)</b>
<b>Cash flows from financing activities</b>					
Proceeds from issue of ordinary shares, net of transaction costs		–	20	20	48
Treasury shares purchased for employee trusts		–	(29)	(29)	(10)
New borrowings drawn down, net expenses		1,435	4,080	5,515	6,322
Repayment of borrowings		(1,365)	(3,852)	(5,217)	(6,000)
Net drawdown of borrowings	47e	70	228	298	322
Interest paid on borrowings		(712)	(825)	(1,537)	(1,208)
Preference dividends paid		–	(17)	(17)	(17)
Ordinary dividends paid		–	(732)	(732)	(500)
Coupon payments on direct capital instrument		–	(56)	(56)	(53)
Finance lease payments		–	(14)	(14)	(7)
Capital contributions from minority shareholders		36	–	36	307
Dividends paid to minority interests of subsidiaries		(83)	(23)	(106)	(66)
Non-trading cash flows between operations		(189)	189	–	–
<b>Net cash from financing activities</b>		<b>(878)</b>	<b>(1,259)</b>	<b>(2,137)</b>	<b>(1,184)</b>
<b>Net increase in cash and cash equivalents</b>		<b>6,484</b>	<b>(863)</b>	<b>5,621</b>	<b>2,324</b>
Cash and cash equivalents at 1 January		11,132	4,432	15,564	12,635
Effect of exchange rate changes on cash and cash equivalents		2,525	359	2,884	605
<b>Cash and cash equivalents at 31 December</b>		<b>20,141</b>	<b>3,928</b>	<b>24,069</b>	<b>15,564</b>

Of the total cash and cash equivalents, £493 million (2007: £96 million) was classified as held for sale (see note 3c).

Cash and cash equivalents in long-term business operations of £20,141 million (2007: £11,132 million) are primarily held for the benefit of policyholders and so are generally not available for use by the Group.



# Notes to the consolidated financial statements

## 1 – Exchange rates

The Group's principal overseas operations during the year were located within the Eurozone and the United States. The results and cash flows of these operations have been translated into sterling at an average rate for the year of €1 = £0.80 (2007: €1 = £0.68) and £1 = US\$1.85 (2007: £1 = US\$2.00). Assets and liabilities have been translated at the year end rate of €1 = £0.97 (2007: €1 = £0.73) and £1 = US\$1.44 (2007: £1 = US\$1.99).

Total foreign currency movements during 2008 resulted in a gain recognised in the income statement of £327 million (2007: £45 million gain).

## 2 – Presentation changes

### (a) Change to operating segments

In November 2006, the IASB issued IFRS 8, *Operating Segments*. Although its requirements are applicable for accounting periods beginning on or after 1 January 2009, the Group has decided to adopt IFRS 8 early and reflect its impact in these financial statements.

The Group has determined its operating segments along regional lines and the results for the year are presented on this basis, using UK Life and UK General Insurance within the United Kingdom, Europe, North America, Asia Pacific and Aviva Investors as the main segments.

- (i) The UK general insurance business covers the Group's UK general insurance business and includes the results of Aviva Re, the Group's captive reinsurance business and agencies in run off.
- (ii) The UK Life segment includes the result of the UK health business which it manages.
- (iii) Europe incorporates all European operations excluding the UK as set out above;
- (iv) North America is made up of our life business in the United States and general insurance business in Canada;
- (v) Asia Pacific includes all our Asian and Australian businesses; and,
- (vi) Aviva Investors comprises the Aviva Investors UK, France, the United States, Canada, and the international fund management businesses.

### (b) Restatement of prior year figures

#### (i) Restatement for the change in accounting policy for latent reserves

As part of the Company's aim to continuously improve the relevance and reliability of its external financial reporting, Aviva undertook a review of the Group's General Insurance Reserving Policy in 2008.

As part of this review, the Group concluded that estimating our latent claim provisions on an undiscounted basis, and discounting back to current values, represented an improvement to the existing estimation technique. This approach is in line with best practice for long-term liabilities and moves the measurement of latent claims onto a more economic basis, consistent with our internal model for economic capital and the measurement model being proposed for both IFRS Phase II and Solvency II. This approach also improves consistency with the reporting of other long-tail classes of business which are already being discounted, namely certain London Market latent claims and our Dutch Permanent Health and Injury Business.

The discount rate that has been applied is based on the relevant swap curve in the relevant currency at the reporting date, having regard to the duration of the expected settlement of the claims. The discount rate is set at the start of the accounting period with any change in rates between the start and end of the accounting period being reflected below operating profit as an economic assumption change. The range of discount rates used is shown in note 38c and depends on the duration of the claim and the reporting date. We estimate that latent claims will be payable for around the next 35 to 40 years with an average duration of 15 years.

The application of discounting to our latent claims reserves represents a change in accounting policy and has therefore been applied retrospectively. The cumulative impact of discounting on our opening reserves as at 1 January 2007 is to reduce insurance liabilities by £214 million and reinsurance assets by £61 million, and to increase retained earnings by £153 million. These have been treated as prior year adjustments in these financial statements.

The impact of the change in accounting policy on the general insurance and health claims provisions and our results for the year ended 31 December 2007 and the opening 1 January 2007 position is set out below.

## 2 – Presentation changes continued

	31 December 2007 £m	1 January 2007 £m
General insurance and health claims provisions		
Carrying amount as reported, net of reinsurance	11,424	10,980
<b>Impact of discounting</b>		
Prior year adjustment brought forward	(153)	(153)
Impact on operating profit	12	–
Impact on short-term fluctuations and economic assumption changes	(2)	–
Impact of foreign exchange movements	(2)	–
	(145)	(153)
<b>Carrying amount restated, net of reinsurance</b>	<b>11,279</b>	<b>10,827</b>

The impact on shareholders' funds after tax was £107 million and £112 million at 31 December 2007 and 1 January 2007 respectively.

### (ii) Consolidation of managed funds

The Group manages a number of specialised investment vehicles around the world, in which our insurance and investment funds have invested. The Group's percentage ownership in these vehicles can fluctuate from day to day according to the Group's and third party participation in them, and control is determined based on an analysis of the guidance in IAS 27. During 2008, we identified that certain such vehicles required consolidation in accordance with IAS 27 which therefore results in grossing up assets and liabilities for the effect of the third party participation.

As a result, certain balance sheet categories have been restated for the gross up. This resulted in increases to cash and cash equivalents (£315 million), investment property (£314 million), debt securities (£2,375 million), equity securities (£2,811 million), and net asset value attributable to unitholders (£1,671 million), and a decrease to other investments (£4,144 million) as at 31 December 2007. The impact on the 2007 income statement has been to restate net investment income and fee and commission expense by reducing both by £139 million and, in the 2007 cash flow statement, to increase cash flows from operating activities by £101 million.

In addition, certain property investment vehicles, which were consolidated in accordance with IAS 27, required restatement in the year ended 31 December 2007 to reanalyse amounts previously classified as minority interests to net asset value attributable to unitholders. This change recognises that the property investment vehicles are unit trusts and, as a result, the third party holding should have been recognised as a liability rather than as a non-controlling interest. Prior year comparatives have been restated with a reduction in minority interests and an increase in amounts due to unitholders of £758 million at 31 December 2007 and £431 million at 1 January 2007.

None of these adjustments has any impact on profit for the period, operating profit or earnings per share in the full year 2007, nor on retained earnings, net assets or total equity at either 1 January 2007 or 31 December 2007.

### (iii) Treatment of shares held by employee trusts

As explained in note 30, employee share trusts have purchased the Company's shares in the market to satisfy awards under various share plans. At 31 December 2007, these trusts held shares with a cost of £10 million which, on materiality grounds, were included within other financial assets rather than being shown as a deduction from total shareholders' equity in the consolidated balance sheet. In view of the Company's current policy of purchasing shares in the market rather than issuing new shares, which will lead to larger balances on this account, we have restated the 2007 figures accordingly.

## Notes to the consolidated financial statements continued

## 3 – Subsidiaries

*This note provides details of the acquisitions and disposals of subsidiaries that the Group has made during the year, together with details of businesses held for sale at the year end. The principal Group subsidiaries are listed on pages 328 to 329.*

## (a) Acquisitions

## (i) VIVAS Health

On 15 May 2008, the Group's Irish subsidiary, Hibernian Group plc, acquired a 70% holding in VIVAS Group Ltd. (VIVAS Health), an Irish health insurance company, for £26 million. Allied Irish Banks plc (AIB) will continue to hold the remaining 30% equity, further strengthening AIB and Hibernian's existing relationship. The company has been re-branded as Hibernian Aviva Health. Its health insurance products will be distributed through Hibernian and AIB's distribution channels, including Hibernian Aviva Health's existing direct and non-direct channels.

The acquisition of this shareholding has given rise to goodwill on acquisition of £22 million, calculated as follows:

Purchase cost:	£m
Cash paid	25
Attributable costs	1
<b>Total consideration</b>	<b>26</b>

The estimated book and fair values of the assets and liabilities at the date of acquisition were:

	Book value £m	Fair value and accounting policy adjustments £m	Fair value £m
<b>Assets</b>			
Reinsurance assets	30	–	30
Cash and cash equivalents	27	–	27
Receivables and financial assets	32	–	32
Other assets	2	–	2
<b>Total assets</b>	<b>91</b>	<b>–</b>	<b>91</b>
<b>Liabilities</b>			
Insurance liabilities	(49)	–	(49)
Payables and other financial liabilities	(35)	–	(35)
Other liabilities	(1)	–	(1)
<b>Total liabilities</b>	<b>(85)</b>	<b>–</b>	<b>(85)</b>
<b>Total net assets</b>	<b>6</b>	<b>–</b>	<b>6</b>
<b>Net assets acquired (70%)</b>			<b>4</b>
<b>Goodwill arising on acquisition of this holding</b>			<b>22</b>

The assets and liabilities as at the acquisition date in the table above are stated at their provisional fair values and may be amended in 2009 in accordance with paragraph 62 of IFRS 3, *Business Combinations*. The residual goodwill represents future cost and revenue synergies from integration with the Hibernian Group.

The results of VIVAS Health have been included in the consolidated financial statements of the Group with effect from 15 May 2008, and have contributed £5 million profit to the consolidated loss before tax.

## (ii) UBI Vita

On 18 June 2008, the Group acquired 50% plus one share in UBI Assicurazioni Vita SpA (UBI Vita), an Italian life insurance company, from Unione di Banche Italiane Scpa (UBI Banca), for a consideration of £52 million. UBI Vita distributes life insurance products through a bancassurance agreement with Banca Popolare di Ancona and other channels.

### 3 – Subsidiaries continued

The acquisition of this shareholding has given rise to goodwill on acquisition of £10 million, calculated as follows:

Purchase cost:	£m
Cash paid	51
Attributable costs	1
<b>Total consideration</b>	<b>52</b>

The estimated book and fair values of the assets and liabilities at the date of acquisition were:

	Book value £m	Fair value and accounting policy adjustments £m	Fair value £m
<b>Assets</b>			
Intangible assets	–	41	41
Reinsurance assets	130	–	130
Prepayments and accrued income	20	–	20
Cash and cash equivalents	8	–	8
Debt securities	1,803	(74)	1,729
Other investments	407	–	407
Property and equipment	17	1	18
Receivables and other financial assets	45	–	45
Other assets	2	2	4
<b>Total assets</b>	<b>2,432</b>	<b>(30)</b>	<b>2,402</b>
<b>Liabilities</b>			
Insurance liabilities	(2,267)	67	(2,200)
Borrowings	(31)	–	(31)
Payables and other financial liabilities	(56)	–	(56)
Other liabilities	(12)	(18)	(30)
<b>Total liabilities</b>	<b>(2,366)</b>	<b>49</b>	<b>(2,317)</b>
<b>Total net assets</b>	<b>66</b>	<b>19</b>	<b>85</b>
<b>Net assets acquired (50%)</b>			<b>42</b>
<b>Goodwill arising on acquisition of this holding</b>			<b>10</b>

The assets and liabilities as at the acquisition date in the table above are stated at their provisional fair values and may be amended in 2009 in accordance with paragraph 62 of IFRS 3, *Business Combinations*. The residual goodwill represents expected future revenue and cost synergies.

The results of UBI Vita have been included in the consolidated financial statements of the Group with effect from 18 June 2008, and have contributed £2 million loss to the consolidated loss before tax.

#### (iii) Swiss Life Belgium

On 30 June 2008, the Group acquired 100% of the shares in Swiss Life Belgium, a multi-line insurer, from SNS REAAL for £112 million. By combining Swiss Life Belgium with our Belgian insurance operation, managed through our Dutch subsidiary Delta Lloyd, the Group will further strengthen its position in the Belgian life insurance market.

The acquisition of this shareholding has given rise to goodwill on acquisition of £48 million, calculated as follows:

Purchase cost:	£m
Cash paid	112
Attributable costs	–
<b>Total consideration</b>	<b>112</b>



## Notes to the consolidated financial statements continued

## 3 – Subsidiaries continued

The estimated book and fair values of the assets and liabilities at the date of acquisition were:

	Book value £m	Fair value and accounting policy adjustments £m	Fair value £m
<b>Assets</b>			
Acquired value of in-force business on insurance contracts	–	17	17
Reinsurance assets	28	–	28
Prepayments and accrued income	33	–	33
Cash and cash equivalents	60	–	60
Equity securities	464	–	464
Debt securities	1,735	–	1,735
Property and equipment	19	–	19
Investment property	80	–	80
Loans	21	–	21
Receivables and other financial assets	46	–	46
Other assets	19	–	19
<b>Total assets</b>	<b>2,505</b>	<b>17</b>	<b>2,522</b>
<b>Liabilities</b>			
Insurance liabilities	(1,635)	92	(1,543)
Liabilities for investment contracts	(818)	52	(766)
Borrowings	(49)	–	(49)
Payables and other financial liabilities	(41)	–	(41)
Other liabilities	(59)	–	(59)
<b>Total liabilities</b>	<b>(2,602)</b>	<b>144</b>	<b>(2,458)</b>
<b>Total net assets</b>	<b>(97)</b>	<b>161</b>	<b>64</b>
<b>Net assets acquired (100%)</b>			<b>64</b>
<b>Goodwill arising on acquisition</b>			<b>48</b>

The assets and liabilities as at the acquisition date in the table above are stated at their provisional fair values and may be amended in 2009 in accordance with paragraph 62 of IFRS 3, *Business Combinations*. The residual goodwill represents cost and revenue synergies from integrating the business with our existing Belgian operations.

The results of Swiss Life Belgium have been included in the consolidated financial statements of the Group with effect from 30 June 2008, and have contributed £35 million loss to the consolidated loss before tax.

### 3 – Subsidiaries continued

#### (iv) Material acquisitions summary

	2008 £m
Total net assets of subsidiaries described above	155
Less: Minority interests	(45)
<b>Net assets acquired</b>	<b>110</b>
Cash paid	188
Attributable costs	2
<b>Total consideration</b>	<b>190</b>
Goodwill arising on material acquisitions above	80
Other goodwill arising (see (v) below)	
Addition to existing shareholding in Cajamurcia	3
Other goodwill arising	23
<b>Total goodwill arising in the year</b> (see note 16a)	<b>106</b>

#### (v) Other goodwill arising

##### Addition to existing shareholding in Cajamurcia Vida

As disclosed in the 2007 financial statements, on 6 June 2007 the Group acquired 5% of the share capital of Caja Murcia Vida y Pensiones, de Seguros y Reaseguros SA (Cajamurcia Vida) from the Spanish savings bank Caja de Ahorros de Murcia (Cajamurcia). Cajamurcia Vida was fully consolidated as a subsidiary from that date, as the Group has the power to govern its financial and operating policies, through having the majority vote at meetings of the company's board of directors.

On signing the shareholders' agreement, Cajamurcia granted the Group a call option over a further 45% of the shares in Cajamurcia Vida. On 27 March 2008, the Group exercised this option and acquired 45% of the shares for £81 million. The fair value of the net assets of the company at the date the option was exercised was £176 million, and the acquisition of the additional shareholding gave rise to additional goodwill of £3 million.

##### Other

Other goodwill has arisen on smaller acquisitions and increases in shareholdings in existing subsidiaries, as well as fair value adjustments to acquisitions made in 2007. None of these is considered material for separate disclosure.

#### (vi) Unaudited pro forma combined revenues and profit

Shown below are unaudited pro forma figures for combined revenues and profit as though the acquisition date for all business combinations effected during the year had been 1 January 2008, after giving effect to purchase accounting adjustments and the elimination of intercompany transactions. The pro forma financial information is not necessarily indicative of the combined results that would have been attained had the acquisitions taken place at 1 January 2008, nor is it necessarily indicative of future results.

	2008 £m
Revenues (net earned premiums and fee income)	36,620
Loss before tax attributable to shareholders	(1,388)

£32 million of the above pre-tax loss has arisen since acquisition.

#### (b) Disposal of subsidiaries, joint ventures and associates

The profit on the disposal of subsidiaries, joint ventures and associates comprises:

	2008 £m	2007 £m
United Kingdom (see (i) below)	(38)	(7)
Turkey	–	71
Offshore operations (see (iii) below)	14	–
Other small operations	31	(15)
<b>Profit on disposal before tax</b>	<b>7</b>	<b>49</b>
Tax on profit/(loss) on disposal	–	3
<b>Profit on disposal after tax</b>	<b>7</b>	<b>52</b>

## Notes to the consolidated financial statements continued

## 3 – Subsidiaries continued

*(i) UK non-core operations*

As part of its strategy to exit certain UK non-core operations, the Group completed the disposals of HPI Limited to Solera Holdings Inc. and RAC Autowindcreens Limited to Arques Management GmbH in December 2008. The loss on disposal of these wholly-owned subsidiaries was £38 million, calculated as follows:

	2008 £m
<b>Assets</b>	
Goodwill and intangible assets	99
Investments and property and equipment	10
Deferred acquisition costs and other assets	9
Receivables and other financial assets	25
Cash and cash equivalents	37
<b>Total assets</b>	<b>180</b>
<b>Liabilities</b>	
Payables and other financial liabilities	(20)
Other liabilities	(28)
Tax liabilities and other provisions	(17)
<b>Total liabilities</b>	<b>(65)</b>
<b>Net assets disposed of</b>	<b>115</b>
Consideration:	
Cash consideration	67
Non-cash consideration	15
Less: transaction costs	(5)
<b>Total consideration</b>	<b>77</b>
<b>Loss on disposal</b>	<b>(38)</b>

*(ii) Luxembourg life operations*

On 5 November 2008, the Group's Dutch subsidiary, Delta Lloyd NV, exchanged its 100% holding in Commercial Union International Life SA (CUIL) for a 15% shareholding in NewPEL SA, a Luxembourg-registered investment company. No profit or loss was realised on disposal.

The assets and liabilities of CUIL at the date of disposal were:

	2008 £m
<b>Assets</b>	
Intangible assets	5
Investments	373
Cash and cash equivalents	5
Other assets	16
<b>Total assets</b>	<b>399</b>
<b>Liabilities</b>	
Liability for investment contracts	(372)
Borrowings	(3)
Other liabilities	(10)
<b>Total liabilities</b>	<b>(385)</b>
<b>Net assets disposed of</b>	<b>14</b>
Consideration:	
Non-cash consideration	14
<b>Profit on disposal</b>	<b>–</b>

### 3 – Subsidiaries continued

#### (iii) Offshore operations

On 11 July 2008, the Group sold its offshore operations, administered through Aviva Global Services Singapore Pte Ltd (AGS), to WNS (Holdings) Limited (WNS). As part of this agreement, we have entered into a master services agreement with WNS, who will provide business process services to the Group's UK, Irish and Canadian businesses through to 2016. The consideration for the shares in AGS was £35 million and the relevant net assets at the disposal date were £21 million, giving rise to a profit on disposal of £14 million.

#### (c) Operations and assets classified as held for sale

Assets held for sale as at 31 December 2008 comprise:

	2008 £m	2007 £m
Property and equipment held for sale (see (i) below)	102	–
Assets of operations classified as held for sale (see (ii) below)	1,448	1,128
<b>Total assets classified as held for sale</b>	<b>1,550</b>	<b>1,128</b>

#### (i) Property and equipment held for sale

As part of its restructuring, the UK data centres, presently owned and managed by Norwich Union Central Services Limited, have been classified as held for sale at 31 December 2008 at their fair value of £102 million. In remeasuring the data centres at fair value, an impairment charge of £44 million has been recognised in the income statement within integration and restructuring costs. The data centres were sold on 25 February 2009 at their fair value above.

#### (ii) Assets and liabilities of operations classified as held for sale

The assets and liabilities of operations classified as held for sale as at 31 December 2008 relate to our Dutch health insurance business and certain UK non-core operations, and were as follows:

	2008 £m	2007 £m
Goodwill and intangible assets	14	–
Investments and property and equipment	396	316
Receivables and other financial assets	386	554
Deferred acquisition costs and other assets	1	–
Prepayments and accrued income	158	145
Tax assets	–	17
Cash and cash equivalents	493	96
<b>Total assets</b>	<b>1,448</b>	<b>1,128</b>
Gross insurance liabilities	(709)	(627)
Borrowings	–	(12)
Payables and financial liabilities	(22)	(72)
Other liabilities	(478)	(220)
Tax liabilities and other provisions	(12)	(11)
<b>Total liabilities</b>	<b>(1,221)</b>	<b>(942)</b>
<b>Net assets</b>	<b>227</b>	<b>186</b>

The 2007 figures relate to our Dutch health insurance business.



**Notes to the consolidated financial statements continued****3 – Subsidiaries continued****(iii) Dutch health insurance business**

On 16 July 2007, the Group announced that its Dutch subsidiary, Delta Lloyd Group ("DL"), had reached an agreement to sell its health insurance business to OWM CZ Groep Zorgverkeeraar UA ("CZ"), a mutual health insurer, and create a long-term alliance for the cross-selling of insurance products. Under the terms of the agreement, CZ will purchase the DL health insurance business and take on its underwriting risk and policy administration. DL will continue to market and distribute health insurance products from CZ to its existing customers and continue to provide asset management for the transferred business. DL will also have exclusive rights to market life, general insurance and income protection products to CZ's customers. The transaction completed on 1 January 2009.

The relevant assets and liabilities of the DL health insurance business have been classified as held for sale, at their carrying values, in the consolidated balance sheet as at 31 December 2008.

**(iv) UK non-core operations**

In 2008, the Group decided to sell, and was actively marketing, certain companies as part of its strategy to exit certain UK non-core operations. As at 31 December 2008, The British School of Motoring Limited and its subsidiaries had yet to be sold and, as a result, their relevant assets and liabilities have been classified as held for sale, at their carrying values, in the consolidated balance sheet as at 31 December 2008. On 11 February 2009, these companies were sold to Arques Consulting GmbH, realising a loss on disposal of £9 million which has been provided for within exceptional items in these financial statements.

**(d) Other information**

Principal subsidiaries at 31 December 2008 are listed on pages 328 to 329.

One of the Group's subsidiaries, Delta Lloyd NV, is subject to the provisions of Dutch corporate law and particularly the Dutch "structure company" regime. Under this regime, Delta Lloyd operates under a Supervisory Board which has a duty to have regard to the interests of a wide variety of stakeholders. The Supervisory Board includes two Aviva Group representatives and is responsible for advising and supervising Delta Lloyd's Executive Board. The shareholder is one of the most important stakeholders to whom the Supervisory Board has a duty.

Dutch Law changed in October 2004 to ensure that Supervisory Board directors in Dutch companies were henceforth to be elected by a company's shareholders voting on nominations made by its Supervisory Board and the Works Council. Under the previous system, Supervisory Board directors appointed their own successors. In 2006, Delta Lloyd commenced proceedings against Aviva plc to try to compel the Company to adhere to the system that existed prior to the change in the law, on the basis of agreements they say were entered into in 1973 when the Group acquired Delta Lloyd. The Company disputes these claims and does not expect the litigation, whatever its outcome, to have any adverse effect on the financial or operational performance of Delta Lloyd or the Group. The court gave a judgement in 2008, requiring Aviva to adhere to the previous system of appointment, which Aviva is appealing.

## 4 – Segmental information

*The Group's results can be segmented, either by activity or by geography. Our primary reporting format is on regional reporting lines, with supplementary information being given by business activity. This note provides segmental information on the consolidated income statement and balance sheet.*

### (a) Operating segments

As explained in note 2(a), the Group has determined its operating segments along regional lines. These reflect the management structure whereby a member of the Executive Management team is accountable to the Group Chief Executive for the operating segment for which he is responsible. The activities of each operating segment are described below:

#### United Kingdom

The United Kingdom comprises two operating segments – UK Life and UK General Insurance (UK GI). The principal activities of UK Life are life insurance, long-term health and accident insurance, savings, pensions and annuity business, whilst UK GI provides insurance cover to individuals and to small and medium-sized businesses, for risks associated mainly with motor vehicles, property and liability, such as employers' liability and professional indemnity liability, and medical expenses. UK GI also includes the RAC motor recovery business, the group reinsurance result and the results of run off business.

#### Europe

Activities reported in the Europe operating segment exclude operations in the UK and include those in Russia and Turkey. Principal activities are long-term business in France, the Netherlands, Ireland, Italy, Poland and Spain, and general insurance in France, the Netherlands, Ireland and Italy.

#### North America

Our activities in North America principally comprise our long-term business operations in the USA and general insurance business operation in Canada.

#### Asia Pacific

Our activities in Asia Pacific principally comprise our long-term business operations in Australia, China, India, Singapore, Hong Kong, Sri Lanka, Taiwan, Malaysia, and South Korea.

#### Aviva Investors

Aviva Investors operates in most of the regions in which the Group operates, in particular the UK, France, the United States and Canada and other international businesses, managing policyholders' and shareholders' invested funds, providing investment management services for institutional pension fund mandates and managing a range of retail investment products, including investment funds, unit trusts, OEICs and ISAs. Fund management activities of Delta Lloyd are included in the Europe operating segment.

#### Other Group activities

Investment return on centrally held assets and head office expenses, such as Group treasury and finance functions, together with certain taxes and financing costs arising on central borrowings are included in "Other Group activities". Similarly, central core structural borrowings and certain tax balances are included in "Other Group activities" in the segmental balance sheet. Also included here are consolidation and elimination adjustments.

#### Measurement basis

The accounting policies of the segments are the same as those for the Group as a whole. Any transactions between the business segments are on normal commercial terms and market conditions. The Group evaluates performance of operating segments on the basis of:

- (i) profit or loss from operations before tax attributable to shareholders.
- (ii) profit or loss from operations before tax attributable to shareholders, adjusted for non-operating items outside the segment management's control, including investment market performance and fiscal policy changes.

## Notes to the consolidated financial statements continued

## 4 – Segmental information continued

## (i) Segmental income statement for the year ended 31 December 2008

	United Kingdom							
	Life £m	GI £m	Europe £m	North America £m	Asia Pacific £m	Aviva Investors <sup>†</sup> £m	Other Group activities £m	Total £m
Gross written premiums	8,108	5,496	15,529	6,486	587	–	–	36,206
Premiums ceded to reinsurers	(612)	(498)	(442)	(214)	(75)	–	–	(1,841)
Internal reinsurance revenue	–	26	(21)	(4)	(1)	–	–	–
Net written premiums	7,496	5,024	15,066	6,268	511	–	–	34,365
Net change in provision for unearned premiums	6	344	(21)	(50)	(2)	–	–	277
Net earned premiums	7,502	5,368	15,045	6,218	509	–	–	34,642
Fee and commission income	310	362	711	40	168	294	–	1,885
	7,812	5,730	15,756	6,258	677	294	–	36,527
Net investment income	(8,844)	326	(6,168)	444	(626)	(407)	(768)	(16,043)
Inter-segment revenue	–	–	–	–	–	203	–	203
Share of loss of joint ventures and associates	(1,058)	–	(38)	–	(32)	–	–	(1,128)
Profit on the disposal of subsidiaries and associates	–	(38)	24	–	–	–	21	7
<b>Segmental income*</b>	<b>(2,090)</b>	<b>6,018</b>	<b>9,574</b>	<b>6,702</b>	<b>19</b>	<b>90</b>	<b>(747)</b>	<b>19,566</b>
Claims and benefits paid, net of recoveries from reinsurers	(8,620)	(3,944)	(13,411)	(2,912)	(464)	–	(2)	(29,353)
Change in insurance liabilities, net of reinsurance	2,674	280	3,409	(2,774)	296	–	–	3,885
Change in investment contract provisions	7,240	–	2,765	(126)	401	349	–	10,629
Change in unallocated divisible surplus	2,151	–	2,331	–	–	–	–	4,482
Amortisation of deferred acquisition costs and acquired value of in-force business	–	–	(44)	(285)	(4)	–	–	(333)
Depreciation and other amortisation expense	(70)	(108)	(120)	(51)	(5)	(5)	–	(359)
Other operating expenses	(1,787)	(2,599)	(2,970)	(633)	(296)	(362)	552	(8,095)
Impairment losses**	–	(26)	(814)	(200)	–	–	–	(1,040)
Inter-segment expenses	(137)	(2)	(18)	(42)	(3)	–	(1)	(203)
Finance costs	(541)	(10)	(703)	(17)	–	–	(276)	(1,547)
<b>Segmental expenses</b>	<b>910</b>	<b>(6,409)</b>	<b>(9,575)</b>	<b>(7,040)</b>	<b>(75)</b>	<b>(18)</b>	<b>273</b>	<b>(21,934)</b>
(Loss)/profit before tax	(1,180)	(391)	(1)	(338)	(56)	72	(474)	(2,368)
Tax attributable to policyholders' returns	1,031	–	49	–	(12)	–	–	1,068
<b>(Loss)/profit before tax attributable to shareholders</b>	<b>(149)</b>	<b>(391)</b>	<b>48</b>	<b>(338)</b>	<b>(68)</b>	<b>72</b>	<b>(474)</b>	<b>(1,300)</b>

\* Total reported income, excluding inter-segment revenue, is split United Kingdom £3,928 million, France £1,005 million, Netherlands £6,759 million, USA £4,954 million and Rest of the World £2,717 million. Income is attributed on the basis of geographical origin which does not materially differ from revenue by geographical destination, as most risks are located in the countries where the contracts were written.

\*\* Impairment losses, and reversal of such losses, recognised directly in equity were £830 million and £nil.

† Aviva Investors comprises the Aviva Investors UK, France, the United States, Canada and International fund management businesses.

# United Kingdom General Insurance includes the Group Reinsurance business, agency run off business and the non-insurance business for the RAC.

#### 4 – Segmental information continued

	United Kingdom							
	Life £m	GI £m	Europe £m	North America £m	Asia Pacific £m	Aviva Investors <sup>†</sup> £m	Other Group activities £m	Total £m
(Loss)/profit before tax attributable to shareholders	(149)	(391)	48	(338)	(68)	72	(474)	(1,300)
Adjusted for non-operating items:								
Reclassification of corporate costs and unallocated interest	7	(71)	54	15	–	–	(5)	–
Investment return variances and economic assumption changes on long-term business	694	–	400	433	104	–	–	1,631
Short-term fluctuation in return on investments backing non-long-term business	–	334	389	(47)	–	–	143	819
Economic assumption changes on general insurance and health business	–	91	3	–	–	–	–	94
Impairment of goodwill	–	–	66	–	–	–	–	66
Amortisation and impairment of intangibles	3	33	34	44	–	3	–	117
(Profit)/loss on the disposal of subsidiaries and associates	–	38	(24)	–	–	–	(21)	(7)
Exceptional items	108	312	133	42	–	6	(50)	551
Integration and restructuring costs	60	195	38	–	–	33	–	326
<b>Operating profit/(loss) before tax attributable to shareholders</b>	<b>723</b>	<b>541</b>	<b>1,141</b>	<b>149</b>	<b>36</b>	<b>114</b>	<b>(407)</b>	<b>2,297</b>



## Notes to the consolidated financial statements continued

## 4 – Segmental information continued

## (ii) Segmental income statement for the year ended 31 December 2007

	United Kingdom		Europe £m	North America £m	Asia Pacific £m	Aviva Investors <sup>†</sup> £m	Other Group activities £m	Restated Total £m
	Life £m	GI £m						
Gross written premiums	6,128	6,039	13,538	4,628	658	–	–	30,991
Premiums ceded to reinsurers	(444)	(577)	(388)	(195)	(54)	–	–	(1,658)
Internal reinsurance revenue	–	28	(19)	(7)	(2)	–	–	–
Net written premiums	5,684	5,490	13,131	4,426	602	–	–	29,333
Net change in provision for unearned premiums	(18)	60	(22)	(40)	(1)	–	–	(21)
Net earned premiums	5,666	5,550	13,109	4,386	601	–	–	29,312
Fee and commission income	246	385	638	30	168	299	(6)	1,760
	5,912	5,935	13,747	4,416	769	299	(6)	31,072
Net investment income	5,186	699	2,761	875	286	(15)	(103)	9,689
Inter-segment revenue	–	–	–	–	–	199	–	199
Share of profit/(loss) of joint ventures and associates	(304)	3	6	–	(9)	–	–	(304)
Profit/(loss) on the disposal of subsidiaries and associates	–	(7)	(5)	–	–	–	61	49
<b>Segmental income*</b>	<b>10,794</b>	<b>6,630</b>	<b>16,509</b>	<b>5,291</b>	<b>1,046</b>	<b>483</b>	<b>(48)</b>	<b>40,705</b>
Claims and benefits paid, net of recoveries from reinsurers	(9,000)	(4,064)	(11,192)	(2,486)	(377)	–	(2)	(27,121)
Change in insurance liabilities, net of reinsurance	(729)	417	(949)	(1,920)	(327)	–	–	(3,508)
Change in investment contract provisions	(694)	–	(1,091)	(153)	(35)	(45)	–	(2,018)
Change in unallocated divisible surplus	1,882	–	1,040	–	–	–	–	2,922
Amortisation of deferred acquisition costs and acquired value of in-force business	–	–	(35)	(122)	(3)	–	–	(160)
Depreciation and other amortisation expense	(24)	(104)	(53)	(45)	(6)	(17)	–	(249)
Other operating expenses	(1,110)	(2,723)	(2,318)	(545)	(251)	(289)	(15)	(7,251)
Impairment losses**	–	–	(50)	(7)	–	–	–	(57)
Inter-segment expenses	(141)	(4)	(18)	(32)	(3)	–	(1)	(199)
Finance costs	(405)	(10)	(527)	(19)	–	–	(256)	(1,217)
<b>Segmental expenses</b>	<b>(10,221)</b>	<b>(6,488)</b>	<b>(15,193)</b>	<b>(5,329)</b>	<b>(1,002)</b>	<b>(351)</b>	<b>(274)</b>	<b>(38,858)</b>
Profit/(loss) before tax	573	142	1,316	(38)	44	132	(322)	1,847
Tax attributable to policyholders' returns	(9)	–	6	–	(9)	(3)	–	(15)
<b>Profit/(loss) before tax attributable to shareholders</b>	<b>564</b>	<b>142</b>	<b>1,322</b>	<b>(38)</b>	<b>35</b>	<b>129</b>	<b>(322)</b>	<b>1,832</b>

\* Total reported income, excluding inter-segment revenue, is split United Kingdom £17,424 million, France £5,731 million, Netherlands £5,922 million, USA £3,777 million and Rest of the World £7,853 million. Income is attributed on the basis of geographical origin which does not materially differ from revenue by geographical destination, as most risks are located in the countries where the contracts were written.

\*\* Impairment losses, and reversal of such losses, recognised directly in equity were £nil and £1 million.

† Aviva Investors comprises the Aviva Investors UK, France, the United States, Canada and International fund management businesses.

# United Kingdom General Insurance includes the Group Reinsurance business, agency run off business and the non-insurance business for the RAC.

#### 4 – Segmental information continued

	United Kingdom		Europe £m	North America £m	Asia Pacific £m	Aviva Investors <sup>†</sup> £m	Other Group activities £m	Restated Total £m
	Life £m	GI £m						
Profit/(loss) before tax attributable to shareholders	564	142	1,322	(38)	35	129	(322)	1,832
Adjusted for non-operating items:								
Reclassification of corporate costs and unallocated interest	(6)	(63)	33	19	–	–	17	–
Investment return variances and economic assumption changes on long-term business	112	–	(309)	181	(1)	2	–	(15)
Short-term fluctuation in return on investments backing non-long-term business	–	86	112	9	–	–	(23)	184
Economic assumption changes on general insurance and health business	–	(1)	–	(1)	–	–	–	(2)
Impairment of goodwill	–	–	1	–	–	9	–	10
Amortisation and impairment of intangibles	4	28	21	40	3	7	–	103
(Profit)/loss on the disposal of subsidiaries and associates	–	7	5	–	–	–	(61)	(49)
Integration and restructuring costs	8	114	12	19	–	–	–	153
<b>Operating profit before tax attributable to shareholders</b>	<b>682</b>	<b>313</b>	<b>1,197</b>	<b>229</b>	<b>37</b>	<b>147</b>	<b>(389)</b>	<b>2,216</b>

## Notes to the consolidated financial statements continued

## 4 – Segmental information continued

## (iii) Segmental balance sheet as at 31 December 2008

	United Kingdom		Europe £m	North America £m	Asia Pacific £m	Aviva Investors <sup>†</sup> £m	Other Group activities £m	Total £m
	Life £m	GI £m						
Goodwill	52	1,208	1,357	903	55	3	–	3,578
Acquired value of in-force business and intangible assets	65	265	1,470	2,196	28	14	–	4,038
Interests in, and loans to, joint ventures and associates	2,080	–	604	2	296	–	1	2,983
Property and equipment	123	173	519	106	32	10	1	964
Investment property	8,872	148	3,920	7	21	655	803	14,426
Loans	20,156	833	19,061	2,130	56	1	–	42,237
Financial investments	69,052	2,482	125,329	24,621	3,865	1,454	2,919	229,722
Deferred acquisition costs	1,221	998	1,254	2,627	43	3	1	6,147
Other assets	13,933	4,971	23,867	5,537	627	661	871	50,467
<b>Total assets</b>	<b>115,554</b>	<b>11,078</b>	<b>177,381</b>	<b>38,129</b>	<b>5,023</b>	<b>2,801</b>	<b>4,596</b>	<b>354,562</b>
Insurance liabilities								
Long-term business and outstanding claims provisions	62,070	6,103	72,464	26,939	2,120	–	–	169,696
Unearned premiums	173	2,966	670	959	22	–	–	4,790
Other insurance liabilities	–	91	182	91	–	–	–	364
Liability for investment contracts	35,109	–	65,106	3,403	1,643	2,298	–	107,559
Unallocated divisible surplus	2,727	–	(405)	–	3	–	–	2,325
Net asset value attributable to unitholders	986	–	3,304	–	175	–	2,453	6,918
External borrowings	2,716	11	6,970	163	–	–	5,341	15,201
Other liabilities, including inter-segment liabilities	8,164	(972)	18,635	4,041	190	324	2,881	33,263
<b>Total liabilities</b>	<b>111,945</b>	<b>8,199</b>	<b>166,926</b>	<b>35,596</b>	<b>4,153</b>	<b>2,622</b>	<b>10,675</b>	<b>340,116</b>
<b>Total equity</b>								<b>14,446</b>
<b>Total equity and liabilities</b>								<b>354,562</b>
Capital expenditure (excluding business combinations)	36	93	72	70	4	5	–	280

External borrowings by holding companies within the Group which are not allocated to operating companies are included in "Other Group activities".

<sup>†</sup> Aviva Investors comprises the Aviva Investors UK, France, the United States, Canada and International fund management businesses.

## 4 – Segmental information continued

### (iv) Segmental balance sheet as at 31 December 2007

	United Kingdom		Europe £m	North America £m	Asia Pacific £m	Aviva Investors <sup>†</sup> £m	Other Group activities £m	Restated Total £m
	Life £m	GI £m						
Goodwill	71	1,276	1,053	642	40	–	–	3,082
Acquired value of in-force business and intangible assets	65	349	1,164	1,579	28	12	–	3,197
Interests in, and loans to, joint ventures and associates	2,972	–	594	1	215	–	–	3,782
Property and equipment	177	317	374	28	37	7	2	942
Investment property	10,415	252	3,061	–	25	966	672	15,391
Loans	20,153	900	13,895	1,206	39	–	–	36,193
Financial investments	83,489	3,679	103,430	17,227	3,934	1,993	2,658	216,410
Deferred acquisition costs	1,477	1,212	914	830	45	4	5	4,487
Other assets	10,535	5,157	16,086	2,804	500	667	2,093	37,842
<b>Total assets</b>	<b>129,354</b>	<b>13,142</b>	<b>140,571</b>	<b>24,317</b>	<b>4,863</b>	<b>3,649</b>	<b>5,430</b>	<b>321,326</b>
Insurance liabilities								
Long-term business and outstanding claims provisions	65,017	6,429	56,505	17,335	1,820	–	–	147,106
Unearned premiums	179	3,468	973	815	15	–	–	5,450
Other insurance liabilities	–	92	113	78	–	–	–	283
Liability for investment contracts	41,845	–	49,551	1,756	1,952	3,140	–	98,244
Unallocated divisible surplus	4,944	–	1,838	–	3	–	–	6,785
Net asset value attributable to unitholders	758	–	2,680	–	189	–	2,782	6,409
External borrowings	2,184	12	6,153	133	–	6	4,169	12,657
Other liabilities, including inter- segment liabilities	10,474	(320)	13,129	1,615	160	294	3,109	28,461
<b>Total liabilities</b>	<b>125,401</b>	<b>9,681</b>	<b>130,942</b>	<b>21,732</b>	<b>4,139</b>	<b>3,440</b>	<b>10,060</b>	<b>305,395</b>
<b>Total equity</b>								<b>15,931</b>
<b>Total equity and liabilities</b>								<b>321,326</b>
Capital expenditure (excluding business combinations)	30	140	106	10	5	6	2	299

### (b) Further analysis by products and services

The Group's results can be further analysed by products and services which comprise long-term business, fund management, general insurance and health, and non-insurance activities.

#### Long-term business

Our long-term business comprises life insurance, long-term health and accident insurance, savings, pensions and annuity business written by our life insurance subsidiaries, including managed pension fund business and our share of the other life and related business written in our associates and joint ventures, as well as the Lifetime mortgage business written in the UK.

#### Fund management

Our fund management business invests policyholders' and shareholders' funds, provides investment management services for institutional pension fund mandates and manages a range of retail investment products, including investment funds, unit trusts, OEICs and ISAs. Clients include Aviva Group businesses and third-party financial institutions, pension funds, public sector organisations, investment professionals and private investors.



## Notes to the consolidated financial statements continued

## 4 – Segmental information continued

*General insurance and health*

Our general insurance and health business provides insurance cover to individuals and to small- and medium-sized businesses, for risks associated mainly with motor vehicles, property and liability, such as employers' liability and professional indemnity liability, and medical expenses.

*Non-insurance*

Non-insurance includes the RAC non-insurance operations, our banking businesses, service companies, head office expenses, such as Group treasury and finance functions, and certain financing costs and taxes not allocated to business segments.

**(i) Segmental income statement – products and services for the year ended 31 December 2008**

	Long-term business £m	Fund management £m	General Insurance and health** £m	Other† £m	Total £m
Gross written premiums*	24,272	–	11,934	–	36,206
Premiums ceded to reinsurers	(1,044)	–	(797)	–	(1,841)
Net written premiums	23,228	–	11,137	–	34,365
Net change in provision for unearned premiums	–	–	277	–	277
Net earned premiums	23,228	–	11,414	–	34,642
Fee and commission income	753	567	160	405	1,885
	23,981	567	11,574	405	36,527
Net investment (expense)/income	(16,671)	3	425	200	(16,043)
Inter-segment revenue	–	185	–	–	185
Share of loss of joint ventures and associates	(1,089)	(12)	(5)	(22)	(1,128)
Profit on the disposal of subsidiaries and associates	–	–	–	7	7
<b>Segmental income</b>	<b>6,221</b>	<b>743</b>	<b>11,994</b>	<b>590</b>	<b>19,548</b>
<b>Segmental expenses</b>	<b>(7,532)</b>	<b>(662)</b>	<b>(12,100)</b>	<b>(1,622)</b>	<b>(21,916)</b>
Tax attributable to policyholder returns	1,068	–	–	–	1,068
<b>Profit/(loss) before tax attributable to shareholders</b>	<b>(243)</b>	<b>81</b>	<b>(106)</b>	<b>(1,032)</b>	<b>(1,300)</b>
Adjusted for non-operating items	1,937	42	1,304	314	3,597
<b>Operating profit before tax attributable to shareholders' profits</b>	<b>1,694</b>	<b>123</b>	<b>1,198</b>	<b>(718)</b>	<b>2,297</b>

\* Gross written premiums includes inward reinsurance premiums assumed from other companies amounting to £255 million, of which £89 million relates to property and liability insurance, £131 million to long-term business and the remainder health business.

\*\* General insurance and health business segment includes gross written premiums of £1,945 million and premiums ceded to other companies of £35 million relating to health business. The remaining business relates to property and liability insurance.

† Other includes the RAC non-insurance operations, our banking business, head office expenses, such as Group treasury and finance functions, and certain financing costs and taxes not allocated to business segments.

## 4 – Segmental information continued

### (ii) Segmental income statement – products and services for the year ended 31 December 2007

	Long-term business £m	Fund management £m	General insurance and health** £m	Other† £m	Restated Total £m
Gross written premiums*	19,622	–	11,369	–	30,991
Premiums ceded to reinsurers	(858)	–	(800)	–	(1,658)
Net written premiums	18,764	–	10,569	–	29,333
Net change in provision for unearned premiums	–	–	(21)	–	(21)
Net earned premiums	18,764	–	10,548	–	29,312
Fee and commission income	692	494	179	395	1,760
Net investment income	19,456	494	10,727	395	31,072
Inter-segment revenue	8,529	45	827	288	9,689
Share of (loss)/profit of joint ventures and associates	–	152	–	–	152
Share of (loss)/profit of joint ventures and associates	(297)	(9)	3	(1)	(304)
Profit/(loss) on the disposal of subsidiaries and associates	–	–	(7)	56	49
<b>Segmental income</b>	<b>27,688</b>	<b>682</b>	<b>11,550</b>	<b>738</b>	<b>40,658</b>
<b>Segmental expenses</b>	<b>(26,139)</b>	<b>(521)</b>	<b>(10,843)</b>	<b>(1,308)</b>	<b>(38,811)</b>
Tax attributable to policyholder returns	(15)	–	–	–	(15)
<b>Profit before tax attributable to shareholders</b>	<b>1,534</b>	<b>161</b>	<b>707</b>	<b>(570)</b>	<b>1,832</b>
Adjusted for non-operating items	76	18	314	(24)	384
<b>Operating profit before tax attributable to shareholders' profits</b>	<b>1,610</b>	<b>179</b>	<b>1,021</b>	<b>(594)</b>	<b>2,216</b>

### (iii) Segmental balance sheet – products and services as at 31 December 2008

	Long-term business £m	Fund management £m	General insurance and health £m	Other £m	Total £m
Segment assets	<b>307,928</b>	<b>732</b>	<b>25,190</b>	<b>20,712</b>	<b>354,562</b>
Segment liabilities	<b>(291,347)</b>	<b>(392)</b>	<b>(19,552)</b>	<b>(28,825)</b>	<b>(340,116)</b>
<b>Net assets</b>	<b>16,581</b>	<b>340</b>	<b>5,638</b>	<b>(8,113)</b>	<b>14,446</b>

### (iv) Segmental balance sheet – products and services as at 31 December 2007

	Long-term business £m	Fund management £m	General insurance and health £m	Other £m	Restated Total £m
Segment assets	280,375	1,871	24,341	14,739	321,326
Segment liabilities	(265,736)	(1,517)	(18,581)	(19,561)	(305,395)
<b>Net assets</b>	<b>14,639</b>	<b>354</b>	<b>5,760</b>	<b>(4,822)</b>	<b>15,931</b>

## Notes to the consolidated financial statements continued

## 5 – Details of income

*This note gives further detail on the items appearing in the first section of the consolidated income statement.*

	2008 £m	Restated 2007 £m
<b>Gross written premiums</b> (note 4a & 4b)		
Long-term:		
Insurance contracts	19,388	15,589
Participating investment contracts	4,884	4,033
General insurance and health	11,934	11,369
	36,206	30,991
Less: premiums ceded to reinsurers (note 4a & 4b)	(1,841)	(1,658)
Gross change in provision for unearned premiums (note 38e)	388	(24)
Reinsurers' share of change in provision for unearned premiums (note 41c(iii))	(111)	3
Net change in provision for unearned premiums	277	(21)
<b>Net earned premiums</b>	<b>34,642</b>	<b>29,312</b>
<b>Fee and commission income</b>		
Fee income from investment contract business	487	416
Fund management fee income	556	576
Other fee income	577	481
Reinsurance commissions receivable	176	223
Other commission income	110	110
Net change in deferred revenue	(21)	(46)
	1,885	1,760
<b>Total revenue</b>	<b>36,527</b>	<b>31,072</b>
<b>Net investment income</b>		
Interest and similar income		
From financial instruments designated as trading and other than trading	7,302	6,611
From AFS investments and financial instruments at amortised cost	2,012	1,485
	9,314	8,096
Dividend income	2,444	2,100
Other income from investments designated as trading		
Realised gains and losses	1,039	49
Unrealised gains and losses (policy J)	108	65
	1,147	114
Other income from investments designated as other than trading		
Realised gains and losses	(1,181)	5,055
Unrealised gains and losses (see policy J)	(25,213)	(6,244)
	(26,394)	(1,189)
Realised gains on AFS investments	126	391
Net income from investment properties		
Rent	959	846
Expenses relating to these properties	(33)	(27)
Realised gains on disposal	14	105
Fair value (losses) on investment properties (note 21)	(3,137)	(757)
	(2,197)	167
Realised gains on loans	7	7
Foreign exchange gains and losses on investments other than trading	(395)	11
Other investment income/(expenses)	(95)	(8)
<b>Net investment income</b>	<b>(16,043)</b>	<b>9,689</b>
Share of (loss) after tax of joint ventures (note 18a)	(1,038)	(339)
Share of (loss)/profit after tax of associates (note 19a)	(90)	35
Share of (loss) after tax of joint ventures and associates	(1,128)	(304)
Profit on disposal of subsidiaries and associates (note 3b)	7	49
<b>Total income</b>	<b>19,363</b>	<b>40,506</b>

## 6 – Details of expenses

*This note gives further detail on the items appearing in the second section of the consolidated income statement.*

	2008 £m	Restated 2007 £m
<b>Claims and benefits paid</b>		
Claims and benefits paid to policyholders on long-term business		
Insurance contracts	16,986	14,743
Participating investment contracts	5,085	5,604
Non-participating investment contracts	115	64
Claims and benefits paid to policyholders on general insurance and health business	8,696	7,779
	30,882	28,190
Less: Claim recoveries from reinsurers		
Insurance contracts	(1,447)	(1,056)
Participating investment contracts	(82)	(13)
Claims and benefits paid, net of recoveries from reinsurers	29,353	27,121
<b>Change in insurance liabilities</b>		
Change in insurance liabilities	(4,792)	3,361
Change in reinsurance asset for insurance provisions	907	147
Change in insurance liabilities, net of reinsurance	(3,885)	3,508
<b>Change in investment contract provisions</b>		
Investment income allocated to investment contracts	(6,957)	885
Other changes in provisions		
Participating investment contracts (note 39)	(3,088)	1,025
Non-participating investment contracts	(591)	90
Change in reinsurance asset for investment contract provisions	7	18
Change in investment contract provisions	(10,629)	2,018
<b>Change in unallocated divisible surplus</b> (note 43)	(4,482)	(2,922)
<b>Fee and commission expense</b>		
Acquisition costs		
Commission expenses for insurance and participating investment contracts	3,521	3,351
Change in deferred acquisition costs for insurance and participating investment contracts	(513)	(627)
Deferrable costs for non-participating investment contracts	160	265
Other acquisition costs	1,337	1,348
Change in deferred acquisition costs for non-participating investment contracts	185	(279)
Investment income attributable to unitholders	(679)	(139)
Reinsurance commissions and other fee and commission expense	400	325
	4,411	4,244
<b>Other expenses</b>		
Other operating expenses		
Staff costs and other expenses (note 10)	3,090	2,724
Central costs and sharesave schemes	141	163
Depreciation (note 20)	131	129
Impairment of goodwill on subsidiaries (note 16a)	48	10
Amortisation of acquired value of in-force business on insurance contracts (note 17)	333	160
Amortisation of intangible assets (note 17)	113	106
Net impairment of acquired value of in-force business (note 17)	2	–
Impairment/reversal of impairment of intangible assets (note 17)	13	4
Integration and restructuring costs (see below)	326	153
Exceptional items (see below)	247	–
	4,444	3,449



## Notes to the consolidated financial statements continued

## 6 – Details of expenses continued

	2008 £m	Restated 2007 £m
Impairments		
Net impairment on loans	50	9
Net impairment on financial investments	973	49
Net impairment on receivables and other financial assets	17	1
Net impairment on non-financial assets	–	(1)
	<b>1,040</b>	<b>58</b>
Other net foreign exchange (gains)	(68)	(34)
<b>Finance costs</b> (note 7)	<b>1,547</b>	<b>1,217</b>
<b>Total expenses</b>	<b>21,731</b>	<b>38,659</b>

**Integration and restructuring costs**

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 £337 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.

**Exceptional items**

We have reported exceptional items of £551 million (2007: £nil) in the year. These include £142 million for closing or exiting non-core business operations such as the lifetime wrap platform and The British School of Motoring in the UK and the structured settlement business in the United States. 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.

In the table above, the £304 million relating to strengthening of latent claims provisions is included in change in insurance liabilities, with the remaining £247 million being included in other expenses.

**Impairment of financial investments**

Group policy is to recognise an impairment on available for sale (AFS) equity securities when there has been a prolonged or significant decline in their fair value below their cost. Although management believes that these equity securities will ultimately recover their value, there can be no certainty that this will happen as, unlike fixed maturity securities, the value of an equity security cannot be recovered in full by holding it to maturity.

## 7 – Finance costs

*This note analyses the interest costs on our borrowings (which are described in note 47) and similar charges.*

Finance costs comprise:

	2008 £m	Restated 2007 £m
Interest expense on core structural borrowings		
Subordinated debt	229	179
Debenture loans	21	25
Commercial paper	36	55
	286	259
Interest expense on operational borrowings		
Amounts owed to credit institutions	82	38
Securitised mortgage loan notes		
At amortised cost	125	105
At fair value	325	220
	450	325
	532	363
Interest on banking customer deposits	250	166
Interest on reinsurance deposits	11	37
Interest on collateral received	321	190
Other similar charges	147	202
<b>Total finance costs</b>	<b>1,547</b>	<b>1,217</b>
These are analysed as:		
Allocated interest and similar charges	1,168	854
Group debt costs and other interest	379	363
	1,547	1,217

## 8 – Long-term business economic volatility

*The long-term nature of much of the Group's operations means that, for management's decision-making and internal performance management, the effects of short-term economic volatility are treated as non-operating items. The Group focuses instead on an operating profit measure that incorporates an expected return on investments supporting its long-term business. This note explains the methodology behind this.*

### (a) Definitions

Operating profit for long-term business is based on expected investment returns on financial investments backing shareholder and policyholder funds over the reporting period, with consistent allowance for the corresponding expected movements in liabilities. Operating profit includes the effect of variance in experience for non-economic items, such as mortality, persistency and expenses, and the effect of changes in non-economic assumptions. Changes due to economic items, such as market value movements and interest rate changes, which give rise to variances between actual and expected investment returns, and the impact of changes in economic assumptions on liabilities, are disclosed separately outside operating profit.

### (b) Economic volatility

The investment variances and economic assumption changes excluded from the long-term business operating profit are as follows:

	Long-term business	
	2008 £m	2007 £m
Investment variances and economic assumption changes	(1,631)	15

The deepening global financial crisis has led to significantly negative investment variances in 2008. The variances primarily relate to debt securities, where the unprecedented widening of credit spreads drove down market values, and to a lesser extent from falling equity and property values. For with-profits and unit-linked business the decline in asset values is largely offset by a corresponding reduction in liabilities. However for other non-profit business and surplus shareholder funds, the reduction in asset values was only partly mitigated by movements in liabilities. Although equity markets suffered major downturns, the profit impact was limited by hedging activity in the Netherlands and limited shareholder exposure elsewhere in the Group.

**Notes to the consolidated financial statements continued****8 – Long-term business economic volatility continued**

Major items included in the economic items for 2008 are as follows:

- additional credit default provisions of £550 million for corporate bonds and commercial mortgages backing UK annuity business;
- the impact of market movements on guarantees and options in France and the Netherlands of £260 million;
- widening credit spreads on assets backing participating business in Spain, with a charge to net income of £220 million; and
- in the USA the impact of credit spread widening on certain assets backing funding agreements that are classified as fair value through profit or loss, and write-downs on assets classified as available for sale, of £430 million.

This compares to a broadly neutral net impact on profit in 2007, when favourable investment variances in the Europe region were largely offset by negative effects in the USA and UK.

**(c) Methodology**

The expected investment returns and corresponding expected movements in long-term business liabilities are calculated separately for each principal long-term business unit.

The expected return on investments for both policyholder and shareholders funds is based on opening economic assumptions applied to the expected funds under management over the reporting period. Expected investment return assumptions are derived actively, based on market yields on risk-free fixed interest assets at the end of each financial year. The same margins are applied on a consistent basis across the Group to gross risk-free yields, to obtain investment return assumptions for equities and properties. Expected funds under management are equal to the opening value of funds under management, adjusted for sales and purchases during the period arising from expected operating experience.

The actual investment return is affected by differences between the actual and expected funds under management and changes in asset mix, as well as movements in interest rates. To the extent that these differences arise from the operating experience of the long-term business, or management decisions to change asset mix, the effect is included in the operating profit. The residual difference between actual and expected investment return is included in investment variances, outside operating profit but included in profit before tax.

The movement in liabilities included in operating profit reflects both the change in liabilities due to the expected return on investments and the impact of experience variances and assumption changes for non-economic items. The effect of differences between actual and expected experience on liabilities, and changes to economic assumptions used to value liabilities, are taken outside operating profit. For many types of long-term business, including unit-linked and with-profits funds, movements in asset values are offset by corresponding changes in liabilities, limiting the net impact on profit. For other long-term business the profit impact of economic volatility depends on the degree of matching of assets and liabilities, and exposure to financial options and guarantees.

**(d) Assumptions**

The expected rate of investment return is determined using consistent assumptions between operations, having regard to local economic and market forecasts of investment return and asset classification under IFRS.

Where assets are classified as fair value through profit or loss, the Group has applied the same “real-world” economic assumptions for fixed interest securities, equities and properties as are used under MCEV principles in 2008, and under EEV principles in 2007. The principal assumptions underlying the calculation of the expected investment return are:

	Fixed interest		Equities		Properties	
	2008 %	2007 %	2008 %	2007 %	2008 %	2007 %
United Kingdom	<b>5.7</b>	4.6	<b>9.2</b>	7.6	<b>7.7</b>	6.6
Eurozone	<b>4.8</b>	4.0	<b>8.3</b>	7.0	<b>6.8</b>	6.0

For 2008 the fixed interest reference rate is the one-year spot rate for risk free swaps in the relevant currency at the start of the year. This is adjusted for different classes of fixed interest securities to reflect current market yields. The expected returns for equities and property assets include risk margins above the reference rate of 3.5% and 2% respectively.

Where fixed interest securities are classified as available for sale, such as in the United States, the expected investment return comprises the expected interest or dividend payments and amortisation of the premium or discount at purchase.

## 9 – Longer term investment return and economic assumption changes for non-long-term business

*For non-long-term business, the total investment income, including realised and unrealised gains, is split between a calculated longer term return and short-term fluctuations from this. This note gives details of the longer term return calculation and the relevant assumptions, as well as the economic assumption changes on our general insurance and health business.*

**(a)** The short-term fluctuations in investment return and economic assumption changes attributable to the non-long-term business result and reported outside operating profit were as follows:

	Non-long-term business	
	2008 £m	2007 £m
Short-term fluctuation in investment return (see (b) below)	<b>(819)</b>	(184)
Economic assumption changes (see (g) below)	<b>(94)</b>	2
	<b>(913)</b>	(182)

**(b)** The longer term investment return and short-term fluctuation are as follows:

	Non-long-term business	
	2008 £m	2007 £m
Net investment income (note 4b(ii))	<b>522</b>	1,115
Internal charges included under other headings	<b>(73)</b>	18
	<b>449</b>	1,133
Analysed between:		
Longer term investment return, reported within operating profit	<b>1,268</b>	1,317
Short-term fluctuation in investment return, reported outside operating profit	<b>(819)</b>	(184)
	<b>449</b>	1,133

**(c)** The longer term investment return is calculated separately for each principal non-long-term business unit. In respect of equities and properties, the return is calculated by multiplying the opening market value of the investments, adjusted for sales and purchases during the year, by the longer term rate of investment return.

The longer term rate of investment return is determined using consistent assumptions between operations, having regard to local economic and market forecasts of investment return. The allocated longer term return for other investments is the actual income receivable for the year.



## Notes to the consolidated financial statements continued

## 9 – Longer term investment return and economic assumption changes for non-long-term business continued

(d) The total assets supporting the general insurance and health business, which contribute towards the longer term return were £19,576 million (2007: £18,291 million). For other operations the longer term return reflects interest income earned in the Netherlands bank and retail mortgage divisions.

The principal assumptions underlying the calculation of the longer term investment return are:

	Longer term rates of return Equities		Longer term rates of return Properties	
	2008 %	2007 %	2008 %	2007 %
United Kingdom	<b>9.2</b>	7.6	<b>7.7</b>	6.6
France	<b>8.3</b>	7.0	<b>6.8</b>	6.0
Ireland	<b>8.3</b>	7.0	<b>6.8</b>	6.0
Netherlands	<b>8.3</b>	7.0	<b>6.8</b>	6.0
Canada	<b>7.7</b>	7.1	<b>6.2</b>	6.1

The Group has applied the same economic assumptions for equities and properties as are used under MCEV principles to calculate the longer term investment return for its non-long-term business in 2008. In 2007 rates were based on EEV.

(e) The table below compares the actual return on investments attributable to the non-long-term business, after deducting investment management expenses and charges, with the aggregate longer term return over a five year period. This table will be built up over time to give comparative figures over a similar five-year period.

	2004–2008 £m
Actual return attributable to shareholders	<b>4,985</b>
Longer-term return credited to operating results	<b>(5,161)</b>
Excess of longer term returns over actual returns	<b>(176)</b>

(f) The table below shows the sensitivity of the Group's non-long-term business operating profit before tax to changes in the longer term rates of return:

Movement in investment return for	By	Change in	2008 £m	2007 £m
Equities	1% higher/lower	Group operating profit before tax	<b>17</b>	27
Properties	1% higher/lower	Group operating profit before tax	<b>3</b>	4

(g) The economic assumption changes arise from movements in the rate used to discount latent claims. As explained in accounting policy K, provisions for latent claims are discounted, using rates based on the relevant swap curve, in the relevant currency at the reporting date, having regard to the duration of the expected settlement of the claims. The discount rate is set at the start of the accounting period, with any change in rates between the start and end of the accounting period being reflected below operating profit as an economic assumption change. The range of discount rates used is disclosed in note 38(c).

## 10 – Employee information

*This note shows where our staff are employed throughout the world and analyses the total staff costs.*

### (a) Employee numbers

The number of persons employed by the Group was:

	At 31 December		Average for the year	
	2008 Number	2007 Number	2008 Number	2007 Number
United Kingdom operations*	<b>28,424</b>	32,872	<b>29,996</b>	32,746
Europe	<b>16,501</b>	15,989	<b>16,283</b>	15,769
North America	<b>5,627</b>	4,634	<b>4,990</b>	4,775
Asia Pacific	<b>2,376</b>	2,052	<b>2,220</b>	2,005
Aviva Investors	<b>1,298</b>	967	<b>1,061</b>	962
Corporate centre	<b>532</b>	497	<b>507</b>	497
	<b>54,758</b>	57,011	<b>55,057</b>	56,754

\* 2007 employee numbers include staff in the offshore operations in Sri Lanka and India. These operations were sold in 2008 and therefore these are not included in the 2008 closing numbers.

### (b) Staff costs

Total staff costs were:

	2008 £m	2007 £m
Wages and salaries	<b>2,114</b>	1,831
Social security costs	<b>258</b>	229
Post-retirement obligations		
Defined benefit schemes (note 46d)	<b>175</b>	191
Defined contribution schemes (note 46d)	<b>58</b>	63
Profit sharing and incentive plans	<b>172</b>	169
Equity compensation plans (note 29d)	<b>39</b>	50
Termination benefits	<b>57</b>	9
	<b>2,873</b>	2,542

These costs are charged within:

	2008 £m	2007 £m
Acquisition costs	<b>584</b>	592
Claims handling expenses	<b>291</b>	318
Central costs and sharesave schemes	<b>83</b>	109
Other operating expenses	<b>1,915</b>	1,523
	<b>2,873</b>	2,542

## 11 – Directors

Information concerning individual directors' emoluments, interests and transactions is given in the Directors' remuneration report.

## Notes to the consolidated financial statements continued

## 12 – Auditors' remuneration

*This note shows the total remuneration payable by the Group to our principal auditors, Ernst & Young.*

The total remuneration payable by the Group, excluding VAT and any overseas equivalent thereof, to its principal auditors, Ernst & Young LLP, and its associates in respect of the audit of these financial statements is shown below, together with fees payable in respect of other work.

	2008 £000	2007 £000
Fees payable to Ernst & Young LLP for the statutory audit of the Aviva Group and Company financial statements	1,548	1,364
Fees payable to Ernst & Young LLP and its associates for other services to Group companies:		
Audit of Group subsidiaries pursuant to legislation	9,981	8,388
Additional fees related to the prior year audit of Group subsidiaries pursuant to legislation	519	372
Other services pursuant to legislation	2,439	2,124
Tax services	185	201
Services relating to information technology	112	173
Services relating to corporate finance transactions	487	736
All other services – Supplementary reporting (see below)	3,468	931
– Other supplementary services	6,224	4,749
Fees payable to Ernst & Young LLP for services to Group pension schemes		
Audit of Group pension scheme	70	67
	25,033	19,105

Fees for Supplementary reporting are in respect of the audit of the Group's MCEV and EEV reporting. Although embedded value is a primary management reporting basis and our disclosures require a full audit, the relevant fees are not classified as being for statutory audit. These fees have increased in 2008 due to the work undertaken on the Group's MCEV restatement that was published in February 2009.

Fees for Other supplementary services include £3.5 million (2007: £0.9 million) for assurance services in connection with the Group's Financial Reporting Control Framework, £1.2 million (2007: £1.4 million) for examination of the Group's ICA capital, and £1.5 million (2007: £2.5 million) for other services.

In addition to the above amounts payable to the principal auditors, fees for audit services of £2.6 million (2007: £3.8 million) were payable to other firms. The total fees payable for audit services were therefore £14.6 million (2007: £14.0 million).

## 13 – Tax

*This note analyses the tax charge for the year and explains the factors that affect it.*

## (a) Tax (credit)/charged to the income statement

(i) The total tax (credit)/charge comprises:

	2008 £m	Restated 2007 £m
<b>Current tax</b>		
For this year	527	885
Prior year adjustments	(284)	(94)
Total current tax	243	791
<b>Deferred tax</b>		
Origination and reversal of temporary differences	(1,814)	(348)
Changes in tax rates or tax laws	(7)	(88)
Write-down of deferred tax assets	95	(6)
Total deferred tax	(1,726)	(442)
Total tax (credited)/charged to income statement (note 13c)	(1,483)	349

## 13 – Tax continued

In February 2009 an Australian tax court case was settled in our favour resulting in the release of tax provisions of £63 million, which has reduced the tax charge in the income statement.

**(ii)** The Group, as a proxy for policyholders in the UK, Ireland, Singapore and Australia, is required to record taxes on investment income and gains each year. Accordingly, the tax benefit or expense attributable to UK, Irish, Singapore and Australian life insurance policyholder returns is included in the tax charge. The tax credit attributable to policyholders' returns included in the credit above is £1,068 million (2007: £15 million charge).

**(iii)** The tax (credit)/charge can be analysed as follows:

	2008 £m	Restated 2007 £m
UK tax	(1,482)	94
Overseas tax	(1)	255
	<b>(1,483)</b>	<b>349</b>

**(iv)** Unrecognised tax losses and temporary differences of previous years were used to reduce current tax expense and deferred tax expense by £139 million and £19 million, respectively (2007: £51 million and £6 million, respectively).

**(v)** Deferred tax credited to the income statement represents movements on the following items:

	2008 £m	2007 £m
Long-term business technical provisions and other insurance items	591	315
Deferred acquisition costs	224	34
Unrealised losses on investments	(1,706)	(793)
Pensions and other post-retirement obligations	16	40
Unused losses and tax credits	(413)	(272)
Subsidiaries, associates and joint ventures	(199)	(33)
Intangibles and additional value of in-force long-term business	30	(75)
Provisions and other temporary differences	(269)	342
Total deferred tax credited to income statement	<b>(1,726)</b>	<b>(442)</b>

### (b) Tax (credited)/charged to equity

**(i)** The total tax (credit)/charge comprises:

	2008 £m	2007 £m
Current tax	(16)	(19)
Deferred tax		
In respect of pensions and other post-retirement obligations	(15)	269
In respect of unrealised losses on investments	(204)	(71)
	<b>(219)</b>	<b>198</b>
Total tax (credited)/charged to equity	<b>(235)</b>	<b>179</b>

**(ii)** The tax credit attributable to policyholders' returns included above is £nil (2007: £nil).

## Notes to the consolidated financial statements continued

## 13 – Tax continued

## (c) Tax reconciliation

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the tax rate of the home country of the Company as follows:

	2008 £m	Restated 2007 £m
(Loss)/profit before tax	(2,368)	1,847
Tax calculated at standard UK corporation tax rate of 28.5% (2007: 30%)	(675)	554
Different basis of tax – policyholders	(767)	5
Adjustment to tax charge in respect of prior years	(283)	(49)
Non-assessable income	(94)	(124)
Non-taxable profit on sale of subsidiaries and associates	(2)	(18)
Disallowable expenses	95	7
Different local basis of tax on overseas profits	(61)	56
Reduction in future UK tax rate (net of movements in unallocated divisible surplus)	–	(64)
Deferred tax not recognised	292	1
Other	12	(19)
<b>Total tax (credited)/charged to income statement (note 13a)</b>	<b>(1,483)</b>	<b>349</b>

## 14 – Earnings per share

*This note shows how we calculate earnings per share, based both on the present shares in issue (the basic earnings per share) and the potential future shares in issue, including conversion of share options granted to employees (the diluted earnings per share). We have also shown the same calculations based on our operating profit as we believe this gives a better indication of operating performance.*

## (a) Basic earnings per share

(i) The profit attributable to ordinary shareholders is:

	2008			Restated 2007		
	Operating profit £m	Adjusting items £m	Total £m	Operating profit £m	Adjusting items £m	Total £m
Profit/(loss) before tax attributable to shareholders' profits	2,297	(3,597)	(1,300)	2,216	(384)	1,832
Tax attributable to shareholders' (loss)/profits	(487)	902	415	(604)	270	(334)
Profit/(loss) for the year	1,810	(2,695)	(885)	1,612	(114)	1,498
Amount attributable to minority interests	(91)	61	(30)	(191)	13	(178)
Cumulative preference dividends for the year	(17)	–	(17)	(17)	–	(17)
Coupon payments in respect of direct capital instruments (DCI) (net of tax)	(40)	–	(40)	(37)	–	(37)
<b>Profit/(loss) attributable to ordinary shareholders</b>	<b>1,662</b>	<b>(2,634)</b>	<b>(972)</b>	<b>1,367</b>	<b>(101)</b>	<b>1,266</b>



## 14 – Earnings per share continued

(ii) Basic earnings per share is calculated as follows:

	2008			Restated 2007		
	Before tax £m	Net of tax, minorities, preference dividends and DCI £m	Per share p	Before tax £m	Net of tax, minorities, preference dividends and DCI £m	Per share p
Operating profit attributable to ordinary shareholders	2,297	1,662	62.9	2,216	1,367	52.8
Non-operating items:						
Investment return variances and economic assumption changes on long-term business (note 8)	(1,631)	(1,280)	(48.4)	15	92	3.6
Short-term fluctuation in return on investments backing non-long-term business (note 9b)	(819)	(553)	(20.9)	(184)	(51)	(2.0)
Economic assumption changes on general insurance and health business	(94)	(67)	(2.5)	2	2	0.1
Impairment of goodwill (note 16a)	(66)	(66)	(2.5)	(10)	(10)	(0.4)
Amortisation and net impairment of intangibles (note 17)	(117)	(89)	(3.4)	(103)	(72)	(2.8)
Profit on the disposal of subsidiaries and associates (note 3b)	7	7	0.3	49	52	2.0
Integration and restructuring costs and exceptional items (note 6)	(877)	(586)	(22.3)	(153)	(114)	(4.4)
<b>(Loss)/profit attributable to ordinary shareholders</b>	<b>(1,300)</b>	<b>(972)</b>	<b>(36.8)</b>	<b>1,832</b>	<b>1,266</b>	<b>48.9</b>

(iii) The calculation of basic earnings per share uses a weighted average of 2,643 million (2007: 2,588 million) ordinary shares in issue, after deducting shares owned by the employee share trusts. The actual number of shares in issue at 31 December 2008 was 2,658 million (2007: 2,622 million).

### (b) Diluted earnings per share

(i) Diluted earnings per share is calculated as follows:

	2008			2007		
	Total £m	Weighted average number of shares m	Per share p	Total £m	Weighted average number of shares m	Per share p
(Loss)/profit attributable to ordinary shareholders	(972)	2,643	(36.8)	1,266	2,588	48.9
Dilutive effect of share awards and options	–	24	–	–	24	(0.4)
<b>Diluted (loss)/earnings per share</b>	<b>(972)</b>	<b>2,667</b>	<b>(36.8)</b>	<b>1,266</b>	<b>2,612</b>	<b>48.5</b>

(ii) Diluted earnings per share on operating profit attributable to ordinary shareholders is calculated as follows:

	2008			2007		
	Total £m	Weighted average number of shares m	Per share p	Total £m	Weighted average number of shares m	Per share p
Operating profit attributable to ordinary shareholders	1,662	2,643	62.9	1,367	2,588	52.8
Dilutive effect of share awards and options	–	24	(0.6)	–	24	(0.5)
<b>Diluted earnings per share</b>	<b>1,662</b>	<b>2,667</b>	<b>62.3</b>	<b>1,367</b>	<b>2,612</b>	<b>52.3</b>

## Notes to the consolidated financial statements continued

## 15 – Dividends and appropriations

*This note analyses the total dividends and other appropriations we have paid during the year. The table below does not include the final dividend proposed after the year end because it is not accrued in these financial statements. The impact of scrip dividends is shown separately in note 35.*

	2008 £m	2007 £m
Ordinary dividends declared and charged to equity in the year		
Final 2007 – 21.10 pence per share, paid on 16 May 2008	554	–
(Final 2006 – 19.18 pence per share, paid on 18 May 2007)	–	492
Interim 2008 – 13.09 pence per share, paid on 17 November 2008	348	–
(Interim 2007 – 11.90 pence per share, paid on 16 November 2007)	–	309
	902	801
Preference dividends declared and charged to equity in the year	17	17
Coupon payments on direct capital instrument	56	53
	975	871

Subsequent to 31 December 2008, the directors proposed a final dividend for 2008 of 19.91 pence per ordinary share (2007: 21.10 pence), amounting to £529 million (2007: £554 million) in total. Subject to approval by shareholders at the AGM, the dividend will be paid on 15 May 2009 and will be accounted for as an appropriation of retained earnings in the year ending 31 December 2009.

Interest on the direct capital instrument issued in November 2004 is treated as an appropriation of retained profits and, accordingly, it is accounted for when paid. Tax relief is obtained at a rate of 28.5% (2007: 30%).

## 16 – Goodwill

*This note analyses the changes to the carrying amount of goodwill during the year, and details the results of our impairment testing on both goodwill and intangible assets with indefinite lives.*

## (a) Carrying amount

	2008 £m	2007 £m
<b>Gross amount</b>		
At 1 January	3,273	3,086
Acquisitions (note 3a(iv))	106	115
Movements in contingent consideration	(59)	(5)
Disposals	(84)	(16)
Transfers from other intangibles	11	–
Foreign exchange rate movements	651	93
At 31 December	3,898	3,273
<b>Accumulated impairment</b>		
At 1 January	(191)	(176)
Impairment losses charged to exceptional items	(20)	–
Other impairment losses charged to expenses	(48)	(10)
Write back of impairment related to disposals	9	9
Foreign exchange rate movements	(65)	(14)
At 31 December	(315)	(191)
<b>Carrying amount at 31 December</b>	3,583	3,082
Less: Amounts classified as held for sale	(5)	–
	3,578	3,082

The impairment losses charged to exceptional items arise in the United Kingdom long-term business (see (b)(i) below). Of the other impairment losses charged to expenses, £46 million arises in the Netherlands (see (b)(viii) below) and £2 million arises in the Italy long-term business (see (b)(vi) below). Together with impairment charges of £18 million recognised in respect of goodwill within interests in joint ventures and associates (notes 18 and 19), the total goodwill impairment loss charged to non-exceptional expenses was £66 million.

## 16 – Goodwill continued

Movements in contingent consideration relate to contingent consideration paid/received in respect of past acquisitions of subsidiaries. Goodwill arising on acquisitions completed before 1 January 1998 was charged directly to reserves. Goodwill arising on the Group's acquisition of joint ventures and associates is included within the carrying value of those investments (see notes 18 and 19).

### (b) Goodwill allocation and impairment testing

A summary of the goodwill and intangibles with indefinite useful lives allocated to cash-generating units is presented below.

	Carrying amount of goodwill		Carrying amount of intangibles with indefinite useful lives (detailed in note 17)		Total	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
United Kingdom						
Long-term business (see (i) below)	52	71	–	–	52	71
General insurance, RAC and health (see (ii) below)	1,208	1,276	201	221	1,409	1,497
Europe						
France (long-term business) (see (iii) below)	–	–	60	45	60	45
Ireland						
Long-term business (see (iv) below)	133	101	–	–	133	101
General insurance and health (see (v) below)	134	81	–	–	134	81
Italy						
Long-term business (see (vi) below)	74	46	334	254	408	300
General insurance and health (see (vii) below)	64	42	137	132	201	174
Netherlands (see (viii) below)	279	212	–	–	279	212
Spain (long-term business) (see (ix) below)	652	552	–	–	652	552
Other	24	19	–	–	24	19
North America						
United States (long-term business) (see (x) below)	865	624	–	–	865	624
Canada	43	17	–	–	43	17
Asia Pacific						
Various	55	41	–	–	55	41
	<b>3,583</b>	<b>3,082</b>	<b>732</b>	<b>652</b>	<b>4,315</b>	<b>3,734</b>

As explained in accounting policy N, the carrying amount of goodwill and intangible assets with indefinite useful lives is reviewed at least annually or when circumstances or events indicate there may be uncertainty over this value. The tests led to impairment of goodwill of £68 million in 2008 (2007: £10 million).

Goodwill and intangibles with indefinite useful lives have been tested for impairment in these businesses as follows:

#### United Kingdom

##### (i) Long-term business

The United Kingdom long-term business goodwill balance is split across five cash generating units, with no individual balance exceeding £25 million.

As disclosed in note 6, the wrap platform of the United Kingdom long-term business was terminated during the year. As a result of this termination, the goodwill relating to this business was impaired and a charge of £20 million has been recognised as an exceptional item in the income statement.

##### (ii) General insurance, RAC and health

Following the reorganisation of the reporting structure for the UK's general insurance business during 2007 and 2008, further integrating the operations, management and reporting of businesses acquired with the RAC, the composition of cash-generating units to which goodwill has been allocated has been reassessed. It has been determined that goodwill should be allocated to a single 'general insurance, RAC and health' cash-generating unit. The analysis above reflects the revised allocation of goodwill. No impairment of goodwill has arisen or been released as a result of the reallocation.

**Notes to the consolidated financial statements continued****16 – Goodwill continued**

The recoverable amount of the UK general insurance, RAC and health unit has been determined based on a value in use calculation. The calculation uses cash flow projections based on business plans approved by management covering a three year period and a risk adjusted discount rate of 10.2%. Cash flows beyond that three year period have been extrapolated using a steady 2.5% growth rate. The recoverable amount exceeds the carrying value of the cash-generating unit including goodwill and intangible assets with indefinite useful lives.

Key assumptions used for the calculation were:

- Budgeted operating profit represents the operating profit in the business plans, approved by management, and as such reflects the best estimate of future profits based on both historical experience and expected growth rates for the relevant UK industry sectors;
- Some of the assumptions that underline the budgeted operating profit include market share, customer numbers, premium rate and fee income changes, claims inflation and commission rates; and
- Growth rates represent the rates used to extrapolate future cash flows beyond the business plan period and have been based upon latest information available regarding future and past growth rates, including external sources of data such as ABI Annual Market Statistics.

As disclosed in note 17(d), as a result of the classification of The British School of Motoring Limited and its subsidiaries as held for sale, an impairment charge of £20 million in respect of intangible assets with indefinite useful lives has been recognised.

**Europe****Long-term business**

The recoverable amount of long-term business cash generating units in the Europe region, with the exception of the Netherlands, has been determined based on a value in use calculation. The first step of the test was to compare the carrying value of each cash generating unit, including goodwill, to the Market Consistent Embedded Value (MCEV) of that cash generating unit. If the MCEV is less than the carrying value of a cash generating unit the present value of profits from expected new business for that cash generating unit is considered.

For European long-term business cash generating units a key assumption used for the calculation was:

- Embedded value represents the shareholder interest in the life business and is calculated in accordance with the Market Consistent Embedded Value (MCEV) principles. The embedded value is the total of the net worth of the life business and the value of the in-force business.

**General insurance, health and other**

The recoverable amount of general insurance, health and other non-life cash generating units in the Europe region has been determined based on a value in use calculation. Value in use is calculated for each cash generating unit using a discounted cash flow projection based on business plans and growth assumptions approved by management for each cash generating unit and discounted at a risk discount rate appropriate for each cash generating unit.

**(iii) France (long-term business)**

The recoverable amount of the indefinite life intangible asset has been assessed as part of the recoverable amount of the French long-term business cash generating unit. The MCEV of the French long-term business was significantly greater than its carrying value, including indefinite life intangible assets.

**(iv) Ireland (long-term business)**

The MCEV of the Irish long-term business is greater than its carrying value so the recoverable value will be significantly in excess of its carrying value, including goodwill.

## 16 – Goodwill continued

### **(v) Ireland (general insurance and health)**

The recoverable amount of the Irish general insurance and health business exceeds the carrying value of the cash generating unit including goodwill.

Key assumptions used for the calculation were:

- Budgeted operating profit for an initial three year period represents the operating profit in the business plans, approved by management and as such reflects the best estimate of future profits based on both historical experience and expected growth rates for the Irish economy. Some of the assumptions that underline the budgeted operating profit include market share, premium rate changes, claims inflation and commission rates;
- Growth rate of 4.6% represents the rate used to extrapolate future cash flows beyond the business plan period. Prices are assumed to remain static in the foreseeable future and volumes are assumed to increase in line with real GDP; and
- A risk adjusted discount rate of 8.1%.

### **(vi) Italy (long-term business)**

This calculation is an actuarially-determined appraisal value and is based on the embedded value of the business together with the present value of expected profits from future new business.

Key assumptions (in addition to MCEV principles) used for the calculation were:

- New business contribution represents the present value of projected future distributable profits generated from business written in a period. This is initially based on the most recent three year business plans approved by management;
- Growth rate represents the rate used to extrapolate new business contributions beyond the business plan period, and is based on management's estimate of future growth of 2.0%; and
- Risk adjusted discount rate of 10.2% represents the rate used to discount expected profits from future new business. The discount rate includes a risk-free rate and a risk margin to make prudent allowance for the risk that experience in future years for new business may differ from that assumed.

As a result of an Italian off-shore long-term business entering run off, the goodwill relating to this business of £2 million has been fully impaired and recognised as an impairment charge in the income statement. For the rest of the Italian long-term business the recoverable amount exceeds the carrying value of the cash generating unit including goodwill.

### **(vii) Italy (non-life)**

The recoverable amount exceeds the carrying value of the cash generating unit including goodwill.

Key assumptions used for the calculation were:

- Budgeted operating profit for an initial three year period represents the operating profit in the most recent business plans, approved by management and as such reflects the best estimate of future profits based on both historical experience and expected growth rates for the Italian economy;
- Growth rate of 2.5% represents the rate used to extrapolate future cash flows beyond the business plan period; and
- A risk adjusted discount rate of 10.2%.

### **(viii) Netherlands (long-term, general insurance, health and fund management)**

The recoverable amount of the Netherlands life and general insurance and health cash generating units has been determined on the basis of a value in use calculation. This calculation is an appraisal value and is based on the discounted expected future cash flows from the operations over a 25-year period. Expected cash flows for future periods have been obtained from the plan figures for a three year period. Expected cash flows for later periods have been extrapolated, taking into account the growth rate.

Key assumptions used for the calculation were:

- Expected cash flows for future periods have been obtained from the plan figures for a three year period;
- Growth rate of 2.0% represents the rate applied to extrapolate new business contributions beyond the business plan period, for the life and general insurance business. In the fund management business growth rates are based on management's prudent best estimate of future growth; and
- Risk-adjusted discount rate of 9.2% for long-term, general insurance and health business, and 11.53% for fund management business represents the rate used to discount expected profits from future new business. The discount rate includes a risk margin to make prudent allowance for the risk that experiences in future years may differ from those assumed.



**Notes to the consolidated financial statements continued****16 – Goodwill continued**

During the year, goodwill allocated to a non-insurance cash-generating unit in Belgium, was tested for impairment. Following the impairment test, an impairment charge of £46 million has been recognised in the income statement.

After recognition of this impairment charge, the recoverable amount of the Dutch cash generating units exceeds their carrying value. An increase in the risk adjusted discount rate of 1% would result in the recoverable amount of the ABN Amro cash generating unit being equal to its carrying value.

**(ix) Spain (long-term business)**

This calculation is based on the embedded value of the business together with the present value of expected profits from future new business. The recoverable amount exceeds the carrying value of the cash generating unit including goodwill.

Key assumptions (in addition to MCEV principles) used for the calculation were:

- New business contribution represents the present value of projected future distributable profits generated from business written in a period. This is initially based on the most recent three year business plans approved by management;
- Growth rate represents the rate used to extrapolate new business contributions beyond the business plan period, and is based on management's conservative estimate of future growth of 3.0%. This growth rate is in line with industry expectations; and
- Risk adjusted discount rate of 10.1% represents the rate used to discount expected profits from future new business. The discount rate is a combination of a risk-free rate and a risk margin to make prudent allowance for the risk that experience in future years for new business may differ from that assumed.

**(x) United States (long-term business)**

The recoverable amount of the United States long-term cash generating unit has been determined based on a value in use calculation.

This calculation is an actuarially-determined appraisal value and is based on an embedded value of the business (the total of the net worth of the life business and the value of the in-force business) together with the present value of expected profits from future new business. The value in use exceeds the carrying value of the cash generating unit including goodwill.

Key assumptions used for the calculation were:

- Embedded value represents the shareholder interest in the life business and is based on projected cash flows of the business including expected investment returns.
- Risk adjusted discount rate of 10% is used to calculate the embedded value;
- New business contribution represents the present value of projected future distributable profits generated from business written in a period. This is initially based on the most recent three year business plans approved by management;
- Growth rate represents the rate used to extrapolate new business contributions beyond the business plan period, and is based on management's estimate of future growth of 5% for life and annuity business; and
- Risk adjusted discount rate of 12% represents the rate used to discount expected profits from future new business. The discount rate includes an additional margin to make prudent allowance for the risk that experience in future years for new business may differ from that assumed.

## 17 – Acquired value of in-force business (AVIF) and intangible assets

*This note shows the movements in cost and amortisation of the in-force business and intangible assets acquired when we have purchased subsidiaries.*

	AVIF on Insurance contracts* £m	AVIF on investment contracts** £m	Other intangible assets with finite useful lives £m	Intangible assets with indefinite useful lives (b) £m	Total £m
<b>Gross amount</b>					
At 1 January 2007	2,185	101	752	263	3,301
Additions	24	–	48	–	72
Acquisition of subsidiaries	29	–	205	386	620
Disposals	–	–	(8)	–	(8)
Transfers	–	–	(54)	54	–
Foreign exchange rate movements	35	9	62	6	112
At 31 December 2007	2,273	110	1,005	709	4,097
Additions (note (a))	331	–	60	–	391
Acquisition of subsidiaries	59	–	24	–	83
Disposals	(4)	(5)	(79)	–	(88)
Transfers	(4)	67	(63)	–	–
Transfers to goodwill and other assets (note (c))	–	–	–	(31)	(31)
Foreign exchange rate movements	869	44	277	149	1,339
<b>At 31 December 2008</b>	<b>3,524</b>	<b>216</b>	<b>1,224</b>	<b>827</b>	<b>5,791</b>
<b>Accumulated amortisation and impairment</b>					
At 1 January 2007	(379)	(9)	(185)	–	(573)
Amortisation for the year	(160)	(7)	(99)	–	(266)
Transfers	–	–	54	(54)	–
Impairment losses charged to expenses	–	–	(4)	–	(4)
Foreign exchange rate movements	(36)	(2)	(16)	(3)	(57)
At 31 December 2007	(575)	(18)	(250)	(57)	(900)
Amortisation for the year	(333)	(13)	(100)	–	(446)
Disposals	–	–	39	–	39
Transfers	(1)	(43)	44	–	–
Impairment losses charged to exceptional item (note (d))	–	–	(32)	(20)	(52)
Other impairment losses charged to expenses (note (e))	(2)	–	(13)	–	(15)
Foreign exchange rate movements	(247)	(18)	(87)	(18)	(370)
<b>At 31 December 2008</b>	<b>(1,158)</b>	<b>(92)</b>	<b>(399)</b>	<b>(95)</b>	<b>(1,744)</b>
<b>Carrying amount</b>					
At 31 December 2007	1,698	92	755	652	3,197
<b>At 31 December 2008</b>	<b>2,366</b>	<b>124</b>	<b>825</b>	<b>732</b>	<b>4,047</b>
Less: Amounts classified as held for sale					
– gross amount	–	–	(9)	(20)	(29)
– accumulated amortisation and impairment	–	–	–	20	20
	–	–	(9)	–	(9)
	<b>2,366</b>	<b>124</b>	<b>816</b>	<b>732</b>	<b>4,038</b>

\* On insurance and participating investment contracts.

\*\* On non-participating investment contracts.

**Notes to the consolidated financial statements continued****17 – Acquired value of in-force business (AVIF) and intangible assets continued**

**(a)** Additions to gross AVIF on insurance contracts in 2008 includes £327m for the movement in the shadow adjustment made to the carrying value of AVIF in Aviva USA.

**(b)** Intangible assets with indefinite useful lives comprise:

**(i)** the RAC brand, and the value of the Union Financière de France Banque distribution channel, where the existing lives of the assets and their competitive position in, and the stability of, their respective markets support this classification; and

**(ii)** the bancassurance distribution agreement with Banco Popolare, signed in December 2007, which is initially for ten years, with five-year automatic renewal periods. It is expected to be renewed indefinitely, due to the unfavourable terms of the put option for failure to renew.

**(c)** During the year the Italian business unit finalised the valuation of Avipop Assicurazioni SpA which was acquired during 2007, and its bancassurance agreement with Banco Popolare. This has resulted in a reallocation of £31 million from intangible assets with indefinite useful lives to goodwill and other assets.

Impairment testing of these intangibles is covered in note 16(b).

Other intangible assets with finite useful lives consist primarily of the value of bancassurance and other distribution agreements.

**(d)** As disclosed in note 6, the wrap platform of the United Kingdom long-term business was terminated during the year. As a result of this termination the intangible asset relating to this business was impaired and a charge of £32 million has been recognised as an exceptional item in the income statement.

The impairment of intangible assets with indefinite useful lives relates to the classification of The British School of Motoring Limited and its subsidiaries as held for sale. This has been recognised as an exceptional item in the income statement.

**(e)** Following a review for indicators of impairment of the finite-lived intangible assets held by the UK general Insurance, RAC and health business, an impairment charge of £9 million has been recognised in the income statement in respect of the intangible asset representing the right to future income from a book of creditor business. The impairment charge arose as a result of current adverse trading experience.

## 18 – Interests in, and loans to, joint ventures

*In several business units, Group companies and other parties jointly control certain entities. This note analyses these interests and describes the principal joint ventures in which we are involved.*

### (a) Carrying amount

(i) The movements in the carrying amount comprised:

	Goodwill and intangibles £m	Equity interests £m	Loans £m	Total £m
At 1 January 2007	–	2,554	241	2,795
Share of results before tax	–	(337)	–	(337)
Share of tax	–	(2)	–	(2)
Share of loss after tax	–	(339)	–	(339)
Acquisitions and additions	196	453	126	775
Disposals and reduction in Group interests	–	(267)	–	(267)
Reclassification to financial investments	–	(208)	(42)	(250)
Fair value gains taken to equity	–	9	–	9
Loans repaid	–	–	(159)	(159)
Foreign exchange rate movements	1	10	1	12
At 31 December 2007	197	2,212	167	2,576
Share of results before tax	–	(1,029)	–	(1,029)
Share of tax	–	(3)	–	(3)
Share of results after tax	–	(1,032)	–	(1,032)
Amortisation and impairment of goodwill and intangibles	(6)	–	–	(6)
Share of loss after tax	(6)	(1,032)	–	(1,038)
Acquisitions and additions	–	175	182	357
Disposals and reduction in Group interests	–	(131)	–	(131)
Fair value losses taken to equity	–	(12)	–	(12)
Loans repaid	–	–	(52)	(52)
Foreign exchange rate movements	7	30	–	37
At 31 December 2008	198	1,242	297	1,737

(iii) The balances at 31 December comprised:

	Goodwill and intangibles £m	Equity interests £m	Loans £m	Total £m
2008				
Property management undertakings	–	1,080	297	1,377
Long-term business undertakings	198	158	–	356
General insurance undertakings	–	4	–	4
Total	198	1,242	297	1,737
2007				
Property management undertakings	–	2,124	167	2,291
Long-term business undertakings	197	88	–	285
Total	197	2,212	167	2,576

The loans are not secured and no guarantees were received in respect thereof. They are interest-bearing and are repayable on termination of the relevant partnership.

## Notes to the consolidated financial statements continued

## 18 – Interests in, and loans to, joint ventures continued

**(b) Property management undertakings**

The principal joint ventures are as follows:

Company	GP proportion held	PLP proportion held
Airport Property Partnership	50.0%	50.0%
Ashtenne Industrial Fund Limited Partnership	66.7%	37.4%
The Junction Limited Partnership	50.0%	46.0%
The Mall Limited Partnership	50.0%	53.8%
Queensgate Limited Partnership	50.0%	50.0%
Quercus Healthcare Property Partnership Limited	50.0%	39.6%
The 20 Gracechurch Limited Partnership	50.0%	50.0%

All the above entities perform property ownership and management activities, and are incorporated and operate in Great Britain. All these investments are held by subsidiary entities.

**(c) Long-term business undertakings**

The principal joint ventures are as follows:

Company	Class of share	Proportion held	Country of incorporation and operation
Aviva-COFCO Life Insurance Co. Limited	Ordinary shares of RMB1 each	50.0%	China
AvivaSA Emeklilik ve Hayat A.S.	Ordinary shares of YTL1 each	49.7%	Turkey
CIMB Aviva Assurance Berhad	Ordinary shares of RM1 each	49.0%	Malaysia
CIMB Aviva Takaful Berhad	Ordinary shares of RM1 each	49.0%	Malaysia
First-Aviva Life Insurance Co., Ltd.	Ordinary shares of NT\$10 each	49.0%	Taiwan
Woori Aviva Life insurance Co. Ltd	Ordinary shares of KRW 5000 each	46.8%	Korea

All investments in the above companies are unlisted and are held by subsidiaries except for the shares in Aviva-COFCO Life Insurance Co. Limited, which are held by the Company. The Group's share of net assets of that company are £57 million (2007: £44 million) and have a fair value of £61 million (2007: £52 million).

On 4 April 2008, the Group acquired 40.65% of LIG Life Insurance Co. Ltd (LIG Life), a South Korean life insurance company, for £34 million. This company was renamed Woori Aviva Life Insurance Co. Ltd and distributes life insurance products through multiple distribution channels, focusing on the Busan metropolitan area in the south-eastern region of the country. Further shareholdings of 5.51% and 0.63% were acquired on 7 April and 29 May 2008 respectively for a total of £4 million. The contractual arrangements with the other major shareholder have led us to account for this investment as an interest in a joint venture.

**(d) Impairment testing****CIMB Aviva Assurance Berhad and CIMB Aviva Takaful Berhad**

The Group's investments in CIMB Aviva Assurance Berhad and CIMB Aviva Takaful Berhad have been tested for impairment by comparing their carrying values (which include goodwill which arose on their acquisition) with their recoverable amounts. The recoverable amounts for both the investments have been determined based on value in use calculations. This calculation is an actuarially-determined appraisal value and is based on the embedded value of the business together with the present value of expected profits from future new business. The recoverable amounts exceeds the carrying values of both the investments.

Key assumptions used for the calculation were:

- The calculations use cash flow projections based on the policy portfolio existing at the valuation date and the future sales based on plans approved by management covering the subsequent three year period. The cashflows from existing policy portfolio is calculated using best estimate assumptions, which have been supported by experience investigation where available and prudent estimates typical for the market where experience investigations are not available;
- The calculations use a risk adjusted discount rate of 10.5%; and
- New sales beyond the three year period have been extrapolated using a growth rate of 7.5%.



## 18 – Interests in, and loans to, joint ventures continued

### AvivaSA Emeklilik ve Hayat A.S.

The Group's investment in AvivaSA Emeklilik ve Hayat A.S. has been tested for impairment by comparing its carrying value (which includes goodwill which arose on its acquisition) with its recoverable amount.

The recoverable amount has been determined based on a value in use calculation.

This calculation is an actuarially-determined appraisal value and is based on the embedded value of the business together with the present value of expected profits from future new business. The recoverable amount exceeds the carrying value of the cash generating unit including goodwill.

Key assumptions used for the calculation were:

- Embedded value represents the shareholder interest in the life business and is calculated in accordance with the Market Consistent Embedded Value (MCEV) principles. The embedded value is the total of the net worth of the life business and the value of the in-force business. The underlying methodology and assumptions have been reviewed by a firm of actuarial consultants;
- New business contribution represents the present value of projected future distributable profits generated from business written in a period. This is initially based on the most recent three year business plans approved by management;
- Growth rate represents the rate used to extrapolate new business contributions beyond the business plan period, and is based on management's estimate of future growth of 5%; and
- Risk adjusted discount rate of 21% represents the rate used to discount expected profits from future new business. The discount rate reflects a risk margin to make prudent allowance for the risk that experience in future years for new business may differ from that assumed.

### (e) Additional information

Summarised aggregate financial information on the Group's interests in its joint ventures is as follows:

	2008 £m	2007 £m
Income, including unrealised (losses)/gains on investments	(876)	242
Expenses	(153)	(579)
Share of results before tax	(1,029)	(337)
Long-term assets	3,115	4,263
Current assets	529	395
Share of total assets	3,644	4,658
Long-term liabilities	(1,968)	(1,684)
Current liabilities	(434)	(762)
Share of total liabilities	(2,402)	(2,446)
Share of net assets	1,242	2,212

The joint ventures have no significant contingent liabilities to which the Group is exposed, nor has the Group any significant contingent liabilities in relation to its interests in them.

## Notes to the consolidated financial statements continued

## 19 – Interests in, and loans to, associates

*This note analyses our interests in entities which we do not control but where we have significant influence.*

## (a) Carrying amount

	Goodwill and intangibles £m	Equity interests £m	Loans £m	Total £m
At 1 January 2007	373	520	2	895
Share of results before tax	–	51	–	51
Share of tax	–	(4)	–	(4)
Share of results after tax	–	47	–	47
Amortisation of acquired value of in-force business	(12)	–	–	(12)
Share of profit after tax	(12)	47	–	35
Acquisitions and additions	39	257	–	296
Disposals	–	(25)	–	(25)
Dividends received	–	(32)	–	(32)
Foreign exchange rate movements	5	32	–	37
Movements in carrying amount	32	279	–	311
At 31 December 2007	405	799	2	1,206
Share of results before tax	–	(54)	–	(54)
Share of tax	–	(9)	–	(9)
Share of results after tax	–	(63)	–	(63)
Impairment of goodwill and intangibles	(16)	–	–	(16)
Amortisation of acquired value of in-force business	(11)	–	–	(11)
Share of loss after tax	(27)	(63)	–	(90)
Additions (see below)	14	56	–	70
Disposals	–	(12)	–	(12)
Fair value losses taken to equity	–	(81)	–	(81)
Dividends received	–	(87)	–	(87)
Reclassification from investment in subsidiaries	–	55	–	55
Reclassification from financial investments	–	62	–	62
Foreign exchange rate movements	13	109	1	123
Movements in carrying amount	–	39	1	40
At 31 December 2008	405	838	3	1,246

The loans are interest-bearing but are not secured, and no guarantees were received in respect thereof.

Additions in 2008 comprise additional capital invested in Aviva Life Insurance Company India Limited, Banca Network Investimenti SpA, RBSG Collective Investments Limited, and RBS Life Investments Limited.

## (b) Principal associates

The principal associates included above are:

Company	Type of business	Class of share	Proportion held	Country of incorporation and operation
Aviva Life Insurance Company India Limited	Insurance	Ordinary shares of RS1 each	26.0%	India
Banca Network Investimenti SpA	Product distribution	Ordinary shares of €1 each	49.75%	Italy
Cyrte Fund I CV	Investment fund	Partnership share	13.04%	Netherlands
Cyrte Fund II BV	Investment fund	Ordinary shares of €1 each	16.00%	Netherlands
Cyrte Fund III CV	Investment fund	Partnership share	17.91%	Netherlands
RBSG Collective Investments Limited	Investment	Ordinary shares of £1 each	49.99%	Great Britain
RBS Life Investments Limited	Insurance	Ordinary shares of £1 each	49.99%	Great Britain

All investments in principal associates are unlisted and are held by subsidiaries.

## 19 – Interests in, and loans to, associates continued

Although the Group's holding in the three Cyrte funds is less than 20%, it has significant influence through ownership of the fund manager, Cyrte Investments BV, a subsidiary of which acts as general partner to the funds, and through membership of its investment committee.

The Group's Dutch subsidiary owns 30.1% of the shares, and depositary receipts for shares, in Van Lanschot NV, a financial services company in the Netherlands. The Group is not able to appoint management representation on the board of this company and is therefore unable to exert significant influence over its affairs. Accordingly, this investment is treated as a financial investment rather than as an associate.

### (c) Additional information

Summarised aggregate financial information on the Group's interests in its associates is as follows:

	2008 £m	2007 £m
Share of revenues	460	385
Share of results before tax	(54)	51
Share of assets	3,812	3,123
Share of liabilities	(2,974)	(2,324)
Share of net assets	838	799

The associates have no significant contingent liabilities to which the Group is exposed, nor has the Group any significant contingent liabilities in relation to its interest in them.

### (d) Impairment testing

#### **RBS Life Investments Limited and RBSG Collective Investments Limited**

The Group's investments in RBS Life Investments Limited and RBSG Collective Investments Limited have been tested for impairment by comparing their carrying values (which include goodwill which arose on their acquisition) with their recoverable amounts.

The recoverable amounts for both investments have been determined based on value in use calculations, using an appraisal value methodology. The appraisal value comprises MCEV and a value of future new business. Future new business is valued using a similar approach as used for the in-force business. The value of 2009 planned new business is based on planned volumes, planned margins for manufactured business and current margins for adopted business all approved by management. This value is then multiplied by an annuity in perpetuity factor to give the value of all years of future new business and then discounted from mid-2009 back to the valuation date. The annuity factor allows for new business growth of 4.5% and a risk discount rate of 7.3%. This value is adjusted to allow for future expense over-runs and under-runs, based on the projected expenses and sales volumes.

The recoverable amounts exceed the carrying values of both the investments.

#### **Banca Network Investimenti SpA**

The Group's investment in Banca Network Investimenti SpA has been tested for impairment by comparing its carrying value (which includes goodwill which arose on its acquisition) with its recoverable amount.

The recoverable amount has been determined based on a value in use calculation prepared by an external valuation expert. Value in use was calculated using a discounted cash flow projection based on business plans and growth assumptions approved by management and discounted at an appropriate risk discount rate.

Key assumptions used for the calculation were:

- A cash flow project based on a three year plan period. Cash flows beyond that three year period have been extrapolated using a steady 2% growth rate;
- Risk adjusted discount rate of 8.5% based on the weighted average cost of capital of similar Italian listed companies; and

As a result of the testing, an impairment of £12 million has been recognised.

## Notes to the consolidated financial statements continued

## 20 – Property and equipment

*This note analyses our tangible fixed assets, which are primarily properties occupied by Group companies and computer equipment.*

	Properties under construction £m	Owner occupied properties £m	Motor vehicles £m	Computer equipment £m	Other assets £m	Total £m
<b>Cost or valuation</b>						
At 1 January 2007	65	499	13	702	359	1,638
Additions	27	9	3	92	96	227
Acquisitions of subsidiaries	–	10	1	1	2	14
Disposals	(16)	(60)	(4)	(37)	(14)	(131)
Transfers	(27)	(14)	–	–	–	(41)
Transfers	(6)	6	–	–	–	–
Fair value gains (see note 34)	–	23	–	–	–	23
Foreign exchange rate movements	2	26	1	14	19	62
Other movements	–	–	–	–	4	4
At 31 December 2007	45	499	14	772	466	1,796
Additions	22	7	1	97	89	216
Acquisitions of subsidiaries	–	37	–	1	2	40
Disposals	(15)	(31)	(3)	(34)	(24)	(107)
Transfers to owner occupied property	(4)	4	–	–	–	–
Fair value losses (see below)	–	(49)	–	–	–	(49)
Foreign exchange rate movements	13	106	2	40	72	233
<b>At 31 December 2008</b>	<b>61</b>	<b>573</b>	<b>14</b>	<b>876</b>	<b>605</b>	<b>2,129</b>
<b>Depreciation and impairment</b>						
At 1 January 2007	–	–	(8)	(499)	(227)	(734)
Charge for the year	–	(1)	(1)	(97)	(30)	(129)
Disposals	–	–	2	32	8	42
Impairment losses charged to restructuring costs	–	(2)	–	–	–	(2)
Foreign exchange rate movements	–	–	–	(14)	(14)	(28)
Other movements	–	–	–	–	(3)	(3)
At 31 December 2007	–	(3)	(7)	(578)	(266)	(854)
Charge for the year	–	(1)	(2)	(93)	(35)	(131)
Disposals	–	1	1	33	14	49
Impairment losses charged to restructuring costs	–	(2)	–	(8)	(40)	(50)
Foreign exchange rate movements	–	–	–	(29)	(48)	(77)
<b>At 31 December 2008</b>	<b>–</b>	<b>(5)</b>	<b>(8)</b>	<b>(675)</b>	<b>(375)</b>	<b>(1,063)</b>
<b>Carrying amount</b>						
At 31 December 2007	45	496	7	194	200	942
<b>At 31 December 2008</b>	<b>61</b>	<b>568</b>	<b>6</b>	<b>201</b>	<b>230</b>	<b>1,066</b>
Less: Amounts classified as held for sale:						
Gross amount	–	–	–	(25)	(130)	<b>(155)</b>
Accumulated depreciation and impairment	–	–	–	9	44	<b>53</b>
	–	–	–	(16)	(86)	<b>(102)</b>
	<b>61</b>	<b>568</b>	<b>6</b>	<b>185</b>	<b>144</b>	<b>964</b>

Fair value losses of £37 million have been charged (2007: £23 million gains credited) to equity (note 34), with the remainder being charged to the income statement.

## 20 – Property and equipment continued

Owner-occupied properties are stated at their revalued amounts, as assessed by qualified external valuers or by local qualified staff of the Group in overseas operations, all with recent relevant experience. These values are assessed in accordance with the relevant parts of the current RICS Appraisal and Valuation Standards in the UK, and with current local valuation practices in other countries. This assessment, on the basis of Existing Use Value and in accordance with UK Practice Statement 1.3, is the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction, after proper marketing wherein the parties had acted knowledgeably, prudently and without compulsion, assuming that the buyer is granted vacant possession of all parts of the property required by the business and disregarding potential alternative uses. The valuation assessment adopts market-based evidence and is in line with guidance from the International Valuation Standards Committee and the requirements of IAS 16, *Property, Plant and Equipment*, for all but specialised-use properties which are valued on a depreciated replacement cost (DRC) basis as permitted by paragraph 33 of IAS 16.

If owner-occupied properties were stated on a historical cost basis, the carrying amount would be £414 million (2007: £301 million).

The Group has no material finance leases for property and equipment.

## 21 – Investment property

*This note gives details of the properties we hold for long-term rental yields or capital appreciation.*

	Freehold £m	Leasehold £m	Total £m
<b>Carrying value</b>			
At 1 January 2007	11,996	3,127	15,123
Additions	1,769	109	1,878
Capitalised expenditure on existing properties	138	11	149
Acquisitions of subsidiaries	4	–	4
Disposals of subsidiaries	(3)	–	(3)
Fair value losses	(660)	(97)	(757)
Disposals	(861)	(432)	(1,293)
Transfers from property and equipment	10	31	41
Foreign exchange rate movements	210	39	249
At 31 December 2007	12,603	2,788	15,391
Additions	1,744	2	1,746
Capitalised expenditure on existing properties	92	8	100
Acquisitions of subsidiaries	81	–	81
Fair value losses	(2,441)	(696)	(3,137)
Disposals	(852)	(297)	(1,149)
Transfers	(2)	2	–
Foreign exchange rate movements	1,276	118	1,394
<b>At 31 December 2008</b>	<b>12,501</b>	<b>1,925</b>	<b>14,426</b>

Investment properties are stated at their market values as assessed by qualified external valuers or by local qualified staff of the Group in overseas operations, all with recent relevant experience. Values are calculated using a discounted cash flow approach and are based on current rental income plus anticipated uplifts at the next rent review, assuming no future growth in rental income. This uplift and the discount rate are derived from rates implied by recent market transactions on similar properties. Further details of the fair value methodology are given in note 24(b).

The fair value of investment properties leased to third parties under operating leases at 31 December 2008 was £13,764 million (2007: £14,616 million). Future contractual aggregate minimum lease rentals receivable under the non-cancellable portion of these leases are given in note 51 (b)(i).



## Notes to the consolidated financial statements continued

## 22 – Loans

*This note analyses the loans our Group companies have made, the majority of which are mortgage loans.*

**(a) Carrying amounts**

The carrying amounts of loans at 31 December 2008 and 2007 were as follows:

	2008			2007		
	At fair value through profit or loss other than trading £m	At amortised cost £m	Total £m	At fair value through profit or loss other than trading £m	At amortised cost £m	Total £m
Policy loans	265	1,861	2,126	215	1,316	1,531
Loans to banks	–	6,415	6,415	–	7,576	7,576
Securitised mortgage loans (see note 23)						
UK	1,861	–	1,861	1,777	–	1,777
Netherlands	4,936	2,262	7,198	3,699	1,911	5,610
	6,797	2,262	9,059	5,476	1,911	7,387
Non-securitised mortgage loans	14,406	7,266	21,672	12,849	4,747	17,596
Loans and advances to bank customers	–	1,886	1,886	–	1,307	1,307
Loans to brokers and other intermediaries	–	98	98	–	80	80
Other loans	–	981	981	–	716	716
<b>Total</b>	<b>21,468</b>	<b>20,769</b>	<b>42,237</b>	<b>18,540</b>	<b>17,653</b>	<b>36,193</b>

Loans to banks include cash collateral received under stock lending arrangements (see note 24(d)). The obligation to repay this collateral is included in payables and other financial liabilities (note 48).

Of the above loans, £30,673 million (2007: £25,666 million) is expected to be recovered more than one year after the balance sheet date.

**Loans at fair value**

Fair values have been calculated by discounting the future cash flows using appropriate current interest rates for each portfolio of mortgages. Further details of the fair value methodology are given in note 24(b).

The change in fair value of these loans during the year, attributable to a change in credit risk, was a loss of £644 million (2007: £210 million). The cumulative change attributable to changes in credit risk to 31 December 2008 was a loss of £854 million (2007: £210 million).

**Loans at amortised cost**

The fair value of these loans at 31 December 2008 was £20,218 million (2007: £17,588 million).

**(b) Collateral**

The Group holds collateral in respect of loans where it is considered appropriate, in order to reduce the risk of non-recovery. This collateral generally takes the form of liens or charges over properties and, in the case of policy loans, the underlying policy, for the majority of the loan balances above. In the event of a default, the Group is able to sell or repledge the collateral.

The amount of collateral received with respect to loans which the Group is permitted to sell or repledge in the absence of default was £3,880 million (2007: £6,282 million). No collateral was actually sold or repledged in the absence of default during the year (2007: £nil).

## 23 – Securitised mortgages and related assets

*The Group has loans receivable, secured by mortgages, which have then been securitised through non-recourse borrowings, in our UK Life and Dutch businesses. This note gives details of the relevant transactions.*

### (a) Description of arrangements

#### (i) United Kingdom

In a long-term business subsidiary (NUER), the beneficial interest in certain portfolios of lifetime mortgages has been transferred to five special purpose securitisation companies ("the ERF companies"), in return for initial consideration and, at later dates, deferred consideration. The deferred consideration represents receipts accrued within the ERF companies after meeting all their obligations to the noteholders, loan providers and other third parties in the priority of payments. The purchases of the mortgages were funded by the issue of fixed and floating rate notes by the ERF companies.

All the shares in the ERF companies are held by independent companies, whose shares are held on trust. Although NUER does not own, directly or indirectly, any of the share capital of the ERF companies or their parent companies, it retains control of the residual or ownership risks related to them, and they have therefore been treated as subsidiaries in the consolidated financial statements. NUER has no right to repurchase the benefit of any of the securitised mortgage loans, other than in certain circumstances where NUER is in breach of warranty or loans are substituted in order to effect a further advance.

NUER has purchased subordinated notes and granted subordinated loans to some of the ERF companies. These have been eliminated on consolidation through offset against the borrowings of the ERF companies in the consolidated balance sheet.

#### (ii) Netherlands and Belgium

In three subsidiaries, Delta Lloyd Levensverzekering NV (DLL), Amstelhuys NV (AMS), and Delta Lloyd Bank (Belgium) NV/SA (DLB), the principal benefits of certain portfolios of mortgage loans have been transferred to a number of special purpose securitisation companies, which were funded primarily through the issue of fixed and floating rate notes.

All the shares in the securitisation companies are held by independent trustee companies. Although DLL, AMS and DLB do not own, directly or indirectly, any of the share capital of the securitisation companies or their parent companies, they retain control of the residual or ownership risks related to them, and these companies have therefore been treated as subsidiaries in the consolidated financial statements. DLL, AMS and DLB have no right, nor any obligation, to repurchase the benefit of any of the securitised mortgage loans before the optional call date, other than in certain circumstances where they are in breach of warranty.

Delta Lloyd companies have purchased notes in the securitisation companies, which have been eliminated on consolidation through offset against the borrowings of the securitisation companies in the consolidated balance sheet.

#### (iii) General

In all of the above transactions, the Company and its subsidiaries are not obliged to support any losses that may be suffered by the noteholders and do not intend to provide such support. Additionally, the notes were issued on the basis that noteholders are only entitled to obtain payment, of both principle and interest, to the extent that the available resources of the respective special purpose securitisation companies, including funds due from customers in respect of the securitised loans, are sufficient and that noteholders have no recourse whatsoever to other companies in the Aviva Group.

## Notes to the consolidated financial statements continued

## 23 – Securitised mortgages and related assets continued

**(b) Carrying values**

The following table summarises the securitisation arrangements:

	Securitised assets 2008 £m	Securitised borrowings 2008 £m	Securitised assets 2007 £m	Securitised borrowings 2007 £m
<b>UK</b>				
Securitised mortgage loans				
– At fair value (note 22)	1,861	(1,614)	1,777	(1,691)
Other securitisation assets/(liabilities)	78	(325)	23	(109)
	<b>1,939</b>	<b>(1,939)</b>	<b>1,800</b>	<b>(1,800)</b>
<b>Netherlands</b>				
Securitised mortgage loans				
– At fair value (note 22)	4,936	(4,820)	3,699	(3,706)
– At amortised cost (note 22)	2,262	(2,353)	1,911	(2,283)
	<b>7,198</b>	<b>(7,173)</b>	<b>5,610</b>	<b>(5,989)</b>
Other securitisation assets/(liabilities)	–	(25)	379	–
	<b>7,198</b>	<b>(7,198)</b>	<b>5,989</b>	<b>(5,989)</b>

Loan notes held by third parties are as follows:

	UK 2008 £m	Netherlands 2008 £m	UK 2007 £m	Netherlands 2007 £m
Total loan notes issued, as above	1,614	7,173	1,691	5,989
Less: Loan notes held by Group companies	(24)	(978)	(17)	(369)
Loan notes held by third parties (note 47(c))	<b>1,590</b>	<b>6,195</b>	<b>1,674</b>	<b>5,620</b>

## 24 – Financial investments

*This note analyses our financial investments by type and shows their cost and fair value. These will change from one period to the next as a result of new business written, claims paid and market movements.*

### (a) Carrying amount

Financial investments comprise:

	2008			
	At fair value through profit or loss		Available for sale	Total
	Trading £m	Other than trading £m	for sale £m	£m
<b>Fixed maturity securities</b>				
<b>Debt securities</b>				
UK government	–	18,854	–	18,854
UK local authorities	–	17	–	17
Non-UK government	9	40,015	756	40,780
Public utilities	–	4,308	1,226	5,534
Convertibles and bonds with warrants attached	–	855	–	855
Other	47	64,379	18,368	82,794
	56	128,428	20,350	148,834
<b>Certificates of deposit</b>	–	1,288	10	1,298
<b>Redeemable preference shares</b>	–	349	110	459
	56	130,065	20,470	150,591
<b>Equity securities</b>				
<b>Ordinary shares</b>				
Public utilities	–	3,933	1	3,934
Banks, trusts and insurance companies	–	5,525	2,332	7,857
Industrial miscellaneous and all other	9	28,182	2,989	31,180
	9	37,640	5,322	42,971
<b>Non-redeemable preference shares</b>	–	345	95	440
	9	37,985	5,417	43,411
<b>Other investments</b>				
Unit trusts and other investment vehicles	–	28,850	139	28,989
Derivative financial instruments (note 56d)	2,910	–	–	2,910
Deposits with credit institutions	115	436	–	551
Minority holdings in property management undertakings	–	969	–	969
Other investments – long-term	–	2,686	4	2,690
Other investments – short-term	–	3	4	7
	3,025	32,944	147	36,116
<b>Total financial investments</b>	3,090	200,994	26,034	230,118
Less assets classified as held for sale				
Fixed maturity securities	–	(336)	–	(336)
Equity securities	–	(60)	–	(60)
	–	(396)	–	(396)
	3,090	200,598	26,034	229,722

Of the above total, £176,752 million (2007: £154,732 million) is expected to be recovered more than one year after the balance sheet date.

## Notes to the consolidated financial statements continued

## 24 – Financial investments continued

	At fair value through profit or loss		Available for sale	Total
	Trading £m	Other than trading £m	£m	£m
<b>Fixed maturity securities</b>				
<b>Debt securities</b>				
UK government	–	18,767	–	18,767
UK local authorities	–	81	–	81
Non-UK government	35	28,278	936	29,249
Public utilities	–	3,922	1,003	4,925
Convertibles and bonds with warrants attached	–	856	–	856
Other	144	51,774	12,276	64,194
	179	103,678	14,215	118,072
<b>Certificates of deposit</b>	–	3,291	26	3,317
<b>Redeemable preference shares</b>	–	3	–	3
	179	106,972	14,241	121,392
<b>Equity securities</b>				
<b>Ordinary shares</b>				
Public utilities	–	6,165	–	6,165
Banks, trusts and insurance companies	–	10,195	66	10,261
Industrial miscellaneous and all other	46	38,672	3,712	42,430
	46	55,032	3,778	58,856
<b>Non-redeemable preference shares</b>	–	209	–	209
	46	55,241	3,778	59,065
<b>Other investments</b>				
Unit trusts and other investment vehicles	4	31,221	181	31,406
Derivative financial instruments (note 56d)	1,609	–	–	1,609
Deposits with credit institutions	114	502	–	616
Minority holdings in property management undertakings	–	977	–	977
Other long-term investments	–	1,640	17	1,657
Other short-term investments	–	4	–	4
	1,727	34,344	198	36,269
<b>Total financial investments</b>	1,952	196,557	18,217	216,726
Less assets classified as held for sale				
Fixed maturity securities	–	(80)	–	(80)
Equity securities	–	(236)	–	(236)
	–	(316)	–	(316)
	1,952	196,241	18,217	216,410



## 24 – Financial investments continued

### (b) Fair value methodology

(i) For investments carried at fair value, we have categorised the measurement basis into a “fair value hierarchy” as follows:

#### *Quoted market prices in active markets – (“Level 1”)*

Inputs to Level 1 fair values are quoted prices (unadjusted) in active markets for identical assets. An active market is one in which transactions for the asset occur with sufficient frequency and volume to provide pricing information on an ongoing basis. Examples are listed equities in active markets, listed debt securities in active markets and quoted unit trusts in active markets.

#### *Internal models with significant observable market parameters – (“Level 2”)*

Inputs to Level 2 fair values are inputs other than quoted prices included within Level 1 that are observable for the asset, either directly or indirectly. If the asset has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset. Level 2 inputs include the following:

- Quoted prices for similar (ie not identical) assets in active markets;
- Quoted prices for identical or similar assets in markets that are not active, the prices are not current, or price quotations vary substantially either over time or among market makers, or in which little information is released publicly;
- Inputs other than quoted prices that are observable for the asset (for example, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment spreads, loss severities, credit risks, and default rates);
- Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means (market-corroborated inputs).

Examples of these are securities measured using discounted cash flow models based on market observable swap yields, investment property measured using market observable information, and listed debt or equity securities in a market that is inactive.

#### *Internal models with significant unobservable market parameters – (“Level 3”)*

Inputs to Level 3 fair values are unobservable inputs for the asset. Unobservable inputs may have been used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset at the measurement date (or market information for the inputs to any valuation models). As such, unobservable inputs reflect the assumptions the business unit considers that market participants would use in pricing the asset. Examples are certain private equity investments and private placements.

The majority of the Group’s investments are valued based on quoted market information or observable market data. A small percentage (1%) of total assets recorded at fair value, are based on estimates and recorded as Level 3 investments. Where estimates are used, these are based on a combination of independent third-party evidence and internally developed models, calibrated to market observable data where possible. Whilst such valuations are sensitive to estimates, it is believed that changing one or more of the assumptions to reasonably possible alternative assumptions would not change the fair value significantly.

## Notes to the consolidated financial statements continued

## 24 – Financial investments continued

(ii) An analysis of investments according to fair value hierarchy is given below:

	2008						
	Fair value hierarchy			Sub-total fair value £m	Amortised cost £m	Less: Assets of operations classified as held for sale £m	Balance sheet Total £m
	Level 1 £m	Level 2 £m	Level 3 £m				
Investment property	–	14,426	–	14,426	–	–	14,426
Loans	–	21,468	–	21,468	20,769	–	42,237
Fixed maturity securities	107,943	40,798	1,850	150,591	–	(336)	150,255
Equity securities	36,608	5,871	932	43,411	–	(60)	43,351
Other investments (including derivatives)	24,262	11,789	65	36,116	–	–	36,116
<b>Total</b>	<b>168,813</b>	<b>94,352</b>	<b>2,847</b>	<b>266,012</b>	<b>20,769</b>	<b>(396)</b>	<b>286,385</b>

	2007						
	Fair value hierarchy			Sub-total fair value £m	Amortised cost £m	Less: Assets of operations classified as held for sale £m	Balance sheet Total £m
	Level 1 £m	Level 2 £m	Level 3 £m				
Investment property	–	15,391	–	15,391	–	–	15,391
Loans	–	18,540	–	18,540	17,653	–	36,193
Fixed maturity securities	101,422	18,710	1,260	121,392	–	(80)	121,312
Equity securities	54,124	4,309	632	59,065	–	(236)	58,829
Other investments (including derivatives)	27,056	8,894	319	36,269	–	–	36,269
Total	182,602	65,844	2,211	250,657	17,653	(316)	267,994

(iii) The tables below show movements in the assets measured at fair value based on valuation techniques for which any significant input is not based on observable market data (Level 3 only). Total funds are then further analysed between policyholder funds, participating funds and shareholder funds.

	Total £m
<b>Total funds</b>	
Balance at 1 January 2008	2,211
Total net gains or losses recognised in the income statement	(97)
Purchases, issues, disposals and settlements (net)	270
Net transfers out of Level 3	(209)
Foreign exchange rate movements	672
<b>Balance at 31 December 2008</b>	<b>2,847</b>

## 24 – Financial investments continued

	Total £m
<b>Policyholder funds</b>	
Balance at 1 January 2008	28
Total gains or losses recognised in the income statement	–
Purchases, issues, disposals and settlements (net)	13
Transfers into/(out of) Level 3	(8)
Foreign exchange rate movements	6
<b>Balance at 31 December 2008</b>	<b>39</b>
	Total £m
<b>Participating funds</b>	
Balance at 1 January 2008	1,498
Total gains or losses recognised in the income statement	(18)
Purchases, issues, disposals and settlements (net)	166
Transfers into/(out of) Level 3	(858)
Foreign exchange rate movements	240
<b>Balance at 31 December 2008</b>	<b>1,028</b>
	Total £m
<b>Shareholder funds</b>	
Balance at 1 January 2008	685
Total gains or losses recognised in the income statement	(79)
Purchases, issues, disposals and settlements (net)	91
Transfers into/(out of) Level 3	657
Foreign exchange rate movements	426
<b>Balance at 31 December 2008</b>	<b>1,780</b>

## Notes to the consolidated financial statements continued

## 24 – Financial investments continued

**(c) Cost, unrealised gains and fair value**

The following is a summary of the cost/amortised cost, gross unrealised gains and losses and fair value of financial investments:

	2008			
	Cost/ amortised cost £m	Unrealised gains £m	Impairment and unrealised losses £m	Fair value £m
Fixed maturity securities	156,097	7,634	(13,140)	150,591
Equity securities	54,518	2,685	(13,792)	43,411
Other investments				
Unit trusts and specialised investment vehicles	28,700	1,994	(1,705)	28,989
Derivative financial instruments	1,792	1,761	(643)	2,910
Deposits with credit institutions	551	–	–	551
Minority holdings in property management undertakings	758	279	(68)	969
Other long-term investments	2,883	209	(402)	2,690
Other short-term investments	8	–	(1)	7
	<b>245,307</b>	<b>14,562</b>	<b>(29,751)</b>	<b>230,118</b>

	Restated 2007			
	Cost / amortised cost £m	Unrealised gains £m	Impairment and unrealised losses £m	Fair value £m
Fixed maturity securities	121,973	1,970	(2,551)	121,392
Equity securities	50,635	9,052	(622)	59,065
Other investments				
Unit trusts and investment vehicles	28,684	3,106	(384)	31,406
Derivative financial instruments	–	1,609	–	1,609
Deposits with credit institutions	616	–	–	616
Minority holdings in property management undertakings	977	–	–	977
Other long-term investments	1,465	249	(57)	1,657
Other short-term investments	4	–	–	4
	<b>204,354</b>	<b>15,986</b>	<b>(3,614)</b>	<b>216,726</b>

## 24 – Financial investments continued

### (d) Financial investment arrangements

#### (i) Stock lending arrangements

The Group has entered into stock lending arrangements in the UK and overseas during the year in accordance with established market conventions. The majority of the Group's stock lending transactions occurs in the UK, where investments are lent to EEA-regulated, locally-domiciled counterparties and governed by agreements written under English law.

The Group receives collateral in order to reduce the credit risk of these arrangements. Collateral must be in a readily realisable form, such as listed securities, and is held in segregated accounts. Transfer of title always occurs for collateral received, although no market risk or economic benefit is taken. The level of collateral held is monitored regularly, with further collateral obtained where this is considered necessary to manage the Group's risk exposure.

In September 2008, a counterparty default led to the sale of the collateral held and the purchase of securities lent to that counterparty. This process was completed without any loss to the Group.

In certain markets, the Group or the Group's appointed stock lending managers obtain legal ownership of the collateral received and can re-pledge it as collateral elsewhere or sell outright in the absence of default. The carrying amounts of financial assets received and pledged in this manner at 31 December 2008 were £18,486 million and £322million respectively (2007: £23,779 million and £4 million respectively). The value of collateral that was actually sold or re-pledged in the absence of default was £nil million (2007: £nil).

In addition to the above, the Group has received and pledged cash collateral under stock lending arrangement that has been recognised on the balance sheet with a corresponding obligation or receivable for its return. These latter balances are shown separately in notes 48 and 25 respectively.

#### (ii) Stock repurchase arrangements

Included within financial investments are £383 million (2007: £358 million) of debt securities and other fixed income securities which have been sold under stock repurchase arrangements. The obligations arising under these arrangements are shown in note 48.

#### (iii) Other arrangements

In carrying on its bulk purchase annuity business, the Group's UK Life operation is required to place certain investments in trust on behalf of the policyholders. Amounts become payable from the trust funds to the trustees if the Group were to be in breach of its payment obligations in respect of policyholder benefits. At 31 December 2008, £474 million (2007:£nil) of financial investments were restricted in this way.

Certain financial investments are also required to be deposited under local laws in various overseas countries as security for the holders of policies issued in those countries. Other investments are pledged as security collateral for bank letters of credit.



## Notes to the consolidated financial statements continued

## 25 – Receivables and other financial assets

*This note analyses our total receivables.*

	2008 £m	Restated 2007 £m
Amounts owed by contract holders	2,303	2,554
Amounts owed by intermediaries	1,649	1,417
Deposits with ceding undertakings	1,747	1,163
Amounts due from reinsurers	802	701
Amounts due from brokers for investment sales	120	326
Amounts receivable for collateral pledged (notes 24d and 56e)	1	21
Reimbursements due from government health insurance	147	402
Corporate owned life insurance	162	112
Dividends receivable	183	152
Finance lease receivables	121	111
Other banking assets	237	50
Other financial assets	2,730	2,164
Total	10,202	9,173
Less: Amounts classified as held for sale	(386)	(554)
	9,816	8,619
Expected to be recovered in less than one year	9,116	8,261
Expected to be recovered in more than one year	700	358
	9,816	8,619

Concentrations of credit risk with respect to receivables are limited due to the size and spread of the Group's trading base. No further credit risk provision is therefore required in excess of the normal provision for doubtful receivables.

## 26 – Deferred acquisition costs and other assets

*This note shows the products on which we are deferring some of our acquisition costs and details the movements in the balance during the year.*

## (a) Carrying amount

The carrying amount comprises:

	2008 £m	2007 £m
Deferred acquisition costs in respect of:		
Insurance contracts – Long-term business	3,306	1,473
Insurance contracts – General insurance and health business	1,489	1,583
Participating investment contracts – Long-term business	87	112
Non-participating investment contracts – Long-term business	1,062	1,126
Retail fund management business	22	27
Total deferred acquisition costs	5,966	4,321
Surpluses in the staff pension schemes (note 46e(vii))	–	27
Other assets	182	139
Total	6,148	4,487
Less: Amounts classified as held for sale	(1)	–
Total	6,147	4,487

Deferred acquisition costs on long-term business are generally recoverable in more than one year whereas such costs on general insurance and health business are generally recoverable within one year after the balance sheet date.

## 26 – Deferred acquisition costs and other assets continued

### (b) Movements in the year

The movements in deferred acquisition costs during the year were:

	2008			
	Long-term business £m	General insurance and health business £m	Retail fund management business £m	Total £m
Carrying amount at 1 January	2,711	1,583	27	4,321
Acquisition costs deferred during the year	1,513	2,660	4	4,177
Amortisation	(682)	(2,828)	(9)	(3,519)
Impairment losses	(100)	–	–	(100)
Impact of assumption changes	(281)	(4)	–	(285)
Effect of portfolio transfers, acquisitions and disposals	3	(1)	–	2
Foreign exchange rate movements	808	79	–	887
Shadow adjustment	483	–	–	483
<b>Carrying amount at 31 December</b>	<b>4,455</b>	<b>1,489</b>	<b>22</b>	<b>5,966</b>

	2007			
	Long-term business £m	General insurance and health business £m	Retail fund management business £m	Total £m
Carrying amount at 1 January	1,778	1,422	22	3,222
Acquisition costs deferred during the year	1,018	2,778	10	3,806
Amortisation	(196)	(2,693)	(5)	(2,894)
Impact of assumption changes	32	–	–	32
Effect of portfolio transfers, acquisitions and disposals	2	34	–	36
Foreign exchange rate movements	55	42	–	97
Shadow adjustment	22	–	–	22
<b>Carrying amount at 31 December</b>	<b>2,711</b>	<b>1,583</b>	<b>27</b>	<b>4,321</b>

The shadow adjustments relate to deferred acquisition costs on business in the United States backed by investments classified as available for sale. As explained in accounting policy K, unrealised gains and losses on the AFS investments and the shadow adjustments above are both recognised directly in shareholders' equity.

### (c) Other assets

Other assets include £1 million (2007: £66 million) that is expected to be recovered more than one year after the balance sheet date.

### (d) Prepayments and accrued income

Prepayments and accrued income of £3,762 million (2007: £2,986 million), include £259 million (2007: £111 million) that is expected to be recovered more than one year after the balance sheet date.

## Notes to the consolidated financial statements continued

## 27 – Assets held to cover linked liabilities

*Certain unit-linked products have been classified as investment contracts, while some are included within the definition of an insurance contract. The assets backing these unit-linked liabilities are included within the relevant balances in the consolidated balance sheet, while the liabilities are included within insurance and investment contract provisions. This note analyses the carrying values of assets backing these liabilities.*

The carrying values of assets backing unit-linked liabilities are as follows:

	2008 £m	2007 £m
Loans	1,799	347
Debt securities	19,588	15,065
Equity securities	23,840	27,743
Other investments	28,799	33,171
Reinsurance assets	1,704	1,905
Cash and cash equivalents	4,125	3,939
	<b>79,855</b>	<b>82,170</b>

## 28 – Ordinary share capital

*This note gives details of Aviva plc's ordinary share capital and shows the movements during the year.*

(a) Details of the Company's ordinary share capital are as follows:

	2008 £m	2007 £m
The authorised share capital of the Company at 31 December 2008 was: 3,000,000,000 (2007: 3,000,000,000) ordinary shares of 25 pence each	750	750
The allotted, called up and fully paid share capital of the Company at 31 December 2008 was: 2,657,701,624 (2007: 2,621,792,828) ordinary shares of 25 pence each	664	655

(b) During 2008, a total of 35,908,796 ordinary shares of 25 pence each were allotted and issued by the Company as follows:

	Number of shares	Share capital £m	Share premium £m
At 1 January	2,621,792,828	655	1,223
Shares issued under the Group's Employee and Executive Share Option Schemes	8,429,587	2	18
Shares issued in lieu of dividends	27,479,209	7	(7)
<b>At 31 December</b>	<b>2,657,701,624</b>	<b>664</b>	<b>1,234</b>

Ordinary shares in issue in the Company rank pari passu. All the ordinary shares in issue carry the same right to receive all dividends and other distributions declared, made or paid by the Company.

Shares in lieu of the 2007 final dividend were issued on 16 May 2008. The issue of shares in lieu of cash dividends is considered a bonus issue under the terms of the Companies Act 1985 and the nominal value of the shares is charged to the share premium account.

## 29 – Equity compensation plans

*This note describes the various equity compensation plans we use, and shows how we value the options and awards of shares in the Company.*

### (a) Description of the plans

The Group maintains a number of active stock option and award schemes. These are as follows:

#### (i) Savings-related options

These are options granted under the Inland Revenue-approved Save As You Earn (SAYE) share option schemes in the UK and in Ireland. Options are normally exercisable during the six month period following either the third, fifth or seventh anniversary of the start of the relevant savings contract.

#### (ii) Executive share options

These are options granted on various dates from 1998 to 2004, under the Aviva Executive Share Option Scheme or predecessor schemes. Options granted between 1998 and 2000 were subject to the satisfaction of conditions relating to either the Company's return on equity shareholders' funds (ROE) or its relative total shareholder return (TSR) against a chosen comparator group. In respect of options granted from 2000 the performance condition has been a mixture of both ROE and TSR measures. In all cases, performance is measured over a three-year performance period and the options are normally exercisable between the third and tenth anniversary of their grant.

#### (iii) Deferred bonus plan options

These are options granted in 1999 and 2000 under the CGU Deferred Bonus Plan. Participants who deferred their annual cash bonus in exchange for an award of shares of equal value also received a matching award over an equal number of share options. The exercise of these options is not subject to the attainment of performance conditions. These options are exercisable up to the tenth anniversary of their grant.

#### (iv) Long-term incentive plan awards

These awards have been made under the Aviva Long-Term Incentive Plan 2005 and are described in Section (b) below and in the Directors' remuneration report.

#### (v) Annual bonus plan awards

These awards have been made under the Aviva Annual Bonus Plan 2005, and are described in Section (b) below and in the Directors' remuneration report.

#### (vi) "One Aviva, twice the value" bonus plan awards

These are conditional awards first granted under the Aviva Annual Bonus Plan 2005 in 2008, and are described in section (b) below and in the Directors' remuneration report.

### (b) Outstanding options and awards

#### (i) Share options

At 31 December 2008, options to subscribe for ordinary shares of 25 pence each in the Company were outstanding as follows:

Aviva Savings Related Share Option Scheme	Option price p	Number of shares	Normally exercisable	Option price p	Number of shares	Normally exercisable
	664	67,015	2008	491	3,155,679	2008, 2010 or 2012
	401	788,469	2009	593	1,648,754	2009, 2011 or 2013
	406	1,102,589	2008 or 2010	563	2,648,189	2010, 2012 or 2014
	428	629,626	2009 or 2011	410	10,902,889	2011, 2013 or 2015
Hibernian Savings Related Share Option Scheme (in euros)	Option price c	Number of shares	Normally exercisable	Option price c	Number of shares	Normally exercisable
	586	125,712	2008	879	102,808	2009 or 2011
	630	39,488	2009	830	137,393	2010 or 2012
	719	116,860	2008 or 2010	509	1,175,307	2011 or 2013

## Notes to the consolidated financial statements continued

## 29 – Equity compensation plans continued

RAC Savings Related Share Option Scheme	Option price p	Number of shares	Normally exercisable	Option price p	Number of shares	Normally exercisable
	312.27	90,281	2008	354.94	184,220	2009

Aviva Executive Share Option Scheme	Option price p	Number of shares	Normally exercisable	Option price p	Number of shares	Normally exercisable
	965.00	7,425	2002 to 2009	960.00	33,104	2003 to 2010
	870.83	28,437	2002 to 2009	1,035.00	483,888	2004 to 2011
	919.00	264,517	2002 to 2009	516.00	784,712	2005 to 2012
	822.00	44,939	2003 to 2010	512.00	983,026	2006 to 2013
	972.33	9,538	2003 to 2010	526.00	700,122	2007 to 2014

CGU plc Deferred Bonus Plan	Option price p	Number of shares	Normally exercisable
	899.5	5,703	2002 to 2009
	996.5	1,986	2002 to 2009
	875.0	15,547	2003 to 2010

The following table summarises information about options outstanding at 31 December 2008:

Range of exercise prices	Outstanding options Number	Weighted average remaining contractual life Years	Weighted average exercise price p
£3.00 – £4.89	15,038,581	3	408.74
£4.90 – £8.04	10,344,558	2	535.04
£8.05 – £11.19	895,084	1	976.99

The comparative figures as at 31 December 2007 were:

Range of exercise prices	Outstanding options Number	Weighted average remaining contractual life Years	Weighted average exercise price p
£3.00 – £4.89	5,079,299	2	399.34
£4.90 – £8.04	16,664,953	5	543.36
£8.05 – £11.19	1,255,280	3	967.45



## 29 – Equity compensation plans continued

### (ii) Share awards

At 31 December 2008, awards issued under the Company's executive incentive plans over ordinary shares of 25 pence each in the Company were outstanding as follows:

Aviva Long-Term Incentive Plan 2005	Number of shares	Vesting period	Number of shares	Vesting period
	2,496,916	2006 to 2008	4,357,937	2008 to 2010
	2,739,856	2007 to 2009		
"One Aviva, twice the value" Bonus Plan	Number of shares	Vesting period		
	1,126,190	2008 to 2010		
Aviva Annual Bonus Plan 2005	Number of shares	Vesting date	Number of shares	Vesting date
	1,928,919	2009	3,475,828	2011
	2,743,250	2010		

The vesting of awards under the Aviva Long-Term Incentive Plan 2005 is subject to the attainment of performance conditions as described in the Directors' remuneration report. Shares which do not vest, lapse.

### (iii) Shares to satisfy awards and options

Prior to March 2003, it was the practice to satisfy awards and options granted under the executive incentive plans through shares purchased in the market and held by employee share trusts which were established for the purpose of satisfying awards under the various executive incentive plans and funded by the Company.

From March 2003 to July 2008, it was generally the Company's practice to satisfy the awards granted after March 2003 by the issue of new shares at the time of vesting.

However, since July 2008, it is the Company's practice to satisfy all awards and options using shares purchased in the market and held by employee trusts except where local regulations make it necessary to issue new shares. Further details are given in note 30.

### (c) Movements in the year

A summary of the status of the option plans as at 31 December 2008 and 2007, and changes during the years ended on those dates, is shown below.

	2008		2007	
	Number of options	Weighted average exercise price p	Number of options	Weighted average exercise price p
Outstanding at 1 January	22,999,532	534.70	27,536,619	514.54
Granted during the year	12,392,826	410.00	6,289,583	563.00
Exercised during the year	(2,344,424)	420.90	(5,144,763)	437.82
Expired during the year	(6,769,711)	561.62	(5,681,907)	594.60
Outstanding at 31 December	26,278,223	477.82	22,999,532	534.70
Exercisable at 31 December	6,709,247	550.41	5,637,127	580.27

### (d) Expense charged to the income statement

The total expense recognised for the year arising from equity compensation plans was as follows:

	2008 £m	2007 £m
Equity-settled expense (note 10b)	39	50
Cash-settled expense	–	–
	39	50

## Notes to the consolidated financial statements continued

## 29 – Equity compensation plans continued

**(e) Fair value of options and awards granted after 7 November 2002**

The weighted average fair values of options and awards granted during the year, estimated by using the Black-Scholes option-pricing model, were £1.99 and £4.44 (2007: £2.13 and £6.17) respectively.

**(i) Share options**

The fair value of the options was estimated on the date of grant, based on the following weighted average assumptions:

Weighted average assumption	2008	2007
Share price	<b>518p</b>	733.5p
Exercise price	<b>410p</b>	563p
Expected volatility	<b>32.6%</b>	24%
Expected life	<b>5.00 years</b>	4.07 years
Expected dividend yield	<b>5.5%</b>	3.83%
Risk-free interest rate	<b>4.4%</b>	5.09%

The expected volatility used was based on the historical volatility of the share price over a period equivalent to the expected life of the options prior to its date of grant.

The risk-free interest rate was based on the yields available on UK government bonds as at the date of grant. The bonds chosen were those with a similar remaining term to the expected life of the options.

1,112,282 options granted after 7 November 2002 were exercised during the year (2007: 1,496,069).

**(ii) Share awards**

The fair value of the awards was estimated on the date of grant, based on the following weighted average assumptions:

Weighted average assumption	2008	2007
Share price	<b>608p</b>	778.5p
Expected volatility*	<b>25%</b>	18.35%
Expected volatility of comparator companies' share price*	<b>26%</b>	19%
Correlation between Aviva and competitors' share price*	<b>65%</b>	53%
Expected life	<b>2.78 years</b>	2.20 years
Expected dividend yield	<b>4.5%</b>	3.83%
Risk-free interest rate*	<b>3.9%</b>	5.36%

\* For awards with market-based performance conditions.

The expected volatility used was based on the historical volatility of the share price over a period equivalent to the expected life of the options prior to its date of grant.

The risk-free interest rate was based on the yields available on UK government bonds as at the date of grant. The bonds chosen were those with a similar remaining term to the expected life of the options.

### 30 – Shares held by employee trusts

*We satisfy awards and options granted under the executive incentive plans primarily through shares purchased in the market and held by employees share trusts. This note gives details of the shares held in these trusts.*

Movements in the carrying value of shares held by employee trusts comprise:

	2008		2007	
	Number	£m	Number	£m
Cost debited to shareholders' funds				
At 1 January	1,521,064	10	682,202	–
Acquired in the year	8,500,000	29	1,556,583	10
Distributed in the year	(1,385,482)	(6)	(717,721)	–
Balance at 31 December	8,635,582	33	1,521,064	10

The shares are owned by an employee share trust with an undertaking to satisfy awards of shares in the Company under the Group's equity compensation plans. Details of the features of the plans can be found in the Directors' remuneration report.

These shares were purchased in the market and are carried at cost less amounts charged to the income statement in prior years. At 31 December 2008, they had an aggregate nominal value of £2,158,896 (2007: £380,266) and a market value of £33,678,770 (2007: £10,236,761). The trustees have waived their rights to dividends on the shares held in the trusts.

### 31 – Preference share capital

*This note gives details of Aviva plc's preference share capital.*

The preference share capital of the Company at 31 December 2008 was:

	2008 £m	2007 £m
Authorised		
200,000,000 cumulative irredeemable preference shares of £1 each	200	200
1,000,000,000 Sterling preference shares of £1 each	1,000	1,000
	1,200	1,200
	2008 €m	2007 €m
700,000,000 Euro preference shares of €1 each	700	700
	2008 £m	2007 £m
Issued and paid up		
100,000,000 8¾% cumulative irredeemable preference shares of £1 each	100	100
100,000,000 8¾% cumulative irredeemable preference shares of £1 each	100	100
	200	200

The Sterling preference shares, if issued and allotted, would rank, as to payment of a dividend and capital, ahead of the Company's ordinary share capital but behind the cumulative irredeemable preference shares currently in issue. The issued preference shares are non-voting except where their dividends are in arrears, on a winding up or where their rights are altered. On a winding up, they carry a preferential right of return of capital ahead of the ordinary shares. The Company does not have a contractual obligation to deliver cash or other financial assets to the preference shareholders and therefore the directors may make dividend payments at their discretion.

## Notes to the consolidated financial statements continued

**32 – Direct capital instrument**

*This note gives details of the direct capital instrument issued in November 2004.*

	2008 £m	2007 £m
Notional amount		
5.9021% £500 million direct capital instrument	500	500
4.7291% €700 million direct capital instrument	490	490
	<b>990</b>	<b>990</b>

The euro and sterling direct capital instruments (the DCIs) were issued on 25 November 2004. They have no fixed redemption date but the Company may, at its sole option, redeem all (but not part) of the euro and sterling DCIs at their principal amounts on 28 November 2014 and 27 July 2020 respectively, at which dates the interest rates change to variable rates, or on any respective coupon payment date thereafter.

In addition, under certain circumstances defined in the terms and conditions of the issue, the Company may at its sole option:

(i) substitute at any time not less than all of the DCIs for, or vary the terms of the DCIs so that they become, Qualifying Tier 1 Securities or Qualifying Upper Tier 2 Securities;

(ii) substitute not less than all of the DCIs for fully paid non-cumulative preference shares in the Company. These preference shares could only be redeemed on 28 November 2014 in the case of the euro DCIs and on 27 July 2020 in the case of the sterling DCIs, or in each case on any dividend payment date thereafter. The Company has the right to choose whether or not to pay any dividend on the new shares, and any such dividend payment will be non-cumulative.

The Company has the option to defer coupon payments on the DCIs on any relevant payment date. Deferred coupons shall be satisfied only in the following circumstances, all of which occur at the sole option of the Company:

(i) Redemption; or

(ii) Substitution by, or variation so they become, alternative Qualifying Tier 1 Securities or Qualifying Upper Tier 2 Securities; or

(iii) Substitution by preference shares.

No interest will accrue on any deferred coupon. Deferred coupons will be satisfied by the issue and sale of ordinary shares in the Company at their prevailing market value, to a sum as near as practicable to (and at least equal to) the relevant deferred coupons. In the event of any coupon deferral, the Company will not declare or pay any dividend on its ordinary or preference share capital.

**33 – Merger reserve**

*This note analyses the movements in the merger reserve during the year.*

Movements in the year comprised:

	2008 £m	2007 £m
<b>Balance at 1 January</b>	<b>3,271</b>	<b>3,271</b>
Movement in the year	–	–
<b>Balance at 31 December</b>	<b>3,271</b>	<b>3,271</b>

Prior to 1 January 2004, certain significant business combinations were accounted for using the “pooling of interests method” (or merger accounting), which treats the merged groups as if they had been combined throughout the current and comparative accounting periods. Merger accounting principles for these combinations gave rise to a merger reserve in the consolidated balance sheet, being the difference between the nominal value of new shares issued by the Parent Company for the acquisition of the shares of the subsidiary and the subsidiary’s own share capital and share premium account.

The merger reserve is also used where more than 90% of the shares in a subsidiary are acquired and the consideration includes the issue of new shares by the Company, thereby attracting merger relief under the Companies Act 1985.

The balance on the reserve has arisen through the mergers of Commercial Union, General Accident and Norwich Union companies, forming Aviva plc in 2000, together with the acquisition of RAC plc in 2005.

## 34 – Other reserves

*This note gives details of the various reserves forming part of the Group's consolidated equity, and shows the movements during the year.*

Movements in the year comprised:

	Currency translation reserve (see accounting policy E) £m	Owner occupied properties reserve (see accounting policy O) £m	Investment valuation reserve (see accounting policy S) £m	Hedging instruments reserve (see accounting policy T) £m	Equity compensation reserve (see accounting policy AA) £m	Restated Total £m
<b>Balance at 1 January 2007</b>	(331)	194	979	78	73	993
Arising in the year:						
Fair value gains	–	23	149	–	–	172
Fair value gains transferred to profit on disposals	–	–	(391)	–	–	(391)
Transfer to profit on disposal of subsidiary (note 3b)	3	–	–	–	–	3
Fair value gains transferred to retained earnings on disposals (note 35)	–	(25)	–	–	–	(25)
Share of fair value changes in joint ventures and associates taken to equity (note 18a)	–	–	9	–	–	9
Reserves credit for equity compensation plans (note 29d)	–	–	–	–	50	50
Shares issued under equity compensation plans (note 35)	–	–	–	–	(34)	(34)
Foreign exchange rate movements	760	–	–	(141)	–	619
Aggregate tax effect – shareholders' tax	–	–	73	–	–	73
<b>Balance at 31 December 2007</b>	432	192	819	(63)	89	1,469
Arising in the year:						
Fair value losses	–	(37)	(2,344)	–	–	(2,381)
Fair value gains transferred to profit on disposals	–	–	(126)	–	–	(126)
Fair value losses transferred to retained earnings on disposals (note 35)	–	1	–	–	–	1
Share of fair value changes in joint ventures and associates taken to equity (notes 18a & 19a)	–	–	(93)	–	–	(93)
Impairment losses on revalued assets taken to income statement	–	–	830	–	–	830
Reserves credit for equity compensation plans (note 29d)	–	–	–	–	39	39
Shares issued under equity compensation plans (note 35)	–	–	–	–	(15)	(15)
Foreign exchange rate movements	3,222	–	–	(1,040)	–	2,182
Aggregate tax effect – shareholders' tax	–	1	203	–	–	204
<b>Balance at 31 December 2008</b>	<b>3,654</b>	<b>157</b>	<b>(711)</b>	<b>(1,103)</b>	<b>113</b>	<b>2,110</b>

The above reserves are shown net of minority interests.



## Notes to the consolidated financial statements continued

## 35 – Retained earnings

*This note analyses the movements in the consolidated retained earnings during the year.*

	2008 £m	Restated 2007 £m
<b>Balance at 1 January as reported</b>	<b>6,338</b>	5,082
Prior year adjustment – impact of discounting on latent claims (note 2b(i))	–	112
<b>Balance at 1 January restated</b>	<b>6,338</b>	5,194
(Loss)/profit for the year attributable to equity shareholders	<b>(915)</b>	1,320
Actuarial (losses)/gains on pension schemes (note 46e(iv))	<b>(929)</b>	648
Actuarial losses/(gains) on pension schemes transferred to unallocated divisible surplus (note 43)	<b>78</b>	(61)
Dividends and appropriations (note 15)	<b>(975)</b>	(871)
Shares issued in lieu of dividends	<b>170</b>	301
Shares issued under equity compensation plans (note 34)	<b>15</b>	34
Shares distributed by employee trusts (note 30)	<b>(6)</b>	–
Fair value (losses)/gains realised from reserves (note 34)	<b>(1)</b>	25
Aggregate tax effect	<b>31</b>	(252)
<b>Balance at 31 December</b>	<b>3,806</b>	6,338

The shares issued in lieu of dividends are in respect of the transfer to retained earnings from the ordinary dividend account, arising from the treatment of shares issued in lieu of the 2007 final dividend, as explained in note 28(b).

The Group's regulated subsidiaries are required to hold sufficient capital to meet acceptable solvency levels based on applicable local regulations. Their ability to transfer retained earnings to the UK parent companies is therefore restricted to the extent these earnings form part of local regulatory capital.

## 36 – Minority interests

*This note gives details of the Group's minority interests and shows the movements during the year.*

### (a) Minority interests at 31 December comprised:

	2008 £m	Restated 2007 £m
Equity shares in subsidiaries	695	660
Share of earnings	673	429
Share of other reserves	577	450
	1,945	1,539
Preference shares in General Accident plc	250	250
Preference shares in other subsidiaries	9	6
	2,204	1,795

### (b) Movements in the year comprised:

	2008 £m	Restated 2007 £m
<b>Balance at 1 January as reported</b>	<b>2,553</b>	<b>1,698</b>
Prior year adjustment (note 2b(ii))	(758)	(431)
<b>Balance at 1 January restated</b>	<b>1,795</b>	<b>1,267</b>
Profit for the year attributable to minority interests	30	178
Minority share of movements in other reserves	–	1
Foreign exchange rate movements	471	100
Recognised income and expense attributable to minority interests	501	279
Capital contributions from minority shareholders	36	–
Minority share of dividends declared in the year	(106)	(66)
Minority interest in acquired subsidiaries	43	315
Changes in minority interest in existing subsidiaries	(65)	–
<b>Balance at 31 December</b>	<b>2,204</b>	<b>1,795</b>

## Notes to the consolidated financial statements continued

## 37 – Contract liabilities and associated reinsurance

The following notes explain how we calculate our liabilities to our policyholders for insurance and investment products we have sold to them. Notes 38 and 39 cover these liabilities and note 40 details the financial guarantees and options given for some of these products. Note 41 details the reinsurance recoverables on these liabilities whilst note 42 shows the effects of the assumptions we have changed during the year.

The following is a summary of the contract provisions and related reinsurance assets as at 31 December.

	2008			Restated 2007		
	Gross provisions £m	Reinsurance assets £m	Net £m	Gross provisions £m	Reinsurance assets £m	Net £m
Long-term business						
Insurance contracts	(156,188)	4,466	(151,722)	(135,312)	4,298	(131,014)
Participating investment contracts	(65,278)	52	(65,226)	(53,609)	22	(53,587)
Non-participating investment contracts	(42,281)	1,047	(41,234)	(44,635)	1,461	(43,174)
	(263,747)	5,565	(258,182)	(233,556)	5,781	(227,775)
Outstanding claims provisions						
Long-term business	(907)	145	(762)	(727)	94	(633)
General insurance and health	(11,842)	1,737	(10,105)	(10,842)	1,634	(9,208)
	(12,749)	1,882	(10,867)	(11,569)	1,728	(9,841)
Provisions for claims incurred but not reported	(2,518)	29	(2,489)	(2,099)	29	(2,070)
	(279,014)	7,476	(271,538)	(247,224)	7,538	(239,686)
Provision for unearned premiums	(5,493)	418	(5,075)	(5,484)	511	(4,973)
Provision arising from liability adequacy tests	(13)	–	(13)	(24)	–	(24)
Other technical provisions	–	–	–	(3)	5	2
<b>Totals</b>	<b>(284,520)</b>	<b>7,894</b>	<b>(276,626)</b>	<b>(252,735)</b>	<b>8,054</b>	<b>(244,681)</b>
Less: Amounts classified as held for sale	709	–	709	627	–	627
	(283,811)	7,894	(275,917)	(252,108)	8,054	(244,054)

## 38 – Insurance liabilities

*This note analyses our insurance contract liabilities by type of product and describes how we calculate these liabilities and what assumptions we have used.*

### (a) Carrying amount

Insurance liabilities at 31 December comprise:

	2008			Restated 2007		
	Long-term business £m	General insurance and health £m	Total £m	Long-term business £m	General insurance and health £m	Total £m
Long-term business provisions						
Participating	66,863	–	66,863	66,093	–	66,093
Unit-linked non-participating	22,060	–	22,060	20,601	–	20,601
Other non-participating	67,265	–	67,265	48,618	–	48,618
	<b>156,188</b>	<b>–</b>	<b>156,188</b>	<b>135,312</b>	<b>–</b>	<b>135,312</b>
Outstanding claims provisions	907	11,842	12,749	727	10,842	11,569
Provision for claims incurred but not reported	–	2,518	2,518	–	2,099	2,099
	<b>907</b>	<b>14,360</b>	<b>15,267</b>	<b>727</b>	<b>12,941</b>	<b>13,668</b>
Provision for unearned premiums	–	5,493	5,493	–	5,484	5,484
Provision arising from liability adequacy tests	–	13	13	–	24	24
Other technical provisions	–	–	–	–	3	3
<b>Total</b>	<b>157,095</b>	<b>19,866</b>	<b>176,961</b>	<b>136,039</b>	<b>18,452</b>	<b>154,491</b>
Less: Obligations to staff pension schemes transferred to provisions (note 45a)	(1,402)	–	(1,402)	(1,025)	–	(1,025)
Amounts classified as held for sale	–	(709)	(709)	–	(627)	(627)
	<b>155,693</b>	<b>19,157</b>	<b>174,850</b>	<b>135,014</b>	<b>17,825</b>	<b>152,839</b>

### (b) Long-term business liabilities

#### (i) Business description

The Group underwrites long-term business in a number of countries as follows:

- In the UK mainly in
  - “with-profit” funds of CGNU Life Assurance (CGNU Life), Commercial Union Life Assurance (CULAC) and the with-profit and Provident Mutual funds of Norwich Union Life & Pensions (NUL&P), where the with-profit policyholders are entitled to at least 90% of the distributed profits, the shareholders receiving the balance;
  - “non-profit” funds of Norwich Union Annuity and NUL&P, where shareholders are entitled to 100% of the distributed profits. Shareholder profits on unitised with-profit business written by Norwich Union Life & Pensions and on stakeholder unitised with-profit business are derived from management fees and policy charges, and emerge in the non-profit funds.
- In France, where the majority of policyholders’ benefits are determined by investment performance, subject to certain guarantees, and shareholders’ profits are derived largely from management fees. In addition, a substantial number of policies participate in investment returns, with the balance being attributable to shareholders.
- In the Netherlands, the balance of profits, after providing appropriate returns for policyholders and after tax, accrues for the benefit of the shareholders. The bases for determining returns for policyholders are complex, but are consistent with methods and criteria followed generally in the Netherlands. In addition, a substantial number of policies provide benefits that are determined by investment performance, subject to certain guarantees, and shareholders’ profits are derived largely from management fees.
- In the United States, there are two main business segments – protection products and accumulation products. Protection products include interest-sensitive whole life, term life, universal life and indexed life insurance policies. The accumulation product segment includes traditional fixed and indexed deferred annuities for individuals and funding agreements for business customers. In addition, there are two closed blocks of participating contracts arising from demutualisations of subsidiary companies. All products are classified as insurance contracts except for the funding agreements and term certain immediate annuities, which are classified as non-participating investment contracts.
- In other overseas operations.

**Notes to the consolidated financial statements continued****38 – Insurance liabilities continued****(ii) Group practice**

The long-term business provision is calculated separately for each of the Group's life operations. The provisions for overseas subsidiaries have generally been included on the basis of local regulatory requirements, mainly using the net premium method, modified where necessary to reflect the requirements of the Companies Act.

Material judgement is required in calculating the provisions and is exercised particularly through the choice of assumptions where discretion is permitted. In turn, the assumptions used depend on the circumstances prevailing in each of the life operations. Provisions are most sensitive to assumptions regarding discount rates and mortality/morbidity rates.

Bonuses paid during the year are reflected in claims paid, whereas those allocated as part of the bonus declaration are included in the movements in the long-term business provision.

**(iii) Methodology and assumptions**

There are two main methods of actuarial valuation of liabilities arising under long-term insurance contracts – the net premium method and the gross premium method – both of which involve the discounting of projected premiums and claims.

Under the net premium method, the premium taken into account in calculating the provision is determined actuarially, based on the valuation assumptions regarding discount rates, mortality and disability. The difference between this premium and the actual premium payable provides a margin for expenses. This method does not allow for voluntary early termination of the contract by the policyholder, and so no assumption is required for persistency. Explicit provision is made for vested bonuses (including those vesting following the most recent fund valuation), but no such provision is made for future regular or terminal bonuses. However, this method makes implicit allowance for future regular or terminal bonuses already earned, by margins in the valuation discount rate used.

The gross premium method uses the amount of contractual premiums payable and includes explicit assumptions for interest and discount rates, mortality and morbidity, persistency and future expenses. These assumptions can vary by contract type and reflect current and expected future experience. Explicit provision is made for vested bonuses and explicit allowance is also made for future regular bonuses, but not terminal bonuses.

**(a) UK*****With-profit business***

The valuation of with-profit business uses the methodology developed for the Realistic Balance Sheet, adjusted to remove the shareholders' share of future bonuses. The key elements of the Realistic Balance Sheet methodology are the with-profit benefit reserve (WPBR) and the present value of the expected cost of any payments in excess of the WPBR (referred to as the cost of future policy-related liabilities). The realistic liability for any contract is equal to the sum of the WPBR and the cost of future policy-related liabilities. The WPBR for an individual contract is generally calculated on a retrospective basis, and represents the accumulation of the premiums paid on the contract, allowing for investment return, taxation, expenses and any other charges levied on the contract.

For a small proportion of business, the retrospective approach is not available or is inappropriate, so a prospective valuation approach is used instead, including allowance for anticipated future regular and final bonuses.

The items included in the cost of future policy-related liabilities include:

- Maturity Guarantees;
- Smoothing (which can be negative);
- Guaranteed Annuity Options;
- GMP underpin on Section 32 transfers; and
- Expected payments under Mortgage Endowment Promise.

In the Provident Mutual and With-Profit sub-funds in NUL&P, this is offset by the expected cost of charges to WPBR to be made in respect of guarantees.

The cost of future policy-related liabilities is determined using a market-consistent approach and, in the main, this is based on a stochastic model calibrated to market conditions at the end of the reporting period. Non-market-related assumptions (for example, persistency, mortality and expenses) are based on experience, adjusted to take into account future trends.



### 38 – Insurance liabilities continued

The principal assumptions underlying the cost of future policy related liabilities are as follows:

#### *Future investment return*

A “risk-free” rate equal to the spot yield on gilts, plus a margin of 0.1% is used. The rates vary, according to the outstanding term of the policy, with a typical rate as at 31 December 2008 being 3.58% (2007: 4.72%) for a policy with ten years outstanding.

#### *Volatility of investment return*

Volatility assumptions are set with reference to implied volatility data on traded market instruments, where available. These are term-dependent, with specimen values for ten year terms as follows:

	Volatility	
	2008	2007
Equity returns	<b>34.6%</b>	25.5%
Property returns	<b>15%</b>	15%
Fixed interest yields	<b>15.9%</b>	10.9%

The table above shows the volatility of fixed interest yields, set with reference to 20 year at-the-money swaption volatilities.

#### *Future regular bonuses*

Annual bonus assumptions for 2009 have been set consistently with the year end 2008 declaration. Future annual bonus rates reflect the principles and practices of the fund. In particular, the level is set with regard to the projected margin for final bonus and the change from one year to the next is limited to a level consistent with past practice.

#### *Mortality*

Mortality assumptions are set with regard to recent company experience and general industry trends. The mortality tables used in the valuation are summarised below:

	Mortality table used	
	2008	2007
Assurances, pure endowments and deferred annuities before vesting	<b>Nil or Axx00 adjusted</b>	Nil or AM92/AF92
Pensions business after vesting and pensions annuities in payment	<b>PCMA00/PCFA00 adjusted plus allowance for future mortality improvement</b>	PCMA00/PCFA00 adjusted plus allowance for future mortality improvement

#### *Non-profit business*

Conventional non-profit contracts, including those written in the with-profit funds, are valued using gross premium methods which discount projected future cash flows. The cash flows are calculated using the amount of contractual premiums payable, together with explicit assumptions for investment returns, inflation, discount rates, mortality, morbidity, persistency and future expenses. These assumptions vary by contract type and reflect current and expected future experience.

For unit-linked and some unitised with-profit business, the provisions are valued by adding a prospective non-unit reserve to the bid value of units. The prospective non-unit reserve is calculated by projecting the future non-unit cash flows on the assumption that future premiums cease, unless it is more onerous to assume that they continue. Where appropriate, allowance for persistency is based on actual experience.

Valuation discount rate assumptions are set with regard to yields on the supporting assets and the general level of long-term interest rates as measured by gilt yields. An explicit allowance for risk is included by restricting the yields for equities and properties with reference to a margin over long-term interest rates or by making an explicit deduction from the yields on corporate bonds, mortgages and deposits, based on historical default experience of each asset class. A further margin for risk is then deducted for all asset classes.

The provisions held in respect of guaranteed annuity options are a prudent assessment of the additional liability incurred under the option on a basis and method consistent with that used to value basic policy liabilities, and includes a prudent assessment of the proportion of policyholders who will choose to exercise the option.

## Notes to the consolidated financial statements continued

## 38 – Insurance liabilities continued

Valuation discount rates for business in the non-profit funds are as follows:

	Valuation discount rates	
	2008	2007
Assurances		
Life conventional non-profit	<b>2.7% to 3.4%</b>	3.1% to 3.9%
Pensions conventional non-profit	<b>3.4% to 3.6%</b>	3.9% to 4.1%
Deferred annuities		
Non-profit – in deferment	<b>3.8%</b>	4.3%
Non-profit – in payment	<b>3.4% to 3.6%</b>	3.9% to 4.1%
Annuities in payment		
Conventional annuity	<b>3.8% to 5.4%</b>	4.3% to 5.2%
Non-unit reserves		
Life	<b>3.0%</b>	3.4%
Pensions	<b>3.7%</b>	4.2%

Mortality assumptions are set with regard to recent company experience and general industry trends. Since 2006, the assurance mortality basis has been reviewed with the aim of harmonising assumptions wherever possible across similar lines of business in order to simplify the basis. The mortality tables used in the valuation are summarised below:

	Mortality tables used	
	2008	2007
Assurances		
Non-profit	<b>AM00/AF00 or TM00/TF00 adjusted for smoker status and age/sex specific factors</b>	AM80/AF80 or AM92/AF92 or TM92/TF92 adjusted for smoker status and age/sex specific factors
Pure endowments and deferred annuities before vesting	<b>AM00/AF00 adjusted</b>	Nil or AM80/AF80 or AM92/AF92 adjusted
Pensions business after vesting	<b>PCMA00/PCFA00 adjusted plus allowance for future mortality improvement</b>	PCMA00/PCFA00 adjusted plus allowance for future mortality improvement
Annuities in payment		
General annuity business	<b>IML00/IFL00 adjusted plus allowance for future mortality improvement</b>	IML00/IFL00 adjusted plus allowance for future mortality improvement

**(b) France**

The majority of reserves arise from a single premium savings product and is based on the accumulated fund value, adjusted to maintain consistency with the value of the assets backing the policyholder liabilities. The net premium method is used for prospective valuations, in accordance with local regulation, where the valuation assumptions depend on the date of issue of the contract. The valuation discount rate also depends on the original duration of the contract and mortality rates are based on industry tables.

## 38 – Insurance liabilities continued

	Valuation discount rates	Mortality tables used
	2008 and 2007	2008 and 2007
Life assurances	<b>0% to 4.5%</b>	<b>TD73-77, TD88-90, TH00-02, TGF05/TGH05</b>
Annuities	<b>0% to 4.5%</b>	<b>TPRV (prospective table)</b>

### (c) Netherlands

On transition to IFRS, the valuation of most long-term insurance and participating investment contracts was changed from existing methods that generally used historic assumptions to an active basis using current market interest rates. A liability adequacy test is performed in line with IFRS requirements. Where liabilities are based on current market interest rates and assets are valued at market value, the margin in the liability adequacy test is determined by comparison of the liabilities with the present value of best estimate cash flows. For 2008 the yield curve basis has been revised from swap rates to a curve constructed from yields on collateralised AAA bonds; this is to avoid distortion from extremities observed in the swap curve under the dislocated market conditions.

	Valuation discount rates	Mortality tables used
	2008 and 2007	2008 and 2007
Life assurances	<b>Market risk-free yield curves, based on iBoxx index for collateralised AAA bonds (2007: based on DNB swap rates)</b>	<b>GBM 61-65, GBM/V 76-80, GBM 80-85, GBM/V 85-90 and GBM/V90-95</b>
Annuities in deferment and in payment	<b>Market risk-free yield curves, based on iBoxx index for collateralised AAA bonds (2007: based on DNB swap rates)</b>	<b>GBM/V 76-80, GBM/V 85-90, GBM/V 95-00, Coll 1993/2003 and DIL 98, plus further allowance for future mortality improvement</b>

### (d) United States

For the major part of our US business, insurance liabilities are measured in accordance with US GAAP as at the date of acquisition.

The liability for future policy benefits for traditional life insurance is computed using the net level method, based on guaranteed interest and mortality rates as used in calculating cash surrender values. Reserve interest assumptions ranged from 2.00% to 7.50% in 2008 (2007: 2.00% to 7.50%). The weighted average interest rate for all traditional life policy reserves in 2008 was 4.47% (2007: 4.46%).

Future policy benefit reserves for universal life insurance, indexed life, deferred annuity products and funding agreements are computed under a retrospective deposit method and represent policy account balances before applicable surrender charges. The weighted average interest crediting rates for universal life products were 4.77% in 2008 (2007: 5.45%). The range of interest crediting rates for deferred annuity products, excluding sales inducement payouts, was 2.50% to 6.00% in 2008 (2007: 2.50% to 7.00%). An additional liability is established for universal life contracts with death or other insurance benefit features, which is determined using an equally-weighted range of scenarios with respect to investment returns, policyholder lapses, benefit election rates, premium payout patterns and mortality. The additional liability represents the present value of future expected benefits based on current product assumptions.

The indexed life and annuity products guarantee the return of principal to the customer, and credit interest based on certain indices. A portion of the premium from each customer is invested in fixed income securities and is intended to cover the minimum guaranteed value. A further portion of the premium is used to purchase derivatives to hedge the growth in interest credited to the customer as a direct result of increases in the related indices. Both the derivatives and the options embedded in the policy are valued at their fair value.

Deferred income reserves are established for fees charged for insurance benefit features which are assessed in a manner that is expected to result in higher profits in earlier years, followed by lower profits or losses in subsequent years. The excess charges are deferred and amortised using the same assumptions and factors used to amortise deferred acquisition costs. Shadow adjustments may be made to deferred acquisition costs, acquired value of in-force business, deferred income reserves and contract liabilities. The shadow adjustments are recognised directly in equity so that unrealised gains or losses on investments that are recognised directly in equity affect the measurement of the liability, or related assets, in the same way as realised gains or losses.

## Notes to the consolidated financial statements continued

## 38 – Insurance liabilities continued

*(e) Other countries*

In all other countries, local generally-accepted interest rates and published standard mortality tables are used for different categories of business as appropriate. The tables are based on relevant experience and show mortality rates, by age, for specific groupings of people.

*(iv) Movements*

The following movements have occurred in the long-term business provisions during the year:

	2008 £m	2007 £m
<b>Carrying amount at 1 January</b>	<b>135,312</b>	<b>126,614</b>
Provisions in respect of new business	<b>13,414</b>	10,470
Expected change in existing business provisions	<b>(6,423)</b>	(6,280)
Variance between actual and expected experience	<b>(9,401)</b>	(877)
Effect of adjusting to PS06/14 realistic basis	<b>(40)</b>	(60)
Impact of other operating assumption changes	<b>(812)</b>	95
Impact of economic assumption changes	<b>(604)</b>	(909)
Effect of special bonus to with-profit policyholders (note 43b)	–	1,728
Other movements	<b>(527)</b>	(324)
Change in liability recognised as an expense	<b>(4,393)</b>	3,843
Effect of portfolio transfers, acquisitions and disposals	<b>1,872</b>	571
Foreign exchange rate movements	<b>23,397</b>	4,284
<b>Carrying amount at 31 December</b>	<b>156,188</b>	<b>135,312</b>

**(c) General insurance and health liabilities***(i) Provisions for outstanding claims*

Delays occur in the notification and settlement of claims and a substantial measure of experience and judgement is involved in assessing outstanding liabilities, the ultimate cost of which cannot be known with certainty at the balance sheet date. The reserves for general insurance and health are based on information currently available. However, it is inherent in the nature of the business written that the ultimate liabilities may vary as a result of subsequent developments.

Provisions for outstanding claims are established to cover the outstanding expected ultimate liability for losses and loss adjustment expenses (LAE) in respect of all claims that have already occurred. The provisions established cover reported claims and associated LAE, as well as claims incurred but not yet reported and associated LAE.

Outstanding claims provisions are based on undiscounted estimates of future claim payments, except for the following classes of business for which discounted provisions are held:

Class	Rate		Mean term of liabilities	
	2008	2007	2008	2007
Netherlands Permanent health and injury	<b>3.82%</b>	3.87%	<b>7 years</b>	8 years
Reinsured London Market business	<b>3.56%</b>	5.00%	<b>8 years</b>	8 years
Latent claims	<b>1.17% to</b>	4.51% to	<b>9 to</b>	9 to
	<b>3.92%</b>	5.21%	<b>15 years</b>	15 years

As explained in note 2, the Group's accounting policy for discounting has been changed in 2008 to present all latent claims on a discounted basis.

The gross outstanding claims provision before discounting was £15,061 million (2007: £13,439 million). The period of time which will elapse before the liabilities are settled has been estimated by modelling the settlement patterns of the underlying claims.

## 38 – Insurance liabilities continued

### (ii) Assumptions

Outstanding claims provisions are estimated based on known facts at the date of estimation. Case estimates are generally set by skilled claims technicians, applying their experience and knowledge to the circumstances of individual claims. The ultimate cost of outstanding claims is then estimated by using a range of standard actuarial claims projection techniques, such as the Chain Ladder and Bornhuetter-Ferguson methods. The main assumption underlying these techniques is that a company's past claims development experience can be used to project future claims development and hence ultimate claims costs. As such, these methods extrapolate the development of paid and incurred losses, average costs per claim and claim numbers based on the observed development of earlier years and expected loss ratios. Historical claims development is mainly analysed by accident period, although underwriting or notification period is also used where this is considered appropriate.

Claim development is separately analysed for each geographic area, as well as by each line of business. Certain lines of business are also further analysed by claim type or type of coverage. In addition, large claims are usually separately addressed, either by being reserved at the face value of loss adjuster estimates or separately projected in order to reflect their future development.

In most cases, no explicit assumptions are made regarding future rates of claims inflation or loss ratios. Instead, the assumptions used are those implicit in the historical claims development data on which the projections are based. Additional qualitative judgement is used to assess the extent to which past trends may not apply in the future, for example, to reflect one-off occurrences, changes in external or market factors such as public attitudes to claiming, economic conditions, levels of claims inflation, judicial decisions and legislation, as well as internal factors such as portfolio mix, policy conditions and claims handling procedures in order to arrive at the estimated ultimate cost of claims that represents the likely outcome, from the range of possible outcomes, taking account of all the uncertainties involved.

### (iii) Movements

The following changes have occurred in the general insurance and health claims provisions during the year:

	2008 £m	Restated 2007 £m
<b>Carrying amount at 1 January – as reported</b>	<b>12,941</b>	12,718
Prior year adjustment – impact of discounting on latent claims (note 2b(i))	–	(214)
<b>Carrying amount at 1 January restated</b>	<b>12,941</b>	12,504
Impact of changes in assumptions	120	(1)
Claim losses and expenses incurred in the current year	8,720	8,273
Decrease in estimated claim losses and expenses incurred in prior years	(828)	(956)
Exceptional strengthening of general insurance latent claims provisions (see below)	356	–
Incurred claims losses and expenses	8,368	7,316
Less:		
Payments made on claims incurred in the current year	(4,682)	(4,408)
Payments made on claims incurred in prior years	(4,307)	(3,686)
Recoveries on claim payments	293	315
Claims payments made in the year, net of recoveries	(8,696)	(7,779)
Unwind of discounting	33	35
Other movements in the claims provisions	(27)	36
Changes in claims reserve recognised as an expense	(322)	(392)
Effect of portfolio transfers, acquisitions and disposals	128	175
Foreign exchange rate movements	1,613	654
<b>Carrying amount at 31 December</b>	<b>14,360</b>	12,941

The effect of changes in the main assumptions is given in note 42 and the economic assumption changes are explained in note 9.



**Notes to the consolidated financial statements continued****38 – Insurance liabilities continued*****Discount rate***

The discount rate that has been applied to latent claims reserves is based on the relevant swap curve in the relevant currency having regard to the expected settlement dates of the claims. The range of discount rates used depends on the duration of the claims and is given in the table in section (i) above. The duration of the claims span over 35 years, with the average duration being between 9 and 15 years depending on the geographical region. Any change in discount rates between the start and the end of the accounting period is reflected below operating profit as an economic assumption change. The sharp decline in interest rates in the second half of 2008 has resulted in an increase in the net discounted provision of £94 million.

***Exceptional strengthening of latent claims provisions***

Separately and in addition to the decision to discount latent claims, our estimation of latent claims reserves in 2008 has been revised to reflect increasing market trends observed in mesothelioma claims. The majority of the Group's latent claims reserves relate to mesothelioma based risks in the UK.

The Institute of Actuaries' Asbestos Working Party report in 2008 contributed to our view that experience variances, which we had previously perceived as normal short-term volatility, reflected a real worsening of expected ultimate claims experience. The market trend in mesothelioma claims has been fully reflected as a significant one-off strengthening of gross latent claims reserves in 2008 of £356 million, with a corresponding increase of £52 million in reinsurance recoverable. The net increase of £304 million comprises £668 million on an undiscounted basis and discounting of £364 million. Due to its size and the fact that this related to discontinued business, this one-off strengthening has been reported as an exceptional item below operating profit.

Whilst this is a significant step change, it should be noted that this reflects the long-term impact of the settlement of latent claims currently running at £30 million per annum, of which £25 million related to mesothelioma. The number of claims is currently predicted to rise slightly in the period to 2015 and then diminish slowly over the next 30 years to 2045.

**(d) Loss development tables*****(i) Description of tables***

The tables that follow present the development of claim payments and the estimated ultimate cost of claims for the accident years 2001 to 2008. The upper half of the tables shows the cumulative amounts paid during successive years related to each accident year. For example, with respect to the accident year 2002, by the end of 2008 £5,715 million had actually been paid in settlement of claims. In addition, as reflected in the lower section of the table, the original estimated ultimate cost of claims of £6,250 million was re-estimated to be £6,056 million at 31 December 2008. This decrease from the original estimate is due to the combination of a number of factors.

The original estimates will be increased or decreased, as more information becomes known about the individual claims and overall claim frequency and severity.

In 2005, the year of adoption of IFRS, only five years were required to be disclosed. This is being increased in each succeeding additional year, until ten years of information is included.

The Group aims to maintain strong reserves in respect of its non-life and health business in order to protect against adverse future claims experience and development. As claims develop and the ultimate cost of claims become more certain, the absence of adverse claims experience will then result in a release of reserves from earlier accident years, as shown in the loss development tables. However, in order to maintain overall reserve adequacy, the Group establishes strong reserves in respect of the current accident year (2008) where the development of claims is less mature and there is much greater uncertainty attaching to the ultimate cost of claims. The release from prior accident year reserves during 2008 is also due to an improvement in the estimated ultimate cost of claims.

### 38 – Insurance liabilities continued

#### (ii) Gross figures

Before the effect of reinsurance, the loss development table is:

Accident year	All prior years £m	2001 £m	2002 £m	2003 £m	2004 £m	2005 £m	2006 £m	2007 £m	2008 £m	Total £m
Gross cumulative claim payments										
At end of accident year		(3,029)	(2,952)	(2,819)	(2,971)	(3,345)	(3,653)	(4,393)	(4,915)	
One year later		(4,766)	(4,486)	(4,190)	(4,561)	(5,011)	(5,525)	(6,676)		
Two years later		(5,303)	(4,921)	(4,613)	(4,981)	(5,449)	(5,971)			
Three years later		(5,701)	(5,233)	(4,972)	(5,263)	(5,784)				
Four years later		(5,966)	(5,466)	(5,258)	(5,448)					
Five years later		(6,121)	(5,618)	(5,409)						
Six years later		(6,223)	(5,715)							
Seven years later		(6,294)								
Estimate of gross ultimate claims										
At end of accident year		6,590	6,250	6,385	6,891	7,106	7,533	8,530	9,508	
One year later		6,770	6,372	6,172	6,557	6,938	7,318	8,468		
Two years later		6,775	6,287	6,124	6,371	6,813	7,243			
Three years later		6,798	6,257	6,036	6,178	6,679				
Four years later		6,754	6,205	5,932	6,008					
Five years later		6,679	6,122	5,853						
Six years later		6,630	6,056							
Seven years later		6,576								
Estimate of gross ultimate claims		6,576	6,056	5,853	6,008	6,679	7,243	8,468	9,508	
Cumulative payments		(6,294)	(5,715)	(5,409)	(5,448)	(5,784)	(5,971)	(6,676)	(4,915)	
	3,600	282	341	444	560	895	1,272	1,792	4,593	<b>13,779</b>
Effect of discounting										
Claims previously discounted	(187)	(4)	(4)	(4)	(2)	(3)	(4)	(7)	(12)	<b>(227)</b>
New discounted claims	(474)	–	–	–	–	–	–	–	–	<b>(474)</b>
Present value	2,939	278	337	440	558	892	1,268	1,785	4,581	<b>13,078</b>
Cumulative effect of foreign exchange movements	–	56	70	129	130	165	240	231	–	<b>1,021</b>
Effect of acquisitions	–	12	12	66	21	31	35	60	24	<b>261</b>
Present value recognised in the balance sheet	<b>2,939</b>	<b>346</b>	<b>419</b>	<b>635</b>	<b>709</b>	<b>1,088</b>	<b>1,543</b>	<b>2,076</b>	<b>4,605</b>	<b>14,360</b>

The effect of discounting on new discounted claims relates to the discounting of latent claims introduced for the first time in 2008.

## Notes to the consolidated financial statements continued

## 38 – Insurance liabilities continued

**(iii) Net of reinsurance**

After the effect of reinsurance, the loss development table is:

Accident year	All prior years £m	2001 £m	2002 £m	2003 £m	2004 £m	2005 £m	2006 £m	2007 £m	2008 £m	Total £m
Net cumulative claim payments										
At end of accident year		(2,970)	(2,913)	(2,819)	(2,870)	(3,281)	(3,612)	(4,317)	(4,808)	
One year later		(4,624)	(4,369)	(4,158)	(4,378)	(4,925)	(5,442)	(6,542)		
Two years later		(5,088)	(4,779)	(4,565)	(4,712)	(5,344)	(5,881)			
Three years later		(5,436)	(5,064)	(4,924)	(4,986)	(5,671)				
Four years later		(5,648)	(5,297)	(5,180)	(5,163)					
Five years later		(5,763)	(5,424)	(5,325)						
Six years later		(5,841)	(5,508)							
Seven years later		(5,896)								
Estimate of net ultimate claims										
At end of accident year		6,186	6,037	6,218	6,602	6,982	7,430	8,363	9,262	
One year later		6,333	6,038	6,093	6,266	6,818	7,197	8,302		
Two years later		6,321	5,997	6,037	6,082	6,688	7,104			
Three years later		6,329	5,973	5,942	5,882	6,544				
Four years later		6,286	5,912	5,851	5,709					
Five years later		6,219	5,855	5,772						
Six years later		6,173	5,786							
Seven years later		6,109								
Estimate of net ultimate claims		6,109	5,786	5,772	5,709	6,544	7,104	8,302	9,262	
Cumulative payments		(5,896)	(5,508)	(5,325)	(5,163)	(5,671)	(5,881)	(6,542)	(4,808)	
	2,100	213	278	447	546	873	1,223	1,760	4,454	<b>11,894</b>
Effect of discounting										
Claims previously discounted	(19)	(4)	(4)	(4)	(2)	(3)	(4)	(6)	(11)	<b>(57)</b>
New discounted claims	(390)	–	–	–	–	–	–	–	–	<b>(390)</b>
Present value	1,691	209	274	443	544	870	1,219	1,754	4,443	<b>11,447</b>
Cumulative effect of foreign exchange movements	–	42	63	115	123	153	224	220	–	<b>940</b>
Effect of acquisitions	–	10	10	43	19	26	29	44	26	<b>207</b>
Present value recognised in the balance sheet	<b>1,691</b>	<b>261</b>	<b>347</b>	<b>601</b>	<b>686</b>	<b>1,049</b>	<b>1,472</b>	<b>2,018</b>	<b>4,469</b>	<b>12,594</b>

The effect of discounting on new discounted claims relates to the discounting of latent claims introduced for the first time in 2008.

In the loss development tables shown above, the cumulative claim payments and estimates of cumulative claims for each accident year are translated into sterling at the exchange rates that applied at the end of that accident year. The impact of using varying exchange rates is shown at the bottom of each table. Disposals are dealt with by treating all outstanding and IBNR claims of the disposed entity as “paid” at the date of disposal.

The loss development tables above include information on asbestos and environmental pollution claims provisions from business written before 2001. The undiscounted claim provisions, net of reinsurance, in respect of this business at 31 December 2008 were £1,019 million (2007: £323 million). The movement in the year reflects exceptional strengthening of provisions by £668 million due to the increased market trend in mesothelioma claim notifications, other strengthening of £16 million (2007: £20 million), foreign exchange rate movements and timing differences between claim payments and reinsurance recoveries.

## 38 – Insurance liabilities continued

### (e) Provision for unearned premiums

#### Movements

The following changes have occurred in the provision for unearned premiums (UPR) during the year:

	2008 £m	2007 £m
<b>Carrying amount at 1 January</b>	<b>5,484</b>	5,182
Premiums written during the year	<b>11,934</b>	11,369
Less: Premiums earned during the year	<b>(12,322)</b>	(11,345)
Changes in UPR recognised as (income)/expense	<b>(388)</b>	24
Gross portfolio transfers and acquisitions	<b>(11)</b>	87
Foreign exchange rate movements	<b>408</b>	191
<b>Carrying amount at 31 December</b>	<b>5,493</b>	5,484

## 39 – Liability for investment contracts

*This note analyses our investment contract liabilities by type of product and describes how we calculate these liabilities and what assumptions we have used.*

### (a) Carrying amount

The liability for investment contracts at 31 December comprised:

	2008 £m	2007 £m
<b>Long-term business</b>		
Participating contracts	<b>65,278</b>	53,609
Non-participating contracts at fair value	<b>39,509</b>	43,608
Non-participating contracts at amortised cost	<b>2,772</b>	1,027
	<b>42,281</b>	44,635
<b>Total</b>	<b>107,559</b>	98,244

### (b) Long-term business investment liabilities

Investment contracts are those that do not transfer significant insurance risk from the contract holder to the issuer, and are therefore treated as financial instruments under IFRS.

Many investment contracts contain a discretionary participation feature in which the contract holder has a contractual right to receive additional benefits as a supplement to guaranteed benefits. These are referred to as participating contracts and are measured according to the methodology and Group practice for long-term business liabilities as described in note 38. They are not measured at fair value as there is currently no agreed definition of fair valuation for discretionary participation features under IFRS. In the absence of such a definition, it is not possible to provide a range of estimates within which a fair value is likely to fall. The IASB has deferred consideration of participating contracts to Phase II of its insurance contracts project.

For participating business, the discretionary participation feature is recognised separately from the guaranteed element and is classified as a liability, referred to as unallocated distributable surplus. Guarantees on long-term investment products are discussed in note 40.

Investment contracts that do not contain a discretionary participation feature are referred to as non-participating contracts and the liability is measured at either fair value or amortised cost.

Most non-participating investment contracts measured at fair value are unit-linked in structure and the fair value liability is equal to the unit reserve plus additional non-unit reserves if required on a fair value basis. For this business, a deferred acquisition cost asset and deferred income reserve liability are recognised in respect of transaction costs and front-end fees respectively, that relate to the provision of investment management services, and which are amortised on a systematic basis over the contract term. The amount of the related deferred acquisition cost asset is shown in note 26 and the deferred income liability is shown in note 49.

## Notes to the consolidated financial statements continued

## 39 – Liability for investment contracts continued

In the United States, funding agreements consist of one to ten year fixed rate contracts. These contracts may not be cancelled by the holders unless there is a default under the agreement, but may be terminated by Aviva at any time. The weighted average interest rates for fixed-rate and floating-rate funding agreements in 2008 were 4.89% and 2.58% (2007: 5.21% and 5.15%) respectively. The funding agreements issued before 2008 are measured at fair value equal to the present value of contractual cash flows, and for new business in 2008 are measured at amortised cost. Most funding agreements are fully collateralised and therefore their fair values are not adjusted for own credit risk.

There is a small volume of annuity certain business for which the liability is measured at amortised cost using the effective interest method.

The fair value of contract liabilities measured at amortised cost is not materially different from the amortised cost liability.

**(c) Movements in the year**

The following movements have occurred in the year:

**(i) Participating investment contracts**

	2008 £m	2007 £m
<b>Carrying amount at 1 January</b>	<b>53,609</b>	49,400
Provisions in respect of new business	3,391	3,009
Expected change in existing business provisions	(1,909)	(1,978)
Variance between actual and expected experience	(4,661)	(404)
Impact of operating assumption changes	(166)	(3)
Impact of economic assumption changes	244	178
Effect of special bonus to with-profit policyholders (note 43b)	–	399
Other movements	13	(176)
Change in liability recognised as an expense	(3,088)	1,025
Effect of portfolio transfers, acquisitions and disposals	2,181	–
Foreign exchange rate movements	12,576	3,184
<b>Carrying amount at 31 December</b>	<b>65,278</b>	53,609

The effect of changes in main assumptions is given in note 42.

**(ii) Non-participating investment contracts**

	2008 £m	2007 £m
<b>Carrying amount at 1 January</b>	<b>44,635</b>	38,958
Provisions in respect of new business	5,314	8,575
Expected change in existing business provisions	(2,273)	(1,094)
Variance between actual and expected experience	(9,503)	(3,231)
Impact of operating assumption changes	(28)	(2)
Impact of economic assumption changes	5	20
Other movements	(169)	61
Change in liability	(6,654)	4,329
Effect of portfolio transfers, acquisitions and disposals	(14)	254
Foreign exchange rate movements	4,314	1,094
<b>Carrying amount at 31 December</b>	<b>42,281</b>	44,635

The negative variance between actual and expected experience relates mainly to lower than expected investment returns on unit funds.

The effect of changes in main assumptions is given in note 42.



## 40 – Financial guarantees and options

*This note details the financial guarantees and options we have given for some of our insurance and investment products.*

As a normal part of their operating activities, various Group companies have given guarantees and options, including investment return guarantees, in respect of certain long-term insurance and fund management products. Further information on assumptions is given in notes 38 and 39.

### (a) UK Life with-profit business

In the UK, life insurers are required to comply with the FSA's realistic reporting regime for their with-profit funds for the calculation of FSA liabilities. Under the FSA's rules, provision for guarantees and options within realistic liabilities must be measured at fair value, using market-consistent stochastic models. A stochastic approach includes measuring the time value of guarantees and options, which represents the additional cost arising from uncertainty surrounding future economic conditions.

The material guarantees and options to which this provision relates are:

#### (i) Maturity value guarantees

Substantially all of the conventional with-profit business and a significant proportion of unitised with-profit business have minimum maturity values reflecting the sums assured plus declared annual bonus. In addition, the guarantee fund has offered maturity value guarantees on certain unit-linked products. For some unitised with-profit life contracts the amount paid after the fifth policy anniversary is guaranteed to be at least as high as the premium paid increased in line with the rise in RPI/CPI.

#### (ii) No market valuation reduction (MVR) guarantees

For unitised business, there are a number of circumstances where a "no MVR" guarantee is applied, for example on certain policy anniversaries, guaranteeing that no market value reduction will be applied to reflect the difference between the accumulated value of units and the market value of the underlying assets.

#### (iii) Guaranteed annuity options

The Group's UK with-profit funds have written individual and group pension contracts which contain guaranteed annuity rate options (GAOs), where the policyholder has the option to take the benefits from a policy in the form of an annuity based on guaranteed conversion rates. The Group also has exposure to GAOs and similar options on deferred annuities.

#### (iv) Guaranteed minimum pension

The Group's UK with-profit funds also have certain policies that contain a guaranteed minimum level of pensions as part of the condition of the original transfer from state benefits to the policy.

In addition, while these do not constitute guarantees, the with-profit fund companies have made promises to certain policyholders in relation to their with-profit mortgage endowments. Subject to certain conditions, top-up payments will be made on these policies at maturity to meet the mortgage value up to a maximum of the 31 December 1999 illustrated shortfall.

### (b) UK Life non-profit business

The Group's UK non-profit funds are evaluated by reference to statutory reserving rules, including changes introduced in 2006 under FSA Policy Statement 06/14 *Prudential Changes for Insurers*.

#### (i) Guaranteed annuity options

Similar options to those written in the with-profit fund have been written in relation to non-profit products. Provision for these guarantees does not materially differ from a provision based on a market-consistent stochastic model, and amounts to £27 million at 31 December 2008 (2007: £36 million).

#### (ii) Guaranteed unit price on certain products

Certain unit-linked pension products linked to long-term life insurance funds provide policyholders with guaranteed benefits at retirement or death. No additional provision is made for this guarantee as the investment management strategy for these funds is designed to ensure that the guarantee can be met from the fund, mitigating the impact of large falls in investment values and interest rates.

### (c) Overseas life businesses

In addition to guarantees written in the Group's UK life businesses, our overseas businesses have also written contracts containing guarantees and options. Details of the significant guarantees and options provided by overseas life businesses are set out below.

## Notes to the consolidated financial statements continued

## 40 – Financial guarantees and options continued

## (i) France

*Guaranteed surrender value and guaranteed minimum bonuses*

Aviva France has written a number of contracts with such guarantees. The guaranteed surrender value is the accumulated value of the contract including accrued bonuses. Bonuses are based on accounting income from amortised bond portfolios, where the duration of bond portfolios is set in relation to the expected duration of the policies, plus income and releases from realised gains on equity-type investments. Policy reserves are equal to guaranteed surrender values. Local statutory accounting envisages the establishment of a reserve, "Provision pour Aléas Financiers" (PAF), when accounting income is less than 125% of guaranteed minimum credited returns. No PAF was established at the end of 2008.

The most significant of these contracts is the AFER Eurofund which has total liabilities of £33 billion at 31 December 2008 (2007: £24 billion). The guaranteed bonus on this contract equals 75% of the average of the last two years' declared bonus rates and was 3.66% for 2008 (2007: 3.64%) compared with an accounting income from the fund of 4.85% (2007: 4.92%).

Non-AFER contracts with guaranteed surrender values had liabilities of £12 billion (2007: £8 billion) at 31 December 2008 and all guaranteed annual bonus rates are between 0% and 4.5%. For non-AFER business, the accounting income return exceeded guaranteed bonus rates in 2008.

*Guaranteed death and maturity benefits*

In France, the Group has also sold unit-linked policies where the death and/or maturity benefit is guaranteed to be at least equal to the premiums paid. The reserve held in the Group's consolidated balance sheet at the end of 2008 for this guarantee is £113 million (2007: £30 million). The reserve is calculated on a prudent basis and is in excess of the economic liability. At the end of 2008, total sums at risk for these contracts were £1,279 million (2007: £63 million) out of total unit-linked funds of £14 billion (2007: £15 billion). The average age of policyholders was approximately 53. It is estimated that this liability would increase by £59 million (2007: £17 million) if yields were to decrease by 1% per annum and by £22 million (2007: £7 million) if equity markets were to decline by 10% from year end 2008 levels. These figures do not reflect our ability to review the tariff for this option.

## (ii) Netherlands

*Guaranteed minimum return at maturity*

In the Netherlands, it is market practice to guarantee a minimum return at maturity on traditional savings and pension contracts. Guarantees on older lines of business are 4% per annum while, for business written since 1 September 1999, the guarantee is 3% per annum. On Group pensions business, it is often possible to recapture guarantee costs through adjustments to surrender values or to premium rates.

On transition to IFRS, Delta Lloyd changed the reserving basis for most traditional contracts to reflect current market interest rates, for consistency with the reporting of assets at market value. The cost of meeting interest rate guarantees is allowed for directly in the liabilities. Although most traditional contracts are valued at market interest rate, the split by level of guarantee shown below is according to the original underlying guarantee.

The total liabilities for traditional business at 31 December 2008 are £14 billion (2007: £10 billion) analysed as follows:

	Liabilities 3% guarantee 31 December 2008 £m	Liabilities 3% guarantee 31 December 2007 £m	Liabilities 4% guarantee 31 December 2008 £m	Liabilities 4% guarantee 31 December 2007 £m
Individual	2,214	1,387	4,684	3,671
Group pensions	689	485	6,804	3,993
<b>Total</b>	<b>2,903</b>	<b>1,872</b>	<b>11,488</b>	<b>7,664</b>

Delta Lloyd has certain unit-linked contracts which provide a guaranteed minimum return at maturity from 4% pa to 2% pa. Provisions consist of unit values plus an additional reserve for the guarantee. The additional provision for the guarantee was £226 million (2007: £70 million). An additional provision of £121 million (2007: £19 million) in respect of investment return guarantees on group segregated fund business is held. It is estimated that the provision would increase by £255 million (2007: £211 million) if yields were to reduce by 1% pa and by £56 million (2007: £21 million) if equity markets were to decline by 10% from year end 2008 levels.

## 40 – Financial guarantees and options continued

### (iii) Ireland

#### *Guaranteed annuity options*

Products with similar GAOs to those offered in the UK have been issued in Ireland. The current net of reinsurance provision for such options is £180 million (2007: £160 million). This has been calculated on a deterministic basis, making conservative assumptions for the factors which influence the cost of the guarantee, principally annuitant mortality option take-up and long-term interest rates.

These GAOs are “in the money” at current interest rates but the exposure to interest rates under these contracts has been hedged through the use of reinsurance, using derivatives (swaptions). The swaptions effectively guarantee that an interest rate of 5% will be available at the vesting date of these benefits so there is reduced exposure to a further decrease in interest rates.

#### *“No MVR” guarantees*

Certain unitised with-profit policies containing “no MVR” guarantees, similar to those in the UK, have been sold in Ireland.

These guarantees are currently “in-the-money” by £16 million (2007: “out-of-the-money” by £53 million). This has been calculated on a deterministic basis as the excess of the current policy surrender value over the discounted value (excluding terminal bonus) of the guarantees. The value of these guarantees is usually sensitive to the performance of investments held in the with-profit fund. Amounts payable under these guarantees are determined by the bonuses declared on these policies. It is estimated that the guarantees would be “in-the-money” by £16 million (2007: “out-of-the-money” by £46 million) if yields were to increase by 1% per annum and by £16 million (2007: “out-of-the-money” by £29 million) if equity markets were to decline by 10% from year end 2008 levels. There is no sensitivity to either interest rates or equity markets since there is no longer any exposure to equity in these funds and a matching strategy has been implemented for bonds.

#### *Return of premium guarantee*

Until 2005, Hibernian Life wrote two tranches of linked bonds with a return of premium guarantee, or a price floor guarantee, after five or six years. The provision for these over and above unit and sterling reserves, at the end of 2008 is £18 million (2007: £0.1 million).

It is estimated that the provision would increase by £4 million (2007: £1 million) if equity markets were to decline by 10% from the year end 2008 levels. However, the provision increase would be broadly off-set by an increase in the value of the hedging assets that were set up on sale of these policies. We would not expect any significant impact on this provision as a result of interest rate movements. It is estimated that the provision would increase by £2 million if property values were to decline by 10% from year end 2008 levels. This would be offset by an increase in the value of the hedging assets by £1 million, the difference reflecting the fact that only the second tranche was hedged for property exposure.

### (iv) Spain and Italy

#### *Guaranteed investment returns and guaranteed surrender values*

The Group has also written contracts containing guaranteed investment returns and guaranteed surrender values in both Spain and Italy. Traditional profit-sharing products receive an appropriate share of the investment return, assessed on a book value basis, subject to a guaranteed minimum annual return of up to 6% in Spain and 4% in Italy on existing business, while on new business the maximum guaranteed rate is lower. Liabilities are generally taken as the face value of the contract plus, if required, an explicit provision for guarantees calculated in accordance with local regulations. At 31 December 2008, total liabilities for the Spanish business were £5 billion (2007: £4 billion) with a further reserve of £19 million (2007: £16 million) for guarantees.

Total liabilities for the Italian business were £5 billion (2007: £4 billion), with a further provision of £55 million (2007: £48 million) for guarantees. Liabilities are most sensitive to changes in the level of interest rates. It is estimated that provisions for guarantees would need to increase by £59 million (2007: £66 million) in Spain and £5 million (2007: £14 million) in Italy if interest rates fell by 1% from end 2008 values. Under this sensitivity test, the guarantee provision in Spain is calculated conservatively, assuming a long-term market interest rate of 1.6% and no lapses or premium discontinuances.

### (v) United States

#### *Indexed and total return strategy products*

In the United States, the Group writes indexed life and deferred annuity products. These products guarantee the return of principal to the policyholder and credit interest based on certain indices, primarily the Standard & Poor's 500 Composite Stock Price Index. A portion of each premium is used to purchase derivatives to hedge the growth in interest credited to the policyholder. The derivatives held by the Group and the options embedded in the policy are both carried at fair value. The US Treasury swap curve plus a risk adjustment of 5.30% (2007: 1.05%) is used as the discount rate to calculate the fair value of the embedded options.

## Notes to the consolidated financial statements continued

## 40 – Financial guarantees and options continued

The risk adjustment calculation is based on market spreads on senior long-term unsecured Aviva plc debt with a reduction to reflect policyholder priority over other creditors in case of default. The amount of change in the fair value of these embedded options resulting from the risk adjustment in 2008 is £514 million, and is principally attributable to market factors rather than instrument specific credit risk. There were no significant gains or losses attributable to the risk adjustment or instrument specific credit risk for these embedded options in 2007. At 31 December 2008, the total liabilities for indexed products were £15 billion (2007: £8 billion), including liabilities for the embedded option of £1.9 billion (2007: £1.2 billion). If interest rates were to increase by 1%, the provision for embedded options would decrease by £138 million (2007: £89 million) and, if interest rates were to decrease by 1%, the provision would increase by £155 million (2007: £86 million).

The Group has certain products that credit interest based on a total return strategy, whereby policyholders are allowed to allocate their premium payments to different asset classes within the general account. The Group guarantees a minimum return of premium plus approximately 3% interest over the term of the contracts. The linked general account assets are fixed maturity securities, and both the securities and the contract liabilities are carried at fair value. At 31 December 2008, the liabilities for total return strategy products were £1.5 billion (2007: £1.2 billion).

The Group offers an optional lifetime guaranteed income benefit focused on the retirement income segment of the deferred annuity marketplace to help customers manage income during both the accumulation stage and the distribution stage of their financial life. At 31 December 2008, a total of £3.2 billion (2007: £0.7 billion) in indexed deferred annuities have elected this benefit taking steps to guarantee retirement income.

**(d) Sensitivity**

In providing these guarantees and options, the Group's capital position is sensitive to fluctuations in financial variables including foreign currency exchange rates, interest rates, real estate prices and equity prices. Interest rate guaranteed returns, such as those available on guaranteed annuity options (GAOs), are sensitive to interest rates falling below the guaranteed level. Other guarantees, such as maturity value guarantees and guarantees in relation to minimum rates of return, are sensitive to fluctuations in the investment return below the level assumed when the guarantee was made.

## 41 – Reinsurance assets

*This note details the reinsurance recoverables on our insurance and investment contract liabilities.*

**(a) Carrying amounts**

The reinsurance assets at 31 December comprised:

	2008 £m	Restated 2007 £m
<b>Long-term business</b>		
Insurance contracts	4,466	4,298
Participating investment contracts	52	22
Non-participating investment contracts	1,047	1,461
Outstanding claims provisions	145	94
	<b>5,710</b>	<b>5,875</b>
<b>General insurance and health</b>		
Outstanding claims provisions	1,737	1,634
Provisions for claims incurred but not reported	29	29
	<b>1,766</b>	<b>1,663</b>
Provision for unearned premiums	418	511
Other technical provisions	–	5
	<b>2,184</b>	<b>2,179</b>
<b>Total</b>	<b>7,894</b>	<b>8,054</b>

Of the above total, £6,097 million (2007: £4,796 million) is expected to be recovered more than one year after the balance sheet date.

## 41 – Reinsurance assets continued

### (b) Assumptions

The assumptions, including discount rates, used for reinsurance contracts follow those used for insurance contracts.

Reinsurance assets are valued net of an allowance for their recoverability.

### (c) Movements

The following movements have occurred in the reinsurance asset during the year:

#### (i) In respect of long-term business provisions

	2008 £m	2007 £m
<b>Carrying amount at 1 January</b>	<b>5,781</b>	<b>5,534</b>
Asset in respect of new business	235	216
Expected change in existing business asset	243	(124)
Variance between actual and expected experience	(1,141)	52
Impact of other operating assumption changes	(761)	14
Impact of economic assumption changes	306	(122)
Other movements	(231)	(40)
Change in asset	(1,349)	(4)
Effect of portfolio transfers, acquisitions and disposals	140	24
Foreign exchange rate movements	993	227
<b>Carrying amount at 31 December</b>	<b>5,565</b>	<b>5,781</b>

#### (ii) In respect of general insurance and health outstanding claims provisions and IBNR

	2008 £m	Restated 2007 £m
<b>Carrying amount at 1 January as published</b>	<b>1,663</b>	<b>1,738</b>
Prior year adjustment – impact of discounting on latent claims (note 2b(i))	–	(61)
<b>Carrying amount at 1 January restated</b>	<b>1,663</b>	<b>1,677</b>
Impact of changes in assumptions	21	–
Exceptional strengthening of latent claims provisions (see below)	52	–
Reinsurers' share of claim losses and expenses		
Incurred in current year	228	169
Incurred in prior years	12	12
Reinsurers' share of incurred claim losses and expenses	240	181
Less:		
Reinsurance recoveries received on claims		
Incurred in current year	(107)	(75)
Incurred in prior years	(257)	(223)
Reinsurance recoveries received in the year	(364)	(298)
Unwind of discounting	24	26
Change in reinsurance asset recognised as income	(27)	(91)
Effect of portfolio transfers, acquisitions and disposals	27	39
Foreign exchange rate movements	105	42
Other movements	(2)	(4)
	<b>1,766</b>	<b>1,663</b>

The one-off strengthening of latent claims reserves during 2008, described in note 38(c)(iii), resulted in an increase in the reinsurers' share of claims and losses of £52 million.



## Notes to the consolidated financial statements continued

## 41 – Reinsurance assets continued

## (iii) Reinsurers' share of the provision for unearned premiums (UPR)

	2008 £m	2007 £m
<b>Carrying amount at 1 January</b>	<b>511</b>	484
Premiums ceded to reinsurers in the year	<b>798</b>	800
Less: Reinsurers' share of premiums earned during the year	<b>(909)</b>	(797)
Changes in reinsurance asset recognised as income	<b>(111)</b>	3
Reinsurers' share of portfolio transfers and acquisitions	<b>8</b>	18
Foreign exchange rate movements	<b>10</b>	6
<b>Carrying amount at 31 December</b>	<b>418</b>	511

## 42 – Effect of changes in assumptions and estimates during the year

*Certain estimates and assumptions used in determining our liabilities for insurance and investment contract business were changed from 2007 to 2008, and this affected the profit recognised for the year with an equivalent effect on liabilities. This note analyses the effect of the changes.*

This disclosure only allows for the impact on liabilities and related assets, such as reinsurance, deferred acquisition costs and AVIF, and does not allow for offsetting movements in the value of backing financial assets.

	Effect on profit 2008 £m	Effect on profit 2007 £m
<b>Assumptions</b>		
<b>Long-term insurance business</b>		
Interest rates	<b>(521)</b>	850
Expenses	<b>24</b>	(13)
Persistency rates	<b>2</b>	(2)
Mortality for assurance contracts	<b>44</b>	16
Mortality for annuity contracts	<b>26</b>	11
Tax and other assumptions	<b>93</b>	60
<b>Investment contracts</b>		
Interest rates	<b>(75)</b>	12
Expenses	<b>(27)</b>	5
Persistency rates	<b>2</b>	–
Tax and other assumptions	<b>36</b>	7
<b>General insurance and health business</b>		
Change in loss ratio assumptions	<b>(1)</b>	–
Change in discount rate assumptions	<b>(94)</b>	3
Change in expense ratio assumptions	<b>–</b>	(4)
<b>Total</b>	<b>(491)</b>	945

The impact of interest rates for long-term business relates primarily to the UK, Ireland and the Netherlands, driven by the market level of risk-free rates. Lower valuation interest rates in 2008 had the effect of increasing liabilities for traditional business and hence a negative impact on profit. This follows an increase in market interest rates in 2007 which had the reverse effect. The overall impact on profit also depends on movements in the value of assets backing the liabilities, which is not included in this disclosure.

Favourable impacts from expense and mortality assumption changes for insurance contracts relate mainly to the UK. Other assumption changes include further implementation of FSA Policy Statement PS06/14 for non-profit business and expense inflation adjustments in the UK, and reserve releases in Asia, partly offset by compensation for unit-linked policies in the Netherlands.

## 43 – Unallocated divisible surplus

*An unallocated divisible surplus (UDS) is established where the nature of policy benefits is such that the division between shareholder reserves and policyholder liabilities is uncertain. This note shows the movements in this surplus during the year.*

### (a) Movements

The following movements have occurred in the year:

	2008 £m	2007 £m
<b>Carrying amount at 1 January</b>	<b>6,785</b>	<b>9,465</b>
Change in participating contract assets	<b>(12,022)</b>	2,463
Change in participating contract liabilities	<b>7,699</b>	(3,244)
Effect of special bonus to with-profit policyholders (see below)	<b>(89)</b>	(2,127)
Other movements	<b>(70)</b>	(14)
Change in liability recognised as an expense	<b>(4,482)</b>	(2,922)
Effect of portfolio transfers, acquisitions and disposals	–	3
Movement in respect of change in pension scheme deficit (note 46c(i))	<b>(78)</b>	61
Foreign exchange rate movements	<b>88</b>	173
Other movements	<b>12</b>	5
<b>Carrying amount at 31 December</b>	<b>2,325</b>	<b>6,785</b>

In France, Italy and Spain the UDS balances were £924 million negative in total at 31 December 2008 (2007: £116 million negative) because of an accounting mismatch between participating assets carried at market value and participating liabilities measured using local practice. In each case the negative balance is considered to be recoverable from margins in the existing participating business liabilities.

### (b) Special bonus declared by UK Life business

On 5 February 2008, the Group's UK long-term business operation, Norwich Union Life, announced a one-off, special bonus worth an estimated £2.3 billion, benefiting around 1.1 million with-profit policyholders in its CGNU Life and CULAC with-profit funds. The bonus is being used to enhance policy values by around 10% in total, in three instalments, with the qualifying dates being 1 January 2008, 1 January 2009 and 1 January 2010. In accordance with the way the funds are managed, the bonus distribution is being split on a 90/10 basis between policyholders and shareholders. Over the three years, policyholders will receive a total currently estimated as £2,127 million and shareholders will receive a total currently estimated as £236 million.

As explained in accounting policies F and K, the Group's insurance and participating investment contract liabilities are measured in accordance with IFRS 4, *Insurance Contracts*, and FRS 27, *Life Assurance*. The latter requires liabilities for with-profit funds falling within the scope of the UK's Financial Services Authority's capital regime to be determined in accordance with this regime, adjusted to remove the shareholders' share of future bonuses. This required us to recognise planned discretionary bonuses within policyholder liabilities at 31 December 2007, even if there was no constructive obligation at the time. As a result of the announcement made above, a transfer of £2,127 million was made in 2007 from the UDS in order to increase insurance liabilities by £1,728 million (note 38(b)) and participating investment contract liabilities by £399 million (note 39(c)). Of the £236 million due to shareholders, £89 million has been transferred from the UDS in 2008 (2007: £nil).

## Notes to the consolidated financial statements continued

## 44 – Tax assets and liabilities

*This note analyses the tax assets and liabilities that appear in the balance sheet, and explains the movements in these balances in the year.*

**(a) Current tax**

Current tax assets and liabilities payable in more than one year are £230 million and £362 million (2007: £223 million and £769 million).

The taxation of foreign profits and worldwide debt cap rules has been the subject of consultation for some considerable time and HMRC are expected to announce measures in the Finance Bill 2009. It is not possible to quantify the impact of these measures at the balance sheet date.

**(b) Deferred tax**

**(i)** The balances at 31 December comprise:

	2008 £m	2007 £m
Deferred tax assets	2,642	590
Deferred tax liabilities	(3,020)	(2,532)
Net deferred tax liability	(378)	(1,942)

**(ii)** The net deferred tax liability arises on the following items:

	2008 £m	2007 £m
Long-term business technical provisions and other insurance items	467	905
Deferred acquisition costs	(769)	(170)
Unrealised gains/(losses) on investments	724	(1,577)
Pensions and other post-retirement obligations	109	79
Unused losses and tax credits	702	465
Subsidiaries, associates and joint ventures	6	(194)
Intangibles and additional value of in-force long-term business	(1,090)	(811)
Provisions and other temporary differences	(527)	(639)
Net deferred tax liability	(378)	(1,942)

## 44 – Tax assets and liabilities continued

(iii) The movement in the net deferred tax liability was as follows:

	2008 £m	2007 £m
<b>Net liability at 1 January</b>	<b>(1,942)</b>	(1,878)
Acquisition and disposal of subsidiaries	(13)	(185)
Amounts credited to profit (note 13a)	1,726	442
Amounts credited/(charged) to equity (note 13b)	219	(198)
Exchange differences	(101)	(37)
Other movements	(267)	(86)
<b>Net liability at 31 December</b>	<b>(378)</b>	(1,942)

Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised. In countries where there is a history of tax losses, deferred tax assets are only recognised in excess of deferred tax liabilities if there is convincing evidence that future profits will be available. Where this is the case the directors have relied on business plans supporting future profits.

The Group has unrecognised tax losses and other temporary differences of £2,961 million (2007: £1,805 million) to carry forward against future taxable income of the necessary category in the companies concerned. Of these, trading losses of £279 million will expire in the next 5-15 years. The remaining losses have no expiry date.

In addition, the Group has an unrecognised capital loss of £556 million (2007: £409 million). This tax loss can be offset against future capital gains and has no expiry date.

Deferred tax liabilities of £912 million (2007: £666 million) have not been established for temporary differences associated with investments in subsidiaries and interests in joint ventures and associates (including tax payable on remittance of overseas retained earnings) because the Group can control the timing of the reversal of these differences and it is probable that they will not reverse in the foreseeable future. Such unremitted earnings totalled £6,121 million at 31 December 2008 (2007: £4,258 million).

## 45 – Provisions

*This note details the non-insurance provisions that the Group holds, and shows the movements in these during the year.*

### (a) Carrying amounts

	2008 £m	2007 £m
Deficits in the staff pension schemes (note 46e(vii))	613	205
Other obligations to staff pension schemes – insurance policies issued by Group companies (note 46e(vii))	1,402	1,025
Total IAS 19 obligations to staff pension schemes	2,015	1,230
Restructuring provision	253	135
Other provisions	722	572
Less amounts held for sale	(6)	–
<b>Total</b>	<b>2,984</b>	1,937

Of the total, £2,328 million (2007: £1,277 million) is expected to be settled more than one year after the balance sheet date.

## Notes to the consolidated financial statements continued

## 45 – Provisions continued

## (b) Movements on restructuring and other provisions

	Restructuring provision £m	Other provisions £m	Total £m
<b>At 1 January 2007</b>	234	501	735
Additional provisions	198	174	372
Unused amounts reversed	–	(11)	(11)
Change in the discounted amount arising from passage of time	–	5	5
Charge to income statement	198	168	366
Utilised during the year	(300)	(101)	(401)
Acquisition of subsidiaries	–	1	1
Foreign exchange rate movements	3	3	6
<b>At 31 December 2007</b>	135	572	707
Additional provisions	355	307	662
Unused amounts reversed	(9)	(73)	(82)
Change in the discounted amount arising from passage of time	–	5	5
Charge to income statement	346	239	585
Utilised during the year	(248)	(193)	(441)
Acquisition of subsidiaries	–	39	39
Foreign exchange rate movements	20	65	85
<b>At 31 December 2008</b>	<b>253</b>	<b>722</b>	<b>975</b>

Other provisions comprise many small provisions throughout the Group for obligations such as costs of compensation, litigation, staff entitlements and reorganisation.

## 46 – Pension obligations

*This note describes the Group's pension arrangements for its employees and explains how our obligations to these schemes are calculated.*

## (a) Introduction

The Group operates a large number of defined benefit and defined contribution pension schemes around the world. The only material defined benefit schemes are in the UK, the Netherlands, Canada and Ireland and, of these, the main UK scheme is by far the largest.

The assets of the main UK, Irish and Canadian schemes are held in separate trustee-administered funds to meet long-term pension liabilities to past and present employees. In the Netherlands, the main scheme is held in a separate foundation which invests in the life funds of the Group. In all schemes, the appointment of trustees of the funds is determined by their trust documentation, and they are required to act in the best interests of the schemes' beneficiaries. The long-term investment objectives of the trustees and the employers are to limit the risk of the assets failing to meet the liabilities of the schemes over the long term, and to maximise returns consistent with an acceptable level of risk so as to control the long-term costs of these schemes.

A full actuarial valuation of each of the defined benefit schemes is carried out at least every three years for the benefit of scheme trustees and members. Actuarial reports have been submitted for each scheme within this period, using appropriate methods for the respective countries on local funding bases.

## (b) Membership

The number of scheme members at 31 December 2008 was as follows:

	United Kingdom		Netherlands		Canada		Ireland	
	2008 Number	2007 Number	2008 Number	2007 Number	2008 Number	2007 Number	2008 Number	2007 Number
Active members	9,972	10,532	4,920	5,048	889	960	1,180	1,157
Deferred members	53,376	53,953	5,739	5,015	529	617	842	830
Pensioners	27,749	27,176	3,014	2,815	1,280	1,350	682	674
<b>Total members</b>	<b>91,097</b>	91,661	<b>13,673</b>	12,878	<b>2,698</b>	2,927	<b>2,704</b>	2,661



## 46 – Pension obligations continued

### (c) Main UK scheme

In the UK, the Group operates two main pension schemes, the Aviva Staff Pension Scheme (ASPS) and the smaller RAC (2003) Pension Scheme. New entrants join the defined contribution section of the ASPS, as the defined benefit section is closed to new employees. This scheme is operated by a trustee company, with 11 trustee directors, comprising representatives of the employers, staff, pensioners and an independent trustee (referred to below as the trustees).

#### (i) Defined benefit section of the ASPS

The Company works closely with the trustees who are required to consult it on the funding of the scheme and its investment strategy. Following each actuarial valuation, the Company and the trustees agree the level of contributions needed. At 31 March 2006, the date of the last actuarial valuation, this section of the scheme had an excess of obligations over available assets, on a funding basis, of £1,019 million. The Company has agreed with the trustees a funding plan through to March 2014, over which it will aim to eliminate the funding deficit. Funding levels are monitored on an annual basis.

The employing companies' contributions to the defined benefit section of the ASPS throughout 2008 were 39% of employees' pensionable salaries, together with the cost of redundancies during the year, and additional deficit funding payments totalling £369 million. As this section of the scheme is closed to new entrants and the contribution rate is determined using the projected unit credit method, it is expected that the percentage cost of providing future service benefits will continue to increase as the membership ages, leading to higher pension costs, and the number of members falls, leading to a higher charge per member. The employers' contribution rate for 2009 has therefore been increased to 41% of pensionable salaries (expected to be £147 million), pending finalisation of the March 2009 valuation. Active members of this section of the ASPS contribute 5% of their pensionable salaries, increasing to either 6% or 7.5% from 1 July 2009.

In 2006, the Group's UK life business carried out an investigation into the allocation of costs in respect of funding the ASPS, to identify the deficit that arose in respect of accruals prior to the introduction of the current management services agreements (MSAs) and to propose a split between individual product companies based on an allocation of the deficit into pre- and post-MSA amounts. The results of this review were agreed by the relevant company boards and accepted by the UK regulator. Consequently, with effect from 1 January 2006, the Company's UK with-profit product companies are liable for a share, currently 12%, of the additional payments for deficit funding referred to above. This has resulted in movements between the unallocated divisible surplus (UDS) and retained earnings via the statement of recognised income of £78 million in 2008 (2007: £61 million) to reflect actuarial movements in the deficit during the year and therefore a change in the amount recoverable from the with-profit product companies.

#### (ii) Defined contribution (money purchase) section of the ASPS

The trustees have responsibility for selecting a range of suitable funds in which the members can choose to invest and for monitoring the performance of the available investment funds. Members are responsible for reviewing the level of contributions they pay and the choice of investment fund to ensure these are appropriate to their attitude to risk and their retirement plans. The employers' contribution rates for members of the defined contribution section throughout 2008 were 8% of pensionable salaries, together with further contributions up to 4% where members contribute, and the cost of the death-in-service benefits. These contribution rates are unchanged for 2009.

### (d) Charges to the income statement

The total pension costs of the Group's defined benefit and defined contribution schemes were:

	2008 £m	2007 £m
UK defined benefit schemes	115	137
Overseas defined benefit schemes	60	54
Total defined benefit schemes (note 10b)	175	191
UK defined contribution schemes	39	44
Overseas defined contribution schemes	19	19
Total defined contribution schemes (note 10b)	58	63
	233	254

There were no significant contributions outstanding or prepaid as at either 31 December 2008 or 2007.

**Notes to the consolidated financial statements continued****46 – Pension obligations continued****(e) IAS 19 disclosures**

Disclosures under IAS 19 for the material defined benefit schemes in the UK, the Netherlands, Canada and Ireland are given below. Where schemes provide both defined benefit and defined contribution pensions, the assets and liabilities shown exclude those relating to defined contribution pensions. Total employer contributions for these schemes in 2009 are expected to be £241 million.

**(i) Assumptions on scheme liabilities***The projected unit credit method*

The inherent uncertainties affecting the measurement of scheme liabilities require these to be measured on an actuarial basis. This involves discounting the best estimate of future cash flows to be paid out by the scheme using the projected unit credit method. This is an accrued benefits valuation method which calculates the past service liability to members and makes allowance for their projected future earnings. It is based on a number of actuarial assumptions, which vary according to the economic conditions of the countries in which the relevant businesses are situated, and changes in these assumptions can materially affect the measurement of the pension obligations.

*Alternative measurement methods*

There are alternative methods of measuring liabilities, for example by calculating an accumulated benefit obligation (the present value of benefits for service already rendered but with no allowance for future salary increases) or on a solvency basis, using the cost of securing the benefits at a particular date with an insurance company or one of the growing market of alternative buy-out providers. This could take the form of a buy-out, in which the entire liability will be settled in one payment with all obligations transferred to an insurance company or buy-out provider, or a buy-in, in which annuities or other insurance products are purchased to cover a part or all of the liability. A valuation of the liabilities in either of these cases will almost always result in a higher estimate of the pension deficit than under an ongoing approach, as they assume that the sponsor immediately transfers the majority, if not all, of the risk to another provider who would be seeking to make a profit on the transaction. However, there are only a limited number of organisations that would be able to offer these options for schemes of the size of those in our Group. The full buy-out cost would only be known if quotes were obtained from such organisations but, to illustrate the cost of a buy-out valuation, an estimate for the main UK scheme is that the year end liabilities of £6.8 billion could be valued some £3.7 billion higher, at £10.5 billion.

There is a small buy-out market in Ireland, largely restricted to pensions currently in payment and it is not clear whether current capacity would enable an immediate buy-out of our Irish pension liabilities at present. The Canadian defined benefit plan's liabilities represent the likely limit on what the Canadian group annuity market could absorb at normal competitive group annuity prices if the entire plan were subject to a buy-out valuation. There is in fact a reasonably high chance that only a portion of the plan's liabilities could be absorbed in one tranche.

IAS 19 requires us to use the projected unit credit method to measure our pension scheme liabilities. Neither of the alternative methods is considered appropriate in presenting fairly the Group's obligations to the members of its pension schemes on an ongoing basis, so they are not considered further.

*Valuations and assumptions*

The valuations used for accounting under IAS 19 have been based on the most recent full actuarial valuations, updated to take account of that standard's requirements in order to assess the liabilities of the material schemes at 31 December 2008. The updating was made by actuaries in each country who were independent of the Group. Scheme assets are stated at their fair values at 31 December 2008.

## 46 – Pension obligations continued

The main actuarial assumptions used to calculate scheme liabilities under IAS 19 are:

	UK		Netherlands		Canada		Ireland	
	2008	2007	2008	2007	2008	2007	2008	2007
Inflation rate	<b>2.9%</b>	3.4%	<b>2.0%</b>	2.0%	<b>2.5%</b>	2.5%	<b>2.0%</b>	2.5%
General salary increases	<b>4.7%</b>	5.2%	<b>3.0%*</b>	3.0%*	<b>3.75%</b>	3.75%	<b>3.75%</b>	4.25%
Pension increases	<b>3.1%</b>	3.4%	<b>2.0%/1.3%**</b>	2.0%/2.4%**	<b>1.25%</b>	1.25%	<b>2.0%</b>	2.4%
Deferred pension increases	<b>3.1%</b>	3.4%	<b>2.0%/1.3%**</b>	2.0%/2.4%**	–	–	<b>2.0%</b>	2.4%
Discount rate	<b>6.2%</b>	5.8%	<b>5.7%</b>	5.5%	<b>6.75%</b>	5.25%	<b>5.9%</b>	5.6%
Basis of discount rate	AA-rated corporate bonds		AA-rated corporate bonds		AA-rated corporate bonds		AA-rated corporate bonds	

\* Age-related scale increases plus 3% (2007: 3%).

\*\*2.0% until 2011 and 1.3% thereafter (2007: 2.0% and 2.4% respectively).

The discount rate and pension increase rate are the two assumptions that have the largest impact on the value of the liabilities, with the difference between them being known as the net discount rate. For each country, the discount rate is based on current average yields of high quality debt instruments taking account of the maturities of the defined benefit obligations. A 1% increase in this rate (and therefore the net discount rate) would reduce the liabilities by £1.4 billion and the service cost for the year by £24 million.

### Mortality assumptions

Mortality assumptions are significant in measuring the Group's obligations under its defined benefit schemes, particularly given the maturity of these obligations in the material schemes. The assumptions used are summarised in the table below and have been selected to reflect the characteristics and experience of the membership of these schemes.

The mortality tables, average life expectancy and pension duration used at 31 December 2008 for scheme members are as follows:

		Life expectancy/pension duration at NRA of a male			Life expectancy/pension duration at NRA of a female	
		Normal retirement age (NRA)	Currently aged NRA	20 years younger than NRA	Currently aged NRA	20 years younger than NRA
Mortality table						
UK	PA92U2009MC with a one year age rating deduction and including an allowance for future improvements	60	89.3 (29.3)	92.2 (32.2)	91.7 (31.7)	93.8 (33.8)
Netherlands	CRC8b, which includes allowance for future improvements up to 2050	65	83.3 (18.3)	84.9 (19.9)	86.1 (21.1)	86.8 (21.8)
Canada	UP1994 projected to 2015, using Scale AA	65	84.0 (19.0)	84.0 (19.0)	86.6 (21.6)	86.6 (21.6)
Ireland	PA92C2020 (current pensioners)/2040 (future pensioners) with allowance for future improvements	65	84.4 (19.4)	85.7 (20.7)	87.4 (22.4)	88.7 (23.7)

The assumptions above are based on commonly-used mortality tables. In the UK, the standard mortality tables have been adjusted to reflect recent research into mortality experience. However, the extent of future improvements in longevity is subject to considerable uncertainty and judgement is required in setting this assumption. In the UK schemes, which are by far the most material to the Group, the assumptions include an allowance for future mortality improvement, based on the actuarial profession's medium cohort projection table and incorporating underpins to the rate of future improvement equal to 1.5% p.a. for males and 1.0% p.a. for females. The effect of assuming all members were one year younger would increase the above schemes' liabilities by £180 million and the service cost for the year by £18 million.

The scheme liabilities have an average duration of between 20 and 23 years in the UK schemes and between 12 and 17 years in the overseas schemes.

## Notes to the consolidated financial statements continued

## 46 – Pension obligations continued

**(ii) Assumptions on scheme assets**

The expected rates of return on the schemes' assets are:

	UK		Netherlands		Canada		Ireland	
	2009	2008	2009	2008	2009	2008	2009	2008
Equities	6.3%	<b>9.2%</b>	6.0%	<b>7.2%</b>	4.5%	<b>7.7%</b>	6.0%	<b>8.3%</b>
Bonds	5.2%	<b>5.3%</b>	3.8%	<b>4.6%</b>	4.3%	<b>4.5%</b>	4.1%	<b>4.5%</b>
Property	4.8%	<b>7.7%</b>	5.7%	<b>5.8%</b>	n/a	<b>n/a</b>	4.5%	<b>6.8%</b>
Cash	3.2%	<b>5.8%</b>	3.8%	<b>4.6%</b>	n/a	<b>n/a</b>	3.0%	<b>2.3%</b>

The overall rates of return are based on the expected returns within each asset category and on current asset allocations. The expected returns for equities and properties have been aligned with the rates used for the longer-term investment return assumptions, other than in the Netherlands, where they have been developed in conjunction with external advisers due to the characteristics of the scheme. The figures for the total expected return on scheme assets in the following section are stated after deducting investment expenses.

**(iii) Investments in Group-managed funds and insurance policies**

Plan assets in the UK and Dutch schemes include investments in Group-managed funds and insurance policies with other Group companies. Their treatment in the relevant parts of the financial statements is as follows:

**Plan assets** – The treatment of these funds and policies in the consolidated balance sheet is described in section (vii) below.

**Expected rates of return** – Where the relevant insurance policies are in segregated funds with specific asset allocations, their expected rates of return are included in the appropriate line in the table in section (ii) above.

**Pension expense** – To avoid double-counting of investment income on scheme assets and the assets backing the underlying policies, adjustments have been made to the former in the tables in section (iv) below.

**(iv) Pension expense**

As noted above, plan assets in the UK and Dutch schemes include insurance policies with other Group companies. To avoid double-counting of investment income on scheme assets and the assets backing the underlying policies, adjustments have been made to the former in the current year as shown in the tables below.

The total pension expense for these schemes comprises:

**Recognised in the income statement**

	2008 £m	2007 £m
Current service cost	<b>(162)</b>	(173)
Past service cost	<b>(1)</b>	–
Gain on curtailments	<b>(3)</b>	(15)
<b>Total pension cost charged to net operating expenses</b>	<b>(166)</b>	(188)
Expected return on scheme assets	<b>706</b>	614
Less: Income on insurance policy assets accounted for elsewhere (see (iii) above)	<b>(64)</b>	(49)
	<b>642</b>	565
Interest charge on scheme liabilities	<b>(585)</b>	(515)
Credit to investment income	<b>57</b>	50
<b>Total charge to income</b>	<b>(109)</b>	(138)

## 46 – Pension obligations continued

### Recognised in the statement of recognised income and expense

	2008 £m	2007 £m
Expected return on scheme assets	(706)	(614)
Actual (negative)/positive return on these assets	(1,245)	404
Actuarial losses on scheme assets	(1,951)	(210)
Less: losses on insurance policy assets accounted for elsewhere (see (iii) above)	58	72
Actuarial losses on admissible assets	(1,893)	(138)
Experience gains/(losses) arising on scheme liabilities	105	(80)
Changes in assumptions underlying the present value of the scheme liabilities	859	902
Loss on acquisitions	–	(36)
<b>Actuarial (losses)/gains recognised in the statement of recognised income and expense</b>	<b>(929)</b>	<b>648</b>

The cumulative amount of actuarial gains and losses on the pension schemes recognised in the statement of recognised income and expense since 1 January 2004 (the date of transition to IFRS) is a loss of £1,090 million at 31 December 2008 (2007: loss of £161 million).

#### (v) Experience gains and losses

The following disclosures of experience gains and losses give a five year history. Scheme assets exclude insurance policies with Group companies and income on the assets underlying them.

	2008 £m	2007 %	2006 £m	2005 %	2004 %
Fair value of scheme assets at the end of the year	7,936	8,814	8,137	7,334	5,473
Present value of scheme liabilities at the end of the year	(9,951)	(10,017)	(10,196)	(9,680)	(7,179)
<b>Net deficits in the schemes</b>	<b>(2,015)</b>	<b>(1,203)</b>	<b>(2,059)</b>	<b>(2,346)</b>	<b>(1,706)</b>
Difference between the expected and actual return on scheme assets					
Amount of (gains)/losses	1,893	138	(251)	(798)	(184)
Percentage of the scheme assets at the end of the year	23.8%	1.6%	3.1%	10.9%	3.4%
Experience (gains)/losses on scheme liabilities (excluding changes in assumptions)					
Amount of (gains)/losses	(105)	80	(63)	86	(12)
Percentage of the present value of scheme liabilities	1.0%	0.8%	0.6%	0.9%	0.2%

#### (vi) Risk management and asset allocation strategy

As noted above, the long-term investment objectives of the trustees and the employers are to limit the risk of the assets failing to meet the liabilities of the schemes over the long term, and to maximise returns consistent with an acceptable level of risk so as to control the long-term costs of these schemes. To meet these objectives, each scheme's assets are invested in a diversified portfolio, consisting primarily of equity and debt securities. These reflect the current long-term asset allocation ranges chosen, having regard to the structure of liabilities within the schemes.

#### Main UK scheme

Both the Group and the trustees regularly review the asset/liability management of the main UK scheme. It is fully understood that, whilst the current asset mix is designed to produce appropriate long-term returns, this introduces a material risk of volatility in the scheme's surplus or deficit of assets compared with its liabilities.

The principal asset risks to which the scheme is exposed are:

**Equity market risk** – the effect of equity market falls on the value of plan assets.

**Inflation risk** – the effect of inflation rising faster than expected on the value of the plan liabilities.



## Notes to the consolidated financial statements continued

## 46 – Pension obligations continued

**Interest rate risk** – falling interest rates leading to an increase in liabilities significantly exceeding the increase in the value of assets.

There is also an exposure to currency risk where assets are not denominated in the same currency as the liabilities. The majority of this exposure has been removed by the use of hedging instruments.

During 2008, there has been a reduction in the proportion of assets invested in equities, thereby mitigating the equity risk. In addition, the trustees have taken measures to partially mitigate inflation and interest rate risks, including entering into inflation and interest rate swaps.

**Other schemes**

The other schemes are considerably less material but their risks are managed in a similar way to those in the main UK scheme.

**(vii) Balance sheet recognition**

The assets and liabilities of the schemes, attributable to defined benefit members, including investments in Group insurance policies (see footnote below), at 31 December 2008 were:

	UK		Netherlands		Canada		Ireland		Total	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
Equities	3,002	4,347	292	306	93	144	182	256	3,569	5,053
Bonds	3,395	3,059	857	556	86	85	172	174	4,510	3,874
Property	405	562	76	52	–	–	26	42	507	656
Other	485	135	184	114	3	2	80	5	752	256
Total fair value of assets	7,287	8,103	1,409	1,028	182	231	460	477	9,338	9,839
Present value of scheme liabilities	(7,732)	(8,229)	(1,424)	(1,049)	(250)	(289)	(545)	(450)	(9,951)	(10,017)
<b>(Deficits)/surplus in the schemes</b>	<b>(445)</b>	<b>(126)</b>	<b>(15)</b>	<b>(21)</b>	<b>(68)</b>	<b>(58)</b>	<b>(85)</b>	<b>27</b>	<b>(613)</b>	<b>(178)</b>
Included in other assets (note 26)	–	–	–	–	–	–	–	27	–	27
Included in provisions (note 45)	(445)	(126)	(15)	(21)	(68)	(58)	(85)	–	(613)	(205)
	(445)	(126)	(15)	(21)	(68)	(58)	(85)	27	(613)	(178)

Other assets comprise cash at bank, derivative financial instruments, receivables and payables.

Plan assets in the table above include investments in Group-managed funds in the consolidated balance sheet of £99 million (2007: £150 million) in the UK scheme, and insurance policies of £150 million and £1,402 million (2007: £143 million and £1,025 million) in the UK and Dutch schemes respectively. Where the investment and insurance policies are in segregated funds with specific asset allocations, they are included in the appropriate line in the table above, otherwise they appear in "Other". The Dutch insurance policies are considered non-transferable under the terms of IAS 19 and so have been treated as other obligations to staff pension schemes within provisions (see note 45).

## 46 – Pension obligations continued

The total IAS 19 obligations and strict IAS 19 assets (ie excluding the non-transferable insurance policies) of the schemes give a net deficit of £1,971 million (2007: £1,203 million), as shown in the following table.

	UK		Netherlands		Canada		Ireland		Total	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
Equities	3,002	4,347	–	–	93	144	182	256	3,277	4,747
Bonds	3,395	3,059	–	–	86	85	172	174	3,653	3,318
Property	405	562	–	–	–	–	26	42	431	604
Other	485	135	7	3	3	2	80	5	575	145
Total fair value of assets	7,287	8,103	7	3	182	231	460	477	7,936	8,814
Present value of scheme liabilities	(7,732)	(8,229)	(1,424)	(1,049)	(250)	(289)	(545)	(450)	(9,951)	(10,017)
<b>IAS 19 net (deficits)/surplus in the schemes</b>	<b>(445)</b>	<b>(126)</b>	<b>(1,417)</b>	<b>(1,046)</b>	<b>(68)</b>	<b>(58)</b>	<b>(85)</b>	<b>27</b>	<b>(2,015)</b>	<b>(1,203)</b>
Included in other assets (note 26)	–	–	–	–	–	–	–	27	–	27
Included in provisions (note 45)	(445)	(126)	(1,417)	(1,046)	(68)	(58)	(85)	–	(2,015)	(1,230)
	(445)	(126)	(1,417)	(1,046)	(68)	(58)	(85)	27	(2,015)	(1,203)

The present value of unfunded post-retirement benefit obligations included in the totals in both of the tables above is £104 million (2007: £107 million).

### (viii) Movements in the scheme deficits and surpluses

Movements in the pension schemes' deficits and surpluses comprise:

	2008				
	Scheme assets £m	Scheme liabilities £m	Pension scheme deficit £m	Adjust for Group insurance policies £m	IAS 19 pensions deficit £m
<b>Net deficits in the schemes at 1 January</b>	<b>9,839</b>	<b>(10,017)</b>	<b>(178)</b>	<b>(1,025)</b>	<b>(1,203)</b>
Employer contributions	620	–	620	(70)	550
Employee contributions	24	(24)	–	(7)	(7)
Benefits paid	(368)	368	–	39	39
Current and past service cost (see (iv) above)	(5)	(158)	(163)	–	(163)
Losses on curtailments (see (iv) above)	–	(3)	(3)	–	(3)
Credit/(charge) to investment income (see (iv) above)	706	(585)	121	(64)	57
Other actuarial gains/(losses) (see (iv) above)	(1,951)	964	(987)	58	(929)
Buy-outs and other transfers	(1)	1	–	1	1
Exchange rate movements on foreign plans	474	(497)	(23)	(334)	(357)
<b>Net deficits in the schemes at 31 December</b>	<b>9,338</b>	<b>(9,951)</b>	<b>(613)</b>	<b>(1,402)</b>	<b>(2,015)</b>

## Notes to the consolidated financial statements continued

## 46 – Pension obligations continued

	2007				
	Scheme assets £m	Scheme liabilities £m	Pension scheme deficit £m	Adjust for Group insurance policies £m	IAS 19 pensions deficit £m
<b>Net deficits in the schemes at 1 January</b>	9,223	(10,196)	(973)	(1,086)	(2,059)
Employer contributions	297	–	297	(41)	256
Employee contributions	23	(23)	–	(4)	(4)
Benefits paid	(339)	339	–	33	33
Current and past service cost (see (iv) above)	(4)	(169)	(173)	–	(173)
Losses on curtailments (see (iv) above)	–	(15)	(15)	–	(15)
Credit/(charge) to investment income (see (iv) above)	614	(515)	99	(49)	50
Acquisitions	72	(91)	(19)	(15)	(34)
Other actuarial gains/(losses) (see (iv) above)	(210)	822	612	72	684
Buy-outs and other transfers	6	(6)	–	(2)	(2)
Changes in asset admissibility	–	–	–	152	152
Exchange rate movements on foreign plans	157	(163)	(6)	(85)	(91)
<b>Net deficits in the schemes at 31 December</b>	<b>9,839</b>	<b>(10,017)</b>	<b>(178)</b>	<b>(1,025)</b>	<b>(1,203)</b>

The change in the pension schemes' net deficits during 2008 is mainly attributable to the fall in equity and property investment values, partly offset by favourable changes in assumptions underlying the present value of the schemes' liabilities and further deficit contribution payments to the main UK scheme made by the employing companies.

## 47 – Borrowings

*Our borrowings are either core structural borrowings, such as subordinated debt, debenture loans and most commercial paper, or operational borrowings, such as bank loans and financing for securitised mortgage loan notes. This note shows the carrying values and contractual maturity amounts of each type, and explains their main features and movements during the year.*

## (a) Analysis of total borrowings

Total borrowings comprise:

	2008 £m	2007 £m
Core structural borrowings, at amortised cost	5,525	4,311
Operational borrowings, at amortised cost	4,233	3,347
Operational borrowings, at fair value	5,443	5,011
	<b>9,676</b>	8,358
	<b>15,201</b>	12,669
Less amounts classified as held for sale	–	(12)
	<b>15,201</b>	<b>12,657</b>

## 47 – Borrowings continued

### (b) Core structural borrowings

The following table provides information about the carrying amounts and maturity periods of these borrowings. Borrowings are considered current if the contractual maturity dates are within a year.

			Maturity dates of undiscounted cash flows					2008
	Carrying value £m	Denominated currency £m	Within 1 year £m	1–5 years £m	5–10 years £m	10–15 years £m	Over 15 years £m	Total £m
<b>Subordinated debt</b>								
6.125% £700 million subordinated notes 2036	689	£	–	–	–	–	700	700
5.750% €800 million subordinated notes 2021	772	€	–	–	–	773	–	773
5.250% €650 million subordinated notes 2023	593	€	–	–	–	628	–	628
5.700% €500 million undated subordinated notes	480	€	–	–	–	–	483	483
6.125% £800 million undated subordinated notes	790	£	–	–	–	–	800	800
Floating rate US\$300 million subordinated notes 2017	208	US\$	–	–	209	–	–	209
6.875% £400 million subordinated notes 2058	394	£	–	–	–	–	400	400
6.875% £200 million subordinated notes 2058	199	£	–	–	–	–	200	200
6.875% €500 million subordinated notes 2038	481	€	–	–	–	–	483	483
	4,606		–	–	209	1,401	3,066	4,676
<b>Debenture loans</b>								
9.5% guaranteed bonds 2016	199	£	–	–	200	–	–	200
2.5% subordinated perpetual loan notes	166	€	–	–	–	–	474	474
Other loans	14	various	–	14	–	–	–	14
	379	–	–	14	200	–	474	688
<b>Commercial paper</b>	540	various	540	–	–	–	–	540
<b>Total</b>	5,525		540	14	409	1,401	3,540	5,904
Contractual undiscounted interest payments			345	1,246	1,498	1,339	2,658	7,086
<b>Total contractual undiscounted cash flows for core structural borrowings</b>			885	1,260	1,907	2,740	6,198	12,990

## Notes to the consolidated financial statements continued

## 47 – Borrowings continued

			Maturity dates of undiscounted cash flows					2007
	Carrying value £m	Denominated currency £m	Within 1 year £m	1–5 years £m	5–10 years £m	10–15 years £m	Over 15 years £m	Total £m
<b>Subordinated debt</b>								
6.125% £700 million subordinated notes 2036	689	£	–	–	–	–	700	700
5.750% €800 million subordinated notes 2021	586	€	–	–	–	588	–	588
5.250% €650 million subordinated notes 2023	474	€	–	–	–	–	477	477
5.700% €500 million undated subordinated notes	364	€	–	–	–	–	367	367
6.125% £800 million undated subordinated notes	790	£	–	–	–	–	800	800
Floating rate US\$300 million subordinated notes 2017	151	US\$	–	–	151	–	–	151
	3,054		–	–	151	588	2,344	3,083
<b>Debenture loans</b>								
9.5% guaranteed bonds 2016	198	£	–	–	200	–	–	200
2.5% subordinated perpetual loan notes	127	€	–	–	–	–	360	360
Other loans	10	various	–	10	–	–	–	10
	335	–	–	10	200	–	360	570
<b>Commercial paper</b>	922	various	935	–	–	–	–	935
<b>Total</b>	4,311		935	10	351	588	2,704	4,588
Contractual undiscounted interest payments			256	834	1,023	869	625	3,607
<b>Total contractual undiscounted cash flows for core structural borrowings</b>								
			1,191	844	1,374	1,457	3,329	8,195

Where subordinated debt is undated or loan notes are perpetual, the interest payments have not been included beyond 15 years. Annual interest payments for these borrowings are £89 million (2007: £79 million).

Contractual undiscounted interest payments are calculated based on underlying fixed interest rates or prevailing market floating rates as applicable. Year end exchange rates have been used for interest projections on loans in foreign currencies.

All the above borrowings are stated at amortised cost.



## 47 – Borrowings continued

### (c) Operational borrowings

The following table provides information about the carrying amounts and maturity periods of these borrowings. Borrowings are considered current if the contractual maturity dates are within a year.

		2008						
		Maturity dates of undiscounted cash flows						
	Carrying value £m	Denominated currency £m	Within 1 year £m	1-5 years £m	5-10 years £m	10-15 years £m	Over 15 years £m	Total £m
<b>Amounts owed to credit institutions</b>								
Bank loans	1,891	various	353	842	152	154	390	1,891
<b>Securitised mortgage loan notes</b>								
UK lifetime mortgage business	1,590	£	9	40	66	–	1,529	1,644
Dutch domestic mortgage business	6,195	€	–	–	–	–	7,913	7,913
	7,785		9	40	66	–	9,442	9,557
<b>Total</b>	<b>9,676</b>		<b>362</b>	<b>882</b>	<b>218</b>	<b>154</b>	<b>9,832</b>	<b>11,448</b>
Contractual undiscounted interest payments			520	2,147	2,508	2,460	13,203	20,838
<b>Total contractual undiscounted cash flows</b>			<b>882</b>	<b>3,029</b>	<b>2,726</b>	<b>2,614</b>	<b>23,035</b>	<b>32,286</b>
		2007						
		Maturity dates of undiscounted cash flows						
	Carrying value £m	Denominated currency £m	Within 1 year £m	1-5 years £m	5-10 years £m	10-15 years £m	Over 15 years £m	Total £m
<b>Amounts owed to credit institutions</b>								
Bank loans	1,064	Various	375	306	314	9	60	1,064
<b>Securitised mortgage loan notes</b>								
UK lifetime mortgage business	1,674	£	–	14	125	–	1,613	1,752
Dutch domestic mortgage business	5,620	€	–	–	–	–	5,890	5,890
	7,294			14	125	–	7,503	7,642
<b>Total</b>	<b>8,358</b>		<b>375</b>	<b>320</b>	<b>439</b>	<b>9</b>	<b>7,563</b>	<b>8,706</b>
Contractual undiscounted interest payments			374	1,392	1,705	1,652	8,452	13,575
<b>Total contractual undiscounted cash flows</b>			<b>749</b>	<b>1,712</b>	<b>2,144</b>	<b>1,661</b>	<b>16,015</b>	<b>22,281</b>

Contractual undiscounted interest payments are calculated based on underlying fixed interest rates or prevailing market floating rates as applicable. Year end exchange rates have been used for interest projections on loans in foreign currencies.

The securitised mortgage loan notes at various fixed, floating and index-linked rates. For further details about the securitised loan notes see note 23.

All the above borrowings are stated at amortised cost, except for the loan notes issued in connection with the UK lifetime mortgage business £1,590 million (2007: £1,674 million) and £3,842 million (2007: £3,337 million) of the loan notes issued in connection with the Dutch domestic mortgage business, which are carried at fair value. These have been designated at fair value through profit and loss in order to present the relevant mortgages, borrowings and derivative financial instruments at fair value, since they are managed as a portfolio on a fair value basis. This presentation provides more relevant information and eliminates any accounting mismatch.

## Notes to the consolidated financial statements continued

## 47 – Borrowings continued

## (d) Description and features

## (i) Subordinated debt

A description of each of the subordinated notes is set out in the table below:

Notional amount	Issue date	Redemption date	Callable at par at option of the Company from	In the event the Company does not call the notes, the coupon will reset at each applicable reset date to
£700 million	14 Nov 2001	14 Nov 2036	16 Nov 2026	5 year Benchmark Gilt + 2.85%
€800 million	14 Nov 2001	14 Nov 2021	14 Nov 2011	3 month Euribor + 2.12%
€650 million	29 Sep 2003	02 Oct 2023	02 Oct 2013	3 month Euribor + 2.08%
€500 million	29 Sep 2003	Undated	29 Sep 2015	3 month Euribor + 2.35%
£800 million	29 Sep 2003	Undated	29 Sep 2022	5 year Benchmark Gilt + 2.40%
US\$300 million	19 Dec 2007	19 Jun 2017	19 Jun 2012	3 month US LIBOR + 0.84%
£400 million	20 May 2008	20 May 2058	20 May 2038	3 month LIBOR + 3.26%
£200 million	8 Aug 2008	20 May 2058	20 May 2038	3 month LIBOR + 3.26%
€500 million	22 May 2008	22 May 2038	22 May 2018	3 month Euribor + 3.35%

The subordinated notes were issued by the Company. They rank below its senior obligations and ahead of its preference shares and ordinary share capital. The dated subordinated notes rank ahead of the undated subordinated notes. The fair value of these notes at 31 December 2008 was £2,979 million (2007: £3,006 million), calculated with reference to quoted prices.

## (ii) Debenture loans

The 9.5% guaranteed bonds were issued by the Company at a discount of £1.1 million. This discount and the issue expenses are being amortised over the full term of the bonds. Although these bonds were issued in sterling, the loans have effectively been converted into euro liabilities through the use of financial instruments in a subsidiary.

The 2.5% perpetual subordinated loan notes were issued by a Dutch subsidiary to finance the acquisition of NUTS OHRA Beheer BV in 1999. They are convertible into ordinary shares in Delta Lloyd NV, should there be a public offering of those shares. These loan notes have a face value of €489.9 million but, because they are considered to be perpetual, their carrying value is €172.4 million, calculated in 1999 and based on the future cash flows in perpetuity discounted back at a market rate of interest. The rate of interest paid on the notes is being gradually increased to a maximum of 2.76% in 2009.

Other loans comprise borrowings in the United States.

All these borrowings are at fixed rates and their fair value at 31 December 2008 was £663 million (2007: £395 million), calculated with reference to quoted prices or discounted future cash flows as appropriate.

## (iii) Commercial paper

The commercial paper consists of £535 million in the Company (2007: £918 million) and £5 million in France (2007: £4 million). All of this is considered core structural funding.

All commercial paper is repayable within one year and is issued in a number of different currencies, primarily sterling, euros and US dollars. Its fair value is considered to be the same as its carrying value.

## 47 – Borrowings continued

### (iv) Bank loans

Bank loans comprise:

	2008 £m	2007 £m
Non-recourse		
Loans to property partnerships (see (a) below)	978	485
Loans to Irish investment funds (see (b) below)	60	74
UK Life reinsurance	103	–
Other non-recourse loans	44	16
	1,185	575
Banking loans	184	103
Other loans	522	386
	1,891	1,064

(a) As explained in accounting policy D, the UK long-term business policyholder funds have invested in a number of property limited partnerships (PLPs). The PLPs have raised external debt, secured on their respective property portfolios, and the lenders are only entitled to obtain payment of both interest and principal to the extent there are sufficient resources in the respective PLPs. The lenders have no recourse whatsoever to the policyholder or shareholders' funds of any companies in the Aviva Group. Loans of £978 million (2007: £485 million) included in the table relate to those PLPs which have been consolidated as subsidiaries.

(b) Certain Irish policyholder investment funds and unit trusts, which have been fully consolidated in accordance with accounting policy D, have raised borrowings with external credit institutions. The borrowings are secured on the funds, with the only recourse on default being the underlying investments in these funds and unit trusts. The lenders have no recourse whatsoever to the shareholders' funds of any companies in the Aviva Group. These loans run for a period of five years, with interest rates fixed monthly and based on a fixed margin above the euro inter-bank rate. The amount of these loans can be varied without any penalty being charged, subject to a maximum of 50% Loan to Value and a maximum facility of €72 million.

(c) During the year, a UK long term business has entered into a financial reinsurance agreement with Swiss Re under which up front payments are received from Swiss Re in return for 90% of future surplus arising. The loan will be repaid as profits emerge on the business.

### (v) Securitised mortgage loan notes

Loan notes have been issued by special purpose securitisation companies in the UK and the Netherlands. Details of these securitisations are given in note 23.

For the Dutch securitised mortgage loan notes carried at amortised cost of £2,353 million (2007: £2,283 million), their fair value is £2,224 million (2007: £2,283 million), calculated based on the future cash flows discounted back at the market rate of interest.

## Notes to the consolidated financial statements continued

## 47 – Borrowings continued

**(e) Movements during the year**

Movements in borrowings during the year were:

	Core structural £m	Operational £m	Total 2008 £m
New borrowings drawn down, net of expenses	3,929	1,586	5,515
Repayment of borrowings	(3,496)	(1,721)	(5,217)
Net cash inflow	433	(135)	298
Foreign exchange rate movements	779	1,779	2,558
Borrowings acquired for non-cash consideration	–	(3)	(3)
Acquisitions	–	81	81
Fair value movements	–	(404)	(404)
Amortisation of discounts and other non-cash items	2	–	2
Movements in the year	1,214	1,318	2,532
Balance at 1 January	4,311	8,358	12,669
<b>Balance at 31 December</b>	<b>5,525</b>	<b>9,676</b>	<b>15,201</b>

Movements in borrowings during the previous year were:

	Core structural £m	Operational £m	Total 2007 £m
New borrowings drawn down, net of expenses	4,780	1,542	6,322
Repayment of borrowings	(4,799)	(1,201)	(6,000)
Net cash inflow	(19)	341	322
Foreign exchange rate movements	133	499	632
Borrowings acquired for non-cash consideration	–	18	18
Acquisitions	–	(174)	(174)
Fair value movements	–	(268)	(268)
Amortisation of discounts and other non-cash items	2	–	2
Movements in the year	116	416	532
Balance at 1 January	4,195	7,942	12,137
<b>Balance at 31 December</b>	<b>4,311</b>	<b>8,358</b>	<b>12,669</b>

All movements in fair value in 2008 and 2007 on securitised mortgage loan notes designated as fair value through profit or loss were attributable to changes in market conditions. These loan notes have external credit ratings which have not changed since the inception of the loans.

**(f) Undrawn borrowings**

The Group and Company have the following undrawn committed central borrowing facilities available to it, of which £1,000 million (2007: £1,000 million) is used to support the commercial paper programme:

	2008 £m	2007 £m
Expiring within one year	815	500
Expiring beyond one year	1,285	1,575
	<b>2,100</b>	<b>2,075</b>

## 48 – Payables and other financial liabilities

*This note analyses our financial liabilities at the end of the year.*

	2008 £m	2007 £m
Payables arising out of direct insurance	1,716	1,731
Payables arising out of reinsurance operations	499	410
Deposits and advances received from reinsurers	1,014	1,294
Bank overdrafts	605	621
Derivative liabilities (note 56d)	1,839	606
Bank customer accounts	4,510	2,460
Bank deposits received from other banks	1,780	1,288
Amounts due to brokers for investment purchases	757	901
Obligations for repayment of collateral received (notes 24d(i) & 56e)	5,497	6,545
Obligations under stock repurchase arrangements (note 24d(ii))	383	358
Other financial liabilities	2,262	1,918
	<b>20,862</b>	18,132
Less: Amounts classified as held for sale	(22)	(72)
	<b>20,840</b>	18,060
Expected to be settled within one year	18,468	16,097
Expected to be settled in more than one year	2,372	1,963
	<b>20,840</b>	18,060

Bank overdrafts arise substantially from unpresented cheques and amount to £111 million (2007: £183 million) in long-term business operations and £494 million (2007: £438 million) in general business and other operations.

## 49 – Other liabilities

*This note analyses our other liabilities at the end of the year.*

	2008 £m	2007 £m
Deferred income	532	339
Reinsurers' share of deferred acquisition costs	202	233
Accruals	1,643	1,274
Other liabilities	2,657	2,139
	<b>5,034</b>	3,985
Less: Amounts classified as held for sale	(478)	(220)
	<b>4,556</b>	3,765
Expected to be settled within one year	3,176	2,914
Expected to be settled in more than one year	1,380	851
	<b>4,556</b>	3,765



**Notes to the consolidated financial statements continued****50 – Contingent liabilities and other risk factors**

*This note sets out the main areas of uncertainty over the calculation of our liabilities.*

**(a) Uncertainty over claims provisions**

Note 38 gives details of the estimation techniques used by the Group to determine the general business outstanding claims provisions and of the methodology and assumptions used in determining the long-term business provisions. These approaches are designed to allow for the appropriate cost of future policy-related liabilities, with a degree of prudence, to give a result within the normal range of outcomes. To the extent that the ultimate cost falls outside this range, for example where experience is worse than that assumed, or future general business claims inflation differs from that expected, there is uncertainty in respect of these liabilities.

**(b) Asbestos, pollution and social environmental hazards**

In the course of conducting insurance business, various companies within the Group receive general insurance liability claims, and become involved in actual or threatened related litigation arising therefrom, including claims in respect of pollution and other environmental hazards. Amongst these are claims in respect of asbestos production and handling in various jurisdictions, including Europe, Canada and Australia. Given the significant delays that are experienced in the notification of these claims, the potential number of incidents which they cover and the uncertainties associated with establishing liability and the availability of reinsurance, the ultimate cost cannot be determined with certainty. However, on the basis of current information having regard to the level of provisions made for general insurance claims, and the strengthening of latent claims that took place during 2008, the directors consider that any additional costs arising are not likely to have a material impact on the financial position of the Group.

**(c) Guarantees on long-term savings products**

As a normal part of their operating activities, various Group companies have given guarantees and options, including interest rate guarantees, in respect of certain long-term insurance and fund management products. Note 40 gives details of these guarantees and options. In providing these guarantees and options, the Group's capital position is sensitive to fluctuations in financial variables including foreign currency exchange rates, interest rates, property values and equity prices. Interest rate guaranteed returns, such as those available on guaranteed annuity options (GAOs), are sensitive to interest rates falling below the guaranteed level. Other guarantees, such as maturity value guarantees and guarantees in relation to minimum rates of return, are sensitive to fluctuations in the investment return below the level assumed when the guarantee was made. The directors continue to believe that the existing provisions for such guarantees and options are sufficient.

**(d) Pensions mis-selling**

The pensions review of past sales of personal pension policies which involved transfers, opt outs and non-joiners from occupational schemes, as required by the Financial Services Authority (FSA), has largely been completed. A provision of some £18 million at 31 December 2008 (2007: £23 million) remains to meet the outstanding costs of the very few remaining cases, the anticipated cost of any guarantees provided, and potential levies payable to the Financial Services Compensation Scheme. It continues to be the directors' view that there will be no material effect either on the Group's ability to meet the expectations of policyholders or on shareholders.

**(e) Endowment reviews**

In December 1999, the FSA announced the findings of its review of mortgage endowments and expressed concern as to whether, given decreases in expected future investment returns, such policies could be expected to cover full repayment of mortgages. A key conclusion was that, on average, holders of mortgage endowments had enjoyed returns such that they had fared at least as well as they would have done without an endowment. Nevertheless, following the FSA review, all of the Group's UK mortgage endowment policyholders received policy-specific letters advising them whether their investment was on track to cover their mortgage.

In May 2002, in accordance with FSA requirements, the Group commenced sending out the second phase of endowment policy update letters, which provide policyholders with information about the performance of their policies and advice as to whether these show a projected shortfall at maturity. The Group will send these updates annually to all mortgage endowment holders, in accordance with FSA requirements. The Group has made provisions totalling £38 million at 31 December 2008 (2007: £96 million) to meet potential mis-selling costs and the associated expenses of investigating complaints. It continues to be the directors' view that there will be no material effect either on the Group's liability to meet the expectations of policyholders or on shareholders.

## 50 – Contingent liabilities and other risk factors continued

In August 2004, the Group confirmed its intention to introduce time barring on mortgage endowment complaints, under FSA rules. The Group now includes details of its endowment policyholders' time bar position within the annual re-projection mailings. Customers will be given at least 12 months' individual notice before a time bar becomes applicable – double the six months' notice required by the FSA.

### (f) Regulatory compliance

The Group's insurance and investment business is subject to local regulation in each of the countries in which it operates. The FSA regulates the Group's UK business and in addition monitors the financial resources and organisation of the Group as a whole. The FSA has broad powers including the authority to grant, vary the terms of, or cancel a regulated firm's authorisation, to investigate marketing and sales practices and to require the maintenance of adequate financial resources. The Group's regulators outside the UK typically have similar powers but in some cases they operate a system of "prior product approval" and hence place less emphasis than the FSA on regulating sales and marketing practices.

The directors believe each of the Group's regulated businesses dedicates appropriate resources to its compliance programme, endeavours to respond to regulatory enquiries in a constructive way, and takes corrective action when warranted. However, all regulated financial services companies face the risk that their regulator could find that they have failed to comply with applicable regulations or have not undertaken corrective action as required.

The impact of any such finding (whether in the UK or overseas) could have a negative impact on the Group's reported results or on its relations with current and potential customers. Regulatory action against a member of the Group could result in adverse publicity for, or negative perceptions regarding, the Group, or could have a material adverse effect on the business of the Group, its results of operations and/or financial condition and divert management's attention from the day-to-day management of the business.

### (g) Aviva USA litigation

In November 2006, the Group completed the acquisition of the AmerUs Group, a US-based insurer. In common with other companies operating in the sector, AmerUs is subject to litigation, including class-action litigation, arising out of its sale of equity-based index-linked annuity products. The Group is aware of a multi-district class action filed against AmerUs in Pennsylvania but is not aware of any adverse development. The directors continue to monitor the situation and consider that the litigation will not have a material effect on the Group's ability to meet shareholder expectations.

### (h) Other

In the course of conducting insurance and investment business, various Group companies receive liability claims, and become involved in actual or threatened related litigation. In the opinion of the directors, adequate provisions have been established for such claims and no material loss will arise in this respect.

The Company and several of its subsidiaries have guaranteed the overdrafts and borrowings of certain other Group companies. At 31 December 2008, the total exposure of the Group and Company is £nil (2007: £7 million) and £88 million (2007: £113 million) respectively but, in the opinion of the directors, no material loss will arise in respect of these guarantees and indemnities.

In addition, in line with standard business practice, various Group companies have been given guarantees, indemnities and warranties in connection with disposals in recent years of subsidiaries and associates to parties outside the Aviva Group. In the opinion of the directors, no material loss will arise in respect of these guarantees, indemnities and warranties.

The Group's insurance subsidiaries pay contributions to levy schemes in several countries in which we operate. Given the economic environment, there is a heightened risk that the levy contributions will need to be increased to protect policyholders if an insurance company falls into financial difficulties. The directors continue to monitor the situation but are not aware of any need to increase provisions at the balance sheet date.

## Notes to the consolidated financial statements continued

## 51 – Commitments

*This note gives details of our commitments to capital expenditure and under operating leases.*

**(a) Capital commitments**

Contractual commitments for acquisitions or capital expenditures of investment property, property and equipment and intangible assets, which have not been recognised in the financial statements, are as follows:

	2008 £m	2007 £m
Investment property	7	55
Property and equipment	108	160
	<b>115</b>	<b>215</b>

Contractual obligations for future repairs and maintenance on investment properties are £1 million (2007: *£nil*).

The Group has capital commitments to its joint ventures of £nil (2007: *£nil*) and to other investment vehicles of £48 million (2007: *£157 million*).

**(b) Operating lease commitments**

**(i)** Future contractual aggregate minimum lease rentals receivable under non-cancellable operating leases are as follows:

	2008 £m	2007 £m
Within 1 year	590	644
Later than 1 year and not later than 5 years	1,761	1,879
Later than 5 years	2,880	3,265
	<b>5,231</b>	<b>5,788</b>

**(ii)** Future contractual aggregate minimum lease payments under non-cancellable operating leases are as follows:

	2008 £m	Restated 2007 £m
Within 1 year	207	161
Later than 1 year and not later than 5 years	626	555
Later than 5 years	971	1,107
	<b>1,804</b>	<b>1,823</b>

The total of future minimum sub-lease payments expected to be received under non-cancellable sub-leases.

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## 52 – Cash flow statement

*This note gives further detail behind the figures in the cash flow statement.*

(a) The reconciliation of profit/(loss) before tax to the net cash inflow from operating activities is:

	2008 £m	Restated 2007 £m
<b>(Loss)/profit before tax</b>	<b>(2,368)</b>	1,847
Adjustments for:		
Share of losses/(profits) of joint ventures and associates	<b>1,128</b>	304
Dividends received from joint ventures and associates	<b>87</b>	32
(Profit)/loss on sale of:		
Investment property	<b>(14)</b>	(105)
Property and equipment	<b>–</b>	(4)
Subsidiaries, joint ventures and associates	<b>(7)</b>	(49)
Investments	<b>9</b>	(5,502)
	<b>(12)</b>	(5,660)
Fair value (gains)/losses on:		
Investment property	<b>3,137</b>	757
Investments	<b>25,510</b>	6,447
Borrowings	<b>(404)</b>	(268)
	<b>28,243</b>	6,936
Depreciation of property and equipment	<b>131</b>	129
Equity compensation plans, equity settled expense	<b>39</b>	50
Impairment of:		
Goodwill on subsidiaries	<b>68</b>	10
Financial investments, loans and other assets	<b>1,040</b>	58
Acquired value of in-force business and intangibles	<b>67</b>	4
	<b>1,175</b>	72
Amortisation of:		
Premium or discount on debt securities	<b>(12)</b>	32
Premium or discount on loans	<b>(20)</b>	(7)
Premium or discount on borrowings	<b>2</b>	2
Premium or discount on participating investment contracts	<b>13</b>	–
Financial instruments	<b>(245)</b>	–
Acquired value of in-force business and intangibles	<b>433</b>	266
	<b>171</b>	293
Change in unallocated divisible surplus	<b>(4,482)</b>	(2,922)
Interest expense on borrowings	<b>1,547</b>	1,208
Net finance income on pension schemes	<b>(121)</b>	(99)
Foreign currency exchange losses/(gains)	<b>327</b>	(45)
<b>Changes in working capital</b>		
Decrease in reinsurance assets	<b>1,543</b>	75
(Increase)/decrease in deferred acquisition costs	<b>(328)</b>	(906)
(Decrease)/increase in insurance liabilities and investment contracts	<b>(15,320)</b>	8,739
(Decrease)/increase in other assets and liabilities	<b>(381)</b>	7,830
	<b>(14,486)</b>	15,738
<b>Net purchases of operating assets</b>		
Purchases of investment property	<b>(1,846)</b>	(2,027)
Proceeds on sale of investment property	<b>1,164</b>	1,398
Net purchases of financial investments	<b>(1,902)</b>	(12,310)
	<b>(2,584)</b>	(12,939)
<b>Cash generated from operations</b>	<b>8,795</b>	4,944

Purchases and sales of investment property, loans and financial investments are included within operating cash flows as the purchases are funded from cash flows associated with the origination of insurance and investment contracts, net of payments of related benefits and claims.

## Notes to the consolidated financial statements continued

## 52 – Cash flow statement continued

(b) Cash flows in respect of the acquisition of subsidiaries, joint ventures and associates:

	2008 £m	2007 £m
Cash consideration for subsidiaries, joint ventures and associates acquired	437	857
Less: Cash and cash equivalents acquired with subsidiaries	(101)	(88)
Cash flows on acquisitions	336	769

(c) Cash flows in respect of the disposal of subsidiaries, joint ventures and associates:

	2008 £m	2007 £m
Cash proceeds from disposal of subsidiaries, joint ventures and associates	396	295
Net cash and cash equivalents divested with subsidiaries	(43)	(12)
Cash flows on disposals	353	283

(d) Cash and cash equivalents in the Cash flow statement at 31 December comprised:

	2008 £m	Restated 2007 £m
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 total cash and cash equivalents shown above, £493 million has been classified as held for sale (2007: £96 million) (see note 3d).

## 53 – Group capital structure

*The Group maintains an efficient capital structure from a combination of equity shareholders' funds, preference capital, subordinated debt and borrowings, consistent with our overall risk profile and the regulatory and market requirements of our business. This note describes the way we manage our capital and shows where this is employed.*

## (a) Capital management objectives

Aviva's capital management philosophy is focused on capital efficiency and effective risk management to support a progressive dividend policy and earnings per share growth. Rigorous capital allocation is one of our primary strategic priorities and is ultimately governed by the Group Executive Committee.

Overall capital risk appetite is set and managed with reference to the requirements of a range of different stakeholders including shareholders, policyholders, regulators and rating agencies. In managing capital we seek to:

- maintain sufficient, but not excessive, financial strength to support new business growth and satisfy the requirements of our regulators and other stakeholders, and thus give both our customers and shareholders assurance of our financial strength;
- optimise our overall debt to equity structure to enhance our returns to shareholders, subject to our capital risk appetite and balancing the requirements of the range of stakeholders;
- retain financial flexibility by maintaining strong liquidity, including significant unutilised committed credit lines and access to a range of capital markets;
- allocate capital rigorously across the Group, to drive value adding growth in accordance with risk appetite; and
- increase the dividend on a basis judged prudent, while retaining capital to support future business growth, using dividend cover on an IFRS operating earnings after tax basis in the 1.5 to 2.0 times range as a guide.



## 53 – Group capital structure continued

### (b) Capital resources

The primary sources of capital used by the group are equity shareholders' funds, preference shares, subordinated debt and borrowings. We also consider and, where efficient to do so, utilise alternative sources of capital such as reinsurance and securitisation in addition to the more traditional sources of funding. Targets are established in relation to regulatory solvency, ratings, liquidity and dividend capacity and are a key tool in managing capital in accordance with our risk appetite and the requirements of our various stakeholders.

In February, the Standard & Poors (S&P) rating committee downgraded NU Life from AA to AA-, which is now aligned with the other 'core' group subsidiaries. At the same time S&P have changed the outlook on NU Life's ratings from "negative" to "stable". There are no changes to any of the group's other ratings or outlooks. The Group's financial strength rating from Moody's is Aa3 ("excellent") with a stable outlook and A+ ("superior") with a stable outlook from AM Best.

### (c) Capital allocation

Capital allocation is undertaken based on a rigorous analysis of a range of financial, strategic, risk and capital factors to ensure that capital is allocated efficiently to value adding business opportunities. A clear management decision-making framework, incorporating ongoing operational and strategic performance review, periodic longer term strategic and financial planning and robust due diligence over capital allocation is in place, governed by the Group Executive Committee and Group Asset Committee. These processes incorporate various capital profitability metrics, including an assessment of return on capital employed and internal rates of return in relation to hurdle rates to ensure capital is allocated efficiently and that excess business unit capital is repatriated where appropriate.

### (d) Different measures of capital

In recognition of the requirements of different stakeholders, we measure capital on a number of different bases, all of which are taken into account when managing and allocating capital across the group. These include measures which comply with the regulatory regimes within which we operate and those which the directors consider appropriate for the management of the business. The primary measures are:

#### (i) Accounting bases

We report our results on both an IFRS and a Market Consistent Embedded Value (MCEV) basis. The directors consider that the MCEV principles provide a more meaningful measure of the long term underlying value of the capital employed in our life and related businesses. This basis allows for the impact of uncertainty in the future investment returns more explicitly and is consistent with the way the life business is priced and managed. Accordingly, in addition to IFRS, we analyse and measure the net asset value and total capital employed for the group on this basis. This is the basis on which group return on equity is measured.

#### (ii) Regulatory bases

Individual regulated subsidiaries measure and report solvency based on applicable local regulations, including in the UK the regulations established by the Financial Services Authority (FSA). These measures are also consolidated under the European Insurance Groups Directive (IGD) to calculate regulatory capital adequacy at an aggregate group level. We fully complied with these regulatory requirements during the year.

#### (iii) Rating agency bases

Agency ratings are an important indicator of financial strength and maintenance of these ratings is one of the key drivers of capital risk appetite. Certain rating agencies have proprietary capital models which they use to assess available capital resources against capital requirements as a component of their overall criteria for assigning ratings. In addition, rating agency measures and targets in respect of gearing and fixed charge cover are also important in evaluating the level of borrowings utilised by the group. While not mandatory external requirements, in practice rating agency capital measures tend to act as one of the primary drivers of capital requirements, reflecting the capital strength required in relation to our target ratings.

#### (iv) Economic bases

We also measure capital using an economic capital model that takes into account a more realistic set of financial and non-financial assumptions. This model continues to be developed and is increasingly relevant in the internal management and external assessment of our capital resources. The economic capital model is used to assess capital strength in accordance with the Individual Capital Assessment (ICA) requirements established by the FSA. Further developments are planned to meet the emerging requirements of the Solvency II framework and other external agencies.

## Notes to the consolidated financial statements continued

## 53 – Group capital structure continued

## Accounting basis and capital employed by segment

The table below shows how our capital, on an MCEV basis, is deployed by segment and how that capital is funded.

	2008 £m	Restated 2007 £m
Long-term savings	19,250	22,397
General insurance and health	5,516	5,594
Fund management	340	355
Other business	(326)	831
Corporate <sup>1</sup>	(30)	(31)
<b>Total capital employed</b>	<b>24,750</b>	<b>29,146</b>
<b>Financed by</b>		
Equity shareholders' funds	12,912	19,998
Minority interests <sup>2</sup>	3,013	2,501
Direct capital instrument	990	990
Preference shares	200	200
Subordinated debt	4,606	3,054
External debt	919	1,257
Net internal debt	2,110	1,146
<b>Total capital employed</b>	<b>24,750</b>	<b>29,146</b>

1. The "corporate" net liabilities represent the element of the pension scheme deficit held centrally.

2. Minority interests have increased to £3,013 million (2007 restated: £2,501 million) due to foreign exchange movement.

At 31 December 2008 we had £24.8 billion (2007: £29.1 billion) of total capital employed in our trading operations, measured on an MCEV basis.

Total capital employed is financed by a combination of equity shareholders' funds, preference capital, subordinated debt and borrowings. In addition to our external funding sources, we have certain internal borrowing arrangements in place which allow some of the assets that support technical liabilities to be invested in a pool of central assets for use across the group. These internal debt balances allow for the capital allocated to business operations to exceed the externally sourced capital resources of the group. Although intra-group in nature, they are included as part of the capital base for the purpose of capital management. These arrangements arise in relation to the following:

- Certain subsidiaries, subject to continuing to satisfy standalone capital and liquidity requirements, loan funds to corporate and holding entities, these loans satisfy arms length criteria and all interest payments are made when due.
- Aviva International Insurance (AII) Ltd acts as both a UK general insurer and as the primary holding company for our foreign subsidiaries. Internal capital management mechanisms in place allocate a portion of the total capital of the company to the UK general insurance operations. These mechanisms also allow for some of the assets backing technical liabilities to be made available for use across the Group. Balances in respect of these arrangements are also treated as internal debt for capital management purposes.

Net internal debt represents the balance of the above amounts due from corporate and holding entities, less the tangible net assets held by these entities.

On 13 May 2008 we issued £0.8 billion equivalent of Lower Tier 2 hybrid in a dual-tranche transaction (£400 million and €500 million). £0.6 billion of the proceeds was used to repay short-term commercial paper borrowings. On 8 August 2008 we issued a further £0.2 billion of lower tier 2 hybrid debt. These transactions have a positive impact on group IGD solvency and economic capital measures.

Financial leverage, the ratio of external senior and subordinated debt to MCEV capital and reserves was 34.7% (2007: 19.2%). Fixed charge cover, which measures the extent to which external interest costs, including subordinated debt interest and preference dividends, are covered by MCEV operating profit was 9.2 times (2007: 9.2 times).

## 54 – Capital statement

FRS 27 requires us to produce a capital statement which sets out the financial strength of our Group entities and provides an analysis of the disposition and constraints over the availability of capital to meet risks and regulatory requirements. The capital statement also provides a reconciliation of shareholders' funds to regulatory capital.

The analysis below sets out the Group's available capital resources.

### Available capital resources

	CGNU with- profit fund £m	CULAC with- profit fund £m	NUL&P with- profit fund <sup>3</sup> £m	Total UK life with- profit funds £m	Other UK life opera- tions £m	Total UK life opera- tions £m	Overseas life opera- tions £m	Total life opera- tions £m	Other opera- tions <sup>4</sup> £m	2008 Total £m	Restated 2007 Total £m
Total shareholders' funds	82	77	48	207	3,425	3,632	12,680	16,312	(1,866)	14,446	15,931
Other sources of capital <sup>1</sup>	–	–	–	–	200	200	109	309	4,606	4,915	3,230
Unallocated divisible surplus	726	615	1,412	2,753	5	2,758	(433)	2,325	–	2,325	6,785
Adjustments onto a regulatory basis:											
Shareholders' share of accrued bonus	(195)	(198)	(363)	(756)	–	(756)	–	(756)	–	(756)	(1,192)
Goodwill and other intangibles <sup>5</sup>	–	–	–	–	(402)	(402)	(5,360)	(5,762)	(2,459)	(8,221)	(6,814)
Regulatory valuation and admissibility restrictions <sup>2</sup>	101	233	150	484	(405)	79	58	137	780	917	(1,135)
<b>Total available capital resources</b>	<b>714</b>	<b>727</b>	<b>1,247</b>	<b>2,688</b>	<b>2,823</b>	<b>5,511</b>	<b>7,054</b>	<b>12,565</b>	<b>1,061</b>	<b>13,626</b>	<b>16,805</b>
Analysis of liabilities:											
Participating insurance liabilities	10,110	9,385	14,540	34,035	7	34,042	32,821	66,863	–	66,863	66,093
Unit-linked liabilities	–	–	–	–	4,278	4,278	17,782	22,060	–	22,060	20,601
Other non-participating life insurance	1,112	1,928	341	3,381	18,761	22,142	44,628	66,770	–	66,770	48,320
<b>Total insurance liabilities</b>	<b>11,222</b>	<b>11,313</b>	<b>14,881</b>	<b>37,416</b>	<b>23,046</b>	<b>60,462</b>	<b>95,231</b>	<b>155,693</b>	<b>–</b>	<b>155,693</b>	<b>135,014</b>
Participating investment liabilities	1,733	2,111	6,123	9,967	2,172	12,139	53,139	65,278	–	65,278	53,609
Non-participating investment liabilities	63	18	–	81	21,958	22,039	20,242	42,281	–	42,281	44,635
<b>Total investment liabilities</b>	<b>1,796</b>	<b>2,129</b>	<b>6,123</b>	<b>10,048</b>	<b>24,130</b>	<b>34,178</b>	<b>73,381</b>	<b>107,559</b>	<b>–</b>	<b>107,559</b>	<b>98,244</b>
<b>Total liabilities</b>	<b>13,018</b>	<b>13,442</b>	<b>21,004</b>	<b>47,464</b>	<b>47,176</b>	<b>94,640</b>	<b>168,612</b>	<b>263,252</b>	<b>–</b>	<b>263,252</b>	<b>233,258</b>

1. Other sources of capital include Subordinated debt of £4,606 million issued by Aviva and £276 million of other qualifying capital issued by Dutch, Italian, Spanish and US subsidiary undertakings.

2. Including an adjustment for minorities.

3. Includes the Provident Mutual with-profit fund.

4. Other operations include general insurance and fund management business.

5. Goodwill and other intangibles includes goodwill of £603 million in JVs and associates.

## Notes to the consolidated financial statements continued

## 54 – Capital statement continued

## Analysis of movements in capital of long-term businesses

For the year ended 31 December 2008

	CGNU with-profit fund £m	CULAC with-profit fund £m	NUL&P with-profit fund £m	Total UK life with-profit funds £m	Other UK life operations £m	Total UK life operations £m	Overseas life operations £m	Total life operations £m
<b>Available capital resources at 1 January</b>	<b>1,433</b>	<b>1,206</b>	<b>1,821</b>	<b>4,460</b>	<b>2,511</b>	<b>6,971</b>	<b>8,666</b>	<b>15,637</b>
Effect of new business	(92)	(62)	14	(140)	(172)	(312)	(583)	(895)
Expected change in available capital resources	32	(11)	(62)	(41)	416	375	732	1,107
Variance between actual and expected experience	(591)	(279)	7	(863)	20	(843)	(3,627)	(4,470)
Effect of operating assumption changes	(15)	(104)	101	(18)	381	363	(18)	345
Effect of economic assumption changes	(140)	(120)	(668)	(928)	(444)	(1,372)	2	(1,370)
Effect of changes in management policy	(14)	(1)	86	71	–	71	8	79
Effect of changes in regulatory requirements	–	–	–	–	–	–	(787)	(787)
Transfers, acquisitions and disposals	–	–	–	–	–	–	52	52
Foreign exchange movements	–	–	–	–	–	–	2,159	2,159
Other movements	101	98	(52)	147	111	258	450	708
<b>Available capital resources at 31 December</b>	<b>714</b>	<b>727</b>	<b>1,247</b>	<b>2,688</b>	<b>2,823</b>	<b>5,511</b>	<b>7,054</b>	<b>12,565</b>

Further analysis of the movement in the liabilities of the long-term business can be found in notes 38 and 39.

The analysis of movements in capital provides an explanation of the movement in available capital of the Group's life business for the year. This analysis is intended to give an understanding of the underlying causes of changes in the available capital of the Group's life business, and provides a distinction between some of the key factors affecting the available capital.

For the UK funds, equity performance has been very adverse. Although hedging assets are in place against the impact of equity movement on guarantees the hedges are not perfect and until October there remained equity exposure in CGNU/CULAC through the estate investment strategy. Since October the exposure of the estate to equity in CGNU/CULAC has been very much reduced and consists largely of indirect exposure through future profit from unit-linked business, or the value of annual management charges accruing to estate from the UWP explicit charge business.

## 54 – Capital statement continued

Fixed interest yields have significantly reduced especially at short duration. The movement is beneficial for CGNU/CULAC where the rise in asset values of assets outside asset share is greater than the rise in guarantee costs, but adverse for NUL&P. Credit spreads have moved materially particularly in the final quarter and this is adverse for all funds and the credit spread movement is unhedged. Implied market volatility on equity has increased significantly in the final quarter, which increases the market consistent cost of guarantees and is unhedged. The combined loss for CGNU/CULAC is £115m, and for NUL&P £208 million. Lapse rate assumptions have been changed for year end 2008 reporting to bring the assumptions more into line with experience. The changes reduced the value of the estates in all funds.

For the Overseas life operations, the negative variance between actual and expected experience is driven mainly by the widening of credit spreads and other market movements, which has led to capital depreciation of fixed interest assets and consequential reduction of the unallocated divisible surplus in France and other European businesses.

In aggregate, the Group has at its disposal total available capital of £13.6 billion (2007: £16.8 billion), representing the aggregation of the solvency capital of all of our businesses.

This capital is available to meet risks and regulatory requirements set by reference to local guidance and EU directives.

After effecting the year end transfer to shareholders, the UK with-profit funds' available capital of £2.7 billion (2007: £4.5 billion) can only be used to provide support for UK with-profit business and is not available to cover other shareholder risks. This is comfortably in excess of the required capital margin and, therefore, the shareholders are not required to provide further capital support to this business.

For the remaining life and general insurance operations, the total available capital amounting to £10.9 billion (2007: £12.3 billion) is significantly higher than the minimum requirements established by regulators and, in principle, the excess is available to shareholders. In practice, management will hold higher levels of capital within each business operation to provide appropriate cover for risk.

As the total available capital of £13.6 billion is arrived at on the basis of local regulatory guidance, which evaluates assets and liabilities prudently, it understates the economic capital of the business which is considerably higher. This is a limitation of the Group Capital Statement which, to be more meaningful, needs to evaluate available capital on an economic basis and compare it with the risk capital required for each individual operation, after allowing for the considerable diversification benefits that exist in our Group.

Within the Aviva Group there exist intra-group arrangements to provide capital to particular business units. Included in these arrangements is a subordinated loan of £200 million from NU Life Holdings Group to the NUL&P non-profit fund to provide capital to support the writing of new business.

The available capital of the Group's with-profit funds is determined in accordance with the "Realistic balance sheet" regime prescribed by the FSA's regulations, under which liabilities to policyholders include both declared bonuses and the constructive obligation for future bonuses not yet declared. The available capital resources include an estimate of the value of their respective estates, included as part of the unallocated divisible surplus. The estate represents the surplus in the fund that is in excess of any constructive obligation to policyholders. It represents capital resources of the individual with-profit fund to which it relates and is available to meet regulatory and other solvency requirements of the fund and, in certain circumstances, additional liabilities may arise.

The liabilities included in the balance sheet for the with-profit funds do not include the amount representing the shareholders' portion of future bonuses. However, the shareholders' portion is treated as a deduction from capital that is available to meet regulatory requirements and is therefore shown as a separate adjustment in the capital statement.

In accordance with the FSA's regulatory rules under its realistic capital regime, the Group is required to hold sufficient capital in its UK life with-profit funds to meet the FSA capital requirements, based on the risk capital margin (RCM). The determination of the RCM depends on various actuarial and other assumptions about potential changes in market prices, and the actions management would take in the event of particular adverse changes in market conditions.



## Notes to the consolidated financial statements continued

## 54 – Capital statement continued

The table below provides the information on the UK with-profits funds on a realistic basis.

	31 December 2008					31 December 2007
	Estimated realistic assets £bn	Estimated realistic liabilities <sup>1</sup> £bn	Estimated realistic inherited estate <sup>2</sup> £bn	Estimated risk capital margin <sup>3</sup> £bn	Estimated excess £bn	Excess £bn
CGNU Life	12.8	(12.1)	0.7	(0.4)	0.3	1.1
CULAC	12.4	(11.7)	0.7	(0.4)	0.3	0.8
NUL&P <sup>4</sup>	21.4	(20.2)	1.2	(0.7)	0.5	1.3
Aggregate	46.6	(44.0)	2.6	(1.5)	1.1	3.2

\* These realistic liabilities include the shareholders' share of future bonuses of £0.8 billion (31 December 2007: £1.2 billion). Realistic liabilities adjusted to eliminate the shareholders' share of future bonuses are £43.2 billion (31 December 2007: £48.8 billion).

1. These realistic liabilities make provision for guarantees, options and promises on a market consistent stochastic basis. The value of the provision included within realistic liabilities is £1.4 billion, £1.5 billion and £4.1 billion for CGNU Life, CULAC and NUL&P respectively (31 December 2007: £0.7 billion, £0.8 billion and £3.0 billion for CGNU Life, CULAC and NUL&P respectively).

2. Estimated realistic inherited estate at 31 December 2008 was £1.4 billion, £1.2 billion and £1.9 billion for CGNU Life, CULAC and NUL&P respectively.

3. The risk capital margin (RCM) is 1.8 times covered by the inherited estate (31 December 2007: 3.5 times).

4. The NUL&P fund includes the Provident Mutual (PM) fund, which has realistic assets and liabilities of £1.8 billion and therefore does not impact the realistic inherited estate.

Under the FSA regulatory regime, UK life with-profits business is required to hold capital equivalent to the greater of their regulatory requirement based on EU Directives ("regulatory peak") and the FSA realistic bases ("realistic peak") described above.

For UK non-participating business, the relevant capital requirement is the minimum solvency requirement determined in accordance with FSA regulations. The available capital reflects the excess of regulatory basis assets over liabilities before deduction of capital resources requirement.

For UK general insurance businesses, the relevant capital requirement is the minimum solvency requirement determined in accordance with the FSA requirements.

For overseas businesses in the EEA, US, Canada, Australia, Hong Kong and Singapore, the available capital and the minimum requirement are calculated under the locally applicable regulatory regimes. The businesses outside these territories are subject to the FSA rules for the purposes of calculation of available capital and capital resource requirement.

For fund management and other businesses, the relevant capital requirement is the minimum solvency requirement determined in accordance with the local regulator's requirements for the specific class of business.

All businesses hold sufficient available capital to meet their capital resource requirement.

The available capital resources in each regulated entity are generally subject to restrictions as to their availability to meet requirements that may arise elsewhere in the Group. The principal restrictions are:

- **(i) UK with-profit funds – (CGNU Life, CULAC and NUL&P)** – any available surplus held in each fund can only be used to meet the requirements of the fund itself or be distributed to policyholders and shareholders. With-profit policyholders are entitled to at least 90% of the distributed profits while the shareholders receive the balance. The latter distribution would be subject to a tax charge, which is met by the fund in the case of CGNU Life, CULAC and NUL&P.
- **(ii) UK non-participating funds** – any available surplus held in these is attributable to shareholders. Capital in the non-profit funds may be made available to meet requirements elsewhere in the Group subject to meeting the regulatory requirements of the fund. Any transfer of the surplus may give rise to a tax charge subject to availability of tax relief elsewhere in the Group.
- **(iii) Overseas life operations** – the capital requirements and corresponding regulatory capital held by overseas businesses are calculated using the locally applicable regulatory regime. The available capital resources in all these businesses are subject to local regulatory restrictions which may constrain management's ability to utilise these in other parts of the Group. Any transfer of available capital may give rise to a tax charge subject to availability of tax relief elsewhere in the Group.
- **(iv) General insurance operations** – the capital requirements and corresponding regulatory capital held by overseas businesses are calculated using the locally applicable regulatory regime. The available capital resources in all these businesses are subject to local regulatory restrictions which may constrain management's ability to utilise these in other parts of the Group. Any transfer of available capital may give rise to a tax charge, subject to availability of tax relief elsewhere in the Group.

## 55 – Risk management

*This note sets out the major risks our businesses face and describes our approach to managing these. It also gives sensitivity analyses around the major economic and non-economic assumptions that can cause volatility in our earnings and capital requirements. Further discussion of the impact of current market conditions is included in the Group Chief Executive's review (page 2 ) and the Business Review (page 32 )*

### (a) Risk management framework

Aviva has established a risk management framework to protect the Group from events that hinder the sustainable achievement of its performance objectives, including failing to exploit opportunities.

The risks faced by the Group can be categorised as follows:

- Financial risks cover market and credit risk, insurance risk, liquidity and capital management.
- Strategic risks include issues such as customer, products and markets as well as any risks to our business model arising from changes in or market and risks arising from mergers and acquisitions.
- Operational risk arises from inadequately controlled internal processes or systems, human error or non-compliance as well as from external events. Operational risks include taxation, reputation and regulatory risks, such as compliance.

The risk management framework provides the means to identify, assess, measure, manage and monitor all of the different types of risk faced by the Group to provide a single picture of the threats and uncertainties faced and opportunities that exist.

The Group sets limits to manage material risks to ensure the risk stay within risk appetite (the amount of risk the Group is willing to accept). The Group assesses the size and scale of a risk by considering how likely it is that the risk will occur and the potential impact the risk could have on our business and our stakeholders. Where risks are outside appetite actions are agreed to mitigate the exposure.

The Group's risk management framework is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can provide only reasonable assurance against material financial misstatement or loss. New risks, which have not been identified as emerging risks, or risks we currently deem as immaterial may also impair the future achievement of business objectives.

The Group recognises the critical importance of maintaining an efficient and effective risk management framework. To this end, the Group has an established governance framework, which has the following key elements:

- Defined terms of reference for the Board, its committees, and the associated executive management committees;
- A clear organisational structure with documented delegated authorities and responsibilities from the Board to Board committees, executive management committees and senior management;
- A risk management function operating across Group centre, regions and business units, with clear responsibilities and objectives;
- A Group policy framework that defines risk appetite and sets out risk management and control standards for the Group's worldwide operations. The policies also set out the roles and responsibilities of businesses, regions, policy owners, and the risk oversight committees; and
- Risk oversight committees that review and monitor aggregate risk data, assess whether the risk profile is within appetite and take overall risk management decisions. The committees monitor adherence to the risk management policies and oversee mitigating actions being taken where risks are outside of appetite.

The Group has developed economic capital models that support the measurement, comparison and further understanding of our risks. The results of the modelling are incorporated into key decision making processes. These models show the relative impact to economic capital from the risks we face. In turn this supports the assessment of appropriate and effective mitigating strategies where risks are outside of appetite.

The Financial Services Authority (FSA) requires Aviva to assess its economic capital requirements to ensure that it adequately reflects business and control risks. In turn this analysis supports our strategic planning and decision-making processes.

**Notes to the consolidated financial statements continued****55 – Risk management continued****(b) Market risk**

Market risk is the risk of adverse financial impact due to changes in fair values or future cash flows of financial instruments from fluctuations in interest rates, equity prices, property prices, and foreign currency exchange rates. Market risk arises in business units due to fluctuations in both the value of liabilities and the value of investments held. At Group level, it also arises in relation to the overall portfolio of international businesses and in the value of investment assets owned directly by the shareholders.

The Group has established a policy on market risk which sets out the principles that businesses are expected to adopt in respect of management of the key market risks to which the Group is exposed. The Group monitors adherence to this market risk policy and regularly reviews how business units are managing these risks locally, through the Group Assets Committee and ultimately the Group Asset Liability Committee. For each of the major components of market risk, described in more detail below, the Group has put in place additional processes and procedures to set out how each risk should be managed and monitored, and the approach to setting an appropriate risk appetite.

The management of market risk is undertaken in both business units and at Group level. Business units manage market risks locally using their market risk framework and within local regulatory constraints. Business units may also be constrained by the requirement to meet policyholders' reasonable expectations and to minimise or avoid market risk in a number of areas. The Group Assets Committee is responsible for managing market risk at Group level, and a number of investment-related risks, in particular those faced by shareholder funds throughout the Group.

The financial impact from changes in market risk (such as interest rates, equity prices and property values) is examined through stress tests adopted in the Individual Capital Assessments (ICA) and scenario analysis which consider the impact on capital from variations in financial circumstances on either a remote scenario, or to changes from the central operating scenario. Both assessments consider the management actions that may be taken in mitigation of the change in circumstances.

The sensitivity of Group earnings to changes in economic markets is regularly monitored through sensitivities to investment returns and asset values in MCEV reporting.

The Group market risk policy sets out the minimum principles and framework for matching liabilities with appropriate assets, the approaches to be taken when liabilities cannot be matched and the monitoring processes that are required. The Group has criteria for matching assets and liabilities for all classes of business to minimise the impact of mismatches between the value of assets and the liabilities due to market movements. The local regulatory environment for each business will also set the conditions under which assets and liabilities are to be matched.

In addition, where the Group's long-term savings businesses have written insurance and investment products where the majority of investment risks are borne by its policyholders, these risks are managed in line with local regulations and marketing literature, in order to satisfy the policyholders' risk and reward objectives.

The Group writes unit-linked business in a number of its operations. In unit-linked business, the policyholder bears the investment risk on the assets held in the unit-linked funds, as the policy benefits are directly linked to the value of the assets in the fund. The shareholders' exposure to market risk on this business is limited to the extent that income arising from asset management charges is based on the value of assets in the fund.

**Equity price risk**

The Group is subject to equity price risk due to daily changes in the market values of its equity securities portfolio. The Group's shareholders are exposed to the following sources of equity risk:

- Direct equity shareholdings in shareholder funds and the Group defined benefit pension funds;
- The indirect impact from changes in the value of equities held in policyholders' funds from which management charges or a share of performance are taken;
- Its interest in the free estate of long-term with profits funds.

At a business unit level, equity price risk is actively managed in order to mitigate anticipated unfavourable market movements where this lies outside the risk appetite of either the company in respect of shareholder assets or the fund in respect of policyholder assets concerned. In addition local asset admissibility regulations require that business units hold diversified portfolios of assets thereby reducing exposure to individual equities. The Group does not have material holdings of unquoted equity securities.

Equity risk is also managed using a variety of derivative instruments, including futures and options.

Businesses actively model the performance of equities through the use of stochastic models, in particular to understand the impact of equity performance on guarantees, options and bonus rates.

## 55 – Risk management continued

The Group Assets Committee actively monitors equity assets owned directly by the Group, which may include some material shareholdings in the Group's strategic business partners.

Sensitivity to changes in equity prices is given in section (g) below.

### **Property price risk**

The Group is subject to property price risk due to holdings of investment properties in a variety of locations worldwide. Investment in property is managed at business unit level, and will be subject to local regulations on asset admissibility, liquidity requirements and the expectations of policyholders as well as overall risk appetite. The Group Assets Committee also monitors property assets owned directly by the Group.

As at 31 December 2008, no material derivative contracts had been entered into to mitigate the effects of changes in property prices.

Sensitivity to changes in property prices is given in section (g) below.

### **Interest rate risk**

Interest rate risk arises primarily from the Group's investments in long-term debt and fixed income securities, which are exposed to fluctuations in interest rates.

Interest rate risk also exists in products sold by the Group, in particular from policies that carry investment guarantees on early surrender or at maturity, where claim values can become higher than the value of backing assets when interest rates rise or fall. The Group manages this risk by adopting close asset liability matching criteria, to minimise the impact of mismatches between the value of assets and liabilities from interest rate movements.

A number of policyholder participation features have an influence on the Group's interest rate risk. The major features include guaranteed surrender values, guaranteed annuity options, and minimum surrender and maturity values. Details of material guarantees and options are given in note 40.

In short-term business such as general insurance business the Group requires a close matching of assets and liabilities to minimise this risk.

Interest rate risk is monitored and managed by the Group Assets Committee, and the Group Asset Liability Committee. Exposure to interest rate risk is monitored through several measures that include Value-at-Risk analysis, position limits, scenario testing, stress testing and asset and liability matching using measures such as duration. The impact of exposure to sustained low interest rates is regularly monitored.

Interest rate risk is also managed using a variety of derivative instruments, including futures, options, swaps, caps and floors, in order to provide a degree of hedging against unfavourable market movements in interest rates inherent in the assets backing technical liabilities.

As at 31 December 2008, the Group had entered into a number of interest rate swap agreements to mitigate the effects of potential adverse interest rate movements, and to enable closer matching of assets and liabilities.

Sensitivity to changes in interest rates is given in section (g) below.

Further information on borrowings is included in note 47.

### **Currency risk**

The Group has minimal exposure to currency risk from financial instruments held by business units in currencies other than their functional currencies, as nearly all such holdings are backing either unit-linked or with-profit contract liabilities. For this reason, no sensitivity analysis is given for these holdings.

The Group operates internationally and as a result is exposed to foreign currency exchange risk arising from fluctuations in exchange rates of various currencies. Approximately half of the Group's premium income arises in currencies other than sterling and the Group's net assets are denominated in a variety of currencies, of which the largest are euro, sterling, and US dollars. The Group does not hedge foreign currency revenues as these are substantially retained locally to support the growth of the Group's business and meet local regulatory and market requirements.

The Group's foreign exchange policy requires that each of our subsidiaries maintains sufficient assets in its local currency to meet local currency liabilities. Therefore, capital held by the Group's business units should be able to support local business activities regardless of foreign currency movements. However, such movements may impact the value of the Group's consolidated shareholders' equity which is expressed in sterling. This aspect of foreign exchange risk is monitored and managed centrally, against pre-determined limits. The Group's foreign exchange policy is to manage these exposures by aligning the deployment of capital by currency with the Group's capital requirements by currency. Limits are set to control the extent to which the deployment of capital is not aligned fully with the Group's capital requirement for each major currency. Currency borrowings and derivatives are used to manage exposures within the limits that have been set.

## Notes to the consolidated financial statements continued

## 55 – Risk management continued

At 31 December 2008, the Group's total equity deployment by currency was:

	Sterling £m	Euro £m	US\$ £m	Other £m	Total £m
<b>Capital 31 December 2008</b>	<b>2,041</b>	<b>7,981</b>	<b>2,130</b>	<b>2,294</b>	<b>14,446</b>
Capital 31 December 2007	3,809	8,667	1,456	1,999	15,931

A 10% change in sterling to euro/US\$ foreign exchange rates would have had the following impact on total equity.

	10% increase in sterling/ euro rate £m	10% decrease in sterling/ euro rate £m	10% increase in sterling/ US\$ rate £m	10% decrease in sterling/ US\$ rate £m
<b>Net assets at 31 December 2008</b>	<b>(798)</b>	<b>798</b>	<b>(213)</b>	<b>213</b>
Net assets at 31 December 2007	(867)	867	(146)	146

The changes arise from retranslation of business unit 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.

Net assets are stated after taking account of the effect of currency swaps and forward foreign exchange contracts.

**Derivatives risk**

Derivatives are used by a number of the businesses, within policy guidelines agreed by the Board of directors, as set out in the Group policy on derivatives use. Activity is overseen by the Derivatives Approvals Committee, which monitors implementation of the policy, exposure levels and approves large or complex transactions proposed by businesses. Derivatives are primarily used for efficient investment management, risk hedging purposes or to structure specific retail savings products. Derivative transactions are covered by either cash or corresponding assets and liabilities. Speculative activity is prohibited, unless prior approval has been obtained from the Derivatives Approvals Committee. Over the counter derivative contracts are entered into only with approved counterparties and using ISDA documentation and credit support annexes (or equivalent) in accordance with the Group derivatives policy. Adherence to the collateral requirements as set out in the Group derivatives and Group credit policies thereby reduces the risk of credit loss.

The Group applies strict requirements to the administration and valuation processes it uses, and has a control framework that is consistent with market and industry practice for the activity that is undertaken.

**Correlation risk**

The Group recognises that identified lapse behaviour and potential increases in consumer expectations are sensitive to and interdependent with market movements and interest rates. These interdependencies are taken into consideration in the ICA in the aggregation of the financial stress tests with the operational risk assessment and in scenario analysis.

**(c) Credit risk****Monitoring credit risk**

We have a significant exposure to credit risk through our investments in corporate bonds, commercial mortgages, and other asset backed securities. We hold these investments for the benefit of both our policyholders and shareholders.

Credit risk is the risk of loss in the value of financial assets due to counterparties failing to meet all or part of their obligations. The Group risk management framework also includes the market related aspect of credit risk. This is the risk of a fall in the value of fixed interest securities from changes in the perceived worthiness of the issuer and is manifested through changes in the fixed interest securities' credit spreads.



## 55 – Risk management continued

The Group's management of credit risk includes monitoring exposures at a Group level and requiring business units to implement local credit risk processes (including limit frameworks). The local business unit credit risk processes involve the establishment and operation of specific risk management committees and the detailed reporting and monitoring of the financial asset portfolio against pre-established risk criteria. Individual counterparty exposures are aggregated and monitored at Group level against centrally-set limits reflecting the credit ratings by multiple ratings agencies and the type of exposure. In addition, the Group evaluates the concentration of exposures by industry sector and geographic region and monitors evolving credit spreads through the Credit Approvals Committee.

### Credit ratings

Financial assets are graded according to current external credit ratings issued. AAA is the highest possible rating. Investment grade financial assets are classified within the range of AAA to BBB ratings. Financial assets which fall outside this range are classified as speculative grade. Credit limits for each counterparty are set based on default probabilities that are in turn based on the rating of the counterparty and the type of exposure concerned.

The following table provides information regarding the aggregated credit risk exposure, for financial assets with external credit ratings, of the Group. Not rated assets capture assets not rated by external ratings agencies.

At 31 December 2008

	Credit rating					Not-rated	Carrying value in the balance sheet £m
	AAA	AA	A	BBB	Speculative grade		
Debt securities	44.0%	16.2%	26.1%	8.4%	1.5%	3.8%	150,255
Reinsurance assets	12.9%	70.0%	8.1%	0.4%	0.2%	8.4%	7,894
Other investments	0.6%	2.7%	6.0%	0.8%	–	89.9%	36,116
Loans	6.1%	5.3%	5.2%	0.3%	1.0%	82.1%	42,237

At 31 December 2007

	Credit rating					Not-rated	Carrying value in the balance sheet restated £m
	AAA	AA	A	BBB	Speculative grade		
Debt securities	45.6%	19.7%	20.4%	9.0%	1.1%	4.2%	121,312
Reinsurance assets	14.7%	67.8%	7.4%	0.4%	1.2%	8.5%	8,054
Other investments	1.7%	2.3%	2.3%	2.3%	–	91.4%	36,269
Loans	3.4%	17.6%	1.0%	0.7%	1.3%	76.0%	36,193

The carrying amount of assets included on the balance sheet represents the maximum credit exposure.

Other investments include:

- £28,990 million of unit trusts and other investment vehicles. The underlying credit ratings of these assets are not reflected in this analysis.
- Derivative financial instruments of £2,911 million representing positions to mitigate the impact of adverse market movements, and
- Other assets of £2,696 million which are primarily deposits linked to annuities, unit linked liabilities and investment funds.

The Group loan portfolio is principally made up of:

- Policy loans which are generally collateralised by a lien or charge over the underlying policy,
- Loans and advances to banks which primarily relate to loans of cash collateral received in stock lending transactions. These loans are fully collateralised by other securities, and
- Mortgage loans collateralised by property assets.

## Notes to the consolidated financial statements continued

## 55 – Risk management continued

**Credit concentration risk**

The long-term businesses and general insurance businesses are generally not individually exposed to significant concentrations of credit risk due to the regulations, applicable in most markets, limiting investments in individual assets and asset classes supplemented by the Group credit policy and limits framework. In cases where the business is particularly exposed to credit risk (e.g. in respect of defaults on mortgages matching annuity liabilities) this risk is translated into a more conservative discount rate used to value the liabilities, creating a greater capital requirement, and this credit risk is actively managed. The impact of aggregation of credit risk is monitored as described above. With the exception of Government bonds the largest aggregated counterparty exposure is approximately 0.4% of the Group's total assets.

**Reinsurance credit exposures**

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. The Group operates a policy to manage its reinsurance counterparty exposures, by limiting the reinsurers that may be used and applying strict limits to each reinsurer. Reinsurance exposures are aggregated with other exposures to ensure that the overall risk is within appetite. The Credit Approvals Committee has a monitoring role over this risk.

The Group's largest reinsurance counterparty is Muenchener Rueckversicherungs AG (including subsidiaries). At 31 December 2008 the reinsurance asset recoverable from Muenchener Rueckversicherungs AG was £1,693 million. This exposure is monitored on a regular basis.

In the event of a catastrophic event, the counterparty exposure to a single reinsurer is estimated not to exceed 3.3% of shareholders' equity.

**Securities finance**

The Group has significant securities financing operations within the UK. The risks within this business are mitigated by over collateralisation which is designed to result in minimal residual risk. The Group operates strict standards around collateral management and controls.

**Derivative credit exposures**

The Group is exposed to counterparty credit risk through derivative trades. This risk is mitigated through collateralising almost all trades (the exception being certain FX trade where it has historically been the market norm not to collateralise). The Group operates strict standards around collateral management and controls including the requirement that all "Over the Counter" derivatives are supported by credit support annexes and ISDAs.

**Unit-linked business**

As discussed previously, in unit-linked business the policyholder bears the market risk, including credit risk, on investment assets in the unit funds, and the shareholders' exposure to credit risk is limited to the extent that their income arises from asset management charges based on the value of assets in the fund.

**Impairment of financial assets**

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.

At 31 December 2008

	Financial assets that are past due but not impaired					Financial assets that have been impaired £m	Carrying value in the balance sheet restated £m
	Neither past due nor impaired £m	0-3 months £m	3-6 months £m	6 months-1 year £m	Greater than 1 year £m		
Debt securities	150,141	–	–	–	–	114	150,255
Reinsurance assets	7,867	25	–	–	–	2	7,894
Other investments	36,114	1	–	–	–	1	36,116
Loans	41,091	227	658	13	11	237	42,237
Receivables and other financial assets	8,932	539	293	33	6	13	9,816

## 55 – Risk management continued

At 31 December 2007

	Financial assets that are past due but not impaired					Financial assets that have been impaired £m	Carrying value in the balance sheet £m
	Neither past due nor impaired £m	0-3 months £m	3-6 months £m	6 months-1 year £m	Greater than 1 year £m		
Debt securities	121,241	–	–	–	–	71	121,312
Reinsurance assets	8,052	–	–	–	–	2	8,054
Other investments	36,269	–	–	–	–	–	36,269
Loans	35,937	210	11	3	15	17	36,193
Receivables and other financial assets	8,337	200	21	13	2	46	8,619

The fair value of collateral held against loans that are past due or impaired at 31 December 2008 was £879 million (2007: £185 million). This predominantly consists of commercial properties.

Credit terms are set locally within overall credit limits prescribed by the Group Credit Committee and within the framework of the Group Credit Policy. The credit quality of financial assets is managed at the local business unit level. Where assets have been classed as “past due and impaired”, an analysis is made of the risk of default and a decision is made whether to seek collateral from the counterparty.

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

### (d) Liquidity risk

The Group and Company have a strong liquidity position and through the application of a Group Liquidity policy seek to maintain sufficient financial resources to meet its obligations as they fall due. In addition to this strong liquidity position, the Group and Company maintain significant committed borrowing facilities from a range of highly rated banks to further mitigate this risk.

### Analysis of maturity of liabilities

For non-linked insurance business, the following table shows the gross liability at 31 December 2008 analysed by remaining duration. The total liability is split by remaining duration in proportion to the cash-flows expected to arise during that period, as permitted under IFRS 4, Insurance Contracts.

Almost all investment contracts may be surrendered or transferred on demand. For such contracts the earliest contractual maturity date is therefore the current balance sheet date, for a surrender amount approximately equal to the current balance sheet liability. We expect surrenders, transfers and maturities to occur over many years, and the tables reflect the expected cash flows for these products. However, contractually, the total liability for non-linked investment contracts of £60,264 million (2007: £45,492 million) would be shown in the “Within 1 year” column below. Unit-linked contracts are repayable or transferable on demand and are therefore excluded from this analysis.

At 31 December 2008

	Total £m	Within 1 year £m	1-5 years £m	5-15 years £m	Over 15 years £m
Long-term business					
Insurance contracts – non-linked	126,450	10,243	34,546	48,031	33,630
Investment contracts – non-linked	60,264	3,639	13,922	24,319	18,384
General insurance and health	19,866	8,849	7,512	3,038	467

At 31 December 2007

	Total £m	Within 1 year £m	1-5 years £m	5-15 years £m	Over 15 years £m
Long-term business					
Insurance contracts – non-linked	106,758	9,480	27,726	44,305	25,247
Investment contracts – non-linked	45,492	2,957	10,263	17,205	15,067
General insurance and health	18,452	8,324	7,508	2,568	52

A maturity analysis of borrowings and derivatives is given in note 47 and 56 respectively.

**Notes to the consolidated financial statements continued****55 – Risk management continued****(e) Insurance risk****(i) Life insurance risk***Types of risk*

Life insurance risk in the Group arises through its exposure to mortality and morbidity insurance and exposure to worse than anticipated operating experience on factors such as persistency levels and management and administration expenses.

*Risk management framework*

The Group has developed a life insurance risk policy and guidelines on the practical application of this policy. Individual life insurance risks are managed at a business unit level but are also monitored at Group level.

The impact of life insurance risks is monitored by the business units as part of the control cycle of business management. Exposure is monitored through the assessment of liabilities, the asset liability management framework, profit reporting (under both IFRS and MCEV), and the ICA process. Significant insurance risks will be reported through the Group risk management framework and overseen by the Life Insurance Committee. At Group level the overall exposure to life insurance risk is measured through the ICA and other management reporting.

The Life Insurance Committee monitors the application of the risk policy in each business, and receives management information on life insurance risks. The committee considers all areas of life insurance risk, but in particular has a remit to monitor mortality, longevity, morbidity, persistency, product development and pricing, unit pricing and expenses.

The committee also considers the reinsurance coverage across the life businesses. It confirms that guidance and procedures are in place for each of the major components of life insurance risk, and that the businesses mitigate against any life insurance risk outside local appetite, within the parameters for the overall Group risk appetite.

The committee has also developed guidance for business units on management of a number of areas of life insurance risk to ensure best practice is shared throughout the Group and common standards are adopted.

*Management of life insurance risks*

The individual life insurance risks are managed as follows:

- Mortality and morbidity risks are mitigated by use of reinsurance. The Group allows business units to select reinsurers, from those approved by the Group, based on local factors, but assesses the overall programme to manage group-wide risk exposures and monitor the aggregation of risk ceded to individual reinsurers is within appetite for credit risk.
- Longevity risk is carefully monitored against the latest external industry data and emerging trends. Whilst individual businesses are responsible for reserving and pricing for annuity business, the Group monitors the exposure to this risk and the capital implications to manage the impact on the group-wide exposure and the capital funding that businesses may require as a consequence. The Group has used reinsurance solutions to reduce the risks from longevity where possible and desirable and continually monitors and evaluates emerging market solutions to mitigate this risk further.
- Persistency risk is managed at a business unit level through frequent monitoring of company experience, benchmarked against local market information. Where possible the financial impact of lapses is reduced through appropriate product design. Businesses also implement specific initiatives to improve retention of policies which may otherwise lapse. The Group Life Insurance Committee has developed guidelines on persistency management.
- Product Design and Pricing risk arises from poorly designed or inadequately priced products and can lead to both financial loss and reputation damage from the Group. Guidelines have been developed to support the businesses through the complete cycle of the product development process, financial analysis and pricing.
- Expense risk is primarily managed by the business units through the assessment of business unit profitability and frequent monitoring of expense levels.

Apart from the ICA, sensitivity testing is widely used to measure the capital required and volatility in earnings due to exposure to life insurance risks, typically through MCEV reporting (examples of which are contained elsewhere in this report). This assessment is taken at both business unit level and at Group level where the impact of aggregation of similar risks can be measured. This enables the Group to determine whether action is required to reduce risk, or whether that risk is within the overall risk appetite.

## 55 – Risk management continued

### *Concentration risk*

The Group writes a diverse mix of business in worldwide markets that are all subject to similar risks (mortality, persistency etc). The Group assesses the relative costs and concentrations of each type of risk through the ICA capital requirements and material issues are escalated to and addressed at the Life Insurance Committee. This analysis enables the Group to assess whether accumulations of risk exceeds risk appetite.

One key concentration of life insurance risk for the Group is improving longevity risk from pensions in payment and deferred annuities in the UK and the Netherlands where the Group has material portfolios. The Group continually monitors this risk and the opportunities for mitigating actions through reinsurance, improved asset liability matching, or innovative solutions that emerge in the market.

When looking at concentrations of risk, for example market risk, the risk within Aviva staff pension schemes is also considered.

ICA analysis and MCEV sensitivity testing help identify both concentrations of risk types and the benefits of diversification of risk

### *Embedded derivatives*

The Group has exposure to a variety of embedded derivatives in its long-term savings business due to product features offering varying degrees of guaranteed benefits at maturity or on early surrender, along with options to convert their benefits into different products on pre-agreed terms. The extent of the impact of these embedded derivatives differs considerably between business units.

Examples of each type of embedded derivative affecting the Group are:

- Options: call, put, surrender and maturity options, guaranteed annuity options, options to cease premium payment, options for withdrawals free of market value adjustment, annuity options, and guaranteed insurability options.
- Guarantees: embedded floor (guaranteed return), maturity guarantee, guaranteed death benefit, and guaranteed minimum rate of annuity payment.
- Other: indexed interest or principal payments, maturity value, loyalty bonus.

The impact of these is reflected in ICA and MCEV reporting and managed as part of the asset liability framework.

### **(iii) General insurance risk**

#### *Types of risk*

General insurance risk in the Group arises from:

- Fluctuations in the timing, frequency and severity of claims and claim settlements relative to expectations;
- Unexpected claims arising from a single source;
- Inaccurate pricing of risks or inappropriate underwriting of risks when underwritten;
- Inadequate reinsurance protection or other risk transfer techniques; and
- Inadequate reserves.

The majority of the general insurance business underwritten by the Group is of a short tail nature such as motor, household and commercial property insurances. The Group's underwriting strategy and appetite is agreed by the Executive Committee and communicated via specific policy statements and guidelines. Like life insurance risk, general insurance risk is managed primarily at business unit level with oversight at a Group level, through the General Insurance Committee.

The vast majority of the Group's general insurance business is managed and priced in the same country as the domicile of the customer.

#### *Management of general insurance risks*

Significant insurance risks will be reported through the Group risk management framework. Additionally, the ICA is used to assess the risks that each general insurance business unit, and the Group as a whole, is exposed to, quantifying their impact and calculating appropriate capital requirements. Increasingly risk-based capital models are being used to support the quantification of risk under the ICA framework. All general insurance business units undertake a quarterly review of their insurance risks, the output from which is a key input into the ICA and risk-based capital assessments.

The General Insurance Committee monitors and develops the management of insurance risk in the general insurance business units, and assesses the aggregate risk exposure. It is responsible for the development, implementation, and review of the Group policies for underwriting, claims, reinsurance and reserving that operate within the Group risk management framework.



**Notes to the consolidated financial statements continued****55 – Risk management continued**

Business units have developed mechanisms that identify, quantify and manage accumulated exposures to contain them within the limits of the appetite of the Group. The Group has pioneered various developments, such as the Norwich Union UK Digital Flood Map to effectively manage exposures arising from specific perils. Where appropriate such projects are employed throughout the business units to promote the adoption of best practice as standard.

**General insurance claims reserving**

Actuarial claims reserving is conducted by local actuaries in the various general insurance business units according to the General Insurance Reserving policy. The General Insurance Committee monitors and maintains the General Insurance Reserving policy, and conducts quarterly reviews of the Group's general insurance claims provisions, and their adequacy. The reviews include peer reviews of the business unit's own conclusions as well as independent analysis to confirm the reasonableness of the local reviews.

The adequacy of the Group's general insurance claims provisions is ultimately overseen by the General Insurance Committee.

A number of business units also have periodic external reviews by local consultant actuaries (often as part of the local regulatory requirement).

**Reinsurance strategy**

Significant reinsurance purchases are reviewed annually at both business unit and Group level, to verify that the levels of protection being bought reflect any developments in exposure and the risk appetite of the Group. Reinsurance purchases must be in line with the strategy set out in our Group General insurance reinsurance policy. The basis of these purchases is underpinned by extensive financial and capital modelling and actuarial analysis to optimise the cost and capital efficiency benefits. For the larger business units, this involves utilising externally sourced probabilistic models to verify the accumulations and loss probabilities based on the Group's specific portfolios of business. Where external models are not available, scenarios are developed and tested using the Group's data to determine potential losses and appropriate levels of reinsurance protection.

The reinsurance is placed with providers who meet the Group's counterparty security requirements, and large reinsurance placements may also require approval from the Group Asset Liability Committee.

**Concentration risk**

Processes are in place to manage catastrophe risk in individual business units and at a Group level. The Group cedes much of its worldwide catastrophe risk to third party reinsurers but retains a pooled element for its own account gaining diversification benefit. Aviva's total retained risk increases as catastrophe events become more remote, so that the total Group loss from its most concentrated catastrophe exposure (Northern European windstorm) is approximately £400 million, on a "one in ten years" basis, compared to approximately £850 million when measured on a "one in 100 years" basis.

**(f) Operational risk****Types of operational risk**

Operational risk is the risk of loss, resulting from inadequate or failed internal processes, people and systems or from external events. Operational risks include taxation, reputation and regulatory risks, such as compliance.

**Operational risk management**

Our businesses are primarily responsible for identifying and managing operational risks in line with minimum standards of control set out in our policies. Each operational risk is assessed by considering the potential impact and the probability of the event occurring. Impact assessments are considered against financial, operational and reputation criteria.

Business management teams must be satisfied that all material risks falling outside our risk appetite are being mitigated, monitored and reported to an appropriate level. Any risks with a high potential impact level are monitored centrally on a regular basis. Businesses use key indicator data to help monitor the status of the risk and control environment. They also identify and capture loss events; taking appropriate action to address actual control breakdowns and promote internal learning from these occurrences.

The Group Operational Risk Committee (ORC) oversees the Group's aggregate operational risk exposure on behalf of the Group Executive Committee and reports to the Board Risk & Regulatory Committee. It makes recommendations on the risk appetite that the Group can work within for operational risk, assesses and monitors overall operational risk exposures, identifying any concentrations of operational risk across the Group, and in particular verifies that mitigating action plans are implemented. The ORC operates a number of sub-committees which focus on specific areas of operational risk including business protection, IT, regulatory, people and business standards.

## 55 – Risk management continued

### (g) Risk and capital management

#### **Sensitivity test analysis**

The Group uses a number of sensitivity test-based risk management tools to understand the volatility of earnings, the volatility of its capital requirements, and to manage its capital more efficiently. Primarily, MCEV, ICA, and scenario analysis are used. Sensitivities to economic and operating experience are regularly produced on all of the Group's financial performance measurements to inform the Group's decision making and planning processes, and as part of the framework for identifying and quantifying the risks that each of its business units, and the Group as a whole are exposed to.

For long-term business in particular, sensitivities of MCEV performance indicators to changes in both economic and non-economic experience are continually used to manage the business and to inform the decision making process. More information on MCEV sensitivities can be found in the presentation of results on an MCEV basis in the supplementary section of to this report.

#### **Life insurance and investment contracts**

The nature of long-term business is such that a number of assumptions are made in compiling these financial statements. Assumptions are made about investment returns, expenses, mortality rates, and persistency in connection with the in-force policies for each business unit. Assumptions are best estimates based on historic and expected experience of the business. A number of the key assumptions for the Group's central scenario are disclosed elsewhere in these statements for both IFRS reporting and reporting under MCEV methodology.

#### **General insurance and health business**

General insurance and health claim liabilities are estimated by using standard actuarial claims projection techniques.

These methods extrapolate the claims development for each accident year based on the observed development of earlier years. In most cases, no explicit assumptions are made as projections are based on assumptions implicit in the historic claims.

#### **Sensitivity test results**

Illustrative results of sensitivity testing for long-term business, general insurance and health business and the fund management and non-insurance business are set out below. For each sensitivity test the impact of a reasonably possible change in a single factor is shown, with other assumptions left unchanged.

Sensitivity factor	Description of sensitivity factor applied
Interest rate and investment return	The impact of a change in market interest rates by a 1% increase or decrease. The test allows consistently for similar changes to investment returns and movements in the market value of backing fixed interest securities.
Equity/property market values	The impact of a change in equity/property market values by $\pm 10\%$ .
Expenses	The impact of an increase in maintenance expenses by 10%.
Assurance mortality/morbidity (life insurance only)	The impact of an increase in mortality/morbidity rates for assurance contracts by 5%.
Annuitant mortality (life insurance only)	The impact of a reduction in mortality rates for annuity contracts by 5%.
Gross loss ratios (non-life insurance only)	The impact of an increase in gross loss ratios for general insurance and health business by 5%.

#### **Long-term business**

##### **Sensitivities as at 31 December 2008**

##### **Impact on profit before tax (£m)**

	Interest rates +1%	Interest rates -1%	Equity/ property +10%	Equity/ property -10%	Expenses +10%	Assurance mortality +5%	Annuitant mortality -5%
Insurance participating	(10)	(165)	85	(90)	(20)	(5)	(10)
Insurance non-participating	(25)	135	90	(90)	(20)	(25)	(310)
Investment participating	(35)	(55)	25	(20)	–	–	–
Investment non-participating	(10)	10	20	(20)	(5)	–	–
Assets backing life shareholders' funds	(20)	30	180	(180)	–	–	–
<b>Total</b>	<b>(100)</b>	<b>(45)</b>	<b>400</b>	<b>(400)</b>	<b>(45)</b>	<b>(30)</b>	<b>(320)</b>

## Notes to the consolidated financial statements continued

## 55 – Risk management continued

## Impact before tax on shareholders' equity (£m)

	Interest rates +1%	Interest rates -1%	Equity/ property +10%	Equity/ property -10%	Expenses +10%	Assurance mortality +5%	Annuitant mortality -5%
Insurance participating	(30)	(135)	85	(90)	(20)	(5)	(10)
Insurance non-participating	(185)	270	110	(105)	(20)	(25)	(310)
Investment participating	(50)	(40)	30	(25)	–	–	–
Investment non-participating	(210)	230	20	(20)	(5)	–	–
Assets backing life shareholders' funds	(80)	95	190	(190)	–	–	–
<b>Total</b>	<b>(555)</b>	<b>420</b>	<b>435</b>	<b>(430)</b>	<b>(45)</b>	<b>(30)</b>	<b>(320)</b>

## Sensitivities as at 31 December 2007

## Impact on profit before tax (£m)

	Interest rates +1%	Interest rates -1%	Equity/ property +10%	Equity/ property -10%	Expenses +10%	Assurance mortality +5%	Annuitant mortality -5%
Insurance participating	15	(10)	–	–	(5)	–	–
Insurance non-participating	(205)	165	45	(35)	(5)	(20)	(295)
Investment participating	(5)	(25)	–	–	(5)	–	–
Investment non-participating	(35)	40	65	(60)	–	–	–
Assets backing life shareholders' funds	(115)	140	180	(175)	–	–	–
<b>Total</b>	<b>(345)</b>	<b>310</b>	<b>290</b>	<b>(270)</b>	<b>(15)</b>	<b>(20)</b>	<b>(295)</b>

## Impact before tax on shareholders' equity (£m)

	Interest rates +1%	Interest rates -1%	Equity/ property +10%	Equity/ property -10%	Expenses +10%	Assurance mortality +5%	Annuitant mortality -5%
Insurance participating	(5)	20	–	–	(5)	–	–
Insurance non-participating	(320)	275	105	(95)	(5)	(20)	(295)
Investment participating	(5)	(25)	–	–	(5)	–	–
Investment non-participating	(170)	190	65	(60)	–	–	–
Assets backing life shareholders' funds	(165)	190	460	(455)	–	–	–
<b>Total</b>	<b>(665)</b>	<b>650</b>	<b>630</b>	<b>(610)</b>	<b>(15)</b>	<b>(20)</b>	<b>(295)</b>

The different impacts of the economic sensitivities on profit and shareholders' equity arise from classification of certain assets as available for sale in some business units, for which movements in unrealised gains or losses would be taken directly to shareholders' equity.

The sensitivities to economic movements relate mainly to business in the UK, USA and the Netherlands. In the UK and USA, a fall in market interest rates has a beneficial impact on non-participating business and shareholders' funds, due to the increase in market value of fixed interest securities and the relative durations of assets and liabilities; similarly a rise in interest rates has a negative impact. In the USA most debt securities are classified as available-for-sale, which limits the overall sensitivity of IFRS profit to interest rate movements. In contrast, a rise in market interest rates has a positive impact for non-participating business in the Netherlands, due to the effect of minimum investment return guarantees, which acts to partly offset the impacts in the UK and USA.

The sensitivity to movements in equity and property market values relates mainly to holdings in the Netherlands, although the impact on IFRS profit is moderated by the classification of equities as available for sale.

Changes in sensitivities between 2007 and 2008 reflect movements in market interest rates, portfolio growth, changes to asset mix and the relative durations of assets and liabilities, and asset liability management actions.

The mortality sensitivities relate primarily to the UK, Netherlands and Ireland.

The impact on the Group's results from sensitivity to these assumptions can also be found in the MCEV sensitivities included in the alternative method of reporting long-term business profits section.

## 55 – Risk management continued

### General insurance and health business

#### Sensitivities as at 31 December 2008

##### Impact on profit before tax (£m)

	Interest rates +1%	Interest rates -1%	Equity/ property +10%	Equity/ property -10%	Expenses +10%	Gross loss ratios +5%
Gross of reinsurance	(310)	300	90	(90)	(170)	(435)
Net of reinsurance	(360)	360	90	(90)	(170)	(425)

##### Impact before tax on shareholders' equity (£m)

	Interest rates +1%	Interest rates -1%	Equity/ property +10%	Equity/ property -10%	Expenses +10%	Gross loss ratios +5%
Gross of reinsurance	(310)	300	90	(90)	(40)	(435)
Net of reinsurance	(360)	360	90	(90)	(40)	(425)

#### Sensitivities as at 31 December 2007

##### Impact on profit before tax (£m)

	Interest rates +1%	Interest rates -1%	Equity/ property +10%	Equity/ property -10%	Expenses +10%	Gross loss ratios +5%
Gross of reinsurance	(205)	235	110	(110)	(150)	(390)
Net of reinsurance	(255)	290	110	(110)	(150)	(365)

##### Impact before tax on shareholders' equity (£m)

	Interest rates +1%	Interest rates -1%	Equity/ property +10%	Equity/ property -10%	Expenses +10%	Gross loss ratios +5%
Gross of reinsurance	(205)	235	110	(110)	(35)	(390)
Net of reinsurance	(255)	290	110	(110)	(35)	(365)

For general insurance, the impact of the expense sensitivity on profit also includes the increase in ongoing administration expenses, in addition to the increase in the claims handling expense provision.

### Fund management and non-insurance business

#### Sensitivities as at 31 December 2008

##### Impact before profit before tax (£m)

	Interest rates +1%	Interest rates -1%	Equity/ property +10%	Equity/ property -10%
Total	15	(20)	50	(50)

##### Impact before tax on shareholders' equity (£m)

	Interest rates +1%	Interest rates -1%	Equity/ property +10%	Equity/ property -10%
Total	–	(10)	130	(130)

#### Sensitivities as at 31 December 2007

##### Impact before profit before tax (£m)

	Interest rates +1%	Interest rates -1%	Equity/ property +10%	Equity/ property -10%
Total	(35)	35	55	(55)

##### Impact before tax on shareholders' equity (£m)

	Interest rates +1%	Interest rates -1%	Equity/ property +10%	Equity/ property -10%
Total	(35)	35	55	(55)

**Notes to the consolidated financial statements continued****55 – Risk management continued****Limitations of sensitivity analysis**

The above tables demonstrate the effect of a change in a key assumption while other assumptions remain unchanged. In reality, there is a correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear, and larger or smaller impacts should not be interpolated or extrapolated from these results.

The sensitivity analyses do not take into consideration that the Group's assets and liabilities are actively managed. Additionally, the financial position of the Group may vary at the time that any actual market movement occurs. For example, the Group's financial risk management strategy aims to manage the exposure to market fluctuations.

As investment markets move past various trigger levels, management actions could include selling investments, changing investment portfolio allocation, adjusting bonuses credited to policyholders, and taking other protective action.

A number of the business units use passive assumptions to calculate their long-term business liabilities. Consequently, a change in the underlying assumptions may not have any impact on the liabilities, whereas assets held at market value on the balance sheet will be affected. In these circumstances, the different measurement bases for liabilities and assets may lead to volatility in shareholder equity. Similarly, for general insurance liabilities, the interest rate sensitivities only affect profit and equity where explicit assumptions are made regarding interest (discount) rates or future inflation.

Other limitations in the above sensitivity analyses include the use of hypothetical market movements to demonstrate potential risk that only represent the Group's view of possible near-term market changes that cannot be predicted with any certainty; and the assumption that all interest rates move in an identical fashion.

**56 – Derivative financial instruments**

*This note gives details of the various derivative instruments we use to mitigate risk.*

The Group uses cash flow, fair value and net investment hedges to mitigate risk, as detailed below.

**(a) Cash flow hedges**

The Group had no cash flow hedge activity at 31 December 2008 (2007: nil).

**(b) Fair value hedges**

The Group has entered into a number of interest rate swaps in order to hedge fluctuations in the fair value of part of its mortgage loans portfolio. The notional value of these interest rate swaps was £1,088 million at 31 December 2008 (2007: £nil) and the fair value was £86 million liability (2007: £nil). These hedges were fully effective during the year.

**(c) Net investment hedges**

To reduce its exposure to foreign currency risk, the Group has entered into the following net investment hedges:

- The Group has designated a portion of its Euro and US dollar denominated debt as a hedge of the net investment in its European and American subsidiaries. The carrying value of the debt at 31 December 2008 was £2,663 million (2007: £1,988 million) and its fair value at that date was £1,755 million (2007: £1,972 million).
- The foreign exchange loss of £716 million (2007: loss of £114 million) on translation of the debt to sterling at the balance sheet date has been recognised in the hedging instruments reserve in shareholders' equity. This hedge was fully effective throughout the current and prior year.
- The Group holds a Sterling/Euro cross currency swap derivative, which has been designated as a hedge of the net investment in its European subsidiaries. During the year, the Group reduced the size of the notional amount from £1 billion to £500 million, realising a loss of £164 million in closing out this part of the contract. The notional value of the derivative at 31 December 2008 was £500 million (2007: £1,000 million) and its fair value at that date was £(185) million liability (2007: £27 million). The fair value loss of £160 million on revaluation of the derivative at the balance sheet date, as well as the £164 million loss realised on closing part of the contract, were recognised in the hedging instruments reserve in shareholders' equity. This hedge was fully effective throughout the year.

The losses on the Group's net investment hedges during the year were more than offset by gains on the relevant subsidiaries which are recognised in the currency translation reserve (see note 34).



## 56 – Derivative financial instruments continued

### (d) Non-hedge derivatives

The Group's non-hedge derivative activity at 31 December 2008 was as follows:

	2008			2007		
	Contract/ notional amount £m	Fair value asset £m	Fair value liability £m	Contract/ notional amount £m	Fair value asset £m	Fair value liability £m
<b>Foreign exchange contracts</b>						
OTC						
Forwards	6,164	89	(340)	9,594	24	(106)
Interest and currency swaps	1,235	3	(255)	859	57	–
<b>Total</b>	<b>7,399</b>	<b>92</b>	<b>(595)</b>	<b>10,453</b>	<b>81</b>	<b>(106)</b>
<b>Interest rate contracts</b>						
OTC						
Forwards	3,008	17	(11)	3,305	15	(2)
Swaps	20,246	482	(909)	16,172	279	(350)
Options	9,309	920	–	986	251	(1)
Exchange traded						
Futures	6,067	615	(15)	6,505	220	(37)
Options	–	–	–	15	–	–
<b>Total</b>	<b>38,630</b>	<b>2,034</b>	<b>(935)</b>	<b>26,983</b>	<b>765</b>	<b>(390)</b>
<b>Equity/Index contracts</b>						
OTC						
Options	11,619	470	(39)	12,278	267	(61)
Exchange traded						
Futures	2,859	45	(68)	5,456	418	(23)
Options	4,513	189	(51)	473	21	(2)
<b>Total</b>	<b>18,991</b>	<b>704</b>	<b>(158)</b>	<b>18,207</b>	<b>706</b>	<b>(86)</b>
Other	771	80	(65)	414	57	(24)
<b>Totals at 31 December</b>	<b>65,791</b>	<b>2,910</b>	<b>(1,753)</b>	<b>56,057</b>	<b>1,609</b>	<b>(606)</b>

The notional amounts above reflect the aggregate of individual derivative positions on a gross basis and so give an indication of the overall scale of the derivative transaction. They do not reflect current market values of the open positions.

Fair value assets are recognised as "Derivative financial instruments" in note 24(a), whilst fair value liabilities are recognised as "other financial liabilities" in note 48.

The Group's derivative risk management policies are outlined in note 55(b).

## Notes to the consolidated financial statements continued

## 56 – Derivative financial instruments continued

The contractual undiscounted cash flows in relation to non-hedge derivative liabilities have the following maturities:

	2008 £m	2007 £m
Within one year	1,001	151
Between one and two years	285	100
Between two and three years	32	20
Between three and four years	43	20
Between four and five years	69	21
After five years	611	516
	<b>2,041</b>	<b>828</b>

**(e) Collateral**

Certain derivative contracts, primarily interest rate and currency swaps, involve the receipt or pledging of collateral. The amounts of collateral receivable or repayable are included in notes 25 and 48 respectively.

## 57 – Assets under management

*In addition to the assets included in the consolidated balance sheet, the Group manages many funds for third parties. This note details the total funds under management.*

The total Group assets under management are:

	2008 £m	Restated 2007 £m
<b>Total IFRS assets included in the consolidated balance sheet</b>	<b>354,562</b>	321,326
<b>Third-party funds under management</b>		
Unit trusts, OEICs, PEPs and ISAs	22,616	24,427
Segregated funds	48,104	50,018
	<b>425,282</b>	395,771
Non-managed assets	(44,176)	(36,342)
<b>Funds under management</b>	<b>381,106</b>	359,429
<b>Managed by:</b>		
Aviva Investors	236,178	235,309
Other Aviva fund managers	120,054	99,906
Total Aviva fund managers	<b>356,232</b>	335,215
External fund managers	24,874	24,214
	<b>381,106</b>	359,429

## 58 – Related party transactions

*This note gives details of the transactions between Group companies and related parties which comprise our joint ventures, associates and staff pension schemes.*

The Group received income from related parties from transactions made in the normal course of business. Loans to related parties are made on normal arm's-length commercial terms.

### Services provided to related parties

	2008		2007	
	Income earned in year £m	Receivable at year end £m	Income earned in year £m	Receivable at year end £m
Associates	61	–	58	–
Joint ventures	5	3	4	2
Employee pension schemes	24	6	26	6
	<b>90</b>	<b>9</b>	<b>88</b>	<b>8</b>

The related parties' receivables are not secured and no guarantees were received in respect thereof. The receivables will be settled in accordance with normal credit terms. Details of guarantees, indemnities and warranties provided on behalf of related parties are given in note 50(h).

### Services provided by related parties

There were no services provided by related parties in either 2007 or 2008.

Details of loans made to joint ventures and associates may be found in notes 18 and 19 respectively.

### Key management compensation

The total compensation to those employees classified as key management, being those having authority and responsibility for planning, directing and controlling the activities of the Group, including the executive and non-executive directors is as follows:

	2008 £m	Restated 2007 £m
Salary and other short-term benefits	38	40
Post-employment benefits	3	4
Equity compensation plans	9	14
Termination benefits	3	2
<b>Total</b>	<b>53</b>	<b>60</b>

Information concerning individual directors' emoluments, interests and transactions is given in the Directors' remuneration report.

# Financial statements of the Company

## Income Statement

At 31 December 2008

	Note	2008 £m	2007 £m
<b>Income</b>			
Dividends received from subsidiaries		<b>1,796</b>	2,568
Interest receivable from Group companies		<b>151</b>	158
Net investment (expenses/income)		<b>(141)</b>	4
		<b>1,806</b>	2,730
<b>Expenses</b>			
Operating expenses	B	<b>(112)</b>	(193)
Interest payable to Group companies		<b>(992)</b>	(944)
Interest payable on borrowings		<b>(289)</b>	(232)
		<b>(1,393)</b>	(1,369)
<b>Profit before tax</b>		<b>413</b>	1,361
Tax credit	C	<b>383</b>	356
<b>Profit after tax</b>		<b>796</b>	1,717

## Statement of recognised income and expense

For the year ended 31 December 2008

	Note	2008 £m	2007 £m
Fair value losses on investments in subsidiaries	A	<b>(8,113)</b>	(3,420)
Actuarial gains on pension scheme		<b>2</b>	5
Aggregate tax effect		<b>16</b>	16
Net expenses recognised directly in equity		<b>(8,095)</b>	(3,399)
Profit for the year		<b>796</b>	1,717
<b>Excess of expenses over income recognised for the year</b>		<b>(7,299)</b>	(1,682)

## Reconciliation of movements in shareholders' equity

For the year ended 31 December 2008

	Note	2008 £m	Restated 2007 £m
<b>Balance at 1 January</b>		<b>20,982</b>	23,136
Excess of expenses over income recognised for the year		<b>(7,299)</b>	(1,682)
Dividends and appropriations	15	<b>(975)</b>	(871)
Issues of share capital	28	<b>20</b>	48
Employee trust shares distributed in the year	30	<b>(6)</b>	—
Shares issued in lieu of dividends	35	<b>170</b>	301
Reserves credit for equity compensation plans	10	<b>39</b>	50
<b>Balance at 31 December</b>		<b>12,931</b>	20,982

Where applicable, the accounting policies of the Company are the same as those of the Group on pages 125 to 139. The notes (identified alphabetically on pages 281 to 285 are an integral part of these separate financial statements. Where the same items appear in the Group financial statements, reference is made to the notes (identified numerically) on pages 146 to 277.

# Balance sheet

At 31 December 2008

	Note	2008 £m	2007 £m
<b>Assets</b>			
<b>Non-current assets</b>			
Investments in subsidiaries	A	16,353	24,466
Investment in joint venture	18c	61	52
Loans owed by subsidiaries		3,417	2,607
Deferred tax assets	C	–	9
Current tax assets		749	714
		<b>20,580</b>	<b>27,848</b>
<b>Current assets</b>			
Loans owed by subsidiaries		–	132
Other amounts owed by subsidiaries		2,179	1,027
Other assets		43	115
Cash and cash equivalents		78	14
<b>Total assets</b>		<b>22,880</b>	<b>29,136</b>
<b>Equity</b>			
Ordinary share capital	28	664	655
Preference share capital	31	200	200
Called up capital		864	855
Share premium account	28b	1,234	1,223
Merger reserve	D	735	735
Investment valuation reserve	D	5,770	13,883
Equity compensation reserve	D	113	89
Retained earnings	D	3,225	3,207
Direct capital instrument	32	990	990
<b>Total equity</b>		<b>12,931</b>	<b>20,982</b>
<b>Liabilities</b>			
<b>Non-current liabilities</b>			
Borrowings	E	4,838	3,252
Loans owed to subsidiaries		3,108	1,842
Provisions		40	40
		<b>7,986</b>	<b>5,134</b>
<b>Current liabilities</b>			
Borrowings	E	535	918
Loans owed to subsidiaries		975	1,846
Other amounts owed to subsidiaries		352	191
Other creditors		101	65
<b>Total liabilities</b>		<b>9,949</b>	<b>8,154</b>
<b>Total equity and liabilities</b>		<b>22,880</b>	<b>29,136</b>

Approved by the Board on 4 March 2009.

**Philip Scott**  
Chief Financial Officer



## Cash flow statement

For the year ended 31 December 2008

All the Company's operating and investing cash requirements are met by subsidiary companies and settled through intercompany loan accounts. As the direct method of presentation has been adopted for these activities, no further disclosure is required. In respect of financing activities, the following items pass through the Company's own bank accounts.

	2008 £m	2007 £m
<b>Cash flows from financing activities</b>		
Funding provided by subsidiaries	401	399
Net borrowings drawdown, net of expenses	3,905	4,780
Repayment of borrowings	(3,463)	(4,606)
Net drawdown of borrowings	442	174
Preference dividends paid	(17)	(17)
Ordinary dividends paid	(732)	(500)
Interest paid on borrowings	(30)	(47)
Net cash from financing activities	64	9
<b>Net increase in cash and cash equivalents</b>	<b>64</b>	<b>9</b>
Cash and cash equivalents at 1 January	14	5
<b>Cash and cash equivalents at 31 December</b>	<b>78</b>	<b>14</b>

# Notes to the Company financial statements

## A – Investments in subsidiaries

(i) Movements in the Company's investments in its subsidiaries are as follows:

	2008 £m	2007 £m
Fair value as at 1 January	<b>24,466</b>	27,886
Movement in fair value	<b>(8,113)</b>	(3,420)
At 31 December	<b>16,353</b>	24,466

(ii) At 31 December 2008, the Company has two wholly-owned subsidiaries, both incorporated in Great Britain. These are General Accident plc and Aviva Group Holdings Limited. Aviva Group Holdings Limited is an intermediate holding company, whilst General Accident plc no longer carries out this function. The principal subsidiaries of the Aviva Group at 31 December 2008 are listed on pages 328 and 329.

## B – Operating expenses

### (i) Operating expenses

Operating expenses comprise:

	2008 £m	2007 £m
Staff costs and other employee related expenditure (see below)	<b>86</b>	92
Other operating costs	<b>109</b>	95
Net foreign exchange losses/(gains)	<b>(83)</b>	6
<b>Total</b>	<b>112</b>	193

### (ii) Staff costs

Total staff costs were:

	2008 £m	2007 £m
Wages and salaries	<b>49</b>	46
Social security costs	<b>7</b>	6
Post-retirement obligations		
Defined benefit schemes (see (iii) below)	<b>6</b>	6
Defined contribution schemes	<b>3</b>	2
Profit sharing and incentive plans	<b>3</b>	13
Equity compensation plans (see (iv) below)	<b>11</b>	17
Termination benefits	<b>7</b>	2
<b>Total</b>	<b>86</b>	92

### (iii) Pension costs

The Company is one of a number of UK companies being charged for its employees participating in the Aviva Staff Pension Scheme, and its contributions are affected by the financial position of the scheme. There is no contractual agreement or policy for charging the net defined benefit cost for this scheme across the participating Group entities but, instead, this cost is recognised in the financial statements of the main UK employing company. The Company therefore recognises a pension expense equal to its contributions payable in the year for its staff, together with the service cost of any unfunded benefits, within staff costs above.

Full disclosure on the Group's pension schemes is given in note 46.

### (iv) Equity compensation plans

All transactions in the Group's equity compensation plans involve options and awards for ordinary shares of the Company. Full disclosure of these plans is given in note 29. The cost of such options and awards is borne by all participating businesses and, where relevant, the Company bears an appropriate charge. As the majority of the charge to the Company relates to directors' options and awards, for which full disclosure is made in the Directors' remuneration report, no further disclosure is given here on the grounds of immateriality.

## Notes to the Company financial statements continued

## C – Tax

## (i) Tax credited to income statement

	2008 £m	2007 £m
<b>Current tax:</b>		
For this year	387	351
Prior year adjustments	5	5
<b>Total current tax</b>	<b>392</b>	<b>356</b>
<b>Deferred tax:</b>		
Origination and reversal of timing differences	(9)	–
<b>Total deferred tax</b>	<b>(9)</b>	<b>–</b>
<b>Total tax credited to income statement</b>	<b>383</b>	<b>356</b>

## (ii) Tax credited to equity

Tax credited to equity comprises £16 million (2007: £16 million) in respect of coupon payments on the direct capital instruments.

## (iii) Tax reconciliation

The tax on the Company's profit before tax differs from the theoretical amount that would arise using the tax rate of the home country of the Company as follows:

	2008 £m	2007 £m
<b>Profit before tax</b>	<b>413</b>	<b>1,361</b>
Tax calculated at standard UK corporation tax rate of 28.5% (2007: 30%)	(118)	(408)
Adjustment to tax charge in respect of prior years	5	5
Non-assessable dividends	512	770
Disallowable expenses	(6)	(11)
Deferred tax asset not recognised	(11)	–
Other	1	–
<b>Total tax credited to income statement</b>	<b>383</b>	<b>356</b>

## (iv) Deferred tax asset

(i) The net deferred tax asset comprises:

	2008 £m	2007 £m
Provisions and other temporary differences	–	9
<b>Net deferred tax asset</b>	<b>–</b>	<b>9</b>

(ii) The movement in the net deferred tax asset was as follows:

	2008 £m	2007 £m
Net asset at 1 January	9	9
Amounts credited to profit	(9)	–
<b>Net asset at 31 December</b>	<b>–</b>	<b>9</b>

The taxation of foreign profits and worldwide debt cap rules has been the subject of consultation for some considerable time and HMRC are expected to announce measures in the Finance Bill 2009. It is not possible to quantify the impact of these measures at the balance sheet date.

The Company has unrecognised other temporary differences of £30 million (2007: nil).

## D – Reserves

	Merger reserve £m	Investment valuation reserve £m	Equity compensation reserve £m	Retained earnings £m
<b>Balance at 1 January 2007</b>	735	17,303	73	2,005
Arising in the year:				
Profit for the year	–	–	–	1,717
Fair value losses on investments in subsidiaries	–	(3,420)	–	–
Actuarial gains on pension schemes	–	–	–	5
Dividends and appropriations	–	–	–	(871)
Reserves credit for equity compensation plans	–	–	50	–
Shares issued in lieu of dividends	–	–	–	301
Issue of share capital under equity compensation scheme	–	–	(34)	34
Aggregate tax effect	–	–	–	16
<b>Balance at 31 December 2007</b>	735	13,883	89	3,207
Arising in the year:				
Profit for the year	–	–	–	796
Fair value losses on investments in subsidiaries	–	(8,113)	–	–
Actuarial gains on pension schemes	–	–	–	2
Dividends and appropriations	–	–	–	(975)
Reserves credit for equity compensation plans	–	–	39	–
Shares issued in lieu of dividends	–	–	–	170
Employee trust shares distributed in the year	–	–	–	(6)
Issue of share capital under equity compensation scheme	–	–	(15)	15
Aggregate tax effect	–	–	–	16
<b>Balance at 31 December 2008</b>	<b>735</b>	<b>5,770</b>	<b>113</b>	<b>3,225</b>

Tax of £16 million is deductible in respect of coupon payments of £56 million on direct capital instruments.

## E – Borrowings

The Company's borrowings comprise:

	2008 £m	2007 £m
Subordinated debt	<b>4,639</b>	3,054
9.5% guaranteed bonds 2016	<b>199</b>	198
Commercial paper	<b>535</b>	918
<b>Total</b>	<b>5,373</b>	4,170

Maturity analysis of contractual undiscounted cash flows:

	2008			2007		
	Principal £m	Interest £m	Total £m	Principal £m	Interest £m	Total £m
Within 1 year	535	312	847	932	235	1,167
1 – 5 years	–	1,163	1,163	–	799	799
5 – 10 years	409	1,449	1,858	351	998	1,349
10 – 15 years	1,402	1,250	2,652	588	867	1,455
Over 15 years	3,066	2,445	5,511	2,344	206	2,550
<b>Total contractual undiscounted cash flows</b>	<b>5,412</b>	<b>6,619</b>	<b>12,031</b>	<b>4,215</b>	<b>3,105</b>	<b>7,320</b>

Where subordinated debt is undated, the interest payments have not been included beyond 15 years. Annual interest payments for these borrowings are £77 million (2007: £70 million).

The fair value of the subordinated debt at 31 December 2008 was £2,979 million (2007: £3,006 million).

The fair value of the 9.5% guaranteed bonds 2016 at 31 December 2008 was £224 million (2007: £249 million).

The fair value of the commercial paper is considered to be the same as its carrying value.

Further details of these borrowings and undrawn committed facilities can be found in note 47.

**Notes to the Company financial statements continued****F – Contingent liabilities**

Details of the Company's contingent liabilities are given in note 50(h).

**G – Risk management**

Risk management in the context of the Group is considered in note 55.

The business of the Company is managing its investments in subsidiary and joint venture operations. Its risks are considered to be the same as those in the operations themselves and full details of the risk management policies are given in note 55. Such investments are held by the Company at fair value in accordance with accounting policy D.

The fair values of the subsidiaries and joint venture are estimated using applicable valuation models, underpinned by the Company's market capitalisation. This uses a three month rolling average of the Company's share price. Given that the key input into the valuation model is based on an observable current share price, and therefore sensitive to movements in that price, the valuation process is not sensitive to non-observable market assumptions. Management believes the resulting estimated fair values recorded in the balance sheet and any changes in fair values recorded in the income statement are reasonable, and are the most appropriate values at the balance sheet date.

Financial assets, other than investments in subsidiaries and the joint venture, largely consist of amounts due from subsidiaries. As at the balance sheet date, these receivable amounts were neither past due nor impaired.

Financial liabilities owed by the Company as at the balance sheet date are largely in respect of borrowings (details of which are provided in notes E and 47) and loans owed to subsidiaries. Loans owed to subsidiaries were within agreed credit terms as at the balance sheet date.

**Interest rate risk**

Loans to and from subsidiaries are at either fixed or floating rates of interest, with the latter being exposed to fluctuations in these rates. The choice of rates is designed to match the characteristics of financial investments (which are also exposed to interest rate fluctuations) held in both the Company and the relevant subsidiary, to mitigate as far as possible each company's net exposure.

The majority of the Company's external borrowings are at fixed rates of interest and are therefore not exposed to changes in these rates. However, for those borrowings that are at floating rates, the Company is affected by changes in these rates. Further details of the Company's borrowings are provided in notes E and 47.

**Currency risk**

The Company's direct subsidiaries are all incorporated and operating in the UK, and therefore are not exposed to currency risk. However, these subsidiaries are themselves exposed to foreign currency risk arising from fluctuations in exchange rates during the course of providing insurance and asset management services around the world. The exposure of the subsidiaries to currency risk is considered from a Group perspective in note 55.

The Company faces exposure to foreign currency risk through some of its borrowings which are denominated in euros and US dollars. However, most of these borrowings have been on-lent to a subsidiary which holds financial investments in these currencies, generating the net investment hedge described in note 56(c).

**H – Related party transactions**

The Company receives dividend and interest income from subsidiaries and pays interest and fee expense to those subsidiaries in the normal course of business. These activities are reflected in the table below.

Loans to and from subsidiaries are made on normal arm's-length commercial terms. The maturity analysis of the related party loans is as follows:

**Loans owed by subsidiaries**

Maturity analysis	2008 £m	2007 £m
Within 1 year	–	132
1-5 years	1,402	1,359
Over 5 years	2,015	1,248
<b>Total</b>	<b>3,417</b>	<b>2,739</b>

## Loans owed to subsidiaries

	2008			2007		
	Principal £m	Interest £m	Total £m	Principal £m	Interest £m	Total £m
Maturity analysis of contractual undiscounted cash flows						
Within 1 year	975	247	1,222	1,846	258	2,104
1-5 years	2,124	593	2,717	843	334	1,177
Over 5 years	984	164	1,148	999	341	1,340
<b>Total</b>	<b>4,083</b>	<b>1,004</b>	<b>5,087</b>	<b>3,688</b>	<b>933</b>	<b>4,621</b>

Other related party balances comprise dividends and interest receivable and payable, as well as inter-company balances for fees and other transactions in the normal course of business.

## Dividends, loans, interest

### Services provided to related parties

	Income earned in year 2008 £m	Receivable at year end 2008 £m	Income earned in year 2007 £m	Receivable at year end 2007 £m
Subsidiaries	1,947	5,596	2,726	3,766

The related parties' receivables are not secured and no guarantees were received in respect thereof. The receivables will be settled in accordance with normal credit terms. Details of guarantees, indemnities and warranties given by the Company on behalf of related parties are given in note 50(h).

### Services provided by related parties

	Expense incurred in year 2008 £m	Payable at year end 2008 £m	Expense incurred in year 2007 £m	Payable at year end 2007 £m
Subsidiaries	992	4,435	944	3,879

The related parties' payables are not secured and no guarantees were received in respect thereof. The payables will be settled in accordance with normal credit terms.

The directors and key management of the Company are considered to be the same as for the Group. Information on both the Company and Group key management compensation may be found in note 58.





“Don’t keep  
me waiting”



# Independent auditor's report to the directors of Aviva plc on the consolidated Aviva Market Consistent Embedded Value (MCEV)

We have audited the consolidated Aviva MCEV financial statements of Aviva plc for the year ended 31 December 2008 which comprise a Market Consistent Embedded Value basis Summarised consolidated income statement, the Consolidated statement of recognised income and expense, the Reconciliation of movements in shareholders' equity, the Summarised consolidated balance sheet, the Reconciliation of shareholders' equity, the Group MCEV analysis of earnings and the Segmentation of summarised consolidated balance sheet and the related notes M1 to M15. The consolidated Aviva MCEV financial statements have been prepared in accordance with the basis of preparation set out on, pages 295 to 299.

We have reported separately on the statutory Group financial statements of Aviva plc for the year ended 31 December 2008. The information contained in the consolidated MCEV financial statements should be read in conjunction with the financial statements prepared on an IFRS basis.

This report is made solely to the Company in accordance with our engagement letter dated 28 July 2008. Our audit work has been undertaken so that we might state to the Company those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company for our audit work, for this report, or for the opinions we have formed.

## Respective responsibilities of directors and auditors

The directors are responsible for preparing the consolidated Aviva MCEV financial statements under the basis of preparation as set out on pages 295 to 299.

Our responsibilities, as independent auditor, in relation to the consolidated Aviva MCEV financial statements are set out in our engagement letter dated 28 July 2008. We report to you our opinion as to whether the consolidated Aviva MCEV financial statements have been properly prepared in all material respects in accordance with the basis of preparation set out on pages 295 to 299. We also report to you if we have not received all the information and explanations we require for our audit of the consolidated Aviva MCEV financial statements.

We read other information contained in the Annual Report and Accounts and consider whether it is consistent with the consolidated Aviva MCEV financial statements.

## 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 Aviva MCEV financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the consolidated Aviva MCEV 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 Aviva MCEV 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 consolidated Aviva MCEV financial statements.

## Opinion

In our opinion the consolidated Aviva MCEV financial statements for the year ended 31 December 2008 has been properly prepared, in all material respects, in accordance with the basis of preparation set out on pages 295 to 299.

Ernst & Young LLP  
London

4 March 2009

# Summarised consolidated income statement

For the year ended 31 December 2008

2008 €m		2008 £m	Restated 2007 £m
	<b>Operating profit before tax attributable to shareholders' profits</b>		
3,501	Life MCEV operating earnings	2,801	2,544
52	Fund management <sup>1</sup>	42	90
1,498	General insurance and health	1,198	1,021
	Other:		
(204)	Other operations and regional costs <sup>2</sup>	(163)	(70)
(176)	Corporate centre	(141)	(157)
(474)	Group debt costs and other interest	(379)	(363)
4,197	<b>Operating profit before tax attributable to shareholders' profits</b>	3,358	3,065
	Adjusted for the following:		
(15,526)	Economic variances on long-term business	(12,422)	(19)
(1,024)	Short-term fluctuation in return of investments on non-long-term business	(819)	(184)
(118)	Economic assumption changes on general insurance and health business	(94)	2
(83)	Impairment of goodwill	(66)	(10)
(134)	Amortisation and impairment of intangibles	(108)	(89)
9	Profit on the disposal of subsidiaries and associates	7	20
(408)	Integration and restructuring costs	(326)	(153)
(943)	Exceptional items	(754)	–
(14,030)	<b>(Loss)/profit before tax</b>	(11,224)	2,632
(1,049)	Tax on operating earnings	(839)	(924)
5,441	Tax on other activities	4,353	238
4,392		3,514	(686)
(9,638)	<b>(Loss)/profit for the period</b>	(7,710)	1,946
	Attributable to:		
(9,540)	Equity shareholders of Aviva plc	(7,632)	1,704
(98)	Minority interests	(78)	242
(9,638)		(7,710)	1,946

All profit is from continuing operations.

1. Excludes the proportion of the results of Aviva Investors fund management businesses and other fund management operations within the group that arises from the provision of fund management services to our life businesses. These results are included within the life MCEV operating earnings consistent with Aviva's MCEV methodology.

2. Excludes the proportion of the results of subsidiaries providing services to the Life business. These results are included within the life MCEV operating earnings.

## Earnings per share – MCEV basis

2008	Earnings per share	2008	2007
	<b>Operating earnings on an MCEV basis after tax, attributable to ordinary shareholders of Aviva plc</b>		
104.3c	Basic (pence per share)	83.4p	70.4p
103.3c	Diluted (pence per share)	82.7p	69.8p
	<b>Earnings after tax on an MCEV basis, attributable to ordinary shareholders of Aviva plc</b>		
(363.6)c	Basic (pence per share)	(290.9)p	63.8p
(363.6)c	Diluted (pence per share)	(290.9)p	63.2p

## Consolidated statement of recognised income and expenses – MCEV basis

For the year ended 31 December 2008

2008 €m		2008 £m	Restated 2007 £m
(348)	Fair value (losses)/gains on AFS securities, owner-occupied properties and hedging instruments	(278)	45
(10)	Fair value gains transferred to profit	(8)	(12)
(1,161)	Actuarial (losses)/gains on pension schemes	(929)	648
98	Actuarial gains/(losses) on pension schemes transferred to unallocated divisible surplus and other movements	78	(61)
101	Impairment losses	81	–
3,741	Foreign exchange rate movements	2,993	1,159
83	Aggregate tax effect – shareholder tax	66	(246)
2,504	<b>Net income recognised directly in equity</b>	2,003	1,533
(9,638)	(Loss)/profit for the period	(7,710)	1,946
(7,134)	<b>Total recognised (expense)/income for the period</b>	(5,707)	3,479
	Attributable to:		
(7,889)	Equity shareholders of Aviva plc	(6,311)	3,044
755	Minority interests	604	435
(7,134)		(5,707)	3,479

## Reconciliation of movements in shareholders' equity – MCEV basis

For the year ended 31 December 2008

2008 €m		2008 £m	Restated 2007 £m
24,422	<b>Balance at 1 January</b>	23,689	20,443
(5,884)	Total recognised (expense)/ income for the period	(5,707)	3,479
(1,005)	Dividends and appropriations	(975)	(871)
21	Issues of share capital	20	48
175	Shares issued in lieu of dividends	170	301
37	Capital contribution from minority shareholders	36	–
(109)	Minority share of dividends declared in the year	(106)	(66)
44	Minority interest in acquired subsidiaries	43	315
(30)	Shares acquired by employee trusts	(29)	(10)
(67)	Changes in minority interest in existing subsidiaries	(65)	–
40	Reserves credit for equity compensation plans	39	50
17,644	<b>Total equity</b>	17,115	23,689
(3,106)	Minority interests	(3,013)	(2,501)
14,538	<b>Balance at 31 December</b>	14,102	21,188

## Summarised consolidated balance sheet – MCEV basis

For the year ended 31 December 2008

2008 €m		2008 £m	Restated 2007 £m
	<b>Assets</b>		
3,689	Goodwill	3,578	3,082
4,163	Acquired value of in-force business and intangible assets	4,038	3,197
2,751	Additional value of in-force long-term business	2,669	7,758
1,791	Interests in, and loans to, joint ventures	1,737	2,576
1,285	Interests in, and loans to, associates	1,246	1,206
994	Property and equipment	964	942
14,872	Investment property	14,426	15,391
43,543	Loans	42,237	36,193
	Financial investments		
154,902	Debt securities	150,255	121,312
44,692	Equity securities	43,351	58,829
37,233	Other investments	36,116	36,269
8,138	Reinsurance assets	7,894	8,054
2,724	Deferred tax assets	2,642	590
641	Current tax assets	622	376
10,119	Receivables and other financial assets	9,816	8,619
6,337	Deferred acquisition costs and other assets	6,147	4,487
3,878	Prepayments and accrued income	3,762	2,986
24,929	Cash and cash equivalents	24,181	16,089
1,598	Assets of operations classified as held for sale	1,550	1,128
<b>368,279</b>	<b>Total assets</b>	<b>357,231</b>	<b>329,084</b>
	<b>Equity</b>		
685	Ordinary share capital	664	655
4,644	Capital reserves	4,505	4,494
3,648	Other reserves	3,539	1,179
(34)	Shares held by employee trusts	(33)	(10)
3,924	Retained earnings	3,806	6,338
444	Additional retained earnings on an MCEV basis	431	7,342
<b>13,311</b>	<b>Equity attributable to ordinary shareholders of Aviva plc</b>	<b>12,912</b>	<b>19,998</b>
1,227	Preference share capital and direct capital instruments	1,190	1,190
3,106	Minority interests	3,013	2,501
<b>17,644</b>	<b>Total equity</b>	<b>17,115</b>	<b>23,689</b>
	<b>Liabilities</b>		
180,258	Gross insurance liabilities	174,850	152,839
110,886	Gross liabilities for investment contracts	107,559	98,244
2,397	Unallocated divisible surplus	2,325	6,785
7,132	Net asset value attributable to unitholders	6,918	6,409
3,076	Provisions	2,984	1,937
3,113	Deferred tax liabilities	3,020	2,532
662	Current tax liabilities	642	1,225
15,671	Borrowings	15,201	12,657
21,485	Payables and other financial liabilities	20,840	18,060
4,696	Other liabilities	4,556	3,765
1,259	Liabilities of operations classified as held for sale	1,221	942
<b>350,635</b>	<b>Total liabilities</b>	<b>340,116</b>	<b>305,395</b>
<b>368,279</b>	<b>Total equity and liabilities</b>	<b>357,231</b>	<b>329,084</b>

The summarised consolidated balance sheet presented above is unaltered from the corresponding IFRS summarised consolidated balance sheet, with the exception of the following:

1. Adding the excess of the Life MCEV, including minority interests, over the corresponding Life IFRS net assets represented as the additional value of in-force long-term business
2. Corresponding item within equity represented by the additional retained profit on an MCEV basis.
3. Corresponding adjustments to minority interests.



## Reconciliation of shareholders' equity

For the year ended 31 December 2008

2008	IFRS £m	Adjustment £m	MCEV £m
Ordinary share capital	664	–	664
Capital reserves	4,505	–	4,505
Other reserves	2,110	1,429	3,539
Shares held by employee trusts	(33)	–	(33)
Retained earnings	3,806	–	3,806
Additional retained earnings on an MCEV basis	–	431	431
<b>Equity attributable to ordinary shareholders of Aviva plc</b>	<b>11,052</b>	<b>1,860</b>	<b>12,912</b>
Preference share capital	200	–	200
Direct capital instruments	990	–	990
Minority interests	2,204	809	3,013
<b>Total equity</b>	<b>14,446</b>	<b>2,669</b>	<b>17,115</b>

Restated 2007	IFRS £m	Adjustment £m	MCEV £m
Ordinary share capital	655	–	655
Capital reserves	4,494	–	4,494
Other reserves	1,469	(290)	1,179
Shares held by employee trusts	(10)	–	(10)
Retained earnings	6,338	–	6,338
Additional retained earnings on an MCEV basis	–	7,342	7,342
<b>Equity attributable to ordinary shareholders of Aviva plc</b>	<b>12,946</b>	<b>7,052</b>	<b>19,998</b>
Preference share capital	200	–	200
Direct capital instruments	990	–	990
Minority interests	1,795	706	2,501
<b>Total equity</b>	<b>15,931</b>	<b>7,758</b>	<b>23,689</b>

### Reconciliation of IFRS total equity to MCEV net worth

	2008 £m	Restated 2007 £m
<b>Net assets on an statutory IFRS net basis</b>	<b>14,446</b>	15,931
Less: general business and other net assets on an statutory IFRS net basis	<b>2,135</b>	(1,292)
<b>Life and related businesses net assets on an statutory IFRS net basis</b>	<b>16,581</b>	14,639
Goodwill and other intangibles	<b>(2,947)</b>	(2,359)
Acquired value of in-force business	<b>(2,490)</b>	(1,790)
Adjustment for share of JVs & associates	<b>(472)</b>	(380)
Adjustment for assets to regulatory value net of tax	<b>1,474</b>	335
Adjustment for DAC & DIR net of tax	<b>(2,680)</b>	(1,740)
Adjustment for differences in technical provisions	<b>1,265</b>	737
Other accounting and tax differences	<b>78</b>	938
<b>MCEV net worth</b>	<b>10,809</b>	10,380
MCEV value of in-force	<b>5,580</b>	9,716
<b>MCEV<sup>1</sup></b>	<b>16,389</b>	20,096

1. Comprises embedded value of £14,089 million (2007: £18,248 million) and minority interest in long-term business assets of £2,300 million (2007: £1,848 million).

# Group MCEV analysis of earnings

For the year ended 31 December 2008

2008 (net of tax and minority interests)	Covered business <sup>1</sup> £m A	Non- covered but related to life business <sup>2</sup> £m B	Total life business <sup>3</sup> £m A+B	Non-covered relating to non-life £m C	Total non- covered business £m B+C	Total £m A+B+C
Opening Group MCEV	18,248	2,059	20,307	881	2,940	21,188
Opening adjustments	—	—	—	—	—	—
<b>Adjusted opening Group MCEV</b>	<b>18,248</b>	<b>2,059</b>	<b>20,307</b>	<b>881</b>	<b>2,940</b>	<b>21,188</b>
Operating MCEV earnings	1,753	—	1,753	535	535	2,288
Non-operating MCEV earnings	(8,638)	(53)	(8,691)	(1,229)	(1,282)	(9,920)
<b>Total MCEV earnings</b>	<b>(6,885)</b>	<b>(53)</b>	<b>(6,938)</b>	<b>(694)</b>	<b>(747)</b>	<b>(7,632)</b>
Other movements in IFRS net equity	—	(28)	(28)	(994)	(1,022)	(1,022)
Capital and dividend flows	(63)	—	(63)	(712)	(712)	(775)
Foreign exchange variances	2,702	567	3,269	(926)	(359)	2,343
Acquired/divested businesses	87	94	181	(181)	(87)	—
<b>Closing Group MCEV</b>	<b>14,089</b>	<b>2,639</b>	<b>16,728</b>	<b>(2,626)</b>	<b>13</b>	<b>14,102</b>
Preference share capital and direct capital instruments						(1,190)
<b>Equity attributable to ordinary shareholders of Aviva plc on an MCEV basis</b>						<b>12,912</b>

Restated 2007 (net of tax and minority interests)	Covered business <sup>1</sup> £m A	Non-covered but related to life business <sup>2</sup> £m B	Total life business <sup>3</sup> £m A+B	Non-covered relating to non-life £m C	Total non- covered business £m B+C	Total £m A+B+C
Opening Group MCEV	16,506	1,594	18,100	528	2,122	18,628
Opening adjustments	—	—	—	—	—	—
<b>Adjusted opening Group MCEV</b>	<b>16,506</b>	<b>1,594</b>	<b>18,100</b>	<b>528</b>	<b>2,122</b>	<b>18,628</b>
Operating MCEV earnings	1,567	—	1,567	309	309	1,876
Non-operating MCEV earnings	52	(33)	19	(191)	(224)	(172)
<b>Total MCEV earnings</b>	<b>1,619</b>	<b>(33)</b>	<b>1,586</b>	<b>118</b>	<b>85</b>	<b>1,704</b>
Other movements in IFRS net equity	—	124	124	316	440	440
Capital and dividend flows	(829)	—	(829)	347	347	(482)
Foreign exchange variances	851	61	912	(14)	47	898
Acquired/divested businesses	101	313	414	(414)	(101)	—
<b>Closing Group MCEV</b>	<b>18,248</b>	<b>2,059</b>	<b>20,307</b>	<b>881</b>	<b>2,940</b>	<b>21,188</b>
Preference share capital and direct capital instruments						(1,190)
<b>Equity attributable to ordinary shareholders of Aviva plc on an MCEV basis</b>						<b>19,998</b>

1. Covered business represents the business that the MCEV calculations cover, as detailed in the Basis of preparation note. The embedded value is presented net of minority interests and tax.

2. Non-covered but related to life business represents the adjustments to the MCEV, including goodwill, to calculate the long-term business net assets on an MCEV basis. An analysis of net assets on an MCEV basis gross of minority interests is provided on page 294.

3. Net assets for the total life businesses on an MCEV basis presented net of minority interests.

# Segmentation of summarised consolidated balance sheet

For the year ended 31 December 2008

	2008			Restated 2007		
	Life and related businesses £m	General business and other £m	Group £m	Life and related businesses £m	General business and other £m	Group £m
<b>Total assets before acquired value of in-force long-term business</b>	<b>305,562</b>	<b>46,634</b>	<b>352,196</b>	278,677	40,951	319,628
Acquired additional value of in-force long-term business	2,366	–	2,366	1,698	–	1,698
<b>Total assets included in the IFRS balance sheet</b>	<b>307,928</b>	<b>46,634</b>	<b>354,562</b>	280,375	40,951	321,326
Liabilities of the long-term business	(291,347)	–	(291,347)	(265,736)	–	(265,736)
Liabilities of the general insurance and other businesses	–	(48,769)	(48,769)	–	(39,659)	(39,659)
<b>Net assets on a statutory IFRS basis</b>	<b>16,581</b>	<b>(2,135)</b>	<b>14,446</b>	14,639	1,292	15,931
Additional value of in-force long-term business <sup>1</sup>	2,669	–	2,669	7,758	–	7,758
<b>Net assets on an MCEV basis<sup>2</sup></b>	<b>19,250</b>	<b>(2,135)</b>	<b>17,115</b>	22,397	1,292	23,689
Equity capital, capital reserves, shares held by employee trusts and other reserves			8,675			6,318
IFRS basis retained earnings			3,806			6,338
Additional MCEV basis retained earnings			431			7,342
<b>Equity attributable to ordinary shareholders of Aviva plc on an MCEV basis</b>			<b>12,912</b>			19,998
Preference share capital and direct capital instruments			1,190			1,190
Minority interests			3,013			2,501
<b>MCEV basis total equity</b>			<b>17,115</b>			23,689

1. The analysis between the Group's and minority interests' share of the additional value of in-force long-term business is as follows:

	2008	Restated 2007	Movement in period
Group's share included in shareholders' funds	431	7,342	(6,911)
Minority interests' share	809	706	103
Movements in AFS securities	1,429	(290)	1,719
<b>Additional value of in-force long-term business</b>	<b>2,669</b>	7,758	(5,089)

2. Analysis of net assets on an MCEV basis is made up as follows:

	2008	Restated 2007
Embedded value	14,089	18,248
Minority interests	2,300	1,848
	<b>16,389</b>	20,096
Goodwill and intangible assets allocated to long-term business <sup>3</sup>	2,947	2,359
Notional allocation of IAS19 pension fund deficit to long-term business <sup>4</sup>	(86)	(58)
<b>Long-term business net assets on an MCEV basis</b>	<b>19,250</b>	22,397

3. Goodwill and intangible assets includes amounts related to associated undertakings and joint ventures

4. The value of the Aviva Staff Pension Schemes deficit has been notionally allocated between segments, based on current funding and the life proportion has been included within the long-term business net assets on an MCEV basis. The pension fund deficit notionally allocated to long-term business is net of the proportion of funding borne by the UK with-profit funds.

# Notes to the MCEV financial statements

## M1 – Basis of preparation

### Introduction

The summarised consolidated income statement and balance sheet on pages 289 to 291 present the Group's results and financial position for the life and related businesses on the Market Consistent Embedded Value (MCEV) basis and for its non-life businesses on the International Financial Reporting Standards (IFRS) basis. The MCEV methodology adopted is in accordance with the MCEV Principles published by the CFO Forum in June 2008 with the exception of the use of an adjusted risk-free yield due to current market conditions for immediate annuities in the UK and Netherlands and for immediate annuities, deferred annuities and all other contracts in the US.

The CFO Forum MCEV Principles were designed during a period of relatively stable market conditions. As announced on 19 December 2008, the CFO Forum has agreed to conduct a review of the impact of turbulent market conditions on the MCEV Principles, the result of which may lead to changes to the published MCEV Principles or the issuance of guidance. The particular areas under review include implied volatilities, the cost of non-hedgeable risks, the use of swap rates as a proxy for risk-free rates and the effect of liquidity premia.

The directors consider that Aviva's MCEV methodology gives useful insight into the drivers of financial performance of the group's life and related businesses. This basis values future cash flows from assets consistently with market prices, including more explicit allowance for the impact of uncertainty in future investment returns and other risks. Embedded value is also consistent with the way pricing is assessed and the business is managed.

The results for 2008 and 2007 have been audited by our auditors, Ernst & Young. Their report in respect of 2008 can be found on page 288 in the Report and Accounts.

### Covered business

The MCEV calculations cover the following lines of business: life insurance, long-term health and accident insurance, savings, pensions and annuity business written by our life insurance subsidiaries, including managed pension fund business and our share of the other life and related business written in our associated undertakings and joint ventures, as well as the equity release business written in the UK.

Covered business includes the Group's share of our joint ventures including our arrangement with The Royal Bank of Scotland Group (RBSG) and our associated undertakings in India, China, Turkey, Malaysia, Taiwan and South Korea. In addition, the results of group companies providing significant administration, fund management and other services and of group holding companies have been included to the extent that they relate to covered business. Together these businesses are referred to as "Life and related businesses".

### Adjusted risk-free rate

Aviva's MCEV methodology adopts the CFO Forum Principles and Guidance with the exception of the use of an adjusted risk-free yield due to current market conditions for UK and Netherlands immediate annuities and for immediate annuities, deferred annuities and all other contracts in the US. In stable markets, swap curves are an appropriate risk-free rate. However, in the current turbulent market it is possible, for products where backing asset portfolios can be held to maturity, to earn returns in excess of swaps by investing in corporate bonds and credit default swaps (CDS).

The reference rate for these products has been increased above the swap curve to estimate the additional returns available through replicating portfolios where backing assets can be held to maturity in the current market. Due to the limited availability of CDS assets, particularly at the long durations, this is a material area of judgement and sensitivity analysis has been provided on page 320 on the additions to the swap curves.

In current markets, adjustments have been made to the swap rate for UK and Netherlands immediate annuities and all US contracts. Details of adjustments can be found in note M14.

**Notes to the MCEV financial statements****M1 – Basis of preparation continued****New business premiums**

New business premiums include:

- premiums arising from the sale of new contracts during the period;
- non-contractual additional premiums, including future Department of Work and Pensions (DWP) rebate premiums; and
- expected renewals on new contracts and expected future contractual alterations to new contracts.

The Group's definition of new business under MCEV includes contracts that meet the definition of "non-participating investment" contracts under IFRS.

For products sold to individuals, premiums are considered to represent new business where a new contract has been signed, or where underwriting has been performed. Renewal premiums include contractual renewals, non-contractual variations that are reasonably predictable and recurrent single premiums that are pre-defined and reasonably predictable.

For Group products, new business includes new contracts and increases to aggregate premiums under existing contracts. Renewal premiums are based on the level of premium received during the reporting period and allow for premiums expected to be received beyond the expiry of any guaranteed premium rates.

**Life and pensions operating earnings**

For life and pensions operating earnings, Aviva uses normalised investment returns, which are generally expressed as one year swap returns plus an asset risk premium. The use of asset risk premiums reflects management's long-term expectations of asset returns in excess of the swap yield from investing in different asset classes. This assumption does not impact the embedded value as asset risk premia are not recognised until earned.

**MCEV methodology****Overview**

Under the MCEV methodology, profit is recognised as it is earned over the life of products defined within covered business. The total profit recognised over the lifetime of a policy is the same as under the IFRS basis of reporting, but the timing of recognition is different.

**Calculation of the embedded value**

The shareholders' interest in the life and related businesses is represented by the embedded value. The embedded value is the total of the net worth of the life and related businesses and the value of in-force covered business. Calculations are performed separately for each business and are based on the cash flows of that business, after allowing for both external and intra-group reinsurance. Where one life business has an interest in another, the net worth of that business excludes the interest in the dependent company.

The embedded value is calculated on an after-tax basis applying current legislation and practice together with future known changes. Where gross results are presented, these have been calculated by grossing up post-tax results at the full rate of corporation tax for each country based on opening period tax rates.

**Net worth**

The net worth is 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, and consists of the required capital and free surplus.

Required capital is the market value of assets attributed to the covered business over and above that required to back liabilities for covered business, for which distribution to shareholders is restricted. Required capital is reported net of implicit items permitted on a local regulatory basis to cover minimum solvency margins which are assessed at a local entity level. The level of required capital for each business unit is set equal to the higher of:

- The level of capital at which the local regulator is empowered to take action;
- The capital requirement of the business unit under the Group's economic capital requirements; and
- The target capital level of the business unit.

This methodology reflects the level of capital considered by the directors to be appropriate to manage the business. The same definition of required capital is used for both existing and new business.

The free surplus is the market value of any assets allocated to, but not required to support, the in-force covered business at the valuation date.

The level of required capital across the business units expressed as a percentage of the EU minimum solvency margin (or equivalent) can be found on page 316.

## M1 – Basis of preparation continued

### **Value of in-force covered business (VIF)**

The value of in-force covered business consists of the following components:

- present value of future profits;
- time value of financial options and guarantees;
- frictional costs of required capital; and,
- cost of residual non-hedgeable risks.

### **Present value of future profits (PVFP)**

This is the present value of the distributable profits to shareholders arising from the in-force covered business projected on a best estimate basis.

Distributable profits generally arise when they are released following actuarial valuations. These valuations are carried out in accordance with any local 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, administration costs, as well as management and policyholder actions. Releases to shareholders arising in future years from the in-force covered business and associated required capital can be projected using assumptions of future experience.

Future profits are projected using best estimate non-economic assumptions and market consistent economic assumptions. In principle, each cash flow is discounted at a rate that appropriately reflects the riskiness of that cash flow, so higher risk cash flows are discounted at higher rates. In practice, the PVFP is calculated using the “certainty equivalent” approach, under which the reference rate is used for both the investment return and the discount rate. This approach ensures that asset cash flows are valued consistently with the market prices of assets without options and guarantees. Further information on the risk-free rates is given in note M14.

The PVFP includes the capitalised value of profits and losses arising from subsidiary companies providing administration, investment management and other services to the extent that they relate to covered business. This is referred to as the “look through” into service company expenses. In addition, expenses arising in holding companies that relate directly to acquiring or maintaining covered business have been allowed for. Where external companies provide services to the life and related businesses, their charges have been allowed for in the underlying projected cost base.

### **Time value of financial options and guarantees (TVOG)**

The PVFP calculation is based on a single (base) economic scenario. However, a single scenario cannot appropriately allow for the effect of certain product features. If an option or guarantee affects shareholder cash flows in the base scenario, the impact is included in the PVFP and is referred to as the intrinsic value of the option guarantee.

However, future investment returns are uncertain and the actual impact on shareholder profits may be higher or lower. The value of in-force business needs to be adjusted for the impact of the range of potential future outcomes. Stochastic modelling techniques can be used to assess the impact of potential future outcomes, and the difference between the intrinsic value and the total stochastic value is referred to as the time value of the option or guarantee.

Stochastic modelling typically involves projecting the future cash flows of the business under thousands of economic scenarios that are representative of the possible future outcomes for market variables such as interest rates and equity returns. Under a market consistent approach, the economic scenarios generated reflect the market’s tendency towards risk aversion. Allowance is made, where appropriate, for the effect of management and/or policyholder actions in different economic conditions on future assumptions such as asset mix, bonus rates and surrender rates.

Stochastic models are calibrated to market yield curves and volatility levels at the valuation date. Tests are performed to confirm that the scenarios used produce results that replicate the market price of traded instruments.

Where evidence exists that persistency rates are linked to economic scenarios, dynamic lapse assumptions are set that vary depending on the individual scenarios. This cost is included in the TVOG. Dynamic lapses are modelled for parts of the US and French business. Asymmetries in non-economic assumptions that are linked to economic scenarios, but that have insufficient evidence for credible dynamic assumptions, are allowed for within mean best estimate assumptions.



**Notes to the MCEV financial statements continued****M1 – Basis of preparation continued*****Frictional costs of required capital***

The additional costs to a shareholder of holding the assets backing required capital within an insurance company rather than directly in the market are called frictional costs. They are explicitly deducted from the PVFP. The additional costs allowed for are the taxation costs and any additional investment expenses on the assets backing the required capital. The level of required capital has been set out above in the net worth section.

Frictional costs are calculated by projecting forwards the future levels of required capital. Tax on investment return and investment expenses are payable on the assets backing required capital up until the point that they are released to shareholders.

***Cost of residual non-hedgeable risks (CNHR)***

The cost of residual non-hedgeable risks (CNHR) covers risks not already allowed for in the time value of options and guarantees or the PVFP. The allowance includes the impact of both non-hedgeable financial and non-financial risks. The most significant risk not included in the PVFP or TVOG is operational risk.

Aviva's methodology includes a cost of non-hedgeable risk equivalent to a charge of 2.5% applied to group-diversified capital. The cost has been calculated as a 1.5% charge applied to business unit-level capital, that is, allowing for diversification within a business unit, but not between business units. The charge was set so as to give an aggregate allowance that was in excess of the expected operational risk costs arising from the in-force covered business over its remaining lifetime.

The capital levels used are projected to be sufficient to cover non-hedgeable risks at the 99.5% confidence level one-year after the valuation date. The capital is equal to the capital from the ICA results for those risks considered. The capital has been projected as running off over the remaining life of the in-force portfolio in line with the drivers of the capital requirement.

In addition to the operational risk allowance, financial non-hedgeable risks and other product level asymmetries have been allowed for. These allowances are not material as significant financial non-hedgeable risks and product level asymmetries are either modelled explicitly and included in the TVOG or are included in the PVFP through the use of appropriate best estimate assumptions. Asymmetric risks allowed for in the TVOG or PVFP are described earlier in the Basis of Preparation. No allowance has been made within the cost of non-hedgeable risk for symmetrical risks as these are diversifiable by investors.

***Participating business***

Future regular bonuses on participating business are projected in a manner consistent with current bonus rates and expected future market-consistent returns on assets deemed to back the policies.

For with-profit funds in the UK 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 assets in the fund over the future lifetime of the in-force with-profit policies. However, under stochastic modelling there may be some extreme economic scenarios when the total assets in the Group's with-profit funds are not sufficient to pay all policyholder claims. The average additional shareholder cost arising from this shortfall has been included in the TVOG.

For profit sharing business in continental Europe, where policy benefits and shareholder value depend on the timing of realising gains, the apportionment of unrealised gains between policyholders and shareholders reflect contractual requirements as well as existing practice. Under certain economic scenarios where additional shareholder injections are required to meet policyholder payments, the average additional cost has been included in the TVOG.

The embedded value of the US spread-based products anticipates the application of management discretion allowed for contractually within the policies, subject to contractual guarantees. This includes the ability to change the crediting rates and indexed strategies available within the policy. Consideration is taken of the economic environment assumed in future projections and returns in excess of the reference rate are not assumed. Anticipated market and policyholder reaction to management action has been considered. The anticipated management action is consistent with current decision rules and has been approved and signed off by management and legal counsel.

## M1 – Basis of preparation continued

### Consolidation adjustments

The effect of transactions between group life companies such as loans and reinsurance arrangements have been included in the results split by territory in a consistent manner. No elimination is required on consolidation.

As the MCEV methodology incorporates the impact of profits and losses arising from subsidiary companies providing administration, investment management and other services to the Group's life companies, the equivalent profits and losses have been removed from the relevant segment (non-insurance or fund management) and are instead included within the results of life and related businesses. In addition, the underlying basis of calculation for these profits has changed from the IFRS basis to the MCEV basis.

The capitalised value of the future profits and losses from such service companies are included in the embedded value and value of new business calculations for the relevant business, but the net assets (representing historical profits and other amounts) remain under non-insurance or fund management. In order to reconcile the profits arising in the financial period within each segment with the assets on the opening and closing balance sheets, a transfer of IFRS profits from life and related business to the appropriate segment is deemed to occur. An equivalent approach has been adopted for expenses within our holding companies.

The assessments of goodwill, intangibles and pension schemes relating to life insurance business utilise the IFRS measurement basis.

### Prior year comparatives

The prior year comparatives have been restated to MCEV as announced on 4 February 2009.

### Presentation changes

Please refer to note 2 of the IFRS section of the Report and Accounts.

### Exchange rates

The Group's principal overseas operations during the period were located within the Eurozone and the United States.

The results and cash flows of these operations have been translated at the average rates for that period and the assets and liabilities have been translated at the period end rates as follows:

	2008	2007
Eurozone		
– Average rate (€1 equals)	<b>£0.80</b>	£0.68
– Period end rate (€1 equals)	<b>£0.97</b>	£0.73
United States		
– Average rate (US\$1 equals)	<b>£0.54</b>	£0.50
– Period end rate (US\$1 equals)	<b>£0.69</b>	£0.50

## Notes to the MCEV financial statements continued

## M2 – Analysis of life and pension earnings

The following table provides an analysis of the movement in embedded value for the covered business. The analysis is shown separately for free surplus, required capital and the value of in-force covered business, and includes amounts transferred between these categories. Included within capital and dividend flows is the transfer to life and related businesses from other segments consisting of service company profits and losses during the reported period that have emerged from the value of in-force. Since the “look through” into service companies includes only future profits and losses, these amounts must be eliminated from the closing embedded value. All figures are shown net of tax and minority interests.

	2008 £m				Restated 2007 £m			
	Earnings on MCEV analysis				Earnings on MCEV analysis			
	Free surplus	Required capital <sup>1</sup>	VIF	Total MCEV	Free surplus	Required capital <sup>1</sup>	VIF	Total MCEV
<b>Opening MCEV</b>	<b>3,204</b>	<b>6,240</b>	<b>8,804</b>	<b>18,248</b>	3,066	5,287	8,153	16,506
New business value	(1,867)	1,109	1,167	409	(1,432)	808	1,128	504
Expected existing business contribution (reference rate)	–	–	654	654	–	–	573	573
Expected existing business contribution (in excess of reference rate)	–	–	303	303	–	–	284	284
Transfers from VIF and required capital to the free surplus	1,926	(637)	(1,289)	–	1,683	(439)	(1,244)	–
Experience variances	154	3	(284)	(127)	271	(13)	(336)	(78)
Assumption changes	563	(114)	(584)	(135)	18	(8)	(40)	(30)
Expected return on shareholders' net worth	270	182	–	452	172	136	–	308
Other operating variances	44	(29)	182	197	2	12	(8)	6
Operating MCEV earnings	1,090	514	149	1,753	714	496	357	1,567
Economic variances	(3,140)	(433)	(4,833)	(8,406)	37	112	(97)	52
Other non-operating variance	(104)	19	(147)	(232)	–	–	–	–
<b>Total MCEV (loss)/earnings</b>	<b>(2,154)</b>	<b>100</b>	<b>(4,831)</b>	<b>(6,885)</b>	751	608	260	1,619
Capital and dividend flows	(63)	–	–	(63)	(829)	–	–	(829)
Foreign exchange variance	459	1,597	646	2,702	172	308	371	851
Acquired/divested business	(98)	211	(26)	87	44	37	20	101
<b>Closing MCEV</b>	<b>1,348</b>	<b>8,148</b>	<b>4,593</b>	<b>14,089</b>	3,204	6,240	8,804	18,248

1. Required capital is shown net of implicit items permitted by local regulators to cover minimum solvency margins.

### M3 – Life MCEV operating return

*The components of the life MCEV earnings in the consolidated income statement have been further analysed in this note. This analysis shows the life MCEV earnings gross of both taxes and minorities analysed in total.*

In this table the life and pensions MCEV earnings have been broken down into constituent parts. The life and pensions MCEV operating earnings comprise:

- the value of new business written during the year;
- the earnings from existing business; and,
- the expected investment return on the shareholders' net worth.

These components are calculated using economic assumptions as at the start of the year (in-force business) or start of the quarter (new business) and operating (demographic and expenses) assumptions as at the end of the year.

	2008 £m	Restated 2007 £m
<b>Life and pensions MCEV earnings</b>		
Value of new business	780	897
Earnings from existing business		
– expected returns at the reference rate	992	877
– expected returns in excess of the reference rate	446	420
– expected returns	1,438	1,297
– experience variances	(224)	(111)
– operating assumption changes	(165)	(25)
– other operating variances	271	1
Expected return on shareholders' net worth	701	485
<b>Life and pensions operating earnings before tax</b>	<b>2,801</b>	<b>2,544</b>
Economic variances	(12,422)	(19)
Other non-operating variances	(329)	–
<b>Life and pensions (loss)/earnings before tax</b>	<b>(9,950)</b>	<b>2,525</b>
Tax on operating earnings	(821)	(754)
Tax on other activities	3,779	48
<b>Life and pensions (loss)/earnings after tax</b>	<b>(6,992)</b>	<b>1,819</b>

There were no separate development costs reported in these years.

The table above presents a summarised breakdown of the life and pensions MCEV earnings on a gross of minorities basis and gross of tax with tax shown separately. The Group favours the gross presentation for consistency with the IFRS results. The table below compares the key items on the different bases as the subsequent analysis is provided predominantly on a net of tax and minorities basis as preferred by the CFO Forum Principles.

Key indicators	2008		Restated 2007	
	Net of minorities and tax £m	Gross of minorities and tax £m	Net of minorities and tax £m	Gross of minorities and tax £m
Value of new business	409	780	504	897
Life and pensions operating earnings	1,753	2,801	1,567	2,544
Life and pensions earnings	(6,885)	(9,950)	1,619	2,525

## Notes to the MCEV financial statements continued

## M4 – New business

*This note gives more detail relating to the value of new business, the capital required to write new business, the rate of return achieved and how quickly the initial capital invested is paid back.*

The tables below set out the present value of new business premiums (PVNBP), written by the life and related businesses, the value of new business and the resulting margin firstly gross and then net of tax and minority interests. The PVNBP calculation is equal to total single premium sales received in the period plus the discounted value of regular premiums expected to be received over the term of the new contracts, and is expressed at the point of sale.

New business sales are expressed as the PVNBP. The premium volumes and projection assumptions used to calculate the present value of regular premiums for each product are the same as those used to calculate the value of new business, so the components of the new business margin are on a consistent basis.

The value generated by new business written during the period is the present value of the projected stream of after tax distributable profit from that business. The value of new business has been calculated using economic assumptions at the point of sale which has been implemented with the assumptions being taken as those appropriate to the start of each quarter. For contracts that are re-priced more frequently, weekly or monthly economic assumptions have been used. The operating assumptions are consistent with those used to determine the embedded value. The value of new business is shown after the effect of the frictional costs of holding required capital, and after the effect of the costs of residual non-hedgeable risks on the same basis as for the in-force covered business.

## (a) Present value of life new business premiums

2008	Regular premiums £m	Weighted average capitalisation factor £m	Present value of regular premiums £m	Single premiums £m	Present value of new business premiums £m
<b>United Kingdom</b>	<b>660</b>	<b>4.8</b>	<b>3,180</b>	<b>8,678</b>	<b>11,858</b>
France	95	6.9	651	3,229	3,880
Ireland	129	4.3	557	742	1,299
Italy	132	6.0	796	1,535	2,331
Netherlands (including Belgium and Germany)	197	9.0	1,775	2,322	4,097
Poland	106	11.2	1,183	659	1,842
Spain	174	6.0	1,042	1,485	2,527
Other Europe	117	7.7	906	108	1,014
<b>Europe</b>	<b>950</b>	<b>7.3</b>	<b>6,910</b>	<b>10,080</b>	<b>16,990</b>
<b>North America</b>	<b>68</b>	<b>8.8</b>	<b>600</b>	<b>5,115</b>	<b>5,715</b>
Asia	174	5.4	941	410	1,351
Australia	60	3.6	217	152	369
<b>Asia Pacific</b>	<b>234</b>	<b>5.0</b>	<b>1,158</b>	<b>562</b>	<b>1,720</b>
<b>Total life and pensions</b>	<b>1,912</b>	<b>6.2</b>	<b>11,848</b>	<b>24,435</b>	<b>36,283</b>

2007	Regular premiums £m	Weighted average capitalisation factor £m	Present value of regular premiums £m	Single premiums £m	Present value of new business premiums £m
<b>United Kingdom</b>	<b>603</b>	<b>4.7</b>	<b>2,852</b>	<b>8,945</b>	<b>11,797</b>
France	90	7.0	632	3,158	3,790
Ireland	139	4.4	615	1,165	1,780
Italy	107	5.7	608	2,367	2,975
Netherlands (including Belgium and Germany)	160	8.6	1,378	1,755	3,133
Poland	63	11.2	707	413	1,120
Spain	114	5.9	672	1,761	2,433
Other Europe	73	4.4	318	135	453
<b>Europe</b>	<b>746</b>	<b>6.6</b>	<b>4,930</b>	<b>10,754</b>	<b>15,684</b>
<b>North America</b>	<b>71</b>	<b>8.2</b>	<b>579</b>	<b>3,067</b>	<b>3,646</b>
Asia	114	6.0	683	458	1,141
Australia	54	3.5	191	263	454
<b>Asia Pacific</b>	<b>168</b>	<b>5.2</b>	<b>874</b>	<b>721</b>	<b>1,595</b>
<b>Total life and pensions</b>	<b>1,588</b>	<b>5.8</b>	<b>9,235</b>	<b>23,487</b>	<b>32,722</b>

## M4 – New business continued

### (b) Geographical analysis of value of new business

	Present value of new business premiums		Value of new business		New business margin	
	2008 £m	Restated 2007 £m	2008 £m	Restated 2007 £m	2008 %	Restated 2007 %
<b>Life and pensions (gross of tax and minority interest)</b>						
<b>United Kingdom</b>	<b>11,858</b>	11,797	<b>204</b>	278	<b>1.7%</b>	2.4%
France	<b>3,880</b>	3,790	<b>135</b>	144	<b>3.5%</b>	3.8%
Ireland	<b>1,299</b>	1,780	<b>15</b>	37	<b>1.2%</b>	2.1%
Italy	<b>2,331</b>	2,975	<b>71</b>	77	<b>3.0%</b>	2.6%
Netherlands (including Belgium and Germany)	<b>4,097</b>	3,133	<b>(73)</b>	8	<b>(1.8)%</b>	0.3%
Poland	<b>1,842</b>	1,120	<b>65</b>	48	<b>3.5%</b>	4.3%
Spain	<b>2,527</b>	2,433	<b>236</b>	181	<b>9.3%</b>	7.4%
Other Europe	<b>1,014</b>	453	<b>29</b>	7	<b>2.9%</b>	1.3%
<b>Europe</b>	<b>16,990</b>	15,684	<b>478</b>	502	<b>2.8%</b>	3.2%
<b>North America</b>	<b>5,715</b>	3,646	<b>55</b>	52	<b>1.0%</b>	1.4%
Asia	<b>1,351</b>	1,141	<b>30</b>	49	<b>2.2%</b>	4.3%
Australia	<b>369</b>	454	<b>13</b>	16	<b>3.5%</b>	3.5%
<b>Asia Pacific</b>	<b>1,720</b>	1,595	<b>43</b>	65	<b>2.5%</b>	4.1%
<b>Total life and pensions</b>	<b>36,283</b>	32,722	<b>780</b>	897	<b>2.1%</b>	2.7%

	Present value of new business premiums		Value of new business		New business margin	
	2008 £m	Restated 2007 £m	2008 £m	Restated 2007 £m	2008 %	Restated 2007 %
<b>Life and pensions (net of tax and minority interests)</b>						
<b>United Kingdom</b>	<b>11,858</b>	11,797	<b>147</b>	195	<b>1.2%</b>	1.7%
France	<b>3,281</b>	3,157	<b>79</b>	81	<b>2.4%</b>	2.6%
Ireland	<b>974</b>	1,335	<b>10</b>	26	<b>1.0%</b>	1.9%
Italy	<b>980</b>	1,284	<b>21</b>	20	<b>2.1%</b>	1.6%
Netherlands (including Belgium and Germany)	<b>3,868</b>	2,941	<b>(67)</b>	3	<b>(1.7)%</b>	0.1%
Poland	<b>1,604</b>	966	<b>46</b>	34	<b>2.9%</b>	3.5%
Spain	<b>1,376</b>	1,223	<b>80</b>	57	<b>5.8%</b>	4.7%
Other Europe	<b>1,014</b>	453	<b>24</b>	4	<b>2.4%</b>	0.9%
<b>Europe</b>	<b>13,097</b>	11,359	<b>193</b>	225	<b>1.5%</b>	2.0%
<b>North America</b>	<b>5,715</b>	3,646	<b>36</b>	34	<b>0.6%</b>	0.9%
Asia	<b>1,344</b>	1,133	<b>24</b>	39	<b>1.8%</b>	3.4%
Australia	<b>369</b>	454	<b>9</b>	11	<b>2.4%</b>	2.4%
<b>Asia Pacific</b>	<b>1,713</b>	1,587	<b>33</b>	50	<b>1.9%</b>	3.2%
<b>Total life and pensions</b>	<b>32,383</b>	28,389	<b>409</b>	504	<b>1.3%</b>	1.8%

### (c) Post-tax internal rate of return on life and pension new business and payback period

The new business written requires up front capital investment, due to high set-up costs and capital requirements. The internal rate of return (IRR) is a measure of the shareholder return expected on this capital investment. It is equivalent to the discount rate at which the present value of the post-tax cash flows expected to be earned over the life time of the business written, including allowance for the time value of options and guarantees, is equal to the total invested capital to support the writing of the business. The capital included in the calculation of the IRR is the initial capital required to pay acquisition costs and set up statutory reserves in excess of premiums received ("initial capital"), plus required capital at the same level as for the calculation of the value of new business.

The payback period shows how quickly shareholders can expect the total capital to be repaid. The payback period has been calculated based on undiscounted cash flows and allows for the initial and required capital.



## Notes to the MCEV financial statements continued

## M4 – New business continued

The projected investment returns in both the IRR and payback period calculations assume that equities, properties and bonds earn a return in excess of risk-free consistent with the long-term rate of return assumed in operating earnings.

The IRR on life and pensions new business for the Group was 11.4% (2007 restated: 12.9%)

	Internal rate of return %	Initial capital £m	Required capital £m	Total invested capital £m	Payback period Years
<b>2008</b>					
<b>United Kingdom</b>	<b>14%</b>	<b>157</b>	<b>136</b>	<b>293</b>	<b>8</b>
France	9%	35	118	153	9
Ireland	8%	53	24	77	9
Italy	14%	9	48	57	6
Netherlands (including Belgium and Germany) <sup>1</sup>	5%	277	244	521	n/a
Poland	21%	31	12	43	4
Spain	37%	28	75	103	3
Other Europe	13%	57	9	66	6
<b>Europe<sup>1</sup></b>	<b>11%</b>	<b>490</b>	<b>530</b>	<b>1,020</b>	<b>7</b>
<b>North America</b>	<b>11%</b>	<b>124</b>	<b>489</b>	<b>613</b>	<b>6</b>
Asia	13%	64	23	87	8
Australia	12%	3	30	33	8
<b>Asia Pacific</b>	<b>12%</b>	<b>67</b>	<b>53</b>	<b>120</b>	<b>8</b>
<b>Total<sup>1</sup></b>	<b>11.4%</b>	<b>838</b>	<b>1,208</b>	<b>2,046</b>	<b>7</b>

1. In the Netherlands, the value of new business is low on a real world basis, and so it is not possible to calculate a meaningful payback period. Consequently, the total and Europe average payback periods exclude the Netherlands. On a comparable basis the total payback period in 2007 is 7 years.

	Internal rate of return %	Initial capital £m	Required capital £m	Total invested capital £m	Payback period Years
<b>2007</b>					
<b>United Kingdom</b>	<b>13%</b>	<b>256</b>	<b>149</b>	<b>405</b>	<b>8</b>
France	12%	29	107	136	8
Ireland	11%	69	23	92	7
Italy	15%	4	52	56	6
Netherlands (including Belgium and Germany)	6%	78	181	259	22
Poland	23%	18	10	28	4
Spain	28%	24	68	92	3
Other Europe	18%	48	4	52	5
<b>Europe</b>	<b>13%</b>	<b>270</b>	<b>445</b>	<b>715</b>	<b>12</b>
<b>North America</b>	<b>12%</b>	<b>125</b>	<b>280</b>	<b>405</b>	<b>6</b>
Asia	23%	48	11	59	4
Australia	15%	–	23	23	6
<b>Asia Pacific</b>	<b>21%</b>	<b>48</b>	<b>34</b>	<b>82</b>	<b>4</b>
<b>Total</b>	<b>12.9%</b>	<b>699</b>	<b>908</b>	<b>1,607</b>	<b>9</b>

Total initial capital for life and pensions new business of £838 million (2007 restated: £699 million) is expressed at the point of sale. Hence, it is higher than the impact of writing that new business on net worth of £758 million (2007 restated: £624 million) shown on page 298, because the latter amount includes expected profits from the point of sale to the end of the reporting period, partly offset by the cost of holding the initial capital. The fall in IRR reflects the reduction on reference rates and the higher weighting of the Netherlands.

## M5 – Free surplus emergence

*This note shows how our business generates free surplus. To do this the impact of the business on net worth and required capital is considered separately for existing business and new business.*

	Existing business					New business		Total business	
	Transfer from VIF to net worth £m	Return on net worth £m	Impact of experience variances and assumption changes on net worth £m	Release of required capital to free surplus £m	Total existing business surplus generation £m	Impact on net worth £m	Reduction in free surplus from required capital £m	Total new business surplus generation £m	Total free surplus generation £m
2008									
United Kingdom	403	119	736	85	1,343	(147)	(159)	(306)	1,037
Europe	619	280	(92)	325	1,132	(438)	(422)	(860)	272
North America	194	39	(24)	197	406	(118)	(475)	(593)	(187)
Asia Pacific	73	14	1	(12)	76	(55)	(53)	(108)	(32)
<b>Total</b>	<b>1,289</b>	<b>452</b>	<b>621</b>	<b>595</b>	<b>2,957</b>	<b>(758)</b>	<b>(1,109)</b>	<b>(1,867)</b>	<b>1,090</b>

	Existing business					New business		Total business	
	Transfer from VIF to net worth £m	Return on net worth £m	Impact of experience variances and assumption changes on net worth £m	Release of required capital to free surplus £m	Total existing business surplus generation £m	Impact on net worth £m	Reduction in free surplus from required capital £m	Total new business surplus generation £m	Total free surplus generation £m
2007									
United Kingdom	549	66	225	57	897	(245)	(149)	(394)	503
Europe	537	197	42	118	894	(225)	(345)	(570)	324
North America	103	33	19	133	288	(107)	(280)	(387)	(99)
Asia Pacific	55	12	(4)	4	67	(47)	(34)	(81)	(14)
<b>Total</b>	<b>1,244</b>	<b>308</b>	<b>282</b>	<b>312</b>	<b>2,146</b>	<b>(624)</b>	<b>(808)</b>	<b>(1,432)</b>	<b>714</b>

## Notes to the MCEV financial statements continued

## M6 – Maturity profile of business

*This note sets out how the VIF generated by the in-force and new business is modelled as emerging into free surplus over future years. Cash flows are projected on a certainty equivalent basis and are discounted at risk-free rates.*

## (a) Total in-force business

To show the profile of the VIF emergence, the value of VIF in the consolidated balance sheet has been split into five year tranches depending on the date when the profit is expected to emerge.

2008 £m	0-5	6-10	11-15	16-20	20+	Total gross of minority interest	Total net of minority interest
United Kingdom	634	542	385	279	213	2,053	2,053
Europe	1,560	1,200	741	447	411	4,359	3,380
North America	(66)	(245)	(238)	(211)	(342)	(1,102)	(1,102)
Asia Pacific	108	71	47	28	16	270	262
<b>Total</b>	<b>2,236</b>	<b>1,568</b>	<b>935</b>	<b>543</b>	<b>298</b>	<b>5,580</b>	<b>4,593</b>

2007 Restated £m	0-5	6-10	11-15	16-20	20+	Total gross of minority interest	Total net of minority interest
United Kingdom	1,574	1,209	615	345	524	4,267	4,267
Europe	2,200	1,170	736	412	332	4,850	3,946
North America	168	129	41	16	(24)	330	330
Asia Pacific	130	105	15	8	11	269	261
<b>Total</b>	<b>4,072</b>	<b>2,613</b>	<b>1,407</b>	<b>781</b>	<b>843</b>	<b>9,716</b>	<b>8,804</b>

## (b) New business

To show the profile of the VIF emergence, the value of new business has been split into five year tranches depending on the date when the profit is expected to emerge.

2008 £m	0-5	6-10	11-15	16-20	20+	Total gross of minority interest	Total net of minority interest
United Kingdom	91	74	69	50	10	294	294
Europe	219	146	103	73	250	791	630
North America	112	45	8	1	(12)	154	154
Asia Pacific	48	17	10	5	10	90	89
<b>Total</b>	<b>470</b>	<b>282</b>	<b>190</b>	<b>129</b>	<b>258</b>	<b>1,329</b>	<b>1,167</b>

2007 Restated £m	0-5	6-10	11-15	16-20	20+	Total gross of minority interest	Total net of minority interest
United Kingdom	192	114	55	31	48	440	440
Europe	283	140	91	56	29	599	450
North America	85	61	6	(1)	(11)	140	140
Asia Pacific	46	41	5	3	4	99	98
<b>Total</b>	<b>606</b>	<b>356</b>	<b>157</b>	<b>89</b>	<b>70</b>	<b>1,278</b>	<b>1,128</b>

## M7 – Geographical analysis of MCEV operating earnings

*This note gives a geographical split of the MCEV operating earnings on a gross basis and an analysis of earnings on a net basis*

Gross of tax and minority interests 2008	UK £m	France £m	Ireland £m	Italy £m	Nether- lands £m	Poland £m	Spain £m	Other Europe £m	Europe £m	North America £m	Asia £m	Australia £m	Asia Pacific £m	Total £m
Value of new business	204	135	15	71	(73)	65	236	29	478	55	30	13	43	780
Earnings from existing business														
– expected existing business contribution (reference rate)	338	188	39	30	107	91	60	19	534	86	9	25	34	992
– expected existing business contribution (in excess of reference rate)	210	38	8	6	95	8	22	–	177	53	4	2	6	446
Experience variances														
– maintenance expense <sup>1</sup>	20	2	(2)	(6)	(35)	6	(1)	(1)	(37)	–	(2)	–	(2)	(19)
– project and other related expenses <sup>1</sup>	(62)	(10)	(7)	–	(26)	–	(6)	(6)	(55)	(14)	–	–	–	(131)
– mortality/morbidity <sup>2</sup>	18	42	2	2	19	20	4	1	90	–	5	2	7	115
– lapses <sup>3</sup>	(23)	(8)	(7)	(15)	(11)	26	(24)	(10)	(49)	(5)	(4)	3	(1)	(78)
– other <sup>4</sup>	7	(45)	(42)	(15)	34	(8)	2	(1)	(75)	(31)	(1)	(11)	(12)	(111)
Operating assumption changes:														
– maintenance expenses <sup>5</sup>	(15)	(12)	(2)	(9)	(167)	4	–	(12)	(198)	(5)	(3)	–	(3)	(221)
– project and other related expenses	13	–	–	–	9	–	–	–	9	–	–	–	–	22
– mortality/morbidity <sup>6</sup>	54	–	25	11	(79)	4	(1)	–	(40)	–	1	(1)	–	14
– lapses <sup>7</sup>	(73)	108	7	(9)	–	(10)	(19)	(20)	57	–	(12)	1	(11)	(27)
– other <sup>8</sup>	16	(1)	23	3	(28)	24	–	13	34	1	(10)	6	(4)	47
Expected return on shareholders' net worth	166	107	34	63	204	13	23	8	452	61	14	8	22	701
Other operating variances <sup>9</sup>	10	148	(15)	(1)	138	(2)	(10)	3	261	–	–	–	–	271
<b>Earnings before tax and minority interests</b>	<b>883</b>	<b>692</b>	<b>78</b>	<b>131</b>	<b>187</b>	<b>241</b>	<b>286</b>	<b>23</b>	<b>1,638</b>	<b>201</b>	<b>31</b>	<b>48</b>	<b>79</b>	<b>2,801</b>

Please refer to footnotes on page 309.

## Notes to the MCEV financial statements continued

## M7 – Geographical analysis of MCEV operating earnings continued

Gross of tax and minority interests Restated 2007	UK £m	France £m	Ireland £m	Italy £m	Nether- lands £m	Poland £m	Spain £m	Other Europe £m	Europe £m	North America £m	Asia £m	Australia £m	Asia Pacific £m	Total £m
Value of new business	278	144	37	77	8	48	181	7	502	52	49	16	65	897
Earnings from existing business														
– expected existing business contribution (reference rate)	373	148	26	23	96	50	46	10	399	75	10	20	30	877
– expected existing business contribution (in excess of reference rate)	190	31	8	5	132	6	23	–	205	22	2	1	3	420
Experience variances														
– maintenance expense	10	2	(3)	9	(6)	3	(1)	(5)	(1)	(21)	(1)	(3)	(4)	(16)
– project and other related expenses <sup>1</sup>	(87)	10	(4)	–	(16)	–	(3)	(8)	(21)	–	(1)	–	(1)	(109)
– mortality/morbidity <sup>2</sup>	12	29	(1)	–	2	14	(4)	2	42	(3)	6	3	9	60
– lapses <sup>3</sup>	(11)	7	6	(15)	7	17	–	1	23	–	(11)	–	(11)	1
– other <sup>4</sup>	(24)	(24)	(6)	–	17	7	7	–	1	(27)	–	3	3	(47)
Operating assumption changes:														
– maintenance expenses <sup>5</sup>	8	3	(1)	(1)	(9)	5	1	(10)	(12)	(29)	1	–	1	(32)
– project and other related expenses <sup>1</sup>	2	(1)	–	–	(7)	–	–	(11)	(19)	–	–	–	–	(17)
– mortality/morbidity <sup>6</sup>	(29)	(2)	–	4	(34)	15	(13)	1	(29)	–	(9)	4	(5)	(5)
– lapses	(16)	1	–	1	4	12	(16)	3	5	(4)	(8)	(2)	(10)	125
– other <sup>7</sup>	(31)	134	–	4	(40)	(4)	–	(14)	80	9	(4)	–	(4)	54
Expected return on shareholders' net worth	93	86	23	40	147	8	14	4	322	51	11	8	19	485
Other operating variances <sup>8</sup>	(4)	–	–	(10)	15	–	(2)	3	6	(1)	–	–	–	1
Earnings before tax and minority interests	822	568	85	137	316	181	233	(17)	1,503	124	45	50	95	2,544

Please refer to footnotes on page 310.

## M7 – Geographical analysis of MCEV operating earnings continued

Net of tax and minority interests 2008	UK £m	France £m	Ireland £m	Italy £m	Nether- lands £m	Poland £m	Spain £m	Other Europe £m	Europe £m	North America £m	Asia £m	Australia £m	Asia Pacific £m	Total £m
Value of new business	147	79	10	21	(67)	46	80	24	193	36	24	9	33	409
Earnings from existing business														
– expected existing business contribution (reference rate)	244	115	26	9	74	64	23	15	326	56	10	18	28	654
– expected existing business contribution (in excess of reference rate)	151	24	5	2	68	6	9	–	114	35	2	1	3	303
Experience variances														
– maintenance expense <sup>1</sup>	15	1	(1)	(2)	(22)	4	–	(1)	(21)	–	(3)	–	(3)	(9)
– project and other related expenses <sup>1</sup>	(45)	(7)	(5)	–	(18)	–	(4)	(5)	(39)	(9)	–	–	–	(93)
– mortality/morbidity <sup>2</sup>	13	26	1	1	12	15	–	1	56	–	4	1	5	74
– lapses <sup>3</sup>	(17)	(4)	(5)	(5)	(1)	18	(10)	(9)	(16)	(2)	(3)	2	(1)	(36)
– other <sup>4</sup>	5	(29)	(27)	(6)	29	(6)	1	(1)	(39)	(20)	(1)	(8)	(9)	(63)
Operating assumption changes:														
– maintenance expenses <sup>5</sup>	(11)	(8)	(1)	(3)	(109)	3	–	(10)	(128)	(3)	(3)	–	(3)	(145)
– project and other related expenses	9	–	–	–	4	–	–	–	4	–	–	–	–	13
– mortality/morbidity <sup>6</sup>	39	–	16	4	(77)	3	(1)	–	(55)	–	1	(1)	–	(16)
– lapses <sup>7</sup>	(53)	65	4	(3)	–	(8)	(7)	(16)	35	–	(10)	1	(9)	(27)
– other <sup>8</sup>	12	–	15	1	(13)	18	–	11	32	–	(8)	4	(4)	40
Expected return on shareholders' net worth	119	66	23	20	145	10	10	6	280	39	8	6	14	452
Other operating variances <sup>9</sup>	7	98	(11)	(1)	104	(1)	(4)	2	187	–	3	–	3	197
<b>Earnings after tax and minority interests</b>	<b>635</b>	<b>426</b>	<b>50</b>	<b>38</b>	<b>129</b>	<b>172</b>	<b>97</b>	<b>17</b>	<b>929</b>	<b>132</b>	<b>24</b>	<b>33</b>	<b>57</b>	<b>1,753</b>

1. Project and other related expenses in the UK reflect project costs associated with strategic initiatives, including developments designed to offer a wider range of products to customers, and the simplification of systems and processes. Expenses in the Netherlands reflect an overrun in Belgium following the acquisition of Swiss Life Belgium, and restructuring within the intermediary division.

2. Mortality experience continues to be better than the assumptions set across a number of our businesses.

3. Lapse experience has been volatile, in part reflecting wider economic volatility. In Poland, lapse experience continued to be better than the long-term assumptions for both life and pension products.

4. In France, other experience profits include the reduction in value arising from reductions in fees and commissions received. In Ireland, certain statutory provisions were increased following a review. The movement in the Netherlands reflects changes in gross pension scheme contributions. In the USA, other experience reflects the cost of enhancing policyholder crediting rates.

5. In the Netherlands, expense assumptions have been updated following a review of expense allocations.

6. In UK, favourable mortality assumption changes are in respect of mortality and morbidity changes across a range of products. In the Netherlands, mortality assumption changes reflect the impact of using a new industry mortality basis.

7. In the UK, an additional lapse provision has been set up in anticipation of higher short-term recession related withdrawals and higher mortgage and income protection claims to reflect rising unemployment. In France, persistency assumptions have been weakened following continual favourable experience on AFER products.

8. In the UK, other operating assumption changes include the impact of the with-profit special distribution. In Ireland, other assumption changes reflect a reduction in the assumed future tax charges. In Poland, other assumptions reflect a change in the pattern of future mortality charging structure.

9. Other operating variances in France are mainly in respect of the impact of the mutualisation of funds following the merger of two legal entities. In the Netherlands, changes are mainly in respect of aligning the profit sharing policy for existing group business in Belgium, following the acquisition of Swiss Life Belgium.



## Notes to the MCEV financial statements continued

## M7 – Geographical analysis of MCEV operating earnings continued

Net of tax and minority interests Restated 2007	UK £m	France £m	Ireland £m	Italy £m	Nether- lands £m	Poland £m	Spain £m	Other Europe £m	Europe £m	North America £m	Asia £m	Australia £m	Asia Pacific £m	Total £m
Value of new business	195	81	26	20	3	34	57	4	225	34	39	11	50	504
Earnings from existing business														
– expected existing business contribution (reference rate)	261	90	17	6	66	36	18	8	241	48	9	14	23	573
– expected existing business contribution (in excess of reference rate)	133	20	5	1	95	5	9	–	135	14	1	1	2	284
Experience variances														
– maintenance expense	7	1	(2)	3	(3)	2	–	(4)	(3)	(13)	(1)	(2)	(3)	(12)
– project and other related expenses <sup>1</sup>	(61)	6	(3)	–	(13)	–	(1)	(7)	(18)	–	(1)	–	(1)	(80)
– mortality/morbidity <sup>2</sup>	8	18	(1)	–	(1)	10	(3)	2	25	(2)	4	2	6	37
– lapses <sup>3</sup>	(9)	5	4	(5)	4	13	(1)	1	21	–	(9)	–	(9)	3
– other <sup>4</sup>	(17)	(14)	(4)	1	12	5	5	1	6	(18)	2	1	3	(26)
Operating assumption changes:														
– maintenance expenses <sup>5</sup>	6	(2)	(2)	–	(12)	4	–	(8)	(20)	(19)	1	–	1	(32)
– project and other related expenses <sup>1</sup>	1	(1)	–	–	(3)	–	–	(9)	(13)	–	–	–	–	(12)
– mortality/morbidity <sup>6</sup>	20	(1)	–	1	(24)	11	(5)	2	(16)	–	(7)	3	(4)	–
– lapses	(11)	–	–	–	2	8	(7)	3	6	(3)	(7)	(1)	(8)	(16)
– other <sup>7</sup>	(22)	85	–	2	(23)	(4)	–	(11)	49	6	(3)	–	(3)	30
Expected return on shareholders' net worth	66	53	15	12	103	5	6	3	197	33	6	6	12	308
Other operating variances <sup>8</sup>	(2)	–	–	(3)	11	–	(3)	3	8	–	–	–	–	6
<b>Earnings after tax and minority interests</b>	<b>575</b>	<b>341</b>	<b>55</b>	<b>38</b>	<b>217</b>	<b>129</b>	<b>75</b>	<b>(12)</b>	<b>843</b>	<b>80</b>	<b>34</b>	<b>35</b>	<b>69</b>	<b>1,567</b>

1. Project and other related expenses in the UK reflect project costs associated with strategic initiatives, including developments designed to offer simpler products to customers, and the simplification of systems and processes. In the Netherlands, project costs mainly represent one-off restructuring costs in the Dutch business.

2. Mortality experience continues to be better than the assumptions set across a range of businesses.

3. Lapse experience in Poland continues to be better than assumptions set across both Life and Pensions businesses.

4. Other experience profits reflect an accumulation of small items, including an increased allowance for operational risk in the USA.

5. Maintenance expense assumptions have been strengthened in the USA following investment to support the growth of the business, and in the Netherlands following a review of expenses.

6. Mortality assumptions in the UK reflect changes to the anti-selection loading on annuities. In the Netherlands, the mortality assumption strengthening reflected a partial implementation of a new industry mortality basis.

7. In France, other operating assumption changes reflect increased profitability driven by product development and the increased proportion of unit-linked assets within managed funds.

8. Other operating variances in the Netherlands relate to changes in asset management fees.

## M8 – Geographical analysis of fund management operating return

*This note sets out further information on the operating earnings from fund management set out in the summarised consolidated income statement.*

The summarised consolidated income statement – MCEV basis, includes earnings from the Group's fund management operations as analysed below. This excludes the proportion of the results of Aviva Investors fund management businesses and other fund management operations within the Group that arise from the provision of fund management services to our Life businesses. These results are included within the Life MCEV operating earnings.

	2008 £m	2007 £m
United Kingdom	34	40
Europe	9	15
North America	(3)	3
Asia Pacific	1	6
<b>Aviva Investors</b>	<b>41</b>	<b>64</b>
United Kingdom	(18)	(10)
Netherlands	2	17
Other Europe	4	4
Asia Pacific	13	15
<b>Total</b>	<b>42</b>	<b>90</b>

## M9 – Analysis of other operations and regional costs

*This note sets out further information on the operating earnings from other operations set out in the summarised consolidated income statement.*

Where subsidiaries provide services to our life business, that proportion has been excluded. These results are included within the life MCEV operating return.

	2008			Restated 2007		
	Regional costs £m	Other operations £m	Total £m	Regional costs £m	Other operations £m	Total £m
United Kingdom	–	(12)	(12)	–	(8)	(8)
Europe	(28)	(88)	(116)	(11)	(34)	(45)
North America	(14)	2	(12)	(2)	(2)	(4)
Asia Pacific	(23)	–	(23)	(13)	–	(13)
<b>Total</b>	<b>(65)</b>	<b>(98)</b>	<b>(163)</b>	<b>(26)</b>	<b>(44)</b>	<b>(70)</b>

## Notes to the MCEV financial statements continued

## M10 – Segmental analysis of life and related business embedded value

2008	Net worth		VIF £m	Total Embedded value £m
	Free surplus £m	Required capital <sup>1</sup> £m		
<b>United Kingdom</b>	<b>1,357</b>	<b>1,477</b>	<b>2,053</b>	<b>4,887</b>
France <sup>2</sup>	(92)	1,567	1,044	2,519
Ireland	135	252	603	990
Italy	261	235	149	645
Netherlands (including Belgium and Germany)	(333)	2,284	159	2,110
Poland	115	134	979	1,228
Spain	143	225	287	655
Other Europe	43	34	159	236
<b>Europe</b>	<b>272</b>	<b>4,731</b>	<b>3,380</b>	<b>8,383</b>
<b>North America<sup>3</sup></b>	<b>(362)</b>	<b>1,528</b>	<b>(1,102)</b>	<b>64</b>
Asia	72	159	193	424
Australia	9	253	69	331
<b>Asia Pacific</b>	<b>81</b>	<b>412</b>	<b>262</b>	<b>755</b>
<b>Total</b>	<b>1,348</b>	<b>8,148</b>	<b>4,593</b>	<b>14,089</b>

1. Required capital is shown net of implicit items permitted by local regulators to cover minimum solvency margins.

2. France, Netherlands and US have a positive surplus on a statutory basis.

3. Aviva USA's holding company debt amounting to £1,128 million at 31 December 2008 has been included within non-covered business.

Restated 2007	Net worth		VIF £m	Total Embedded value £m
	Free surplus £m	Required capital <sup>1</sup> £m		
<b>United Kingdom</b>	<b>1,255</b>	<b>1,389</b>	<b>4,267</b>	<b>6,911</b>
France	28	1,280	1,228	2,536
Ireland	159	201	465	825
Italy	208	156	125	489
Netherlands (including Belgium and Germany)	1,247	1,713	856	3,816
Poland	111	116	816	1,043
Spain	61	175	334	570
Other Europe	32	24	122	178
<b>Europe</b>	<b>1,846</b>	<b>3,665</b>	<b>3,946</b>	<b>9,457</b>
<b>North America<sup>2</sup></b>	<b>(70)</b>	<b>946</b>	<b>330</b>	<b>1,206</b>
Asia	124	53	190	367
Australia	49	187	71	307
<b>Asia Pacific</b>	<b>173</b>	<b>240</b>	<b>261</b>	<b>674</b>
<b>Total</b>	<b>3,204</b>	<b>6,240</b>	<b>8,804</b>	<b>18,248</b>

1. Required capital is shown net of implicit items permitted by local regulators to cover minimum solvency margins.

2. Aviva USA's holding company debt amounting to £349 million at 31 December 2007 has been included within non-covered business.

The shareholders' net worth is 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. This is split between required capital, net of implicit items, and free surplus.

## M11 – Risk allowance with present value of in-force (PVIF)

Within the VIF in the tables on page 312, there are additional allowances for risks not included within the basic present value of future profits calculation.

2008	PVFP £m	Frictional costs £m	Non- hedgeable risks £m	Time value of financial options and guarantees £m	VIF £m
<b>United Kingdom</b>	<b>2,470</b>	<b>(176)</b>	<b>(165)</b>	<b>(76)</b>	<b>2,053</b>
France	1,779	(174)	(147)	(414)	1,044
Ireland	637	(10)	(24)	–	603
Italy	196	(22)	(12)	(13)	149
Netherlands (including Belgium and Germany)	856	(246)	(132)	(319)	159
Poland	1,074	(14)	(73)	(8)	979
Spain	355	(18)	(32)	(18)	287
Other Europe	169	(4)	(4)	(2)	159
<b>Europe</b>	<b>5,066</b>	<b>(488)</b>	<b>(424)</b>	<b>(774)</b>	<b>3,380</b>
<b>North America</b>	<b>(864)</b>	<b>(15)</b>	<b>(43)</b>	<b>(180)</b>	<b>(1,102)</b>
Asia	262	(20)	(23)	(26)	193
Australia	132	(27)	(26)	(10)	69
<b>Asia Pacific</b>	<b>394</b>	<b>(47)</b>	<b>(49)</b>	<b>(36)</b>	<b>262</b>
<b>Total</b>	<b>7,066</b>	<b>(726)</b>	<b>(681)</b>	<b>(1,066)</b>	<b>4,593</b>

Restated 2007	PVFP £m	Frictional costs £m	Non- hedgeable risks £m	Time value of financial options and guarantees £m	VIF £m
<b>United Kingdom</b>	4,698	(183)	(154)	(94)	4,267
France	1,713	(132)	(126)	(227)	1,228
Ireland	491	(9)	(16)	(1)	465
Italy	160	(17)	(9)	(9)	125
Netherlands (including Belgium and Germany)	1,422	(263)	(67)	(236)	856
Poland	897	(15)	(60)	(6)	816
Spain	378	(17)	(22)	(5)	334
Other Europe	128	(3)	(3)	–	122
<b>Europe</b>	<b>5,189</b>	<b>(456)</b>	<b>(303)</b>	<b>(484)</b>	<b>3,946</b>
<b>North America</b>	<b>581</b>	<b>(105)</b>	<b>(28)</b>	<b>(118)</b>	<b>330</b>
Asia	210	(7)	(7)	(6)	190
Australia	123	(30)	(16)	(6)	71
<b>Asia Pacific</b>	<b>333</b>	<b>(37)</b>	<b>(23)</b>	<b>(12)</b>	<b>261</b>
<b>Total</b>	<b>10,801</b>	<b>(781)</b>	<b>(508)</b>	<b>(708)</b>	<b>8,804</b>

## Notes to the MCEV financial statements continued

## M12 – Implied discount rates (IDR)

In the valuation of a block of business, the implied discount rate is the rate of discount such that a traditional embedded value for the business equates to the MCEV.

The cashflows projected are the expected future cashflows including expected investment cashflows from equities, bond and properties earning a risk premium in excess of risk free, statutory reserves and required capital. The risk premiums used are consistent with those used in the expected existing business contribution within operating earnings. As the risk premiums are positive, a discount rate higher than risk-free is required to give a value equal to the market-consistent embedded value.

Average derived risk discount rates are shown below for the embedded value.

	Total in-force business	
	2008 %	2007 %
<b>United Kingdom</b>	<b>7.9%</b>	8.4%
France	<b>6.4%</b>	6.8%
Ireland	<b>4.7%</b>	6.2%
Italy	<b>5.9%</b>	6.5%
Netherlands (including Belgium and Germany) <sup>1</sup>	<b>n/a</b>	9.0%
Poland	<b>6.0%</b>	7.2%
Spain	<b>9.7%</b>	6.5%
Other Europe	<b>9.8%</b>	11.3%
<b>Europe<sup>1</sup></b>	<b>n/a</b>	7.5%
<b>North America<sup>1</sup></b>	<b>n/a</b>	14.3%
Asia	<b>7.2%</b>	9.5%
Australia	<b>7.8%</b>	9.1%
<b>Asia Pacific</b>	<b>7.5%</b>	9.4%
<b>Total<sup>1</sup></b>	<b>n/a</b>	8.0%

1. Where the value of in force business is negative, an IDR can not be calculated. Consequently an average total IDR is not meaningful.

## M13 – Summary of minority interests in life and related businesses' MCEV results

	France £m	Ireland £m	Italy £m	Nether- lands £m	Poland £m	Spain £m	Europe £m	Asia Pacific £m	Total £m	Share- holders' interest £m	Group £m
<b>2008</b>											
Value of new business, net of tax	9	3	27	12	7	85	143	–	143	409	552
Life MCEV operating earnings after tax	29	17	50	5	24	102	227	–	227	1,753	1,980
Life MCEV (loss)/earnings after tax	18	(21)	(30)	(22)	20	(72)	(107)	–	(107)	(6,885)	(6,992)
Closing covered businesses' embedded value	304	323	727	204	177	550	2,285	15	2,300	14,089	16,389
<b>Restated 2007</b>											
Value of new business, net of tax	14	6	27	3	5	70	125	1	126	504	630
Life MCEV operating earnings after tax	32	19	46	19	18	88	222	1	223	1,567	1,790
Life MCEV earnings after tax	24	15	66	13	22	57	197	3	200	1,619	1,819
Closing covered businesses' embedded value	235	266	551	158	154	472	1,836	12	1,848	18,248	20,096

There are no minority interests in the United Kingdom or North America.

## M14 – Principal economic assumptions

### (a) Economic assumptions – Deterministic calculations

Economic assumptions are derived actively, based on market yields on risk-free fixed interest assets at the end of each reporting period.

In setting the risk-free rate we have, wherever possible used the mid-price swap yield curve for an AA-rated bank.

The curve is extrapolated if necessary to get rates suitable to the liabilities. For markets in which there is no reliable swap yield curve the relevant government bond yields are used.

Required capital is shown as a multiple of the EU statutory minimum solvency margin or equivalent.

The adjustments made to swap rates to derive a risk-free rate for UK and Netherlands immediate annuities and immediate annuities, deferred annuities and all other US business are shown below the reference rate table.

The principal economic assumptions used are as follows:

#### Reference rate and expense inflation

	United Kingdom		Eurozone (excluding the Netherlands)	
	2008	2007	2008	2007
Reference rate – term 1 year	<b>2.8%</b>	5.7%	<b>2.5%</b>	4.8%
Reference rate – term 5 years	<b>3.2%</b>	5.1%	<b>3.3%</b>	4.6%
Reference rate – term 10 years	<b>3.5%</b>	5.0%	<b>3.8%</b>	4.7%
Reference rate – term 15 years	<b>3.8%</b>	4.9%	<b>3.9%</b>	4.9%
Reference rate – term 20 years	<b>3.8%</b>	4.8%	<b>3.9%</b>	4.9%
Expense inflation	<b>3.5%</b>	3.6%	<b>2.1%</b>	2.9%

	Netherlands <sup>1</sup>		Poland	
	2008	2007	2008	2007
Reference rate – term 1 year	<b>2.5%</b>	4.7%	<b>4.4%</b>	6.2%
Reference rate – term 5 years	<b>3.3%</b>	4.6%	<b>4.3%</b>	5.8%
Reference rate – term 10 years	<b>3.8%</b>	4.7%	<b>4.2%</b>	5.5%
Reference rate – term 15 years	<b>4.0%</b>	4.9%	<b>4.1%</b>	5.4%
Reference rate – term 20 years	<b>3.9%</b>	5.0%	<b>4.0%</b>	5.4%
Expense inflation	<b>2.5%</b>	3.0%	<b>2.9%</b>	4.7%

	United States	
	2008	2007
Reference rate – term 1 year	<b>1.3%</b>	4.2%
Reference rate – term 5 years	<b>2.2%</b>	4.2%
Reference rate – term 10 years	<b>2.6%</b>	4.7%
Reference rate – term 15 years	<b>2.9%</b>	4.9%
Reference rate – term 20 years	<b>2.9%</b>	5.0%
Expense inflation	<b>3.0%</b>	3.5%

1. The economic assumptions used in the Netherlands differ from those in the Eurozone as the Dutch bank swap rate is used in the Netherlands.

For service companies, expense inflation relates to the underlying expenses rather than the fees charged to the life company.

In current markets, the following adjustments are made to the swap rate for UK and Netherlands immediate annuities and all US contracts. The risk-free rate is taken as the swap yield curve for the currency of the liability, adjusted by:

	New business				Embedded value	
	Fourth Quarter 2008	Third Quarter 2008	First half 2008	Second half 2007	2008	2007
UK and Netherlands immediate annuities	<b>1.45%</b>	<b>0.85%</b>	<b>0.55%</b>	0.25%	<b>1.50%</b>	0.50%
US immediate annuities	<b>2.00%</b>	<b>0.65%</b>	<b>0.55%</b>	0.25%	<b>3.00%</b>	0.50%
US deferred annuities and other contracts	<b>1.50%</b>	<b>0.65%</b>	<b>0.55%</b>	0.25%	<b>2.50%</b>	0.50%



## Notes to the MCEV financial statements continued

## M14 – Principal economic assumptions continued

**Risk premium – used for operating profit, Implied Discount Rates (IDR), Internal Rates of Return (IRR) and payback period**

For life and pensions operating earnings, Aviva uses normalised investment returns, which are generally expressed as one year swap returns plus an asset risk premium. The use of asset risk premia only impacts operating earnings as expected returns reflect management's long-term expectations of asset returns in excess of the reference rate from investing in different asset classes. This assumption does not impact the balance sheet embedded value or value of new business as asset risk premia are not recognised until earned. The asset risk premia set out in the table below are added to the 1 year reference rate to calculate expected returns.

	All territories	
	2008	2007
Equity risk premium	<b>3.5%</b>	3.5%
Property risk premium	<b>2.0%</b>	2.0%

Future returns on corporate fixed interest investments are calculated from prospective yields less an adjustment for credit risk.

**Required capital and tax**

	Tax rates <sup>1</sup>		Required capital (% EU minimum or equivalent)	
	2008	2007	2008	2007
United Kingdom	<b>28.0%</b>	28.0%	<b>100%/110%</b>	100%/110%
France	<b>34.4%</b>	34.4%	<b>110%</b>	110%
Ireland	<b>12.5%</b>	12.5%	<b>150%</b>	150%
Italy	<b>32.4%</b>	32.4%	<b>115%/184%</b>	115%/184%
Netherlands	<b>25.5%</b>	25.5%	<b>168%</b>	188%
Poland	<b>19.0%</b>	19.0%	<b>150%</b>	150%
Spain	<b>30.0%</b>	30.0%	<b>110%/125%</b>	110%/125%
United States	<b>35.0%</b>	35.0%	<b>325%</b>	325%

1. The required capital in the United Kingdom under MCEV is 100% for unit-linked and other non-participating business and 110% for annuity business

2. Required capital in Italy under MCEV is 184% of the EU minimum for Eurovita and 115% for other companies

3. Required capital in the Netherlands is 168%. This capital level is the aggregate capital required for the Netherlands.

4. Required capital in Spain is 125% of the EU minimum for Aviva Vida y Pensiones and 110% for bancassurance companies.

5. Correct tax legislation and rates have been assumed to continue unaltered except where changes in future tax rates have been announced.

**Other economic assumptions**

Required capital relating to with-profit business is assumed to be covered by the surplus within the with-profit funds and no effect has been attributed to shareholders. Bonus rates on participating business have been set at levels consistent with the economic assumptions. 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.

**(b) Economic Assumptions – Stochastic calculations**

The calculation of time value of options and guarantees allows for expected management and policyholder actions in response to varying future investment conditions. The management actions modelled include changes to asset mix, bonus rates and rates of interest and other guarantees granted to policyholders. Modelled policyholder actions are described under "Other assumptions".

The embedded value of the US spread based products anticipates the application of management discretion allowed for contractually within the policies, subject to contractual guarantees. This includes the ability to change the crediting rates and indexed strategies available within the policy. Consideration is taken of the economic environment assumed in future projections and returns in excess of the reference rate are not assumed. Anticipated market and policyholder reaction to management action has been considered. The anticipated management action is consistent with current decision rules and has been approved and signed off by management and legal counsel.

**Model – United Kingdom, Europe (excluding Delta Lloyd) and North America**

Swap rates are generated by a model, the Libor Market Model (LMM), that projects a full swap curve at monthly intervals. Forward rates are assumed to have a log-normal distribution which guarantees non-negative interest rates. The model is calibrated to at-the-money swaptions of a variety of terms and tenors. Swaption volatilities are taken from Bloomberg. Tests have been performed to ensure that sufficient scenarios have been used that the result converges to the stochastic value of the business being valued.

## M14 – Principal economic assumptions continued

The total annual return on equities is calculated as the return on one-year swaps plus an excess return. This excess return is modelled using a log-normal model where volatility varies by time horizon. This allows the model to capture the term structure of implied volatilities. The model is calibrated to at-the-money options of a variety of terms. Option volatilities are taken from a survey of investment banks.

The model also generates property total returns and real yield curves, although these are not significant asset classes for Aviva outside the UK. In the absence of liquid market data, the volatilities of these asset classes are based on historic data.

Assumptions for correlations between asset classes have been set based on historic data.

### Model – Netherlands

In the Netherlands, yield curves are based on De Nederlandsche Bank (DNB) yield curve data.

The interest rate model used is a short rate G2++ model. The model is calibrated to the DNB yield curve and the swaption implied volatilities. Swaption implied volatilities are taken from Bloomberg.

The equity model is a Heston model. The model considers an equity volatility surface in the market and covers strike levels between 0.8 and 1.2. The model is calibrated to the same DNB curves used in interest rate model. The option volatilities used for year-end 2007 are DJ Eurostoxx 50-quotes taken from Bloomberg. For 2008 the model was calibrated to DJ Eurostoxx 50-quotes (end of August 2008) provided by a market maker.

The inflation model used is based on the standard Jarrow-Yildirim inflation model which connects real and nominal yields and an inflation index. This is calibrated to ZCII quotes on HICPxT-index.

### Asset classes

The significant asset classes for UK participating business are equities, property and long-term fixed rate bonds.

The most significant assumption is the distribution of future long-term interest rates, since this is the most important factor in the cost of guaranteed annuity options.

For many businesses, including US, France and Netherlands, the most important assets are fixed rate bonds of various durations.

## Summary statistics

### Swaption implied volatilities

The implied volatility is that determined by Black's formula to reproduce the market price of the option. The following table sets out the model swaption implied volatilities.

Option length	2008 <sup>1</sup> Swap length				2007 Swap length			
	10 years	15 years	20 years	25 years	10 years	15 years	20 years	25 years
<b>UK sterling</b>								
10 years	n/a	n/a	11.8%	n/a	n/a	n/a	10.9%	n/a
15 years	n/a	n/a	11.9%	n/a	n/a	n/a	10.8%	n/a
20 years	n/a	n/a	12.1%	n/a	n/a	n/a	10.8%	n/a
25 years	n/a	n/a	12.4%	n/a	n/a	n/a	10.9%	n/a
<b>Euro</b>								
10 years	11.7%	11.7%	11.7%	11.8%	11.7%	11.1%	10.6%	10.3%
15 years	10.9%	10.9%	10.4%	10.9%	11.4%	10.9%	10.5%	10.2%
20 years	10.5%	10.4%	10.4%	10.3%	10.6%	10.2%	9.9%	9.7%
25 years	10.0%	10.0%	9.9%	9.5%	10.3%	9.9%	9.6%	9.4%
<b>Netherlands</b>								
10 years	11.6%	11.6%	11.7%	11.7%	11.1%	10.9%	10.7%	10.7%
15 years	10.8%	10.7%	10.6%	10.8%	10.7%	10.4%	10.2%	10.3%
20 years	10.5%	10.3%	10.2%	10.3%	10.3%	10.0%	9.8%	9.8%
25 years	10.0%	9.8%	9.8%	9.7%	10.1%	9.8%	9.4%	9.4%
<b>US dollar</b>								
10 years	15.2%	14.4%	14.0%	14.0%	17.1%	15.0%	13.4%	12.2%
15 years	13.9%	13.0%	12.8%	12.7%	15.0%	13.2%	11.9%	10.9%
20 years	13.3%	12.4%	12.1%	12.1%	13.3%	11.8%	10.7%	10.0%
25 years	12.9%	11.9%	11.6%	11.7%	12.4%	11.2%	10.3%	9.8%

1. Volatilities are calibrated to end August 2008.

## Notes to the MCEV financial statements continued

## M14 – Principal economic assumptions continued

**Equity implied volatilities**

The implied volatility is that determined by the Black-Scholes' formula to reproduce the market price of the option. The following tables sets out the model equity implied volatilities.

2008 <sup>1</sup>	Country						
Option length	UK	France	Italy	Ireland	Netherlands	Spain	US
5 years	25.8%	24.9%	24.4%	24.5%	26.1%	26.3%	24.6%
10 years	27.2%	26.3%	n/a	26.2%	26.8%	28.8%	27.3%
15 years	27.7%	n/a	n/a	27.0%	27.1%	n/a	25.9%

2007	Country						
Option length	UK	France	Italy	Ireland	Netherlands	Spain	US
5 years	23.7%	26.2%	23.7%	24.6%	26.5%	25.5%	23.4%
10 years	25.2%	27.5%	26.0%	26.7%	28.9%	27.2%	25.1%
15 years	25.8%	29.1%	26.0%	28.2%	29.5%	28.3%	27.0%

1. Volatilities are calibrated to end August 2008.

**Property implied volatilities**

Best estimate levels of volatility have been used, in the absence of meaningful option prices from which implied levels of volatility can be derived.

For the UK and the Netherlands, model property implied volatility is 15% for 31 December 2008 (31 December 2007:15%).

**Demographic assumptions**

Assumed future mortality, morbidity and lapse rates have been derived from an analysis of Aviva's recent operating experience with a view to giving a best estimate of future experience. We have anticipated future changes in experience where that is appropriate, e.g. we have allowed for improvements in future policyholder longevity.

We have set the assumptions based on a best estimate of outcome of shareholder outcomes. In particular, where the policyholder behaviour varies with economic experience, we have set assumptions which are dynamic, i.e. vary depending on the economic assumptions. For example, surrender and option take up rate assumptions that vary according to the investment scenario under consideration have been used in the calculation of the time value of options and guarantees, based on our assessment of likely policyholder behaviour in different investment scenarios.

Additionally, where demographic experience is not driven by economic scenarios but is asymmetric on a stand-alone basis, the best estimate assumption considers the weighted-average expected experience, not simply the median or most likely outcome.

**Expense assumptions**

Management expenses and operating expenses of holding companies attributed to life and related businesses have been included in the MCEV calculations and split between expenses relating to the acquisition of new business, the maintenance of business in-force and project expenses. Future expense assumptions include an allowance for maintenance expenses and a proportion of recurring project expenses. Certain expenses of an exceptional nature, when they occur, are identified separately and are generally charged as incurred. No future productivity gains have been anticipated.

Where subsidiary companies provide administration, investment management or other services to our life businesses, the value of profits or losses arising from these services have been included in the embedded value and value of new business.

**Non-hedgeable risk**

A charge of 2.5% has been applied to the Group-diversified capital required on a 1-in-200 one-year basis over the remaining lifetime of in-force business.

## M14 – Principal economic assumptions continued

### (c) Other assumptions

#### Valuation of debt

Borrowings in the MCEV consolidated balance sheet are valued on an IFRS basis, consistent with the primary financial statements. At 31 December 2008 the market value of the Group's external debt, subordinated debt, preference shares including General Accident plc preference shares of £250 million (classified as minority interests) and direct capital instrument was £4,911 million (31 December 2007: £5,774 million).

	2008 £m	2007 £m
<b>Borrowings per summarised consolidated balance sheet – MCEV basis</b>	<b>15,201</b>	12,657
Add: amount included within held for sale	–	12
Less: Securitised mortgage funding	<b>(7,785)</b>	(7,295)
Borrowings excluding non-recourse funding – MCEV basis	<b>7,416</b>	5,374
Less: Operational financing by businesses	<b>(1,891)</b>	(1,063)
External debt and subordinated debt – MCEV basis	<b>5,525</b>	4,311
Add: Preference shares (including General Accident plc) and direct capital instrument	<b>1,440</b>	1,440
External debt, subordinated debt, preference shares and direct capital instrument – MCEV basis	<b>6,965</b>	5,751
Effect of marking these instruments to market	<b>(2,054)</b>	23
<b>Market value of external debt, subordinated debt, preference shares and direct capital instrument</b>	<b>4,911</b>	5,774

#### Other

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, except where driven by varying future investment conditions under stochastic economic scenarios.

## M15 – Sensitivity analysis

*In this note the sensitivity of both our embedded value and value of new business is presented. There are sensitivities to the economic assumptions used and the non-economic assumptions.*

### (a) Economic assumptions

The following tables show the sensitivity of the embedded value and the value of new business to:

- Using swap yields as the risk-free rate.
- one and two percentage point increase and decrease in the risk-free rate, including all consequential changes (including assumed investment returns for all asset classes, market values of fixed interest assets, risk discount rates);
- 10% increase and decrease in market values of equity and property assets;
- 25% increase in equity and swaption volatilities;
- 50 basis point increase and decrease in credit spreads; and
- decrease in the level of required capital to 100% EU minimum (or equivalent).

In each sensitivity calculation, all other assumptions remain unchanged except where they are directly affected by the revised economic conditions. For example, future bonus rates are automatically adjusted to reflect sensitivity changes to future investment returns. Some of the sensitivity scenarios may have consequential effects on valuation bases, where the basis for certain blocks of business is actively updated to reflect current economic circumstances. Consequential valuation impacts on the sensitivities are allowed for where an active valuation basis is used. Where businesses have a target asset mix, the portfolio is re-balanced after a significant market movement otherwise no re-balancing is assumed.

For new business, the sensitivities reflect the impact of a change immediately after inception of the policy.

In general, the magnitude of the sensitivities will reflect the size of the embedded values, though this will vary as the sensitivities have different impacts on the different components of the embedded value. In addition, other factors can have a material impact, such as the nature of the options and guarantees, as well as the types of investments held.

Sensitivities will also vary according to the current economic assumptions, mainly due to the impact of changes to both the intrinsic cost and time value of options and guarantees. Options and guarantees are the main reason for the asymmetry of the sensitivities where the guarantee impacts to different extents under the different scenarios. This can be seen in the sensitivity of a 1%–2% movement in the interest rate for the Netherlands and US, where there is a significant amount of business with investment return guarantees.

## Notes to the MCEV financial statements continued

## M15 – Sensitivity analysis continued

## Embedded value

2008 Embedded value (net of tax and minority interest)	Risk free rates					
	As reported on page 312 £m	Risk free rate as swap yields £m	1% increase £m	1% decrease £m	2% increase £m	2% decrease £m
<b>United Kingdom</b>	<b>4,887</b>	<b>(2,117)</b>	<b>(105)</b>	<b>90</b>	<b>(215)</b>	<b>175</b>
France	2,519	–	(70)	(60)	(210)	(360)
Ireland	990	–	(50)	55	(90)	120
Italy	645	–	5	(45)	5	(100)
Netherlands (including Belgium and Germany)	2,110	(120)	560	(805)	900	(1,525)
Poland	1,228	–	(30)	40	(55)	95
Spain	655	–	(15)	20	(35)	40
Other Europe	236	–	(5)	5	(10)	10
<b>Europe</b>	<b>8,383</b>	<b>(120)</b>	<b>395</b>	<b>(790)</b>	<b>505</b>	<b>(1,720)</b>
<b>North America</b>	<b>64</b>	<b>(3,862)</b>	<b>(505)</b>	<b>210</b>	<b>(845)</b>	<b>90</b>
Asia	424	–	20	(35)	30	(175)
Australia	331	–	(15)	15	(25)	30
<b>Asia Pacific</b>	<b>755</b>	<b>–</b>	<b>5</b>	<b>(20)</b>	<b>5</b>	<b>(145)</b>
<b>Total</b>	<b>14,089</b>	<b>(6,099)</b>	<b>(210)</b>	<b>(510)</b>	<b>(550)</b>	<b>(1,600)</b>

2008 Embedded value (net of tax and minority interest)	Equity/property			
	As reported on page 312 £m	Market values		Volatility 25% increase £m
		10% increase £m	10% decrease £m	
<b>United Kingdom</b>	<b>4,887</b>	<b>400</b>	<b>(410)</b>	<b>(25)</b>
France	2,519	145	(160)	(150)
Ireland	990	15	(10)	–
Italy	645	–	–	–
Netherlands (including Belgium and Germany)	2,110	410	(385)	(220)
Poland	1,228	15	(15)	–
Spain	655	5	(10)	(10)
Other Europe	236	5	–	–
<b>Europe</b>	<b>8,383</b>	<b>595</b>	<b>(580)</b>	<b>(380)</b>
<b>North America</b>	<b>64</b>	<b>–</b>	<b>–</b>	<b>–</b>
Asia	424	10	(10)	–
Australia	331	5	(5)	–
<b>Asia Pacific</b>	<b>755</b>	<b>15</b>	<b>(15)</b>	<b>–</b>
<b>Total</b>	<b>14,089</b>	<b>1,010</b>	<b>(1,005)</b>	<b>(405)</b>

## M15 – Sensitivity analysis continued

2008 Embedded value (net of tax and minority interest)	As reported on page 312 £m	Swaption implied volatilities 25% increase £m	Corporate bond credit spreads		EU minimum capital (or equivalent) £m
			50bps increase £m	50bps decrease £m	
<b>United Kingdom</b>	<b>4,887</b>	<b>–</b>	<b>(610)</b>	<b>770</b>	<b>10</b>
France	2,519	(95)	(120)	125	15
Ireland	990	–	–	–	5
Italy	645	–	–	–	5
Netherlands (including Belgium and Germany)	2,110	(165)	(265)	285	100
Poland	1,228	–	–	–	5
Spain	655	–	(55)	60	5
Other Europe	236	–	–	–	–
<b>Europe</b>	<b>8,383</b>	<b>(260)</b>	<b>(440)</b>	<b>470</b>	<b>135</b>
<b>North America</b>	<b>64</b>	<b>(45)</b>	<b>(625)</b>	<b>660</b>	<b>5</b>
Asia	424	–	(25)	20	15
Australia	331	–	(5)	10	5
<b>Asia Pacific</b>	<b>755</b>	<b>–</b>	<b>(30)</b>	<b>30</b>	<b>20</b>
<b>Total</b>	<b>14,089</b>	<b>(305)</b>	<b>(1,705)</b>	<b>1,930</b>	<b>170</b>

## Value of new business

2008 Value of new business (net of tax and minority interest)	As reported on page 303 £m	Risk free rate as swap yields £m	Risk free rates			
			1% increase £m	1% decrease £m	2% increase £m	2% decrease £m
<b>United Kingdom</b>	<b>147</b>	<b>(161)</b>	<b>17</b>	<b>(25)</b>	<b>28</b>	<b>(60)</b>
France	79	–	4	(7)	7	(21)
Ireland	10	–	3	(3)	6	(8)
Italy	21	–	(1)	–	(2)	(1)
Netherlands (including Belgium and Germany)	(67)	(10)	30	(47)	58	(138)
Poland	46	–	(3)	3	(5)	7
Spain	80	–	(4)	4	(8)	8
Other Europe	24	–	(1)	3	(5)	8
<b>Europe</b>	<b>193</b>	<b>(10)</b>	<b>28</b>	<b>(47)</b>	<b>51</b>	<b>(145)</b>
<b>North America</b>	<b>36</b>	<b>(101)</b>	<b>(61)</b>	<b>50</b>	<b>(127)</b>	<b>68</b>
Asia	24	–	5	(9)	8	(31)
Australia	9	–	(2)	4	(5)	7
<b>Asia Pacific</b>	<b>33</b>	<b>–</b>	<b>3</b>	<b>(5)</b>	<b>3</b>	<b>(24)</b>
<b>Total</b>	<b>409</b>	<b>(272)</b>	<b>(13)</b>	<b>(27)</b>	<b>(45)</b>	<b>(161)</b>



## Notes to the MCEV financial statements continued

## M15 – Sensitivity analysis continued

2008 Value of new business (net of tax and minority interest)	Equity/property			
	As reported on page 303 £m	Market values		Volatility 25% increase £m
		10% increase £m	10% decrease £m	
<b>United Kingdom</b>	<b>147</b>	<b>5</b>	<b>(5)</b>	<b>(2)</b>
France	79	2	(2)	(3)
Ireland	10	1	(1)	–
Italy	21	–	–	–
Netherlands (including Belgium and Germany)	(67)	–	–	(1)
Poland	46	–	–	–
Spain	80	–	–	–
Other Europe	24	1	(2)	–
<b>Europe</b>	<b>193</b>	<b>4</b>	<b>(5)</b>	<b>(4)</b>
<b>North America</b>	<b>36</b>	<b>–</b>	<b>–</b>	<b>–</b>
Asia	24	–	–	–
Australia	9	–	–	–
<b>Asia Pacific</b>	<b>33</b>	<b>–</b>	<b>–</b>	<b>–</b>
<b>Total</b>	<b>409</b>	<b>9</b>	<b>(10)</b>	<b>(6)</b>

2008 Value of new business (net of tax and minority interest)	As reported on page 303 £m	Swaption implied volatilities 25% increase £m	Corporate bond credit spreads		EU minimum capital (or equivalent) £m
			50bps increase £m	50bps decrease £m	
<b>United Kingdom</b>	<b>147</b>	<b>–</b>	<b>(79)</b>	<b>85</b>	<b>1</b>
France	79	(2)	2	(9)	1
Ireland	10	–	–	–	1
Italy	21	–	–	–	–
Netherlands (including Belgium and Germany)	(67)	–	(11)	12	14
Poland	46	–	–	–	–
Spain	80	–	(4)	5	–
Other Europe	24	–	(1)	(1)	2
<b>Europe</b>	<b>193</b>	<b>(2)</b>	<b>(14)</b>	<b>7</b>	<b>18</b>
<b>North America</b>	<b>36</b>	<b>(12)</b>	<b>(67)</b>	<b>72</b>	<b>10</b>
Asia	24	–	–	–	2
Australia	9	–	–	–	–
<b>Asia Pacific</b>	<b>33</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>2</b>
<b>Total</b>	<b>409</b>	<b>(14)</b>	<b>(160)</b>	<b>164</b>	<b>31</b>

**(b) Non-economic assumptions**

The following tables below show the sensitivity of the embedded value and the value of new business to the following changes in non-economic assumptions:

- 10% decrease in maintenance expenses (a 10% sensitivity on a base expense assumption of £10 pa would represent an expense assumption of £9 pa). Where there is a “look through” into service company expenses the fee charged by the service company is unchanged while the underlying expense decreases;
- 10% decrease in lapse rates (a 10% sensitivity on a base assumption of 5% pa would represent a lapse rate of 4.5% pa); and
- 5% decrease in both mortality and morbidity rates disclosed separately for life assurance and annuity business.

No future management actions are modelled in reaction to the changing non-economic assumptions. In each sensitivity calculation all other assumptions remain unchanged. No changes to valuation bases have been included.

## M15 – Sensitivity analysis continued

### Embedded value

2008 Embedded value (net of tax)	As reported on page 312 £m	10% decrease in maintenance expenses £m	10% decrease in lapse rates £m	5% decrease in mortality/ morbidity rates – life assurance £m	5% decrease in mortality/ morbidity rates – annuity business £m
<b>United Kingdom</b>	<b>4,887</b>	<b>165</b>	<b>100</b>	<b>70</b>	<b>(190)</b>
France	2,519	50	35	30	–
Ireland	990	20	25	10	(5)
Italy	645	5	5	5	–
Netherlands (including Belgium and Germany)	2,110	195	5	30	(195)
Poland	1,228	40	65	15	–
Spain	655	10	45	15	(5)
Other Europe	236	5	15	–	–
<b>Europe</b>	<b>8,383</b>	<b>325</b>	<b>195</b>	<b>105</b>	<b>(205)</b>
<b>North America</b>	<b>64</b>	<b>85</b>	<b>80</b>	<b>70</b>	<b>(20)</b>
Asia	424	15	5	5	–
Australia	331	10	20	15	–
<b>Asia Pacific</b>	<b>755</b>	<b>25</b>	<b>25</b>	<b>20</b>	<b>–</b>
<b>Total</b>	<b>14,089</b>	<b>600</b>	<b>400</b>	<b>265</b>	<b>(415)</b>

### Value of new business

2008 Value of new business (net of tax)	As reported on page 303 £m	10% decrease in maintenance expenses £m	10% decrease in lapse rates £m	5% decrease in mortality/ morbidity rates – life assurance £m	5% decrease in mortality/ morbidity rates – annuity business £m
<b>United Kingdom</b>	<b>147</b>	<b>18</b>	<b>23</b>	<b>15</b>	<b>(20)</b>
France	79	1	2	1	–
Ireland	10	2	4	–	–
Italy	21	1	–	–	–
Netherlands (including Belgium and Germany)	(67)	15	4	2	(14)
Poland	46	3	5	2	–
Spain	80	2	12	3	–
Other Europe	24	2	6	2	(2)
<b>Europe</b>	<b>193</b>	<b>26</b>	<b>33</b>	<b>10</b>	<b>(16)</b>
<b>North America</b>	<b>36</b>	<b>6</b>	<b>4</b>	<b>7</b>	<b>(3)</b>
Asia	24	5	2	1	–
Australia	9	1	5	2	–
<b>Asia Pacific</b>	<b>33</b>	<b>6</b>	<b>7</b>	<b>3</b>	<b>–</b>
<b>Total</b>	<b>409</b>	<b>56</b>	<b>67</b>	<b>35</b>	<b>(39)</b>

## Statement of directors' responsibilities in respect of the Market Consistent Embedded Value (MCEV) basis

When compliance with the European Insurance CFO Forum Market Consistent Embedded Value Principles (MCEV Principles), published in June 2008, is stated, those principles require the directors to prepare supplementary information in accordance with the methodology contained in the MCEV Principles and to disclose and explain any non-compliance with the guidance included in the MCEV Principles.

In preparing this supplementary information, the directors have done so in accordance with these MCEV Principles and have also fully complied with all the guidance included therein, with the exception of the use of an adjusted risk-free yield due to current market conditions for immediate annuities in the UK and Netherlands and immediate annuities, deferred annuities and other US contracts. Specifically, the directors have:

- determined assumptions on a realistic basis, having regard to past, current and expected future experience and to relevant external data, and then applied them consistently;
- made estimates that are reasonable and consistent; and,
- provided additional disclosures when compliance with the specific requirements of the MCEV Principles is insufficient to enable users to understand the impact of particular transactions, other events and conditions and the Group's financial position and financial performance.

By order of the Board

**Philip Scott**  
Chief Financial Officer  
4 March 2009

## Glossary

### Definitions of Group key performance indicators and other terms

Asymmetric risk	Risks that will cause shareholder profits to vary where the variation above and below the average are not equal in distribution.
CFO Forum	The CFO Forum <a href="http://www.cfoforum.nl">www.cfoforum.nl</a> is a high-level group formed by the Chief Financial Officers of major European listed and non-listed insurance companies. Its aim is to discuss issues relating to proposed new accounting regulations for their businesses and how they can create greater transparency for investors. The Forum was created in 2002, the Market Consistent Embedded Value principles were launched in June 2008 and CFO Forum members across Europe have agreed to adopt these for their 2009 published accounts. The principles are a further development of the European Embedded Value principles first launched in May 2004.
Cost of non-hedgeable risks	This is the cost of undertaking those risks for which a deep and liquid market in which to hedge that risk does not exist. This can include both financial risks and non-financial risks such as mortality, persistency and expense.
Covered business	The contracts to which the MCEV methodology has been applied.
EU solvency	The excess of assets over liabilities and the world-wide minimum solvency margins, excluding goodwill and the additional value of in-force long-term business, and excluding the surplus held in the Group's life funds. The Group solvency calculation is determined according to the UK Financial Services Authority application of EU Insurance Group's Directive rules.
Financial options and guarantees	Features of the covered business conferring potentially valuable guarantees underlying, or options to change, the level or nature of policyholder benefits and exercisable at the discretion of the policyholder, whose potential value is impacted by the behaviour of financial variables.
Free surplus	The amount of any capital and surplus allocated to, but not required to support, the in-force covered business.
Frictional costs	The additional taxation and investment costs incurred by shareholders through investing the Required Capital in the Company rather than directly.
Funds under management	Represents all assets actively managed or administered by or on behalf of the Group including those funds managed by third parties.
Funds under management by Aviva	Represents all assets actively managed or administered by the fund management operations of the Group.
Group MCEV	A measure of the total consolidated value of the Group with covered life business included on an MCEV basis and non-covered business (including pension schemes and goodwill) included on an IFRS basis.
Gross risk-free yields	Gross of tax yields on risk-free fixed interest investments, generally swap rates under MCEV.
Holding company	A legal entity with a function of being a consolidating entity for primary financial reporting of covered business.

## Glossary continued

IFRS operating profit	From continuing operations on an IFRS basis, stated before tax attributable to shareholders' profits, impairment of goodwill and exceptional items.
Implicit items	Amounts allowed by local regulators to be deducted from capital amounts when determining the EU required minimum margin.
Inherited estate	The assets of the long-term with-profit funds less the realistic reserves for non-profit policies, less asset shares aggregated across the with-profit policies
Life business	Subsidiaries selling life and pensions contracts that are classified as covered business under MCEV.
Life MCEV	The MCEV balance sheet value of covered business as at the reporting date. Excludes non-covered business including pension schemes and goodwill.
Life MCEV operating earnings	Operating earnings on the MCEV basis relating to the lines of business included in the embedded value calculations. From continuing operations
Life MCEV earnings	Total earnings on the MCEV basis relating to the lines of business included in the embedded value calculations. From continuing operations.
IFRS operating profit	From continuing operations on an IFRS basis, stated before tax attributable to shareholders' profits, impairment of goodwill and exceptional items.
Implicit items	Amounts allowed by local regulators to be deducted from capital amounts when determining the EU required minimum margin.
Inherited estate	The assets of the long-term with-profit funds less the realistic reserves for non-profit policies, less asset shares aggregated across the with-profit policies and any additional amounts expected at the valuation date to be paid to in-force policyholders in the future in respect of smoothing costs and guarantees.
Look-through basis	Inclusion of the capitalised value of profits and losses arising from subsidiary companies providing administration, investment management and other services to the extent that they relate to covered business.
Long-term savings	Includes life and pension sales calculated under MCEV and retail investment sales.
Market consistent	A measurement approach where economic assumptions are such that projected asset cash flows are valued consistently with current market prices for traded assets.
MCEV	Aviva's Market Consistent Embedded Value methodology which is in accordance with the MCEV Principles published by the CFO Forum in June 2008 with the exception of the use of an adjusted risk-free yield due to current market conditions for immediate annuities in the UK and the Netherlands and for immediate annuity, deferred annuity and other contracts in the US.
Net asset value per ordinary share	Net asset value divided by the number of ordinary shares in issue. Net asset value is based on equity shareholders' funds.
Net worth	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, and consists of the required capital and free surplus.
New business margin	New business margins are calculated as the value of new business divided by the present value of new business premiums (PVNBP), and expressed as a percentage.
Present value of new business premiums (PVNBP)	Present value of new regular premiums plus 100% of single premiums, calculated using assumptions consistent with those used to determine the value of new business.
Required capital	The amount of assets, over and above the value placed on liabilities in respect of covered business, whose distribution to shareholders is restricted.

Risk-free rate (reference rate in CFO Forum terminology)	The risk-free return that can be earned on investments in the currency of the liability being valued. In stable markets, including the period from 31 December 2006 to 30 June 2007, the risk-free rate is taken as the swap curve yield. In current markets, including the period from 1st July 2007, the risk-free rate is taken as swaps except for UK and Netherlands immediate annuities and immediate annuities, deferred annuities and other US contracts. The adjusted risk-free rate is taken as swaps plus the additional return available for products and where backing asset portfolios can be held to maturity.
Service companies	Companies providing administration or fund management services to the covered business.
Solvency cover	The excess of the regulatory value of total assets over total liabilities, divided by the regulatory value of the required minimum solvency margin.
Spread business	Contracts where a significant source of shareholder profits is the taking of credit spread risk that is not passed on to policyholders. The most significant spread business in Aviva are immediate annuities and US deferred annuities and life business.
Statutory basis	The valuation basis and approach used for reporting financial statements to local regulators.
Stochastic techniques	Techniques that incorporate the potential future variability in assumptions.
Symmetric risks	Risks that will cause shareholder profits to vary where the variation above and below the average are equal and opposite. Financial theory says that investors do not require compensation for non-market risks that are symmetrical as the risks can be diversified away by investors.
Time value and intrinsic value	A financial option or guarantee has two elements of value, the time value and intrinsic value. The intrinsic value is the discounted value of the option or guarantee at expiry, assuming that future economic conditions follow best estimate assumptions. The time value is the additional value arising from uncertainty about future economic conditions.
Value of new business	Is calculated using economic assumptions set at the start of each quarter and the same operating assumptions as those used to determine the embedded values at the end of the reporting period and is stated after the effect of any frictional costs. Unless otherwise stated, it is also quoted net of tax and minority interests.



# Aviva Group of Companies

## Parent Company

Aviva plc

## Subsidiaries

The principal subsidiaries of the Company are listed below by country of incorporation. All are wholly-owned, directly or indirectly, and transact insurance or reinsurance business, fund management or services in connection therewith, unless otherwise stated.

### United Kingdom

Aviva Employment Services Limited  
Aviva Insurance Limited  
Aviva International Insurance Limited  
Aviva Investors Global Services Limited  
Aviva Investors Pensions Limited  
Aviva Investors UK Fund Services Limited  
Aviva Investors UK Funds Limited  
CGNU Life Assurance Limited  
CGU Bonus Limited  
CGU Underwriting Limited  
Commercial Union Life Assurance Company Limited  
Gresham Insurance Company Limited  
Hamilton Insurance Company Limited  
Hamilton Life Assurance Company Limited  
Lifetime Group Limited  
London and Edinburgh Insurance Company Limited  
Norwich Union Annuity Limited  
Norwich Union Central Services Limited  
Norwich Union Consumer Products Limited  
Norwich Union Equity Release Limited  
Norwich Union Healthcare Limited  
Norwich Union Insurance Limited  
Norwich Union Insurance Services Limited  
Norwich Union Life (RBS) Limited  
Norwich Union Life & Pensions Limited  
Norwich Union Life Services Limited  
Norwich Union Risk Services Limited  
NUI Investments Limited  
RAC Financial Services Limited  
RAC Insurance Limited  
RAC Motoring Services  
RAC plc

### Australia

Aviva Australia Holdings Limited and its principal subsidiaries:

Norwich Union Life Australia Limited  
Navigator Australia Limited  
Aviva Investors Australia Limited

### Belgium

Delta Lloyd Life N.V.  
Swiss Life Belgium N.V.

### Bermuda

Aviva Re Limited

## Canada

Aviva Canada Inc. and its principal operating subsidiaries:

Aviva Insurance Company of Canada  
Elite Insurance Company  
Pilot Insurance Company  
Scottish & York Insurance Co. Limited  
S&Y Insurance Company  
Traders General Insurance Company

## Czech Republic

Aviva zivotni pojist'ovna, a.s.

## France

Aviva Participations SA and its principal subsidiaries:

Antarius S.A. (50.0%)  
Aviva Assurances S.A.  
Aviva France SA  
Aviva Investors France S.A.  
Aviva Vie SA  
Eurofil S.A.  
Société d'Epargne Viagère SA (83.7%)  
Union Financière de France Banque (Banking) (74.4%)

## Germany

Delta Lloyd Deutschland AG and its principal subsidiary:  
Delta Lloyd Lebensversicherung AG (99.8%)

## Hong Kong

Aviva Life Insurance Company Limited

## Hungary

Aviva Életbiztosító Zártkörűen Működő Részvénytársaság

## Ireland

Hibernian Group plc and its principal subsidiaries:

Ark Life Assurance Company Limited  
Hibernian Aviva General Insurance Limited  
Hibernian Aviva Health Group Limited (70%)  
Hibernian Aviva Life & Pensions Limited  
Aviva Investors Ireland Limited

## Italy

Aviva Italia Holding S.p.A and its principal subsidiaries:

Aviva Assicurazioni S.p.A (50.0%)  
Aviva Italia S.p.A  
Aviva Life SpA (50.0%)  
Aviva Previdenza S.p.A (55.0%)  
Aviva Vita S.p.A (25.5%)  
Eurovita Assicurazioni S.p.A (40.5%)  
Aviva Assicurazioni Vita S.p.A (50.0%)

## Lithuania

Uždaroji akcinė gyvybės draudimo ir pensijų bendrovė "Aviva Lietuva"

## Luxembourg

Aviva Investors Luxembourg SA

## Netherlands

Delta Lloyd N.V. (92.0%) and its principal subsidiaries:  
 Delta Lloyd ABN AMRO Verzekeringen Holding BV (51.0%)  
 Delta Lloyd Asset Management N.V.  
 Delta Lloyd Bankengroep N.V. (Banking)  
 Delta Lloyd Levensverzekering N.V.  
 Delta Lloyd Schadeverzekering N.V.  
 Erasmus Groep BV  
 OHRA Levensverzekeringen N.V.  
 OHRA Schadeverzekeringen N.V.

## Poland

Commercial Union Polska – Towarzystwo Ubezpieczeń  
 Na Zycie SA (90.0%)  
 Commercial Union Polska – Towarzystwo Ubezpieczeń  
 Ogólnych SA (90.0%)  
 Commercial Union Powszechnie Towarzystwo Emerytalne  
 BPH CU WBK S.A. (88.8%)

## Romania

Aviva Asigurari de Viata SA

## Russia

Closed Joint Stock Insurance Company Aviva (Zao)

## Singapore

Aviva Limited  
 Navigator Investment Services Limited

## Spain

Aseguradora Valenciana S.A., de Seguros y  
 Reaseguros (Aseval) (50.0%)  
 Aviva Vida y Pensiones, Sociedad Anonima de  
 Seguros y Reaseguros  
 Caja Espana Vida, Compania de Seguros y Reaseguros  
 (50.0%)  
 Caja Murcia Vida y Pensiones, de Seguros y Reaseguros  
 S.A. (50.0%)  
 Caja Granada Vida, de Seguros y Reaseguros, S.A. (25.0%)  
 CxG Aviva Corporación CaixaGalicia de Seguros y Reaseguros,  
 S.A. (50.0%)  
 Unicorp Vida, Compania de Seguros y Reaseguros (50.0%)

## Sri Lanka

Eagle Insurance PLC (51.0%)

## Turkey

Aviva Sigorta A.S. (98.6%)

## United States

Aviva USA Corporation and its principal subsidiaries:  
 American Investors Life Insurance Company, Inc  
 AmerUs Annuity Group Co. (AAG)  
 Aviva Investors North America, Inc  
 Aviva Life and Annuity Company

## Associates and joint ventures

The Group has ongoing interests in the following operations that are classified as associates or joint ventures. Further details of those operations that were most significant in 2008 are set out in notes 18 and 19.

### United Kingdom

RBS Life Investments Limited (49.99%)  
 RBSG Collective Investments Limited (49.99%)

The Group also has interests in several property limited partnerships. Further details are provided in note 18.

### China

Aviva-COFCO Life Insurance Co. Limited (50.0%)

### India

Aviva Life Insurance Company India Limited (26.0%)

### Malaysia

CIMB Aviva Assurance Berhad (49.0%)  
 CIMB Aviva Takaful Berhad (49.0%)

### South Korea

Woori Aviva Life Insurance Co, Ltd (46.8%)

### Taiwan

First-Aviva Life Assurance Co., Ltd (49.0%)

### Turkey

AvivaSA Emeklilik ve Hayat A.S (49.7%)

Aviva plc is a public limited company incorporated on 09 February 1990 and registered in England and Wales.

Registered Office:  
 St Helen's, 1 Undershaft  
 London EC3P 3DQ

Registered number: 2468686

Aviva plc's ordinary and preference shares are listed on the London Stock Exchange and the Luxembourg Stock Exchange.

Documents concerning the Company which are referred to in the report and accounts are available for inspection at St Helen's, 1 Undershaft, London EC3P 3DQ.

Aviva plc's objects can be found in the Memorandum of Association in the Memorandum and Articles

## Shareholder services

### Managing your shareholding

Our Registrar, Equiniti, maintains the Company's Register of Members and if you have any queries in respect of your shareholding, please contact them directly using the contact details provided on page 332. In addition to assisting with general queries, Equiniti can also help with the following:

#### Amalgamating your shareholding

If you receive more than one copy of our communications, it could be because you have more than one record on the share register. To avoid duplicate mailings, please contact Equiniti who can arrange for your accounts to be amalgamated.

#### Dividend payments direct to your bank account

Instead of having your dividends paid by cheque, you can, if you wish, have them credited directly into your bank or building society account on the dividend payment date. This reduces the risk of cheques getting lost in the post and is also quicker and more convenient as payment is credited automatically on the payment date. Your tax voucher will be sent to your registered address as usual. If you would like to set up a dividend mandate, you can do so via our website [www.aviva.com/dividendmandate](http://www.aviva.com/dividendmandate) or by contacting Equiniti to request a mandate form.

If you live overseas, an **Overseas Payment Service** is available for certain countries, which may allow you to receive your dividends directly in your bank account in your local currency.\*

#### Consolidated tax vouchers

If you are a private shareholder who currently receives dividends paid directly into your bank or building society account, you will receive one consolidated tax voucher each year instead of a voucher with each dividend payment, unless you request otherwise.

\* Please note that a payment charge will be deducted from each dividend payment before conversion into your chosen currency.

### Dividend Reinvestment Plan ("DRIP")/Scrip Dividend Scheme

Following a review by the Board of the operation of the current DRIP, the Company intends to propose a resolution at the forthcoming AGM to reintroduce a SCRIP dividend scheme ("SCRIP Scheme"). The Board has therefore decided to withdraw the DRIP and, subject to shareholder approval, will reintroduce the SCRIP Scheme commencing with the 2008 final dividend in order to provide shareholders with the opportunity to elect to receive their dividends in the form of new shares in the Company instead of in cash. All shareholders will be contacted with full details of the relevant terms and conditions of the proposed SCRIP Scheme and details of how to join in due course.

### ID fraud/unsolicited mail

Share-related fraud and identity theft still affects many shareholders and we urge you to continue to be vigilant. If you receive any unsolicited mail offering advice, you should inform Equiniti immediately. More information on this can be found on our website at [www.aviva.com/shareholderupdates](http://www.aviva.com/shareholderupdates)

### Corporate nominee

We offer a corporate nominee service, the Aviva Share Account, for shareholders who wish to remain anonymous. If you choose to join the nominee account, your personal details will not be entered on our share register but you will have the same rights as registered shareholders and will receive the same shareholder communications. To join the Aviva Share Account or find out about the terms and conditions, please contact Equiniti.

### Our website – [www.aviva.com](http://www.aviva.com)

Visit [www.aviva.com/shareholders](http://www.aviva.com/shareholders) for up-to-date investor information including our latest financial results and key dates. An electronic copy of current and past Annual and Interim Reports can be downloaded from the website. You can also find our current and historic share prices, sharedealing information, news, updates and when available, presentations from the Group Chief Executive. You can also register to receive future shareholder communications electronically.

A range of frequently asked shareholder questions including practical help on transferring shares and updating personal details is available online at [www.aviva.com/shareholderguide](http://www.aviva.com/shareholderguide)

### Electronic communications

We have embraced the changes brought about by the Companies Act 2006 which recognises the growing importance of electronic communications. We therefore provide documentation and communications to you via our website unless you have specifically elected to receive a hard copy.

Using electronic communications enables fast receipt of documents, reduces our printing, paper and postage costs and has a positive impact on the environment.

You can also cast your vote for the next AGM online, quickly and easily using the Sharevote service by visiting [www.aviva.com/agm](http://www.aviva.com/agm) for a reliable and environmentally friendly way of voting.



### ShareGift

The Orr Mackintosh Foundation operates a purely voluntary charity share donation scheme for shareholders who wish to dispose of small numbers of shares when the dealing costs or minimum fee makes it uneconomical to sell them. Details of the scheme are available from ShareGift at [www.sharegift.org](http://www.sharegift.org) or can be obtained from Equiniti.

## Share dealing

We have arranged the following services that can be used to buy or sell Aviva shares which you may find useful.

	Available to shareholders in	If you hold a share certificate	If your shares are held in the Aviva Share Account
<b>Equiniti Financial Services Limited*</b>	UK only	<a href="http://www.shareview.co.uk/dealing">www.shareview.co.uk/dealing</a> Telephone: 08456 037 037	<a href="http://www.shareview.co.uk/dealing">www.shareview.co.uk/dealing</a> Telephone: 08456 037 037
<b>NatWest Stockbrokers Limited**</b>	UK only	Freephone: 0808 208 4411	Freephone: 0808 208 4422
<b>Barclays Stockbrokers Limited†</b>	UK and overseas	<b>UK shareholders:</b> Telephone: 0870 549 3002† For postal applications: 0870 514 3263† <b>Overseas shareholders:</b> Telephone: +44 (0)141 352 3959†	<b>UK shareholders:</b> Telephone: 0870 549 3001†  <b>Overseas shareholders:</b> Telephone: +44 (0)141 352 3959†
<b>WH Ireland Limited‡</b>	UK and overseas	<b>UK shareholders:</b> Telephone: 0845 603 1470 Email: <a href="mailto:CSOS@WH-ireland.co.uk">CSOS@WH-ireland.co.uk</a> <b>Overseas shareholders:</b> Telephone +44 113 394 6603 Email: <a href="mailto:CSOS@WH-ireland.co.uk">CSOS@WH-ireland.co.uk</a>	Not available

Alternatively, if you hold a share certificate, you can also use any bank, building society or stockbroker offering share dealing facilities to buy or sell shares. If you are in any doubt about buying or selling shares, you should seek professional financial advice.

\* Equiniti Financial Services Limited is authorised and regulated by the Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (FSA reference 468631). Registered in England and Wales, number 6208699.

\*\* Natwest Stockbrokers Limited (NWS) is a member of the London Stock Exchange and PLUS. NWS is authorised and regulated by the Financial Services Authority registered number 124395. Registered Office: Waterhouse Square, 138-142 Holborn, London EC1N 2TH. Registered in England and Wales, registered number 1959479. NWS is operated by a joint venture between The Royal Bank of Scotland Group plc and The Toronto-Dominion Bank.

† Barclays Stockbrokers is the group name for the businesses of: Barclays Stockbrokers Limited, a member of the London Stock Exchange and PLUS. Registered No. 1986161; Barclays Sharedealing, Registered No. 2092410 and Barclays Bank Trust Company Limited, Registered No. 920880. All companies are registered in England and the registered address is: 1 Churchill Place, London E14 5HP. All companies are authorised and regulated by the Financial Services Authority.

Calls made to 0870 numbers will cost no more than 8p per minute, plus 6p call set-up fee for BT residential customers. The price on non-BT phone lines may be different. You can only use these numbers if you are calling from within the UK. Calls may be recorded to monitor the quality of service, to check instructions and for security purposes.

‡ If you are not UK resident, you will need to provide various documents to Barclays Stockbrokers Limited in order to use this service and details will be provided on registration. Please note that regulations prevent this service from being offered to US, Canadian and Australian residents. Settlement proceeds will be sent to either a UK sterling bank account or by sterling cheque.

# WH Ireland Limited is a member of the London Stock Exchange and is authorised and regulated by the Financial Services Authority, registered in England No. 02002044.

## Share price

You can access the current share price of Aviva plc ordinary shares at [www.aviva.com/investors](http://www.aviva.com/investors)

or by calling FT Cityline on 09058 171 690.\*

If you would like to find out the price of Aviva preference shares, please follow the link on the Aviva website to the London Stock Exchange at [www.londonstockexchange.com/en-gb/pricesnews](http://www.londonstockexchange.com/en-gb/pricesnews)

\* Calls are currently charged at 75 pence per minute from a BT landline. The average time to access the share price is approximately one minute. Other telephony provider costs may vary.

## Shareholder profile

The categories of ordinary shareholders and the range and size of shareholding as at 31 December 2008 are set out below:

Analysis of shareholders	No. of shareholders	%	No. of shares	%
Individual	598,082	97.01	245,637,541	9.24
Banks and nominee companies	14,513	2.35	2,285,095,085	85.98
Pension fund managers and insurance companies	106	0.02	132,557	0.01
Other corporate bodies	3,814	0.62	126,836,441	4.77
<b>Total</b>	<b>616,515</b>	<b>100</b>	<b>2,657,701,624</b>	<b>100</b>

Range of shareholdings	No. of shareholders	%	No. of shares	%
1–1,000	567,909	92.12	154,660,246	5.82
1,001–5,000	43,909	7.12	80,741,476	3.04
5,001–10,000	2,283	0.37	15,652,103	0.59
10,001–250,000	1,736	0.28	90,933,998	3.42
250,001–500,000	188	0.03	67,822,546	2.55
500,001 and above	490	0.08	2,247,891,255	84.58
<b>Total</b>	<b>616,515</b>	<b>100</b>	<b>2,657,701,624</b>	<b>100</b>

## Annual General Meeting

Our Annual General Meeting will be held at the Barbican Centre, Silk Street, London EC2Y 8DS on:

**29 April 2009 at 11.00am**

The Notice of Meeting, together with details of the business to be conducted at the Meeting is available on our website [www.aviva.com/agm](http://www.aviva.com/agm)

If you are unable to attend but would like to ask the directors any questions, please do so via our website [www.aviva.com/agm](http://www.aviva.com/agm) or complete and return the shareholder questions form, which can be found at the back of the Notice of Meeting. Answers to the most frequently asked questions will be circulated at the meeting and published on our website after the meeting.

The voting results for our 2009 AGM, including proxy votes and votes withheld will be available on our website shortly after the meeting at the following address [www.aviva.com/agm](http://www.aviva.com/agm)

## Shareholder services continued

**Group financial calendar for 2009**

Announcement of financial results for the year ended 31 December 2008	5 March
Annual General Meeting	29 April
Announcement of first quarter interim management statement	30 April
Announcement of unaudited six months' interim results	6 August
Announcement of third quarter interim management statement	4 November

**Ordinary shares - 2008 final dividend**

Ex-dividend date	25 March
Record date	27 March
Dividend payment date	15 May

**Preference shares**

First dividend payment for 8¼% cumulative irredeemable preference shares	31 March
First dividend payment for 8¼% cumulative irredeemable preference shares	30 June
Second dividend payment for 8¼% cumulative irredeemable preference shares	30 September
Second dividend payment for 8¼% cumulative irredeemable preference shares	31 December

**Useful contact details**

Detailed below are the contact details that shareholders may find useful. Please quote Aviva plc as well as the name and address in which the shares are held in all correspondence. Please quote your shareholder reference number as well, which you will find on your latest dividend stationery.

**General shareholding, administration and Aviva Share Account queries**

Equiniti  
Aspect House  
Spencer Road  
Lancing  
West Sussex BN99 6DA

**e-mail:** [aviva@equiniti.com](mailto:aviva@equiniti.com) | **Telephone** 0871 384 2953\*

**Alternative format**

If you would like to request a copy of our Annual Report and Accounts in an alternative format, for example, braille or audio, please contact Equiniti by calling 0871 384 2953\*.

\* Calls to this number are charged at 8p per minute from a BT landline. Other telephony provider costs may vary.

**Internet sites**

Aviva owns various internet sites, most of which interlink with each other:

**Aviva Group**

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

**UK Long-term savings and general insurance\*\***

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

**Asset management**

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

**Aviva worldwide internet sites**

[www.aviva.com/websites](http://www.aviva.com/websites)

\*\* From 1 June 2009, this website will change to [www.aviva.co.uk](http://www.aviva.co.uk)

Other useful links for shareholders:

**Dividend information**

[www.aviva.com/dividend](http://www.aviva.com/dividend)

**General shareholder information**

[www.aviva.com/shareholders](http://www.aviva.com/shareholders)

**Annual General Meeting information**

[www.aviva.com/agm](http://www.aviva.com/agm)

**Electronic voting for Annual General Meeting**

[www.aviva.com/agm](http://www.aviva.com/agm)

**Aviva plc details****Registered in England Number:**

2468686

**Registered Office:**

St Helen's, 1 Undershaft, London, EC3P 3DQ

**Telephone**

+44 (0)20 7283 2000

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



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Aviva are committed to caring for the environment and looking for sustainable ways to minimise our impact on it.

This year our annual report and accounts has been printed by Beacon Press using pureprint environmental print technology. We choose Beacon Press because they have the important environmental certification by SGS for the FSC standards.

Also we take care to minimise the impact on the environment in the paper we use. The paper we have used, Revive 50:50 Silk, is a recycled paper containing 50% recovered waste and 50% virgin fibre and manufactured at a mill accredited with ISO 14001 environmental management standard. The pulp used in this product is bleached using an Elemental Chlorine Free process. The laminate used on the outer cover is biodegradeable.

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**Aviva plc**  
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Registered in England  
Number 2468686