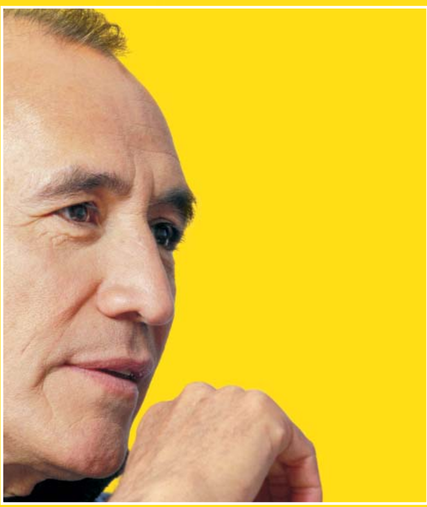
Aviva plc

Annual Report and Accounts 2005

AVIVA



Aviva is the world's sixth-largest insurance group and the largest insurance services provider in the UK. We are one of the leading providers of life and pension products in Europe and are actively growing our long-term savings businesses in Asian markets, Australia and the USA. Our main activities are long-term savings, fund management and general insurance. We have premium income and investment sales of £35.0 billion and £317 billion of assets under management. We have more than 54,000 employees serving millions of customers.

Strengths and highlights

We have a balanced portfolio that benefits from diversification of distribution, products and geography.

We continue to focus on managing the business to create value for shareholders and customers.

We have delivered another strong performance from our international long-term savings businesses.

Bancassurance goes from strength to strength, with total sales up 22%.

The acquisition of RAC has created a powerful new force in insurance and motoring services.

Commitment to new combined operating ratio target of 98% demonstrates our confidence in sustaining our excellent general insurance results.

Overview

Business review

Governance

Financial statements

* On an IFRS basis.

**From continuing operations, including long-term savings result on a European Embedded Value (EEV) basis before amortisation of goodwill.

† Return based on opening equity shareholders' funds on an EEV basis.

‡ From continuing operations, including share of associates' premiums.

≠ On an EEV basis.

The Aviva brand is about life and vitality – helping our 30 million customers worldwide to make the most of their lives.

We are a progressive company with a 300-year heritage – one that creates better ways to understand and meet people's needs. And it's this insight – this ability to think beyond the immediate and the everyday – that makes us who we are.

This is what we call forward thinking. It's at the heart of everything we do: the company's business model, how we behave as employees, and how we treat our customers, partners and the communities in which we operate.

Financial highlights

£2,528m
IFRS profit before tax attributable to shareholders*

£2,904m
EEV operating profit**

15.0%
Return on capital employed†

£35.0bn
Worldwide sales‡

27.27p
Full year dividend per share

£14.9bn
Equity shareholders' funds≠

Aviva is a leading international savings, investment and insurance group. We focus on managing our business for value. Our aim is to create prosperity and peace of mind for our customers, shareholders and employees, while acting as a good corporate citizen.

Long-term savings and fund management

£1,814m
Worldwide operating profit before tax*

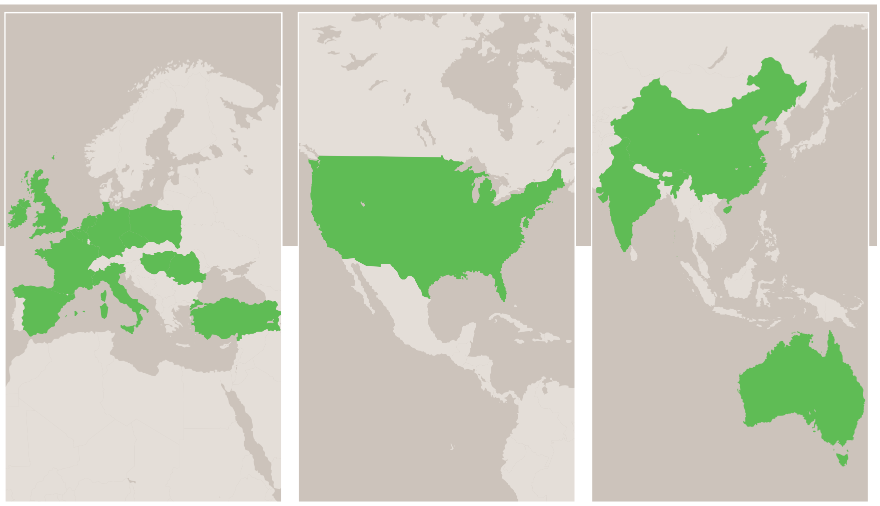
£24,645m
Worldwide sales**

Operating profit*	
UK	585
Europe	1,130
International	99
Total	**1,814**

Our credentials
We aim to grow this business aggressively and profitably by building strong positions in our chosen markets. Aviva is one of the leading life and pensions providers in Europe, and we are developing businesses with strong long-term potential in Asia.

Market position
We are in the top three in all our chosen life and pension markets in the UK, our Spanish business is placed second and Hibernian in Ireland is third. We have top-five businesses in the Netherlands, and top-ten in France and Italy.

Our strategy
To offer a superior range of long-term savings, investment and protection products in markets that offer significant opportunities for growth.



Our leading long-term savings and fund management brands

AVIVA · NORWICH UNION · MORLEY Fund Management · HIBERNIAN · delta lloyd · COMMERCIAL UNION Polska

* On an EEV basis.
**Present value of new business premiums plus investment sales.
† From continuing operations.

General insurance and health

£1,551m
Worldwide operating profit before tax

£10,311m
Worldwide net written premiums†

Operating profit	
UK	974
Europe	390
International	187
Total	**1,551**

Our credentials

A disciplined and efficient core operation, increased access to our customers, excellent service and innovative propositions are central to our general insurance business. We aim to deliver sustainable earnings from market-leading positions in personal insurance and selected commercial lines.

Market position

Norwich Union Insurance is a leading general insurer in the UK, with a market share of 15%. We are the largest general insurer in Ireland and second-largest in Canada and have established businesses in France and the Netherlands.

Our strategy

To provide a broad range of competitive motor, property, health and related insurance services to individuals and small to medium-sized enterprises in our chosen markets.

Our leading general insurance and health brands

AVIVA · NORWICH UNION · RAC · HIBERNIAN · delta lloyd · COMMERCIAL UNION Polska

Chairman's statement

Group performance
Our business is increasingly multinational. During 2005, for the first time, our long-term savings new business premiums from continental Europe exceeded 50% of the group total. We have announced a major bancassurance deal in Ireland and continue to make good progress with our newer operations in India and China. In the UK, we have purchased the RAC. This represents a significant opportunity for us. We have made good progress towards realising cost savings and have identified growth opportunities. I firmly believe that this purchase will assist the sustainability of our general insurance earnings. Our UK long-term savings performance has been robust and is strongly positioned for the future.

Strategy outlook
Aviva is a complex and evolving business and we have recently given consideration to clarifying our strategy. In summary, our business strategy is to be a clear leader in helping our customers grow their wealth and protect their assets and their health. We do this by offering a superior range of long-term savings, investment and protection products in markets that offer significant opportunities for growth; and by providing a broad range of competitive motor, property, health and related insurance services to individuals and small to medium-sized enterprises in chosen markets. References in our strategy to withdrawing from businesses that do not offer the potential for market-leading positions or superior returns have been discontinued, as that work is now complete.

Market developments
The European Commission has described the state pension deficits in the European Union (EU) as its major structural economic challenge. Although the impact varies between member states, governments across the EU are increasingly focussed on strategies to address the consequences of an ageing population.

In November, the Turner Report was issued by the Pensions Commission, setting out their views of the future of UK pensions and recommending changes for a new policy direction. The key recommendations were the establishment of a low cost National Pension Saving Scheme in which people are automatically enrolled and an increase in the state retirement age.

We continue to believe that cost-effective solutions are required and that to achieve this, unnecessary legislation, regulation and complexity must be removed. Pension simplification on "A day" in April 2006 will provide a great opportunity for Norwich Union to offer customers a choice of simpler, more flexible products. We should not underestimate the challenges that lie ahead, but I am confident that we will succeed.

Share performance
Our end of year share price rose to 705 pence *(2004: 628 pence)*, an increase of 12% during 2005. When adding in dividends paid during 2005, this represents a total shareholder return of 21.2%* for the year. While this is a strong stand-alone performance, it is below average for our sector. It is always difficult to explain share price performance, but there is little doubt the share issue supporting the acquisition of RAC dampened our share performance during the first half of 2005.

This was compensated by a strong recovery in the second half which can be attributed to a combination of demonstrating the value of the RAC acquisition and a growing confidence in the sustainability of our general insurance result.

Dividend
I am pleased to announce that the board has recommended a final dividend of 17.44 pence per share, which brings the total dividend for the year to 27.27 pence. This represents an increase of 7.5% on the 2004 full year dividend and exceeds the group's previous policy of seeking to grow the dividend by approximately 5% per annum.

Our previous target, to grow the dividend by 5%, was put in place when the dividend was cut in 2002. Naturally, at that time, the board wanted to give a high degree of certainty to our shareholders regarding future dividend growth. The board believes that the target has become too rigid a constraint. Our future intention is to increase the dividend on a basis judged prudent using a dividend cover in the 1.5 to 2.0 times range as a guide, on an IFRS operating earnings after tax basis, while retaining capital to support future business growth.

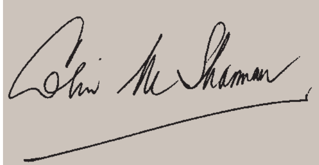
Board matters
The end of last year saw the retirement of Pehr Gyllenhammar. I would like to thank Pehr, on behalf of the board and our shareholders, for his vision, hard work and dedication to Aviva in his role as chairman. He leaves a company that is financially fit and strongly positioned. Deputy chairman George Paul and non-executive director Elizabeth Vallance also retired at the end of 2005. They go with the thanks of the board for their significant contributions to the success of Aviva.

*Source: Deloitte.

+7.5%

Increase in the full year ordinary dividend

Good governance and an understanding of the impacts of our international business operations are important aspects of the way we conduct business.



Lord Sharman of Redlynch OBE
Chairman

Mary Francis has been appointed as a non-executive director during the year. Mary is, among other roles, a non-executive director of the Bank of England and a former director general of the Association of British Insurers. The experience and knowledge she brings with her will add to the strength of the board.

The board is committed to the highest standards of governance and has an excellent record in this area. To develop further our governance work, we are introducing a governance committee that will provide even greater focus on this important aspect of the board's responsibilities. I would like to thank Russell Walls for agreeing to become chairman of this committee.

Additionally, we recognise the importance of our responsibilities to all of Aviva's stakeholders. Consequently, we have introduced a corporate social responsibility committee to enable our pioneering work in this area to be recognised and regularly reported to the board. I am grateful to Wim Dik for chairing this committee.

Brand
October 2005 saw the launch of our first pan-European advertising campaign to promote "Aviva: Forward thinking". I firmly believe that Aviva is in the business of building better tomorrows, and is a progressive company in all that it does. This campaign seeks to communicate our "Forward thinking" message to key decision makers across Europe.

The Aviva brand earned further exposure during the year through sport. We are supporting yachtswoman Dee Caffari as she attempts to sail solo, non-stop around the world against the prevailing winds and currents in the Aviva Challenge.

We sponsored two major badminton tournaments in Asia, the Aviva-COFCO China Masters in Beijing and the Aviva Open in Singapore, and we continued our sponsorship of the Aviva Ballkids at the Australian Open tennis tournament. All these sponsorships generated a huge amount of interest around the world.

Recognition
It is gratifying when our hard work is noticed and recognised. For the third consecutive year, Norwich Union Insurance was named general insurer of the year by *Insurance Times*. Commercial Union Poland was named life insurance company of the decade by *Home & Market* magazine, reflecting the consistently high quality of our products and services. Further success was achieved by Morley Fund Management, named as property manager of the year at the UK Pensions Awards, and by our French business Aviva Gestion d'Actifs, which once again secured a number of awards for fund management.

Corporate social responsibility
The board believes that good governance and an understanding of the impacts of our international business operations are important aspects of the way we conduct business. It is therefore pleasing to be recognised for our performance in this area. We are the only UK insurer to be included in both the Dow Jones Sustainability World and STOXX (European) Indices. Additionally, out of 100 global companies we were ranked second in our sector by *Fortune* magazine for our management of corporate social responsibility (CSR) issues. As chair of the United Nations Global Compact in the UK, Aviva continues to lead development in CSR thinking and practice.

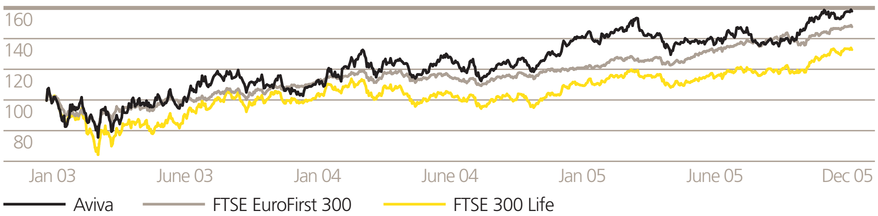
More than £700,000 was committed by Aviva to tsunami relief work in Asia, including over £200,000 given by staff. Part of this funding has been directed towards building schools and replacing fishing boats to help families in India rebuild their lives. This, and numerous other unheralded examples, illustrates the commitment of staff to making a positive difference to the communities in which we operate.

Employees
I would like to give my warm thanks to the staff of Aviva for their continued commitment and hard work. We operate in a complex and ever-changing environment, and it is through the efforts of all our employees across the world that Aviva has been able to achieve the excellent results set out in this report.

Outlook
I believe that our multinational, composite structure puts us in a good position to provide stable earnings and sustained growth into the future. While we encounter challenging trading conditions in certain of our markets, others offer good opportunities for growth, notably the increasing demand for private pension provision. It is this balance that differentiates us from our peers.

21.2%
Total shareholder return

Aviva relative to FTSE EuroFirst 300 and FTSE 300 Life, 2003-2005



Group chief executive's statement

Overview

During 2005, we delivered another set of strong results that are a reflection of our balanced portfolio and composite structure. This provides us with flexibility, strength, resilience and reliability. It is not just in the split between long-term savings and general insurance or our geographic spread that we achieve balance. Every major business has the advantage of a broad product range, trusted brand and balanced distribution model that meets the needs of the local market. Additionally, 2005 saw the acquisition of RAC. This has created a powerful combination with our general insurance business and will deliver substantial shareholder value.

Growth in our international businesses

During the year, we continued to grow our international long-term savings portfolio and it now generates over 60% of our worldwide gross new business contribution. Our international portfolio comprises large established businesses in mature markets, bancassurance-led distribution in developed markets, direct sales force businesses that are moving towards a multi-distribution model and smaller well established business with high growth potential. We have ambitious plans to grow across this portfolio. We now have over 30 bancassurance relationships across the world and are generating excellent growth through this channel. These relationships genuinely benefit both parties and we are fast becoming the "partner of first choice". This is highlighted by our new joint venture with Allied Irish Banks within Ireland. We have invested further in our partnership with UniCredit Group in Italy and have 18 bancassurance partnerships in India. However, bancassurance represents only part of our international story and we have strength in our intermediated businesses and direct sales forces.

Resilient UK long-term savings performance

In the UK long-term savings market, we have demonstrated our strength and resilience during 2005. We have seen new entrants attempting to grow their market share, which has meant a more competitive market. Our approach has been to focus on value while maintaining market share. We are able to write all new business at returns exceeding our cost of capital. We have maintained our broad product offering and have a wide range of distribution channels, and this combination puts us in a unique position. We recognise that customer service is vital to the future of our business and we are actively addressing service standards provided to individuals and intermediaries. We are now starting to see the benefits of these actions. During 2005, our bancassurance joint venture with the Royal Bank of Scotland has seen significant growth and is demonstrating the benefits of such partnerships. Additionally, we launched our Lifetime "wrap" product, an innovative proposition that we expect to be the preferred platform for leading investment solutions.

A strong and sustainable general insurance performance

Our general insurance business has a uniquely balanced distribution range covering brokers, partnerships and direct sales. This mix means that we are less dependent on any one product or distribution channel than our competitors, enabling us to take selective pricing actions. The purchase, in May 2005, of RAC further enhances our options and provides significant growth potential. The integration is on track and, in October, we announced that we expect the total pre-tax profits arising from the RAC acquisition to reach £250 million per annum on a like-for-like basis by the end of 2008 through cost savings and significant additional revenues. Our businesses in Canada and Ireland continue to deliver strong results and, in the UK, we are generating significant growth in our direct sales, particularly online. We have consistently proved that our general insurance business is able to produce sustainable profits which, in turn, provide capital to fund new business growth and acquisitions.

This sustainability, allied to confidence in our operating model, has allowed us to announce a worldwide Combined Operating Ratio (COR) target of 98% for the forseeable future.

Group results

Our pre-tax operating profit* of £2,904 million *(2004: £2,224 million)* reflected another strong performance as most businesses reported increased profit. Our return on capital employed was 15%* *(2004: 13.7%).* Worldwide long-term savings new business sales were £24.6 billion *(2004: £22.3 billion),* reflecting strong international sales growth and continued success in the bancassurance channel.

Pre-tax life operating return on a European embedded value (EEV) basis was £1,814 million *(2004: £1,611 million).*

Our general insurance operating profit of £1,551 million *(2004: £1,259 million)* is another excellent result in a year were we have also acquired and integrated the RAC. We have achieved a combined operating ratio** of 95% *(2004: 97%)*, beating our target of 98%.

Our fund management operating profit of £92 million *(2004: £40 million),* reflected good income growth as a result of investment market conditions and the benefits of cost initiatives.

On an IFRS basis, the group operating profit before tax was £2,128 million *(2004: £1,669 million)*. The group delivered an overall profit before tax attributable to shareholders of £2,528 million *(2004: £1,642 million)*.

Capital and financial strength

Shareholders' funds[†] increased to £14.9 billion *(2004: £11.7 billion)* as a result of the strong operational performance and the impact of investment markets in 2005. Net asset value per share* was up by 22% to 622 pence *(2004: 511 pence)*.

The solvency position in our main trading operations remains robust. Excess capital measured according to the Insurance Groups Directive is £3.5 billion *(2004: £3.6 billion)*. The orphan estate of our UK life businesses was £5.2 billion *(2004: £4.6 billion)*, based on a realistic assumption of liabilities.

£2,528m

IFRS profit before tax

Richard Harvey
Group chief executive

Our dividend grew by 7.5% to 27.27 pence, and we have recommended to the pension scheme trustees that the group makes an additional deficit funding contribution of £700 million to the Aviva and RAC pension schemes over the next two years. The dividend and the funding contribution reflect our capital strength, and will benefit both shareholders and employees.

Reporting developments
The 2005 financial statements are our first full set that have been produced using International Financial Reporting Standards. This is a change to the reporting and presentation of our results; however, it does not reflect a change to the underlying economics of our business.

As a market leader, it is essential that Aviva engages actively with external regulators, professional bodies and industry groups on technical issues affecting financial services. We need to understand these issues and influence how they will affect our external reporting and hence how we are viewed by the market.

External view
It is vital that Aviva plays a leading role in shaping industry opinion and developments in our important markets.

In Europe, the Solvency II Directive will play a key part in setting out the future framework for the allocation of insurers' capital. Consequently, it will have a significant impact on the formation of a single market that delivers wider choice for the consumer. We are supportive of the move towards a transparent and risk-based approach to capital allocation for insurers and are actively engaging with regulators to achieve the best results for the industry. We are also supportive of the European Commission's White Paper on financial services policy for the next five years, with its over-riding theme of dynamic consolidation.

During 2005, in my twin capacity as chairman of the Association of British Insurers (ABI) and Aviva group chief executive, I hosted a number of high-level focus groups to identify the main issues affecting the long-term savings industry and to agree what we need to do to resolve them. The meetings involved politicians, regulators, employers, charities, consumer groups and people from the financial services industry. The starkest messages were that young people are not sufficiently aware of the need to save and that there is a lack of trust in the savings industry. It was also clear that employers have a key role to play in encouraging savings in the workplace and that the current pensions system in the UK is seen as being too complex. In response, the ABI set out a five-point programme of action to address the main concerns. It is clear that many of the issues raised are equally applicable to our other markets, particularly in Europe. There is no single, simple solution and much remains to be done. However, I am determined that Aviva will play a full part in improving products and services, and restoring confidence in long-term savings.

Across Aviva, we recognise the importance of listening and responding to our customers. In addition to the ongoing work in our business units, we undertake an annual survey across many countries to track consumers' changing needs and attitudes to savings. The findings provide valuable insights that underpin our strategic thinking and support new product development in our businesses.

Our people
I am delighted to welcome Lord Sharman of Redlynch, who became our chairman on 1 January 2006. He has wide international experience and an outstanding track-record in international finance. We are fortunate to have him as successor to Pehr Gyllenhammar, and I am looking forward to working with him on the next stage of Aviva's development.

In November 2005, we conducted our first global employee survey. It is important to listen to the voice of our staff and the survey has helped us to gain a clear picture of personal views across the group. In turn, this information will enable us to focus on the issues that are most important to our employees.

We have also been running an internal "think again" diversity campaign. The world is more competitive than ever, and we regard the diversity of our business and the people we employ as key strengths. Our employees are responding positively to the changes in our markets, technology, products, regulations and the needs of our customers. To retain our competitive advantage in these challenging environments, we are embracing diversity in everything we do. Our future success depends on business teams that include people with different backgrounds, experiences and perspectives and who identify with, and respond to, our customers.

Outlook
We have a balanced portfolio that benefits from diversification of distribution, products and geography. Our business model provides capital to fund new business growth and acquisitions, and to support dividend growth.

Our international long-term savings operations continue to grow strongly, and we have a positive outlook on our competitive position in the UK. We continue to deliver sustainable profits from our general insurance businesses and are creating significant momentum in our asset management operations. Across all businesses, we have a track record of delivering on our commitments.

We continue to focus on managing our business for value, have laid strong foundations to achieve further growth with improving profitability, and continue to explore value-driven inorganic growth opportunities.

* On an EEV basis.
**Combined operating ratio (COR) broadly expresses the total of claims costs, commissions and expenses as a percentage of premiums.
† On an EEV basis, excluding preference shares, direct capital instrument and minority interests.

15.0%
ROCE

+28%
Increase in equity shareholders' funds*

£2,904m
Operating profit before tax*

During 2005, we have produced another set of excellent results, while acquiring and integrating RAC into our general insurance business. We continue to create strong returns for our shareholders and are in a good position to generate further growth.

Generating growth in Ireland

We have created a new bancassurance joint venture in Ireland between Hibernian and Allied Irish Banks. This partnership will bring further opportunities for growth in the Irish life and pensions market, where we have an ambition to be the leading player by 2010. The agreement creates a new channel for business that is complementary to Hibernian's highly successful intermediary distribution network. It will provide exclusive access to Ireland's largest retail bank, with more than 280 retail outlets and 1.6 million customers.

Supporting sport in Asia and Australia

The Aviva brand is being promoted to a wider audience through sport. Tennis fans around the world saw the Aviva logo on the uniforms of more than 300 ballkids at the Australian Open tournament in Melbourne, and we have extended this highly successful sponsorship deal for another four years. We shall also be reaching millions of homes across Asia as we have agreed to sponsor three major badminton events – the China, Singapore and Hong Kong Opens – through to 2007.

Expanding into new regions and markets

We continue to explore new opportunities to expand our business in less developed markets.

With businesses already established in several Eastern European states, we have opened a representative office in Moscow to evaluate the potential that might exist for us in the Russian long-term savings market. In India, since launching in 2002, we have expanded rapidly to become the leader in the bancassurance market, ranking seventh amongst private insurers.

We have won approval to sell life insurance products in a total of 9 Chinese cities. Aviva-COFCO is the first international insurer to open an office in some of these cities. China is an important long-term market for Aviva, and we are pleased to be able to continue our expansion.

£24.6bn

Present value of new business premiums (PVNBP)*

+10%

Growth in PVNBP*

Long-term savings and fund management

Operating profit

Our worldwide long-term savings and fund management business reported an operating profit of £1,865 million *(2004: £1,631 million)*, an increase of 13%, reflecting strong sales growth, particularly in our continental European business and bancassurance channel.

A balanced portfolio in mature markets

Our businesses in the mature markets of the UK, France and the Netherlands benefit from balanced product offerings and distribution channels. This benefit has been demonstrated by our robust performance in 2005.

Increasing our presence in high-growth markets

We now have 18 bancassurance partnerships in India and have extended our agreement with American Express for 10 years and have partnerships with ABN AMRO, Canara Bank and Centurion Bank of Punjab. In China, Aviva-COFCO is now licensed in four cities and has sales offices in five further cities.

Enhancing our UK distribution

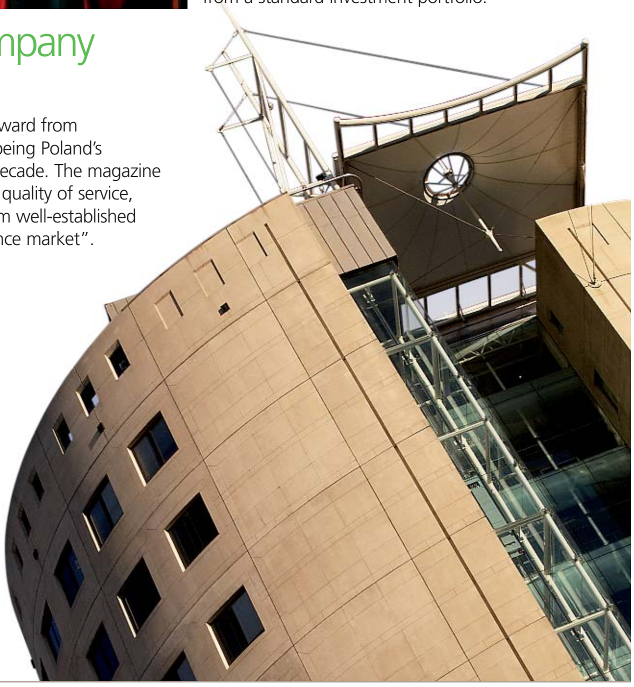
We have continued to develop our strong multi-distribution framework in the UK, where the majority of our business comes from independent financial advisers. During 2005, we signed a five-year deal with Sesame, the UK's largest IFA network. We are also building our corporate partnerships and reached major distribution agreements with Barclays and Co-Operative Insurance Society. Additionally, our existing bancassurance partnership with The Royal Bank of Scotland has grown strongly during the year.

Poland: life company of the decade

We received a golden parasol award from *Home & Market* magazine for being Poland's life insurance company of the decade. The magazine praised us for our "persistence, quality of service, recognisability and our long-term well-established position in the Polish life insurance market".

New property funds

Morley Fund Management has bolstered its focus on Europe with a commitment to growing and expanding its European property portfolio and expertise. Morley's property team manages in excess of £22 billion of UK and European property assets, making us one of the largest property fund managers in Europe. We have been at the forefront of innovation in property fund management. We also teamed up with Barclays Capital, the investment banking arm of Barclays, to create the Woolwich Global Distribution Bond. The bond uses derivatives to generate higher income for customers than could normally be expected from a standard investment portfolio.



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Bancassurance partnerships worldwide

11

Awards in fund management

Operating return £m

£1,814m

2001	1,665**
2002	1,524**
2003	1,496†
2004	1,611†
2005	**1,814†**

Worldwide new business sales‡ £bn

£19.5bn

2001	15.0
2002	14.6
2003	14.9
2004	17.2
2005	**19.5**

Forming partnerships

We recently announced a bancassurance joint venture in Ireland with AIB that will create a leading force in the Irish life and pensions market. Sales through our joint venture with Crédit du Nord in France, which commenced in October 2004, were £728 million in 2005. We extended our deal with Banche Popolari Unite in Italy to distribute through an additional 380 branches.

Recognition for our fund management businesses

We launched new institutional and retail funds during the year, particularly in property-related investments where Morley was named property manager of the year at the UK Pensions Awards 2005. Our French business won a number of awards, including being named best insurer in the 2005 *Le Revenu* fund management awards.

* The present value of new premiums (PVNBP) is equal to total single premium sales received in the year plus the discounted value of annual premiums expected to be received over the term of new contracts, and is expressed at the point of sale.

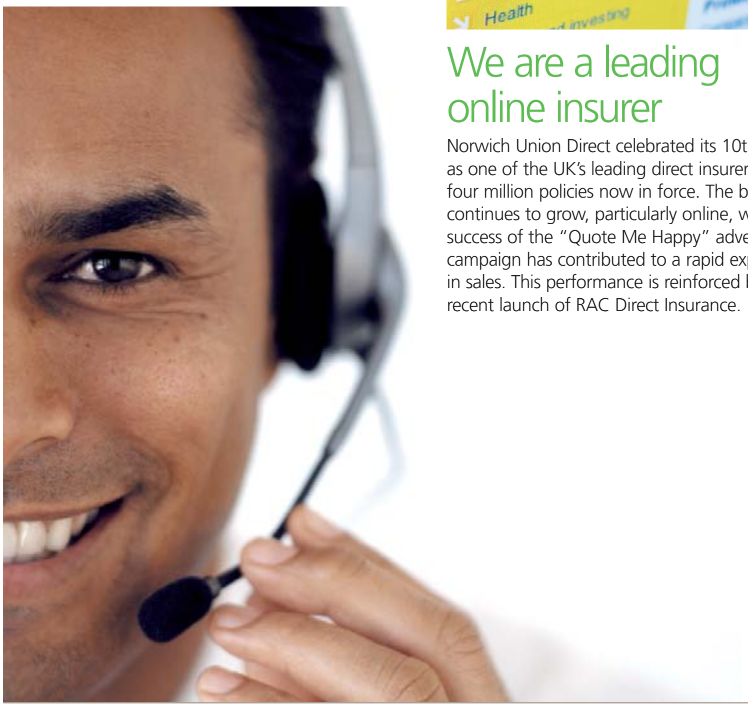
** On an achieved profits basis.

† On a European Embedded Value (EEV) basis.

‡ Single premiums, regular premiums and investment sales.

Raising the bar on customer service

Customer service is vital to the success of our business. In 2005, 92% of UK customers were satisfied with the sales service they received, and 83% with the handling of their claim. While these scores represent a significant achievement, we're aiming higher in 2006 and are looking to set industry-leading standards. To achieve this we are implementing initiatives to understand, direct from customers, what they see as key elements of good service.



We are a leading online insurer

Norwich Union Direct celebrated its 10th anniversary as one of the UK's leading direct insurers, with almost four million policies now in force. The business continues to grow, particularly online, where the success of the "Quote Me Happy" advertising campaign has contributed to a rapid expansion in sales. This performance is reinforced by our recent launch of RAC Direct Insurance.

Cracking down on insurance fraud

We believe that people should be less tolerant of fraud. Although it is sometimes described as a "victimless crime", insurance fraud costs the UK economy an estimated £14 billion – £20 billion each year, and the costs have to be recouped from customers. Norwich Union continues to lobby actively on this subject. In November 2005, we published our Fraud Report, highlighting the impact of insurance crime and making proposals for dealing with it, including: establishing a UK commission on fraud; publishing national fraud statistics and trends; and adopting interim fraud targets for the police and Crown Prosecution Service.

95%
Combined operating ratio

+5%
Growth in net written premiums

>200%
Growth in online sales in the UK

General insurance and health

Operating profit

Our worldwide general insurance and health business reported an operating profit of £1,551 million *(2004: £1,259 million)*, an increase of 22%, reflecting our sustained underwriting discipline, cost-cutting initiatives and innovative use of technology.

New distribution channels

In the UK, we have signed a deal with Barclays to become its sole provider of homeowner, motor and travel insurance and extended our existing deal to be Asda's sole provider of general insurance. Our online sales have increased by over 200%, making Norwich Union Direct one of the UK's largest online insurance brands. In Canada, we extended our deal with Loblaws, the country's largest supermarket chain, with product launches in Quebec and Alberta. In Ireland, our corporate partnership with Tesco moved from pilot stage into full roll-out.

* From continuing operations.
**On a UK GAAP basis.
† Restated for changes to IFRS and discretionary changes to longer-term investment return methodology.

Offering a complete motoring solution

The acquisition of RAC is transforming our UK business, making us a leading provider of insurance and motoring services. We've already launched new motor and travel insurance products under the RAC Direct Insurance brand and will shortly be launching a homeowner product. In acquiring a group that provides roadside assistance, windscreen repair, vehicle inspection and driver training, we're now able to offer a complete motoring solution for our customers.

Developing our Autograph™ proposition

Aviva Canada is rolling out Autograph™, an innovative motor product that allows customers to take more control of the premiums they pay. Autograph™ was developed last year and is now offered through a select team of 12 brokers in Ontario. Its technology allows drivers to track their driving patterns and, if they choose, submit the data to Aviva for a discount on their premiums. Autograph™ offers customised insurance for the individual and we are confident that there will be a person in every household who can benefit from this unique programme. For example, mothers who are driving a second car with low mileage, or who have younger drivers living at home on their policy, are ideal candidates. The Ontario test will provide us with the information and feedback we need to develop a national rollout plan.

£268m

Savings from purchasing power

>2.8 million

Roadside callouts attended

Operating profit £m

£1,551m

2001	946**
2002	942**
2003	972**
2004	1,259†
2005	**1,551**

Net written premium* £bn

£10.3bn

2001	7.9
2002	7.8
2003	8.5
2004	9.8
2005	**10.3**

RAC integration cost savings

We expect to achieve annualised cost savings of £100 million in 2006, exceeding the £80 million per annum cost savings target announced when RAC was acquired. We are making substantial progress on delivering revenue benefits, and expect to generate annualised operating profit of £250 million on a like-for-like basis from RAC by 2008, including an additional 1.4 million customers.

Expanding on our insurance proposition

Our ownership of HPI vehicle information check specialists and Solus Accident Repair Centre enables us to provide a more complete range of motoring services to our customers, while gaining revenue and cost-saving benefits.

Leveraging group knowledge

Knowledge gained from HPI, digital flood mapping and our Pay As You Drive™ scheme has allowed us to improve our pricing decisions. Our Canadian business is now serviced by more than 150 staff in India, benefiting from cost and service advantages already seen in the UK.

Promoting good CSR performance in others

As a member of the global community, Aviva has a responsibility to encourage and influence the behaviour of others in the promotion of responsible business practice. We do this through our supplier management and investment activities. For example, our established socially responsible investment funds continue to grow and now have over £800 million in funds under management. Through our supplier management programme, over 75% of Aviva businesses worldwide now include CSR aspects in supplier tendering and review processes.

Recognition of our performance in 2005

Our performance in developing and managing our CSR programme has been recognised by a range of external parties. We are the only UK insurer included in both the Dow Jones Sustainability World and STOXX indexes. We are a member of the FTSE4Good Index Series and ranked 2nd among financial services companies, and 23rd out of the Fortune Global 100™ companies for CSR management as measured by the Accountability Rating™. We were ranked top CSR performer in our sector out of 18 global insurance companies by Triodos Bank. We were also listed in the Global 100 Most Sustainable Corporations in the World.

Climate change and Aviva's response

We are committed to reducing our own CO_2 impact through, for example, increasing energy efficiency, reducing wastage and switching to renewable sources of electricity. In the UK, we use 100% zero emission electricity, while our businesses in Ireland and the Czech Republic also use renewable sources of electricity. We further seek to achieve positive influence on others through products such as Pay As You Drive™.

-11.0%
Reduction in CO_2 emissions

24,000
Hours volunteered

£5.7m
Amount donated to charitable causes and community initiatives

Corporate social responsibility

What we mean by CSR

Our CSR policy embraces performance in respect of standards of business conduct, the environment, human rights and health and safety as well as the promotion of good and fair relations with our employees, our suppliers, our customers and the broader community.

Looking after our customers

Our businesses are focused on looking after our customers. For example, Norwich Union Life has taken a market-leading approach to protecting policyholders' interests. It is restructuring its pension strategy by writing all new pensions policies under a single scheme thereby enabling customers to move seamlessly between products and tailor their retirement planning to their own needs.

Further details of our CSR programme can be found on pages 42 to 44. Alternatively a printed summary copy of our annual CSR report is available from the group company secretary and the full report may be viewed on www.aviva.com/csr.

Diversity

Our diversity vision is, "Diversity is about everyone. We believe in a working culture that respects, celebrates and harnesses our differences to the benefit of customers, employees, shareholders, business partners and the wider community. Our competitive advantage depends on business teams that include people with different backgrounds, experiences and perspectives, who feel valued for the positive contribution they can make to Aviva's success". During 2005, we achieved the gold award for progress in providing an inclusive environment for women from Opportunity Now. We were one of only 12 FTSE 100 companies to be included in Stonewall's Corporate Equality index, moving from 71st to 39th in the index during 2005, and achieved a bronze award for efforts in creating a racially inclusive workforce from Race for Opportunity.

Leadership and care

In Norwich Union Insurance (NUI), our "leadership and care" programme exemplifies the links we make between our customers and our employees. The programme continues to work towards the goal of maximising engagement and performance of all employees and putting the customer at the heart of decision making. In 2005, 82% of NUI employees considered themselves to be "passionate about delivering a great customer experiences", up 8% on the beginning of 2004. This successful programme is being adopted by other business units worldwide.

Making a difference

In Morley, a programme has been introduced to help non-investment employees to understand better, think proactively about and anticipate industry issues. In our corporate office, staff have a quarterly opportunity to nominate a colleague or a team who have exemplified one or more of the Aviva values. Providing the tools to help employees make a difference and measuring progress is very important. Financial reward schemes now recognise those employees who really make a positive difference to our customers' experiences.

25

Countries in which we have employees

>41,000

Employees surveyed during 2005

Employees

The changing face of Aviva plc

Our worldwide workforce is made up of people from diverse cultural backgrounds. Developing a flexible and adaptable workforce is a key element in our determination to meet the changing needs of our business.

Listening to our employees

In 2005, we introduced our first global employee opinion survey to enable us to compare and contrast employee engagement between businesses worldwide. Over 41,000 employees have now participated and the results will enable us to identify and share good practice across the group. 2006 will see the first complete coverage.

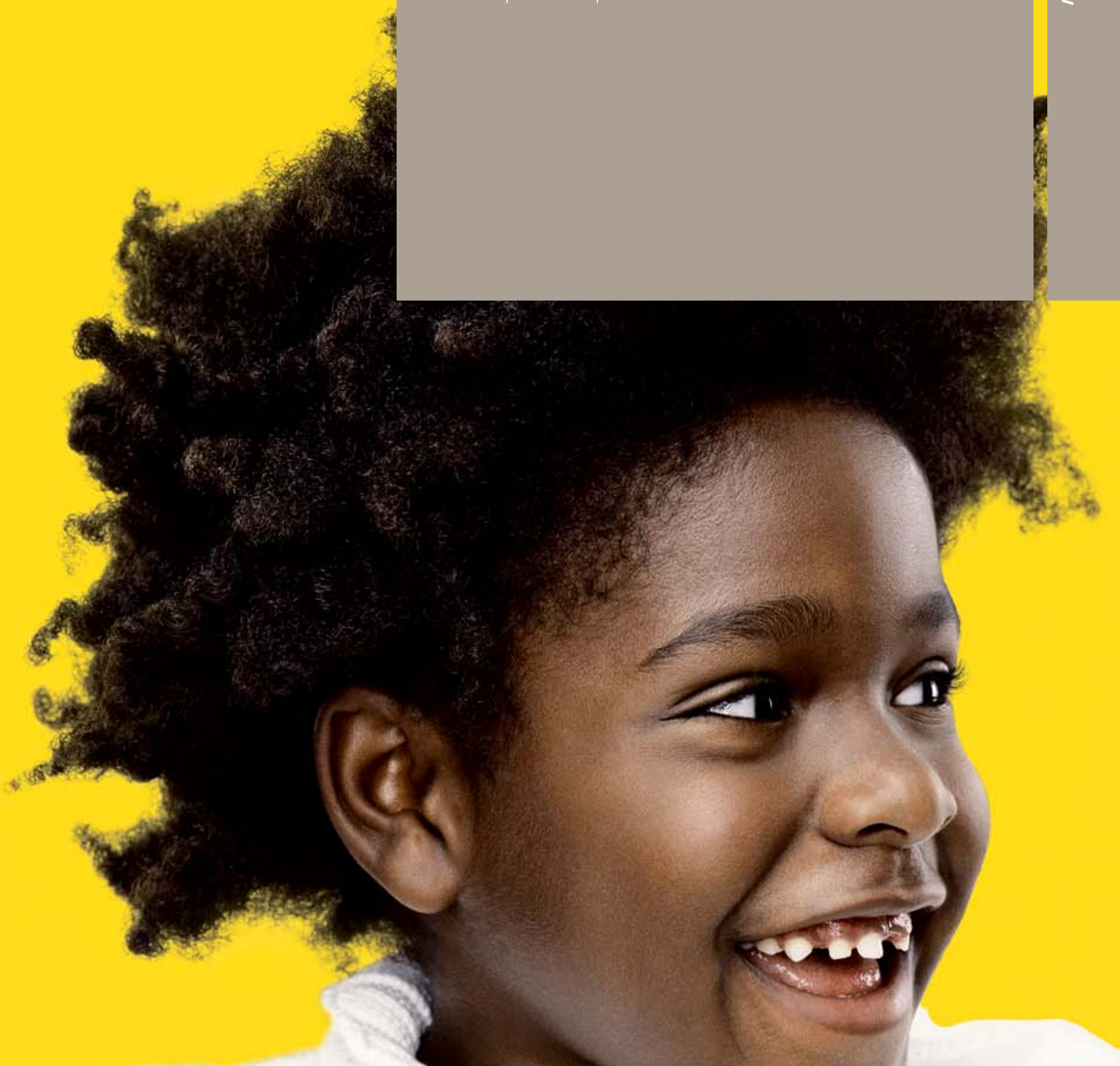
Developing future leaders

We seek to identify and nurture our talented people. Our annual "organisation and development review" enables us to review talent on a consistent basis worldwide. This process is complemented by the Aviva Leadership Academy which provides international development opportunities for our future leaders.

We're helping to
create prosperity and
peace
for millions of people
around the world

of mind

Business review
Group overview



Group overview: Basis of preparation

This business review has been prepared in accordance with the recommendations of the European Union (EU) Modernisation Directive 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 providing this review, we aim to present a view that is both 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 EU Modernisation Directive requires that business reviews contain financial and, where applicable, non-financial key performance indicators. We consider that our key financial performance indicators (KPIs) are those that communicate the financial performance and strength of the group as a whole to the members. These KPIs comprise:

– Return on capital employed

– Proposed ordinary dividend

– Dividend cover

– Operating profit (International Financial Reporting Standards basis)

– Operating profit (European Embedded Value basis).

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

From 2006, non-financial performance indicators covering customer service and employee satisfaction will also be disclosed. We see both as being important to the ongoing success of our business. Additionally, performance against customer and employee measures will be incorporated into executive and senior management remuneration.

Forward-looking statements

This business review contains "forward-looking statements" with respect to certain of Aviva's plans and its current goals and expectations relating to its 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 Aviva's control. For example, certain insurance risk disclosures are dependent on our choices about assumptions and models, and by their nature are only estimates. As a result, actual future gains and losses could differ materially from those that have been estimated. Other factors that could cause actual results to differ materially from those estimated by the forward-looking statements include, but are not limited to:

– UK domestic and 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 or UK and foreign legislation

– The timing and impact of acquisitions or business combinations in relevant industries

– Natural and other disasters

– Changes to consumer saving or spending habits

– Aviva's success in managing the above factors.

As a result, Aviva's actual future financial condition, performance and results may differ materially from the plans, goals and expectations set forth in Aviva's forward-looking statements. Aviva undertakes 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 European Embedded Value (EEV) as an alternative performance measure. Details of the accounting basis of preparation are set out in the 'financial reporting' section of this business review on page 46.

Strategy and values

Aviva is the world's sixth-largest insurance group and the largest insurance services provider in the UK. We are one of the leading providers of life and pension products in Europe and are actively growing long-term savings businesses in Asian markets, Australia and the USA. Our main activities are long-term savings, fund management and general insurance. We have premium income and investment sales of £35.0 billion and £317 billion of assets under management. We have more than 54,000 employees serving millions of customers.

The group's activities are organised into two strategic areas: Long-term savings and fund management; and general insurance, health and related services.

Group strategy

Our overriding goal is to provide prosperity and peace of mind for our customers. To achieve this goal, we need to be a clear leader in helping our customers grow their wealth and protect their assets and their health.

Our objectives for achieving this are:

Long-term savings and fund management
– Offering a superior range of long-term savings, investment and protection products in markets that offer significant opportunities for growth

General insurance, health and related services
– Providing a broad range of competitive motor, property, health and related insurance services to individuals and small to medium-sized enterprises in chosen markets

To meet our objectives, our strategic focus is on:

– Understanding and meeting the evolving needs of our customers

– Building profitable businesses in selected areas where we have, or can achieve, market leading positions

– Working closely with business partners to deliver efficient and effective distribution channels

– Using brands to widen our leading positions

– Delivering growth organically and through carefully selected acquisitions designed to increase shareholder value

– Using our scale to deliver benefits, including cost-competitiveness

– Attracting, motivating and retaining talented people who are committed to Aviva's values and ambitions.

These strategies set out the overall high-level direction of the group. Individual business units subsequently select those strategic options that are relevant to their individual markets. Details of the strategies adopted by each of the business units, and the effectiveness of those strategies, are set out in the business segment performance reviews on pages 24 to 35.

Our values

In everything that we do, we are mindful of our brand values. They inform not only what we do, but the manner in which we do it. Our values are set out below:

Progressiveness
Being progressive is having a vision of the future, encouraging innovation and improvement, and championing continuous learning. It is about leading the industry by listening and responding to customers and keeping ahead of the competition.

Integrity
Integrity is behaving in a way consistent with professional and ethical standards. It is being open, honest and keeping commitments, taking personal responsibility for what we say and do. It is about earning trust and respect through honesty and fairness.

Performance
Performance-driven is having clear goals and achieving them by everyone working towards them in an efficient manner.

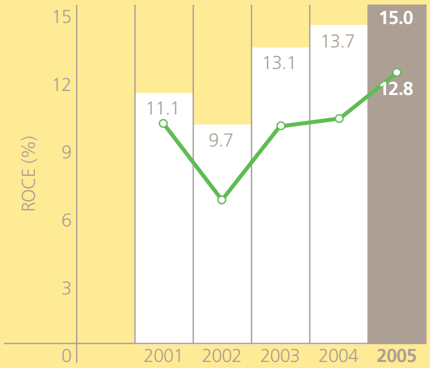
Teamwork
Teamwork is the lifeblood of Aviva. It means commitment to a common vision and objectives, depending on one another, pulling together and sharing knowledge and learning. It is creating a sense of community and belonging in how we operate as a business. It means taking pride in Aviva's achievements.

Group overview: Financial position and performance

In 2005, 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.

Return on capital employed*

15.0%



Aviva aims to deliver an after-tax operating return on equity, including life profits on a European Embedded Value (EEV) basis, equivalent to a 10% net real return on opening equity capital.

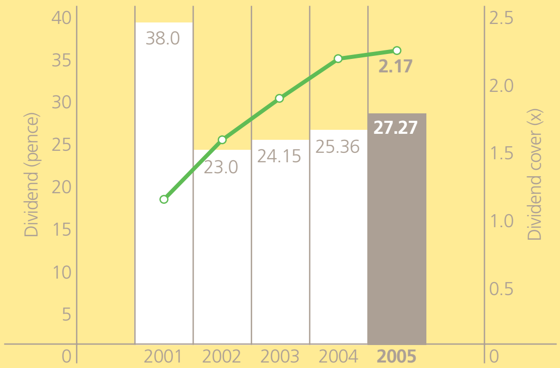
Our 2005 post-tax operating return on equity was 15.0% *(2004: 13.7%)*, which reflects the strong operational performance delivered by our businesses. Net of inflation, this figure was 12.8% *(2004: 10.2%)*

Actual ROCE

Actual ROCE less inflation

Proposed ordinary dividend per share and dividend cover**

27.27p



Our previous target was to grow the dividend by 5% per annum whilst looking to sustain a target dividend cover in the range of 1.5 to 2.0 times operating earnings after tax on an IFRS basis.

Our future intention is to increase the 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.

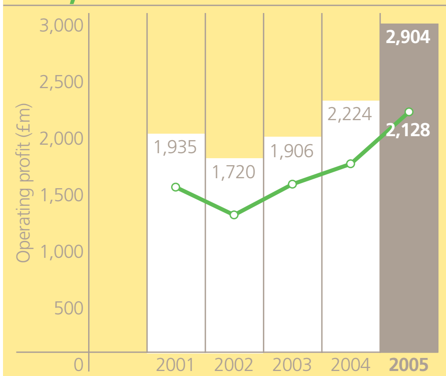
Our dividend has grown by 7.5% during 2005 *(2004: 5.0%)*. Dividend cover is 2.17 times *(2004: 2.11 times)*.

Dividend

Dividend cover

Group operating profit before tax†

£2,904m



The group aims to achieve steady and sustainable growth in its operating profit, both on an EEV and IFRS basis. In seeking to achieve this growth Aviva continues to adopt strict financial management disciplines underpinned by strong corporate governance.

Our EEV operating profit grew by 29% to £2,904 million *(2004: £2,224 million)*. On an IFRS basis, we achieved growth of 25% to £2,128 million *(2004: £1,669 million)*, reflecting strong operation performance and strong equity market performance.

EEV basis

IFRS basis

* Return on capital employed is calculated using after-tax return and opening equity capital, based on operating profit, including long-term savings profit on an European Embedded Value basis before amortisation of goodwill. The ROCE in 2001 and 2002 incorporates long-term savings profit that is calculated on an achieved profits basis and general insurance and health business on a UK GAAP basis and has not been restated.

**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. The calculations in respect of 2001, 2002 and 2003 are performed on a modified statutory solvency basis.

† Group EEV operating profit is calculated using long-term savings operating profit on an EEV basis before amortisation of goodwill. The group EEV operating profit in 2001 and 2002 incorporates long-term savings profit that is calculated on an achieved profits basis, and has not been restated.

Group IFRS operating profit is calculated using long-term savings operating profit on an IFRS basis before amortisation of goodwill. The group IFRS operating profit in 2001, 2002 and 2003 incorporates long-term savings profit that is calculated on a modified statutory solvency basis, and general insurance and health business on a UK GAAP basis has not been restated.

Group operating profit before tax – IFRS and EEV bases

	IFRS basis		EEV basis	
	2005 £m	2004 £m	2005 £m	2004 £m
Life EEV operating return	**1,065**	1,116	**1,814**	1,611
Fund management	**92**	40	**51**	20
General insurance and health	**1,551**	1,259	**1,551**	1,259
Other:				
Other operations	**(8)**	(121)	**60**	(41)
Corporate costs	**(136)**	(188)	**(136)**	(188)
Net unallocated interest charges	**(436)**	(437)	**(436)**	(437)
EEV/IFRS operating profit before tax	**2,128**	1,669	**2,904**	2,224

*The proportion of the results of the group's UK and French asset management operation, the results of Norwich Union Equity Release and the proportion of the results of Norwich Union Life Services operation that arise from the provision of fund management and other services to the life business have been included within the life operating profit on an EEV basis but are included within fund management and non-insurance on an IFRS basis.

2005 saw a continuation of our strong operational performance across all our major businesses. We achieved an operating profit before tax, including life EEV operating return, of £2,904 million (2004: £2,224 million), an increase of 29%. On an IFRS basis, worldwide operating profit before tax increased by 25% to £2,128 million (2004: £1,669 million). This strong set of results has been achieved by our continued focus on profitable growth, pricing and cost, our disciplined approach to underwriting and efficient claims management.

The operating results of our life, fund management and general insurance and health businesses are discussed in detail in the business segment performance reviews on pages 24 to 35. Other components of our operating profit are discussed below.

Other operations

The result of our other operations on an IFRS basis improved to a loss of £8 million (2004: loss of £121 million). This improvement reflects the inclusion of the results of RAC non-insurance operations, including RAC Services and RAC Auto Windscreens of £30 million. Additionally, there were lower losses from NU Life services Ltd of £66 million (2004: loss of £80 million) and an improved performance from the non-insurance operations in the Netherlands, including the banking division result, of £39 million (2004: loss of £5 million). The 2005 result also includes a loss of £14 million relating to the development of the Lifetime platform, while in 2004, the results were depressed by a £40 million vacant property provision, which has not recurred.

Following our acquisition of RAC, we sold Hyundai Cars (UK) to Hyundai Motor UK Limited and the commercial fleet division of Lex Transfleet Limited to Fraikin Limited. The post-acquisition operating profits from RAC's non-insurance operations, including RAC Services and RAC Auto Windscreens, was £30 million *(2004: nil)*, reflecting increased levels of investment and the sale on Hyundai.

In October 2005, HBoS plc exercised their option to purchase RAC's 50% shareholding in Lex Vehicle Leasing (LVL). We are currently in negotiations to agree a fair value. Accordingly, the assets and liabilities of LVL have been presented as held for sale on the balance sheet.

On an EEV basis, operating profit for our other operations was £60 million *(2004: loss of £41 million)* as this excludes the majority of NU Life Services Ltd losses that are incorporated in the life EEV operating return.

Corporate costs

Following the successful completion of our global finance transformation programme (GFTP) in the first half of the year, GFTP costs were £28 million *(2004: £85 million)*, lowering our corporate costs to £136 million *(2004: £188 million)*. Other corporate costs amounted to £108 million *(2004: £103 million)*.

Unallocated interest charges

Unallocated interest charges comprise internal and external interest on borrowings, subordinated debt and intra-group loans that are not allocated to local business operations. The charge is shown net of pension income. Our total interest costs in the period were £436 million *(2004: £437 million).* Our external costs amounted to £248 million *(2004: £246 million),* while internal interest costs were broadly unchanged at £220 million *(2004: £219 million)*. The net pension income of £32 million *(2004: £28 million)* represents the expected return on our pension scheme assets less the interest on our pension scheme liabilities, recognised as a consequence of adopting IFRS.

Interest on our direct capital instrument of £42 million *(2004: nil)* is not included in unallocated interest because it is treated as an appropriation of profits retained in the period. In accordance with IFRS, the appropriation was charged upon declaration and settlement in November 2005. The coupon payment attracts tax relief at 30%. The net impact of the appropriation on the profit attributable to ordinary shareholders was £29 million.

Group overview: Financial position and performance continued

Group profit on ordinary activities before tax

	IFRS basis		EEV basis	
	2005 £m	2004 £m	2005 £m	2004 £m
Operating profit before tax	**2,128**	1,669	**2,904**	2,224
Adjusted for the following items:				
Impairment of goodwill	**(43)**	(41)	**(43)**	(41)
Amortisation and impairment of acquired value of in-force business	**(73)**	(85)	**–**	–
Amortisation and impairment of intangibles	**(45)**	(7)	**(21)**	(3)
Financial Services Compensation Scheme and other levies	**–**	(49)	**–**	(49)
Short term fluctuation in return on investments backing general insurance and health business	**517**	161	**–**	–
Variation from longer-term investment return	**–**	–	**2,805**	662
Effect of economic assumption changes	**–**	–	**(406)**	(318)
Profit on the disposal of subsidiaries and associates	**153**	34	**153**	34
Integration costs	**(109)**	–	**(109)**	–
Exceptional costs for termination of operations	**–**	(40)	**–**	(40)
Profit before tax – attributable to shareholders' profits	**2,528**	1,642	**5,283**	2,469
Tax attributable to shareholders' profits	**(630)**	(271)	**(1,601)**	(650)
Profit for the year	**1,898**	1,371	**3,682**	1,819
Minority interests	**(131)**	(96)	**(212)**	(178)
Preference dividends	**(17)**	(17)	**(17)**	(17)
Coupon payment on Direct Capital Instrument net of tax	**(29)**	–	**(29)**	–
Profit attributable to ordinary shareholders	**1,721**	1,258	**3,424**	1,624
Ordinary dividends declared and charged in the period	**(598)**	(553)	**(598)**	(553)
	1,123	705	**2,826**	1,071

On an EEV basis, our profit before tax was substantially higher at £5,283 million *(2004: £2,469 million)*. The increase includes positive investment return variances of £2,805 million *(2004: £662 million)* and the adverse impact of economic assumption changes of £406 million *(2004: £318 million)*.

2005 saw a return to strong equity market performance, particularly during the second half of the year. In the UK, the FTSE All Share Index rose by 18% from the end of 2004 levels, in France the CAC 40 by 23% and in the Netherlands the AEX by 25%. The variance from the longer-term investment return reflects the higher than assumed overall equity returns during the year following these improvements in the equity markets, and increased market values of fixed income securities following the fall of 50 basis points and 40 basis points in UK and Eurozone bond yields, respectively.

Long-term economic assumption changes, which are set by reference to long-term bond yields, were revised downwards at 31 December 2005 and these lower assumptions have reduced the expected value of future profits from in-force life contracts, reducing profits by £406 million. The non-life short-term fluctuations of £517 million *(2004: £161 million)* are principally due to higher equity market returns compared to our longer-term investment return assumptions.

In the second half of 2005, we completed the sale of our Asian general insurance business and recorded a profit on sale of £165 million. Following the acquisition of RAC, we have spent a total of £109 million on integration activities to date, and anticipate a further £21 million will be incurred in 2006.

The overall effect of the non-life short-term fluctuations, profit on disposal of subsidiaries and integration costs is included in the IFRS profit before tax attributable to shareholders' profits of £2,528 million *(2004: £1,642 million)*.

Tax

The tax charge for the period was £1,601 million *(2004: £650 million)* on an EEV basis and includes a charge of £927 million *(2004: £618 million)* in respect of operating profit. The tax charge equates to an effective rate of 31.9% *(2004: 27.8%)*. On an IFRS basis, the effective tax rate on operating profit was 25.2% *(2004: 19.1%)*.

The increase in our effective tax rate in 2005, reflects the combination of the non-recurrence of one-off items in 2004 that reduced the tax charge, offset by the release of current tax provisions following agreements reached with tax authorities on a number of issues around the group.

Dividends

The directors are recommending a final dividend of 17.44 pence net per share *(2004: 16.00 pence)* which, together with the interim dividend of 9.83 pence per share *(2004: 9.36 pence)*, produces a total dividend for the year of 27.27 pence per share *(2004: 25.36 pence)*.

Under IFRS, dividends are only recognised in the financial statements once the shareholders' right to receive payment is established. For the final dividend this right is only established when the dividend has been approved at the Annual General Meeting. Consequently, the cost of the final dividend for 2005 is not recorded in these accounts but will be recorded in the 2006 accounts. The total cost of dividends for 2005 incorporates the 2004 final dividend and the 2005 interim dividend.

The total cost of dividends for 2005, including preference dividends and direct capital instrument appropriation, will amount to £598 million *(2004: £553 million)*, leaving £1,123 million to be transferred to reserves *(2004: £705 million)*.

The final dividend for 2005 will be paid on 17 May 2006 to all holders of ordinary shares on the Register of Members at the close of business on 10 March 2006. The company's Scrip Dividend Scheme will be available to shareholders in respect of the payment of the final dividend. In addition, a local currency payment service will be available to shareholders residing in certain participating countries outside the UK. Further details of these arrangements can be found in the shareholder information on page 223.

+29%

Growth in EEV operating profit

Summarised group consolidated balance sheet

As at 31 December 2005:

	IFRS basis		EEV basis	
	31 December 2005 £m	31 December 2004 £m	31 December 2005 £m	31 December 2004 £m
Assets				
Acquired value of in-force business and intangible assets	**803**	516	**803**	516
Goodwill	**2,274**	1,184	**2,274**	1,184
Investment properties, properties and equipment	**14,160**	11,869	**14,160**	11,869
Additional value of in-force long-term business	**–**	–	**6,454**	5,018
Investments in joint ventures and associates	**3,014**	2,128	**3,014**	2,128
Financial Investments	**182,388**	166,356	**182,388**	166,356
Other assets	**47,076**	44,471	**47,076**	44,471
Cash and cash equivalents	**13,732**	12,779	**13,732**	12,779
Total Assets	**263,447**	239,303	**269,901**	244,321
Equity				
Capital and reserves	**8,974**	7,093	**8,668**	7,093
Additional retained profit on an EEV basis	**–**	–	**6,431**	4,768
Equity attributable to shareholders of Aviva plc	**8,974**	7,093	**15,099**	11,861
Direct capital instrument	**990**	990	**990**	990
Minority interests	**1,128**	910	**1,457**	1,160
Total Equity	**11,092**	8,993	**17,546**	14,011
Liabilities				
Gross liability for insurance and investment contracts	**209,911**	193,677	**209,911**	193,677
Unallocated divisible surplus	**8,978**	7,549	**8,978**	7,549
Borrowings				
External debt	**1,002**	2,050	**1,002**	2,050
Subordinated debt	**2,808**	2,847	**2,808**	2,847
Securitised mortgages and other borrowings	**7,203**	5,193	**7,203**	5,193
Other liabilities	**19,316**	16,747	**19,316**	16,747
Net asset value attributable to unitholders	**3,137**	2,247	**3,137**	2,247
Total liabilities	**252,355**	230,310	**252,355**	230,310
Total equity and liabilities	**263,447**	239,303	**269,901**	244,321

Equity shareholders' funds

During 2005, the equity attributable to our shareholders on an IFRS basis has increased by 27% to £8,974 million *(2004: £7,093 million)*. This increase primarily reflects the growth in retained earnings, in turn reflecting our strong operational performance during 2005. Under EEV, we recognise an additional retained profit of £6,431 million *(2004: £4,768 million)* bringing the total shareholders' funds on an EEV basis to £15,099 million *(2004: £11,861 million)*.

Total assets

At 31 December 2005, our total assets were £263.4 billion *(2004: £239.3 billion)* on an IFRS basis. Under EEV principles, our total assets are £6,454 million *(2004: £5,018 million)* higher. The difference relates to the recognition as an asset under EEV of internally-generated additional value of in-force long-term business.
The growth in total assets was substantially through an increase of £16.0 billion in financial investments. This growth is related to strong new business sales and investment market performance and is mirrored by an increase of £16.2 billion in gross liabilities for insurance and investment contracts.

Goodwill and other assets

AVIF and intangible assets includes goodwill, which has increased by £1,090 million during 2005 primarily as a result of the acquisition of RAC. The growth in other assets is predominantly driven by a £2,489 million increase in loan balances.

Other liabilities – pension deficit

Other liabilities include our total pension deficit of £1,471 million (gross of tax). This is an increase of £578 million on the previous year end and has been driven by a number of factors, including the acquisition of the pension deficit of RAC staff of £313 million and the adverse impact on the valuation of liabilities of a 70 basis point reduction in real interest rates during 2005. These changes have been offset by the positive effect of the strong rise in equity markets. The UK pension schemes are the largest and have a total deficit of £1,371 million.

Currently, substantially all of the deficit is borne by shareholders as historic contractual arrangements have, to date, meant that no deficit funding has been recharged to our UK with-profit funds. We are close to finalising our negotiations on the appropriate proportion to be borne by the UK with-profit funds and are hopeful that these funds will contribute approximately 12% of the future deficit funding payments to the Norwich Union pension fund. Should this level of deficit funding be agreed, shareholders' funds will improve by approximately £120 million (pre-tax), and this will be accounted for in 2006.

We commenced regular deficit funding contributions in 2004 that amounted to £52 million during 2005. Given our strong capital and cash flow position, the board will propose to the pension scheme trustees that the group makes an additional deficit funding contribution to both the Norwich Union and RAC pension schemes of £700 million over the next two years. It is expected that 12% of the payments to the Norwich Union scheme will be made from the UK with-profit funds, and the remainder will be paid from the Group's internal resources. In anticipation that these proposals will be accepted, shareholders contributed an additional £160 million at the end of 2005.

Summarised consolidated cash flow statement – IFRS basis

	Long-term business operations £m	Non-long-term business operations £m	Total Full year 2005 £m	Total Full year 2004 £m
Net cash from operating activities	**1,365**	**1,044**	**2,409**	1,855
Net cash from investing activities	**(736)**	**(567)**	**(1,303)**	(242)
Net cash flow from financing activities	**453**	**(570)**	**(117)**	1,458
Net increase in cash and cash equivalents	**1,082**	**(93)**	**989**	3,071
Cash and cash equivalents at 1 January	**9,087**	**3,039**	**12,126**	9,023
Effect of exchange rate changes	**(62)**	**14**	**(48)**	32
Cash and cash equivalents at 31 December	**10,107**	**2,960**	**13,067**	12,126

Cash flows from operating activities increased by 30% to £2,409 million *(2004: £1,855 million)*, reflecting our strong operating performance. Conversely, investing activities generated a net cash outflow of £1,303 million, primarily due to acquisition activities.

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Business review
Business segment performance

We're safeguarding
irements
across Europe

Business segment performance: Long-term savings and fund management

Long-term savings

2005	IFRS profit before tax £m	IFRS operating profit £m	EEV operating profit £m	PVNBP* £m	New business contribution £m	New business margin %
UK	**1,210**	**384**	**585**	**9,053**	**265**	**2.9**
France	**234**	**258**	**321**	**3,530**	**135**	**3.8**
Ireland	**56**	**28**	**20**	**665**	**16**	**2.4**
Italy	**35**	**53**	**96**	**2,294**	**59**	**2.6**
Netherlands (including Belgium and Luxembourg)	**164**	**168**	**318**	**2,407**	**88**	**3.7**
Poland	**90**	**91**	**128**	**285**	**14**	**4.9**
Spain	**75**	**89**	**214**	**2,013**	**175**	**8.7**
Other Europe	**(7)**	**(4)**	**33**	**739**	**7**	**0.9**
International	**8**	**(2)**	**99**	**1,260**	**49**	**3.9**
Long-term savings total	**1,865**	**1,065**	**1,814**	**22,246**	**808**	**3.6**

2004	IFRS profit before tax £m	IFRS operating profit £m	EEV operating profit £m	PVNBP* £m	New business contribution £m	New business margin %
UK	654	353	551	9,172	269	2.9
France	196	213	286	2,782	95	3.4
Ireland	52	31	40	561	19	3.4
Italy	28	49	79	1,799	48	2.7
Netherlands (including Belgium and Luxembourg)	220	214	277	2,168	80	3.7
Poland	80	80	93	241	11	4.6
Spain	61	72	180	2,110	143	6.8
Other Europe	(8)	5	22	804	5	0.6
International	102	99	83	1,024	36	3.4
Long-term savings total	1,385	1,116	1,611	20,661	706	3.4

*Excludes investment sales. Investment sales totalled £2,399 million *(2004: £1,629 million)* giving overall new business sales of £24,645 million *(2004: £22,290 million)*.

UK

Our UK business, operating as Norwich Union, provides a comprehensive suite of long-term savings products, focusing on competitive and sustainable investment returns. We are a top-three player in all our chosen life and pensions market sectors. Our business is mainly written through a network of financial advisers and we have developed a strong distribution footprint for the depolarised marketplace with major product multi-tie agreements with Sesame, Barclays, Bankhall and Millfield Alliance, together with protection multi-tie agreements with SimplyBiz and Direct Life and Pensions and a single-tie agreement with CIS. Additionally, we have a bancassurance joint venture with The Royal Bank of Scotland giving us access to their large retail branch network. We are regulated by the Financial Services Authority (FSA) and are based in York, with significant operating sites in Norwich, Sheffield, Stevenage and Pune and Bangalore in India.

We aim to be the leader in the UK long-term savings market, achieving profitable growth while maintaining our leading positions in our chosen sectors. We will achieve this objective by differentiating ourselves from our competitors, continuing to earn the trust of our customers, using a broad range of products and distribution partners to give a full service and further increasing our efficiency and effectiveness. In addition, we are committed to helping our people enjoy their work while maximising the value they create for the company.

In April, we launched a "wrap" proposition through Lifetime, which enables financial advisers to manage all of a client's portfolio. More than 100 firms and 800 advisers have signed up to this. The popularity of this product underlines the desire for innovation in the market and our view is that demand for wraps will be significant. Increased focus and awareness in the RBS retail branch network and upgrading our protection and investment products has resulted in improved bancassurance performance. We have also made significant progress in the collective investment sales market, which we see as a growth area.

We are committed to delivering excellent service to our customers and therefore a recent financial adviser service rating of 1 star is very disappointing. In 2005, we put in place a customer feedback programme that has given us regular insights into all aspects of our service and has enabled us to carefully target and track improvements. Customer service standards to policyholders have increased throughout 2005 and to financial advisers, standards have increased over the final quarter. Plans are in place for further improvement during 2006, with an emphasis on service to financial advisers. We have continued to develop our "process excellence" capability, which has reduced both end-to-end service times and costs. Our Indian operation continues to develop successfully. We have around 1,000 employees in India, covering a full range of processes. These activities have quickly achieved or exceeded the target performance levels based on UK standards. We are also seeing further benefits in cost, quality and operational flexibility.

Our life EEV operating return increased to £585 million *(2004: £551 million)*, primarily driven by increased expected returns from in-force business and shareholders' net worth. The net impact of experience variances and operating assumption changes amounted to a loss of £150 million *(2004: loss of £139 million)*.

Adverse persistency and expense variances have been offset by mortality profits of £105 million *(2004: £51 million profits)* arising principally on protection contracts, better than expected default experience on corporate bonds and commercial mortgages of £19 million *(2004: £29 million)*. Additionally, £110 million has arisen from the change in the level of required capital for annuity business from 200% to 150%.

Adverse exceptional expenses of £148 million *(2004: £153 million adverse)* included £47 million in respect of ongoing restructuring in the UK life business and a further £101 million of other exceptional and project costs associated with regulatory change and strategic initiatives.

Persistency experience on our unitised with-profit and unit-linked bonds, as well as pensions products, continues to be adverse, generating a loss of £78 million *(2004: £50 million loss)*. This loss principally arises in relation to bond contracts, on surrenders occurring at set anniversary dates where market value adjustments do not apply. Actual lapse experience has continued to be higher than assumed, notwithstanding the change in lapse assumptions made in 2004. While action is ongoing to improve our current persistency experience, this coupled with an increase in the expected number of lapses on pension business has resulted in a provision for lapses with a consequential adverse impact on profits of £130 million *(2004: £110 million adverse)*.

Our total sales, including investment sales were up by 2% to £10,213 million *(2004: £10,031 million)*. Our fourth quarter sales were the highest of the year, and reflected the actions taken in the second half to improve performance and volume growth in our key markets. We took strong and appropriate pricing actions to generate medium and long-term profitable growth.

Our new business contribution was £265 million *(2004: £269 million)* reflecting the change in product mix during the second half of 2005.

We launched our pension simplification (A-Day) strategy in October 2005 and are well-positioned to benefit in what we anticipate will be a growing market. We will offer flexible solutions for our customers' long-term needs and are confident in our ability to grow our pension business and reduce costs after A-Day.

We are continuing to review the possibility of a reattribution of the inherited estate, or orphan assets, of two of our with-profit funds, CGNU Life and Commercial Union Life Assurance Company. The inherited estate consists of surplus assets accumulated over time in a with-profit fund. We are exploring the benefits to policyholders and shareholders from a reattribution and have established a project team to perform the research. Under FSA rules, a condition of the new regulatory system for reattributing an inherited estate is the appointment of an independent policyholder advocate to represent policyholder interests. We welcome this initiative and are pleased to announce the appointment of Clare Spottiswoode, a former director of Ofgas, as the policyholder advocate. At this stage, no decision has been taken to proceed with a reattribution; it will only be undertaken if there are clear benefits for policyholders and shareholders.

We shall continue to focus on profitable growth for shareholders, while maintaining market-leading positions in our chosen sectors. We constantly monitor market developments and will exploit opportunities as they arise.

Bancassurance

Success through bancassurance
Our distribution strategy is to offer choice and excellent service to customers through a mix of distribution channels. This includes bancassurance, in addition to other channels such as independent advisers, direct sales and partnerships with non-banking organisations.

What is bancassurance?
Bancassurance is the distribution of insurance products by banks. It is a significant sales channel in most countries and dominant in a few. The sales model varies according to the market place and the type of partnership, and can include sales by bank counter staff, by a branch-based adviser or by referral from the branch to one of our sales advisers.

Why distribute through banks?
Banks typically have large customer bases, well-established and trusting relationships with their customers and well-known brands. Banks also have financial knowledge of their customers and are in a good position to identify financial needs and appropriate products, including insurance solutions. This leads to a cost effective form of distribution for insurance products.

We have expertise in product design, insurance risk management, service delivery and the sales process for insurance products. Particularly important for our success is our knowledge and experience of making bancassurance partnerships work effectively in many different markets. We also have a highly respected brand name that complements our bank partners' strong brands and reputations. Through bancassurance partnerships, we can achieve high sales volumes with economies of scale. In turn, these benefits are passed on to consumers through competitively priced products.

For a partnership to work successfully there must be clear benefits for both parties.

How are we doing?
We have a leading position in bancassurance distribution throughout the world and it is an integral part of our distribution strategy. We generate significant sales volumes through our partnerships, and see bancassurance as continuing to grow in future years. This year, bancassurance has generated 25% of Aviva's new long-term savings business, an increase from 23% in 2004. Additionally, we are rapidly becoming the "partner of first choice".

Specific details of our major bancassurance partnerships are set out in the detailed reviews of the business units.

Business segment performance: Long-term savings and fund management continued

France

Aviva France is one of the top 10 long-term savings businesses in France with a market share of 5%. It focuses on higher-margin unit-linked products in which its market share is 8%. We offer a comprehensive range of life and savings products for both private and corporate clients. Distribution is multi-channel, including a direct sales force, brokers, AFER (the largest retirement savings association in France), the UFF network of financial advisers, Aviva Direct, Aviva Assurances agents and our bancassurance partnership with Crédit du Nord. The centralisation of operations in the outskirts of Paris in the first half of 2005 is expected to yield benefits through closer co-operation and operating efficiencies.

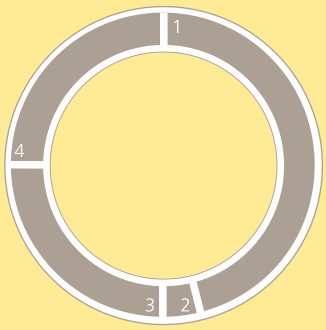
We aim to generate organic growth with a specific focus on our strength in the unit-linked market while also taking advantage of attractive opportunities that arise for non-organic growth. Our efforts are focused on achieving greater efficiency in sales, administration and the management of our key business partnerships. We will, as always, seek to maintain high levels of customer service and market leading investment performance through our fund manager Aviva Gestion d'Actifs.

+22%

Growth in bancassurance PVNBP

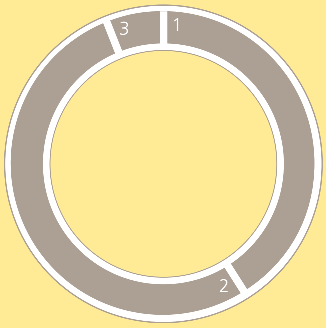
Worldwide sales by distribution channel

1 Financial advisers	**46%**
2 Partnerships	**4%**
3 Direct	**25%**
4 Bancassurance	**25%**



Worldwide sales by country

1 UK	**41%**
2 Europe	**53%**
3 International	**6%**



During 2005, we have had continued success with limited-period savings offers. We had strong growth in unit-linked sales through AFER and achieved healthy growth in unit-linked sales across other distribution channels. The regulatory environment is entering a period of change, including tighter regulations surrounding the sales process and the "Fourgous" amendment, which will enable conversion from earlier generation euro funds to unit-linked funds without the loss of tax benefits. We have anticipated these changes and we are well placed to respond to customers wishing to convert. Greater use of intranet and extranet tools to communicate with the sales network has produced service improvements and cost savings. Additionally, efficient administration procedures supporting our Crédit du Nord partnership are being introduced to other distribution channels.

Our life EEV operating return rose to £321 million *(2004: £286 million)* including £33 million from our bancassurance partnership with Crédit du Nord *(2004: £4 million).* This performance primarily reflects the increased contribution from new business sales. Higher expected returns and experience variances were offset by lower operating assumption variances. The favourable experience variance of £32 million *(2004: £22 million)* includes mortality profits of £29 million *(2004: £21 million)*. We generated strong sales growth of 26% to £3,530 million *(2004: £2,782 million)*. Within this total, unit linked sales increased by 73% to £1,423 million *(2004: £818 million)* and we are well positioned for continued growth in unit-linked business. Our bancassurance partnership with Crédit du Nord recorded sales of £728 million in its first full year *(2004: £127 million)* and AFER unit-linked sales grew substantially by 78% to £367 million *(2004: £205 million)*. Our strategic focus on more profitable unit-linked sales resulted in a 41% increase in new business contribution to £135 million *(2004: £95 million)* giving a higher full year new business margin of 3.8% *(2004: 3.4%).*

We expect to see overall market growth slowing in 2006. However, we have built a strong base from which to grow while seeking to retain our focus on the higher-margin unit-linked market.

Netherlands (including Belgium and Luxembourg)

Delta Lloyd is a top-five financial services group based in the Netherlands, with operations in Belgium, Luxembourg and Germany, which is reported in Other Europe. We offer a comprehensive range of life and savings products in both the group and individual markets and have a multi-channel distribution strategy. We have a bancassurance joint venture with ABN AMRO, sell products directly to customers under our OHRA brand and via independent financial advisers under our Delta Lloyd brand.

Our vision is to be a trusted financial services provider by excelling in customer service, innovation efficiency and financial position and challenge for the number one position in the Dutch life market.

During 2005, the development of our venture with ABN AMRO has continued, with the introduction of new products to complete our range. We have adapted our existing pension products and introduced new ones in anticipation of changing pension laws that come into effect during 2006, with a particular focus on sales to small-to-medium sized enterprises. Given continuing low interest rates, we have increased provisions to cover our commitments in respect of contract guarantees. In Belgium, a major reorganisation has substantially improved our operating model and has brought improvements to our cost base and we will focus on strengthening our distribution. In December 2005, we completed the sale of our 80% holding in ENNIA Caribe Holding NV, a Dutch Antilles and Aruba-based insurer, to Banco di Caribe NV in Curaçao for a cash consideration. The sale had no material impact on our financial position and is in line with our strategy of focusing on our core markets.

Our EEV operating return of £318 million *(2004: £277 million)* included favourable operating assumption changes and a higher contribution from new business. Our life and pension sales grew to £2,407 million *(2004: £2,168 million)* with a 9% increase in sales through the bancassurance joint venture with ABN AMRO to £543 million *(2004: £493 million)*, in a market characterised by low investment returns. We generated a new business contribution of £88 million *(2004: £80 million)*, reflecting strong sales with a steady new business margin of 3.7% *(2004: 3.7%)*.

Italy

Aviva Italy is the seventh-largest life insurer, with a market share of 5.5% at the end of December 2005. We sell profit-sharing, unit-linked and structured investment bond products predominantly to individuals but we also sell group business. Our distribution is principally through our bancassurance partnerships and we have significant relationships with UniCredit Group, Banca delle Marche, Banche Popolari Unite and Banca Popolare Italiana. Our agent network and financial sales force currently trade under the Commercial Union brand but will re-brand as Aviva during 2006.

Our main goal is to increase profitability by strengthening our position in the life insurance market. To achieve our goal, we continue to work with our bancassurance partners and aim to increase customer penetration. We also seek to improve value for customers through product innovation, and to maintain a cost-efficient operation.

During 2005, our agreement to expand the number of Banche Popolari Unite branches in which our products are sold generated strong growth. In all, we introduced or improved 50 products during the year.

Our life EEV operating return increased to £96 million *(2004: £79 million),* reflecting the new business growth and the return on our additional investment in the BPU Group at the start of 2005. We outperformed the local market by achieving sales growth of 27% to £2,294 million *(2004: £1,799 million)*, benefiting from product innovation and the extension of our bancassurance agreement with Banche Popolari Unite to a further 380 branches. New business contribution increased to £59 million *(2004: £48 million)* due to significantly higher sales, representing a new business margin of 2.6% *(2004: £2.7%)*.

The long-term savings market has significant medium-term growth potential. The prospects for continuing growth in 2006 are good and we expect to increase our access to the UniCredit Group branch network.

Spain

Aviva Spain operates in the long-term savings, pensions and protection markets through a multi-distribution platform. We are the second-largest life insurer with a 9% market share. Our distribution is dominated by five bancassurance partnerships with Bancaja, Caja España, Caixa Galicia, Unicaja and Caja de Granada. The majority of our products are marketed through the brands of our bancassurance partners. We use the Aviva brand in relation to our Aviva Vida y Pensiones (AVP) business, which distributes products through an agency-based network. We are based in Madrid, with operating companies in other major Spanish cities.

We aim to maintain our position as a leading player in the Spanish market through sustained profitable growth. We will concentrate on consolidating relationships with existing bancassurance partners, maintaining an emphasis on higher-margin protection and pension products, and maintaining a cost-efficient operation. We will also pursue additional bancassurance arrangements while improving penetration in our current partnerships. We are further developing our adviser-based business in AVP.

During 2005, we launched new financial annuity, unit-linked and protection products to enhance our market proposition. We continue to focus on increasing penetration of the banks customer bases and cross-selling in all of our major relationships.

Our life EEV operating return rose to £214 million *(2004: £180 million)* due to higher new business contribution as a result of a beneficial change in product mix. Total sales were £2,013 million *(2004: £2,110 million)* and we achieved an underlying growth, excluding one-off sales, of 6%. New business contribution increased significantly by 22% to £175 million *(2004: £143 million)*, improving the new business margin to 8.7% *(2004: 6.8%)* as we continue to focus on higher margin protection and pension products. The growth outlook in the Spanish long-term savings and pension market continues to be positive.

Business segment performance: Long-term savings and fund management continued

Poland

In Poland, we are developing a multi-distribution strategy, built upon the strength of our direct sales force which currently number over 3,000 sales people. We have strong product manufacturing capabilities covering single and regular premium life business aimed at both individuals and groups. Our pension business sells a unit-linked regular premium product in the compulsory private pension market. We are the largest pension provider in Poland, with a 28% market share, and have the second-largest life insurance business, with a 12% market share.

We aim to become Poland's market leader in long-term savings by improving new business sales while maintaining our in-force portfolio. Specifically, we intend to increase the size of our direct sales force while improving productivity, reposition our existing products and build a significant bancassurance distribution channel. During 2005, we made further progress in terms of developing new products, extending distribution and improving systems. We also signed a new bancassurance agreement with Deutsche Bank. We were also pleased to be named life insurance company of the decade by *Home & Market* magazine.

Our life EEV operating return increased to £128 million *(2004: £93 million)* due to increased experience profits and operating assumption changes including mortality profits of £23 million *(2004: £6 million)*. Our new business sales grew, in local currency terms, by 4% to £285 million *(2004: £241 million)*. New business contribution was £14 million *(2004: £11 million),* resulting in a margin of 4.9% *(2004: 4.6%)*.

During 2006, we expect the Polish life market to continue the favourable trend shown in the latter part of 2005 and we are well placed to benefit from this development.

Ireland

Hibernian is the third-largest life and pensions provider in Ireland, with a 10% market share. We provide a broad product range, with a strong emphasis on pension products. We distribute primarily through brokers but are seeking to develop sales through financial institutions.

Our objective is to be Ireland's leading provider of long-term savings and protection products through a range of business partners. We are developing strategies to increase our market share and distribution profile significantly. To that end, we have announced a new bancassurance partnership with Allied Irish Banks (AIB) to create a leading force in the Irish life and pensions market and bringing further opportunities for growth. In January 2006, we acquired all the shares of AIB-owned Ark Life in exchange for 24.99% of the joint venture and a balancing cash payment of €195.4 million. This is a transformational deal for our Irish life business and increases our share of the Irish life market to 16%. We will have exclusive access to Ireland's largest retail bank, with over 280 branches and 1.6 million customers. Additionally, the management of the investments of the current Ark Life policyholders, totalling €3.0 billion at 30 September 2004, will transfer to a wholly owned subsidiary of Morley Fund Management.

During 2005, we launched a new series of the Guaranteed Fund and developed a number of property fund offerings that have proved attractive to investors. We also continue to achieve significant improvements in the quality of our operational data, which enable us to provide a better experience for customers.

We increased our sales by 18% to £665 million *(2004: £561 million)* benefiting from strong sales of single premium business during the year. Our life EEV operating return was £20 million *(2004: £40 million),* impacted by adverse experience variances. Variances were predominantly as a result of lapses on unit-linked pension business. Our new business contribution of £16 million *(2004: £19 million)* with a new business margin of 2.4% *(2004: 3.4%)*, reflects investor preference for lower-margin single premium products and the lower level of lower protection sales.

During 2006 and into 2007, the maturing of special savings incentive accounts (SSIAs) will provide an opportunity for increased sales. We anticipate that a significant amount of the maturing monies will be invested in pension and saving products.

Other European operations

Our other European operations are based in the Czech Republic, Germany, Hungary, Lithuania, Romania, Turkey and NUIL in Dublin. Our Turkish life and pensions business is ranked second and fourth in the life and pensions markets respectively. We have top-10 businesses in Lithuania, Hungary and Romania, and are ranked 12th in the Czech Republic.

Our business in Germany adapted its sales focus in 2005, with sales of profit-sharing savings products and credit life products performing well.

In Turkey, our main products are unit-linked savings and protection plans, together with group and individual pensions. Sales are mainly through our direct sales force. We aim to be the leading long-term savings provider in Turkey and will achieve this by developing our direct sales force and exploiting pension opportunities as the market continues to grow rapidly. We are also exploring other distribution opportunities, including bancassurance. Single premium pension sales were boosted by transfers from existing life policies ahead of an October 2006 regulatory deadline.

Our other European operations are seeking to achieve strong organic growth with unit-linked savings products focused on high-net-worth individuals. We are looking to grow our direct sales forces and improve performance while investigating other distribution channels, particularly brokers and banks. For example, during 2005 volumes increased in our Czech business through a bancassurance deal with Zivnostenka Banka, and in our Romanian business through our distribution agreements with BRD and ABN AMRO.

We have opened a representative office in Moscow while we continue to evaluate opportunities in the Russian market.

In October 2005, we completed the disposal of our 50% shareholding in Eurovida, our Portugese life joint venture to Banco Popular Portugal for a profit.

We generated a life EEV operating return of £33 million *(2004: £22 million)* through our other European operations. Total life and pension sales were £739 million (2004: £804 million).

International business

Our international operations are based in Australia, USA, Hong Kong, Singapore, India and China and all trade under the Aviva brand. The product ranges, distribution channels and strategies of each operation vary according to local market conditions.

Our USA operation has adopted a niche-based strategy, based on retirement and estate planning with distribution through independent agents and banks. During 2005, six new products were launched, including two fixed-indexed annuities and a deferred annuity tailored for the bank channel. During 2006, we expect sales growth through our existing lines of business supported by the recent ratings upgrade to A+ from A.M. Best. We expect favourable demographic trends for the life industry in the USA.

Aviva Australia provides wealth management services through the Navigator platform, and life products. Both operations are ranked ninth in their respective markets. Growth will be achieved through expanding independent adviser distribution and will be supported by our recent alliances with key adviser groups and institutions. Aviva Australia was awarded the prestigious *Money Management DEXX&R* 2005 risk company of the year.

Aviva Singapore and Hong Kong employ a multi-channel distribution strategy alongside a strong partnership with banking group Development Bank of Singapore (DBS). In Singapore we are ranked fifth and in Hong Kong 24th. Our business in Singapore remains the market leader in the developing broker market as well as the employee benefits and healthcare segment.

We aim to broaden and deepen business opportunities with DBS whilst developing the independent financial adviser and international financial solutions market.

In both China and India, we are actively pursuing growth in cities and provinces with significant long-term potential. Aviva India is a leader in the bancassurance market and is now ranked seventh overall among private insurance companies. We have recently entered into a significant new bancassurance agreement with Centurion Bank of Punjab, a leading private bank, thereby extending our market-leading bancassurance position. This latest agreement brings the total number of bancassurance agreements to 18. We also doubled our direct sales force to 6,700 and in addition, there are more than 1,800 people in training due to join soon, allowing us to expand our representation in smaller cities.

In China, our joint venture, Aviva-COFCO, operates a multi-channel, multi-product strategy. We distribute individual products through direct sales force, agencies, brokers and bancassurance; and sell group business both directly and through intermediaries.
We now have the fourth largest foreign joint venture (out of a total of 22), based on first year premiums. We seek to obtain "first mover" advantage in new cities wherever possible, supported by a centralised back office function. During 2005, Aviva-COFCO increased the total number of major cities where it is licensed to four, with sales offices in a further five cities. We have recently been granted permission to apply to open a branch in Jinan, the capital city of Shandong province, and are looking forward to the rapid development of this new market.

Overall, the life EEV operating return from our international businesses was £99 million *(2004: £83 million)*. We generated life and pension sales growth of 21% to £1,260 million *(2004: £1,024 million)* with encouraging performances in Asia and the USA. Our new business contribution increased by 33% to £49 million *(2004: £36 million)* with a new business margin of 3.9% *(2004: 3.4%)*, benefiting from improved business mix and volumes.

Continued economic growth in both China and India offers high potential returns in the longer term. New products, branches and sales offices will cater for the anticipated high growth rates.

On 1 February 2006, we acquired a 51% interest in Eagle Insurance Limited (Eagle), the third-largest insurer in Sri Lanka, for a cash sum of £15 million. At the same time, Eagle entered into a bancassurance agreement with National Development Bank Limited, Sri Lanka's biggest development bank and Eagle's other major shareholder.

Business segment performance: Long-term savings and fund management continued

Fund management

	2005		2004	
	IFRS profit before tax £m	EEV operating profit £m	IFRS profit before tax £m	EEV operating profit £m
Morley	**49**	**26**	18	9
UK (excluding Morley)	**8**	**8**	(2)	(2)
France	**26**	**8**	15	5
Other Europe	**2**	**2**	2	1
International	**7**	**7**	7	7
Fund management total	**92**	**51**	40	20

Morley

Morley is the largest UK-based active fund manager, with total funds under management of £154 billion *(2004: £134 billion)*. We have offices in London, Melbourne, Dublin, Warsaw, Boston, Milan and Madrid. Our clients include Aviva group companies, leading UK financial services companies, external pension funds, public sector organisations and public companies and specialist distributors of retail financial products in the UK and Europe. Our distribution capabilities, in this highly intermediated industry, are focused on the UK and a small number of pan-European markets. We are recognised as a provider of fund management solutions to third party distributors, and we hold key relationships with pension fund consultants, third-party life companies and discretionary fund managers.

We aim to compete against the best in the areas of investment management and client service, with a focus on repeatable outperformance in our core areas of fixed income, pan-European equities, property and tactical asset allocation. We are also developing a small number of specialist asset classes. By increasing the level of specialist, higher-margin business and actively managing our cost base, we aim to deliver sustainable and profitable growth. Our strategy is primarily one of organic growth, while considering acquisitions where synergies and strategic alignment are compelling. Developing innovative products to meet the needs of our clients remains a priority. We continue to work actively with our distribution partners to identify such opportunities.

During 2005, we launched a number of new institutional and retail funds, sold under the Morley and Norwich Union brand names in the UK, and under the Aviva Funds brand name overseas. To meet high demand for new property-related investments, we launched a number of new funds, including the £800 million Airport Property Partnership (a joint initiative with BAA), the Central European Industrial Fund and the Central European Property Fund. Other fund launches included the Central European Long Short Fund and the Norwich Active Protector Fund, a fund that offers protection against adverse equity market movements. Together with Barclays Capital, we launched the Woolwich Global Distribution Bond, which uses derivatives to deliver higher income than could normally be expected from a standard investment portfolio.

The achievements of our property team were recognised when Morley was named property manager of the year at the UK Pension Awards 2005. Other award-winning funds include the Aviva Emerging Countries Equity Fund (Lipper Fund Award), Morley Sustainable Future Corporate Bond Fund (Standard & Poor's Award) and Aviva Funds Long-Term European Bond (Standard & Poor's Award).

Corporate social responsibility is integral to the way Morley runs its business. We are an acknowledged leader in socially responsible investment (SRI) and were named SRI provider of the year at the Global Pension Awards 2006. We continue to build on Morley's reputation as a responsible investor.

We are regulated by the FSA and maintain a constructive working relationship. We have responded to a number of consultation papers during 2005 and anticipate further engagement in 2006, particularly in respect of the Markets in Financial Instruments Directive.

We have achieved strong growth in 2005. Operating profit rose to £49 million *(2004: £18 million)*, reflecting increased investment fee revenue, increased profit from higher performance fees (recognised in the second half of the year) of £9 million *(2004: £4 million)* and ongoing cost control. Of the total profit, £36 million was in respect of the UK *(2004: £10 million)* while overseas businesses, including Hibernian Investment Managers (HIM), accounted for £13 million *(2004: £8 million)*. Our fee income benefited from new business mandates, revenue enhancing initiatives and strongly performing investment markets. Management of our expense base delivered an improved cost/income ratio of 77% *(2004: 88%)* bringing it into line with the industry average.

In 2005, our new business wins included £2.8 billion of new funded external mandates from UK retail and institutional investors, £1.8 billion in property partnership vehicles and £1.0 billion through overseas operations.

Following the decision to outsource our fund administration to JPMorgan in 2004, all staff and systems have now transferred and the new platform and service are operating effectively. We will seek opportunities to develop this strategic relationship further. The joint venture in Ireland between Aviva and Allied Irish Banks will result in the transfer of the investment management of Ark Life's policyholder funds (€3 billion at 30 September 2005) to HIM in 2006.

UK (excluding Morley)

In addition to sales under the Morley brand in the UK, we sell retail Isas, unit trusts, open-ended investment companies (Oeics) and structured products under the Norwich Union and The Royal Bank of Scotland Group (RBSG) brands.

Operating profit from Norwich Union's retail investment business amounted to £9 million *(2004: £4 million)*, while our collective investment business with RBSG benefited from lower new business strain from sales of regular premium investment products to report a loss of £1 million *(2004: loss of £6 million)*.

France

Aviva Gestion d'Actifs is widely recognised in the French market as a leading asset manager. At the end of December 2005, 94% of our managed funds were ranked in the top half for returns over five years. Our continued strong performance was recognised through a number of awards. For the second year running we were named best provider of an extended fund range over one, three and five years by *La Tribune/Standard & Poor's*, and as the best performing insurer in the 2005 fund management awards by *Le Revenu*, a leading French investment magazine. Additionally, we were the only fund manager to win two group categories in the Lipper Fund Awards 2005.

We have £46.2 billion of funds under management, mostly on behalf of group companies, including the non-linked funds of Crédit du Nord. Operating profit was £26 million *(2004: £15 million)*, reflecting strongly performing equity markets and new business inflows.

Other Europe and International

Our other Europe and International fund management businesses consist primarily of Navigator, operating in Australia and Singapore, and small fund management operations in Poland and Canada.

In Australia, Navigator is one of the top 10 investment administration services. We offer full-service and low-cost platforms that give customers access to various wealth-creation and post-retirement products. We seek to differentiate ourselves through superior service, leading product features, adviser tools and integrated infrastructure. We are recognised by financial advisers for the quality of our product. The Australian financial services market is one of the fastest growing in the world and we are well placed to take advantage of this expanding market.

In Singapore, Navigator is a fund supermarket that allows customers to buy and sell a range of mutual funds from different fund managers through one product wrapper. The business has grown substantially during 2005 through developing stronger relationships with key brokers and by increasing the number of funds offered.

Our other Europe and International businesses reported operating profits of £9 million *(2004: £9 million)*. New business sales through Navigator grew 37% to £938 million *(2004: £661 million)*. In this total, sales in Australia increased by 26% to £848 million *(2004: £648 million)*, benefiting from continuing improvements in product offerings and customer service. Singapore reported significantly higher sales of £90 million *(2004: £13 million)* reflecting strong distribution relationships with key brokers and an increased fund choice.

Funds under management £bn

£317bn

2001	209
2002	208
2003	240
2004	280
2005	**317**

Investing in property

Morley's property business

Morley Property is a mature, profitable business with a strong growth record. Five years ago, our property team managed £7.6 billion in property assets, including just £300 to £400 million in external assets. Today we are the largest property fund manager in the UK and one of the largest in Europe, with a team of over 100 people managing more than £22 billion, including £10 billion in external assets. In the same period, the number of specialist property funds we manage has grown from six to twenty.

Independent research undertaken by industry body Investment Property Databank shows, over the last three years, that Morley has enjoyed the highest rate of growth in property funds under management in the UK.

The business model we put in place has been vital to our efficiency and success. We decided to focus on what we're good at – active property fund management – and work with property partners who are specialists in their chosen sectors. Subsequently we have delivered one of the most comprehensive ranges of innovative property products in the market, for example:

- The first, and now largest, retail property unit trust in the UK – the Norwich Property Trust which is over £2 billion in size
- The first specialist healthcare fund – Quercus Healthcare Property Partnership
- The first student accommodation fund – the Beach Student Accommodation Fund
- The first Central European multi-let industrial fund – the Central European Industrial Fund.

Our growing size has worked to our clients' advantage and has given us reach and the ability to deliver significant deals. The Airport Property Partnership, the £800 million joint venture with BAA that we announced in February 2005, is a good example.

So where next for Morley property?

We still think there are some exciting opportunities – continued innovation in specialist property funds and the advent of real estate investment trusts in the UK to name a few. We are aiming to grow over the next three years across our retail, specialist fund and institutional business. We also have ambitious plans in Europe and we've made a promising start, building our team and launching five products in just over a year. Investors have a growing appetite for European property and Morley is set to meet that demand. So far countries in which Morley has invested include Spain, Italy, Portugal, Poland, Czech Republic, Hungary, Slovakia, Slovenia, Croatia, Bulgaria and Romania.

Business segment performance: General insurance, health and related services

2005

	IFRS profit before tax £m	IFRS operating profit £m	Combined operating ratio* %	Net written premium £m	Underwriting result £m
UK	**1,294**	**974**	**96**	**6,127**	**303**
France	**68**	**35**	**101**	**726**	**(21)**
Ireland	**181**	**171**	**78**	**499**	**116**
Netherlands	**171**	**137**	**93**	**1,270**	**54**
Canada	**178**	**147**	**97**	**1,324**	**35**
Other	**103**	**87**	**95**	**365**	**18**
General Insurance and health total	**1,995**	**1,551**	**95**	**10,311**	**505**

2004

	IFRS profit before tax £m	IFRS operating profit £m	Combined operating ratio* %	Net written premium £m	Underwriting result £m
UK	778	797	97	5,715	146
France	71	33	101	670	(16)
Ireland	142	135	87	545	82
Netherlands	145	88	95	1,286	10
Canada	153	133	97	1,202	37
Other	79	73	97	400	12
General Insurance and health total	1,368	1,259	97	9,818	271

*General insurance business only.

UK

Norwich Union Insurance (NUI) is the leading general insurer in the UK, with a market share of 15%. We underwrite a wide range of personal and small commercial risks, including personal motor, homeowner, commercial motor, commercial property and liability. We have a multi-distribution strategy, selling insurance products through brokers, partners such as banks and building societies, and direct to our customers. NU Direct is one of the UK's leading online insurers and we are looking to build further our partnership capability and mutually beneficial intermediary relationships. We deliver high levels of service, with consistently strong customer satisfaction scores. Our headquarters are in Norwich and we operate from over 40 UK locations, with overseas operations in India and Sri Lanka.

Our goal is to deliver consistent earnings. We adhere to a clear underwriting strategy, supported by our aim to achieve continuous improvement in the efficiency, effectiveness and simplicity of our processes and structures. We are investing to improve further the quality and breadth of our customer offering, and increase retention and cross-selling opportunities.

In our core insurance markets, we achieved a 4% increase in personal motor rates *(2004: 2%)* and 6% in homeowner rates *(2004: 6%)*. Commercial rates are holding up well and profitability remains strong.

We acquired RAC in May 2005 and have made significant progress in integrating its operations into our business. We believe the acquisition is a transformational opportunity for NUI, enabling us to deliver an extensive portfolio of products and services to our customers, and to provide higher quality earnings to shareholders. In the final quarter of 2005, we launched motor and travel products under the RAC Direct Insurance brand.

Following the RAC acquisition, we sold Hyundai Cars (UK) to Hyundai Motor UK Limited and the commercial fleet division of Lex Transfleet Limited to Fraikin Limited. In October 2005 HBOS plc exercised their call option to purchase RAC's 50% shareholding in LVL. We are currently in negotiations to agree a fair value.

During 2005, we signed a deal with Barclays to become its sole provider of homeowner, motor and travel insurance, and extended our long-standing agreement with Asda to be its sole provider of general insurance until the end of 2009. Both deals underscore our position as partner of choice to the UK's top brands. We have won *Insurance Times* general Insurer of the year for the third successive year.

We continue to invest in strategic initiatives. Our internet business is already successful, holding a 14% share of the online insurance market, and 40% of new NU Direct motor policies are now purchased online. We aim to deliver further service improvements and cost efficiencies using e-technology. Our Pay As You Drive™ pilot has been successful and we plan to install 100,000 PAYD devices by the end of 2006.

NUI delivered an excellent set of results, with an operating profit of £970 million *(2004: £788 million)* and COR of 96% *(2004: 97%)*. This performance reflects the success of our balanced portfolio, supported by our disciplined approach to underwriting and pricing, and focus on efficiency. We have achieved net written premium growth of 15% in our direct operation, including an increase of 200% in online sales. Weather costs in the period were broadly in line with long term averages *(2004: £50 million benefit)*. We have delivered £268 million annualised savings in claims costs through effective supply chain management, an additional £40 million in the year. Our expense ratio (excluding the impact of RAC) improved to 10.5% *(2004: 10.6%)*; including RAC the expense ratio was 10.9%.

RAC delivered a good performance in the period with post acquisition operating profits of £59 million. The Rescue business, presented as general insurance, contributed £29 million to NUI's underwriting result; the remainder is included in the non-insurance result.

As announced in October, we now expect to achieve savings of £100 million in 2006, exceeding the £80 million per annum cost savings target announced when RAC was acquired. We expect to deliver an annualised operating profit of £250 million on a like-for-like basis from the RAC acquisition and an additional 1.4 million RAC customers by 2008. As part of this plan, we will be launching a new RAC Direct Insurance home product in March 2006.

The excellent performance in both RAC and our UK general insurance operation has enabled us to commit to a worldwide combined operating ratio (COR) target of 98% or below across the insurance cycle.

Our total UK result also includes Norwich Union Healthcare, a leading UK health insurer providing private medical insurance and income protection for over 750,000 customers. During 2005, we acquired the business and fixed assets of Private Health Care Limited, one of the leading independent occupational health services providers in the UK. The acquisition allowed us to broaden the services we offer to corporate clients. Our operating profit for the year was £4 million *(2004: £9 million)*.

RAC

Why buy the RAC?
We aim to provide a complete range of motoring services, giving reassurance to our customers and providing sales and cost saving opportunities for the group. RAC is a well-known and highly respected brand, and research has shown that it is perceived as being both professional and trustworthy. Through this acquisition, we are aiming to generate value from the brand, become the first choice motoring services provider and increase our 'non-cyclical' income to produce enhanced earnings growth and stability.

How are we doing with the integration?
We will spend £130 million (£109 million to date) to achieve annualised cost savings of £130 million by 2008. Savings have been achieved by removing duplication, achieving operational efficiencies and through cost benefits arising from the purchasing power of the enlarged group. We have simplified the business model, applied the group's financial disciplines and re-focused on profitable growth areas. To this end, we have created the following operational divisions:

– RAC Rescue (incorporating the previous roadside business)

– RAC Services (including BSM, HPI, loans and Auto Windscreens)

– RAC Insurance

We have also commenced the disposal of non-core businesses including Hyundai Cars (UK) and Lex Vehicle Leasing.

What are our plans for the future?
We expect significant revenue benefits to be created from the acquisition of RAC, and anticipate growth in customer numbers of over 1.4 million by the end of 2008. This includes increasing individual Rescue membership from 2.2 million to 3.0 million; including growth in Ireland in partnership with Hibernian. Additionally, we aim to acquire 600,000 RAC Insurance customers over the same period. The additional sales and the projected annual cost savings are expected to produce £250 million annual pre-tax profits by the end of 2008, when compared to the RAC profits of £80 million before acquisition.

Canada

We are Canada's second-largest general insurer, with an 8.9% market share. Around 80% of our business is written through brokers with the remainder split between groups, affinity schemes and corporate partners. At a time of stability and consolidation in the personal and commercial insurance market, we are experiencing exceptional retention rates (greater than 90%) and have achieved 4.1% growth in the number of policies written.

Our ambition is to increase progressively our market share in order to leverage economies of scale. To achieve this goal, we continue to expand our distribution channels. Our corporate partnership with Loblaws, under the President's Choice brand, continues to play an important role in producing growth, with launches in Quebec and Alberta in 2005. We have also had considerable success developing our group insurance business, agreeing contracts with the Ontario Medical Association and the Public Services Association of Canada.

We continue to lead the market in developing innovative new products. Premiere Healthcare was launched in October to provide the best healthcare outcomes for our customers, through timely, effective and high quality healthcare services. The Autograph motor insurance product, providing pay-as-you-drive cover, has been successfully piloted. Significant investment in supply chain initiatives and development of our offshore operations in India will allow us to improve customer and broker satisfaction as well as leverage scale benefits.

We reported an increased operating profit of £147 million *(2004: £133 million)* and our COR was unchanged at 97% *(2004: 97%)*. Our results have benefited from lower claims frequency compared to historical norms on our motor business. However, these benefits were offset by the storm losses in Ontario in August, the second-largest 'catastrophe' loss in Canadian history, impacting our property class results in the second half of the year. Our longer-term investment return rose to £112 million *(2004: £96 million)*, reflecting a higher asset base and positive cash inflow in 2005. Our net written premiums increased slightly to £1,324 million *(2004: £1,202 million)* in spite of legislative automobile reforms that have led to lower premium rates. The reduction in premium rates has been matched by lower claim costs, and has improved our renewal retention level. We have maintained our underwriting discipline as rates in the commercial market have continued to decrease.

Into 2006, we anticipate market growth in personal lines in terms of both volume and rating. Our market-leading position in Ontario will allow us to continue to grow sales of our motor insurance products particularly through our traders and corporate partnership businesses. In the commercial market, we will maintain our underwriting discipline to protect our business as rates continue to soften.

We continue to work with industry regulators and the provincial and federal governments to the benefit of the insurance industry as a whole.

Business segment performance: General insurance, health and related services continued

Ireland

Hibernian is the largest general insurer in Ireland, with a market share of 21%. Around 65% of our business is via brokers, with the remainder being split between direct and corporate partners. However, we expect further growth in the proportion of business written through our direct channel, while brokers continue to dominate the commercial market. Our expertise in the management of underwriting and claims has allowed us to maintain our leading position. Hibernian has earned strong brand recognition in the Irish market.

We continue to focus on growing our personal and small commercial lines business. Efficient claims handling and continuous cost management remain core elements of our strategy.

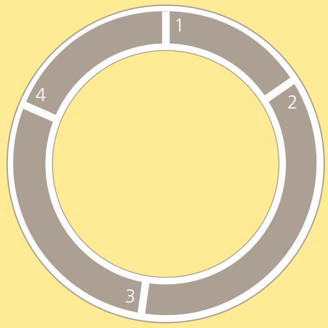
During 2005, our disciplined underwriting strategy enabled us to manage reducing premium rates effectively. We implemented the strategic decision to stop underwriting motorcycle business due to concerns over the longer term profitability of this business and in July, our corporate partnership with Tesco moved from completion of the pilot to a full rollout. We have also expanded our RAC Rescue capability in Ireland and are targeting the addition of 400,000 roadside customers by 2008. We continue to invest in Geocoding, our flood mapping project that will improve risk selection and pricing.

The Irish general insurance market remains highly competitive, leading to a reduction in our net written premiums to £499 million *(2004: £545 million)*. However, personal motor rates stabilised in the second half of the year. Our operating profit increased to £171 million *(2004: £135 million)* while the COR improved to 78% *(2004: 87%)*. Our underwriting result increased to £116 million *(2004: £82 million)* reflecting our focus on disciplined underwriting, lower average claim costs and frequency. Weather-related claims were below long-term averages and benefited operating profit by £7 million *(2004: neutral impact)*.

We expect to see a decline in market profitability until late in 2007 for personal business and until at least 2008 for small commercial business but we still anticipate good returns from the Irish market. Uncertainty regarding the Personal Injuries Assessment Board's impact on the cost of settling claims continues. In addition, pressure continues from media and lobby groups to curb the current level of general insurance profits. However, the RAC acquisition gives us the opportunity to grow our revenues in this currently under developed market.

UK net written premium

1 Intermediaries (personal)	**16%**
2 Intermediaries (commercial)	**37%**
3 Corporate partners	**29%**
4 Direct	**19%**



98%

Worldwide COR target

+22%

Increase in worldwide operating profit

>2 million

claims settled in the UK alone

France

Our French general insurance business sells predominantly personal, small commercial and health insurance and has a market share of over 2%. We operate a multi-distribution strategy selling products through an 850-strong agent network, our direct insurer Eurofil and La Paix, our legal protection specialist. Our agent network is particularly strong in provincial cities where its key strength is the proximity to and understanding of customers. Eurofil is the second-largest direct insurer in the French market and is now integrated with our other general insurance operations.

Our aim is to improve profitability and to develop our agent network successfully. To achieve these goals we are undertaking a programme to renew and grow our agent network by recruiting new agents and adopting a targeted approach to our products and rating policy. We are also seeking to increase the volume of life business sold through our agents, particularly AFER unit-linked sales. Additionally, we are pursuing a programme to simplify and standardise our internal processes to reduce costs and increase efficiency.

During 2005, we reviewed our small commercial risks book, resulting in the repricing of some contracts and the cancellation of other higher-risk policies. Our pricing and selection of household risks has been upgraded to take account of exposure to flooding. We have achieved greater efficiency in the claims handling process through the use of a common claims platform.

Our combined general insurance and health business reported an operating profit of £35 million *(2004: £33 million)*. Our net written premiums increased by 8% to £726 million *(2004: £670 million)* reflecting rating increases in commercial and health lines. The longer-term investment return was higher at £56 million *(2004: £49 million)*. Our general insurance business reported an unchanged COR of 101% *(2004: 101%)*.

In the health market, new regulations are expected to lead to an overhaul of our current healthcare product range. We anticipate a stabilisation of rates and a moderate increase in market competition on motor business during 2006.

Netherlands

Delta Lloyd sells a range of general insurance products including personal motor, household and small commercial policies in addition to healthcare policies in the Dutch market. Distribution is through intermediaries under the Delta Lloyd brand, directly under the OHRA brand, and through our bancassurance joint venture with ABN AMRO.

During 2005, our general insurance shared service centre became operational, leading to greater efficiency and improved customer service standards. Significant changes to the Dutch health and disability markets are forthcoming. In 2006, health provision will be reformed with the amalgamation of public healthcare provision into the private sector. We have been planning for these changes during 2005, through organisational restructuring, consolidation of back offices, introduction of new IT systems and product redesign. We are also looking at opportunities presented by partnerships with care providers. A new occupational disability law will be introduced in 2006, giving insurers access to this market in 2007. New products are being developed, particularly in Delta Lloyd Insurance and ABN AMRO.

Our operating profit increased by 54% to £137 million (*2004: £88 million)* and our general insurance COR improved to 93% *(2004: 95%)* reflecting strong premium rates and favourable claims experience, including the benefit of lower than average weather-related claims.

Delta Lloyd has achieved a strong performance in 2005, supported by favourable climatic claims experience. We anticipate that the strong results in the market will lead to some weakening of premium rating in 2006. We will continue to focus on control of our cost base. By the end of 2006, a shared service centre for health insurance and HRM will be operational. This, together with a focus on product harmonisation will lead to greater efficiency, cost effectiveness and high quality customer service.

Other

During November, we completed the disposal of our Asian general insurance businesses to Mitsui Sumitomo Insurance for a total of US$450 million (£256 million) in cash. These businesses comprised operations in Singapore, Malaysia (including our branch in Brunei), Thailand, Indonesia and Hong Kong. Additionally, we sold branch operations in Hong Kong, the Philippines, Marianas, Macau and Taiwan.

The transaction completed in two phases. Phase I completed in February 2005 and included all businesses listed above except for Malaysia, Indonesia, Macau, Marianas, Taiwan, Hong Kong and the Philippines. Phase II completed in November 2005, when the last of these businesses was sold.

Our other European general insurance operations are based in Italy, Poland and Turkey. They sell predominantly personal and small commercial insurance through networks of agents and brokers. We also have a healthcare business in Asia.

Our aim is to achieve profitable growth in the selected markets we operate in and contribute cash generation in support of our life businesses.

The operating profit from our other general insurance businesses was £87 million *(2004: £73 million)*.

to

We're trusted
protect
17% of the UK's homeowners

Business review
Other corporate information

Other corporate information: Group capital structure

Capital structure

We maintain an efficient capital structure using a combination of equity shareholders' funds, preference capital, subordinated debt and borrowings. The structure is consistent with our risk profile and the regulatory and market requirements of our business.

In managing our capital, we seek to:

– Match the profile of our assets and liabilities, taking into account the risks inherent in each business

– Maintain financial strength to support new business growth whilst still satisfying the requirements of policyholders, regulators and rating agencies

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

– Allocate capital efficiently to support growth and repatriate excess capital where appropriate

– Manage exposures to movements in exchange rates by aligning the deployment of capital by currency with our capital requirements by currency.

Capital management principles

We set target risk-adjusted rates of return for individual business units that are aligned to performance and incentive targets in order to focus management on the creation of value for shareholders.

We have a number of sources of capital available to us and seek to optimise our debt to equity structure so we can maximise returns to shareholders. We consider alternative sources of capital such as reinsurance and securitisation in addition to traditional sources of capital funding. The selection of the source of capital funding is appropriate to its deployment and usage.

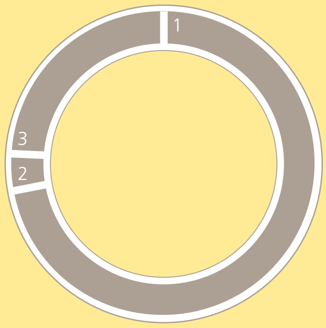
Capital employed by segment

	2005 £m	2004 £m
Long-term savings	**15,598**	13,826
General insurance and health	**5,581**	5,005
Other business	**1,876**	838
Corporate	**(36)**	(372)
Total capital employed	**23,019**	19,297
Financed by		
Equity shareholders' funds and minority interests	**16,356**	12,821
Direct capital instrument	**990**	990
Preference shares	**200**	200
Subordinated debt	**2,808**	2,847
External debt	**1,002**	1,452
Net internal debt	**1,663**	987
	23,019	19,297

At 31 December 2005 we had £23 billion *(31 December 2004: £19.3 billion)* of total capital employed in our trading operations. Total equity is efficiently financed by a combination of equity shareholders' funds, preference capital, direct capital instruments, subordinated debt and internal and external borrowings.

Financing of group capital

1 Equity	**72%**
2 Direct capital instrument	**4%**
3 Debt	**24%**



Financial leverage

We aim to maintain financial leverage and fixed charge cover ratios at a level consistent with our AA/Aa rating. Financial leverage, the ratio of the Group's external senior and subordinated debt to EEV capital and reserves was 22% *(2004: 31%)*. Fixed charge cover, which measures the extent to which external interest costs, including subordinated debt interest and preference dividends, are covered by EEV operating profit was 9.6 times *(2004: 8.7 times)*.

Group capital strength and solvency

We are subject to a number of regulatory capital tests and also employ a number of realistic scenario tests to allocate capital and manage risk. Overall, the group and its subsidiaries satisfy all existing requirements. The ratings of our main operating subsidiaries are AA/AA- ("very strong") with a stable outlook from Standard and Poor's and Aa2 ("excellent") from Moody's. The ratings were reaffirmed in November 2005 reflecting our financial and capital strength, strong underlying earnings and positive strategic management.

We measure our capital using a number of different bases which include measures that comply with the regulatory regime and measures that the directors consider appropriate for the management of the business. The measures which we use are:

Accounting bases

We are required to report our results on an International Financial Reporting Standards basis. However, the directors consider that the European Embedded Value (EEV) methodology provides a more accurate and meaningful reflection of the value of the group's life operations. Accordingly, we analyse and measure the net asset value and total capital employed for the group on an EEV basis.

Regulatory bases

Relevant capital and solvency regulations are used to measure and report the financial strength of our insurance subsidiaries. These measures are based on local regulatory requirements and consolidated under the European Insurance Groups Directive (IGD). The regulatory capital tests verify that we retain an excess of solvency capital above the required minimum level calculated using a series of prudent assumptions about the type of business written by our insurance subsidiaries.

In addition to the FSA realistic reporting regime, the UK Accounting Standards Board requires certain capital disclosures to be made in accordance with Financial Reporting Standard 27, Life Assurance (FRS 27). The purpose of the capital statement is to set out the financial strength of the entity and to provide an analysis of the disposition and constraints over the availability of capital to meet risks and regulatory requirements. The disclosures required by FRS 27 are set out in Note 49 on pages 176 to 178.

Economic bases

We have developed a framework using ICA principles for identifying the risks that business units and the group as a whole are exposed to and quantifying their impact on economic capital. The ICA estimates the capital required to mitigate the risk of insolvency to a 99.5% confidence level over a one year time horizon against financial and non-financial tests.

Currently, our ICA uses a mixture of scenario based approaches and risk-based capital models. The Financial Services Authority (FSA) will use the results of our ICA process when discussing the target levels of capital it believes the UK regulated businesses should maintain. We have been discussing our ICA with the FSA over the past six months and we expect to conclude discussions shortly.

We continue to develop our risk-based capital modelling capability for all our businesses as part of our longer-term development programme for more complex risk modelling techniques, and to operate increasingly our business by reference to economic and risk-based capital requirements.

Group

Accounting bases

Our capital funding, from all sources, has been allocated so that the capital employed by trading operations is greater than the capital provided to those operations by the shareholders and its subordinated debt holders. As a result, we are able to enhance the returns earned on our equity capital.

At 31 December the group as a whole had £23.0 billion *(2004: £19.3 billion)* of total capital employed in its trading operations, financed by a combination of equity shareholders' funds, preference share capital, subordinated debt and borrowings.

	2005	2004
Shareholders' funds – EEV basis	**£17.5bn**	£14.0bn
Total capital employed	**£23.0bn**	£19.3bn
Net asset value per share	**622p**	511p

Shareholders' funds have increased to £17.5 billion *(2004: £14.0 billion)*, reflecting strong operational performance in the year and the capital raised as part of the acquisition of RAC in May. Accordingly, our net asset value per ordinary share, based on equity shareholders' funds, was higher at 622 pence per share.

Regulatory bases – EU group's directive

	2005	2004
Insurance Groups Directive (IGD)	**£3.5bn**	£3.6bn
Cover (times)	**1.8 times**	1.9 times

At 31 December 2005, we had an estimated excess regulatory capital of £3.5 billion *(31 December 2004: £3.6 billion)*, as measured under the EU Group's Directive. 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 our UK life funds. In broad terms, this is set at 4% and 1% for non-linked and unit-linked life reserves respectively. For our general insurance portfolio of business, the minimum solvency requirement 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 other major non-European businesses (USA, Australia and Canada), a risk charge on assets and liabilities approach is used.

The FSA introduced further changes to the valuation rules which applied during 2005. From 1 January 2005, our valuations of non-insurance subsidiaries were restated from market value to net asset value reducing IGD by £0.6 billion. Furthermore, the FSA introduced the rules for accounting for pension fund deficits under IAS with effect from April 2005. The impact of this is to reduce our excess solvency by £0.4 billion. The impact of these valuation changes has been offset by our strong solvency capital generation in the period which amounted to £1.5 billion while the acquisition of RAC reduced our excess regulatory capital by a further £0.8 billion. As previously announced, completion of the sale of our Asian general insurance in the period improved the IGD excess solvency by £0.2 billion. The revised FSA rules do not incorporate the full value of our pension fund deficit. Including the full value of the deficit would have the effect of reducing the IGD by £0.5 billion.

Other corporate information: Group capital strength and solvency continued

From 1 January 2005, we are required to monitor our capital in accordance with the requirements of the Prudential Sourcebook (PSB), as set out by the FSA. We have established risk and governance frameworks to monitor compliance and finalised the parameters and assumptions that underpin the individual capital assessment (ICA). From 1 January 2006, we are required to have a positive IGD basis solvency level at all times. Our risk management process verify that adequate review of our IGD solvency at all times.

Life operations

Economic bases

For our non-participating worldwide life assurance businesses the capital requirements are set as the higher of:

– Target levels set by reference to internal risk assessment and internal objectives

– Minimum capital requirements (i.e. level of solvency capital at which the local regulator is empowered to take action).

Having undertaken an assessment of the level of operational, demographic, market and currency risk of each of our life business, the required level of capital required for each business is quantified and expressed as a percentage of the EU minimum. The required capital across our businesses varies between 100% and 150% of the EU minimum. In the UK, the required capital for the annuity book is set at 150% of the EU minimum and the remainder of the non-participating portfolio has been set at 100% of the EU minimum. The weighted average level of required capital for the whole of our non-participating life business, expressed as a percentage of the EU minimum solvency margin is 128% *(2004: 135%)*. This is a blended rate and is expected to change over time with changes in the product mix.

The required capital levels discussed above are used in the calculation of our embedded value to evaluate the cost of locked-in capital. At December 2005, the aggregate regulatory capital, based on the requirements of the EU minimum test, amounted to £3.9 billion (31 December 2004: £3.7 billion). As at this date, the actual net worth held in our long-term business was £7.2 billion (31 December 2004: £6.3 billion), which represents 183% (31 December 2004: 168%) of these minimum requirements.

UK life operations

Our UK life businesses are required to hold sufficient capital to meet the FSA's capital requirements. Under the FSA's realistic reporting regime, the UK with-profits business capital requirement is determined from the "twin peaks" approach, such that capital resources must be sufficient to cover the greater of the statutory and realistic liability and capital requirements. The businesses must also take into account the ICA which considers certain business risks not reflected in the twin peaks approach. For UK non-participating business, the capital requirement is calculated on the statutory basis based on EU Directives.

The 2005 realistic results have been prepared in accordance with the Prudential Source Book for insurers. The results make allowance for all the liabilities of the with-profit funds, including provision for future bonuses, the fair value of guarantees, options and promises on a market consistent basis, the cost of shareholder transfers and tax associated with future bonuses. The calculations also make allowance for how the with-profit funds are expected to be run (eg investment policy) and how policyholders are expected to behave (eg persistency).

The available capital of the with-profit funds is represented by the realistic orphan estate. The orphan estate consists of the long-term with-profit funds less the realistic liabilities for non-profit policies, less asset shares aggregated across the with-profit policies including any additional amounts expected to be paid to in-force policyholders at the valuation date in respect of smoothing costs and guarantees.

Realistic balance sheet information is shown below for the three UK with-profit funds, CGNU Life (CGNUL), Commercial Union Life Assurance Company (CULAC) and Norwich Union Life and Pensions (NUL&P). The realistic liabilities have been included in the long-term business provision and the liability for investment contracts on our IFRS balance sheet at both 31 December 2005 and 31 December 2004.

	Realistic assets £bn	Realistic liabilities[1] £bn	Estimated realistic orphan estate £bn	Estimated required capital margin £bn	Estimated excess £bn
CGNU Life	**14.0**	**(11.9)**	**2.1**	**0.5**	**1.6**
CULAC	**14.0**	**(12.1)**	**1.9**	**0.6**	**1.3**
NUL&P	**25.9**	**(24.7)**	**1.2**	**0.8**	**0.4**
Provident Mutual	**2.5**	**(2.5)**	**–**	**–**	**–**
Aggregate	**56.4**	**(51.2)**	**5.2**	**1.9**	**3.3**

1. Realistic liabilities include shareholders' portion of future bonuses of £0.7 billion. Realistic liabilities adjusted to eliminate the shareholders' share of future bonuses are £50.5 billion *(2004: £47 billion)*.
2. These realistic liabilities make provision for guarantees and options on a market consistent stochastic basis. The value of the provision included within realistic liabilities is £0.7 billion, £0.9 billion and £3.4 billion for CGNU Life, CULAC and NUL&P respectively. *(2004: £0.6 billion, £0.9 billion and £3.3 billion for CGNU Life, CULAC and NUL&P respectively).*
3. The required capital margin (RCM) is 2.7 times covered by the orphan estate *(2004: 2.6 times)*.

The aggregate investment mix of the assets in the three main with-profit funds at 31 December 2005 was:

	31 December 2005 %	31 December 2004 %
Equity	**42**	36
Property	**15**	15
Fixed interest	**37**	43
Other	**6**	6
	100	100

The equity backing ratios, including property, supporting with-profit asset shares are 72% in CGNU Life, 60% in CULAC and NUL&P. With-profit new business is mainly written through CGNU Life.

1.8 times

Group solvency cover on IGD basis

General insurance

Regulatory basis

Our principal UK regulated general insurance subsidiaries are CGU International Insurance Group (CGUII) and Norwich Union Insurance (NUI). The combined businesses of the CGUII group and the NUI group have strong solvency positions. The table below sets out the regulatory basis of the general insurance groups at 31 December 2005 and 31 December 2004:

			2005
	NUI plc	CGUII Group	NUI and CGUII Group pro forma
Regulated asset value (£bn)	**1.0**	**8.7**	**9.7**
Required minimum margin (£bn)	**0.4**	**3.9**	**4.3**
Excess solvency margin (£bn)	**0.6**	**4.8**	**5.4**
Cover (times)	**2.8**	**2.2**	**2.3**

			2004
	NUI plc	CGUII Group	NUI and CGUII Group pro forma
Regulated asset value (£bn)	1.0	8.8	9.8
Required minimum margin (£bn)	0.4	3.7	4.1
Excess solvency margin (£bn)	0.6	5.1	5.7
Cover (times)	2.6	2.4	2.4

On an aggregate basis, the estimated excess solvency margin (representing the regulatory value of excess available assets over the required minimum margin) was £5.4 billion *(31 December 2004: £5.7 billion)* after covering the minimum capital base of £4.3 billion *(31 December 2004: £4.1 billion).*

Economic bases

We use a number of measures of risk based capital to assess the capital requirements for our general insurance businesses. Financial modelling techniques enhance our practice of active capital management, verifying that sufficient capital is available to protect against unforeseen events and adverse scenarios, and to manage risk. Our aim continues to be an optimal use of capital.

Our traditional risk-based capital methodology for general insurance business assesses insurance, market and credit risks and makes prudent allowance for diversification benefits. The capital assessed under this methodology is that necessary to enable the general insurance business to meet regulatory solvency margins over a five year period with a 99% probability of not requiring further capital. We consider risks over the five year period, allowing for planned levels of business growth. Based on the model, our risk-based capital requirement may be expressed as 34% of net written premiums, which is equivalent to £3.5 billion *(2004: £3.3 billion)* of capital. This compares with a total of £5.6 billion *(2004: £5.0 billion)* of shareholders' capital deployed in the general insurance business.

Other corporate information: Corporate social responsibility

Our Corporate Social Responsibility (CSR) policy embraces performance in respect of standards of business conduct, the environment, human rights and health & safety as well as the promotion of good and fair relations with our employees, our customers, our suppliers and the broader community.

We believe that responsibility involves forward thinking in all aspects of our business and that performance in the eight elements of our CSR framework is important to our success in the short, medium and long term. We report fully on our progress in a separate annual CSR report, which is available online at www.aviva.com. A printed summary of our CSR report is also available from the group company secretary.

In deciding upon the CSR elements that should be included in our business review, we have worked with the FORGE group; a CSR focused UK industry body for the financial services sector. Following a rigorous process, we concluded that four CSR elements should be included, covering our performance in respect of Standards of Business Conduct, Customers, Environment and Employees. The latter is dealt with in a separate report on pages 44 and 45.

Standards of Business Conduct

We are committed to conducting all aspects of our business according to rigorous ethical, professional and legal standards. We regard ethical practice as critical to responsible business and have put in place measures to refresh regularly our employees' understanding of our Standards of Business Conduct policy.

Our general guidance on Standards of Business Conduct has been reinforced by particular measures to take account of the challenge of financial crime. Each year this costs industry billions of pounds and we, like other companies, are not immune to its effects. To meet this challenge, we have implemented policies that meet the requirements of applicable legislation, regulatory guidance and industry best practice regarding fraud management, anti-money laundering and malpractice reporting.

We have also introduced a single financial crime network across the group, bringing together expertise on fraud and anti-money laundering. Significant progress has been made in raising awareness of, and understanding, financial crime risk around the group.

Proposed regulatory changes, together with the impact of the 3rd EU Directive on anti-money laundering, have reinforced the need to adopt a risk-based approach to financial crime prevention, which has historically underpinned our financial crime management framework.

Customers

Successful interaction with customers is vital to the future development of our business. We comment here on progress with particular reference to three of our largest business units, representing our core business activities: our long-term savings, fund management and general insurance businesses in the UK.

Long-term savings

2005 saw Norwich Union create a three-year vision, which focuses on building the trust and confidence of our customers. Our aim is to provide a high level of trust, value and support to customers – listening to and understanding their needs, meeting our promises and treating them fairly.

We are committed to delivering excellent service to our customers. This has been a high priority during 2005, when we put in place a customer feedback programme. This has given us regular insights into all aspects of our service and has enabled us to target and track improvements. Our target for call handling customer satisfaction in 2006 is 75% "extremely" and "very" satisfied customers, up from 70% in 2005.

We have taken a leading approach to protecting our policyholders' interests. We are restructuring our pension strategy by writing all new pension policies under a single scheme, allowing customers to move seamlessly between products and tailor their retirement planning to their own needs. We are also involved in the ongoing pension debate in the UK. We have engaged with senior stakeholders in relation to Pensions Commission activity to address the future of pensions in the UK.

We are committed to the Financial Services Authority's (FSA) Treating Customers Fairly (TCF) initiative. A Customer committee, chaired at executive level, monitors adherence to the principles of TCF and our approach is to embed these principles across the company. We will be judged on our success in this area during regular visits undertaken by the FSA. We openly share data with the media and consumer groups regarding customer complaints on request.

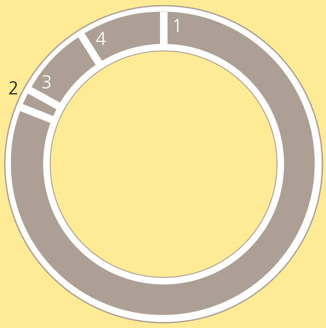
In addition, Norwich Union chairs the Association of British Insurers (ABI) committee that is looking at improving the clarity of annual statements to customers. We will undertake a systematic review of our customer communications and we are refreshing our internal writing guidelines for customer materials.

Fund management

Morley is committed to openness and dialogue with clients because it is important in enhancing client understanding, trust and confidence in our services. By way of example, in 2005 we introduced two new client communication tools for sharing information and developing client investment knowledge: the Trustee Tutor website which helps to enhance pension trustees' industry knowledge and the Morley Client Informer, an on-line newsletter which gives clients up-to-date news about us. We also run regular training sessions for clients, including trustee training, aimed at enhancing trustees' investment knowledge.

Global community investment

1 Cash support	**81%**
2 Gifts in kind	**2%**
3 Staff time	**8%**
4 Management time	**9%**



-11.0%

Reduction in CO_2 emissions in 2005

>£800m

Value of our SRI managed funds

We have an in-house Socially Responsible Investment (SRI) team that engages on behalf of all our assets under management, including all of our unscreened funds, to raise issues of concern with companies, including environmental liability, corporate governance and human rights. We believe that these "extra financial" issues can have a long-term impact on shareholder value. As responsible investors we need to analyse, assess and, where necessary, vote on companies' management in these areas.

The SRI team also manages a range of SRI funds, currently valued at over £800 million. These give our customers the option of investing in funds that are positively screened, and therefore invest in companies contributing to sustainable development. In 2005, we published our Sustainability Matrix; rating the FTSE 100 and Eurotop 50 for the third time. By publishing our ratings, we give our customers a clear insight into how we rate companies' performance on social, environmental, ethical and governance issues. We also engage in debate with the largest companies in Europe to encourage higher standards of corporate social responsibility.

General insurance

Norwich Union Insurance has embarked on a journey to be recognised by customers and non-customers as a great service provider. Since 2002, all employees have been engaged in a programme entitled "Leadership & Care". This has created a culture where the customer is front of mind in all interactions. Consequently, blockages to services have been greatly reduced.

Our focus is now shifting to providing infrastructure below our people to support great customer experiences in a consistent and deliberate manner. Major programmes are underway to improve processes and technology, including e-enablement and operating platforms. We are also changing how we target, measure and reward our people to better reflect the customer service aspect.

Continuous and extensive service satisfaction research is conducted across all products and elements of our service experience. In 2005, sales and service satisfaction averaged 92% with claims service averaging 83%. These scores represent customers explicitly stating satisfaction with our service. In 2006, in recognition of our customers' rating claims as the most significant aspect of our service, we have set ourselves the challenge of achieving 85% "extremely" and "very" satisfied customers. Achieving our target would represent industry-leading performance.

Our focus will also be on the harder challenge of creating customer advocacy; new insight tools are being deployed to assist this journey. We will implement a Customer Experience Monitor (CEM), enabling us to understand, direct from customers, what they see as the key touchpoints with us in any period of interactions and enabling us to address rapidly any areas where we are not creating customer advocates. This will be based on "willingness to recommend, renew or upgrade present products".

Other corporate information: Corporate social responsibility continued

Environment

Our general insurance business has significant exposure to claims from weather-based events across our European and Canadian businesses. In the UK alone, the ABI estimates that weather related costs to insurers are in the order of £500 million to £1 billion per year.

We established a climate change forum in 2005 to co-ordinate related activities across our businesses. Significant climate change related initiatives that our businesses are involved in include flood research, flood mitigation and prevention work and the sponsorship of a pan-European flood project. Additionally, we are developing products and services that provide a positive link between climate change and premium paid, for example Norwich Union's Pay As You Drive™ product. We also use the investment influence of our fund management subsidiaries to encourage environmentally responsible behaviour.

In terms of our direct impacts on the environment, our total carbon dioxide emissions have reduced by 11.0% during 2005. This has been achieved by increasing energy efficiency, reducing wastage and securing a progressive move to purchasing 100% zero emission electricity for the UK. Our Irish business purchases 20% of zero emission electricity and this year, for the first time, so did our business in the Czech Republic.

Governance

Our business units regularly review their CSR performance and undertake an annual self-assessment. This assessment is subject to an external review, performed as part of the overall assurance of our summary CSR report. In 2005, this work was performed by Ernst & Young LLP.

We report annually on our progress in accordance with the FORGE management and reporting guidelines for banks and insurers. Additionally, we duly respect the disclosure guidelines issued by the ABI. Governance of the programme is subject to both a regular schedule and continual review. The board is presented with plans and a progress report annually. CSR forms a segment in the induction programme for all new directors upon joining the board. In the past two years, the chairman has presented to the annual meeting of our CSR Review Group, which brings together representatives from corporate office, business units, partner non-governmental organisations and auditors. The meeting reviews performance, considers developments, exchanges ideas and initiatives and sets the programme for the year ahead. Quarterly reviews are also carried out by a CSR steering group; the group includes senior management from our principal businesses.

To mitigate CSR risks, we have an established system of risk management that is embedded into our business planning and performance monitoring processes. This system includes the management of risks relating to social, environmental and ethical (SEE) matters. Further details of this process are contained in the internal controls section of the Corporate Governance Report on pages 57 to 61.

Employees

Employee numbers

During 2005, our average number of employees worldwide was 54,791, compared with 55,872 during 2004.

	Number of employees 2005	Number of employees 2004
UK	**33,827**	32,588
Europe	**16,356**	17,429
International	**4,608**	5,855
Total	**54,791**	55,872

Our relationship with our people

Aviva has a presence in over 25 countries across Europe, North America, Asia and Australia. In each location that we do business, our relationship with our employees is governed by our people strategy, our values and the group's human resources policies. These policies relate to reward, management development and training, diversity, recruitment and health and safety.

Our people strategy, delivered against a backdrop of constant change, captures a need to:

- Attract and retain top talent while complying with corporate governance best practice
- Invest in the development of our people
- Build change capability whilst maintaining employee morale
- Enable the delivery of excellent customer service through our employees.

Talent management

Talent management was a focus in 2005, and will remain so in 2006. We continue to build on embedded processes such as the Organisation and Development Review (ODR) complemented by the Aviva Leadership Academy. The ODR is our succession and development planning framework through which approximately 80% of our top 140 roles have internal succession cover. The Aviva Leadership Academy is a suite of development programmes with international business schools, focused on preparing current and emerging leaders for our business's challenges.

In addition to these initiatives, research conducted amongst our senior managers has resulted in a refreshed focus on structured development planning, the increased provision of international career opportunities through short-term secondments and a strengthened link between measured performance and reward. 2005 saw the implementation of our senior manager reward strategy, covering the group's top four tiers of senior management. The main reasons for this new strategy were to drive performance through highly differentiated rewards and to bring greater alignment with shareholders' interests and good corporate governance practice.

During 2005, our commitment to diversity has strengthened and a "diversity launch" was implemented across 17 of our business units, raising awareness of the business benefits of harnessing diversity in the workforce. A variety of media has been used to encourage employees to "think again…" about the competitive advantage we can derive from business teams that include people with different backgrounds, experiences and perspectives. In 2006, our diversity steering group, sponsored by the group executive, will lead further initiatives to enhance employee awareness, to encourage innovation and creativity and to deepen understanding of the benefits to our customers. The success of the group's diversity work is reflected in the increasing number of senior managers who are female: 18%, following an upward trend since 2000 when this figure was 13%.

Morale and engagement

We believe that our business performance benefits if we keep our staff motivated, informed and involved in our successes and challenges. A group-wide climate survey was launched in 2005 that will enable us to benchmark externally our performance as an "employer of choice", to draw on good practice around the group and to focus future actions accordingly. The survey has been completed by around 58% of our business units, covering over 41,000 of our employees. The remainder of the group will complete the survey for the first time in 2006.

Following up the 2005 survey will form a key aspect of our business planning for 2006. We will address issues arising from the survey as part of our drive for increased personal and organisational effectiveness, and increased employee morale and engagement.

We remain committed to other forms of dialogue with employees. We place a strong emphasis on the provision of company news through a variety of media, including intranets, Aviva radio and poster campaigns. Employee forums have been established in the UK and we continue to have a positive relationship with our European Consultative Forum.

Working with our customers

Great customer service and operational efficiency are both central to our success. We care about the morale of our employees not just as a responsible employer, but also because we know that satisfied and engaged employees deliver a higher standard of service to our customers. Measurements of both customer and employee satisfaction will be part of the business measures used in the annual bonus awards for senior managers from 2006 onwards.

We continue to deliver value to our customers through lower cost, 24-hour claims processing and sales facilities in India and Sri Lanka. More than 4,300 people are now servicing Aviva general and life insurance customers in the UK and Canada from these facilities. By the end of 2007, approximately 7,800 people will be employed in these centres and, over a period of five to seven years, the majority will become employees of the Aviva Group.

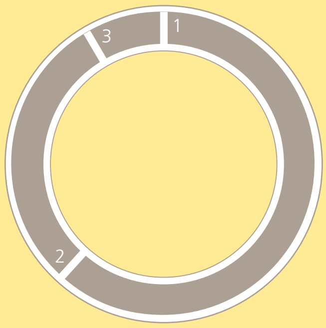
Looking ahead

We strive to ensure that access to employment, training and promotion is free from discrimination on the grounds of gender, sexual orientation, marital status, creed, colour, race, age, ethnic origin, union status, religion or disability. We are also constantly trying to anticipate the changing nature and needs of our workforce. Employee demographics are shifting, as are employees' needs and expectations. For example, responding to the needs of an ageing population in the UK, work will take place to encourage older workers to remain with the organisation. Additionally, acknowledging the difficulties our employees face in balancing their home and working lives has resulted in flexible working arrangements being implemented in over 65% of our business units, covering over 90% of our workforce.

Developing a flexible and adaptable workforce is a key element in our determination to make effective change management a sustainable capability to meet our changing needs.

Average employees by segment

1 UK	**62%**
2 Europe	**30%**
3 International	**8%**



Other corporate information: Financial reporting

Accounting basis of preparation

International Financial Reporting Standards (IFRS)
For the first time, our 2005 consolidated financial statements have been prepared under IFRS, rather than under UK GAAP. The change from UK GAAP to IFRS is driven by the European Union (EU) requiring all European listed companies to prepare consolidated financial statements using standards issued by the International Accounting Standards Board (IASB) and endorsed by the EU with effect from 1 January 2005. Where applicable, the financial statements have also been prepared in accordance with the revised Statement of Recommended Practice (SORP) on accounting for insurance business issued by the Association of British Insurers (ABI) in December 2005.

Following the successful completion of our IFRS conversion programme, we restated our 2004 results in accordance with IFRS and presented these to the market on 5 July 2005. The impact of IFRS on the 2004 results was to reduce statutory operating profit before tax by 5% to £1,766 million, increase statutory profit before tax by 10% to £1,642 million and reduce statutory shareholders' funds by 3% to £8,083 million. Note 1 to the financial statements on pages 93 to 106 provides further detail on the financial reporting impact of adopting IFRS.

We continue to believe that:

– IFRS represents a technical accounting change and does not represent a material change to the economics of our business

– IFRS will not impact our dividend policy

– IFRS will have no significant impact on our solvency calculations

– EEV results are unaffected by IFRS.

The financial data contained in the report and accounts has been prepared using the group's accounting policies under IFRS set out on pages 78 to 86. These policies are in accordance with standards issued by the IASB and endorsed by the EU, including early adoption of certain standards detailed in policy A on page 78.

European Embedded Value (EEV) basis of reporting
We present the results and financial position of our life and related businesses on an EEV basis, in addition to the IFRS basis. The directors' opinion is that the EEV basis provides a more accurate and transparent view of the performance of the life and related operations year on year than the results presented under the IFRS basis. The EEV methodology adopted is in accordance with the EEV Principles introduced by the CFO Forum in May 2004, and updated in October 2005. Under the EEV methodology, the total profit recognised over the full lifetime is the same as under the IFRS basis of reporting. However, the EEV basis gives a fairer indication of the profitability of business on inception. Additionally, shareholders' funds incorporate internally-generated additional value in-force (AVIF) on an EEV basis, this is not the case under IFRS. The financial statements include supplementary information on EEV reporting on pages 200 to 221 and our incentive schemes and internal management reporting are aligned to the EEV basis.

Longer-term investment return
The long-term nature of much of our operations means that short-term realised and unrealised gains and losses on general insurance and health business are shown as an adjustment to operating profit. We focus instead on operating profit incorporating a longer-term investment return (LTIR). During 2005, we changed our LTIR methodology to align the equity and property rates used in the calculation with the rates used under EEV principles. We have also changed the LTIR calculation for fixed interest securities to include the amortisation of premiums or discounts arising on purchase, thereby producing an LTIR that is equivalent to the gross redemption yield. The change in LTIR methodology meant that the 2004 operating profit before tax was reduced by £97 million but there was no overall impact on the profit for the year or shareholders' funds. Further details are contained in note 1 on pages 93 to 106.

Critical accounting policies and estimates

The preparation of financial statements requires us to make estimates and assumptions that affect items reported in the consolidated income statement, balance sheet and the disclosure of contingent assets and liabilities. Estimates are based on management's current knowledge, assumptions and predictions of future events and actions. However, actual results can always differ from estimates, possibly significantly. Items that are particularly susceptible to changes in estimates and assumptions include, but are not limited to, long-term insurance reserves, general insurance reserves and pension provisions.

Future accounting developments

We actively engage in the development of new accounting standards, via industry forums and working parties, reviewing and providing comment on proposals from the IASB.

The most important change in the pipeline is phase II of the IASB's project on insurance contracts. The timing of this project remains uncertain, however the IASB estimate that a final standard is unlikely to be published before 2008 at the earliest. The range of possible outcomes is large and therefore it is too early to assess the impact this change in accounting may have.

We support the IASB's efforts to develop a comprehensive global accounting standard for insurance and we are engaging with stakeholders in Europe and the US. We are aiming for a final standard that reflects the underlying economics of the business and provides relevant information for investors on value added capital adequacy and cash flow. Whilst the standard is under development we will continue to focus on EEV as the best measure of value added for long-term savings business.

Risk and risk management

The Group's approach to risk management

Governance framework

We have established a risk and financial management framework whose primary objective is to protect the group from events that hinder sustainable achievement of our objectives and financial performance, including failing to exploit opportunities. Additionally, we have an established governance framework, details of which are given in the Corporate Governance section on pages 57 to 61. The framework has three key elements:

- Clear terms of reference for the board, its committees and the associated executive management committees
- A clear organisation structure with documented delegated authorities and responsibilities from the board to executive management committees and senior management
- A group policy framework that sets out risk appetite, risk management and control and business conduct standards for the group's worldwide operations. Each policy has a member of senior management who is charged with overseeing compliance with the policy throughout the group.

The governance structure and policy set is regularly reviewed to reflect the changing commercial and regulatory environment and our own organisational structure.

Integration of financial risk and capital management

We have developed a framework using Individual Capital Assessment (ICA) principles for identifying the risks that business units, and the group as a whole, are exposed to and quantifying their impact on economic capital. The ICA estimates the capital required to mitigate the risk of insolvency to a 99.5% confidence level against financial and non-financial tests. In addition, we are developing a risk-based capital model for our businesses that will provide a more detailed assessment of the capital needs of the business. We also use financial condition reports (FCRs) to inform capital management decisions.

Further details on the ICA and capital management are set out in the "Group capital strength and solvency" section of this review on pages 39 to 41.

Regulatory impact on risks and risk assessments

A significant proportion of our longer-term savings business involves insurance products where the majority of the risk is borne by the policyholder. Risks attributable to policyholders are prudently managed to satisfy the policyholders' risk and reward objectives. In addition, our worldwide insurance operations are subject to numerous local regulatory requirements that help to inform the acceptable level of risk in each of the jurisdictions in which we operate.

Management of financial and non-financial risk

We have established a number of policies dealing with the management of both financial and non-financial risks. The adoption of these policies throughout the group enables a broadly consistent approach to the management of risk at business unit level. Additionally, we operate a number of oversight committees that monitor aggregate risk data and take risk management decisions.

We also monitor specific risks on a regular basis through our risk monitoring framework. Business units are required to disclose all material risks along with information on the likelihood and severity of risks and mitigating actions taken or planned. The framework enables us to assess the overall risk exposure of the group, to develop a group-wide risk map identifying concentrations of risk and to define the risks that we are prepared to accept. The risk map is continually monitored and refreshed quarterly.

Insurance risk

Life insurance risk

Life insurance risk arises through our exposure to mortality, morbidity and experience factors such as persistency and unforeseen expenses.

The Life Insurance Risk committee monitors whether guidance and procedures are in place for each of the major components of life insurance risk and that businesses adopt a local risk management framework. The local frameworks adopted in business units are reviewed in detail and approved twice yearly by the committee. The committee also considers the reinsurance coverage across the life business. Business units can select reinsurers locally but the overall programme is assessed centrally to manage group-wide risk exposures.

We have exposure to the full range of life insurance risks, including a significant exposure to annuity business and the associated longevity risk. Longevity statistics are monitored in detail and the results are used to inform the reserving for, and pricing of, annuities. Inevitably, there remains uncertainty about future longevity that cannot be removed.

General insurance risk

General insurance risk 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 risk when underwritten
- Inadequate reinsurance protection or other risk transfer techniques
- Inadequate reserves.

Our underwriting strategy is agreed by the executive committee and communicated by specific policy statements and guidelines. Group policies exist for underwriting, claims management, reinsurance and reserving and operate within the group risk-management framework. The General Insurance Risk committee has been established to oversee management of these risks.

Other corporate information: Risk and risk management continued

Mechanisms are in place in each of the business units to identify, quantify and manage accumulated exposures within the limits of our risk appetite. Reinsurance is used to assist in reducing the financial impact of a catastrophe and to reduce the volatility of earnings. Reinsurance purchases are reviewed annually at both business unit and group level to check that the levels of protection being purchased match developments in exposure. The basis of these reinsurance arrangements is underpinned by extensive financial modelling and actuarial analysis to optimise the cost and risk management benefits. Reinsurance arrangements are only placed with providers who meet our counterparty security standards.

The adequacy of our general insurance reserves is ultimately approved by the Reserving committee. The committee maintains the General Insurance Reserving policy and regularly monitors the adequacy of the general insurance reserves. The reserves are subject to audit and peer review.

Asset and Liability Management (ALM)

Our group-wide policy on asset/liability management for technical provisions sets out the minimum principles that business units are required to adopt. We centrally monitor adherence to this policy and regularly review how business units are managing ALM risks locally through the Investment committee and ultimately through the Asset Liability Management committee. The policy sets out the framework for matching assets with appropriate liabilities, approaches to take when liabilities cannot be matched and the monitoring processes that are required. Further details on specific areas of ALM risk are given below:

Cash flow and liquidity risk
Liquidity risk is the risk that we do not have sufficient available assets to meet our obligations as they fall due. Robust liquidity management forms an important component of our financial management practices.

Each business unit is required to identify sources of liquidity risk and implement systems to both measure and monitor potential exposures. Business units must also install controls to manage liquidity requirements. At group level, liquidity is maintained at a prudent level and consistent with the expectations of the FSA and the investment community. At a group level, we also maintain a liquid asset buffer to cover contingencies including the provision of temporary funds to business units that experience temporary liquidity shortfalls.

Interest rate risk and maturity periods
Interest rate risk arises primarily from the products we sell and the value of our investments. For example, long-term debt and fixed income securities are exposed to fluctuations in interest rates. Exposure to interest rate risk is monitored through several measures, including Value-at-Risk analysis, position limits, scenario testing, stress testing and asset and liability matching using measures such as duration. Interest rate risk is managed using a variety of derivative instruments, including futures, options, swaps, caps and floors in order to hedge against unfavourable market movements in interest rates inherent in the underlying assets and liabilities.

On certain categories of long-term business, interest rate risk is reduced through close matching of assets and liabilities. On short-term business such as general insurance business, we require a close matching of assets and liabilities by duration to minimise this risk.

Market risk

Market risk is the potential adverse financial impact of changes in values of financial instruments from fluctuations in foreign currency exchange rates, interest rates, property prices and equity prices. Market risks arise in business units due to fluctuations in the value of liabilities arising from products sold against the value of investments held. At group level, market risk also arises in relation to the overall portfolio of international businesses. For each of the main components of market risk described below, we have policies and procedures on how each risk should be monitored and managed. At group level, the Investment committee is responsible for overseeing market risk, including ALM risk. Additionally, the potential financial impact of changes to market values is monitored through the ICA and FCR processes.

Foreign currency exchange risk
We operate internationally, meaning we are exposed to foreign currency exchange risk arising from changes to the exchange rates of various currencies. Our financial results and competitiveness are also affected indirectly by the domestic currencies of our main competitors, principally sterling and euros. Over half of our premium income arises in currencies other than sterling and net assets are denominated in a variety of currencies.

We do not hedge foreign currency revenues as they are substantially retained locally to support the growth of our business and meet local and regulatory market requirements. Our foreign currency exchange policy requires that each of our subsidiaries maintain sufficient assets in the local currency to meet local currency liabilities. Therefore, capital held by business units should be able to support local activities regardless of foreign currency movements. However, such movements may affect the value of consolidated shareholders' equity, which is expressed in sterling. This aspect of foreign exchange risk is monitored centrally against predetermined limits to control the extent to which capital deployment and capital requirements are not aligned. Currency borrowings and derivatives are used as required to keep exposures within the predetermined limits.

Property price risk
We are subject to property price risk through fluctuations in the value of investment properties that we hold in a variety of locations worldwide. Property price risk is managed at business unit level and is subject to local regulations on asset admissibility and liquidity requirements.

Equity price risk
We are subject to equity price risk due to changes in the market values of equity securities. The equity price risk is actively managed by the use of derivative instruments, including futures and options, to lessen anticipated unfavourable market movements. The Asset Liability Management committee actively monitors directly owned equities and material shareholdings in our strategic business partners. Business units model the performance of equities using stochastic models, in particular to understand the impact of equity performance on guarantees, options and bonus rates. We do not have material holdings of unquoted securities.

Derivatives risk
We are subject to derivatives risk due to the use of derivative contracts for efficient investment management, risk hedging purposes or structuring specific retail-savings products. We have a derivatives policy that sets out the minimum standards for the use and approval of derivatives. The Derivatives committee exists to maintain and monitor an appropriate control environment, monitor exposures and approve any proposed derivative transactions that fall outside the control framework.

Credit risk

Credit risk is the risk of loss in the value of financial assets due to counterparties failing to meet part or all of their obligations, or changes to the market value of assets caused by changed perceptions of the creditworthiness of counterparties.

Our management of credit risk includes monitoring of aggregate group exposures to individual counterparties. The aggregate exposure is then measured against centrally set limits based on the credit ratings issued by companies such as Standard and Poor's. The process measures exposure to individual counterparties across a broad range of asset types including fixed income securities, bank deposits and mortgages. These specific credit risks are monitored by the Credit and Reinsurance Security committees. In addition to monitoring specific credit risks, we assess general credit risks such as the concentration of exposures by industry sector and geographic region. This general credit risk is the responsibility of the Investment committee.

Operational risk

Operational risk arises from inadequately controlled internal processes or systems, human error and from external events. This definition is intended to include all risks that we are exposed to, other than the financial risks described above and the strategic and group risks considered below. Operational risks include, for example, information technology, information security, human resources, project management, outsourcing, tax, legal, fraud and compliance.

In accordance with group-wide policies, line management in business units has primary responsibility for the effective identification, management, monitoring and reporting of operational risks to the business unit executive management team and to group. Business unit risk management and governance functions are responsible for implementing the group-wide risk management methodologies and frameworks to assist line management in this work. They also provide support and independent challenge on the completeness, accuracy and consistency of risk assessments and the adequacy of mitigating action plans. As a result, business unit executive management teams satisfy themselves that material risks that fall outside pre-set appetite levels are being mitigated and reported to an acceptable level.

Operational risks are assessed according to the potential impact and probability of the event concerned. Impact assessments are made against financial, operational and reputational criteria and are reported on a quarterly basis by business units to group. Risks assessed by business units to be at the two highest impact assessments are escalated to group between quarterly reporting. This reporting enables us to:

– Assess and monitor overall operational risk exposures

– Identify any concentrations of operational risk across the group

– Monitor progress towards the mitigation of operational risk

– Verify that operational risk exposures remain within risk appetites.

More detail of the operational and financial risks we face and the frameworks, processes and controls in place to mitigate those risks are given in note 50 on pages 178 to 187. Note 50 also contains data on significant financial risks we face and the sensitivity of the result to those risks.

Andrew Moss
Group Finance Director

We're respected

for commitment to socially

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investment

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Governance

Board of directors

Executive directors

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Non-executive directors

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1. **Richard Harvey FIA** (55)
Group chief executive

Appointed to the board in May 2000 and became group chief executive in April 2001. Joined Norwich Union in 1992, holding senior positions in New Zealand and the UK before joining the Norwich Union board in 1995 and becoming group chief executive of Norwich Union in 1998. Former chairman of the Association of British Insurers.

Member of the nomination and corporate social responsibility committees.

2. **Andrew Moss** (47)
Group finance director

Appointed to the board in May 2004 upon joining the company. Previously director – finance, risk management and operations in Lloyd's *(insurance)* and formerly held a number of senior management positions at HSBC plc *(banking)*.

3. **Philip Scott FIA** (52)
Executive director

Appointed to the board in May 2000. Joined Norwich Union in 1973 and held a number of senior positions before joining the Norwich Union board in 1993. Currently responsible for the group's international insurance businesses and United Kingdom fund management operations.

4. **Patrick Snowball** (55)
Executive director

Appointed to the board in March 2001. Joined the group in 1989, holding a number of senior positions before joining the board of Norwich Union in 1999. Currently responsible for the group's United Kingdom businesses namely Norwich Union Insurance, Norwich Union Life and RAC. A member of the Financial Services Authority's Practitioner Panel.

5. **Lord Sharman of Redlynch OBE** (63)
Chairman

Appointed to the board in January 2005 and became chairman from 1 January 2006. Currently chairman of Aegis Group plc *(media services)*, an independent non-executive director of BG Group plc *(utility)* and Reed Elsevier plc *(publisher)* and a member of the supervisory board of ABN AMRO NV *(banking)*. Former chairman of KPMG International *(auditors)*, former deputy chairman of Group 4 Securicor plc (*security services*) and a former independent non-executive director of Young & Co.'s Brewery PLC (*drinks*) and AEA Technology plc (*commercial / technology*).

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

6. **Guillermo de la Dehesa** (64)
Independent non-executive director

Appointed to the board in May 2000. Joined the board of Norwich Union as a non-executive director in 1999. Currently non-executive chairman of Aviva's operations in Spain, non-executive vice-chairman of Goldman Sachs Europe *(banking)* and a director of Campofrio *(consumer)*, Unión Eléctrica Fenosa *(utility)*, Bank Santander Central Hispano *(banking)* and Telepizza *(consumer)*. Chairman for the Centre of Economic Policy Research and a member of the Group of Thirty *(consultative group on international economic and monetary affairs)*. A former deputy governor of the International Monetary Fund and the World Bank, a former deputy general manager of the Bank of Spain and former Secretary of State of Finance in Spain.

Member of the nomination and corporate social responsibility committees.

7. **Wim Dik** (67)
Independent non-executive director

Appointed to the board in December 1999, having served as chairman of Nuts Ohra, a Dutch insurer acquired by the group in 1999. Currently chairman of the supervisory board of Casema Holding B.V. *(telecommunications)* and Tele Atlas N.V. *(information systems)*, a non-executive director of Unilever N.V. and Unilever plc *(consumer)* and of LogicaCMG plc *(computer services)*. 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 a former member of the supervisory boards of TNT Post Group *(mail services)*, Vos Logistics *(transport)* and ABN AMRO N.V. *(banking)*.

Senior independent director, Chairman of the corporate social responsibility committee and member of the nomination, governance and regulatory committees.

8. **Mary Francis CBE** (57)
Independent non-executive director

Appointed to the board in October 2005. Currently a non-executive director of Centrica plc *(utilities)*, St Modwen Properties plc *(property development)*, a director of the Bank of England and Fund Distribution Limited. A member of the advisory board of the National Consumer Council and Governor of the Pensions Policy Institute. A former Director General of the Association of British Insurers and senior civil servant.

Member of the remuneration and governance and regulatory committees.

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9. **Richard Karl Goeltz** (63)
Independent non-executive director

Appointed to the board in May 2004. Currently a non-executive director of the Warnaco Group Inc *(clothing)*, Federal Home Loan Mortgage Corporation (Freddie Mac) *(financial services)*, New Germany Fund *(investment trust)* and a director of The London School of Economics and Political Science. A former chief financial officer of American Express Company *(financial services)*, NatWest Group plc *(banking)* and The Seagram Company Ltd *(drinks)* and a former member of the Accounting Standards Board (UK).

Chairman of the remuneration committee and member of the audit committee.

10. **Carole Piwnica** (48)
Independent non-executive director

Appointed to the board in May 2003. Currently non-executive vice-chairman – governmental affairs for Tate & Lyle plc *(agricultural/industrial)*. A member of the New York and Paris bars, practising law in Europe and the United States specialising in private equity and EU regulatory matters. A former chairman of Amylum Group *(agricultural/industrial)*.

Member of the audit, remuneration and corporate social responsibility committees.

11. **Derek Stevens** (67)
Independent non-executive director

Appointed to the board in August 1995. Currently non-executive chairman of The Airline Group Limited *(transport)* and non-executive director of NATS Holdings Limited *(transport)*. A member of the financial sector committee of the Accounting Standards Board, chairman of The Royal Academy of Arts Pension Scheme Board, a trustee of the Rothschild pension funds, a member of the Council of the Institute of Education at the University of London and chairman of The Travel Foundation *(charity)*. A former director and chief financial officer of British Airways Plc *(transport)*, a former finance director of TSB Group plc *(banking)* and a former chairman of the trustees of British Airways pension schemes.

Chairman of the audit committee and of Aviva Staff Pension Trustee Limited and member of the corporate social responsibility committee.

12. **André Villeneuve** (61)
Independent non-executive director

Appointed to the board in May 1996. Currently non-executive chairman of Euronext Liffe *(financial services)*, a non-executive director of United Technologies Corporation *(aerospace)* and a director of the Institut Francais de Relations Internationales. A former executive chairman of Instinet Corporation *(securities broker)*, a former executive director of Reuters plc *(media)* and a former chairman of Promethee.

Member of the nomination and remuneration committees.

13. **Russell Walls** (62)
Independent non-executive director

Appointed to the board in May 2004. Currently a non-executive director of Signet Group plc *(retail)* and the senior independent director of Stagecoach Group plc *(transport)*. A former group finance director of BAA plc *(transport)*, Wellcome plc *(pharmaceuticals)* and Coats Viyella plc *(textiles)*. Former non-executive director of Hilton Group plc *(leisure)* and the Mersey Docks and Harbour Company *(transport)*.

Chairman of the governance and regulatory committee and member of the audit committee.

Richard Whitaker LLB, DMS, FCII
Group company secretary

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 2005.

Pursuant to amendments made to the Companies Act 1985 in 2005 companies will be required to produce a business review as part of their directors' report in respect of financial years beginning on or after 1 April 2005. The Company has decided to comply with the Companies Act amendments early and the business review is contained on pages 16 to 49. Certain matters that are required to be disclosed within the directors' report have been included within the business review. Accordingly, the review of the Group's operations, current position and future prospects together with a description of its principal activities are included within the business review.

Details of material acquisitions and disposals made by the Group during the year are contained on pages 106 to 111.

Results
The Group results for the year are shown in the consolidated income statement on page 87.

Dividends
The directors are recommending a final dividend of 17.44 pence per share *(2004: 16.00 pence)*, which together with the interim dividend of 9.83 pence *(2004: 9.36 pence)*, produces a total dividend for the year of 27.27 pence per share *(2004: 25.36 pence)*. The total cost of ordinary dividends for 2005, will amount to £598 million *(2004: £553 million)*, leaving £1,123 million to be transferred to reserves *(2004: £705 million to reserves)*.

The final dividend for 2005 will be paid on 17 May 2006 to all holders of ordinary shares on the Register of Members at the close of business on 10 March 2006. The Company's Scrip Dividend Scheme will be available to shareholders in respect of the payment of the final dividend. In addition, a local currency payment service will be available to shareholders residing in certain participating countries outside the UK. Further details of these arrangements can be found within the shareholder services on page 223.

Share capital
At the Annual General Meeting, held on 26 April 2005, shareholders approved an increase in the Company's authorised share capital from £950 million to £1.45 billion and €700 million by the creation of 500 million preference shares of £1 each and 700 million preference shares of €1 each.

The issued ordinary share capital of the Company was increased by 113.3 million ordinary shares during the year. 87.9 million new shares were allotted in part consideration for the acquisition of RAC plc, which completed on 4 May 2005. The balance of 25.4 million shares was allotted under the Group's employee share and incentive plans and the Aviva Scrip Dividend Scheme. At 31 December 2005 the issued ordinary share capital totalled 2,395.7 million shares. Details of the share capital and shares under option as at 31 December 2005, and shares issued during the year, are given in note 27 on page 141.

At the forthcoming Annual General Meeting shareholders' approval will be sought to increase the Company's authorised preference share capital to £1.2 billion and €700 million by the creation of 500 million new preference shares of £1 each. Further details are set out in the notice of the Annual General Meeting.

Authority to purchase own shares
At the Annual General Meeting held on 26 April 2005, shareholders renewed the Company's authority to make market purchases of up to 228 million ordinary shares, up to 100 million 8¾% preference shares and up to 100 million 8⅜% preference shares. This authority was not used during the year and at the forthcoming Annual General Meeting shareholders will be asked to renew these authorities for another year. Details are contained in the Notice of Meeting. The Company held no Treasury shares during the year.

Post balance sheet events
There have been no material events between 31 December 2005 and the date of this report which are required to be brought to the attention of shareholders.

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

Guillermo de la Dehesa
Wim Dik
Mary Francis (appointed 1 October 2005)
Richard Karl Goeltz
Pehr Gyllenhammar (retired 31 December 2005)
Richard Harvey
Andrew Moss
George Paul (retired 31 December 2005)
Carole Piwnica
Philip Scott
Lord Sharman of Redlynch (appointed 14 January 2005)
Derek Stevens
Patrick Snowball
Elizabeth Vallance (retired 31 December 2005)
André Villeneuve
Russell Walls

The biographical details of the persons currently serving as directors appear on pages 52 to 53.

In accordance with the Company's Articles of Association, directors appointed during the year by the Board are required to retire at the first Annual General Meeting following their appointment and stand for election by shareholders. On 14 January 2005 Lord Sharman was appointed as an independent non-executive director of the Company. He retired at the 2005 Annual General Meeting and was subsequently elected by the shareholders. On 1 October 2005, Mary Francis was appointed by the Board as an independent non-executive director. Mrs Francis will retire at the forthcoming Annual General Meeting and, being eligible, will offer herself for election by shareholders. Mrs Francis does not have a service contract with a Group company.

The Company's Articles of Association require one-third of the directors to retire by rotation each year. At the forthcoming Annual General Meeting Richard Harvey, Carole Piwnica, Philip Scott and Patrick Snowball will retire and, being eligible, will offer themselves for re-election. Richard Harvey, Philip Scott and Patrick Snowball are executive directors and each has a service contract with a Group company, details of which can be found on page 69.

Independent non-executive directors Derek Stevens and André Villeneuve were re-elected by shareholders at last year's Annual General Meeting. Both these directors have now served on the Board for more than nine years and therefore will retire and seek re-election again at this year's meeting. However, subject to being re-elected, it is intended that these directors will retire on or before 31 December 2006 in line with the Board's plans to renew and refresh its composition.

Pehr Gyllenhammar, the chairman of the Board since 1998, retired on 31 December 2005 and was succeeded as chairman by Lord Sharman on 1 January 2006. George Paul and Elizabeth Vallance, both independent non-executive directors, also retired from the Board on 31 December 2005 in line with the Company's succession plans.

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 a third party 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 which may attach to them in their capacity as directors of the Company or of associated companies. These provisions, which are qualifying third party indemnity provisions as defined by s.309B of the Companies Act 1985, 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 on pages 65 to 74.

Substantial shareholdings
The Company's register of substantial shareholdings is maintained in accordance with the provisions of s. 211 of the Companies Act 1985. At 1 March 2006, the register showed that the holdings exceeding the 3% disclosure threshold were those of Barclays Plc which held 109,751,163 ordinary shares (4.57%) and Legal & General Group Plc which held 81,072,340 ordinary shares (3.38%) of the issued ordinary share capital of the Company.

Financial instruments
Group companies use financial instruments to manage certain types of risks including those relating to credit, foreign currency exchange, cash flow, liquidity, interest rates, equity and property prices. Details of the objectives and management of these instruments are contained in the Business Review on pages 16 to 49 and an indication of the exposure of the Group companies to such risks is contained in note 51 to the accounts on page 188.

Health and safety
The health and safety of staff 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
Aviva has continued to support community initiatives and charitable causes worldwide and the total Group commitment during the year, as measured in accordance with Business in the Community's PerCent Standard, was over £5.7 million *(2004: £4.6 million)*.

In 2005, the Group's community investment in the United Kingdom totalled £3.9 million *(2004: £3.4 million)* of which £1.7 million *(2004: £1.3 million)* was given in the form of donations to charitable organisations. The Company allocates a part of its budget to matching contributions raised by staff and to providing financial support to charities and communities where members of staff give a personal commitment in terms of their time. In addition, the Company provides a significant level of support to a small number of national charities. During 2005, the Company continued its commitment to Breakthrough Breast Cancer, Wheelpower (the British wheelchair sports association) and The Princess Royal Trust for Carers. In addition, the Group supported the Make A Wish Foundation UK, which was chosen by staff in the United Kingdom as their "charity of the year", and NCH (the children's charity). The Group and its staff worldwide made substantial donations to the Asian Tsunami appeal in 2005.

Directors' report continued

Political donations

It is the Company's policy not to make donations to political organisations or for political causes, and it does not intend to change this policy. Accordingly, no political donations were made in the United Kingdom or elsewhere during the year *(2004: nil)*.

In 2004, shareholders passed a resolution authorising the Board to incur expenditure, up to an aggregate limit of £100,000 per annum, on activities that fall under the Political Parties, Elections and Referendums Act 2000 (PPER). The PPER introduced a very broad definition of political expenditure, such that some of the activities undertaken throughout the Group's businesses could arguably fall within that definition. The Board sought shareholders' authority to incur such expenditure in order to avoid any inadvertent breaches of the PPER. The Board does not believe that the Group has incurred any such political expenditure in the past year. The Board's authority to incur such political expenditure expires in 2008.

Group employees

The Group's statement on its employees is set out on pages 44 and 45.

In summary, the Group's commitment to communication and dialogue with employees continues. A strong emphasis is placed on the provision of news through a variety of media, including intranets (both a Group-wide intranet, Arena, and local business unit intranets), Aviva radio, which can be accessed via mobile phone or computer, and poster campaigns. Employees have opportunities to voice their opinions and ask questions through intranet sites and climate surveys. Face to face briefings and team meetings are actively encouraged and are held in all business units across the Group. During 2005 the Group's businesses in the United Kingdom established employee consultative forums.

Employee practice

Aviva Group companies are committed to providing equal opportunities to all employees, irrespective of their sex, sexual orientation, marital status, creed, colour, race, ethnic origin or disability. The commitment extends to recruitment and selection, training, career development, flexible working arrangements and promotion and performance appraisal. In the event of members of staff 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.

Aviva plc, the holding company of the Group, has no trade creditors. In respect of Group activities in the UK, the amounts due to trade creditors at 31 December 2005 represented approximately 8 days of average daily purchases through the year *(2004: 11 days)*.

Auditor and the disclosure of information to the auditor

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow directors and the Company's auditor, each director has taken all the steps that he/she is obliged to take as a director in order to make himself/herself aware of any relevant audit information and to establish that the auditor is aware of that information.

In accordance with s. 385 of the Companies Act 1985, a resolution is to be proposed at the Annual General Meeting for the reappointment of 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 in the Audit Committee Report on pages 62 and 63.

Annual General Meeting

The Annual General Meeting of the Company will be held on 10 May 2006 at The Barbican Centre, Silk Street, London EC2Y 8DS at 11.00am. 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.

Richard Whitaker
Group Company Secretary
1 March 2006

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

Corporate governance

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 United Kingdom 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.

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, save that as the Chairman would be retiring on 31 December 2005 no performance review of the Chairman was carried out during the year. This report sets out details of how the Company has applied the principles and complied with the provisions of the Combined Code during 2005.

The Board
The Board of directors meets regularly to determine the Group's strategic direction, to review its operating and financial performance, to oversee that it is adequately resourced and effectively controlled. The specific duties of the Board are clearly set out in terms of reference which 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:

– 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;

– Key business policies including the remuneration policy.

Matters which are not specifically reserved to the Board and its committees under its terms of reference, or to shareholders in General Meeting, are delegated to the Group Chief Executive. The Board's terms of reference also set out those matters which 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 Board meetings are dealt with.

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. No director obtained any such independent professional advice during 2005.

The Board and its committees operate in line with a work plan agreed prior to the start of each year. At Board 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 Chairman and the non-executive directors met on two occasions in the absence of the executive directors during 2005 to discuss the executive directors' performance and succession planning.

The directors
The Board currently comprises the Chairman, eight independent non-executive directors and four 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. All directors are required to be elected by shareholders at the Annual General Meeting following their appointment by the Board and re-elected at least once every three years. Non-executive directors who have served on the Board for nine years or more are required to submit themselves 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 it 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 64.

Against the above background the Board appointed two new independent non-executive directors in 2005, Lord Sharman of Redlynch in January and Mary Francis in October. The biographical details of these directors are set out on pages 52 and 53. Lord Sharman brought to the Board a strong financial background having spent his career at KPMG, becoming its international chairman, and has served on the boards of a number of listed companies in the United Kingdom and Europe. Lord Sharman was elected by shareholders at the Company's 2005 Annual General Meeting and in August 2005, it was announced that he would succeed Pehr Gyllenhammar on 1 January 2006 as the chairman of the Board. Mary Francis has held a number of senior positions in HM Treasury and more recently served as the Director General of the Association of British Insurers until March 2005, during which time she gained a detailed knowledge of the insurance industry, its issues and regulation. Mrs Francis will retire and seek election by shareholders at the Company's 2006 Annual General Meeting.

Corporate governance continued

In accordance with the Company's articles of association, the directors retiring, and proposed for re-election at the forthcoming Annual General Meeting, are Richard Harvey, Carole Piwnica, Philip Scott and Patrick Snowball. Richard Harvey is the Group's Chief Executive. Philip Scott is the executive director responsible for the Group's international businesses and Morley, the United Kingdom fund management business. Patrick Snowball is the executive director responsible for the Group's UK businesses namely Norwich Union Insurance, Norwich Union Life and RAC. Carole Piwnica is an independent non-executive director who joined the Board in 2003. She is a non-executive vice-chairman of Tate & Lyle plc, practices law in the United States and Europe and is a member of the Company's Audit, Remuneration and Corporate Social Responsibility committees.

Derek Stevens and André Villeneuve have both served as directors for more than nine years and will therefore retire at the Annual General Meeting and seek re-election. However, in line with the Board's succession plans, it is the intention that subject to being re-elected, they will both retire on or before 31 December 2006. Derek Stevens is a member of the financial sector committee of the Accounting Standards Board and is a former Chief Financial Officer of British Airways plc and of the TSB Group plc. He is able to contribute recent and relevant financial experience and is the chairman of the Board's Audit Committee and a member of the Corporate Social Responsibility Committee. André Villeneuve has knowledge of broking and financial markets and wide general management experience in the United Kingdom and the United States. He is a member of the Nomination and Remuneration committees.

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, in addition to being free of any conflicts, 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 requires a sound understanding of the insurance industry and the Company so as to be able to properly evaluate 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.

All the directors being proposed for re-election have been subject to a formal performance evaluation and took part in a peer assessment review during 2005, other than Mary Francis who was not a director at the time.

Biographical details of all the directors, including those proposed for election or re-election, are set out on pages 52 and 53.

The Chairman

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 management of the Board and the Group Chief Executive's priority is the management of the Company.

Pehr Gyllenhammar served as the Chairman from 1998 until his retirement from the Board on 31 December 2005. He was succeeded by Lord Sharman on 1 January 2006. There were no significant changes to Pehr Gyllenhammar's commitments during the year. Lord Sharman's main duties outside the Company are set out in his biographical details on pages 52 and 53. He resigned from the board of Group 4 Securicor plc on 31 December 2005 in anticipation of the time commitment he would need to give to the Aviva Board. Lord Sharman's contractual commitment to the Company is two to three days per week.

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. George Paul served as Deputy Chairman and as the senior independent director throughout 2005. Mr Paul retired from the Board on 31 December 2005 and Wim Dik was appointed as the senior independent director on 25 January 2006.

Board effectiveness

The effectiveness of the Board is vital to the success of the Group. The Company undertakes an annual performance review to assess how well the Board, its committees and directors are performing. Directors complete a confidential questionnaire on the Board and committees' processes, their effectiveness and areas where they may be improved. The process also includes a peer review in which directors assess their own and their fellow directors' performance against set criteria, including the skills which they bring to the Company and the contribution they make. This process is complemented by separate meetings between each director and the Chairman. The Board discussed the feedback from the 2005 process when it met in October and a number of actions were agreed. The review was conducted by the Chairman with the assistance of the Group Company Secretary.

The performance of the Chairman is also reviewed annually using a peer review process. Directors are asked for their views on the Chairman's performance against the key aspects of the role. At a subsequent Board meeting, the Chairman leaves the meeting whilst a summary of the views expressed by the directors is used as an introduction for discussion. This process is managed by the senior independent director who subsequently provides feedback to the Chairman. It has become the Board's practice to undertake the Chairman's review in December each year. However, because Pehr Gyllenhammar would be retiring from the Board at the end of December, no review was performed in 2005.

Training and development

The Board believes strongly in the development of all its employees, including its directors and it is a requirement of directors' appointments that they commit to continue their development. The form of this development is subject to each director's requirements and the quality and relevance of the training available. During the year individual directors attended a number of external courses on issues ranging from an international directors' forum to a seminar on pensions simplification. In addition, directors received two tailored training sessions outside of the formal Board meetings regarding international financial reporting standards and the assessment of the Group's capital requirements. Further tailored training sessions have been built into the Board's work plan for 2006. The Board made two site visits during the year to gain a closer understanding of the Group's businesses.

During 2005 Lord Sharman and Mary Francis each completed detailed induction programmes. The initial programme, which was undertaken over a number of months, comprised 13 separate sessions, including discussions with 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. Subsequently, both directors arranged follow-up sessions in areas where they felt that a deeper understanding would be beneficial.

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. On occasions it may be necessary to call or rearrange meetings at short notice and it is recognised that in such circumstances it may be difficult for all directors, particularly those based overseas, to attend. The attendance of the directors at the Board and committee meetings held in 2005 was as follows:

Board and Board committee attendance 2005

	Board	Audit Committee	Remuneration Committee	Nomination Committee
Number of meetings held	9	5	8	3
Number of meetings attended				
Guillermo de la Dehesa	7/9	–	–	2/3
Wim Dik	8/9	–	6/8	2/3
Mary Francis*	3/3	–	–	–
Pehr Gyllenhammar	9/9	–	–	3/3
Richard Goeltz	9/9	5/5	7/8	–
Richard Harvey	9/9	–	–	3/3
Andrew Moss	9/9	–	–	–
George Paul	9/9	–	8/8	–
Carole Piwnica	9/9	5/5	–	–
Philip Scott	9/9	–	–	–
Lord Sharman	9/9	–	–	–
Derek Stevens	9/9	5/5	–	–
Patrick Snowball	9/9	–	–	–
Elizabeth Vallance	9/9	–	7/8	–
André Villeneuve	9/9	–	8/8	3/3
Russell Walls	9/9	5/5	–	–

– Indicates not a member of that committee.

*Appointed October 2005.

Board committees

The Board has established a number of standing committees to oversee and debate important issues of policy and oversight outside the main Board meetings. The Chairmen of each committee provide the Board with a summary of the key issues considered and the minutes of their meetings are circulated to the Board. The committees operate within defined terms of reference, copies of which are published on the Company's website www.aviva.com or are available from the Group Company Secretary upon request. Board committees are authorised to engage the services of external advisers as they deem necessary, at the Company's expense.

The reports of the Audit, Nomination and Remuneration committees are set out below.

In January 2006, the Board established two new committees:

- Corporate Social Responsibility Committee – in order to maintain and build further on the Company's leading position this committee will provide guidance and direction to the Group's corporate social responsibility programme and monitor its progress.

  Membership of the Corporate Social Responsibility Committee comprises Wim Dik (chairman), Guillermo de la Dehesa, Richard Harvey, Carole Piwnica, Lord Sharman and Derek Stevens.

- Governance and Regulatory Committee – in order to maintain the Group's strong governance and compliance disciplines this committee will provide leadership and oversight of the Group's governance processes including regulatory compliance. The work of this committee will form an important part of the Group's control function and as such the Committee will work closely with the Audit Committee.

  Membership of the Governance and Regulatory Committee comprises Russell Walls (chairman), Mary Francis and Wim Dik.

Internal controls

The Board has ultimate responsibility for maintaining the systems of internal control of the Company and for reviewing their effectiveness. The systems 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:

- Safeguard assets;
- Maintain proper accounting records;
- Provide reliable financial information;
- Identify and manage business risks;
- Maintain compliance with appropriate legislation and regulation;
- Identify and adopt best practice.

The principal features of the control framework and the methods by which the Board satisfies itself that it is operating effectively are detailed below.

Corporate governance continued

Control environment
The Group has an established governance framework. The key features include:

– 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;

– A Group policy framework, which sets out risk management and control standards for the Group's operations worldwide;

– Defined procedures for the approval of major transactions and capital allocation.

The Group adapted its risk and governance frameworks in 2004 to implement the Prudential Sourcebook – the Financial Services Authority's risk-based framework for integrating and embedding risk and capital management. Further refinements continued during 2005 to reflect developing good practice.

Risk identification, assessment and management
The Group's risk management and control 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 number of policies relating to the management and control of both financial and non financial risks. The adoption of these policies throughout the Group enables a broadly consistent approach to the management of risk at business unit level. Group policy owners are responsible for Group-wide aggregation and oversight of their specific risks. In addition, the Group operates a number of oversight committees that monitor aggregate risk data and take overall risk management decisions. In particular, the aggregation of financial risks, including the capital impact of non-financial risks are monitored by a Group Asset and Liability Committee, chaired by the Group Chief Executive.

The Group also monitors the completeness of the risk profile on a regular basis through the Group Risk monitoring framework. Each quarter, businesses report residual risk profiles, and the adequacy of the mitigating action programmes, based on local materiality levels. These impact assessments are based on financial, reputational and operational criteria and also take into account social, ethical and environmental risk as well as business risk. This enables the Group risk function to assess the overall risk exposure and to develop a Group-wide risk profile. This is refreshed quarterly and material items in the Group risk report are reported to the Group's Executive Committee, the Audit Committee (from 2006 the Governance and Regulatory Committee rather than the Audit Committee) and the Board, who consider whether residual risks are within the Group's risk appetite, and the adequacy of the mitigating actions.

Local business unit boards, audit committees and management also consider local risk reports in a similar way. Regular reports are supported by escalation procedures for new or deteriorating risks that are classified at the highest impact levels. In addition, all business unit heads and Group functional heads provide a certificate every six months to confirm compliance with the Group's governance and risk management frameworks and the terms of their delegated authority. They must also specify any risk or control issues not already reported through the regular risk management processes.

Control procedures and monitoring systems
The Group has a well-developed system of planning and monitoring, 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 reports on risk, audit, compliance, solvency and liquidity. Performance is also reported through the half-yearly publication of Group results based on accounting policies that are applied consistently throughout the Group. Operational management reports frequently to the Executive Committee and the Board receives regular representations from the senior executives responsible for each principal business operation.

The Audit Committee, and going forward the Governance and Regulatory Committee, receives regular reports on control processes 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 systems of internal control. Throughout 2005, the Audit Committee received quarterly reports from the Group Audit Director on issues arising, and updates on previously reported items.

In the Board's view, the Group maintains effective and embedded systems of internal control in accordance with the Guidance on Internal Control (the Turnbull Guidance) and such systems were in place throughout the year and up to the date of the signing of this report.

Internal audit
The Group's internal audit function advises management on the effectiveness of internal control systems, the adequacy of these systems to manage business risk and to safeguard the Group's assets and resources. Through the Group Audit Director, the internal audit function provides objective assurance on risk and control to the Audit 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 the 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 the issues which have been raised with management at the regular meetings held with the large investors. During the year the Chairman and the senior independent director held a meeting with the major institutional investors. In addition, the senior independent director is available to meet with major shareholders to discuss any areas of concern which cannot be resolved through normal channels of investor communication and arrangements can be made to meet the senior independent director through the Group Company Secretary. Similarly, arrangements can be made for major shareholders to meet with newly appointed directors.

The Board consults with shareholders in connection with specific issues where it considers appropriate. For example, the chairman of the Remuneration Committee met with institutional shareholder bodies and a number of major shareholders in 2004 to seek their views on the Company's proposed remuneration review. It is the intention to undertake similar consultation in 2006 regarding the proposed changes to the directors' pension arrangements described on pages 67 and 68.

The Board is equally interested in the concerns of private shareholders and, on its behalf, the Group Company Secretary oversees communication with these shareholders. The Company issues a postage paid reply form with its Annual General Meeting documentation to enable shareholders to put questions to the directors. This is 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'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. Details of proxy voting by shareholders, including votes withheld, are made available on request and are placed on the Company's website.

The Company's annual report and accounts and annual review, together with the Company's interim reports, trading statements and other public announcements are designed to present a balanced and understandable view of the Group's activities and prospects. The Chairman's statement, Group Chief Executive's review, and Business Review on pages 16 to 49 provide an assessment of the Group's affairs and will be supported by a presentation to be made at the Annual General Meeting.

Institutional investor

Morley Fund Management Limited, the Group's asset management company, believes that good governance contributes to better performance and practices. Therefore, as a major investor, the Group monitors the governance of the companies in which it invests. To this end, Morley holds regular meetings with the senior management of companies where it will raise matters which may affect the future performance of those companies.

Morley 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 also extends to cover social, environmental and ethical issues. Its policy is applied pragmatically, after careful consideration of all relevant information. In addition, Morley makes detailed voting reports available to clients and publishes summary statistics on its website.

Directors' responsibilities

The directors are required to prepare accounts for each accounting period that comply with the relevant provisions of the Companies Act 1985 and of the 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 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 provides relevant, reliable, comparable and understandable information;

– 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 has 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 above.

Going concern

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.

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 control and monitoring the effectiveness of the internal and external auditors and the objectivity of the external auditor. The full terms of reference for the Committee can be found on the Company's website www.aviva.com and are available from the Group Company Secretary.

The Audit Committee
The Audit Committee currently comprises the following independent non-executive directors, appointed by the Board:

Derek Stevens (Chairman)
Richard Karl Goeltz
Carole Piwnica
Russell Walls

There were no changes to the membership of the Committee during 2005. The Committee met on five occasions in 2005 and each member attended every meeting. The Group Company Secretary acts as the secretary to the Committee.

Derek Stevens, a Chartered Accountant, is a member of the financial sector committee of the Accounting Standards Board and is a former Chief Financial Officer of British Airways plc and the TSB Group plc. Richard Karl Goeltz is a former Chief Financial Officer of American Express Company, NatWest Group plc and The Seagram Company Ltd. Russell Walls, a Fellow of the Chartered Certified Accountants, is a former Group Finance Director of BAA plc, Wellcome plc and Coats Viyella plc. The Board is satisfied that all these directors have recent and relevant financial experience.

The Group Chief Executive, Group Finance Director, Group Audit 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. In performing its duties, the Committee has access to the services of the Group Audit Director, the Group Company Secretary and external professional advice.

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 Group Audit Director concerning the Company's systems of internal 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.

During 2005, the Committee received regular reports on risk management, fraud, anti money laundering, "whistle blowing", legal and corporate governance matters to help it assess the effectiveness of the risk management and control frameworks. The Group Tax and Regulatory Director reported on the Group's compliance with appropriate rules and regulations, highlighting significant regulatory developments and compliance issues. During the early part of 2006 the responsibility for overseeing governance, regulatory and compliance issues, as well as the oversight of the non-financial internal controls will be transferred to the Governance and Regulatory Committee which was established in January 2006.

In addition the Committee reviewed the Group's capital and risk frameworks against the regulatory reforms incorporated in the Financial Services Authority's Prudential Sourcebook (PSB) concerning individual capital assessments (ICA). The Committee considered the proposed assumptions, methodology and process followed in determining the amount of capital required to support the Group's business plans, and the adequacy of its capital resources. It recommended the Group's ICA for 2005 to the Board for submission to the Financial Services Authority.

For the past three years a major programme has been in place to manage the transformation of the Group's financial reporting framework and the Committee has received quarterly reports on the progress being made. In August 2005, the Committee agreed that with the successful introduction of the European Embedded Value as the basis for the supplementary reporting of the Group's life assurance results and the publication of the Group's 2005 interim results on an IFRS basis, the programme had achieved its major objectives. Accordingly, the programme was terminated and the remaining developments are being managed in business units as part of their normal operations.

Each of the Group's major business units has an audit committee that provides an oversight role for their business. All such committees include members who are independent of the relevant business. The Group Audit Director reviews the papers and minutes from these committees and brings all significant matters to the Committee's attention.

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 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.

Internal audit

The Group's internal audit function advises management on the effectiveness of internal control systems, the adequacy of these systems to manage business risk and to safeguard the Group's assets and resources. Through the Group Audit Director, the internal audit function provides objective assurance on risk and control to the Committee. The plans and level of resources of the internal audit function are reviewed each year by the Committee. The Committee 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. This guidance recommends that an independent review of the internal audit function be performed at least every five years. Accordingly, the Committee's 2006 review will be conducted by an independent third party.

External auditor

Ernst & Young LLP was appointed auditor of the Company in 2001 having previously been the auditor of Norwich Union plc. The audit signing partner changed as part of a rotation process in 2002. Ernst & Young LLP audits the whole of the Group other than Delta Lloyd (the Group's subsidiary operating in the Netherlands, Belgium, Luxembourg and Germany), which is audited by PricewaterhouseCoopers LLP (PwC) and part of the RAC group which remains audited by KPMG LLP. To fulfil its Group reporting responsibilities Ernst & Young LLP reviews the work of PwC and KPMG LLP in accordance with standard auditing practices.

The Company has policies aimed at safeguarding and supporting the independence and objectivity of the external auditors. The policies regulate the appointment of former audit employees to senior finance positions in the Group and set out the approach to be taken by the Group when using the services of the auditors. It distinguishes between those matters where an independent view is required, such as audit and assurance work, and other advisory services. In addition to statutory audits, audit and assurance work includes reviewing statutory returns, actuarial assurance, regulatory advice requiring auditor reporting, due diligence on acquisitions and disposals, fraud investigations and control reviews and audit reviews. As a general principle the auditor cannot be engaged by the Company for any other purpose, although the policy recognises that there may be areas of minor significance where, for pragmatic reasons, it may be in the Group's interests to use the external auditor for this work. During the year the Committee also reviewed independence issues in relation to PwC.

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 £10.0 million to Ernst & Young LLP for audit services in 2005, relating to the statutory audit and the audit of other regulatory and supplementary reporting (*2004: £10.1 million*). In addition the Group engaged Ernst & Young in relation to certain assurance work including verification of its Corporate Social Responsibility Report. The fees for other services which included advice on accounting and regulatory matters, restatement of supplementary reporting, reporting on internal controls, and corporate governance matters, and due diligence work were £3.1 million giving a total fee to Ernst & Young LLP of £13.1 million *(2004: £14.9 million)*. Further details are provided in note 11 on page 124.

During the year, the Committee performed its annual review of the independence, effectiveness and objectivity of the external auditor; evaluating both the audit firm 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 auditor against those criteria. The questionnaires were collated by the Group Company Secretary. Based on this review, the Committee concluded that the audit service of Ernst & Young LLP was fit for purpose and provided a robust overall examination of the Group's business and the risks involved.

This report was reviewed and approved by the Board on 1 March 2006.

D Stevens
Chairman, Audit Committee

Nomination committee report

This report provides details of the role of the Nomination Committee and the work it has undertaken during the year.

The purpose of the Committee is to assist the Board by 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' independence. The full terms of reference for the Committee can be found on the Company's website www.aviva.com and are available from the Group Company Secretary.

The Committee currently comprises the following directors, appointed by the Board:

Lord Sharman (Chairman)
Guillermo de la Dehesa
Richard Harvey
Wim Dik
André Villeneuve

Pehr Gyllenhammar was a member of the Committee and its chairman throughout the year, until his retirement on 31 December 2005. Lord Sharman joined the Committee in January 2006. There were no other changes in the membership of the Committee during the year save that George Paul, as the senior independent director, joined and chaired the Committee for discussions relating to the succession of the Chairman. The Committee met on three occasions in 2005 and the members' attendance record is set out on page 59. The Group Company Secretary acts as the secretary to the Committee

The Committee reviews the skills, experiences and independence of the directors and, as appropriate, identifies and assesses potential new directors. It also reviews those directors retiring by rotation in accordance with the Company's articles of association with a view to making recommendations to the Board regarding their re-election.

The Committee monitors the skill requirements of 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 committed to their duties to the Company. The Committee also 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 of directors. Members of the Committee take no part in any discussions concerning their own circumstances.

As part of the planning process for the smooth replacement of current non-executive directors, including refreshing the skill set with a view to the future, the Committee identified a number of potential candidates. During the year the Board accepted the Committee's recommendations that Lord Sharman and Mary Francis join the Board. In respect of Lord Sharman's appointment the Committee engaged a search agency to help it identify suitable candidates and assist with the preparation of an interview list. Mrs Francis, due to her industry profile, was known to many members of the Board and therefore a search agency was not used in connection with this appointment.

The appointment of five new non-executive directors over the past two and a half years facilitated the retirement of George Paul and Elizabeth Vallance at the end of 2005 and supports the Board's intention that Derek Stevens and André Villeneuve will retire at the end of 2006.

This report was reviewed and approved by the Board on 1 March 2006.

Lord Sharman
Chairman, Nomination Committee

Directors' remuneration report

This report sets out the remuneration policy for the Company's directors and senior executives, outlines the elements of their remuneration and discloses the amounts paid to the directors in 2005.

The Remuneration Committee
The purpose of the Committee is to review and recommend to the Board the Company's remuneration policy and strategy and within the policy to set the individual remuneration terms and packages for the executive directors and the Chairman. The Committee also sets the remuneration structure and terms for the Company's other senior executives and exercises the powers of the Board in relation to the executive incentive and all-employee share plans. The full terms of reference for the Committee can be found on the Company's website www.aviva.com and are available from the Group Company Secretary.

The Remuneration Committee comprises the following independent non-executive directors appointed by the Board:

Richard Karl Goeltz (chairman)
Mary Francis
Carole Piwnica
André Villeneuve

George Paul and Elizabeth Vallance were members of the Committee throughout the year until their retirement on 31 December 2005. Mr Paul was the chairman. In January 2006, Mrs Francis and Mrs Piwnica joined the Committee and Mr Dik, who had been a member throughout 2005, left the Committee. Mr Goeltz was appointed chairman. The Committee met on eight occasions in 2005 and the members' attendance record is set out on page 59. The Group Company Secretary acts as the secretary to the Committee.

The Group Chief Executive is normally invited to attend the meetings of the Committee, except when his own remuneration is being discussed, as is the Group Human Resources Director.

Mike Pemberton, the Group Human Resources Director, provided material assistance to the Committee during the year, advising on market trends, practices and appropriate levels of remuneration. Deloitte advised the Committee on the calculation of total shareholder return for the purposes of the long-term incentive plans. Deloitte provided actuarial and accounting services to the Group during the year. In addition, the Committee has considered the views of the Chairman and Group Chief Executive in assessing the performance of the executive directors.

A major review of senior executive pension provisions was undertaken during 2005 and is described in detail below. The Company was supported by Aon Consulting. Lane Clark & Peacock LLP (LC&P), consulting actuaries, were appointed by the Committee to provide an independent opinion on certain aspects of the recommendations arising from the review. LC&P provided no other services to the Group during the year.

Remuneration policy
Executive directors
The Company's remuneration policy seeks to provide remuneration packages appropriate for each particular market in which the Company operates that will attract and retain high calibre employees and encourage and reward superior performance consistent with the interests of shareholders. The policy aims to reward senior executives fairly for their individual and collective contributions to the Company's performance. It is designed to provide an appropriate balance between the delivery of the annual business plan and the long-term profitable growth of the Company.

Under this broad policy, the Committee sets the content of the senior executives' total remuneration by reference to a variety of factors, including market practices for companies of similar size, type and standing. It also considers the current prevailing operating conditions in both the Group and the financial services industry generally. Additionally, it considers the skills and management capabilities that the Group must have so that it can attain its strategic objectives, and the level of remuneration required to secure individuals with those skills.

It is the Company's policy that an executive director's total potential remuneration for a target performance would be positioned at broadly median levels, compared with similar target performance levels of the Company's peers (its comparator group), whilst also acknowledging the size and complexity of the Company.

The Board's philosophy is that the senior executives' own interests should be aligned with those of the Company's shareholders. It therefore believes that, whilst paying a competitive basic salary, a substantial proportion of the targeted total remuneration package should be closely linked to the performance of the business and delivered in the form of shares.

The remuneration policy is reviewed by the Committee on a regular basis to ensure that it remains appropriate within the market and for the achievement of its objectives. A major review was undertaken in 2004 which became effective in 2005. In respect of the share schemes the review included all aspects of their operation including the discretions exercised, levels of grant, performance criteria and vesting schedules. New share incentive plans arising from the review were put to, and approved by, shareholders at the Company's 2005 Annual General Meeting. Full details of the review and the proposed changes were fully described in last year's Directors' Remuneration Report and therefore this report sets out the remuneration policy and packages which applied from the beginning of the 2005 financial year.

Directors' remuneration report continued

Chairman and non-executive directors

It is the Company's policy to set the fees paid to its Chairman and non-executive directors at the median level for international companies of similar size and complexity. Non-executive directors receive a basic annual fee in respect of their Board duties. A further fee is paid to directors (other than the Chairman) in respect of their membership and, where appropriate, chairmanship of Board committees. Fees are reviewed regularly and are set by the Board to attract individuals with the range of skills and experience appropriate for a major international company. In determining the level of fees paid to the non-executive directors, the Board receives recommendations from the executive directors who consider the non-executive directors' 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. Other than Pehr Gyllenhammar, who received a car allowance, the non-executive directors receive no benefits in addition to their fees nor do they participate in any incentive or performance plans.

The Company's articles of association provide that the total aggregate remuneration paid to directors 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 fees paid to the non-executive directors are made under that authority. Executive directors are remunerated under their service contracts and receive no additional fee for serving as directors. As a consequence, the limit of £1.5 million relates to the fees paid to the Chairman and non-executive directors.

In recognition of the growing accountabilities, time commitments and the demand for independent non-executive directors, the level of fees paid in the market has increased over recent years. The Company last reviewed its directors' fees in 2003 and to keep the fees competitive, a review was performed during the year. The review considered the level of fees paid to FTSE30 companies and the financial services sector and took into account international scope, regulatory oversight and the complexity of the business. As a result, the following changes were made from 1 April 2005:

- The Board fee was increased from £42,000 pa to £50,000 pa;
- Committee membership fees of £10,000 pa were introduced for membership of the Audit and Remuneration committees and £5,000 for membership of the Nomination Committee;
- The fee paid to the Chairman of the Audit Committee was increased from £25,000 pa to £35,000 pa (inclusive of the £10,000 membership fee); and
- The fee paid to the Chairman of the Board was increased from £300,000 pa to £360,000 pa.

The fee paid to the Deputy Chairman (including acting as the chairman of the Remuneration Committee and as the senior independent director) was left unchanged at £160,000 pa.

From 1 January 2006, the fee paid to the Chairman increased from £360,000 to £375,000 but the car allowance of £18,000 ceased from that date.

Remuneration package

The remuneration package for the Group's senior executives comprises the following elements:

- A basic salary;
- An annual bonus;
- A long-term incentive plan;
- A pension provision;
- Other benefits comprising a car allowance and private medical insurance.

Basic salaries

In determining the level of basic salaries, the Committee gathers data from a number of independent sources regarding the level of salaries paid to senior executives performing comparable functions within the 50 largest listed companies in the UK, with an additional focus on leading UK and European financial services companies. In addition to market data the Committee also takes into account the executive's individual performance as well as the level of salaries and salary increases for employees generally. The Company's policy is to set basic salaries for competent performance around the median level, with further progression based on performance. Salaries are reviewed annually.

Annual bonuses

Senior executives participate in a discretionary annual bonus plan that provides for the payment of an annual bonus. For executive directors the bonus for "Target" performance is 75% of basic salary and for achieving "Stretch" performance a payment of up to 150% could be awarded.

The balance between fixed and variable elements of pay for the executive directors is set out below (Group Chief Executive in brackets):

	Basic salary	Annual bonus	Long-term incentive plan
Target performance	45% (44%)	34% (33%)	21% (23%)
Stretch performance	25% (24%)	37.5% (35%)	37.5% (41%)

"Stretch" performance is measured against those key measures that influence share price performance and equates to 120% of "Target" level. No bonus is paid if performance falls below 90% of "Target".

In 2005, the performance targets comprised numerous relevant measures, including but not limited to:

- Group and business unit operating profits;
- Return on capital employed;
- Combined operating ratios; and
- New business contributions.

For 2006, employee morale and customer service measures have been included.

The actual performance against each of the measures is aggregated to determine the bonus levels paid. The performance measures vary between participants depending upon their particular responsibilities and spheres of influence.

In respect of any bonuses that are earned under the plan, one-third is paid in cash when the bonus is awarded. The remainder is converted into shares of the Company. The shares are transferred to the executive on the third anniversary of the grant provided that he/she remains in service over that period.

If an executive leaves service during the vesting period for reasons of ill-health or redundancy, the shares are released in full at the end of the vesting period. Upon retirement the shares are released in full at the date of retirement. If an executive resigns prior to the end of the year in which the shares are awarded all the shares would be forfeited. If resignation took place in the following year 50% of the shares would be forfeited with 25% being lost if resignation took effect in the third year. All the shares would be forfeited if a director was dismissed for cause during the vesting period.

Long-term incentives

The Aviva Long-Term Incentive Plan is a discretionary share plan. It is the Committee's policy to make an annual award of shares to executive directors with a value equal to 150% of basic salary (175% for the Group Chief Executive). All awards are made subject to the achievement of stretching performance conditions. The awards vest after three years, but only to the extent that the performance conditions are satisfied. Awards which do not vest, lapse.

The first performance condition compares the Total Shareholder Return (TSR) produced by the Company over a three-year period with the TSR of companies in a chosen comparator group. 50% of the award is subject to this measure. The achievement of median TSR performance in the comparator group triggers the vesting of 15% of the shares. This rises to 50% if the Company's performance is in the top 20% of the group. The comparator group for this part of the plan comprises 15 European financial services companies (including Aviva) that trade similar products in similar geographic markets, namely, AEGON, Allianz, AXA, Fortis, Friends Provident, Generali, HBOS, ING, Legal & General, Lloyds TSB, Prudential, Royal Bank of Scotland, Royal & Sun Alliance and Zurich.

The second performance condition measures the Company's Return on Capital Employed (ROCE) over a three-year period against a target return. 50% of the award is subject to this measure. ROCE is measured against the context of the Company's three-year business plan, which takes into account the trading conditions and shareholder expectations at the time each award is made. At threshold performance 15% of the awards vest moving to 50% at higher levels of performance. For awards granted for the three-year performance period commencing 1 January 2005 the Company's ROCE over the period must exceed 33% for 15% of the shares to vest, with the full 50% vesting if the ROCE exceeds 39% over the three-year period.

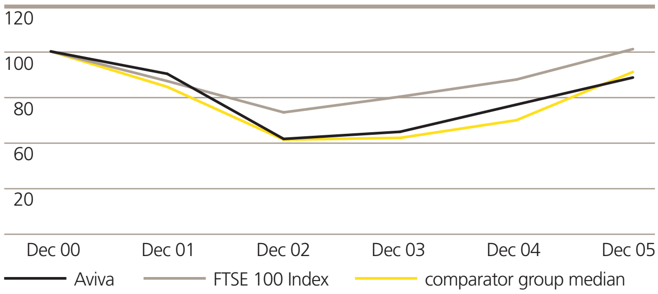
The Committee believes that this combination is an appropriate way to incentivise executives because it takes into account both the comparative returns to shareholders and the Company's actual performance.

The Committee decides whether, and to what extent, the performance conditions have been met. The rules of the plan require the Committee to request an independent consultant to determine the relevant TSR positions. The Committee requests that the Group's external auditor expresses a formal opinion on the basis of the ROCE calculation used.

Performance graph

The following graph compares the TSR performance of the Company over the past five years with the TSR of the FTSE100 Return Index. This index has been chosen because it is a recognised equity market index, of which Aviva is a member. The graph also includes the median TSR of the companies in the comparator group as this is the group against which performance is measured for the purpose of the Aviva Long-Term Incentive Plan. The companies which compose the comparator group for TSR purposes were amended when the new Long-Term Incentive Plan was introduced in 2005 so that the group matches more closely the companies which offer similar products in similar geographic markets to Aviva. The TSR graph for the comparator group has therefore been plotted using the 19 companies (excluding Aviva) in the comparator group pre-2005 and the 14 companies (excluding Aviva) in the group for 2005.

Aviva 5-year TSR performance against the FTSE 100 Index and the median of the comparator group



Dilution

Awards granted under the Aviva Annual Bonus Plan 2005 and the Aviva Long-Term Incentive Plan 2005 are met by the issue of new shares at the time that the awards vest. The Committee monitors the number of shares issued under its various all-employee and discretionary share plans and their effect on dilution limits. The relevant dilution limits established by the Association of British Insurers in respect of all share plans (10% in any rolling 10 year period) and executive share plans (5% in any rolling 10 year period) were, based on the Company's issued share capital at 31 December 2005, 3.2% and 1.5% respectively.

Between March 1998 and March 2003, the Company met its liability for shares awarded under the incentive plans by funding an employee trust that acquired shares in the market at the time of grant. Details of the shares currently held in the employee trust are set out in note 29 on page 145.

Major changes to accounting policies and practices in 2005, including adopting international financial reporting standards and European Embedded Value principles for supplementary reporting, affected a number of the key performance indicators and performance measures used in connection with the Company's long-term incentive plans. During the transition period the Committee received reports showing the impacts of these changes on the performance measures and satisfied itself that the evaluation of actual performance against the performance conditions which were originally set using prior accounting practices is appropriate having made allowance for the accounting changes.

Directors' remuneration report continued

Pension arrangements and long term benefits

During 2005, the remuneration package for senior executives in the United Kingdom included Company contributions into the defined benefit section of the Aviva Staff Pension Scheme (the Scheme). Executive directors accrued pensions at a rate of one thirtieth (Richard Harvey, Philip Scott and Patrick Snowball) or one forty-fifth (Andrew Moss) of their final pensionable salary for each year of service as a senior executive, subject to a maximum pension of two-thirds of their final pensionable salary. No pension benefits were accrued on bonuses or other benefits. The Scheme provides a lump sum death-in-service benefit of four times the member's basic salary at the date of death and a spouse's pension equal to two-thirds of a member's actual or prospective pension. Post-retirement, pensions are reviewed annually and increases are guaranteed at a rate equivalent to the increase in the Retail Prices Index up to a maximum of 10% pa. Under the Scheme, executive directors have a normal retirement age of 60.

From 1 April 2005, all members of the defined benefit section of the Scheme were required to contribute 5% of their total gross basic salary to the Scheme.

The benefits paid from the Scheme are subject to HM Revenue and Customs (HMRC) limits . An Unapproved Unfunded Retirement Benefit (UURB) exists in order to provide executives with the benefits promised to them by the Scheme, notwithstanding a limit relating to their level of earnings which, in some cases caps the amount of pension which can be paid from a tax approved scheme. Where this limit applies, the benefits that cannot be paid from the Scheme are provided from the UURB. Richard Harvey and Andrew Moss are both affected by this limit. At retirement, they will receive some of their pension benefits from the UURB.

Major changes to the legislation governing the provision of pensions in the UK (known as "pension simplification") will come into effect from April 2006. In anticipation of the changes, and as part of an holistic review of senior executive remuneration, the Committee undertook a review of the pension provisions for its executives and how they relate to the total remuneration package. The review was set against a number of design principles which included:

- The need to continue attracting and retaining top quality management;
- Keeping the employee retention element that is built into an occupational pension scheme;
- Future pension arrangements for senior executives were not to cost the Company more than its current arrangements;
- The Company would not pay or compensate managers in respect of any increased tax liability arising from pensions simplification.

As a result from April 2006, executives will continue to accrue pension benefits on their current basis under the Scheme up to the lifetime allowance, the amount of which is determined by HMRC. From April 2006, the lifetime allowance will be £1.5 million, equating to an annual pension of c. £75,000 pa. The contribution of 5% paid by the executives will continue. Once the value of the executive's pension benefits reaches the lifetime allowance, further accrual in the Scheme will cease and no pension will be provided in excess of this. However, the death in service benefit of four times a member's salary will continue.

As mentioned above it has been the practice of the Company to provide for pensions in excess of the HMRC earnings cap through the provision of an UURB. The UURB liability is unfunded and therefore once it falls into payment it is met each year from the Company's general resources and recorded as an expense.
At 31 December 2005 30 current employees had accrued an UURB benefit and the aggregate liability of these benefits was estimated to be £23.5 million. Following the changes brought about by pension simplification the Company is taking the opportunity to curtail its UURB liability by funding it either through the Scheme, in cases where there is scope within the lifetime allowance, or through the capitalisation of the UURB benefit into an investment fund, thus crystallising the liability. Fifteen executives, including Richard Harvey, have benefits which currently exceed the lifetime allowance and are currently considering the terms which the Company has offered regarding the crystallising of these benefits into an investment fund. Those executives who do not accept the offer will remain entitled to an UURB. The Company ceased offering any new UURB benefits from April 2005.

All new employees in the United Kingdom including senior executives are now offered membership of the defined contribution section of the Scheme.

Long-term benefits

In order to provide a long-term savings opportunity for those senior executives whose pensions benefits from the Aviva Staff Pension Scheme are restricted by the lifetime allowance, the Company will consider making discretionary contributions into a capital accumulation plan. The level of any contribution will vary depending upon seniority but will not exceed 50% of the executive's basic salary. Executives leaving the Company, either by resignation or breach of contract, would forfeit any contribution for the year in which they left.

Other benefits

In addition to the benefits described above, senior executives are entitled to the benefit of a company car allowance and private medical insurance.

The Company operates a number of HMRC approved all-employee share plans in the United Kingdom. Senior executives are entitled to participate in these plans on the same basis as other eligible employees. These include the Free 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 pa in the form of shares from the profits of the Company, free of tax, subject to a retention period. The Partnership element of the AESOP allows participants to invest up to £125 per month out of their gross salary in the Company's shares.

The Aviva Savings Related Share Option Scheme allows eligible employees to acquire options over the Company's shares at a discount of up to 20% to their market value at the date of grant. In order to exercise these options, participants must have saved the consideration through either a three, five or seven-year approved savings contract, subject to a maximum savings limit of £250 per month.

Share ownership requirements
The Group Chief Executive and the executive directors are required to build, over a five-year period, a shareholding in the Company equivalent to 1.75 times annual salary and 1.5 times annual salary respectively.

Service contracts
Service contracts agreed with each executive director incorporate their terms and conditions of employment.

Executive directors have rolling service contracts that can be terminated by the Company giving 12 months' notice and by the director giving six months' notice. In respect of the early termination of a service contract by the Company, other than on the grounds of dismissal for cause, the Company would, depending upon the circumstances, either seek to make a payment in respect of damages, less an amount for appropriate mitigation, or would invoke a provision in the contract allowing it to be terminated by the Company making a payment of one year's basic salary in lieu of notice. Under the Company's discretionary redundancy arrangements, which apply to United Kingdom based employees, an executive director may, depending on his length of service, receive an ex-gratia payment of up to one year's basic salary, should he leave employment on the grounds of redundancy. The maximum payment receivable by an executive director on termination of his contract is therefore one year's basic salary in lieu of notice and, if made redundant, an additional payment up to a maximum of one year's salary. No special arrangements would apply should there be a change in the control of the Company.

Service contracts issued since November 2003 meet recommended corporate governance practice, including a specific requirement for employees to mitigate their losses and the phasing of termination payments over the notice period. During the current year, the Company proposes to amend the service contracts for all its senior executives in the UK onto the same basis. It is the Company's practice to notify the market of the terms offered to executive directors upon their appointment.

Directors' service contracts

	Contract date	Unexpired term	Notice period
Richard Harvey	1 June 2000	Rolling 1 year	1 year
Andrew Moss	10 May 2004	Rolling 1 year	1 year
Philip Scott	1 June 2000	Rolling 1 year	1 year
Patrick Snowball	1 June 2000	Rolling 1 year	1 year

Non-executive appointments
The non-executive directors, including the Chairman, have letters of appointment which set out their duties and responsibilities. Whilst the appointments are for a maximum of three years they can be terminated at any time by either party giving one month's written notice without the payment of compensation. The dates of the appointments/reappointments for the current directors are as follows.

	Date of last appointment	Date appointment terminates
Guillermo de la Dehesa	30 May 2005	30 May 2008
Wim Dik	7 December 2005	7 December 2008
Mary Francis	1 October 2005	1 October 2008
Richard Goeltz	3 May 2004	3 May 2007
Carole Piwnica	8 May 2003	8 May 2006*
Lord Sharman	14 January 2005	14 January 2008
Derek Stevens	31 May 2005	31 May 2006*
André Villeneuve	31 May 2005	31 May 2006*
Russell Walls	3 May 2004	3 May 2007

*Carole Piwnica, Derek Stevens and André Villeneuve will stand for re-election at the Company's 2006 Annual General Meeting. However, it is the Board's intention that, if re-elected, Derek Stevens and André Villeneuve will retire on or before 31 December 2006.

Of the directors seeking election/re-election at the Company's 2006 Annual General Meeting Mr Harvey, Mr Snowball and Mr Scott each have a service contract with a Group company as set out above. Mrs Francis, Mrs Piwnica, Mr Stevens and Mr Villeneuve do not have service contracts. Directors' service contracts and letters of appointment are available for inspection at the Company's registered office during normal hours of business.

Directors' remuneration report continued

Directors' remuneration in 2005

This section of the report (which has been subject to audit) sets out the remuneration paid or payable to the directors in respect of the year to 31 December 2005. The remuneration payable to directors, who held office for any part of the financial year, including amounts paid to them as directors of subsidiary undertakings, was as follows:

	Basic salary/fees		Bonuses[1]		Benefits[2]		Total	
	2005 £'000	2004 £'000	2005 £'000	2004 £'000	2005 £'000	2004 £'000	2005 £'000	2004 £'000
Chairman								
Pehr Gyllenhammar	**345**	300	**–**	–	**20**	20	**365**	320
Executive directors								
Richard Harvey	**790**	752	**1,028**	355	**104**	96	**1,922**	1,203
Andrew Moss	**470**	283	**589**	200	**20**	10	**1,079**	493
Philip Scott	**515**	491	**583**	223	**54**	35	**1,152**	749
Patrick Snowball	**503**	456	**693**	218	**104**	21	**1,300**	695
Non-executive directors[3]								
Guillermo de la Dehesa	**77**	67	**–**	–	**–**	–	**77**	67
Wim Dik	**59**	42	**–**	–	**–**	–	**59**	42
Mary Francis*	**13**	–	**–**	–	**–**	–	**13**	–
Richard Karl Goeltz	**63**	28	**–**	–	**–**	–	**63**	28
George Paul	**160**	160	**–**	–	**4**	–	**164**	160
Carole Piwnica	**56**	42	**–**	–	**–**	–	**56**	42
Lord Sharman*	**48**	–	**–**	–	**–**	–	**48**	–
Derek Stevens	**91**	77	**–**	–	**–**	–	**91**	77
Elizabeth Vallance	**59**	42	**–**	–	**–**	–	**59**	42
André Villeneuve	**59**	42	**–**	–	**–**	–	**59**	42
Russell Walls	**56**	28	**–**	–	**–**	–	**56**	28
Total emoluments of directors	**3,364**	2,810	**2,893**	996	**306**	182	**6,563**	3,988

*From date of appointment: Lord Sharman (14 January 2005) and Mary Francis (1 October 2005).

Notes

1. "Bonuses" include the value of shares granted under the free share part of the Aviva All-Employee Share Ownership Plan (maximum £3,000) and the total amounts earned in respect of the 2005 performance under the Annual Bonus Plan (i.e. including the amounts deferred and granted in the form of shares). The Annual Bonus Plan which was approved by shareholders in 2005, came into effect for the 2005 financial year replacing the Deferred Bonus Plan which operated in 2004. The disclosure of the awards made under these plans differs. Under the Deferred Bonus Plan participants were encouraged to defer their cash bonuses (35% of salary for "Target" performance) into shares by the Company providing matching shares on a 1 for 1 basis, thus effectively doubling the value of the bonus. The bonus awarded was disclosed in the table showing directors' remuneration and the matching shares were disclosed in the table showing the share awards. Under the Annual Bonus Plan, a larger cash bonus is awarded (75% of salary at "Target" performance). Recipients are required to defer two thirds of their bonus into shares. However, under the Annual Bonus Plan, the deferred shares are not matched. As explained at the time the Annual Bonus Plan was introduced, at "Target" performance the Annual Bonus Plan would provide a bonus broadly 5% higher than that provided by the Deferred Bonus Plan when the value of the matching shares was taken into account. However, to encourage and incentivise outperformance the Annual Bonus Plan provides the potential to pay out significantly higher bonuses at Stretch level of outperformance. (see page 69 regarding the operation of the Annual Bonus Plan).

   When calculating the level of bonus under the Annual Bonus Plan, 70% is based on financial measures and 30% is based on personal targets. The constitution of the financial measures varies between directors. For example, in respect of the Group Chief Executive and the Group Finance Director the performance measures used are those relating to the Group, whereas for the other executive directors bonuses are based partly on the Group's performance and partly on the performance measures relating to the business units for which the directors have responsibility. Performance measures are reviewed in order to determine the financial bonuses for all the executive directors. For 2005, the performance measures for the Group included new business contribution, operating profit, combined operating ratio (COR), total expenses and the return on capital employed. Overall performance against these measures in 2005 was better than the targets set. In addition to the Group and business unit performance measures, the directors were set individual personal targets.

2. "Benefits". All the executive directors received the benefit of private medical insurance and, along with the Chairman, a car allowance. The above disclosure also includes, in respect of Richard Harvey, an amount relating to the cost incurred by the Company of insuring the life assurance and spouses' benefits which, had he died during the year, could not have been paid by the pension scheme as a result of the "earnings cap" and which would therefore have been met by the Company. In respect of Mr Snowball the disclosure includes an allowance of £66,000 incurred as a result of him being required to relocate from Norwich to London following a change in his responsibilities. The disclosure also includes a benefit relating to accompanied travel (Mr Harvey £10,000, Mr Snowball £22,000 and Mr Scott £32,000). All the numbers disclosed include the tax charged on the benefits. No directors received an expense allowance during the year.

3. Non-executive directors. The benefit disclosed for Pehr Gyllenhammar refers to a car allowance. The fee for George Paul reflects his duties as deputy chairman, chairman of the Remuneration Committee and for acting as the senior independent director. The fee for Derek Stevens includes an additional amount for serving as the chairman of the Board's Audit Committee and of the trustee of the Aviva Staff Pension Scheme. The fee for Guillermo de la Dehesa includes an amount for serving as the non-executive chairman of the Group's operations in Spain. No non-executive director accrued retirement benefits during the year.

4. No compensation payment for loss of office was made to any director, or former director, during the year.

5. 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 2005 was £6.6 million. *(2004: £4.2 million).*

6. Payments to former directors. Since his retirement as a director in 2003, Anthony Wyand has served as a consultant and as a director on the boards of some of the Group's European operations. Under this arrangement, a fee of £126,000 was paid to him in 2005. During the year, shares granted to certain former executive directors under the Company's incentive plans vested. Details of these awards were fully disclosed in the year of grant.

7. No executive director served on the board of an external company in a personal capacity during the year for which he was remunerated.

8. 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 directors and non-executive directors (as required to be disclosed by International Accounting Standard 24) is set out in note 53 on page 189.

Pension benefits

During the year, each of the executive directors accumulated pension benefits under the defined benefits section of the Aviva Staff Pension Scheme, the Group's pension scheme for its United Kingdom employees. For Mr Harvey and Mr Moss, who are subject to the earnings cap, any benefits that cannot be provided through the Scheme are provided via an Unfunded Unapproved Retirement Benefit (UURB).

Executive directors' defined benefit pension arrangements

	Richard Harvey £'000	Andrew Moss £'000	Philip Scott £'000	Patrick Snowball £'000
Accrued annual pension at 1 January 2005	**501**	**6**	**312**	**191**
Increase in accrued annual pension during year as a result of inflation	**14**	**–**	**8**	**5**
Adjustment to accrued annual pension as a result of salary increase relative to inflation	**12**	**1**	**8**	**16**
Increase in accrued annual pension as a result of additional service[1]	**–**	**10**	**15**	**19**
Accrued annual pension at 31 December 2005[2]	**527**	**17**	**343**	**231**
Employee contributions during the year[3]	**35**	**24**	**23**	**22**
Transfer value of accrued pension at 31 December 2004[4]	**6,900**	**53**	**3,715**	**2,702**
Transfer value of accrued pension at 31 December 2005[4]	**7,681**	**166**	**4,357**	**3,465**
Change in transfer value during the period less employee contributions[4]	**746**	**89**	**619**	**741**
Age at 31 December 2005 (years)	**55**	**47**	**51**	**55**

Notes

1. Mr Harvey has reached the maximum service accrual and therefore received no increase during 2005 for an additional year of service.
2. 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 2005.
3. The amount of the benefits to be paid out of the Aviva Staff Pension Scheme in respect of Mr Harvey and Mr Moss are restricted due to the earnings cap, with the benefits in excess of the cap to be paid by the Company. As a result, £15,705 of the contributions paid by these directors was paid to the Scheme with the balance paid to the Company.
4. Transfer values represent the estimated liability on the Scheme to pay the stated level of benefits (in respect of benefits in excess of the earnings cap the liability rests with the Company). They are not sums paid, or due, to a director.

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.

Directors' remuneration report continued

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 as follows:

(a) Share options

	At 1 January 2005 Number	Options granted during year Number	Options exercised during year Number	Options lapsing during year Number	At 31 December 2005 Number	Exercise price p	Exercise period
Richard Harvey							
– Savings related options 2002	4,426	–	–	–	**4,426**	401.0	December 2009 – May 2010
Andrew Moss							
– Savings related options 2005	–	3,279	–	–	**3,279**	491.0	December 2010 – May 2011
Philip Scott							
– Savings related options 2002	4,096	–	–	–	**4,096**	401.0	December 2007 – May 2008
Patrick Snowball							
– Savings related options 2003	2,272	–	–	–	**2,272**	406.0	December 2006 – May 2007

"Savings related options" are options granted under the HM Revenue and Customs-approved Save As You Earn (SAYE) share option scheme. Options are normally exercisable during the six month period following the end of the relevant (three, five or seven year) savings contract.

The mid-market price of an ordinary share in the Company on 30 December 2005 ie the last business day of the year, was 705 pence, and the mid-market prices during the year ranged from 577.5 pence to 709.5 pence.

(b) Share awards

Details of the performance conditions relating to these awards are set out in the notes below:

	At 1 January 2005 Number	Awards granted during year Number	Awards vesting during year Number	Awards lapsing during year Number	At 31 December 2005 Number	Market price at date awards granted p	Market price at date awards vested p	Vesting date
Richard Harvey								
Aviva Long-Term Incentive Plan								
– 2000	107,988	–	54,101	53,887	**–**	960.0	642.5	March 2005
– 2002	86,814	–	40,194	46,620	**–**	739.0	642.5	March 2005
– 2003	175,000	–	–	–	**175,000**	379.5	–	March 2006
– 2004	139,059	–	–	–	**139,059**	527.5	–	March 2007
Aviva Long-Term Incentive Plan 2005								
– 2005	–	207,437	–	–	**207,437**	633.5	–	March 2008
Aviva Deferred Bonus Plan								
– 2002	72,924	–	72,924	–	**–**	739.0	642.5	March 2005
– 2003	127,750	–	–	–	**127,750**	379.5	–	March 2006
– 2004	118,478	–	–	–	**118,478**	527.5	–	March 2007
– 2005	–	109,764	–	–	**109,764**	633.5	–	March 2008
Andrew Moss								
Aviva Share Plan	36,539	–	23,077	–	**13,462**	520.0	708.0	December 2006
Aviva Long-Term Incentive Plan								
– 2004	83,650	–	–	–	**83,650**	535.0	–	March 2007
Aviva Long-Term Incentive Plan 2005								
– 2005	–	102,803	–	–	**102,803**	633.5	–	March 2008
Aviva Deferred Bonus Plan								
– 2005	–	61,408	–	–	**61,408**	633.5	–	March 2008

(b) Share awards continued

	At 1 January 2005 Number	Awards granted during year Number	Awards vesting during year Number	Awards lapsing during year Number	At 31 December 2005 Number	Market price at date awards granted p	Market price at date awards vested p	Vesting date
Philip Scott								
Aviva Long-Term Incentive Plan								
– 2000	34,453	–	17,260	17,193	**–**	960.0	642.5	March 2005
– 2002	54,177	–	25,083	29,094	**–**	739.0	642.5	March 2005
– 2003	111,250	–	–	–	**111,250**	379.5	–	March 2006
– 2004	88,867	–	–	–	**88,867**	527.5	–	March 2007
Aviva Long-Term Incentive Plan 2005								
– 2005	–	116,822	–	–	**116,822**	633.5	–	March 2008
Aviva Deferred Bonus Plan								
– 2002	44,424	–	44,424	–	**–**	739.0	642.5	March 2005
– 2003	80,100	–	–	–	**80,100**	379.5	–	March 2006
– 2004	68,960	–	–	–	**68,960**	527.5	–	March 2007
– 2005	–	68,690	–	–	**68,690**	633.5	–	March 2008
Patrick Snowball								
Aviva Long-Term Incentive Plan								
– 2000	24,682	–	12,365	12,317	**–**	960.0	642.5	March 2005
– 2002	45,691	–	21,154	24,537	**–**	739.0	642.5	March 2005
– 2003	96,250	–	–	–	**96,250**	379.5	–	March 2006
– 2004	84,452	–	–	–	**84,452**	527.5	–	March 2007
Aviva Long-Term Incentive Plan 2005								
– 2005	–	107,943	–	–	**107,943**	633.5	–	March 2008
Aviva Deferred Bonus Plan								
– 2002	36,552	–	36,552	–	**–**	739.0	642.5	March 2005
– 2003	35,612	–	–	–	**35,612**	379.5	–	March 2006
– 2004	70,802	–	–	–	**70,802**	527.5	–	March 2007
– 2005	–	67,068	–	–	**67,068**	633.5	–	March 2008

The Aviva Long-Term Incentive Plan was approved by shareholders at the 2001 Annual General Meeting and awards were made on an annual basis up to and including 2004. Awards are subject to the attainment of performance conditions over a three-year performance period. The performance condition relating to the awards granted in March 2002 fell due for testing during the year. For any awards to vest under the TSR condition, the Company's TSR, when compared with the TSR of a comparator group of European financial services companies would need to match at least median performance when 20% of the awards become exercisable. At upper decile performance, 70% of the awards would vest. Between median and upper decile the number of awards vesting is determined on a straight-line basis. For any awards to vest under the ROCE condition, the Company's ROCE would have to exceed 24% in excess of RPI over the three-year performance period when 24% of the awards would vest, rising to 30% if the ROCE exceeded 30% over the same period. At the end of the performance period relating to the awards granted in 2002, the Company was ranked 10 out of the 20 companies in the comparator group and the ROCE was 26.2%. Accordingly, 23% of the awards vested based on the TSR part of the Plan and 17.2% of the awards vested under the ROCE condition. The 59.8% of the awards, which did not vest, lapsed.

Where no awards vest at the end of the three-year performance period the performance conditions can, under this particular Plan, be retested at the end of five years with the performance conditions being suitably adjusted. This situation occurred in relation to the awards granted in 2000, which fell for retesting in March 2005. For any awards to vest under the TSR condition, the Company's TSR, when compared with the TSR of a comparator group of European financial services companies would need to at least match median performance when 20% of the awards become exercisable. For a top 10% performance, 70% of the awards would vest. Between median and upper decile the number of awards vesting is determined on a straight-line basis. For any awards to vest under the ROCE condition, the Company's ROCE would have to exceed 40% in excess of RPI over the five-year performance period which would mean 24% of the awards would vest, rising to 30% if the ROCE exceeded 50% over the same period. At the end of the performance period relating to the awards granted in 2000, the Company was ranked 8 out of the 20 companies in the comparator group and the ROCE was 42.6%. Accordingly, 34.9% of the awards vested based on the TSR part of the Plan and 15.2% of the awards vested under the ROCE condition. The 49.9% of the awards that did not vest, lapsed.

The Aviva Long-Term Incentive Plan 2005 was approved by shareholders at the 2005 Annual General Meeting and is described on page 67. This "2005 Plan" replaced the Aviva Long-Term Incentive Plan described above.

Directors' remuneration report continued

The Aviva Deferred Bonus Plan was approved by shareholders at the 2001 Annual General Meeting. The awards disclosed include those made in lieu of some or all of the cash bonus earned and deferred under the Company's Annual Bonus Plan and also the matching awards granted on a "one-for-one" basis. The vesting of the awards on the third anniversary of their grant is not subject to performance conditions.

The Aviva Share Plan was established in May 2004 specifically to facilitate the recruitment of Andrew Moss. The awards made under the Plan compensate Andrew Moss for the value of long-term incentive awards granted to him by his previous employer and which lapsed when he resigned to join Aviva. Andrew Moss is the only participant in the Plan. On 10 May 2004, the date Andrew Moss joined the Company, 103,846 shares in the Aviva Employee Trust (with a market value of £540,000) were allocated to him. On 31 October 2004 67,307 of the shares vested, 23,077 vested on 31 December 2005 and the balance of 13,462 will vest on 31 December 2006. The vesting of these shares is not subject to any performance conditions.

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 is shown 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 on pages 72 to 73 and the Aviva Share Plan is described above.

	Shares[1]		Bonus Plan Awards[2]		Long-Term Incentive Awards[3]		Options[4]		Aviva Share Plan[5]	
	1 January 2005	31 December 2005	1 January 2005	31 December 2005	1 January 2005	31 December 2005	1 January 2005	31 December 2005	1 January 2005	31 December 2005
Guillermo de la Dehesa	144	**144**	–	**–**	–	**–**	–	**–**	–	**–**
Wim Dik	200	**200**	–	**–**	–	**–**	–	**–**	–	**–**
Mary Francis*	1,000*	**1,000**	–	**–**	–	**–**	–	**–**	–	**–**
Richard Goeltz	–	**2,500**	–	**–**	–	**–**	–	**–**	–	**–**
Pehr Gyllenhammar	28,378	**29,539**	–	**–**	–	**–**	–	**–**	–	**–**
Richard Harvey	24,036	**44,781**	319,152	**355,992**	508,861	**521,496**	4,426	**4,426**	–	**–**
Andrew Moss	39,632	**35,040**	–	**61,408**	83,650	**186,453**	–	**3,279**	36,539	**13,462**
George Paul	30,816	**30,894**	–	**–**	–	**–**	–	**–**	–	**–**
Carole Piwnica	–	**–**	–	**–**	–	**–**	–	**–**	–	**–**
Philip Scott	107,519	**170,004**	193,484	**217,750**	288,747	**316,939**	4,096	**4,096**	–	**–**
Lord Sharman*	–*	**–**	–	**–**	–	**–**	–	**–**	–	**–**
Patrick Snowball	5,542	**16,250**	142,966	**173,482**	251,075	**288,645**	2,272	**2,272**	–	**–**
Derek Stevens	2,032	**2,989**	–	**–**	–	**–**	–	**–**	–	**–**
Elizabeth Vallance	830	**830**	–	**–**	–	**–**	–	**–**	–	**–**
André Villeneuve	640	**640**	–	**–**	–	**–**	–	**–**	–	**–**
Russell Walls	1,500	**1,500**	–	**–**	–	**–**	–	**–**	–	**–**

*At appointment – Lord Sharman (14 January 2005); Mary Francis (1 October 2005).

Notes

1. "Shares" are the directors' beneficial holdings in the ordinary shares of the Company and in respect of the executive directors 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. Executive directors are required to build and maintain a beneficial interest in the Company's shares equal in value to 1.5 times their annual salary (1.75 times annual salary in the case of the Group Chief Executive). The requirement was introduced as part of the revised remuneration arrangements from 2005; the holding must be attained within five years.
2. "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.
3. "Long-Term Incentive Awards" are awards granted under the Aviva Long-Term Incentive Plans which vest only if the performance conditions are achieved.
4. "Options" are options over shares granted under the Save As You Earn share scheme.
5. "Aviva Share Plan" relates to shares held under the Plan referred to above in which only Andrew Moss participates.

The following changes to directors' interests during the period 1 January 2005 to 1 March 2006 have been reported to the Company. The changes in interests relate to shares acquired each month under the partnership element of the AESOP:

	Number of shares
Richard Harvey	34
Philip Scott	35
Patrick Snowball	34

This report was reviewed and approved by the Board on 1 March 2006.

Richard Karl Goeltz
Chairman, Remuneration Committee

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 2005 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 Balance Sheets, the Consolidated and Parent Company Statement of Recognised Income and Expense, the Consolidated and Parent Company Statements of Change in Shareholders' Equity, the Consolidated and Parent Company Cash Flow Statements and the related notes 1 to 53 and A to J. These financial statements have been prepared under the accounting policies set out therein. 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 are responsible 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 as 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 Article 4 of the IAS Regulation. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if 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 Statement reflects the company's compliance with the nine provisions of the 2003 FRC 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 Management Review, the Directors' Report, the Corporate Governance statement, the Audit Committee report, the Nomination Committee Report 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 judgments 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.

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 2005 and of the group's and the parent company's profit for the year then ended; and

– 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 Article 4 of the IAS Regulation.

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 obligations 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 2005 and of its profit for the year then ended.

Ernst & Young LLP
Registered Auditor
London
1 March 2006

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We're
pporting
lth and
well-being
of people and their families
across four continents

Financial statements

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 also invests in securities, properties, mortgages and loans and carries on the business of trading in property.

The Group is managed using reportable segments based on the above activities. These are long-term business, fund management, general insurance and health, further details of which 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

From 2005, all European Union listed companies are 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. This is the Group's first set of full year results prepared in accordance with IFRS accounting policies and its previously reported 2004 consolidated financial statements have accordingly been restated to comply with IFRS, with the date of transition to IFRS being 1 January 2004. The principal effects of the adoption of IFRS have been reflected within note 1 on first time adoption.

The consolidated financial statements have been prepared in accordance with IFRS applicable at 31 December 2005. The IASB issued amendments to IAS 19, *Employee Benefits,* and IAS 39, *The Fair Value Option,* in December 2004 and June 2005 respectively, and its Interpretations Committee (IFRIC) issued IFRIC Interpretation 4, *Determining whether an Arrangement contains a Lease,* in December 2004. Their requirements are applicable for accounting periods beginning on or after 1 January 2006, but the Group has decided to adopt them early and reflect their impact in these financial statements.

In August 2005, the IASB issued IFRS 7, *Financial Instruments: Disclosures,* and amendments to IAS 1, *Capital Disclosures,* and IAS 39/IFRS 4, *Financial Guarantee Contracts.* Their requirements are applicable for accounting periods beginning on or after 1 January 2007 for the first two and, for the third, 1 January 2006. In addition, IFRIC Interpretation 8, *Scope of IFRS 2*, was issued in January 2006 and is effective for accounting periods beginning on or after 1 May 2006. The Group has decided not to adopt any of the standards early in these financial statements but the impact of adopting them is not expected to have a material effect on its results. IFRS 7 will result in amendments to the disclosure of financial assets and liabilities, whilst the amendments to IAS 1 bring the capital disclosures into line with IFRS 7. The amendments to IAS 39 and IFRS 4 will not affect the manner in which the Group accounts for financial guarantee business. In addition, IFRS 6 and IFRIC Interpretations 5, 6 and 7 have been issued during 2005 but are not relevant to the activities of the Group.

In accordance with Phase I 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 E 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 190 to 198.

FRS 27

Financial Reporting Standard 27, *Life Assurance,* (FRS 27) was issued by the UK's Accounting Standards Board (ASB) on 13 December 2004, following the Penrose inquiry. 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 within the Group's IFRS financial statements.

Within FRS 27, the ASB acknowledged the difficulty of applying the requirements retrospectively and it is the Group's view that it would be impractical to do so in accordance with IAS 8. Therefore, only the balance sheet at 31 December 2004 has been restated for the impact of FRS 27. This has no impact on net assets or profit for the year ended 31 December 2004, as the adjustments reflect changes in balance sheet presentation between the unallocated divisible surplus and insurance liabilities. No adjustments have been made, nor are any required, to the balance sheet at 1 January 2004 or the income statement for the year ended 31 December 2004.

The comparatives presented for the year ended 31 December 2004 have therefore been prepared in accordance with the Group's IFRS accounting policies and the transitional arrangements above.

(B) Use of estimates

The preparation of financial statements requires the Group to make estimates and assumptions that affect items reported in the consolidated balance sheet and income statement and the disclosure of contingent assets and liabilities at the date of the financial statements. Although these estimates are based on management's best knowledge of current facts, circumstances and, to some extent, future events and actions, actual results ultimately may differ from those estimates, possibly significantly.

(C) 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 M 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.

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 have given rise to a merger reserve in the consolidated balance sheet. 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

Investment vehicles such as OEICs, where a Group company owns more than 50%, are consolidated. The interests of parties other than Aviva in such vehicles are classified as liabilities and appear as "Net asset value attributable to unitholders" in the consolidated balance sheet.

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 where 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. 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.

When 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 financial assets, with changes in their fair value being recorded in a separate investment valuation reserve within equity.

(D) 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.

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 R) are included in foreign exchange gains and losses in the income statement. For monetary financial assets designated as available for sale (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.

(E) 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 date of transition to IFRS. Accounting for insurance contracts is determined in accordance with the Statement of Recommended Practice issued by the Association of British Insurers in December 2005. However, in certain businesses, the accounting policies have been changed, as permitted by IFRS 4, to remeasure designated insurance liabilities to reflect current market interest rates.

(F) 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

Financial statements

Accounting policies continued

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 computed principally 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 4) 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.

(G) Other investment contract fee revenue
Investment contract policyholders are charged fees for mortality, policy administration, investment management, surrenders or other contract services. These fees are recognised as revenue in the period in which they are collected unless they relate to services to be provided in future periods. Amounts are considered to be assessed when the policyholder's balance has been adjusted for those fees. If the fees are for services to be provided in future periods, then 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 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.

(H) Other fee and commission income
Other fee and commission income consists primarily of investment fund management fees, distribution fees from mutual funds, commission revenue from the sale of mutual fund shares, and transfer agent fees for shareholder record keeping. Revenue from investment management fees, distribution fees and transfer agent fees is recognised when earned. Reinsurance commissions receivable and other commission income are recognised on the trade date.

(I) 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 R). 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.

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 a longer term return on investments supporting its general insurance and health business. Total investment income, including realised and unrealised gains, is therefore analysed between that calculated using a longer term return and short-term fluctuations from this. Further details of this analysis and the assumptions used are given in note 8.

(J) 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 contracts. In certain cases, shadow adjustments to the liabilities or related deferred acquisition costs are recognised directly in equity so that unrealised gains or losses on assets that are recognised directly in equity affect the measurement of the liability or related deferred acquisition costs in the same way as realised gains or losses. From 31 December 2004, the Group has adopted FRS 27, *Life Assurance,* for liabilities relating to such contracts. FRS 27 adds to the requirements of IFRS but does not vary them in any way, and further details are given in policy A above.

The long-term business provisions are calculated separately for each life operation, based on local regulatory requirements 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 35(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.

Present value of future profits (PVFP) on non-participating business written in a with-profit fund
For 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 either to policyholders or shareholders has not been determined by the end of the financial year are held within liabilities as an unallocated divisible surplus.

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 the 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. Provisions for certain claims are discounted, using rates having regard to the returns generated by the assets supporting the liabilities. Any estimate represents a determination within a range of possible outcomes. Further details of estimation techniques are given in note 35(c).

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 in order that revenue is recognised 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 and additional value in force) 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 within insurance liabilities but are included under "Provisions" in the balance sheet.

(K) 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.

Provisions

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. Liabilities for non-linked non-participating contracts are generally 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.

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.

(L) 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.

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.

Accounting policies continued

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.

(M) 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 associates and joint ventures since that date is included within the carrying value of these investments.

The carrying amount of goodwill for each cash generating unit is reviewed when circumstances or events indicate that there may be uncertainty over its carrying value, and at least annually. Goodwill is 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 15(b).

Under UK GAAP, goodwill previously written off to shareholders' funds is taken back through the profit and loss account when calculating the profit or loss in the event of any subsequent disposal of the underlying investment. There is no requirement for this adjustment under IFRS.

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. In most cases, this is classified as AVIF but, for non-participating investment contracts, it is included within intangibles. If this results from the acquisition of an investment in an associate, the AVIF is held within the carrying amount of that associate. 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.

The full embedded value of the long-term business and further details of the methodology and assumptions are included as supplementary information on pages 200 to 221.

Intangible assets

Intangibles consist primarily of access to distribution networks and customer lists. These are amortised over their useful lives in each case, using the straight-line method. The amortisation charge for the period is included in the income statement under "Other operating expenses".

(N) 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. 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 provision for any impairment in their values.

Land is not depreciated. 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:

– Properties under construction	No depreciation
– Motor vehicles	Three years, or lease term if longer
– Computer equipment	Three to five years
– Other assets	Three to five years

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 are expensed as they are incurred. Repairs and maintenance 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.

(O) 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 within net investment income.

(P) 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.

(Q) 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 Company 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 Company has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) 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.

(R) Financial investments
The Group classifies its investments as either financial assets at fair value through profit or loss (FV) or available for sale financial assets (AFS). The classification depends on the purpose for which the investments were acquired, and is determined by local management at initial recognition. In general, the FV category is used as, in most cases, the Group's strategy is to manage its financial investments on a fair value basis. In certain circumstances, the FV category is used where this eliminates an accounting mismatch. The AFS category is used where the relevant life liability (including shareholders' funds) is passively managed and carried at amortised cost.

The FV category has two sub-categories – 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"). Fixed maturities, purchased loans and equity securities, which the Group buys with the intention to resell in the near term (typically between three and six months), are classified as trading. All other securities in the FV category are classified as other than trading.

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 less transaction costs. 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.

The fair values of investments are 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.

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:

Listed 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. This review takes into account the likelihood of the current market price recovering to former levels.

Unlisted AFS securities: The Group considers the current financial position of the issuer and the future prospects in identifying the requirement for an impairment provision.

For both listed and unlisted AFS securities identified as being impaired, the cumulative unrealised net loss previously recognised within the AFS 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.

(S) 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 potential gain or loss associated with such transactions. These amounts are disclosed in note 51.

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

Accounting policies continued

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 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 where 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 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, both at inception and on an ongoing basis, of whether the hedge is expected to be, and has been, highly effective in offsetting the risk in the hedged item.

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.

(T) 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.

Certain mortgages, which back long-term business, have been classified at fair value through profit or loss in order to match the movement in those liabilities. These loans are revalued to fair value at each period end, with movements in valuation being taken to the income statement.

To the extent that a loan is uncollectible, it is written off as impaired. Subsequent recoveries are credited to the income statement.

(U) 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 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.

(V) 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 with less than 90 days' maturity from the date of acquisition. For the purposes of the cash flow statement, cash and cash equivalents also include bank overdrafts, which are included within payables and other financial liabilities on the balance sheet.

(W) 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 lessees 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.

(X) 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 the future obligation is probable and the amount cannot be reasonably estimated.

(Y) Employee benefits
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 number of defined benefit and defined contribution plans throughout the world, the assets of which are generally held in separate trustee-administered funds. The pension plans are generally funded by payments from employees and by 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. The resulting pension scheme surplus or deficit appears as an asset or obligation in the consolidated balance sheet. The Group has early adopted the December 2004 amendment to IAS 19, *Employee Benefits,* with the result that all actuarial gains and losses 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-retirement obligations
Some Group companies provide post-retirement 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. None of these schemes is material to the Group. The costs of the Dutch and Canadian schemes are included within those for the defined benefit pension schemes in those countries. 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 on pages 65 to 74 and in note 28.

The Group accounts for options and awards under share 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.

(Z) 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.

Accounting policies continued

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.

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 and Australia pay tax on policyholders' investment returns ("policyholder tax") on certain products. Policyholder tax is accounted for as an income tax and is included within 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. Current policyholder tax is tax paid at policyholder tax rates. Deferred policyholder tax is the tax expected to be paid at policyholder tax rates when temporary differences unwind in future periods. In the pro forma reconciliations, operating profit has been calculated after charging policyholder tax.

(AA) Borrowings

Borrowings are recognised initially at their issue proceeds less transaction costs incurred. Subsequently, most borrowings are generally 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 securitised equity release mortgages, the Group has taken advantage of the revised fair value option under IAS39 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 and presentation at fair value provides more relevant information and eliminates any accounting mismatch.

(AB) 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, other than in connection with business combinations, are shown in equity as a deduction, net of tax, from the proceeds. Share issue costs incurred directly in connection with a business combination are included in the cost of acquisition.

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 obtains 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.

(AC) 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.

(AD) 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 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 13.

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.

(AE) Operations held for sale

The requirements of IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations,* have been applied prospectively from 1 January 2005. Assets held for disposal as part of operations which are held for sale are recorded at the lower of their carrying amount and their fair value, less the estimated cost to sell the assets.

Consolidated income statement
For the year ended 31 December 2005

2005 €m		Note	2005 £m	2004 £m
	Income	5		
38,675	Gross written premiums		**26,299**	24,778
(1,937)	Premiums ceded to reinsurers		**(1,317)**	(1,427)
36,738	Premiums written net of reinsurance		**24,982**	23,351
(181)	Net change in provision for unearned premiums		**(123)**	(176)
36,557	Net premiums earned	F	**24,859**	23,175
2,716	Fee and commission income	G&H	**1,847**	1,268
34,886	Net investment income	I	**23,722**	15,733
526	Share of profit after tax of joint ventures and associates	C	**358**	242
225	Profit on the disposal of subsidiaries and associates		**153**	34
74,910			**50,939**	40,452
	Expenses	6		
(28,979)	Claims and benefits paid, net of recoveries from reinsurers		**(19,706)**	(17,799)
(15,259)	Change in insurance liabilities, net of reinsurance		**(10,376)**	(6,104)
(11,491)	Change in investment contract provisions		**(7,814)**	(5,635)
(2,167)	Change in unallocated divisible surplus		**(1,474)**	(1,330)
(6,362)	Fee and commission expense		**(4,326)**	(4,471)
(4,682)	Other expenses		**(3,184)**	(2,566)
(896)	Finance costs		**(609)**	(522)
(69,836)			**(47,489)**	(38,427)
5,074	**Profit before tax**		**3,450**	2,025
(1,356)	Tax attributable to policyholders' returns	12	**(922)**	(383)
3,718	**Profit before tax attributable to shareholders' profits**		**2,528**	1,642
(2,283)	Tax expense	Z & 12	**(1,552)**	(654)
1,356	Less: tax attributable to policyholders' returns	12	**922**	383
(927)	Tax attributable to shareholders' profits		**(630)**	(271)
2,791	**Profit for the year**		**1,898**	1,371
	Attributable to:			
2,598	Equity shareholders of Aviva plc		**1,767**	1,275
193	Minority interests		**131**	96
2,791			**1,898**	1,371
	Earnings per share	AD&13		
108.1c	Basic (pence per share)		**73.5p**	55.8p
107.2c	Diluted (pence per share)		**72.9p**	55.3p

The accounting policies (identified alphabetically) on pages 78 to 86 and notes (identified numerically) on pages 93 to 189 are an integral part of these financial statements.

Pro forma reconciliation of Group operating profit to profit before tax

For the year ended 31 December 2005

2005 €m		Note	2005 £m	2004 £m
	Operating profit before tax attributable to shareholders' profits			
1,566	Long-term business		**1,065**	1,116
135	Fund management		**92**	40
2,281	General insurance and health		**1,551**	1,259
	Other			
(12)	Other operations		**(8)**	(121)
(200)	Corporate costs		**(136)**	(188)
(641)	Unallocated interest charges		**(436)**	(437)
3,129	Operating profit before adjusting items and tax attributable to shareholders' profits		**2,128**	1,669
	Adjusted for the following items			
	Impairment of goodwill	15		
–	– long-term business subsidiaries		**–**	(18)
(63)	– non-long-term business subsidiaries		**(43)**	(23)
	Amortisation and impairment of acquired value of in-force business			
(81)	– long-term business subsidiaries	16	**(55)**	(64)
(26)	– long-term business associates	18	**(18)**	(21)
(66)	Amortisation and impairment of intangibles	16	**(45)**	(7)
–	Financial Services Compensation Scheme and other levies		**–**	(49)
	Short-term fluctuation in return on investments backing			
760	general insurance and health business	8b	**517**	161
225	Profit on the disposal of subsidiaries and associates	3b	**153**	34
(160)	Integration costs	3a(i)	**(109)**	–
–	Exceptional costs for termination of operations	3d	**–**	(40)
3,718	**Profit before tax attributable to shareholders' profits**		**2,528**	1,642
	Tax attributable to shareholders' profits			
(790)	Operating profit	13a(iii)	**(536)**	(319)
(137)	Other activities	13a(iii)	**(94)**	48
(927)			**(630)**	(271)
2,791	**Profit for the year**		**1,898**	1,371

The accounting policies (identified alphabetically) on pages 78 to 86 and notes (identified numerically) on pages 93 to 189 are an integral part of these financial statements.

Operating profit can be further analysed into the following geographical segments:

Year ended 31 December 2005	Long-term business £m	Fund management £m	General insurance and health £m	Total £m
United Kingdom	**384**	**44**	**974**	**1,402**
France	**258**	**26**	**35**	**319**
Netherlands	**168**	**–**	**137**	**305**
Other Europe	**257**	**10**	**218**	**485**
International	**(2)**	**12**	**187**	**197**
	1,065	**92**	**1,551**	**2,708**
Other operations				**(8)**
Corporate costs				**(136)**
Unallocated interest charges				**(436)**
				2,128

Year ended 31 December 2004	Long-term business £m	Fund management £m	General insurance and health £m	Total £m
United Kingdom	353	8	797	1,158
France	213	15	33	261
Netherlands	214	–	88	302
Other Europe	237	10	167	414
International	99	7	174	280
	1,116	40	1,259	2,415
Other operations				(121)
Corporate costs				(188)
Unallocated interest charges				(437)
				1,669

Consolidated balance sheet
As at 31 December 2005

2005 €m		Note	2005 £m	2004 £m
	Assets			
3,296	Goodwill	M & 15	**2,274**	1,184
1,164	Acquired value of in-force business and intangible assets	M & 16	**803**	516
3,086	Investments in joint ventures	C&17	**2,129**	1,255
1,283	Investments in associates	C&18	**885**	873
1,283	Property and equipment	N&19	**885**	812
19,239	Investment property	O&20	**13,275**	11,057
35,571	Loans	T&21	**24,544**	22,055
	Financial investments	Q,R&23		
150,604	Debt securities		**103,917**	98,719
75,426	Equity securities		**52,044**	47,291
38,300	Other investments		**26,427**	20,346
264,330			**182,388**	166,356
10,333	Reinsurance assets	L&36	**7,130**	8,503
1,475	Deferred tax assets	Z&40	**1,018**	908
126	Current tax assets	40a	**87**	–
11,168	Receivables and other financial assets	24	**7,706**	7,509
5,458	Deferred acquisition costs and other assets	U&25	**3,766**	3,189
3,425	Prepayments and accrued income	25d	**2,363**	2,307
19,900	Cash and cash equivalents	V	**13,732**	12,779
670	Assets of operations classified as held for sale	AE&3c	**462**	–
381,807	**Total assets**		**263,447**	239,303
	Equity			
	Capital	AB		
868	Ordinary share capital	27	**599**	570
290	Preference share capital	30	**200**	200
1,158			**799**	770
	Capital reserves			
1,691	Share premium	27	**1,167**	1,115
4,741	Merger reserve	C&3a	**3,271**	2,763
6,432			**4,438**	3,878
–	Shares held by employee trusts	29	**–**	–
1,652	Other reserves	32	**1,140**	736
3,764	Retained earnings	33	**2,597**	1,709
13,006	**Equity attributable to shareholders of Aviva plc**		**8,974**	7,093
1,435	Direct capital instrument	31	**990**	990
1,634	Minority interests	34	**1,128**	910
16,075	**Total equity**		**11,092**	8,993
	Liabilities			
192,177	Gross insurance liabilities	J&35	**132,602**	124,122
112,042	Gross liability for investment contracts	K&37	**77,309**	69,555
13,012	Unallocated divisible surplus	J	**8,978**	7,549
4,546	Net asset value attributable to unitholders	C	**3,137**	2,247
4,167	Provisions	X,Y&41	**2,875**	2,125
3,562	Deferred tax liabilities	Z&40	**2,458**	1,543
1,497	Current tax liabilities	40a	**1,033**	922
15,961	Borrowings	AA&43	**11,013**	10,090
13,746	Payables and other financial liabilities	Q&44	**9,485**	7,240
4,812	Other liabilities	45	**3,320**	4,917
210	Liabilities of operations classified as held for sale	3c	**145**	–
365,732	**Total liabilities**		**252,355**	230,310
381,807	**Total equity and liabilities**		**263,447**	239,303

Approved by the Board on 1 March 2006.

Andrew Moss, Director

The accounting policies (identified alphabetically) on page 78 to 86 and notes (identified numerically) on pages 93 to 189 are an integral part of these financial statements.

Consolidated statement of recognised income and expense
For the year ended 31 December 2005

2005 €m		Note	2005 £m	2004 £m
(76)	Fair value gains/(losses) on AFS securities, owner-occupied properties and hedging instruments	32	**(52)**	3
604	Fair value gains transferred to profit	32	**411**	109
(66)	Impairment losses on revalued assets	32	**(45)**	–
–	Fair value gains/(losses) transferred to retained earnings on disposal of owner-occupied properties	32	**–**	18
3	Share of fair value changes in joint ventures and associates taken to equity	32	**2**	–
(804)	Actuarial (losses) on pension schemes	42	**(547)**	(145)
(3)	Foreign exchange rate movements		**(2)**	59
32	Reserves credit for equity compensation plans	32	**22**	21
4	Aggregate tax effect – policyholder tax	12b	**3**	–
400	Aggregate tax effect – shareholder tax	12b	**272**	(15)
94	Net income recognised directly in equity		**64**	50
2,791	Profit for the year		**1,898**	1,371
2,885	Total recognised income and expense for the year		**1,962**	1,421
	Attributable to:			
2,719	Equity shareholders of Aviva plc		**1,849**	1,323
166	Minority interests		**113**	98
2,885			**1,962**	1,421

Reconciliation of movements in consolidated shareholders' equity
For the year ended 31 December 2005

2005 €m		Note	2005 £m	2004 £m
13,033	**Balance at 1 January**		**8,993**	7,024
2,843	Total recognised income and expense for the year		**1,962**	1,421
(952)	Dividends and appropriations	14	**(657)**	(570)
768	Issue of share capital for the acquisition of RAC plc	3a	**530**	–
86	Other issues of share capital, net of transaction costs	27	**59**	25
145	Shares issued in lieu of dividends	33	**100**	103
–	Issue of direct capital instrument, net of transaction costs of £9 million		**–**	981
307	Capital contributions from minority shareholders		**212**	4
(101)	Minority share of dividends declared in the year		**(70)**	(41)
(52)	Minority interest in (disposed)/acquired subsidiaries		**(36)**	45
–	Movement in shares held by employee trusts	29	**–**	1
(1)	Other movements		**(1)**	–
16,076	**Balance at 31 December**		**11,092**	8,993

The accounting policies (identified alphabetically) on page 78 to 86 and notes (identified numerically) on pages 93 to 189 are an integral part of these financial statements.

Consolidated cash flow statement

For the year ended 31 December 2005

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 2005 £m	Non-long-term business operations 2005 £m	Total 2005 £m	Total 2004 £m
Cash flows from operating activities					
Cash generated from operations	48a	**1,717**	**1,067**	**2,784**	2,050
Tax paid		**(352)**	**(23)**	**(375)**	(195)
Net cash from operating activities		**1,365**	**1,044**	**2,409**	1,855
Cash flows from investing activities					
Acquisitions of subsidiaries, joint ventures and associates, net of cash acquired	48b	**(629)**	**(794)**	**(1,423)**	(540)
Disposals of subsidiaries, joint ventures and associates, net of cash transferred	48c	**50**	**414**	**464**	308
Loans to joint ventures and associates		**(128)**	**–**	**(128)**	–
Purchases of property and equipment		**(26)**	**(180)**	**(206)**	(127)
Proceeds on sale of property and equipment		**41**	**9**	**50**	122
Purchases of intangible assets		**(44)**	**(16)**	**(60)**	(5)
Net cash used in investing activities		**(736)**	**(567)**	**(1,303)**	(242)
Cash flows from financing activities					
Proceeds from issue of ordinary shares, net of transaction costs	27b	**–**	**59**	**59**	3
Proceeds from issue of direct capital instrument, net of transaction costs		**–**	**–**	**–**	981
Net drawdown of borrowings	43c	**150**	**706**	**856**	1,526
Interest paid on borrowings		**(203)**	**(406)**	**(609)**	(522)
Preference dividends paid		**–**	**(17)**	**(17)**	(17)
Ordinary dividends paid		**–**	**(498)**	**(498)**	(450)
Coupon payments on direct capital instrument		**–**	**(42)**	**(42)**	–
Finance lease payments		**–**	**(8)**	**(8)**	(26)
Capital contributions from minority shareholders		**204**	**8**	**212**	4
Dividends paid to minority interests of subsidiaries		**–**	**(70)**	**(70)**	(41)
Non-trading cash flows between operations		**302**	**(302)**	**–**	–
Net cash from financing activities		**453**	**(570)**	**(117)**	1,458
Net increase/(decrease) in cash and cash equivalents		**1,082**	**(93)**	**989**	3,071
Cash and cash equivalents at 1 January	48d	**9,087**	**3,039**	**12,126**	9,023
Effect of exchange rate changes on cash and cash equivalents		**(62)**	**14**	**(48)**	32
Cash and cash equivalents at 31 December	48d	**10,107**	**2,960**	**13,067**	12,126

Of the total cash and cash equivalents shown above, £25 million has been classified as held for sale (see note 3c).

Notes to the consolidated financial statements

1 – First time adoption of International Financial Reporting Standards

(a) The Group has adopted International Financial Reporting Standards (IFRS) for these financial statements for the year ended 31 December 2005. In order to show comparative balances, the year ended 31 December 2004 is also shown under IFRS. The date of transition to IFRS is 1 January 2004.

In general, a company is required to determine its IFRS accounting policies and apply these retrospectively to determine its opening balance sheet under IFRS. However, International Financial Reporting Standard 1, First time adoption of International Financial Reporting Standards, (IFRS 1) allows a number of exemptions to this general principle upon adoption of IFRS. The Group has taken advantage of the following transitional arrangements.

Business combinations

The Group has elected not to apply retrospectively the provisions of IFRS 3, Business Combinations, to business combinations that occurred prior to 1 January 2004. At the date of transition, no adjustment was made between UK GAAP and IFRS for any historical business combination.

Cumulative translation differences

The Group has elected that the cumulative translation differences of foreign operations were deemed to be zero at the transition date to IFRS.

Equity compensation plans

The Group has elected not to apply the provisions of IFRS 2, *Share-based Payment,* to options and awards granted on or before 7 November 2002 which had not vested by 1 January 2005.

Employee benefits

All cumulative actuarial gains and losses on the Group's defined benefit pension schemes have been recognised in equity at the transition date.

Comparatives

The Group has not taken advantage of the exemption within IFRS 1 that allows comparative information presented in the first year of adoption of IFRS not to comply with IAS 32, *Financial Instruments: Disclosure and Presentation,* IAS 39, *Financial Instruments: Recognition and Measurement* and IFRS 4, *Insurance Contracts*.

Estimates

Where estimates had previously been made under UK GAAP, consistent estimates (after adjustments to reflect any difference in accounting policies) have been made for the same date on transition to IFRS (ie judgements affecting the Group's opening balance sheet have not been revisited for the benefit of hindsight).

Held for sale

The requirements of International Financial Reporting Standard 5, *Non-current Assets Held for Sale and Discontinued Operations,* have been applied prospectively from 1 January 2005.

Transitional provisions

The Group has elected to disclose only five years of data in its loss development tables, as permitted by IFRS 4 in the year of adoption of IFRS. This will be increased in each succeeding additional year, until the full ten years of information is included.

Notes to the consolidated financial statements

1 – First time adoption of International Financial Reporting Standards continued

(b) The following tables show the effect of adopting IFRS on the statements that have previously been reported under UK GAAP for the year ending 31 December 2004. They also show the effect of implementing FRS 27, *Life Assurance,* and of changing the methodology for the Group's longer term investment return.

(i) Summarised consolidated balance sheet at date of transition to IFRS – 1 January 2004

	UK GAAP as published £m	Adjustments £m	IFRS £m
Assets			
Goodwill	1,105	40	1,145
Acquired value of in-force business and intangible assets	488	–	488
Investments in joint ventures and associates	1,912	69	1,981
Property and equipment	320	563	883
Investment property	9,106	618	9,724
Financial investments and loans	129,032	40,518	169,550
Assets held to cover linked liabilities	40,665	(40,665)	–
Reinsurance assets	6,883	328	7,211
Tax assets	215	633	848
Other assets	15,955	(3,610)	12,345
Cash and cash equivalents	2,999	6,524	9,523
Total assets	208,680	5,018	213,698
Equity			
Share capital	764	–	764
Capital reserves	3,859	–	3,859
Shares held by employee trusts	(1)	–	(1)
Revaluation and other reserves	–	543	543
Retained earnings	1,932	(877)	1,055
Equity attributable to shareholders of Aviva plc	6,554	(334)	6,220
Minority interests	811	(7)	804
Total equity	7,365	(341)	7,024
Liabilities			
Insurance liabilities	175,304	(62,055)	113,249
Liability for investment contracts	–	57,467	57,467
Unallocated divisible surplus	8,443	1,650	10,093
Net asset value attributable to unitholders	–	1,606	1,606
Provisions	336	1,586	1,922
Tax liabilities	1,276	630	1,906
Borrowings (including subordinated debt)	4,722	3,645	8,367
Other liabilities	11,234	830	12,064
Total liabilities	201,315	5,359	206,674
Total equity and liabilities	208,680	5,018	213,698

1 – First time adoption of International Financial Reporting Standards continued

Analysis of adjustments to the balance sheet at 1 January 2004 as a result of the transition to IFRS

	Investment valuation (note 1) £m	Insurance changes (note 2) £m	Employee benefits (note 3) £m	Goodwill (note 4) £m	Dividend recognition (note 5) £m	Deferred tax (note 6) £m	Borrowings/ cash (note 7) £m	Other items (note 9) £m	Total adjustments £m
Assets									
Goodwill				40					40
Acquired value of in-force business and intangible assets									–
Investments in joint ventures and associates	7							62	69
Property and equipment								563	563
Investment property								618	618
Financial investments and loans	1,854						44	38,620	40,518
Assets held to cover linked liabilities								(40,665)	(40,665)
Reinsurance assets		(134)						462	328
Tax assets						617		16	633
Other assets		(36)	(427)				67	(3,214)	(3,610)
Cash and cash equivalents							3,547	2,977	6,524
Total assets	1,861	(170)	(427)	40	–	617	3,658	(561)	5,018
Equity									
Share capital									–
Capital reserves									–
Revaluation and other reserves	543								543
Retained earnings	(352)	242	(834)	40	344	(351)	(37)	71	(877)
Equity attributable to shareholders of Aviva plc	191	242	(834)	40	344	(351)	(37)	71	(334)
Minority interests								(7)	(7)
Total equity	191	242	(834)	40	344	(351)	(37)	64	(341)
Liabilities									
Insurance liabilities	161	(57,892)	(715)			58		(3,667)	(62, 055)
Liability for investment contracts		57,445						22	57,467
Unallocated divisible surplus	1,509	(79)				(48)		268	1,650
Net asset value attributable to unitholders								1,606	1,606
Provisions			1,475					111	1,586
Tax liabilities		14	(353)			958	(15)	26	630
Borrowings (including subordinated debt)							3,484	161	3,645
Other liabilities		100			(344)		226	848	830
Total liabilities	1,670	(412)	407	–	(344)	968	3,695	(625)	5,359
Total equity and liabilities	1,861	(170)	(427)	40	–	617	3,658	(561)	5,018

Note references are to section (iii) on pages 98 to 102.

Notes to the consolidated financial statements

1 – First time adoption of International Financial Reporting Standards continued

(ii) Summarised consolidated balance sheet at 31 December 2004

	UK GAAP as published £m	Adjustments £m	IFRS £m
Assets			
Goodwill	1,135	49	1,184
Acquired value of in-force business and intangible assets	451	65	516
Investments in joint ventures and associates	2,088	40	2,128
Property and equipment	283	529	812
Investment property	9,407	1,650	11,057
Financial investments and loans	140,763	47,648	188,411
Assets held to cover linked liabilities	51,144	(51,144)	–
Reinsurance assets	7,540	963	8,503
Tax assets	63	845	908
Other assets	16,275	(3,270)	13,005
Cash and cash equivalents	3,121	9,658	12,779
Total assets	232,270	7,033	239,303
Equity			
Share Capital	1,760	–	1,760
Capital reserves	3,878	–	3,878
Revaluation and other reserves	–	736	736
Retained earnings	2,682	(973)	1,709
Equity attributable to shareholders of Aviva plc	8,320	(237)	8,083
Minority interests	924	(14)	910
Total equity	9,244	(251)	8,993
Liabilities			
Insurance liabilities	195,591	(71,469)	124,122
Liability for investment contracts	–	69,555	69,555
Unallocated divisible surplus	9,218	(1,669)	7,549
Net asset value attributable to unitholders	–	2,247	2,247
Provisions	340	1,785	2,125
Tax liabilities	1,617	848	2,465
Borrowings (including subordinated debt)	4,560	5,530	10,090
Other liabilities	11,700	457	12,157
Total liabilities	223,026	7,284	230,310
Total equity and liabilities	232,270	7,033	239,303

1 – First time adoption of International Financial Reporting Standards continued
Analysis of adjustments to the balance sheet at 31 December 2004 as a result of the transition to IFRS

	Investment valuation (note 1) £m	Insurance changes (note 2) £m	Employee benefits (note 3) £m	Goodwill (note 4) £m	Dividend recognition (note 5) £m	Deferred tax (note 6) £m	Borrowings/ cash (note 7) £m	FRS 27 (note 8) £m	Other items (note 9) £m	Total £m
Assets										
Goodwill				49					–	49
Acquired value of in-force business and intangible assets				65					–	65
Investments in joint ventures and associates	8			15					17	40
Property and equipment									529	529
Investment property									1,650	1,650
Financial investments and loans	2,599						(3,598)		48,647	47,648
Assets held to cover linked liabilities									(51,144)	(51,144)
Reinsurance assets		(108)						417	654	963
Tax assets						845			–	845
Other assets		(19)	(475)					(13)	(2,763)	(3,270)
Cash and cash equivalents							8,792		866	9,658
Total assets	2,607	(127)	(475)	129	–	845	5,194	404	(1,544)	7,033
Equity										
Share capital									–	–
Capital reserves									–	–
Revaluation and other reserves	736								–	736
Retained earnings	(452)	166	(909)	129	364	(322)	(26)	–	77	(973)
Equity attributable to shareholders of Aviva plc	284	166	(909)	129	364	(322)	(26)		77	(237)
Minority interests									(14)	(14)
Total equity	284	166	(909)	129	364	(322)	(26)		63	(251)
Liabilities										
Insurance liabilities	250	(69,797)	(813)			28		4,226	(5,363)	(71,469)
Liability for investment contracts		69,555								69,555
Unallocated divisible surplus	2,073	(165)				(62)	17	(3,822)	290	(1,669)
Net asset value attributable to unitholders									2,247	2,247
Provisions			1,643						142	1,785
Tax liabilities			(396)			1,201	(4)		47	848
Borrowings (including subordinated debt)							5,207		323	5,530
Other liabilities		114			(364)				707	457
Total liabilities	2,323	(293)	434	–	(364)	1,167	5,220	404	(1,607)	7,284
Total equity and liabilities	2,607	(127)	(475)	129	–	845	5,194	404	(1,544)	7,033

Note references are to section (iii) on page 98 to 102.

Notes to the consolidated financial statements

1 – First time adoption of International Financial Reporting Standards continued

(iii) Notes to the analysis of adjustments to the balance sheets as at 1 January and 31 December 2004 as a result of the transition to IFRS

The UK GAAP balance sheet has been presented in a format consistent with IFRS. The only significant change in heading is that the Fund for Future Appropriations is now renamed the Unallocated Divisible Surplus.

The basis for the material adjustments between UK GAAP and IFRS is as follows:

(1) Investment valuation

The adjustments in respect of investment valuation arise from the following:

	1 January 2004 £m	31 December 2004 £m
Increase in valuation of debt securities	1,718	2,459
Change in valuation of certain mortgages	113	119
Other sundry adjustments	23	21
	1,854	2,599

The principal changes are discussed further below:

a) Debt securities Under UK GAAP, equity securities and unit trusts are carried at current value. Debt and other fixed income securities are carried at current value, with the exception of many non-linked long-term business debt securities and fixed income securities, which are carried at amortised cost.

As a result of applying IAS 39, the Group now carries all investments in debt and equity securities at fair value. The change in valuation of debt securities from amortised cost to fair value increases the valuation of investments by £1,718 million at 1 January 2004 and £2,459 million at 31 December 2004. This change in the valuation of debt securities is largely offset by corresponding movements in the unallocated divisible surplus and technical liabilities. The net impact on shareholders' funds at 1 January 2004 and 31 December 2004 is to increase them by £191 million and £284 million respectively.

b) Commercial mortgages backing certain annuity business Under IFRS, the Group has chosen to move certain of its commercial mortgage portfolio to an active fair valuation basis in accordance with IAS39, which has increased the value of investments by £113 million at 1 January 2004 and £119 million at 31 December 2004. The annuity liabilities which are backed by these assets have been correspondingly revalued, with the result that there is an insignificant impact on shareholders' funds at either date.

c) Revaluation reserve Under IFRS, certain investment gains are recorded as a separate component of shareholders' equity, whereas under UK GAAP they would be included in retained earnings.

Separate revaluation reserves are created for:

– Changes in the fair value of securities classified as available for sale;

– Changes in the value of owner-occupied property;

– Exchange differences arising from the translation of the net investment in foreign subsidiaries, associates and joint ventures and from borrowings designated as hedges of such items; and

– Changes in the fair value of derivatives that are designated and qualify as cash flow hedges.

The amounts included in the above reserves are, where appropriate, net of deferred tax and impairment losses.

The above requirements have resulted in transfers from retained earnings into separate revaluation reserves of £543 million and £736 million at 1 January 2004 and 31 December 2004 respectively.

(2) Insurance changes

The impact on shareholders' funds of insurance changes is as follows:

	1 January 2004 £m	31 December 2004 £m
Derecognition of claims equalisation provision	364	388
Change in the value of reinsurance treaties	(48)	(34)
Application of an active liability valuation basis in the Netherlands	(7)	(52)
Change in value of non-participating investment contracts and other sundry items	(67)	(136)
	242	166

The principal changes to the Group's insurance accounting upon transition to IFRS are discussed further below.

1 – First time adoption of International Financial Reporting Standards continued

a) Product classification IFRS 4, *Insurance Contracts,* requires all products issued to be classified for accounting purposes as either insurance or investment contracts, depending on whether significant insurance risk exists. In the case of a life contract, insurance risk exists if the amount payable on death differs from the amount payable if the policyholder survives. The Group has deemed insurance risk to be significant if the difference exceeds 5% of the policy value, although the classification would be similar if a 10% test had been used.

Following a detailed review, 61% of life policy reserves on an modified statutory solvency basis (MSSB) at 31 December 2003 *(31 December 2004: 59%)* have been classified as insurance and 24% (at both dates) have been classified as participating investment contracts (being those investment contracts containing a discretionary participating feature as defined within IFRS 4). Both classes will continue to be accounted for under the Group's existing accounting policies. The remaining 15% *(31 December 2004: 17%)* have been classified as non-participating investment contracts and therefore are required to be accounted for under IAS 39 and IAS 18, *Revenue*. Virtually all our general insurance products are classified as insurance.

This product classification change has led to technical provisions being allocated between insurance and investment contracts. This has resulted in £57,445 million and £69,555 million of liabilities at 1 January 2004 and 31 December 2004 respectively being classified as investment contracts.

b) Equalisation provision An equalisation provision is recorded in the balance sheets of individual general insurance companies in the United Kingdom and in a limited number of other countries, to eliminate or reduce the volatility in incurred claims arising from exceptional levels of claims in certain classes of business. The provision is required by law even though no actual liability exists at the balance sheet date and is included in the UK GAAP consolidated balance sheet. The annual change in the equalisation provision is recorded in the UK GAAP profit and loss account. Under IFRS, no equalisation provision is recorded, as no actual liability exists at the balance sheet date. There are increases of £364 million and £388 million in shareholders' funds at 1 January 2004 and 31 December 2004 respectively as a result of the removal of this provision.

c) Reinsurance treaties Following a full review of all our reinsurance contracts, a small number of the Group's long-term reinsurance treaties have been revalued under IFRS, leading to reductions in the value of reinsurance assets of £134 million and £108 million at 1 January 2004 and 31 December 2004 respectively. The majority of these changes relate to participating contracts and so these value changes principally affect the unallocated divisible surplus rather than shareholders' funds.

d) Application of an active liability valuation basis in the Netherlands The conversion to IFRS has been a particular issue in the Dutch industry where, traditionally, both bond investments and associated insurance liabilities have been held at amortised cost. IAS 39 requires bonds to be held at fair value and hence, to prevent an equity mis-match, the Group has chosen to move to a more active liability valuation basis for its insurance liabilities within the Netherlands. As a result of this change, gross liabilities increased by £41 million and £213 million at 1 January 2004 and 31 December 2004 respectively.

Having applied an active basis for valuing liabilities on a traditional gross and individual savings business, the amounts representing undistributed gains on investments backing these products which were previously booked to the fund for future appropriations under UK GAAP of £34 million at 1 January 2004 and £161 million at 31 December 2004 have been released to equity.

e) Non-participating investment contracts and other sundry items The liability for those contracts classified as non-participating investment contracts is valued in accordance with IAS 39. The majority of the Group's contracts classified as non-participating investment contracts are unit-linked contracts and have been valued at fair value. For unit-linked contracts, the fair value liability is deemed to equal the current unit fund value, plus positive non-unit reserves if required on a fair value basis. This replaces the reserve held under UK GAAP which equals the unit fund value plus any positive or negative non-unit reserves determined on the local valuation basis, and which differs from that required on a fair value basis.

In addition to the change in liability valuation, the accounting for deferred acquisition costs has been revised in accordance with IAS 18. This restricts the types of acquisition costs that can be deferred, leading to a reduction in deferred acquisition costs as compared to UK GAAP.

The net impact on shareholders' funds of the above changes and of other sundry items is a reduction of £67 million at 1 January 2004 and of £136 million at 31 December 2004.

In addition to the above, IFRS now requires that any front end fees received on non-participating investment contracts are included within an explicit deferred income reserve within creditors. Under UK GAAP, any deferred acquisition cost asset created would have been net of these fees. This has led to increases in "Other assets" and "Other liabilities" of £100 million and £114 million at 1 January 2004 and 31 December 2004 respectively.

Notes to the consolidated financial statements continued

1 – First time adoption of International Financial Reporting Standards continued

(3) Employee benefits

a) Pensions Under the Group's UK GAAP pension policy, as set out in Statement of Standard Accounting Practice 24, *Accounting for Pension Costs* (SSAP 24), the cost of providing pension benefits is expensed using actuarial valuation methods which give a substantially even charge over the expected service lives of employees, and results in either a prepayment or an accrual to the extent that this charge does not equate to the cash contributions made into the schemes. Under IAS 19, *Employee Benefits*, the projected benefit obligation is matched against the fair value of the underlying assets and other unrecognised actuarial gains and losses in determining the pension expense for the year. Any pension asset or obligation must be recorded in the balance sheet. Aviva has not applied the "corridor approach" to valuing pension deficits.

This change in accounting has resulted in the removal of the Group's SSAP 24 balances, a net debtor of £251 million after allowing for deferred tax, at 1 January 2004 *(31 December 2004: £279 million)* and the recognition of a deficit of £583 million *(31 December 2004: £630 million)*, net of deferred tax, valued in accordance with IAS 19. This gives an overall impact on shareholders' funds of £834 million at 1 January 2004 and £909 million at 31 December 2004.

The Group has assumed that substantially all of the pension deficit will fall to be borne by the shareholders. This is particularly relevant to the UK pension scheme deficit, which forms the majority of the deficit recognised by the Group. Costs, including pension costs, are charged to the UK Life companies and with-profit funds on the basis of a pre-determined Management Services Agreement (MSA). As reported at the time of the conversion to EEV, where similar assumptions have been made in connection with deficit funding, under the MSA, NU Life Services Limited can renegotiate the terms relating to the recharging of the costs to the UK with-profit fund in 2008, subject to regulatory approval. In evaluating the impact on IFRS, Aviva has not sought to pre-empt the outcome of this renegotiation. Any changes to the recharges in respect of the pension deficit will be credited to equity in the period agreement is obtained.

In some countries, the pension schemes have invested in the Group's long-term business funds. IAS 19 requires the liquidity of the schemes' assets to be considered and, if these are deemed non-transferable, the presentation of the total obligation to the schemes must include these amounts. Accordingly, insurance liabilities have been reduced by £715 million at 1 January 2004 *(£813 million at 31 December 2004)* and provisions increased by the same amounts, to reflect this disclosure. There is no impact on equity or income arising from this presentation.

There are a number of adjustments impacting the Group's "Provisions" line. However, the most significant adjustment relates to the recognition of the pension obligations as shown in the table below:

	1 January 2004 £m	31 December 2004 £m
Provisions as stated under UK GAAP	336	340
Less: SSAP 24 pension obligation	(78)	(63)
Deficit in the staff pension schemes	838	893
Other obligations to staff pension schemes – insurance policies issued by Group companies	715	813
Total IAS 19 obligations to staff pension schemes	1,553	1,706
Adjustments to other provisions arising under IFRS	111	142
Provisions as stated under IFRS	1,922	2,125

b) Equity compensation plans Under UK GAAP, the costs of awards to employees under equity compensation plans, other than the Save As You Earn plans, are recognised immediately if they are not conditional on performance criteria. If the award is conditional upon future performance criteria, the cost is recognised over the period to which the employee's service relates. The minimum cost for the award is the difference between the fair value of the shares at the date of grant less any contribution required from employee or exercise price. The cost is based on a reasonable expectation of the extent that the performance criteria will be met. Any subsequent changes in that expectation are reflected in the income statement as necessary.

Under IFRS 2, *Share-based Payment,* compensation costs for equity compensation plans that were granted after 7 November 2002, but had not yet vested at 1 January 2005, are determined based on the fair value of the share-based compensation at grant date, which is recognised in the income statement over the period of the expected life of the share-based instrument.

This change in accounting has not resulted in any material changes to the balance sheets at 1 January 2004 or 31 December 2004.

1 – First time adoption of International Financial Reporting Standards continued

(4) Goodwill and intangibles

Under UK GAAP, goodwill arising before 1 January 1998 was eliminated against shareholders' funds and was not subsequently reinstated. Goodwill previously written off to shareholders' funds is taken back through the profit and loss account when calculating the profit or loss in the event of any subsequent disposal of the underlying investment. Under UK GAAP for acquisitions subsequent to 1997, goodwill arising on acquisition is carried on the balance sheet and amortised in the consolidated profit and loss account on a straight-line basis over its useful economic life, not exceeding 20 years.

Under IAS 36, *Impairment of Assets,* goodwill is no longer amortised but is tested for impairment at least annually. Any goodwill previously amortised prior to the date of transition (1 January 2004) or, for goodwill arising before 1 January 1998, eliminated against shareholders' funds has not been reinstated. Amortisation charged in 2004 under UK GAAP is not charged to profit under IFRS to the extent that it does not relate to an impairment, and hence shareholders' funds increase upon conversion to IFRS. In addition, negative goodwill of £40 million at 1 January 2004 and £37 million at 31 December 2004, previously recognised under UK GAAP, is included directly in retained earnings.

IFRS 3, *Business combinations,* requires that intangible assets such as customer lists, which can be separately identified and valued, must be recognised separately in the balance sheet. The Group has applied IFRS 3 to acquisitions since 1 January 2004, which has resulted in £65 million of goodwill being reclassified as intangibles upon conversion to IFRS.

(5) Dividend recognition

Under UK GAAP, dividends are accrued in the period to which they relate, regardless of when they are declared and approved. Under IAS 10, *Events after the Balance Sheet Date,* shareholders' dividends are accrued only when declared and appropriately approved. This has increased shareholders' funds by £344 million at 1 January 2004 and £364 million at 31 December 2004.

(6) Deferred tax

Under UK GAAP, provision is made for deferred tax assets and liabilities, using the liability method, arising from timing differences between the recognition of gains and losses in the financial statements and their recognition in a tax computation. No provision is made for tax that might arise on undistributed earnings of subsidiaries unless a binding arrangement for distribution exists. Deferred tax is recognised as a liability or asset if the transactions or events that give the entity an obligation to pay more tax in future or a right to pay less tax in future have occurred by the balance sheet date. The Group policy is to discount its deferred tax balances.

Under IAS 12, *Income tax,* deferred tax is provided under the liability method for all relevant temporary differences, being the difference between the carrying amount of an asset or liability in the balance sheet and its value for tax purposes. IAS 12 does not require all temporary differences to be provided for. In particular, the Group does not provide for deferred tax on undistributed earnings of subsidiaries where the Group is able to control the timing of the distribution and the temporary difference created is not expected to reverse in the foreseeable future. Deferred tax assets are recognised for unused tax losses and other deductible temporary differences to the extent that it is probable that future taxable profit will be utilised against the unused tax losses and credits. Discounting is prohibited under IAS 12.

The changes to deferred tax arise from the removal of discounting, changes to the valuation of the Group's assets and liabilities under IFRS and presentational changes to disclosure of tax assets and liabilities. The main net increases in deferred tax that reduce shareholders' funds are:

	1 January 2004 £m	31 December 2004 £m
Reversal of discounting (the total discounting applied to UK GAAP deferred tax liabilities at 1 January 2004 was £151 million *(31 December 2004: £277 million)*, of which £110 million *(31 December 2004: £215 million)* relates to non-life and shareholders' interests)	110	215
Deferred tax impact of the removal of the equalisation provision	108	117
Deferred tax impact of other changes to technical provisions, valuation of investments and other sundry adjustments	133	(10)
Net decrease to shareholders' funds	351	322

Notes to the consolidated financial statements continued

1 – First time adoption of International Financial Reporting Standards continued

(7) Borrowings and cash

IFRS requires a number of presentational changes to borrowings and cash. The most significant change is that the linked presentation can no longer be adopted for the Group's borrowing securitised on certain of its mortgage portfolios. This increases borrowings and investments by £3,143 million at 1 January 2004 and £5,110 million at 31 December 2004. The equity impact of £37 million at 1 January 2004 and £26 million at 31 December 2004 relates to the application of the fair value option to the mortgages of the UK equity release business, the loan notes which are securitised upon them and backing derivatives, which more appropriately reflects the commercial substance of this business. This has increased borrowings by £90 million at 1 January 2004 and £97 million at 31 December 2004. Additionally, £3,307 million of the Group's investments at 1 January 2004 *(31 December 2004: £8,792 million)* meet the definition of cash equivalents and so have been reclassified to this heading in the consolidated balance sheets.

(8) FRS 27 Life Assurance

In December 2004, the UK's Accounting Standards Board (ASB) issued Financial Reporting Standard 27, *Life Assurance* (FRS 27). In accordance with the Memorandum of Understanding (MoU) signed by the Group along with other major insurance companies, the Association of British Insurers (ABI) and the ASB, the Group has adopted FRS 27 in its 2004 IFRS balance sheet. FRS 27 requires insurance companies to measure their liabilities on with-profit business, on a "realistic basis" (ie the FSA's definition of a "realistic" valuation). The use of the "realistic" basis to measure liabilities for with-profit business does not impact reported profits, as an offsetting adjustment is made to the unallocated divisible surplus.

(9) Other items

The other changes that arise as a result of the transition to IFRS are principally reclassifications and presentational changes. The total effect of the other changes to shareholders' funds is £71 million at 1 January 2004 and £77 million at 31 December 2004.

(i) Assets held to cover linked liabilities of £40,665 million at 1 January 2004 and £51,144 million at 31 December 2004 are no longer disclosed in a single line but have been reported in the various asset classifications. Of this amount, assets of £3,343 million at 1 January 2004 and £4,965 million at 31 December 2004 have been netted off technical liabilities, reducing the gross assets and investment contract liabilities of the Group. There is no impact on profit or shareholders' funds as a result of this change.

(ii) The assets and liabilities of the banking business are no longer disclosed entirely in "other debtors" and "other creditors" but have been reported in the appropriate balance sheet classifications.

(iii) Owner-occupied properties have been reclassified from "investment property" to property and equipment. We continue to hold these properties at fair value.

(iv) Mutual funds have been consolidated where these vehicles meet the definition of a subsidiary. This has resulted in an increase in gross assets of £1,606 million at 1 January 2004 and £2,247 million at 31 December 2004, representing the part of the funds owned by third parties. This third party interest is recorded in the line "net assets attributable to unitholders" within liabilities. The consolidation of mutual funds has no impact on shareholders' funds or profit after tax.

1 – First time adoption of International Financial Reporting Standards continued

(iv) Summarised consolidated pro forma operating profit statement for the year ended 31 December 2004

	UK GAAP £m	IFRS changes £m	Restated for IFRS changes £m	LTIR (note 6) £m	Restated for IFRS and LTIR changes £m
Net premiums written (excluding associates)					
Life premiums	19,899	(6,357)[1]	13,542	–	13,542
General insurance and health	9,809	–	9,809	–	9,809
	29,708	**(6,357)**	**23,351**	**–**	**23,351**
Operating profit					
Long-term business	1,185	(69)	1,116	–	1,116
Fund management	43	(3)	40	–	40
General insurance and health business	1,384	(28)	1,356	(97)	1,259
Non-insurance operations	(108)	(13)	(121)	–	(121)
Corporate costs	(178)	(10)	(188)	–	(188)
Unallocated interest charges	(465)	–	(465)	–	(465)
Unallocated income	–	28	28	–	28
Operating profit before tax attributable to shareholders' profits	**1,861**	**(95)**	**1,766**	**(97)**	**1,669**
Amortisation/impairment of goodwill	(120)	79	(41)	–	(41)
Amortisation of acquired additional value of in-force long-term business and intangibles	(126)	34	(92)	–	(92)
Financial Services Compensation Scheme and other levies	(49)	–	(49)	–	(49)
Short-term fluctuation in return on investments	131	(67)	64	97	161
Change in the equalisation provision	(23)	23	–	–	–
Net loss on the disposal of subsidiaries and associates	(136)	170	34	–	34
Exceptional costs for termination of operations	(50)	10	(40)	–	(40)
Profit before tax attributable to shareholders' profits	**1,488**	**154**	**1,642**	**–**	**1,642**
Tax attributable to shareholders' profits	(355)	84	(271)	–	(271)
Profit for the year	**1,133**	**238**	**1,371**	**–**	**1,371**
Attributable to:					
Equity shareholders of Aviva plc	1,057	218	1,275	–	1,275
Minority interests	76	20	96	–	96
Earnings per share based on operating profit after tax attributable to ordinary shareholders	57.2p		56.9p		53.9p
Earnings per share based on profit after tax attributable to ordinary shareholders	45.8p		55.5p		55.5p
Dividend cover[2]	2.25 times		2.23 times		2.11 times

Note references are to section (v) on pages 104 to 106.

1. Represents the application of deposit accounting for those contracts classified as non-participating investment contracts.

2. Calculated as operating profit net of tax, minorities and preference dividend over interim and final ordinary dividends declared in respect of the financial year.

Notes to the consolidated financial statements continued

1 – First time adoption of International Financial Reporting Standards continued

Analysis of IFRS adjustments to the pro forma operating profit statement for the year ended 31 December 2004 as a result of the transition to IFRS

	Investment valuation (note 1) £m	Insurance changes (note 2) £m	Employee benefits (note 3) £m	Goodwill (note 4) £m	Policyholder tax (note 5) £m	Other items £m	Total adjustments £m
Operating profit							
Long-term business	111	(77)	(27)		(93)	17	(69)
Fund management			(3)				(3)
General insurance and health business		5	(33)				(28)
Non-insurance operations			(3)			(10)	(13)
Corporate costs			(10)				(10)
Unallocated interest charges							–
Unallocated income			28				28
Operating profit before tax attributable to shareholders	111	(72)	(48)	–	(93)	7	(95)
Amortisation/impairment of goodwill				79			79
Amortisation of AVIF and intangibles					37	(3)	34
Financial Services Compensation Scheme and other levies							–
Short-term investment fluctuation	(67)						(67)
Change in equalisation provision		23					23
Net loss on the disposal of subsidiaries and associates				169		1	170
Exceptional costs for termination of operations						10	10
Profit before tax attributable to shareholders' profits	44	(49)	(48)	248	(56)	15	154
Tax attributable to shareholders' profits	–	(7)	15	–	56	20	84
Profit for the year	44	(56)	(33)	248	–	35	238

Note references are to section (v) on pages 104 to 106.

(v) Notes to the Analysis of adjustments to the pro forma operating profit statement for the year ended 31 December 2004 as a result of the transition to IFRS

(1) Investment valuation

The main investment valuation change upon conversion to IFRS is that assets, which are not classified as being held to maturity, are required to be held at fair value. Under UK GAAP, certain of the Group's bonds were held at amortised cost. This change in valuation of debt securities resulted in a £2,459 million increase in the valuation of securities at 31 December 2004. Most of this change was offset by corresponding movements in the unallocated divisible surplus and technical liabilities. However, there was a residual uplift which resulted in a positive increase in the Group's shareholders' funds, and the year-on-year movement in respect of those investments classified as "at fair value through profit and loss account" is reported as an increased profit in the 2004 income statement.

In addition, changes to investment accounting have resulted in £67 million of investment gains being reclassified from short-term fluctuations to the life operating profit.

(2) Insurance changes

Insurance changes consist of:

– The removal of the claims equalisation provision, improving profit before tax by £23 million but with no impact on operating profit;

– The revaluation of liabilities and deferred acquisition costs on those contracts classified as non-participating investment contracts, reducing operating profit by £91 million;

– The revaluation of certain life reinsurance treaties, increasing operating profit by £14 million;

– Other sundry changes to our general insurance business reserves, increasing operating profit in 2004 by £5 million.

Of these changes, the most significant impact occurs on our UK Life business, where profit falls by £90 million as a result of the adoption of IAS 39. On the basis of 2004 gross written premiums, 44% of our total life business within the UK is classified as non-participating investment contracts and includes unit-linked bonds and unit-linked pension contracts. IAS 39 reduces the level of deferred acquisition costs that can be recognised, as well as requiring the removal from technical provisions of positive or negative non-unit reserves determined on the local valuation basis held over and above the unit fund value. The effect of these changes is that the profits on a non-participating investment contract will arise later in the contract term under IFRS than under UK GAAP.

1 – First time adoption of International Financial Reporting Standards continued

The overall impact on annual profits arising from this accounting change is dependent upon levels of new business, product mixes, the ageing profile of the existing in-force business and reserving policies. Additional new business strain under IFRS would be expected to be mitigated by the emergence of higher IFRS basis profits of the in-force book of business. Until mid-2003, unit-linked bond business sold by Norwich Union in the UK contained a guaranteed minimum death benefit, and hence contained significant insurance risk, and accordingly, as permitted by IFRS Phase 1, the UK GAAP basis profit profile has been retained. After mid-2003, this benefit was removed and business written since this time has been classified as non-participating investment business. The existing in-force business is therefore small and profits are insufficient to offset the new business strain. A significant conversion effect on profit therefore arises.

This reduction in profit is no more than a timing adjustment. Aviva's main value measure remains European embedded value and the profit arising on this basis is unaffected by this technical accounting change.

(3) Employee benefits

The overall impact of adopting IAS 19, *Employee benefits,* and IFRS 2, *Share based compensation,* has been to increase costs by *£48 million in 2004.* This partly reflects the fact that IAS 19 has used a more current actuarial valuation to measure the ongoing pension service cost. The charge under UK GAAP was based on the SSAP 24 valuation which, as disclosed in the 2004 Annual Report and Accounts, was last updated for financial reporting purposes in April 2002.

(4) Goodwill

Goodwill is no longer amortised under IFRS but is subject to annual impairment review. Impairment charges of £41 million were incurred in 2004, relating to sundry small overseas businesses, which had been fully reflected within the UK GAAP amortisation charge of £120 million. No additional impairment arose as a result of the transition to IFRS.

A further £169 million credit arises to profit before tax, as goodwill previously charged directly to reserves was deducted from profit upon disposal of subsidiaries under UK GAAP. Under IFRS no such deduction is required. This change has no impact on operating profit or shareholders' funds.

(5) Policyholder tax

Operating profit before tax has fallen relative to the UK GAAP result by £93 million as a result of a change in the allocation of the tax charged to the life funds between policyholders and shareholders. This presentational change has no impact on operating profit after tax or the tax suffered by the life funds but merely represents how the tax charge is presented in the financial statements. The increase in tax costs charged to operating profit arises principally in the UK, but has been partly offset by a change in allocation in the Netherlands, where all tax is now deemed to be shareholder tax.

It is a feature of the UK tax regime that the tax attributable to life business operations is a single charge in respect of policyholder income and shareholder profits. Under UK GAAP, the difficulty of allocating this charge between policyholders and shareholders is generally acknowledged and hence, under UK GAAP, the total tax charge is deducted from life operating profit in the long-term technical account, the net result of which is then grossed up at the effective shareholder tax rate. Traditionally, Aviva has grossed up at 30% which represents its view of the long-term effective rate. We remain of the view that this will be the rate suffered by shareholders over the longer term.

Under IFRS, all taxation must be reported within the taxation line. The profit before this total tax would present a misleading picture of the Group's profit as (i) much of the policyholder tax is in the with-profits funds where the unallocated divisible surplus is adjusted on a net of tax basis; (ii) the cost of policyholder tax is priced into the relevant products; and (iii) the level of tax will vary on an annual basis in line with the investment return on assets backing the long-term funds.

The UK industry has therefore agreed that it is appropriate to adopt an income statement presentation which depicts profit before tax attributable to the shareholders. This requires an allocation of the total tax charge between policyholders and shareholders, with the policyholder charge being offset against operating profit. There is no universal view on how this allocation should be performed. Aviva has taken the view that the IFRS conceptual framework does not permit companies to use notional allocation or gross-up methods. Instead, the allocation to policyholder tax should reflect the actual tax payable at policyholder rates, including deferred tax. Aviva has therefore developed a conceptual methodology to achieve this consistently year-on-year.

In 2004, the level of tax attributed to the shareholders was reduced by the following arrangement. The £1.5 billion of capital injected into the life funds on the demutualisation of Norwich Union in 1997 had the effect that future distributions up to that amount by Norwich Union Life and Pensions are treated as already having suffered some shareholder tax. In 2004, a substantial proportion of the company's shareholders' surplus was sheltered by this arrangement and this has the impact of lowering the actual tax paid at shareholder rates. This is a genuine benefit to shareholders and resulted in higher profit after tax. This tax benefit has a finite capacity and will at some point be exhausted, such that over the long-term there will be an increase in shareholder tax rates back towards 30%. The use of this capacity is dependent on the level of distributions made by Norwich Union Life & Pensions.

The impact of this is that operating profit before tax falls relative to the UK GAAP result, as the actual shareholder rate suffered in the UK in 2004 was lower than 30%.

It should be noted that, from an EEV perspective, an asset representing this tax benefit is already established and so 30% remains as an appropriate shareholder tax rate for this business.

Notes to the consolidated financial statements continued

1 – First time adoption of International Financial Reporting Standards continued

(6) Longer-term investment return

The Group has chosen to revisit its longer-term investment return (LTIR) methodology from 2005 as part of a discretionary change not required by IFRS. In order to provide suitable trend analysis, the 2004 comparatives are presented in accordance with this new methodology. The key changes are as follows:

– For properties and equity, we have applied lower start of year long-term rates of investment return consistent with those adopted for reporting life operating returns under EEV principles. This would have reduced operating profit in 2004 by £25 million;

– For fixed income securities, we have included the amortisation of the premium or discount arising upon acquisition of a bond within our LTIR calculation. This would have reduced operating profit before tax by £72 million in 2004;

– The LTIR is only being applied to general insurance and health business.

These changes have no effect on profit before tax.

(vi) Reconciliation of the cash flows reported under UK GAAP to cash flows reported under IFRS

Under UK GAAP, as amended by the ABI SORP for insurance companies, the consolidated statement of cash flows presents only the cash flows of general insurance business and shareholders' funds. Cash flows of the long-term business, other than amounts transferred to shareholders, are not included in this statement. IAS 7, *Cash Flow Statements,* requires the cash flow statement to include cash flows from all activities of the Group, including the reconciliation of cash flows from operating activities to profit or loss reported in the income statement. Other differences arise between the UK cash flow statements and IFRS, mainly due to reclassification of items under IFRS.

For the year ended 31 December 2004, the only material differences between the cash flow statements prepared under the two bases were the inclusion of cash flows from the Group's long-term businesses and from newly-consolidated securitisation vehicles and investment vehicles, together with changes arising from the different definitions of cash and cash equivalents under these bases.

2 – Exchange rates

The Group's principal overseas operations are located within the Eurozone. The results and cash flows of these operations have been translated into sterling at an average rate for the year of 1 euro = £0.68 *(2004: 1 euro = £0.68)* and their assets and liabilities have been translated at the year-end rate of 1 euro = £0.69 *(2004: 1 euro = £0.71)*.

Total foreign currency movements during 2005 resulted in a loss recognised in the income statement of £203 million *(2004: £31 million gain)*.

3 – Subsidiaries

(a) Acquisitions

(i) RAC plc

On 4 May 2005, the Group acquired 100% of the share capital of RAC plc. The results of RAC plc's operations have been included in the consolidated financial statements of the Group with effect from 4 May 2005, and contributed £15 million to the consolidated profit before tax.

	£m
Purchase cost	
Cash paid	566
Fair value of 88 million shares issued, based on their published price at date of exchange (average of £6.03 per share)	530
Costs attributable	17
Total	1,113

The issue of new shares in the Company in exchange for shares in RAC plc has attracted merger relief under section 131 of the Companies Act 1985. Of the £530 million above, £22 million has been credited to share capital (see note 27(b)) and £508 million has been credited to the merger reserve, increasing that reserve from £2,763 million to £3,271 million.

3 – Subsidiaries continued

The assets and liabilities at the date of acquisition were:

	Book value £m	Revaluation of Intangibles £m	Pension scheme valuation £m	Fair value and accounting policy adjustments £m	Fair value £m
Assets					
Intangible assets	59	333	–	–	392
Tax assets	58	–	–	(58)	–
Other assets	608	–	–	38	646
Total assets	725	333	–	(20)	1,038
Liabilities					
Provisions					
Pension deficit	(257)	–	(56)	–	(313)
Other	(8)	–	–	(14)	(22)
Tax liabilities	–	(118)	17	83	(18)
Other liabilities	(708)	–	–	(3)	(711)
Total liabilities	(973)	(118)	(39)	66	(1,064)
Net assets acquired	(248)	215	(39)	46	(26)
Goodwill (including £118 million arising from the creation of the deferred tax liability on intangibles)					1,139
Intangible assets					392
Total goodwill and intangible assets					1,531
Less: deferred tax liability					(118)
Total value of goodwill and intangible assets net of associated tax included on balance sheet					1,413

Separable intangible assets have been identified and valued by an independent third party at £392 million, using estimated post-tax cash flows and post-tax discount rates. The Group has assessed the useful economic lives of these intangibles, 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. In the case of the RAC and BSM brands, it has been determined that the existing lives of the assets, their competitive position in and the stability of their respective markets indicate that the brands have indefinite useful lives, and thus no amortisation has been charged in the period since acquisition. Of the total £392 million, £260 million has been assessed as having an indefinite life, with the remaining £132 million, mainly contractual customer relationships, being amortised over nine to 22 years.

A deferred tax liability of £118 million has been provided against these intangible assets, resulting in an increase in residual goodwill by this amount. Although this liability has been recognised in accordance with IAS 12, and a proportion will be amortised to the income statement as the related intangible asset is amortised, this liability is only payable if the intangible asset is sold separately and this is not expected to happen.

The pension scheme valuation adjustment and associated deferred taxation represents the effect of aligning the assumptions of the RAC plc schemes to those of Aviva. The fair value of the RAC pension deficit at the date of acquisition amounted to £313 million (£219 million after deferred tax).

The residual goodwill of £1,139 million essentially represents synergies, both in increased revenues and in reduced costs, expected to arise in RAC plc and our UK general insurance business as a result of the acquisition.

£109 million of integration costs for the restructuring of the combined Norwich Union Insurance and RAC businesses has been included in the results to 31 December 2005.

(ii) Gresham Insurance Company Limited

On 31 March 2005, the Group acquired 100% of the share capital of Gresham Insurance Company Limited. The cash consideration including purchase costs was £75 million. The fair value of the net assets acquired, including intangibles of £14 million, was £75 million, giving rise to no goodwill on acquisition.

(iii) Solus Automotive Limited

On 11 May 2005, the Group acquired 100% of the share capital of Solus Automotive Limited. The cash consideration including purchase costs was £20 million, including £12 million of cash and £8 million of deferred consideration. The fair value of the net assets acquired was nil, giving rise to £20 million of goodwill on acquisition.

Notes to the consolidated financial statements continued

3 – Subsidiaries continued

(iv) 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 2005, 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 2005, nor is it necessarily indicative of future results.

	2005 £m
Revenues (premiums and fee income)	**27,842**
Profit before tax attributable to shareholders	**2,578**

Of the above pre-tax profit, £21 million has arisen since acquisition.

(v) Non-adjusting post-balance sheet events:

Irish bancassurance agreement

On 22 November 2005, the Group announced a new bancassurance agreement in Ireland between its wholly-owned subsidiary Hibernian Group plc ("Hibernian") and Allied Irish Banks plc ("AIB"). This will create a leading force in the Irish life and pensions market and bring further opportunities for growth in this market. The transaction completed on 27 January 2006, following the receipt of regulatory and European Commission approval.

Under the terms of the agreement, Hibernian Life Holdings Limited (HLH), the parent company of Hibernian Life & Pensions Limited, has acquired all the shares of Ark Life Assurance Company Limited (Ark Life) from AIB in exchange for a 24.99% stake in the enlarged HLH and a balancing cash payment of €195.4 million which also reflects the management of Ark Life funds by Hibernian Investment Managers Limited, part of the Group's fund management business. A further deferred cash payment of up to €10 million is payable, subject to the fulfilment of certain performance criteria.

AIB calculate embedded value on a different basis to that used by the Group and, in particular, do not use EEV principles. In view of the very recent timing of completion, it is currently impractical to comply with the requirements of paragraph 67 of IFRS 3, *Business Combinations,* and to state with any certainty the fair values of the assets and liabilities acquired, and therefore to estimate the goodwill arising on this acquisition and the unrealised gain on disposal of the Group's 24.99% interest in HLH.

The gain on disposal of this interest in HLH will be calculated in accordance with SIC 13, *Jointly Controlled Entities – Non-Monetary Contributions by Venturers,* and will be recognised in 2006.

Acquisition in Sri Lanka

On 1 February 2006, the Group acquired a 51% interest in Eagle Insurance Limited (Eagle), the third largest insurer in Sri Lanka, by buying a majority shareholding in Eagle's immediate holding company, NDB Finance Lanka (Pvt) Limited, for cash of £15 million. At the same time, Eagle has entered into a bancassurance agreement with National Development Bank Limited (NDB), Sri Lanka's biggest development bank and Eagle's other major shareholder. In view of the very recent timing of completion, it is currently impractical to comply with the requirements of paragraph 67 of IFRS 3, *Business Combinations,* and to state with any certainty the fair values of the assets and liabilities acquired, and therefore to estimate the goodwill arising on this acquisition.

(b) Disposals of subsidiaries and associates

The profit on disposal was determined as follows:

	2005 £m	2004 £m
Proceeds from sale	**421**	327
Net assets sold	**(245)**	(293)
Transaction costs	**(23)**	–
Profit on disposal before tax	**153**	34
Tax on profit on disposal	**(43)**	–
Profit on disposal after tax	**110**	34

3 – Subsidiaries continued

The profit/(loss) on the disposal of subsidiaries and associates comprises:

	2005 £m	2004 £m
General insurance businesses		
United Kingdom	**10**	28
France	**–**	6
Asia (see below)	**122**	–
Other small operations	**(22)**	–
	110	34

(i) Sale of Asian general insurance businesses

During 2005, the Group completed the disposal of its Asian general insurance businesses to Mitsui Sumitomo Insurance (MSI) for a total of US$450 million in cash. Under the terms of the agreement, MSI acquired all of Aviva's general insurance businesses in Asia. These comprised the general insurance business of Aviva Limited and the general insurance assets of Aviva Asia Pte Limited in Singapore; Aviva Insurance Berhad in Malaysia (including its branch in Brunei); Aviva Insurance (Thai) Company Limited in Thailand; PT Aviva Insurance in Indonesia; Dah Sing General Insurance Co Limited in Hong Kong; and Aviva's branch operations in Hong Kong, the Philippines, Marianas, Macau and Taiwan. The transaction was achieved through share purchase of Aviva's interests in joint venture operations, business purchase and asset purchase in Singapore, and transfer of Aviva's general insurance branch operations in Hong Kong, the Philippines, Marianas, Macau and Taiwan.

The transaction completed in two phases. Phase I completed on 28 February 2005 and included all businesses above except for Malaysia, Indonesia, Macau, Marianas, Taiwan, Dah Sing and the Philippines. Phase II completed in December 2005, when the last of these businesses was sold, with the exception of Taiwan which completed in February 2006. Due to its immateriality, this last disposal has been treated as a 2005 transaction.

The total sale proceeds were fixed by reference to the net assets of the businesses as at 31 December 2003 and were not adjusted to reflect the results in the period from 1 January 2004 to completion. The Group therefore hedged its exposure to the sale proceeds of US$450 million through the purchase of foreign currency forward contracts. The Group did not bear any continuing operating risk from 31 December 2003.

The results of the Asian general insurance business have been consolidated with those of the Group's ongoing operations until the completion of each transaction. Although the Group retained no economic interest in the operations of this business beyond 31 December 2003, the post-tax operating profits have been incorporated in the Group's consolidated income statement from 1 January 2004 to the date of completion. This has been offset by a corresponding change to the final profit on sale. The total pre-tax profit on sale was £165 million (£122 million after tax) and is summarised below:

	2005 £m
Net assets as at 31 December 2003	**60**
Post-tax operating profit to disposal	**14**
Dividends paid	**(5)**
Foreign exchange rate movements on net assets	**4**
Net assets at disposal	**73**
Proceeds	**256**
Less: Net assets	**(73)**
Transaction costs	**(18)**
Pre-tax profit on sale	**165**
Tax attributable to profit on sale	**(43)**
Post-tax profit on sale	**122**

The net assets at disposal of £73 million, comprised financial investments (£220 million) and other assets (£95 million), less insurance liabilities (£207 million) and other liabilities (£35 million).

Notes to the consolidated financial statements continued

3 – Subsidiaries continued

(ii) Other

In July 2005, the Group completed the sale of the business and certain operational assets and liabilities of Hyundai Cars (UK), which was acquired as part of the RAC group, to Hyundai Motor UK Limited for a total of £70 million. This sale did not give rise to any gain or loss.

In December 2005, the Group sold its commercial fleet business in Lex Transfleet Limited to Fraikin Limited for a total of £69 million, of which £10 million is deferred consideration. The Group acquired 50% of Lex Transfleet Limited with the RAC group, and this company became a wholly-owned subsidiary after the Group acquired the remaining 50% of its share capital in November 2005. The sale resulted in a gain of £5 million.

No other disposal is considered material for further disclosure.

(c) Operations classified as held for sale

The assets and liabilities of operations classified as held for sale as at 31 December 2005 were as follows:

	2005 £m	2004 £m
Intangible assets	**9**	–
Investments and property and equipment	**320**	–
Receivables and other financial assets	**68**	–
Deferred acquisition costs and other assets	**40**	–
Cash and cash equivalents	**25**	–
Total assets	**462**	–
Payables and financial liabilities	**(96)**	
Other liabilities	**(49)**	–
Total liabilities	**(145)**	–
Net assets	**317**	–

In October 2005, the Group announced its decision to sell its 50% stake in Lex Vehicle Leasing (Holdings) Limited (LVL), a joint venture with HBOS, as a result of HBOS exercising an option under the JV shareholders agreement. LVL provides vehicle leasing, supply, management, maintenance and incident support for companies who outsource the day-to-day operations of their fleets, and was acquired as a part of the Group's acquisition of RAC. Completion of the sale of the investment in LVL is expected in the second quarter of 2006 and so the relevant assets and liabilities have been classified as Held for Sale in the consolidated balance sheet.

At year end, the Group held for sale certain divisions of Manufacturer Support Services (MSS), part of the RAC group. The decision to sell is part of the Group's wider strategy to integrate RAC and exit non-core operations. The divisions being sold primarily comprise Lex Transfleet Limited, Multipart Holdings Limited and Lex Commercials Limited, both wholly-owned subsidiaries, and Hyundai Car Finance Limited, an associate in which the Group holds 49.99%. Lex Transfleet is a provider of complex fleet solutions, Multipart Holdings provides logistics and aftermarket services to the automotive sector and Lex Commercials is a leading UK commercial vehicles dealership group, while Hyundai Car Finance Limited provides vehicle instalment finance and leasing. The disposal groups have also been treated as Held for Sale and are expected to be sold by the second quarter of 2006.

3 – Subsidiaries continued

(d) Exceptional costs for termination of operations

In February 2004, the Group announced the closure of its UK national broker subsidiary, Hill House Hammond (HHH) together with the sale of its commercial business. The associated pre-tax costs of the closure of HHH were £40 million and relate to termination activities, including redundancy costs and closure provisions.

(e) Other information

Principal subsidiaries at 31 December 2005 are listed on page 222.

One of the Group's wholly-owned 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.

4 – Segmental information

(a) Primary reporting format – business segments

(i) Reporting segments

The principal activity of the Group is financial services, which is managed using the following reportable segments: long-term business, fund management, general insurance and health.

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 equity release business written in the United Kingdom.

Fund management activities

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.

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.

Other

Other activities not related to the core business segments or which are not reportable segments due to their immateriality, such as the RAC non-insurance operations, our banking businesses and service companies, are included as "Other", in the following tables. Head office expenses, such as Group treasury and finance functions are also reported as "Other", together with eliminations and other reconciling items. Certain financing costs and taxes are not allocated among the segments.

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.

Segment assets and liabilities comprise operating assets and liabilities, being the majority of the balance sheet but excluding items such as tax and borrowings.

Notes to the consolidated financial statements continued

4 – Segmental information continued
(ii) Segmental results – business segments

For the year ended 31 December 2005	Long-term business £m	Fund management £m	General insurance and health £m	Other £m	Total £m
Gross written premiums	15,282	–	11,017	–	26,299
Premiums ceded to reinsurers	(611)	–	(706)	–	(1,317)
Net written premiums	14,671	–	10,311	–	24,982
Change in unearned premium reserve	–	–	(123)	–	(123)
Net earned premiums	14,671	–	10,188	–	24,859
Fee and commission income	598	264	214	771	1,847
	15,269	264	10,402	771	26,706
Net investment income	21,985	11	1,603	123	23,722
Inter-segment revenue	–	112	–	–	112
Other income	(10)	–	41	122	153
Segment income	37,244	387	12,046	1,016	50,693
Claims and benefits paid, net of recoveries from reinsurers	(13,482)	–	(6,224)	–	(19,706)
Change in insurance liabilities, net of reinsurance	(10,004)	–	(372)	–	(10,376)
Change in investment contract provisions	(7,814)	–	–	–	(7,814)
Change in unallocated divisible surplus	(1,474)	–	–	–	(1,474)
Fee and commission expense	(1,481)	(55)	(2,752)	(38)	(4,326)
Other operating expenses					
Depreciation	(11)	(6)	(17)	(78)	(112)
Amortisation of acquired value of in force business	(45)	–	–	–	(45)
Amortisation of intangible assets	(18)	–	(5)	(16)	(39)
Net impairment of acquired value of in force business	(28)	–	–	–	(28)
Net impairment of intangible assets	(6)	–	–	–	(6)
Impairment of goodwill	(14)	–	–	(29)	(43)
Other net impairment losses recognised in the income statement	(37)	–	–	–	(37)
Inter-segment expenses	(103)	–	(9)	–	(112)
Other expenses	(999)	(233)	(615)	(1,027)	(2,874)
Finance costs	(203)	–	(58)	(100)	(361)
Segment expenses	(35,719)	(294)	(10,052)	(1,288)	(47,353)
Segment result before share of profit/(loss) of joint ventures and associates	1,525	93	1,994	(272)	3,340
Share of profit/(loss) of joint ventures and associates	340	(1)	1	18	358
Segment result before tax	1,865	92	1,995	(254)	3,698
Unallocated costs					
Finance costs on central borrowings (see below)					(248)
Tax attributable to policyholders' returns					(922)
Tax attributable to shareholders' profits					(630)
Profit for the year					1,898

Finance costs on central borrowing comprise interest payable on borrowings by holding companies within the Group which is not allocated to operating companies.

Impairment losses, and reversal of such losses, recognised directly in equity were £nil and £124 million respectively in long-term business.

4 – Segmental information continued

Pro forma reconciliation to operating profit before tax attributable to shareholders' profits

For the year ended 31 December 2005	Long-term business £m	Fund management £m	General insurance and health £m	Other £m	Total £m
Segment result before tax	**1,865**	**92**	**1,995**	**(254)**	**3,698**
Finance costs on central borrowings				**(248)**	**(248)**
Adjusted for the following items					
Impairment of goodwill	**14**	**–**	**–**	**29**	**43**
Amortisation and impairment of acquired value of in-force business	**73**	**–**	**–**	**–**	**73**
Amortisation and impairment of intangibles	**24**	**–**	**5**	**16**	**45**
Short-term fluctuation in return on investments backing general insurance and health business	**–**	**–**	**(517)**	**–**	**(517)**
(Profit)/loss on the disposal of subsidiaries and associates	**10**	**–**	**(41)**	**(122)**	**(153)**
Integration costs	**–**	**–**	**77**	**32**	**109**
Unallocated interest	**–**	**(1)**	**25**	**(24)**	**–**
Corporate costs reallocation	**1**	**1**	**7**	**(9)**	**–**
	1,987	**92**	**1,551**	**(580)**	**3,050**
Less:					
Tax attributable to policyholders' returns	**(922)**	**–**	**–**	**–**	**(922)**
Operating profit before tax attributable to shareholders' profits	**1,065**	**92**	**1,551**	**(580)**	**2,128**

Notes to the consolidated financial statements continued

4 – Segmental information continued

For the year ended 31 December 2004	Long-term business £m	Fund management £m	General insurance and health £m	Other £m	Total £m
Gross written premiums	14,216	–	10,562	–	24,778
Premiums ceded to reinsurers	(683)	–	(744)	–	(1,427)
Net written premiums	13,533	–	9,818	–	23,351
Change in unearned premium reserve	–	–	(176)	–	(176)
Net earned premiums	13,533	–	9,642	–	23,175
Fee and commission income	534	203	197	334	1,268
	14,067	203	9,839	334	24,443
Net investment income	14,503	8	1,176	46	15,733
Inter-segment revenue	–	114	–	–	114
Other income	–	–	13	21	34
Segment income	28,570	325	11,028	401	40,324
Claims and benefits paid, net of recoveries from reinsurers	(12,015)	–	(5,784)	–	(17,799)
Change in insurance liabilities, net of reinsurance	(5,393)	–	(711)	–	(6,104)
Change in investment contract provisions	(5,635)	–	–	–	(5,635)
Change in unallocated divisible surplus	(1,330)	–	–	–	(1,330)
Fee and commission expense	(1,865)	(70)	(2,482)	(54)	(4,471)
Other operating expenses					
Depreciation	(14)	(4)	(19)	(60)	(97)
Amortisation of acquired value of in force business	(72)	–	–	–	(72)
Amortisation of intangible assets	–	–	–	–	–
Net impairment of acquired value of in force business	(13)	–	–	–	(13)
Amortisation of other intangible assets	(7)	–	–	–	(7)
Impairment of goodwill on subsidiaries	(18)	–	(2)	(21)	(41)
Net impairment of property and equipment	(1)			(24)	(25)
Net impairment of other financial assets	(3)	–	–	–	(3)
Other reversal of impairment losses recognised in the income statement					
Inter-segment expenses	(105)	–	(9)	–	(114)
Other expenses	(788)	(218)	(610)	(692)	(2,308)
Finance costs	(161)	–	(43)	(72)	(276)
Segment expenses	(27,420)	(292)	(9,660)	(923)	(38,295)
Segment result before share of profit/(loss) of joint ventures and associates	1,150	33	1,368	(522)	2,029
Share of profit/(loss) of joint ventures and associates	235	(6)	–	13	242
Segment result before tax	1,385	27	1,368	(509)	2,271
Unallocated costs					
Finance costs on central borrowings (see below)					(246)
Tax attributable to policyholders' returns					(383)
Tax attributable to shareholders' profits					(271)
Profit/(loss) for the year					1,371

Finance costs on central borrowings comprise interest payable on borrowings by holding companies within the Group which is not allocated to operating companies.

Impairment losses, and reversal of such losses, recognised directly in equity were £nil and £138 million respectively in long-term business.

4 – Segmental information continued

Pro forma reconciliation to operating profit before tax attributable to shareholders' profits

For the year ended 31 December 2004	Long-term business £m	Fund management £m	General insurance and health £m	Other £m	Total £m
Segment result before tax	1,385	27	1,368	(509)	2,271
Finance costs on central borrowings	–	–	–	(246)	(246)
Adjusted for the following items					
Impairment of goodwill	18	–	2	21	41
Amortisation and impairment of acquired value of in-force business	85	–	–	–	85
Amortisation and impairment of intangibles	7	–	–	–	7
Financial Services Compensation Scheme and other levies	–	9	40	–	49
Short-term fluctuation in return on investments backing general insurance and health business	–	–	(161)	–	(161)
Profit on the disposal of subsidiaries and associates	–	–	(12)	(22)	(34)
Exceptional costs for termination of operations	–	–	–	40	40
Corporate costs reallocation	4	4	22	(30)	–
	1,499	40	1,259	(746)	2,052
Less:					
Tax attributable to policyholders' returns	(383)	–	–	–	(383)
Operating profit before tax attributable to shareholders' profits	1,116	40	1,259	(746)	1,669

(iii) Segmental balance sheet – business segments

As at 31 December 2005	Long-term business £m	Fund management £m	General insurance and health £m	Other £m	Total £m
Goodwill	**631**	**–**	**398**	**1,245**	**2,274**
Acquired value of in-force business and intangible assets	**424**	**–**	**265**	**114**	**803**
Investments in joint ventures and associates	**2,815**	**46**	**39**	**114**	**3,014**
Property and equipment	**367**	**4**	**126**	**388**	**885**
Investment property	**12,895**	**–**	**338**	**42**	**13,275**
Loans	**18,240**	**–**	**3,661**	**2,643**	**24,544**
Financial investments	**166,211**	**22**	**12,496**	**3,659**	**182,388**
Other assets	**23,185**	**436**	**9,425**	**2,113**	**35,159**
Segment assets	**224,768**	**508**	**26,748**	**10,318**	**262,342**
Unallocated assets – tax assets					**1,105**
Total assets					**263,447**
Insurance liabilities	**114,176**	**–**	**18,426**	**–**	**132,602**
Liability for investment contracts	**77,309**	**–**	**–**	**–**	**77,309**
Unallocated divisible surplus	**8,978**	**–**	**–**	**–**	**8,978**
Net asset value attributable to unitholders	**3,137**	**–**	**–**	**–**	**3,137**
External borrowings	**4,060**	**–**	**2,565**	**578**	**7,203**
Other liabilities, including inter-segment liabilities	**6,149**	**278**	**(224)**	**9,622**	**15,825**
Segment liabilities	**213,809**	**278**	**20,767**	**10,200**	**245,054**
Unallocated liabilities					
Central borrowings (see below)					**3,810**
Tax liabilities					**3,491**
Total liabilities					**252,355**
Total equity					**11,092**
Total equity and liabilities					**263,447**
Capital expenditure					
Intangible assets	**44**	**–**	**6**	**2**	**52**
Property and equipment	**26**	**3**	**11**	**166**	**206**
	70	**3**	**17**	**168**	**258**

Central borrowings are borrowings by holding companies within the Group which are not allocated to operating companies.

Notes to the consolidated financial statements continued

4 – Segmental information continued

As at 31 December 2004	Long-term business £m	Fund management £m	General insurance and health £m	Other £m	Total £m
Goodwill	595	–	308	281	1,184
Acquired value of in-force business and intangible assets	451	–	19	46	516
Investments in joint ventures and associates	1,995	40	13	80	2,128
Property and equipment	404	7	133	268	812
Investment property	10,639	–	362	56	11,057
Loans	17,090	–	2,635	2,330	22,055
Financial investments					
Debt securities	86,897	2	9,255	2,565	98,719
Equity securities	44,269	1	2,449	572	47,291
Other investments	20,067	6	224	49	20,346
Other assets	23,455	311	9,786	735	34,287
Segment assets	205,862	367	25,184	6,982	238,395
Unallocated assets – tax assets					908
Total assets					239,303
Insurance liabilities	106,329	–	17,793	–	124,122
Liability for investment contracts	69,555	–	–	–	69,555
Unallocated divisible surplus	7,549	–	–	–	7,549
Net asset value attributable to unitholders	2,247	–	–	–	2,247
External borrowings	4,082	–	1,439	270	5,791
Other liabilities, including inter-segment liabilities	6,250	191	474	7,367	14,282
Segment liabilities	196,012	191	19,706	7,637	223,546
Unallocated liabilities					
Central borrowings (see below)					4,299
Tax liabilities					2,465
Total liabilities					230,310
Total equity					8,993
Total equity and liabilities					239,303
Capital expenditure					
Intangible assets	–	–	5	–	5
Property and equipment	27	3	12	173	215
	27	3	17	173	220

Central borrowings are borrowings by holding companies within the Group which are not allocated to operating companies.

(b) Secondary reporting format – geographical segments

(i) Reporting segments

Although the Group's business segments are managed on a worldwide basis, they operate in five main geographical areas. These are United Kingdom, France, Netherlands (including Belgium and Luxembourg), Other Europe and International.

Revenue by destination does not differ materially from revenue by geographical origin, as most risks are located in the countries where the contracts were written.

4 – Segmental information continued

(ii) Segmental results and balance sheets – geographical segments

Year ended 31 December 2005	United Kingdom £m	France £m	Netherlands £m	Other Europe £m	International £m	Total £m
Gross written premiums	**11,510**	**4,250**	**3,878**	**4,316**	**2,345**	**26,299**
Premiums ceded to reinsurers	**(914)**	**35**	**(22)**	**(306)**	**(110)**	**(1,317)**
Internal reinsurance revenue	**(10)**	**(6)**	**(4)**	**(1)**	**21**	**–**
Net written premiums	**10,586**	**4,279**	**3,852**	**4,009**	**2,256**	**24,982**
Fee and commission income	**1,002**	**200**	**192**	**239**	**214**	**1,847**
Segment revenue	**11,588**	**4,479**	**4,044**	**4,248**	**2,470**	**26,829**
Segment result before tax	**2,057**	**304**	**348**	**461**	**553**	**3,723**
Segment assets	**136,235**	**46,682**	**38,871**	**29,868**	**11,791**	**263,447**
Segment liabilities:						
External borrowings	**(2,128)**	**(10)**	**(5,013)**	**(52)**	**–**	**(7,203)**
Other liabilities, including inter-segment liabilities	**(126,759)**	**(44,274)**	**(30,714)**	**(26,387)**	**(9,717)**	**(237,851)**
	(128,887)	**(44,284)**	**(35,727)**	**(26,439)**	**(9,717)**	**(245,054)**
Segment net assets	**7,348**	**2,398**	**3,144**	**3,429**	**2,074**	**18,393**
Unallocated liabilities						**(7,301)**
Total net assets						**(11,092)**
Capital expenditure	**167**	**5**	**31**	**32**	**23**	**258**

Year ended 31 December 2004	United Kingdom £m	France £m	Netherlands £m	Other Europe £m	International £m	Total £m
Gross written premiums	11,449	3,625	3,231	4,274	2,199	24,778
Premiums ceded to reinsurers	(945)	(57)	(86)	(188)	(151)	(1,427)
Internal reinsurance revenue	(21)	(6)	(4)	11	20	–
Net written premiums	10,483	3,562	3,141	4,097	2,068	23,351
Fee and commission income	620	193	187	164	104	1,268
Segment revenue	11,103	3,755	3,328	4,261	2,172	24,619
Segment result before tax	718	245	335	431	296	2,025
Segment assets	124,127	44,216	30,539	30,089	10,332	239,303
Segment liabilities:						
External borrowings	(1,737)	(21)	(4,007)	(21)	(5)	(5,791)
Other liabilities, including inter-segment liabilities	(116,850)	(41,866)	(23,911)	(26,832)	(8,296)	(217,755)
	(118,587)	(41,887)	(27,918)	(26,853)	(8,301)	(223,546)
Segment net assets	5,540	2,329	2,621	3,236	2,031	15,757
Unallocated liabilities						(6,764)
Total net assets						8,993
Capital expenditure	110	1	88	17	4	220

Notes to the consolidated financial statements continued

4 – Segmental information continued

(iii) Life and pensions and investment sales – new business and total income

For the purpose of recording life and pensions new business premiums, the Group's policy is to include 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 equity release business written in the UK. This includes both insurance and investment contracts as defined under IFRS 4, *Insurance Contracts,* and is consistent with the definition of covered business used for our supplementary embedded value reporting.

An analysis of new long-term business sales is provided below. In this table, single premiums are those relating to products issued by the Group which provide for the payment of one premium only. Regular premiums are those where there is a contractual obligation to pay on an ongoing basis. Life and pensions total income represents all net written premiums in the year for insurance contracts and investment contracts, excluding non-participating investment contracts which are required to be accounted for under IAS 39, *Financial Instruments: Recognition and Measurement,* and IAS 18, *Revenue.*

	New single premiums		New regular premiums		Total income	
	2005 £m	2004 £m	2005 £m	2004 £m	2005 £m	2004 £m
Life and pensions:						
United Kingdom – Group companies	**6,573**	6,297	**485**	499	**4,676**	4,768
– associates and joint ventures	**–**	205	**–**	17	**–**	319
	6,573	6,502	**485**	516	**4,676**	5,087
France	**3,077**	2,454	**76**	62	**3,553**	2,892
Netherlands	**1,245**	1,131	**146**	148	**2,582**	1,859
Other Europe						
Ireland	**372**	203	**63**	66	**182**	195
Italy	**1,940**	1,529	**58**	45	**1,357**	1,084
Poland	**120**	60	**30**	31	**312**	267
Spain	**1,395**	1,566	**100**	91	**1,248**	1,206
Other	**406**	336	**80**	90	**152**	565
International	**798**	660	**113**	105	**870**	706
Total life and pensions (including share of associates and joint ventures)	**15,926**	14,441	**1,151**	1,154	**14,932**	13,861
Retail sales of mutual fund type products:						
United Kingdom	**1,139**	840	**21**	19	**1,160**	859
Netherlands	**563**	196	**–**	–	**563**	196
Other Europe						
Poland	**49**	75	**4**	2	**53**	77
Other	**410**	254	**–**	–	**410**	254
International	**213**	243	**–**	–	**213**	243
Total investment sales	**2,374**	1,608	**25**	21	**2,399**	1,629
Total long term savings (including share of associates and joint ventures)	**18,300**	16,049	**1,176**	1,175	**17,331**	15,490

Included within new business sales is £5,071 million single premiums and £357 million regular premiums *(2004: £4,338 million and £410 million respectively)* in respect of contracts that meet the definition of "non-participating investment" contracts under IFRS 4, Insurance Contracts. Under IFRS, the premiums on these contracts are not included in the Group income statement under earned premiums, but are included on the balance sheet as a deposit.

5 – Details of income

	Note	2005 £m	2004 £m
Gross written premiums			
Long-term:			
Insurance contracts		**9,916**	10,038
Participating investment contracts		**5,366**	4,178
General insurance and health		**11,017**	10,562
	4a	**26,299**	24,778
Less: premiums ceded to reinsurers	4a	**(1,317)**	(1,427)
Gross change in provision for unearned premiums	35e	**(216)**	(232)
Reinsurers' share of change in provision for unearned premiums	36c	**93**	56
Net change in provision for unearned premiums		**(123)**	(176)
Net premiums earned		**24,859**	23,175
Fee and commission income			
Fee income from investment contract business		**288**	349
Fund management fee income		**274**	176
Other fee income		**921**	211
Reinsurance commissions receivable		**274**	512
Other commission income		**99**	28
Net change in deferred revenue		**(9)**	(8)
		1,847	1,268
Total revenue		**26,706**	24,443
Net investment income			
Interest and similar income		**6,396**	6,052
Dividend income		**1,778**	1,494
Other income from investments designated as trading			
Realised gains and losses		**(78)**	(250)
Unrealised gains and losses		**42**	190
		(36)	(60)
Other income from investments designated as other than trading			
Realised gains and losses		**4,502**	1,873
Unrealised gains and losses		**8,771**	4,007
		13,273	5,880
Realised gains and losses on AFS investments		**154**	322
Net income from investment properties			
Rent		**747**	728
Expenses relating to these properties		**(19)**	(8)
Gains on disposal		**41**	89
Fair value gains on investment properties		**1,571**	1,154
Gains on loans		**38**	34
Foreign exchange gains and losses on investments other than trading		**(207)**	43
Other investment (expense)/income		**(14)**	5
Net investment income		**23,722**	15,733
Share of profit after tax of joint ventures	17	**326**	234
Share of profit after tax of associates	18	**32**	8
Share of profit after tax of joint ventures and associates		**358**	242
Profit on the disposal of subsidiaries and associates	3b	**153**	34
Total income		**50,939**	40,452

Notes to the consolidated financial statements continued

6 – Details of expenses

	Note	2005 £m	2004 £m
Claims and benefits paid			
Claims and benefits paid to policyholders on long-term business			
Insurance contracts		**10,325**	9,276
Participating investment contracts		**2,465**	3,114
Non-participating investment contracts		**1,188**	62
Claims and benefits paid to policyholders on general insurance and health business		**6,523**	6,131
		20,501	18,583
Less: Claim recoveries from reinsurers			
Insurance contracts		**(697)**	(595)
Participating investment contracts		**(50)**	(89)
Non-participating investment contracts		**(48)**	(100)
Claims and benefits paid, net of recoveries from reinsurers		**19,706**	17,799
Change in insurance liabilities			
Change in insurance liabilities		**9,673**	6,434
Less: Change in reinsurance asset for insurance provisions		**703**	(330)
Change in insurance liabilities, net of reinsurance		**10,376**	6,104
Change in investment contract provisions			
Investment income allocated to investment contracts		**3,633**	2,192
Other changes in provisions			
Participating investment contracts		**3,530**	2,847
Non-participating investment contracts		**69**	596
Less: Change in reinsurance asset for investment contract provisions		**582**	–
		7,814	5,635
Change in unallocated divisible surplus		**1,474**	1,330
Fee and commission expense			
Acquisition costs			
Commission expenses for insurance and participating investment contracts		**2,700**	2,443
Change in deferred acquisition costs for insurance and participating investment contracts		**(208)**	340
Deferrable costs for non-participating investment contracts		**165**	134
Other acquisition costs		**1,245**	1,213
Changes in deferred acquisition costs for non-participating investment contracts		**(258)**	(92)
Reinsurance commissions and other fee and commission expense		**682**	433
		4,326	4,471

6 – Details of expenses continued

	Note	2005 £m	2004 £m
Other operating expenses			
Staff costs and other employee-related expenditure	9	**1,640**	1,815
Global finance transformation programme		**28**	85
Other corporate costs		**108**	49
Depreciation	19	**112**	97
Impairment losses on property and equipment	19	**–**	25
Impairment of goodwill on subsidiaries	15	**43**	41
Amortisation of acquired value of in-force business	16 & 18	**44**	72
Amortisation of intangible assets	16	**39**	7
Impairment of acquired value of in-force business	16	**29**	13
Impairment of intangible assets	16	**6**	–
Integration costs		**109**	–
		2,158	2,204
Net impairments on loans	21	**4**	1
Net impairments on financial investments		**5**	1
Net impairments on receivables and other financial assets		**10**	1
Net impairments on non-financial assets		**38**	–
		57	3
Other net foreign exchange (gains)/losses		**(4)**	12
Other expenses		**973**	347
		3,184	2,566
Finance costs			
Interest expense on:			
Subordinated debt		**169**	169
Debenture loans		**41**	37
Amounts owed to credit institutions		**37**	10
Commercial paper		**24**	34
Securitised mortgage loan notes		**183**	174
Banking customer deposits		**79**	71
		533	495
Other similar charges		**76**	27
		609	522
Total expenses		**47,489**	38,427

Notes to the consolidated financial statements continued

7 – Analysis of investment return

(a) The total investment return reflected in profit before tax comprises:

	2005 £m	2004 £m
Share of result after tax of joint ventures	**326**	234
Share of result after tax of associates	**32**	8
Net rental income from investment properties	**728**	720
Interest, dividend and similar income	**8,174**	7,546
Foreign exchange gains and losses on investments designated as at fair value through profit or loss	**(207)**	43
Realised investment gains on financial investments, loans, investment property and owner occupied property	**4,657**	2,068
Net impairment losses on investments designated as available for sale and on loans	**(57)**	(3)
Other investment (expenses)/income	**(14)**	5
Finance costs		
Allocated costs	**(361)**	(276)
Unallocated interest charges:		
Subordinated debt	**(169)**	(169)
Other borrowings	**(79)**	(77)
	(248)	(246)
Investment return before unrealised gains	**13,030**	10,099
Unrealised investment gains on financial investments and loans designated as at fair value through profit or loss	**10,384**	5,351
Total investment return included in profit before tax	**23,414**	15,450

In addition to the investment return recognised above, £110 million of investment losses *(2004: £64 million)* has been recognised directly in equity as detailed in the statement of recognised income and expense on page 91.

(b) Effective interest rates

The table below summarises the average effective interest rate by major currency for monetary financial instruments:

	2005			2004		
	Sterling %	Euro %	Can $ %	Sterling %	Euro %	Can $ %
Monetary assets						
Loans	**5.9**	**4.6**	**4.5**	6.4	4.6	4.1
Debt securities	**4.9**	**4.3**	**4.6**	5.1	4.5	4.7
Other investments	**–**	**4.0**	**–**	4.5	4.3	–
Monetary liabilities						
Borrowings	**6.3**	**5.4**	**–**	6.2	4.8	–

The investment liabilities in relation to long-term business valued at amortised cost represent only 0.4% of the total liabilities relating to long-term business. On grounds of materiality, their effective interest rate has not been calculated.

8 – Longer term investment return

(a) The longer-term investment return, net of expenses, attributable to the general insurance and health business result was £1,046 million *(2004: £988 million)*.

(b) The longer-term investment return and short-term fluctuation are as follows:

	General insurance and health business	
	2005 £m	2004 £m
Net investment income (note 4a)	**1,603**	1,176
Less: Internal charges reflected in other headings	**(40)**	(27)
	1,563	1,149
Longer term investment return	**1,046**	988
Short-term fluctuation in investment return	**517**	161
	1,563	1,149

8 – Longer term investment return continued

(c) The longer term investment return is calculated separately for each principal general insurance and health 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.

(d) 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	
	2005 %	2004 %	2005 %	2004 %
United Kingdom	**7.6%**	7.8%	**6.6%**	6.8%
France	**6.7%**	7.3%	**5.7%**	6.3%
Netherlands	**6.7%**	7.3%	**5.7%**	6.3%
Ireland	**6.7%**	7.3%	**5.7%**	6.3%
Canada	**7.4%**	7.7%	**6.4%**	6.7%

For 2006, the Group intends to apply the same economic assumptions for equities and properties as are used under EEV principles to calculate the longer-term investment return for its general insurance and health business.

The above rates are consistent with the economic assumptions for equities and properties used under EEV principles.

(e) The table below compares the actual return on investments attributable to the general insurance and health business, after deducting investment management expenses and charges, with the aggregate longer term return over a two year period. This table will be built up over time to give aggregate and comparative figures over a five-year period.

	2004 – 2005 £m
Actual return attributable to shareholders	**2,712**
Longer term return credited to operating results	**(2,034)**
Surplus of actual returns over longer term returns	**678**

(f) The table below shows the sensitivity of the Group's general insurance and health operating profit before tax to changes in the longer term rates of return:

Movement in investment return for	By	Change in	2005 £m	2004 £m
Equities	1% higher/lower	Group operating profit	**29**	25
Properties	1% higher/lower	Group operating profit	**4**	3

9 – Employee information

The average number of persons employed by the Group during the year was:

	2005 Number	2004 Number
United Kingdom	**33,827**	32,588
France	**4,351**	4,399
Netherlands	**6,338**	6,671
Other Europe	**5,667**	6,359
International	**4,608**	5,855
	54,791	55,872

Total staff costs were:

	2005 £m	2004 £m
Wages and salaries	**1,677**	1,645
Social security costs	**210**	208
Post-retirement obligations		
Defined benefit schemes (note 42b)	**158**	158
Defined contribution schemes (note 42b)	**47**	47
Profit sharing and incentive plans	**116**	61
Equity compensation plans (notes 28d & 32)	**22**	21
Termination benefits	**10**	14
	2,240	2,154

Notes to the consolidated financial statements continued

9 – Employee information continued
These costs are charged within:

	2005 £m	2004 £m
Acquisition costs	**600**	339
Other operating expenses	**1,640**	1,815
	2,240	2,154

10 – Directors
Information concerning individual directors' emoluments, interests and transactions is given in the Directors' Remuneration Report on pages 65 to 74.

11 – Auditors' remuneration
The total remuneration payable by the Group, excluding VAT and any overseas equivalent thereof, to its principal auditors, Ernst & Young LLP, in respect of the audit of these accounts is shown below, together with fees payable in respect of other work.

	2005 £m	2004 £m
Audit services		
Statutory audit	**6.9**	7.0
Audit-related regulatory and supplementary reporting	**3.1**	3.1
Further assurance services	**2.6**	3.3
Other services	**0.5**	1.5
	13.1	14.9

In addition to the above amounts payable to the principal auditors, fees for audit services of £2.9 million *(2004: £2.0 million)* were payable to other firms. The total fees payable for audit services were therefore £12.9 million *(2004: £12.1 million)*.

Audit-related supplementary reporting is in respect of the audit of the Group's EEV figures on pages 200 to 221. Although EEV is the Group's primary management reporting basis and our disclosures require a full audit, the relevant fees cannot be classified as being for statutory audit.

Further assurance services included advice on accounting and regulatory matters, restatement of supplementary reporting opening balance sheet, reporting on internal controls and corporate governance matters, and due diligence work.

12 – Tax
(a) Tax charged to the income statement
(i) The total tax charge comprises:

	2005 £m	2004 £m
Current tax		
For the year	**799**	475
Prior year adjustments	**(212)**	(92)
Total current tax	**587**	383
Deferred tax		
Origination and reversal of timing differences	**881**	272
Changes in tax rates or tax laws	**(5)**	(1)
Write down of deferred tax assets	**89**	–
Total deferred tax	**965**	271
Total tax charged to income statement (note 12c)	**1,552**	654

(ii) The Group, as a proxy for policyholders in the UK, Ireland and Australia, is required to record taxes on investment income and gains each year. Accordingly, the tax benefit or expense attributable to UK, Irish and Australian life insurance policyholder returns is included in the tax charge. The tax expense attributable to policyholders' returns included in the charge above is £922 million *(2004: £383 million)*.

12 – Tax continued

(iii) The tax charge can be analysed as follows:

	2005 £m	2004 £m
United Kingdom tax	**1,150**	280
Overseas tax	**402**	374
	1,552	654

(iv) Unrecognised tax losses and temporary differences of previous years were used to reduce current tax expense and deferred tax expense by £49 million and £33 million, respectively *(2004: £148 million and £nil, respectively)*.

(b) Tax (credited)/charged to equity

(i) The total tax (credit)/charge comprises:

	2005 £m	2004 £m
Current tax	**(13)**	–
Deferred tax	**(262)**	15
Total tax (credited)/charged to equity	**(275)**	15

(ii) The tax credit attributable to policyholders' returns included in the credit above is £3 million *(2004: £nil)*.

(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:

	2005 £m	2004 £m
Profit before tax	**3,450**	2,025
Tax calculated at standard UK corporation tax rate of 30% *(2004: 30%)*	**1,035**	608
Different basis of tax for UK life insurance	**616**	217
Adjustment to tax charge in respect of prior years	**(253)**	(88)
Non-assessable dividends	**(26)**	(30)
Non-taxable (profit)/loss on sale of subsidiaries and associates	**(4)**	12
Disallowable expenses	**55**	65
Different basis of tax on overseas profits/(losses)	**168**	(13)
Deferred tax assets not recognised	**(25)**	(120)
Other	**(14)**	3
Total tax charged to income statement (note 12a)	**1,552**	654

Notes to the consolidated financial statements continued

13 – Earnings per share

(a) Basic earnings per share

(i) The profit attributable to ordinary shareholders is:

	2005 £m	2004 £m
Profit for the year	**1,898**	1,371
Amount attributable to minority interests	**(131)**	(96)
Cumulative preference dividends for the year	**(17)**	(17)
Coupon payments on direct capital instrument (DCI) (net of tax)	**(29)**	–
Profit attributable to ordinary shareholders	**1,721**	1,258

(ii) Basic earnings per share is calculated as follows:

	2005			2004		
	Before tax £m	Net of tax, minorities, preference dividends and DCI appropriation £m	Per share p	Before tax £m	Net of tax, minorities preference dividends and DCI appropriation £m	Per share p
Operating profit attributable to ordinary shareholders	**2,128**	**1,415**	**60.5**	1,669	1,221	54.1
Adjusted for the following:						
– Impairment of goodwill (note 15)	**(43)**	**(43)**	**(1.8)**	(41)	(41)	(1.8)
– Amortisation and net impairment of acquired additional value of in-force business (note 16 & 18)	**(73)**	**(73)**	**(3.1)**	(85)	(85)	(3.8)
– Amortisation and net impairment of intangibles (note 16)	**(45)**	**(42)**	**(1.8)**	(7)	(7)	(0.3)
– Financial Services Compensation Scheme and other levies	**–**	**–**	**–**	(49)	(29)	(1.3)
– Short-term fluctuation in return on investments backing general insurance and health business (note 8b)	**517**	**430**	**18.2**	161	195	8.7
– Profit on the disposal of subsidiaries and associates (note 3b)	**153**	**110**	**4.7**	34	34	1.5
– Integration costs (note 3a(i))	**(109)**	**(76)**	**(3.2)**	–	–	–
– Exceptional costs for termination of operations (note 3d)	**–**	**–**	**–**	(40)	(30)	(1.3)
Profit attributable to ordinary shareholders	**2,528**	**1,721**	**73.5**	1,642	1,258	55.8

(iii) The profit attributable to ordinary shareholders in the table above is calculated as follows:

	2005			2004		
	Operating profit £m	Adjusting items £m	Total £m	Operating profit £m	Adjusting items £m	Total £m
Profit before tax	**2,128**	**400**	**2,528**	1,669	(27)	1,642
Tax attributable to shareholders' profits	**(536)**	**(94)**	**(630)**	(319)	48	(271)
Minority interests	**(131)**	**–**	**(131)**	(112)	16	(96)
Preference dividends	**(17)**	**–**	**(17)**	(17)	–	(17)
Coupon payments in respect of direct capital instrument (net of tax)	**(29)**	**–**	**(29)**	–	–	–
Profit attributable to ordinary shareholders	**1,415**	**306**	**1,721**	1,221	37	1,258

Earnings per share has been calculated based on the operating profit before impairment of goodwill and other non-operating items, after tax, attributable to ordinary shareholders, as well as on the profit attributable to ordinary shareholders. The directors believe the former earnings per share figure provides a better indication of operating performance.

13 – Earnings per share continued

(iv) The calculation of basic earnings per share uses a weighted average of 2,340 million *(2004: 2,256 million)* ordinary shares in issue, after deducting shares owned by the employee share trusts. The actual number of shares in issue at 31 December 2005 was 2,396 million *(2004: 2,282 million)*.

(b) Diluted earnings per share

Diluted earnings per share is calculated as follows:

			2005			2004
	Total £m	Weighted average number of shares m	Per share p	Total £m	Weighted average number of shares £m	Per share p
Profit attributable to ordinary shareholders	**1,721**	**2,340**	**73.5**	1,258	2,256	55.8
Dilutive effect of share awards and options	**–**	**20**	**(0.6)**	–	18	(0.5)
Diluted earnings per share	**1,721**	**2,360**	**72.9**	1,258	2,274	55.3

Diluted earnings per share on operating profit attributable to ordinary shareholders is 60.0p *(2004: 53.7p).*

14 – Dividends and appropriations

	2005 £m	2004 £m
Ordinary dividends declared and charged to equity in the year		
Final 2003 – 15.15 pence per share, paid on 17 May 2004	**–**	342
Interim 2004 – 9.36 pence per share, paid on 17 November 2004	**–**	211
Final 2004 –16.00 pence per share, paid on 17 May 2005	**364**	–
Interim 2005 – 9.83 pence per share, paid on 17 November 2005	**234**	–
	598	553
Preference dividends declared and charged to equity in the year	**17**	17
Coupon payments on direct capital instrument	**42**	–
	657	570

Subsequent to 31 December 2005, the directors proposed a final dividend for 2005 of 17.44 pence per ordinary share, £418 million in total, making a total dividend for the year of 27.27 pence *(2004: 25.36 pence)*. Subject to approval by shareholders at the AGM, the dividend will be paid on 17 May 2006 and will be accounted for as an appropriation of retained earnings in the year ending 31 December 2006.

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 30%.

Irish shareholders who are due to be paid a dividend denominated in euros will receive a payment at the exchange rate prevailing on 1 March 2006.

Notes to the consolidated financial statements continued

15 – Goodwill

(a) Carrying amount

	2005 £m	2004 £m
Gross amount		
At 1 January	**1,225**	1,145
Additions	**1,178**	90
Disposals	**(21)**	(15)
Foreign exchange rate movements	**(23)**	5
At 31 December	**2,359**	1,225
Accumulated impairment		
At 1 January	**(41)**	–
Impairment losses	**(43)**	(41)
Disposals	**–**	–
Foreign exchange rate movements	**(1)**	–
At 31 December	**(85)**	(41)
Carrying value at 31 December	**2,274**	1,184

Goodwill arising on acquisitions completed before 1 January 1998 was charged directly to reserves. Goodwill arising on the Group's investment in joint ventures and associates is included within the carrying value of those investments (see notes 17 and 18).

Of the £1,139 million arising on the acquisition of the RAC group, £1,054 million relating to subsidiaries is included in the additions figure above and £85 million relating to joint ventures is dealt with in note 17(a).

(b) Goodwill allocation and impairment testing

The carrying amount of goodwill allocated to Spain (long-term business), United Kingdom (general insurance and health) and RAC (non-insurance operations) is considered significant in comparison with the total carrying amount of goodwill.

A summary of the goodwill allocated to cash-generating units is presented below.

	Spain (Long-term business)		United Kingdom (General insurance and health)		RAC (non–insurance operations)		Other		Total	
	2005 £m	2004 £m	2005 £m	2004 £m	2005 £m	2004 £m	2005 £m	2004 £m	2005 £m	2004 £m
Carrying amount of goodwill	**503**	456	**311**	149	**892**	–	**568**	579	**2,274**	1,184
Carrying amount of intangibles with indefinite useful lives	**–**	–	**185**	–	**75**	–	**–**	–	**260**	–
	503	456	**496**	149	**967**	–	**568**	579	**2,534**	1,184

As explained in accounting policy M, 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 in the amount of £43 million.

Goodwill and intangibles with indefinite useful lives have been tested for impairment in these businesses as follows:

15 – Goodwill continued

Spain (long-term business)

The recoverable amount of the Spanish unit has been determined based on a fair value less costs to sell 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 significantly exceeds the carrying value of the cash generating unit including goodwill and a reasonably possible change in a key assumption will not cause the carrying value of the cash generating unit to exceed its recoverable amount.

Key assumptions used for the calculation were:

– Embedded value represents the shareholder interest in the life business and is calculated in accordance with the European Embedded Value (EEV) 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 and by the Group's auditors;

– New business contribution represents the present value of projected future distributable profits generated from business written in a period. This is based on 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 best estimate of future growth. The rate is in line with industry expectations; and

– Risk adjusted discount rate 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 may differ from that assumed.

United Kingdom (general insurance and health)

The recoverable amount of the United Kingdom general insurance and health unit has also 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 10.45% *(2004: 9.63%)*. Cash flows beyond that three-year period have been extrapolated using a steady 3% growth rate *(2004: 5%)*. The recoverable amount significantly exceeds the carrying value of the cash generating unit including goodwill and intangible assets with indefinite useful lives and a reasonably possible change in a key assumption will not cause the carrying value of the cash generating unit to exceed its recoverable amount.

Key assumptions used for the calculation were:

– Budgeted operating profit represents the operating profit in the business plans, approved by management and as such reflect the best estimate of future profits based on both historical experience and expected growth rates for the UK general insurance industry. Some of the assumptions that underline the budgeted operating profit include market share, premium rate changes, claims inflation and commission rates.

– Growth rate represents the rate used to extrapolate future cash flows beyond the business plan period and has been based upon latest information available regarding future and past growth rates. The growth rate is considered to be consistent with both past experience and external sources of data (ABI Annual Market Statistics).

RAC (non–insurance operations)

The recoverable amount of the RAC (non-insurance operations) has also 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 10.45%. Cash flows beyond that three year period have been extrapolated using a steady 2% growth rate. The recoverable amount significantly exceeds the carrying value of the cash generating unit including goodwill and intangible assets with indefinite useful lives and a reasonably possible change in a key assumption will not cause the carrying value of the cash generating unit to exceed its recoverable amount.

Key assumptions used for the calculation were:

– Budgeted operating profit represents the operating profit in the business plans, approved by management and as such reflect the best estimate of future profits based on both historical experience and expected growth. Some of the assumptions that underline the budgeted operating profit include market share, fee income and customer numbers.

Other

During the year, goodwill allocated to a Life cash-generating unit in Germany was tested for impairment. Following the impairment test, an impairment charge of £21 million has been recognised in the income statement. The impairment charge arose as a result of the low interest rate environment in which the cash generating unit operates in and the further decline in interest rates during the year. The recoverable amount for the cash-generating unit has been measured based on a value in use calculation. A pre-tax discount rate of 6.75% was used in the value in use calculation and cash flows beyond the plan period have been extrapolated using a steady 4.85% growth rate.

The remaining £22 million related to other small European businesses. The 2004 impairment charge of £41 million comprise £21 million on one non-insurance Dutch operation, £17 million on other small European businesses and £3 million on other operations.

Notes to the consolidated financial statements continued

16 – Acquired value of in-force business (AVIF) and intangible assets

	AVIF £m	Intangible assets £m	Total £m
Gross amount			
At 1 January 2004	578	166	744
Additions	–	5	5
Acquisition of subsidiaries	30	61	91
Foreign exchange rate movements	5	1	6
At 31 December 2004	613	233	846
Additions	13	60	73
Acquisition of subsidiaries	–	333	333
Foreign exchange rate movements	(12)	(1)	(13)
At 31 December 2005	**614**	**625**	**1,239**
Accumulated amortisation			
At 1 January 2004	(182)	(74)	(256)
Amortisation for the year	(51)	(7)	(58)
Impairment losses recognised	(13)	–	(13)
Foreign exchange rate movements	(2)	(1)	(3)
At 31 December 2004	(248)	(82)	(330)
Amortisation for the year	(26)	(39)	(65)
Impairment losses recognised	(29)	(6)	(35)
Foreign exchange rate movements	4	(1)	3
At 31 December 2005	**(299)**	**(128)**	**(427)**
Carrying amount			
At 1 January 2004	396	92	488
At 31 December 2004	365	151	516
At 31 December 2005	**315**	**497**	**812**
Less: amount classified as held for sale	**–**	**(9)**	**(9)**
	315	**488**	**803**

Of the £392 million of intangibles acquired in the RAC group, £310 million relating to subsidiaries is included in the acquisitions figure above and £82 million relating to joint ventures is dealt with in note 17(a). Note 3(a)(i) gives details of the nature of these assets, some of which have indefinite lives, and of the amortisation periods adopted.

17 – Investments in joint ventures

(a) Carrying amount

	Goodwill and intangibles (see notes 15(a) and 16) £m	Equity interests £m	Loans £m	Total 2005 £m	Total 2004 £m
At 1 January	–	**1,255**	–	**1,255**	871
Share of results before tax	–	**332**	–	**332**	234
Share of tax	–	**(6)**	–	**(6)**	–
Share of profit after tax	–	**326**	–	**326**	234
Acquisitions and additions	**167**	**587**	–	**754**	272
Disposals and reductions in group interests	–	**(43)**	–	**(43)**	–
Reclassification to subsidiaries	–	**(8)**	–	**(8)**	(89)
Dividends received	–	**(34)**	–	**(34)**	(33)
Additional loans	–	–	**128**	**128**	–
Foreign exchange rate movements	–	**1**	–	**1**	–
Other movements and amounts classified as held for sale	**(167)**	**(83)**	–	**(250)**	–
Movements in carrying amount	–	**746**	**128**	**874**	384
At 31 December	–	**2,001**	**128**	**2,129**	1,255

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.

(b) Property management undertakings

(i) 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.

Most of the PLPs have raised external debt, secured on their respective property portfolios. The lenders are only entitled to obtain payment, of both interest and principal, to the extent that there are sufficient resources in the respective PLPs. The lenders have no recourse whatsoever to the policyholder or shareholders' funds of any company in the Aviva Group.

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 take via the relevant PUT and GP) may be greater than 50%, such PUTs and PLPs have been classified as jointly-controlled entities. These are accounted for as joint ventures, and are covered in this note. Where the Group holds minority stakes in PLPs, with no disproportionate influence, the relevant investments are included in financial investments at their fair value.

(ii) The principal joint ventures are as follows:

Company	GP proportion held	PLP proportion held
Airport Property Partnership	50.0%	50.0%
Apia Regional Office Fund	50.0%	70.0%
Ashtenne Industrial Fund Limited Partnership	66.7%	40.2%
The Global Switch Limited Partnership	25.0%	25.0%
The Junction Limited Partnership	50.0%	48.8%
The Mall Limited Partnership	50.0%	38.2%
Paddington Central 1 Limited Partnership	50.0%	50.0%
Queensgate Limited Partnership	50.0%	50.0%
Quercus Property Partnership Limited	50.0%	66.4%

All the above entities perform property ownership and management activities, and are incorporated and operate in Great Britain. The Global Switch Limited Partnership has subsidiaries in several European countries which carry out property ownership and management activities locally. All these investments are held by subsidiary entities.

Notes to the consolidated financial statements continued

17 – Investments in joint ventures continued

(c) Other

The Group also has a 50% holding in AVIVA-COFCO Life Insurance Company Limited, a life assurance company incorporated and operating in China. These shares are held by the Company, with a share of net assets of £10 million *(2004: £14 million)* and a fair value of £22 million *(2004: £22 million)*.

(d) Additional information

Summarised aggregate financial information on the Group's interests in its joint ventures is as follows:

	2005 £m	2004 £m
Income	**394**	249
Expenses	**(62)**	(15)
Share of profit before tax	**332**	234
Long-term assets	**3,333**	2,049
Current assets	**116**	110
Total assets	**3,449**	2,159
Long-term liabilities	**(1,311)**	(743)
Current liabilities	**(137)**	(161)
Total liabilities	**(1,448)**	(904)
Share of net assets	**2,001**	1,255

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 interest in the joint ventures.

18 – Investments in associates

(a) Carrying amount

	Goodwill £m	Equity interests £m	Loans £m	Total 2005 £m	Total 2004 £m
At 1 January	**247**	**615**	**11**	**873**	1,108
Share of results before tax	**–**	**39**	**–**	**39**	28
Share of tax	**–**	**(7)**	**–**	**(7)**	(20)
Share of results after tax	**–**	**32**	**–**	**32**	8
Amortisation of acquired value of in-force business	**–**	**(18)**	**–**	**(18)**	(21)
Share of profit/(loss) after tax	**–**	**14**	**–**	**14**	(13)
Acquisitions	**5**	**65**	**–**	**70**	83
Disposals	**–**	**–**	**–**	**–**	(275)
Fair value gains/(losses) taken to equity	**–**	**(2)**	**–**	**(2)**	–
Dividends received	**–**	**(61)**	**–**	**(61)**	(19)
Foreign exchange rate movements	**–**	**(4)**	**–**	**(4)**	(11)
Additional loans/(loans repaid)	**–**	**–**	**–**	**–**	1
Other movements and amounts classified as held for sale	**–**	**(5)**	**–**	**(5)**	(1)
Movements in carrying amount	**5**	**7**	**–**	**12**	(235)
At 31 December	**252**	**622**	**11**	**885**	873

The loans are not secured and no guarantees were received in respect thereof. They bear an annual interest of 10%, and will be settled in cash through monthly payments over the next two years.

18 – Investments in associates continued

(b) 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 Pvt. Limited	Insurance	Ordinary Rs1 shares	26.0%	India
ProCapital S.A.	Online brokerage	Ordinary €1 shares	43.5%	France
RBSG Collective Investments Limited	Investment	Ordinary £1 shares	49.99%	Great Britain
RBS Life Investments Limited	Insurance	Ordinary £1 shares	49.99%	Great Britain
The British Aviation Insurance Company Limited	Insurance	Ordinary £1 shares	38.1%	Great Britain

All investments in principal associates are unlisted and are held by subsidiaries.

(c) Additional information

(i) Summarised aggregate financial information on the Group's interests in its associates is as follows:

	2005 £m	2004 £m
Revenues	**277**	445
Share of profit before tax	**39**	28
Assets	**2,897**	2,786
Liabilities	**(2,275)**	(2,171)
Share of net assets	**622**	615

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 the associates.

(ii) In France, the Group has invested in a number of specialised investment companies. These invest mainly in equities, bonds, cash and cash equivalents, and properties, and distribute most of their income. Where the Group owns less than 50% of such companies, its interests are included in the consolidated balance sheet within financial investments or cash and cash equivalents as appropriate.

(d) Impairment testing

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 the investments have been determined based on value in use calculations. The calculations use cash flow projections based on business plans approved by management covering a five year period and a risk adjusted discount rate of 9.9%. Cash flows beyond that five-year period have been extrapolated using a growth rate of 4.5%.The recoverable amounts significantly exceed the carrying values of both the investments and a reasonably possible change to the key underlying assumptions will not cause the carrying values of the investments to exceed their recoverable amounts.

Notes to the consolidated financial statements continued

19 – Property and equipment

	Properties under construction £m	Owner-occupied properties £m	Motor vehicles £m	Computer equipment £m	Other assets £m	Total £m
Cost or valuation						
At 1 January 2004	145	442	39	514	297	1,437
Additions	1	8	14	95	65	183
Capitalised expenditure on existing assets	19	13	–	–	–	32
Acquisitions of subsidiaries	–	–	–	–	7	7
Disposal of subsidiaries	–	(7)	–	(6)	(6)	(19)
Disposals	(63)	(100)	(26)	(23)	(38)	(250)
Transfers to investment property	(43)	40	–	–	–	(3)
Fair value gains (see note 32)	–	42	–	–	–	42
Foreign exchange rate movements	(2)	3	–	2	2	5
At 31 December 2004	57	441	27	582	327	1,434
Additions	10	2	18	106	63	199
Capitalised expenditure on existing assets	7	–	–	–	–	7
Acquisitions of subsidiaries	–	35	44	9	49	137
Disposals	(19)	(7)	–	(42)	(70)	(138)
Fair value gains (see note 32)	–	33	–	–	–	33
Foreign exchange rate movements	(1)	(5)	–	–	(1)	(7)
At 31 December 2005	**54**	**499**	**89**	**655**	**368**	**1,665**

	Properties under construction £m	Owner-occupied properties £m	Motor vehicles £m	Computer equipment £m	Other assets £m	Total £m
Depreciation						
At 1 January 2004			(18)	(319)	(217)	(554)
Charge for the year	–	–	(8)	(68)	(21)	(97)
Disposals	–	–	9	17	22	48
Disposal of subsidiaries	–	–	–	4	4	8
Impairment losses	–	–	–	(19)	(6)	(25)
Foreign exchange rate movements	–	–	–	(2)	–	(2)
At 31 December 2004	–	–	(17)	(387)	(218)	(622)
Charge for the year	–	–	(4)	(77)	(31)	(112)
Disposals	–	–	–	26	12	38
Foreign exchange rate movements	–	–	–	1	–	1
At 31 December 2005	**–**	**–**	**(21)**	**(437)**	**(237)**	**(695)**
Carrying amount						
At 1 January 2004	145	442	21	195	80	883
At 31 December 2004	57	441	10	195	109	812
At 31 December 2005	**54**	**499**	**68**	**218**	**131**	**970**
Less assets classified as held for sale	**–**	**–**	**–**	**–**	**(85)**	**(85)**
	54	**499**	**68**	**218**	**46**	**885**

Impairment losses/reversal of impairment losses recognised in the income statement and in equity were £nil *(2004: £25 million)* and £nil *(2004: £nil)* respectively.

19 – 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. Values are calculated on the basis of existing use, being the estimated arms-length value at which the properties could be exchanged with vacant possession and without allowing for alternatives to their current use.

If owner-occupied properties were stated on a historical cost basis, the carrying amount would be as follows:

	2005 £m	2004 £m
Cost	**449**	359
Accumulated depreciation	**(43)**	(36)
Carrying amount	**406**	323

The Group has no material finance leases for property and equipment.

20 – Investment property

	Freehold £m	Leasehold £m	Total £m
Carrying value			
At 1 January 2004	7,692	2,032	9,724
Additions	992	219	1,211
Capitalised expenditure on existing properties	93	17	110
Fair value gains	1,056	98	1,154
Disposals	(747)	(409)	(1,156)
Transfers from property and equipment	3	–	3
Foreign exchange rate movements	11	–	11
At 31 December 2004	9,100	1,957	11,057
Additions	1,596	173	1,769
Capitalised expenditure on existing properties	126	61	187
Fair value gains	1,169	402	1,571
Disposals	(1,171)	(80)	(1,251)
Foreign exchange rate movements	(55)	(3)	(58)
At 31 December 2005	**10,765**	**2,510**	**13,275**

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.

The fair value of investment properties leased to third parties under operating leases was as follows:

	2005 £m	2004 £m
Freeholds	**9,036**	9,065
Long leaseholds – over 50 years	**3,018**	1,939
Short leaseholds – under 50 years	**–**	6
	12,054	11,010

Notes to the consolidated financial statements continued

21 – Loans

(a) Carrying amounts

The carrying amounts of loans at 31 December 2005 and 2004 were as follows:

	2005 £m	2004 £m
Policy loans	**1,020**	1,032
Bank loans	**125**	52
Securitised mortgage loans (see note 22)	**7,476**	5,106
Non-securitised mortgage loans	**15,224**	14,663
Other loans	**699**	1,202
Total	**24,544**	22,055

Of the above loans, £12,257 million *(2004: £11,014 million)* is expected to be recovered more than one year after the balance sheet date.

The impairment charge in respect of the above loans, charged to profit for the year, was £8 million *(2004: £5 million)* and reversals of impairments on these loans were £4 million *(2004: £4 million*).

(b) Collateral

At 31 December 2005, the fair values of collateral which the Group has accepted and is permitted to sell or repledge in the absence of default, and of collateral that the Group has sold and has an obligation to return, were £580 million and £nil, respectively *(2004: £nil and £nil, respectively)*.

22 – Securitised mortgages and related assets

The Group has loans secured by mortgages, subject to non-recourse finance arrangements, in a UK long-term business subsidiary and in two Dutch subsidiaries. Details of the relevant transactions are as follows:

(a) United Kingdom

In a United Kingdom long-term business subsidiary (NUER), the beneficial interest in certain portfolios of lifetime mortgages has been transferred to five special purpose securitisation companies, Equity Release Funding (No 1) plc (ERF1), Equity Release Funding (No 2) plc (ERF2), Equity Release Funding (No 3) plc (ERF3), ERF Trustee (No 4) Limited (ERF4T) held on trust for the benefit of Equity Release Funding (No. 4) plc (ERF4), and ERF Trustee (No 5) Limited (ERF5T) held on trust for the benefit of Equity Release Funding (No. 5) plc (ERF5) (together "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 note holders, loan providers and other third parties in the priority of payments. No gain or loss was recognised on the transfers to ERF1, ERF3 and ERF5T, and gains of £5 million and £9 million were recognised on the transfers to ERF2 and ERF4T respectively. The purchases of the mortgages were funded by the issue of fixed rate, floating rate and index-linked 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, these have 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 offset against the borrowings of the ERF companies in the consolidated balance sheet.

(b) Netherlands

In two Dutch subsidiaries, Delta Lloyd Levensverzekering NV (DLL) and Amstelhuys NV (AMS), the principal benefits of certain portfolios of mortgage loans have been transferred to a number of special purpose securitisation companies, Arena 2000 - I BV, Arena 2001 - I BV, Arena 2002 - I BV, Arena 2003 - I BV, Arena 2004 - I BV, Arena 2004 - II BV, Arena 2005 - I BV and DARTS Finance BV (the securitisation companies), which were funded primarily through the issue of fixed rate, floating rate and index-linked notes. No gains or losses were recognised on these transfers.

22 – Securitised mortgages and related assets continued
All the shares in the Arena companies are held by independent trustee companies. Although DLL and AMS do not own, directly or indirectly, any of the share capital of the securitisation companies or their parent companies, these companies have been treated as subsidiaries in the consolidated financial statements. DLL and AMS have no right, nor any obligation, to repurchase the benefit of any of the securitised mortgage loans, 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 offset against the borrowings of the securitisation companies in the consolidated balance sheet.

(c) 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 principal 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.

23 – Financial investments
(a) Financial investments comprise:

				2005
	At fair value through profit or loss			
	Trading £m	Other than trading £m	Available for sale* £m	Total £m
Debt securities				
UK government	**–**	**22,845**	**–**	**22,845**
Non-UK government	**4**	**22,908**	**438**	**23,350**
Corporate – UK	**–**	**11,492**	**58**	**11,550**
Corporate – Non-UK	**81**	**31,345**	**5,237**	**36,663**
Other	**–**	**8,834**	**675**	**9,509**
	85	**97,424**	**6,408**	**103,917**
Equity securities				
Corporate – UK	**–**	**29,036**	**13**	**29,049**
Corporate – Non-UK	**58**	**21,610**	**1,327**	**22,995**
	58	**50,646**	**1,340**	**52,044**
Other investments				
Unit trusts	**4**	**14,419**	**3**	**14,426**
Derivative financial instruments	**1,003**	**(536)**	**–**	**467**
Deposits with credit institutions	**–**	**165**	**–**	**165**
Specialised investment companies (see note 18c)	**–**	**9,783**	**–**	**9,783**
Minority holdings in property management undertakings (see note 17b)	**–**	**499**	**–**	**499**
Other	**(6)**	**1,069**	**24**	**1,087**
	1,001	**25,399**	**27**	**26,427**
Total financial investments	**1,144**	**173,469**	**7,775**	**182,388**

*The loss related to AFS investments recognised in equity was £65 million *(2004: £64 million loss)* and the amount recognised in the income statement on disposals was £154 million *(2004: £322 million gain)*. (See notes 5 and 32).

Of the above total, £19,509 million *(2004: £17,794 million)* is expected to be recovered more than one year after the balance sheet date.

Notes to the consolidated financial statements continued

23 – Financial investments continued

				2004
	At fair value through profit or loss			
	Trading £m	Other than trading £m	Available for sale* £m	Total £m
Debt securities				
UK Government	–	23,581	–	23,581
Non – UK government	34	24,260	586	24,880
Corporate – UK	–	9,472	45	9,517
Corporate – Non-UK	112	31,651	6,033	37,796
Other	–	2,433	512	2,945
	146	91,397	7,176	98,719
Equity securities				
Corporate – UK	36	27,094	4	27,134
Corporate – Non-UK	23	17,468	2,666	20,157
	59	44,562	2,670	47,291
Other investments				
Unit trusts	3	9,561	2	9,566
Derivative financial instruments	549	58	10	617
Deposits with credit institutions	–	1,699	2	1,701
Specialised investment companies (see note 18c)	–	7,942	–	7,942
Minority holdings in property management undertakings (see note 17b)	–	410	–	410
Other	7	75	28	110
	559	19,745	42	20,346
Total financial investments	764	155,704	9,888	166,356

*The loss related to AFS investments recognised in equity was £65 million *(2004: £64 million loss)* and the amount recognised in the income statement on disposals was £154 million *(2004: £322 million gain)*. (See notes 5 and 32).

(b) The following is a summary of the cost/amortised cost, gross unrealised gains and losses and fair value of financial investments:

				2005
	Cost/ amortised cost £m	Unrealised gains £m	Unrealised losses £m	Fair value £m
Debt securities	**99,086**	**5,006**	**(175)**	**103,917**
Equity securities	**42,578**	**9,562**	**(96)**	**52,044**
Other investments				
Unit trusts	**12,552**	**1,885**	**(11)**	**14,426**
Derivative financial instruments	**–**	**467**	**–**	**467**
Deposits with credit institutions	**165**	**–**	**–**	**165**
Specialised investment companies	**9,783**	**–**	**–**	**9,783**
Minority holdings in property management undertakings	**499**	**–**	**–**	**499**
Other	**1,040**	**49**	**(2)**	**1,087**
	165,703	**16,969**	**(284)**	**182,388**

23 – Financial investments continued

	Cost/ amortised cost £m	Unrealised gains £m	Unrealised losses £m	Fair value £m
				2004
Debt securities	94,338	4,527	(146)	98,719
Equity securities	42,161	5,429	(299)	47,291
Other investments				
Unit trusts	8,903	737	(74)	9,566
Derivative financial instruments	–	617	–	617
Deposits with credit institutions	1,701	–	–	1,701
Specialised investment companies	7,942	–	–	7,942
Minority holdings in property management undertakings	410	–	–	410
Other	83	34	(7)	110
	155,538	11,344	(526)	166,356

(c) Other information on investments

(i) In addition to the investments in associates detailed in note 18, the Group holds investments exceeding 20% of a class of the equity capital in a number of other companies in the United Kingdom and elsewhere. These investments do not represent a material part of the assets or investment income of the Group. These include the Group's shareholding in Delta Lloyd Investment Fund NV where nil *(2004: 20.13%)* is held directly and a further nil *(2004: 11.74%)* is held in segregated policyholders funds. As this company invests mainly in equities and all dividends received are passed on to the shareholders, the Group's interest has been shown in other financial instruments in these financial statements.

(ii) Included within financial investments are strategic investments held on a long-term basis as follows:

	Market value of shareholding								
	Long-term business		Non-long-term business		Total		Proportion held		
	2005 £m	2004 £m	2005 £m	2004 £m	2005 £m	2004 £m	2005 %	2004 %	Country of incorporation
Münchener Rückversicherungs-Gesellschaft	**150**	205	**–**	179	**150**	384	**0.8%**	2.5%	Germany
UniCredito Italiano	**383**	283	**501**	255	**884**	538	**2.1%**	2.8%	Italy
Société Générale	**–**	242	**–**	2	**–**	244	**–**	1.1%	France
	533	730	**501**	436	**1,034**	1,166			

All of the above are banking companies, except Münchener Rückversicherungs-Gesellschaft which is a reinsurance company.

(d) Impairments

The accumulated impairment charges on available for sale investments are as follows:

	Debt securities £m	Equity securities £m	Other investments £m	Total £m
				2005
At 1 January	**2**	**369**	**–**	**371**
Impairment charges for the year	**4**	**44**	**7**	**55**
Reversal of impairment charges during the year	**(1)**	**(122)**	**(1)**	**(124)**
Other	**1**	**(11)**	**–**	**(10)**
At 31 December	**6**	**280**	**6**	**292**

	Debt securities £m	Equity securities £m	Other investments £m	Total £m
				2004
At 1 January	3	510	–	513
Impairment charges for the year	–	–	–	–
Reversal of impairment charges during the year	(1)	(137)	–	(138)
Other	–	(4)	–	(4)
At 31 December	2	369	–	371

Notes to the consolidated financial statements continued

23 – Financial investments continued

(e) Stocklending

The Group has entered into stocklending arrangements in the United Kingdom and overseas during the year in accordance with established market conventions. In the United Kingdom, investments are lent to locally-domiciled counterparties and governed by agreements written under English law. Other investments are specifically deposited under local laws in various countries overseas as security to holders of policies issued there.

Included within financial investments are £461 million *(2004: £240 million)* of debt securities and other fixed income securities which have been sold under stock repurchase arrangements. The obligations arising under these arrangements are included in other financial liabilities (see note 44).

The carrying amounts of financial assets received and pledged as collateral under stocklending arrangements at 31 December 2005 are £1,869 million and £nil million respectively *(2004: £3,210 million and £nil respectively)*.

24 – Receivables and other financial assets

	2005 £m	2004 £m
Amounts owed by contract holders	**1,873**	1,949
Amounts owed by intermediaries	**1,543**	1,711
Deposits with ceding undertakings	**1,050**	984
Amounts due from reinsurers	**820**	736
Other financial assets	**2,488**	2,129
Total	**7,774**	7,509
Less: Amounts classified as held for sale	**(68)**	–
	7,706	7,509
Expected to be recovered in less than one year	**7,210**	7,026
Expected to be recovered in more than one year	**496**	483
	7,706	7,509

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.

25 – Deferred acquisition costs and other assets

(a) The carrying amount comprises:

	Long-term business £m	General insurance and health £m	Total 2005 £m	Total 2004 £m
Deferred acquisition costs in respect of:				
Insurance contracts	**1,139**	**1,281**	**2,420**	2,120
Participating investment contracts	**3**	**–**	**3**	95
Non-participating investment contracts	**752**	**–**	**752**	494
	1,894	**1,281**	**3,175**	2,709
Other assets	**393**	**238**	**631**	480
Total	**2,287**	**1,519**	**3,806**	3,189
Less: Amounts classified as held for sale	**–**	**(40)**	**(40)**	–
	2,287	**1,479**	**3,766**	3,189

Deferred acquisition costs on long-term business are generally recoverable in more than one year whilst such costs on general insurance and health business are generally recoverable within one year after the balance sheet date.

25 – Deferred acquisition costs and other assets continued

(b) The movements in deferred acquisition costs during the year were:

	2005 £m	2004 £m
Carrying amount at 1 January	**2,709**	2,872
Acquisition costs deferred during the year	**3,108**	2,807
Amortisation	**(2,704)**	(3,027)
Impairment losses	**(4)**	(7)
Reversal of impairment losses	**–**	2
Other movements	**66**	62
Carrying amount at 31 December	**3,175**	2,709

(c) Other assets include £472 million *(2004: £369 million)* that is expected to be recovered more than one year after the balance sheet date.

(d) Prepayments and accrued income include £467 million *(2004: £456 million)* that is expected to be recovered more than one year after the balance sheet date.

26 – 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 disclosed in notes 35 and 37.

The carrying values of assets backing these unit-linked liabilities are as follows:

	2005 £m	2004 £m
Loans	**–**	1
Debt securities	**18,220**	13,484
Equity securities	**16,332**	18,251
Other investments	**21,704**	16,378
Reinsurance assets	**1,232**	854
Cash and cash equivalents	**2,675**	953
	60,163	49,921

27 – Ordinary share capital

(a) Details of the Company's ordinary share capital are as follows:

	2005 £m	2004 £m
The authorised share capital of the Company at 31 December 2005 was: 3,000,000,000 *(2004: 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 2005 was: 2,395,693,688 *(2004: 2,282,385,200)* ordinary shares of 25 pence each	**599**	570

(b) During 2005, a total of 113,308,488 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	**2,282,385,200**	**570**	**1,115**
Shares issued under the Group's employee and executive share option schemes	**9,299,569**	**3**	**56**
Shares issued in connection with acquisitions	**87,865,495**	**22**	**–**
Shared issued in lieu of dividends	**16,143,424**	**4**	**(4)**
At 31 December	**2,395,693,688**	**599**	**1,167**

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 2004 final and 2005 interim dividends were issued on 17 May and 17 November 2005 respectively. 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.

Notes to the consolidated financial statements continued

28 – Equity compensation plans

(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 United Kingdom and in Ireland. Options are normally exercisable during the six-month period following either the third, fifth or seventh anniversary of the relevant savings contract.

(ii) Executive share options

These are options granted on various dates from 1996 to 2004, under the Aviva Executive Share Option Scheme or predecessor schemes. The exercise of options granted before 1997 is not subject to performance conditions. Options granted between 1997 and 2000 were subject to the satisfaction of conditions relating to either the Company's return on capital employed (ROCE) 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 ROCE 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 to senior Group executives since 2001 and are described in section (b) below and on pages 66 and 67.

(v) Deferred bonus plan awards

These awards have been made under the Aviva Deferred Bonus Plan, and are described in section (b) below and on page 74.

The Group has established various employee share trusts to facilitate the delivery of shares under the above schemes. Details of these trusts are given in note 29.

(b) Outstanding options and awards

(i) Share options

At 31 December 2005, 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
	797.60	108,651	2005	401.00	5,701,071	2005, 2007 or 2009
	750.00	54,005	2006	406.00	3,136,755	2006, 2008 or 2010
	895.20	277,481	2005 or 2007	428.00	1,929,984	2007, 2009 or 2011
	664.00	475,852	2006 or 2008	491.00	5,465,734	2008, 2010 or 2012

Hibernian Savings Related Share Option Scheme (in euros)	Option price c	Number of shares	Normally exercisable	Option price c	Number of shares	Normally exercisable
	1,653.37	1,253	2005	586.00	345,248	2006 or 2008
	1,087.56	10,502	2006	630.12	117,791	2007 or 2009
	662.85	122,334	2005 or 2007	719.00	184,251	2008 or 2010

RAC Savings Related Share Option Scheme	Option price p	Number of shares	Normally exercisable	Option price p	Number of shares	Normally exercisable
	175.44	1,229	2005	312.27	1,207,928	2006 or 2008
	291.27	437,793	2004 or 2006	354.94	1,046,850	2007 or 2009

Aviva Executive Share Option Scheme	Option price p	Number of shares	Normally exercisable	Option price p	Number of shares	Normally exercisable
	581.17	35,382*	1999 to 2006	965.00	7,425	2002 to 2009
	601.17	17,299*	1999 to 2006	870.83	48,186	2002 to 2009
	689.17	13,690*	1999 to 2006	919.00	543,069	2002 to 2009
	733.50	5,817	2000 to 2007	822.00	51,478	2003 to 2010
	677.50	13,587	2000 to 2007	972.33	15,104	2003 to 2010
	725.50	2,345	2000 to 2007	960.00	50,759	2003 to 2010
	763.50	3,929	2000 to 2007	1,035.00	794,809	2004 to 2011
	773.50	5,817	2000 to 2007	499.00	14,272	2005 to 2012
	857.00	19,987	2000 to 2007	516.00	2,036,445	2005 to 2012
	1,073.31	8,385	2001 to 2008	512.00	4,086,909	2006 to 2013
	1,119.00	35,193	2001 to 2008	526.00	4,015,805	2007 to 2014
	853.00	287,420	2001 to 2008			

28 – Equity compensation plans continued

General Accident Executive Share Option Scheme	Option price p	Number of shares	Normally exercisable	Option price p	Number of shares	Normally exercisable
	553.93	59,173	1999 to 2006	766.42	119,887	2000 to 2007

Aviva Executive Share Option Scheme (Delta Lloyd)	Option price p	Number of shares	Normally exercisable	Option price p	Number of shares	Normally exercisable
	950.00	96,858	2001 to 2006	380.00	2,077,700	2003 to 2008
	739.00	697,792	2002 to 2007			

RAC Executive Share Option Scheme	Option price p	Number of shares	Normally exercisable	Option price p	Number of shares	Normally exercisable
	347.49	18,274	2005 to 2009	251.30	30,387	2000 to 2010

CGU plc Deferred Bonus Plan	Option price p	Number of shares	Normally exercisable	Option price p	Number of shares	Normally exercisable
	899.50	19,223	2002 to 2009	875.00	36,507	2006 to 2010
	966.50	1,986	2002 to 2009			

Other than those grants marked with an asterisk, the exercise of options outstanding under the Aviva Executive Share Option Scheme and the Aviva Executive Share Option Scheme (Delta Lloyd) are subject to the attainment of performance conditions. Options which are not exercised lapse.

The following table summarises information about options outstanding at 31 December 2005:

Range of exercise prices	Outstanding options Number	Weighted average remaining contractual life Years	Weighted average exercise price p
£1.75 – £4.89	**15,587,971**	**2**	**389.20**
£4.90 – £8.04	**18,090,563**	**5**	**532.73**
£8.05 – £11.19	**2,305,625**	**4**	**950.85**

The comparative figures as at 31 December 2004 were:

Range of exercise prices	Outstanding options Number	Weighted average remaining contractual life Years	Weighted average exercise price p
£1.75 – £4.89	19,771,909	3	402.88
£4.90 – £8.04	16,202,411	6	555.36
£8.05 – £11.19	3,643,158	4	963.02

(ii) Share awards

At 31 December 2005, 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	Number of shares	Vesting period
	3,379,189	2003 to 2005
	2,684,832	2004 to 2006

Aviva Long-Term Incentive Plan 2005	Number of shares	Vesting date
	3,847,369	2005 to 2007

Aviva Deferred Bonus Plan	Number of shares	Vesting date	Number of shares	Vesting date
	3,403,442	28 March 2006	3,109,886	24 March 2008
	3,391,464	26 March 2007		

Aviva Share Plan	Number of shares	Vesting date
	13,462	31 December 2006

The vesting of awards under the Aviva Long-Term Incentive Plan is subject to the attainment of performance conditions as described in the Directors' remuneration report on page 67. Shares which do not vest, lapse.

Notes to the consolidated financial statements continued

28 – Equity compensation plans continued

(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 an employee share trust which was established for the purpose of satisfying awards under the various executive incentive plans and funded by the Company. From March 2003, no shares have been purchased by the trust, it being the Company's current practice to satisfy the awards granted after that date by the issue of new shares at the time of vesting. At 31 December 2005, 1,823,788 shares were held by the employee share trust with an aggregate nominal value of £455,947 and market value of £12.8 million. The trustees have waived their right to dividends on the shares held in this trust. Further details are given in note 29.

(c) Movements in the year

A summary of the status of the option plans as at 31 December 2005 and 2004, and changes during the years ended on those dates, is shown below.

	2005		2004	
	Number of options	Weighted average exercise price p	Number of options	Weighted average exercise price p
Outstanding at 1 January	**39,617,478**	**516.75**	41,818,166	556.10
Granted during the year	**7,956,344**	**434.64**	6,830,193	493.88
Forfeited during the year	**(890)**	**719.00**	–	
Exercised during the year	**(5,918,840)**	**419.69**	(902,698)	418.16
Expired during the year	**(5,669,933)**	**581.58**	(8,128,183)	696.65
Outstanding at 31 December	**35,984,159**	**497.34**	39,617,478	516.75
Exercisable at 31 December	**8,238,435**	**600.59**	8,077,112	720.94

(d) Expense charged to income statement

The total expense recognised for the year arising from equity compensation plans was as follows

	2005 £m	2004 £m
Equity-settled expense	**22**	21
Cash-settled expense	**–**	–
	22	21

(e) Fair value of options and awards granted after 7 November 2002

The weighted average fair value of options and awards granted during the year, estimated by using the Black-Scholes option-pricing model was £1.88 and £4.50 *(2004: £1.56 and £4.08)* 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	2005	2004
Share price	**618p**	538p
Exercise price	**491p**	492p
Expected volatility	**35%**	42%
Expected life	**3.81 years**	4.69 years
Expected dividend yield	**4.1%**	4.6%
Risk free interest rate	**4.2%**	4.9%

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 of 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.

No options were exercised during the year *(2004: nil)*.

28 – Equity compensation plans continued

(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	2005	2004
Share price	**632p**	528p
Expected volatility*	**41%**	46%
Expected volatility of comparator companies' share price*	**44%**	50%
Correlation between Aviva and competitors' share price*	**64%**	55%
Expected life	**3.0 years**	3.0 years
Expected dividend yield	**4.0%**	4.7%
Risk free interest rate*	**4.7%**	4.5%

*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 of 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.

29 – Shares held by employee trusts

Movements in the cost of shares held by employee trusts comprise:

	2005		2004	
	Number	£m	Number	£m
Cost debited to shareholders' funds				
At 1 January	**5,894,264**	**–**	7,598,384	41
Cost of options granted to employees in prior years		**–**		(40)
Net deduction from shareholders' funds		**–**		1
Distributed in year	**(4,070,476)**	**–**	(1,704,120)	(1)
Balance at 31 December	**1,823,788**	**–**	5,894,264	–

These shares are owned by employee share trusts in the Company and a subsidiary undertaking to satisfy awards under the Group's Long Term Incentive Plan and Deferred Bonus Plans. The shares are purchased in the market and carried at cost. Further details of the shares held can be found in note 28. Details of the features of the plans can be found in the Directors' remuneration report on pages 65 and 74.

30 – Preference share capital

The preference share capital of the Company at 31 December 2005 was:

	2005 £m	2004 £m
Authorised		
200,000,000 cumulative irredeemable preference shares of £1 each	**200**	200
500,000,000 sterling new preference shares of £1 each	**500**	–
	700	200

	€m	€m
700,000,000 Euro new preference shares of €1 each	**700**	–

	£m	£m
Issued and paid up		
100,000,000 8⅜% cumulative irredeemable preference shares of £1 each	**100**	100
100,000,000 8¾% cumulative irredeemable preference shares of £1 each	**100**	100
	200	200

Notes to the consolidated financial statements continued

30 – Preference share capital continued

At the Annual General Meeting on 26 April 2005, the Company's authorised preference share capital was increased to £700 million and €700 million by the creation of the new shares in the above table, in connection with the November 2004 issue of direct capital instruments (DCIs) of the same value. Note 31 below gives the conditions under which the Company has the right (but not the obligation) to substitute the sterling DCIs with Sterling New Preference Shares and the euro DCIs with Euro New Preference Shares. Although the directors have no present intention to allot these new shares, and consider the likelihood of such an issue and allotment to be remote, the Company is obliged to create and maintain a sufficient number of authorised new shares to effect a substitution.

The new 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.

31 – Direct capital instrument

Notional amount	2005 £m	2004 £m
5.9021% £500 million direct capital instrument	**500**	500
4.7291% €700 million direct capital instrument	**490**	490
	990	990

The euro and sterling direct capital instruments (the DCIs) were issued on 25 November 2004, and issue costs of £9 million have been charged to reserves. The DCIs have no fixed redemption date but the Company may, at its sole option, redeem all (but not part) of the DCIs at their principal amount on 28 November 2014 and 27 July 2020 for the euro and sterling DCIs respectively, 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) redeem all (but not part) of the DCIs at their principal amount at any time prior to 28 November 2014 and 27 July 2020 for the euro and sterling DCIs respectively;

(ii) substitute at any time all (but not some only) 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;

(iii) substitute all (but not some only) 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.

32 – Other reserves

	Currency translation reserve (see accounting policy D) £m	Owner-occupied properties reserve (see accounting policy N) £m	Investment valuation reserve (see accounting policy R) £m	Hedging instruments reserve (see accounting policy S) £m	Equity compensation reserve (see accounting policy Y) £m	Total £m
Balance at 1 January 2004	–	104	439	–	–	543
Arising in the year:						
Fair value gains/(losses)	–	47	(64)	20	–	3
Fair value (gains)/losses transferred to profit	–	–	109	–	–	109
Fair value (gains)/losses transferred to retained earnings on disposals	–	18	–	–	–	18
Reserves credit for equity compensation plans (note 28d)	–	–	–	–	21	21
Foreign exchange rate movements	57	–	–	–	–	57
Aggregate tax effect – shareholder tax	–	(23)	14	(6)	–	(15)
Balance at 31 December 2004	57	146	498	14	21	736
Arising in the year:						
Fair value gains/(losses)	–	32	(65)	(19)	–	(52)
Fair value (gains)/losses transferred to profit	–	–	411	–	–	411
Share of fair value changes in joint ventures and associates taken to equity	–	2	–	–	–	2
Impairment losses on revalued assets	–	–	(45)	–	–	(45)
Reserves credit for equity compensation plans (note 28d)	–	–	–	–	22	22
Foreign exchange rate movements	(2)	–	–	19	–	17
Aggregate tax effect – policyholder tax	–	3	–	–	–	3
Aggregate tax effect – shareholder tax	–	(4)	45	5	–	46
Balance at 31 December 2005	**55**	**179**	**844**	**19**	**43**	**1,140**

The above reserves are shown net of minority interests.

33 – Retained earnings

	2005 £m	2004 £m
Balance at 1 January	**1,709**	1,055
Profit for the year attributable to equity shareholders	**1,767**	1,275
Actuarial gains and losses on pension schemes (note 42)	**(547)**	(145)
Dividends and appropriations (note 14)	**(657)**	(570)
Shares issued in lieu of dividends	**100**	103
Transaction costs on issue of direct capital instrument	**–**	(9)
Aggregate tax effect	**226**	–
Other movements	**(1)**	–
Balance at 31 December	**2,597**	1,709

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 2004 final and 2005 interim dividends, as explained in note 27(b).

Notes to the consolidated financial statements continued

34 – Minority interests

Minority interests at 31 December comprised:

	2005 £m	2004 £m
Equity shares in subsidiaries	**320**	388
Share of earnings	**153**	197
Share of other reserves	**399**	68
	872	653
Preference shares in General Accident plc	**250**	250
Preference shares in other subsidiaries	**6**	7
	1,128	910

35 – Insurance liabilities

(a) Carrying amount

Insurance liabilities at 31 December comprise:

	2005			2004		
	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	**59,958**	**–**	**59,958**	58,304	–	58,304
Unit-linked non-participating	**17,999**	**–**	**17,999**	15,227	–	15,227
Other non-participating	**36,473**	**–**	**36,473**	32,960	–	32,960
	114,430	**–**	**114,430**	106,491	–	106,491
Outstanding claims provisions	**605**	**10,641**	**11,246**	730	10,727	11,457
Provision for claims incurred but not reported	**–**	**2,324**	**2,324**	–	2,023	2,023
	605	**12,965**	**13,570**	730	12,750	13,480
Provision for unearned premiums	**–**	**5,381**	**5,381**	–	4,923	4,923
Provision arising from liability adequacy tests	**–**	**48**	**48**	–	33	33
Other technical provisions	**16**	**32**	**48**	2	87	89
Total	**115,051**	**18,426**	**133,477**	107,223	17,793	125,016
Less: Obligations to staff pension schemes transferred to provisions (note 41a)	**(875)**	**–**	**(875)**	(813)	–	(813)
AVIF recognised in realistic liabilities	**–**	**–**	**–**	(81)	–	(81)
	114,176	**18,426**	**132,602**	106,329	17,793	124,122

35 – Insurance liabilities continued

(b) Long-term business liabilities

(i) Business description

The Group underwrites long-term business in a number of countries as follows:

- In the United Kingdom mainly in
  - "with-profit" funds of CGNU Life Assurance, Commercial Union Life Assurance, and the With Profit and Provident Mutual funds of Norwich Union Life & Pensions ("NUL&P"), where the with-profits 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 which are determined by investment performance, subject to certain guarantees, and shareholders' profits are derived largely from management fees.
- In other overseas operations.

(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 there is discretion over these. 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, whilst 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.

Notes to the consolidated financial statements continued

35 – Insurance liabilities continued

The principal assumptions in the United Kingdom, France and the Netherlands are:

(a) United Kingdom

With-profit business The valuation of with-profit business has changed significantly during 2005 in accordance with the realistic basis set out by the UK's Financial Services Authority, 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 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 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, mainly 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. Where policyholders have valuable guarantees, options or promises, then future persistency is assumed to improve, and future take-up rates of guaranteed annuity options are assumed to increase.

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 year end 2005 being 4.23% for a policy with ten years outstanding.

Volatility of investment return The volatility of returns is assumed to be distributed as follows:

Financial investment	Volatility
Equities	20% (for UK stocks)
Property	15%
Gilts	3.25% (NUL&P WP)/4.75% (other WP funds)
Corporate bonds	5.25% (NUL&P WP)/6.75% (other WP funds)

Future regular bonuses Annual bonus assumptions for 2006 have been set consistently with the year end 2005 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. Since 2004, there have been some changes to the adjustments to the base tables for annuities in payment in order to reflect more closely the actual experience of this business.

35 – Insurance liabilities continued

		Mortality table used
	2005	2004
Assurances, pure endowments and deferred annuities before vesting	**Nil or AM92/AF92 or AM80/AF80 adjusted**	Nil or AM92/AF92 or AM80/AF80 or A67/70 adjusted
Pensions business after vesting and pensions annuities in payment	**PCMA00/PCFA00 or PMA92/PFA92 adjusted plus allowance for future mortality improvement**	PMA80/PFA80 or PMA92/PFA92 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. All contracts are assumed to continue for the contractual term.

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.

For all non-profit business, including annuities, 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 changes in the valuation discount rates since 2004 reflect the changes in the yields on the supporting assets.

	Valuation discount rates	
	2005	2004
Assurances		
Life conventional non-profit	**2.9% to 3.6%**	3.2% to 4.0%
Pensions conventional non-profit	**3.6% to 4.0%**	4.0% to 4.5%
Deferred annuities		
Non-profit – in deferment	**3.6% to 4.6%**	4.0% to 5.5%
Non-profit – in payment	**3.6%**	4.0%
Annuities in payment		
Convention annuity	**4.0% to 4.6%**	4.7% to 5.3%
Non-unit reserves		
Life	**3.2%**	3.5%
Pensions	**3.9%**	4.3%

Mortality assumptions are set with regard to recent company experience and general industry trends. Since 2004, there have been changes to the base tables in order to reflect more closely actual experience.

Notes to the consolidated financial statements continued

35 – Insurance liabilities continued

	Mortality tables used	
	2005	2004
Assurances		
Non-profit	**AM80/AF80 or AM92/AF92 or TM92/TF92 adjusted for smoker status and age/sex specific factors**	AM80/AF80 or AM92/AF92 or TM92/TF92 adjusted for smoker status and age/sex specific factors
Pure endowments and deferred annuities before vesting	**Nil or AM80/AF80 or AM92/AF92 adjusted**	Nil or AM80/AF80 or AM92/AF92 adjusted
General annuity business after vesting	**IML00/IFL00 adjusted plus allowance for future mortality improvement**	IM80/IF80 adjusted plus allowance for future mortality improvement
Pensions business after vesting	**PCMA00/PCFA00 adjusted plus allowance for future mortality improvement**	PMA80/PFA80 adjusted plus allowance for future mortality improvement
Annuities in payment		
General annuity business	**IML00/IFL00 adjusted plus allowance for future mortality improvement**	IMA80/IFA80 adjusted plus allowance for future mortality improvement
Pensions business	**PCMA00/PCFA00 adjusted plus allowance for future mortality improvement**	PMA80/PFA80 adjusted plus allowance for future mortality improvement

(b) France

The majority of provisions arise from a single premium savings product and are 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. There have been some reductions to valuation discount rates in 2005.

	Valuation discount rates		Mortality tables used
	2005	2004	2005 and 2004
Life assurances	**1.75% to 4.5%**	2.5% to 4.5%	PM60-64, TD73-77, TD 88/90
Annuities	**1.75% to 4.5%**	2.5% to 4.5%	TPRV (prospective table)

(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, using investment values and future investment income. Where assets are valued at market value, then the future investment income is based on expected market-based investment yields.

	Valuation discount rates	Mortality tables used
	2005 and 2004	2005 and 2004
Life assurances	actual swap rate	GBM 61-65, GMB71-75, GBM/V 76-80, GBM 80-85, GBM/V 85-90 and GBM/V 90-95
Annuities in deferment and in payment	actual swap rate	GBMV 76-80, GBMV 85-90, GBMV 95-00, Coll 1993/2003 and DIL 98, plus further allowance for future mortality improvement

35 – Insurance liabilities continued

(d) In all 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.

Movements

The following movements have occurred in the long-term business provisions during the year:

	2005 £m	2004 £m
Carrying amount at 1 January	**106,491**	96,228
Provisions in respect of new business	**6,589**	5,839
Expected change in existing business provisions	**(2,703)**	(3,164)
Variance between actual and expected experience	**3,784**	1,680
Impact of operating assumption changes	**(1,034)**	377
Impact of economic assumption changes	**2,411**	1,004
Other movements	**340**	227
Change in liability recognised as an expense	**9,387**	5,963
Portfolio transfers, acquisitions and disposals	**(360)**	924
Foreign exchange rate movements	**(684)**	289
Effect of adjusting to FRS 27 realistic basis	**–**	3,087
Other movements	**(404)**	–
Carrying amount at 31 December	**114,430**	106,491

The effect of changes in the main assumptions is given in note 39.

(c) General insurance and health liabilities

Provisions for outstanding claims

Significant 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:

		Rate		Mean term of liabilities	
Country	Class	2005	2004	2005	2004
Netherlands	Permanent health and injury	**3.21%**	3.27%	**7 years**	10 years

No equalisation or catastrophe reserves have been recognised. This treatment differs from UK GAAP and is explained in note 1 on the first time adoption of IFRS.

The net outstanding claims provisions before discounting were £13,014 million *(2004: £12,816 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.

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.

Notes to the consolidated financial statements continued

35 – Insurance liabilities continued
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 historic 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.

Movements
The following changes have occurred in the general insurance and health claims provisions during the year:

	2005 £m	2004 £m
Carrying amount at 1 January	**12,750**	12,378
Impact of changes in assumptions	**(6)**	(30)
Claim losses and expenses incurred in the current year	**7,124**	6,770
Increase/(decrease) in estimated claim losses and expenses incurred in prior years	**(372)**	(234)
Incurred claims losses and expenses	**6,746**	6,506
Less:		
Payments made on claims incurred in the current year	**(3,379)**	(3,120)
Payments made on claims incurred in prior years	**(3,407)**	(3,244)
Recoveries on claim payments	**263**	233
Claims payments made in the year, net of recoveries	**(6,523)**	(6,131)
Other movements in the claims provisions	**(9)**	27
Changes in claims reserve recognised as an expense	**214**	402
Gross portfolio transfers, acquisitions and disposals	**(153)**	2
Foreign exchange rate movements	**146**	32
Other gross movements	**8**	(64)
Carrying amount at 31 December	**12,965**	12,750

The effect of changes in the main assumptions is given in Note 39.

(d) Loss development tables
The tables that follow present the development of claim payments and the estimated ultimate cost of claims for the accident years 2001 to 2005. 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 2001, by the end of 2005 £5,966 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 £6,590 million was re-estimated to be £6,754 million at 31 December 2005. This increase from the original estimate is due to the combination of a number of factors, including claims being settled for larger amounts than originally estimated. The original estimates will also be increased or decreased, as more information becomes known about the individual claims and overall claim frequency and severity.

In the year of adoption of IFRS, only five years are required to be disclosed. This will be 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 claim 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 below. However, in order to maintain strong reserves, the Group transfers much of this release to current accident year (2005) reserves 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 2005 is also due to an improvement in the estimated ultimate cost of claims.

35 – Insurance liabilities continued

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	Total £m
Gross cumulative claim payments							
At end of accident year		(3,029)	(2,952)	(2,819)	(2,971)	(3,345)	
One year later		(4,766)	(4,486)	(4,190)	(4,561)		
Two years later		(5,303)	(4,921)	(4,613)			
Three years later		(5,701)	(5,233)				
Four years later		(5,966)					
Estimate of gross ultimate claims							
At end of accident year		6,590	6,250	6,385	6,891	7,106	
One year later		6,770	6,372	6,172	6,557		
Two years later		6,775	6,287	6,124			
Three years later		6,798	6,257				
Four years later		6,754					
Estimate of ultimate claims		6,754	6,257	6,124	6,557	7,106	
Cumulative payments		(5,966)	(5,233)	(4,613)	(4,561)	(3,345)	
	3,851	788	1,024	1,511	1,996	3,761	**12,931**
Effect of discounting	(22)	(5)	(5)	(5)	(5)	(7)	**(49)**
Present value	3,829	783	1,019	1,506	1,991	3,754	**12,882**
Cumulative effect of foreign exchange movements	–	13	18	23	29	–	**83**
Present value recognised in the balance sheet	3,829	796	1,037	1,529	2,020	3,754	**12,965**

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	Total £m
Net cumulative claim payments							
At end of accident year		(2,970)	(2,913)	(2,819)	(2,870)	(3,281)	
One year later		(4,624)	(4,369)	(4,158)	(4,378)		
Two years later		(5,088)	(4,779)	(4,565)			
Three years later		(5,436)	(5,064)				
Four years later		(5,648)					
Estimate of net ultimate claims							
At end of accident year		6,186	6,037	6,218	6,602	6,982	
One year later		6,333	6,038	6,093	6,266		
Two years later		6,321	5,997	6,037			
Three years later		6,329	5,973				
Four years later		6,286					
Estimate of ultimate claims		6,286	5,973	6,037	6,266	6,982	
Cumulative payments		(5,648)	(5,064)	(4,565)	(4,378)	(3,281)	
	2,417	638	909	1,472	1,888	3,701	**11,025**
Effect of discounting	(16)	(4)	(5)	(5)	(5)	(7)	**(42)**
Present value	2,401	634	904	1,467	1,883	3,694	**10,983**
Cumulative effect of foreign exchange movements	–	–	17	22	29	–	**68**
Present value recognised in the balance sheet	2,401	634	921	1,489	1,912	3,694	**11,051**

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 of entity as "paid" at the date of disposal.

The tables above include information on asbestos and environmental pollution claims provisions from business written before 2001. The claim provisions, net of reinsurance, in respect of this business were £289 million *(2004: £224million)*. These provisions were strengthened during the year by £83 million *(2004: £71 million)*.

Notes to the consolidated financial statements continued

35 – Insurance liabilities continued
(e) Provision for unearned premiums
Movements
The following changes have occurred in the provision for unearned premiums ("UPR") during the year:

	2005 £m	2004 £m
Carrying amount at 1 January	**4,923**	4,686
Premiums written during the year	**11,017**	10,562
Less:		
Premiums earned during the year	**(10,802)**	(10,339)
Other movements in UPR	**1**	9
Changes in UPR recognised as an expense	**216**	232
Gross portfolio transfers and acquisitions	**174**	7
Foreign exchange rate movements	**74**	8
Other movements	**(6)**	(10)
Carrying amount at 31 December	**5,381**	4,923

36 – Reinsurance assets
(a) Carrying amounts
(i) The reinsurance assets at 31 December comprised:

	2005 £m	2004 £m
Long-term business	**4,706**	5,878
General insurance and health	**2,424**	2,625
Total	**7,130**	8,503

Of the above total, £3,717 million *(2004: £4,433 million)* is expected to be recovered more than one year after the balance sheet date.

(ii) The following is a summary of the reinsurance assets and related insurance reserves as at 31 December.

	2005			2004		
	Gross provisions £m	Reinsurance assets £m	Net £m	Gross provisions £m	Reinsurance assets £m	Net £m
Long-term business provisions						
Long-term insurance contracts	**(113,555)**	**3,816**	**(109,739)**	(105,678)	4,304	(101,374)
Participating investment contracts	**(47,258)**	**–**	**(47,258)**	(43,974)	619	(43,355)
Non-participating investment contracts	**(30,051)**	**890**	**(29,161)**	(25,581)	955	(24,626)
	(190,864)	**4,706**	**(186,158)**	(175,233)	5,878	(169,355)
Outstanding claims provisions	**(11,246)**	**1,859**	**(9,387)**	(11,457)	2,140	(9,317)
Provisions for claims incurred but not reported	**(2,324)**	**82**	**(2,242)**	(2,023)	86	(1,937)
	(204,434)	**6,647**	**(197,787)**	(188,713)	8,104	(180,609)
Provision for unearned premiums	**(5,381)**	**482**	**(4,899)**	(4,923)	398	(4,525)
Provision arising from liability adequacy tests	**(48)**	**–**	**(48)**	(33)	–	(33)
Other technical provisions	**(49)**	**1**	**(48)**	(89)	1	(88)
Totals	**(209,912)**	**7,130**	**(202,782)**	(193,758)	8,503	(185,255)

(b) Assumptions
The assumptions used for reinsurance contracts follow those used for insurance contracts.

Reinsurance assets are valued net of an allowance for their recoverability.

36 – Reinsurance assets continued

(c) Movements

The following movements have occurred in the reinsurance asset during the year:

(i) Long-term business

	2005 £m	2004 £m
Carrying amount at 1 January	**5,878**	4,285
Asset in respect of new business	**183**	397
Expected change in existing business asset	**(128)**	(109)
Variance between actual and expected experience	**257**	175
Impact of operating assumption changes	**(1,178)**	140
Impact of economic assumption changes	**159**	70
Other movements	**177**	145
Change in asset recognised as income	**(530)**	818
Portfolio transfers and acquisitions	**–**	313
Foreign exchange rate movements	**(78)**	32
Effect of adjusting provisions to FRS 27 realistic basis	**–**	417
Other movements	**(564)**	13
Carrying amount at 31 December	**4,706**	5,878

(ii) General insurance and health

	2005 £m	2004 £m
Carrying amount at 1 January	**2,196**	2,541
Impact of changes in assumptions	**–**	–
Reinsurers' share of claim losses and expenses incurred in current year	**146**	193
Reinsurers' share of claim losses and expenses incurred in prior years	**(10)**	(158)
Reinsurers' share of incurred claim losses and expenses	**136**	35
Less:		
Reinsurance recoveries received on claims incurred in current year	**(48)**	(103)
Reinsurance recoveries received on claims incurred in prior years	**(251)**	(244)
Reinsurance recoveries received in the year	**(299)**	(347)
Other movements	**5**	3
Change in reinsurance asset recognised as income	**(158)**	(309)
Reinsurers' share of portfolio transfers and acquisitions	**(93)**	–
Foreign exchange rate movements	**26**	1
Other movements	**(57)**	(37)
Carrying amount at 31 December	**1,914**	2,196

(iii) Reinsurers' share of the provision for unearned premiums ("UPR")

	2005 £m	2004 £m
Carrying amount at 1 January	**398**	348
Premiums ceded to reinsurers in the year	**706**	744
Less:		
Reinsurers' share of premiums earned during the year	**(612)**	(688)
Other movements in reinsurers' share of UPR	**(1)**	–
Changes in reinsurance asset recognised as income	**93**	56
Reinsurers' share of portfolio transfers and acquisitions	**(6)**	3
Foreign exchange rate movements	**2**	–
Other movements	**(5)**	(9)
Carrying amount at 31 December	**482**	398

Notes to the consolidated financial statements continued

37 – Liability for investment contracts

(a) Carrying amount

The liability for investment contracts at 31 December comprised:

	2005 £m	2004 £m
Long-term business		
Participating contracts	**47,258**	43,974
Non-participating contracts at fair value	**29,304**	24,903
Non-participating contracts at amortised cost	**747**	678
	30,051	25,581
Total	**77,309**	69,555

(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 35. 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 38.

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 25 and the deferred income reserve is shown in note 45.

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

	2005 £m	2004 £m
Carrying amount at 1 January	**43,974**	36,974
Reserves in respect of new business	**3,467**	3,284
Expected change in existing business provisions	**(1,720)**	(1,340)
Variance between actual and expected experience	**2,034**	1,400
Impact of operating assumption changes	**5**	(18)
Impact of economic assumption changes	**513**	47
Other movements	**(153)**	73
Change in liability	**4,146**	3,446
Portfolio transfers and acquisitions	**4**	2,030
Foreign exchange rate movements	**(856)**	304
Effect of adjusting to FRS 27 realistic basis	**–**	1,220
Other movements	**(10)**	–
Carrying amount at 31 December	**47,258**	43,974

The effect of changes in main assumptions is given in note 39.

37 – Liability for investment contracts continued
(ii) Non-participating investment contracts

	2005 £m	2004 £m
Carrying amount at 1 January	**25,581**	20,493
Reserves in respect of new business	**5,247**	3,872
Expected change in existing business provisions	**936**	769
Variance between actual and expected experience	**(1,732)**	160
Impact of operating assumption changes	**2**	–
Impact of economic assumption changes	**–**	5
Other movements	**93**	78
Change in liability	**4,546**	4,884
Portfolio transfers and acquisitions	**–**	194
Foreign exchange rate movements	**(76)**	10
Carrying amount at 31 December	**30,051**	25,581

The effect of changes in main assumptions is given in note 39.

38 – Financial guarantees and options
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.

(a) UK Life with-profits 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.

(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 guaranteed value of the policy and the market value of the underlying assets.

(iii) Guaranteed annuity options – The Group's UK with-profit funds have written individual and group pensions 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 which 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 Group has made promises to certain policyholders, in relation to their mortgage endowments, that payments on these policies will meet the mortgage value, provided investment returns exceed 6% per annum net of tax between 1 January 2000 and maturity and the investment returns on the free reserves are sufficient to meet the top-up costs.

(b) UK Life non-profit business
The Group's UK non-profit funds are not subject to the requirements of the FSA's realistic reporting regime and, therefore, liabilities are evaluated by reference to local statutory reserving rules.

(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 £44 million at 31 December 2005 *(2004: £47 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.

Notes to the consolidated financial statements continued

38 – Financial guarantees and options continued

(c) Overseas life businesses

In addition to guarantees written within 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.

(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. A PAF of £16 million was established at the end of 2005.

The most significant of these contracts is the AFER Eurofund which has total liabilities of £22 billion at 31 December 2005 *(2004: £21 billion)*. The guaranteed bonus on this contract equals 65% of the average of the last two years' declared bonus rates (or 60% of the TME index rates if higher) and was 3.51% for 2005 *(2004: 3.69%)* compared with an accounting income from the fund of 4.91% *(2004: 5.25%)*.

Non-AFER contracts with guaranteed surrender values had liabilities of £7 billion *(2004: £6 billion)* at 31 December 2005 and guaranteed annual bonus rates are between 0% and 4.5% on 97.8% of liabilities. There are higher guarantees in force on some older policies including a small number of policies with a guarantee of 8.5%. For non-AFER business, the accounting income return exceeded guaranteed bonus rates in 2005.

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 2005 for this guarantee is £14 million *(2004: £17 million)*. The reserve is calculated on a prudent basis and is in excess of the economic liability. At the end of 2005, total sums at risk for these contracts were £73 million *(2004: £182 million)* out of total unit-linked funds of £8 billion *(2004: £6 billion)*. The average age of policyholders was approximately 53. It is estimated that the economic liability would increase by £1 million *(2004: £2 million)* if yields were to decrease by 1% per annum and by £0.1 million *(2004: £1 million)* if equity markets were to decline by 10% from year end 2005 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 pensions 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.

The total liabilities for traditional business at 31 December 2005 are £8 billion *(2004: £8 billion)* analysed as follows:

	Liabilities 3% guarantee 31 December 2005 £m	Restated* Liabilities 3% guarantee 31 December 2004 £m	Liabilities 4% guarantee 31 December 2005 £m	Restated* Liabilities 4% guarantee 31 December 2004 £m
Individual	**1,210**	1,098	**3,112**	3,169
Group pensions	**412**	263	**3,175**	3,695
Total	**1,622**	1,361	**6,287**	6,864

*Restated to reflect the move to the active liability basis under IFRS.

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 £127 million *(2004: £118 million)*. An additional provision of £77 million *(2004: £27 million)* in respect of investment return guarantees on group segregated fund business is held. It is estimated that the provision would increase by £293 million *(2004: £234 million)* if yields were to reduce by 1% pa and by £44 million *(2004: £49 million)* if equity markets were to decline by 10% from year end 2005 levels.

38 – 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 £145 million *(2004: £125 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 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 no 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 out-of-the-money by £84 million *(2004: £79 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 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 out-of-the-money by £74 million *(2004: £80 million)* if yields were to increase by 1% per annum and by £39 million *(2004: £40 million)* if equity markets were to decline by 10% from year end 2005 levels.

Return of premium guarantee

In 2005 Hibernian Life has written two tranches of linked bonds with a return of premium guarantee after five or six years. The provision for these at the end of 2005 is £3 million. It is expected that the provision would increase by £4 million if equity markets were to decline by 10% from year end 2005 levels. We would not expect any significant impact on this provision as a result of interest movements.

(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, where 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. 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 2005, total liabilities for the Spanish business were £2 billion *(2004: £2 billion)* with a further reserve of £20 million *(2004: £13 million)* for guarantees. Total liabilities for the Italian business were £4 billion *(2004: £4 billion)*, with a further provision of £55 million *(2004: £49 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 £66 million *(2004: £56 million)* in Spain and £12 million *(2004: £14 million)* in Italy if interest rates fell by 1% from end 2005 values. Under this sensitivity test, the guarantee provision in Spain is calculated conservatively, assuming a long-term market interest rate of 1.68% and no lapses or premium discontinuances.

(d) 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.

Notes to the consolidated financial statements continued

39 – Effect of changes in assumptions and estimates during the year

Certain estimates and assumptions used in determining liabilities for insurance and investment contract business were changed from 2004 to 2005, and had the following effect on liabilities and the profit recognised for the year: This disclosure only shows the impact on liabilities and does not allow for offsetting movements in the value of backing assets.

Assumptions	Effect on profit £m
Long-term insurance business	
Interest rates	(1,078)
Expenses	(12)
Persistency rates	3
Mortality for assurance contracts	25
Mortality for annuity contracts	(39)
Tax and other assumptions	(3)
Investment contracts	
Interest rates	(11)
Expenses	(6)
Tax and other assumptions	(2)
General insurance and health business	
Change in loss ratio assumptions	2
Change in expense ratio assumptions	4
Total	(1,117)

The impact of interest rates for long-term business relates primarily to the UK and the Netherlands. This results from the use of lower valuation interest rates on annuities and other business, reflecting the fall in market interest rates over the year.

The mortality impacts relate primarily to assumption changes in the UK and Ireland.

40 – Tax assets and liabilities

(a) General

Current tax assets and liabilities recoverable or payable in more than one year are £78 million and £339 million *(2004: £nil and £435 million)* respectively.

(b) Deferred tax

(i) The balances at 31 December comprise:

	2005 £m	2004 £m
Deferred tax assets	**1,018**	908
Deferred tax liabilities	**(2,458)**	(1,543)
Net deferred tax liability	**(1,440)**	(635)

(ii) The net deferred tax liability arises on the following items:

	2005 £m	2004 £m
Long-term business technical provisions and other insurance items	**1,155**	991
Deferred acquisition costs	**(245)**	(210)
Unrealised gains/losses on investments	**(2,561)**	(1,932)
Provisions and other timing differences	**(223)**	(64)
Impairment of assets	**1**	–
Pensions and other post-retirement obligations	**488**	275
Unused losses and tax credits	**57**	318
Other temporary differences	**(112)**	(13)
Net deferred tax liability	**(1,440)**	(635)

40 – Tax assets and liabilities continued

(iii) The movement in the net deferred tax liability was as follows:

	2005 £m	2004 £m
Net liability at 1 January	**(635)**	(331)
Acquisition of subsidiaries	**(36)**	–
Amounts charged to profit (note 12a)	**(965)**	(271)
Amounts credited/(charged) to equity (note 12b)	**262**	(15)
Exchange differences	**6**	(4)
Other movements	**(72)**	(14)
Net liability at 31 December	**(1,440)**	(635)

Deferred tax credited to equity includes amounts in respect of pensions and other post-retirement obligations (£213 million) and unrealised gains on investments (£49 million). The deferred tax charged to the income statement of £965 million represents the remainder of the movements during the year in the items analysed in note 40(b)(ii) above.

Deferred tax assets are recognised for tax loss carry forwards to the extent that realisation of the related tax benefit through future taxable profits is probable. The Group has unrecognised tax losses of £1,035 million *(2004: £754 million)* to carry forward against future taxable income of the necessary category in the companies concerned. These tax losses will expire as follows; £40 million 5 – 10 years and £35 million 15 – 20 years *(2004: £46 million within 5 – 10 years and £12 million within 15 – 20 years).* The remaining losses have no expiry date. In addition, the Group has an unrecognised capital loss of £446 million *(2004: £376 million)*. This tax loss can only be offset against future capital gains and has not been recognised in these financial statements. This tax loss has no expiry date.

Deferred tax liabilities of £347 million *(2004: £181 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 £1,659 million at 31 December 2005 *(2004: £1,185 million)*.

41 – Provisions

(a) Carrying amounts

	2005 £m	2004 £m
Deficits in the staff pension schemes (note 42)	**1,471**	893
Other obligations to staff pension schemes – insurance policies issued by Group companies (note 35a)	**875**	813
Total IAS 19 obligations to staff pension schemes	**2,346**	1,706
Restructuring provisions	**36**	41
Other provisions	**493**	378
Total	**2,875**	2,125

Of the total, £2,370 million *(2004: £1,812 million)* is expected to be settled more than one year after the balance sheet date.

(b) Movements during the year on restructuring and other provisions

	Restructuring provision £m	Other provisions £m	Total £m
At 1 January 2005	**41**	**378**	**419**
Additional provisions	**131**	**243**	**374**
Unused amounts reversed	**(3)**	**(37)**	**(40)**
Change in the discounted amount arising from passage of time	**–**	**(13)**	**(13)**
Change in the discounted amount arising from a change in discount rate applied	**–**	**2**	**2**
Charge to income statement	**128**	**195**	**323**
Utilised during the year	**(132)**	**(106)**	**(238)**
Acquisition of subsidiaries	**–**	**34**	**34**
Disposal of subsidiaries	**(1)**	**(8)**	**(9)**
At 31 December 2005	**36**	**493**	**529**

Other provisions comprise many small provisions throughout the Group for obligations such as costs of compensation, litigation, staff entitlements and reorganisation.

Notes to the consolidated financial statements continued

42 – Pension obligations

(a) Introduction

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 final salary) or a defined contribution basis. The only material defined benefit schemes are in the United Kingdom, the Netherlands, Canada and Ireland and, of these, the main United Kingdom scheme is by far the largest. The assets of the main United Kingdom, Irish and Canadian schemes are held in separate trustee-administered funds and, in the Netherlands, the main scheme is held in a separate foundation which invests in the life funds of the Group. An actuarial report has been submitted for each of the defined benefit schemes within the last three years, using appropriate methods for the respective countries on local funding bases.

In the United Kingdom, the Group operates one main pension scheme, the Aviva Staff Pension Scheme. New entrants join the defined contribution section of the scheme, as the defined benefit section is closed to new employees.

For funding purposes, the scheme was valued as at an effective date of 1 April 2005, on a market value basis using the Projected Unit Method.

The employing companies' contributions to the defined benefit section of the scheme throughout 2005 were 29% of employees' pensionable salaries together with the cost of redundancies during the year and an additional payment of £51 million. As this section of the scheme is closed to new entrants and the contribution rate is determined using the projected unit method, it is expected that the percentage cost of providing future service benefits will increase as the membership ages. The employers' contribution rate for 2006 has therefore been increased to 35% of pensionable salaries (expected to be £119 million). The Group has also decided to make further contributions of £540 million into this and the RAC schemes over the next two years.

The contribution rates for members of the defined contribution section throughout 2005 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 2006.

The acquisition of RAC plc in May 2005 has resulted in the main RAC scheme now being included in the UK disclosures that follow. A one-off payment of £160 million for deficit funding was made into that scheme during the year, which together with the £540 million allocated above, will bring total additional contributions into the two schemes to £700 million.

Disclosures under the amendment to IAS 19 issued in December 2004 for the material schemes in the United Kingdom, the Netherlands, Canada and Ireland are provided in the following pages. Total pension costs for these schemes have been calculated under IAS 19. Excluding the deficit funding discussed above, total employer contributions for these schemes in 2006 are expected to be £259 million.

(b) Charges to the income statement

The total pension costs of the Group's defined benefit and defined contribution schemes were:

	2005 £m	2004 £m
UK defined benefit schemes	**141**	106
UK defined contribution schemes	**33**	31
Overseas defined benefit schemes	**17**	52
Overseas defined contribution schemes	**14**	16
	205	205

There were no significant contributions outstanding or prepaid as at either 31 December 2005 or 2004.

42 – Pension obligations continued

(c) Details of the material defined benefit schemes

(i) The valuation used for accounting under IAS 19 has 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 2005. The updating was made by actuaries in each country who, other than the actuary of the Aviva Staff Pension Scheme and Dutch arrangements, were independent of the Group. Scheme assets are stated at their market values at 31 December 2005.

The details for the material defined benefit schemes are shown below. Where schemes provide both defined benefit and defined contribution pensions, the assets and liabilities shown exclude those relating to defined contribution pensions.

	UK		Netherlands		Canada		Ireland	
	2005	2004	2005	2004	2005	2004	2005	2004
Date of most recent actuarial valuation	**1.4.05**	1.4.04	**31.12.05**	31.12.03	**31.12.04**	31.12.03	**1.1.04**	1.1.04
The main financial assumptions used to calculate scheme liabilities under IAS 19 are:								
Inflation rate	**2.8%**	2.7%	**1.4%**	1.5%	**2.5%**	2.5%	**2.0%**	2.5%
General salary increases	**4.6%**	4.5%	**1.4%***	1.5%*	**3.75%**	3.75%	**3.75%**	4.25%
Pension increases	**2.8%**	2.7%	**1.4%**	1.5%	**1.25%**	1.25%	**1.9%**	2.25%
Deferred pension increases	**2.8%**	2.7%	**1.4%**	1.5%	**0%**	0%	**1.9%**	2.25%
Discount rate	**4.8%**	5.4%	**4.0%**	4.5%	**5.0%**	5.5%	**4.2%**	4.65%

*Age-related scale increases plus 1.4% *(2004: 1.5%)*.

The discount rate is the assumption that has the largest impact on the value of the liabilities. A 1% increase in this rate would reduce the liabilities by £1.7 billion.

The UK schemes are by far the most material to the Group. The post-retirement mortality base table used for these schemes is PA92 (calendar year 2006) with a one-year age rating deduction schemes, which is considered appropriate based on the mortality experience of the schemes. In addition, post-retirement mortality improvements are allowed for through a reduction to the discount rate of 30 basis points which is considered a best estimate. However, the extent of future improvements in longevity is subject to considerable uncertainty and judgement is required in setting this assumption. Increasing the allowance by 10 basis points to a 40 basis point reduction to the discount rate would increase the schemes' liabilities by £150 million.

(ii) The expected rates of return on the schemes' assets are:

	UK		Netherlands		Canada		Ireland	
	2006 %	2005 %	2006 %	2005 %	2006 %	2005 %	2006 %	2005 %
Equities	8.0%	**8.2%**	6.3%	**7.25%**	8.0%	**8.25%**	7.5%	**8.25%**
Bonds	4.45%	**4.8%**	3.6%	**4.0%**	4.4%	**5.0%**	3.6%	**4.0%**
Property	5.95%	**6.0%**	5.3%	**5.5%**	n/a	**n/a**	5.0%	**5.5%**
Other	4.1%	**4.5%**	3.6%	**4.0%**	n/a	**n/a**	n/a	**n/a**

The overall rates of return are based on the expected returns within each asset category and on current asset allocations. The expected returns are developed in conjunction with external advisers and take into account both current market expectations of future returns, where available, and historical returns.

Notes to the consolidated financial statements continued

42 – Pension obligations continued

(iii) The pension expense for these schemes comprises:

	2005 £m	Total 2004 £m
Current service cost	**158**	148
Past service (credit)/cost	**(7)**	1
Gain/(loss) on curtailments	**(21)***	8
Charge to net operating expenses	**130**	157
Expected return on scheme assets	**(439)**	(390)
Interest charge on scheme liabilities	**407**	362
Credit to investment income	**(32)**	(28)
Total charge to income	**98**	129
Expected return on scheme assets	**439**	390
Actual return on these assets	**(1,270)**	(595)
Actuarial (gains) on scheme assets	**(831)**	(205)
Experience losses/(gains) arising on scheme liabilities	**86**	(12)
Changes in assumptions underlying the present value of the scheme liabilities	**1,292**	362
Actuarial losses recognised in the statement of recognised income and expense	**547**	145

*The current year credit mainly arises in the Netherlands as a result of changes in the Dutch health care system which reduce the obligations of the relevant scheme.

The cumulative amount of actuarial gains and losses recognised in the statement of recognised income and expenses since 1 January 2004 (the date of transition to IFRS) is £692 million at 31 December 2005 *(2004: £145 million)*.

(iv) The following disclosures of experience gains and losses will be built up over time to give a five year history:

	2005 £m	2005 %	2004 £m	2004 %
Fair value of scheme assets at the end of the year	**8,209**		6,286	
Present value of scheme liabilities at the end of the year	**(9,680)**		(7,179)	
Deficits in the schemes	**(1,471)**		(893)	
Difference between the expected and actual return on scheme assets				
Amount	**(831)**		(205)	
Percentage of the scheme assets at the end of the year		**10.1%**		3.3%
Experience losses/(gains) on scheme liabilities (excluding changes in assumptions)				
Amount	**86**		(12)	
Percentage of the present value of scheme liabilities		**0.9%**		0.2%

(v) The assets and liabilities of the schemes, attributable to defined benefit members, at 31 December 2005 were:

	UK 2005 £m	UK 2004 £m	Netherlands 2005 £m	Netherlands 2004 £m	Canada 2005 £m	Canada 2004 £m	Ireland 2005 £m	Ireland 2004 £m	Total 2005 £m	Total 2004 £m
Equities	**4,251**	3,148	**223**	179	**141**	100	**235**	200	**4,850**	3,627
Bonds	**1,660**	1,207	**495**	403	**83**	68	**154**	133	**2,392**	1,811
Property	**480**	382	**36**	31	**–**	–	**22**	25	**538**	438
Other	**336**	254	**78**	142	**2**	–	**13**	14	**429**	410
Total fair value of assets	**6,727**	4,991	**832**	755	**226**	168	**424**	372	**8,209**	6,286
Present value of scheme liabilities	**(8,098)**	(5,734)	**(876)**	(838)	**(288)**	(202)	**(418)**	(405)	**(9,680)**	(7,179)
(Deficits)/surplus in the schemes	**(1,371)**	(743)	**(44)**	(83)	**(62)**	(34)	**6**	(33)	**(1,471)**	(893)

42 – Pension obligations continued

Plan assets include investments in Group-managed funds in the consolidated balance sheet of £578 million *(2004: £2,405 million)* in the UK scheme, and insurance policies of £143 million and £732 million *(2004: £117 million and £696 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 comprise virtually all the assets in each of the first three lines of the relevant column above, whilst the UK policies are included in "Other". These insurance policies, totalling £875 million *(2004: £813 million)* 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 41). Excluding these policies, the total fair value of scheme assets is £7,334 million *(2004 : £5,473 million)* and the total IAS 19 obligations to the schemes are therefore £2,346 million *(2004: £1,706 million)*.

(vi) Movements in the pension schemes' deficits comprise:

			2005
	Scheme assets £m	Scheme liabilities £m	Pension deficit £m
Deficits in the schemes at 1 January	**6,286**	**(7,179)**	**(893)**
Employer contributions	**383**	**–**	**383**
Employee contributions	**21**	**(21)**	**–**
Benefits paid	**(281)**	**281**	**–**
Charge to net operating expenses (see (iii) above)	**(3)**	**(127)**	**(130)**
Credit/(charge) to investment income (see (iii) above)	**439**	**(407)**	**32**
Actuarial gains/(losses) (see (iii) above)	**831**	**(1,378)**	**(547)**
Acquisitions	**538**	**(851)**	**(313)**
Exchange rate movements on foreign plans	**(5)**	**2**	**(3)**
Deficits in the schemes at 31 December	**8,209**	**(9,680)**	**(1,471)**

			2004
	Scheme assets £m	Scheme liabilities £m	Pension deficit £m
Deficits in the schemes at 1 January	5,696	(6,534)	(838)
Employer contributions	220	–	220
Employee contributions	9	(9)	–
Benefits paid	(243)	243	–
Charge to net operating expenses (see (iii) above)	(3)	(154)	(157)
Credit/(charge) to investment income (see (iii) above)	390	(362)	28
Actuarial gains/(losses) (see (iii) above)	205	(350)	(145)
Exchange rate movements on foreign plans	12	(13)	(1)
Deficits in the schemes at 31 December	6,286	(7,179)	(893)

The change in the net pension deficit during 2005 is mainly attributable to changes in assumptions underlying the present value of the schemes' liabilities, partially offset by an increase in the market value of their assets. In the United Kingdom, the value of the liabilities has increased due to lower corporate bond yields, which are used to set the valuation discount rate, a higher assumed inflation rate and a strengthening to the post-retirement mortality future improvements allowed for in the basis. The increase in scheme assets is primarily due to an improvement in equity and bond values since the previous year end, together with deficit contribution payments made by the employing companies. The deficit has further increased by £313 million as a result of the acquisition of the RAC group in May 2005.

Notes to the consolidated financial statements continued

43 – Borrowings

(a) Carrying amounts

The following table provides information about the maturity periods and effective interest rates of the Group's borrowings.

Borrowings are considered current if the contractual repricing or maturity dates are within a year.

									2005
		Contractual repricing or maturity dates							
	Denominated currency	Within 1 year £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	Over 5 years £m	Total £m	Effective interest rate %
Subordinated debt									
6.125% £700 million subordinated notes 2036	£	–	–	–	–	–	689	**689**	**6.2%**
5.750% €800 million subordinated notes 2021	€	–	–	–	–	–	548	**548**	**5.8%**
5.250% €650 million subordinated notes 2023	€	–	–	–	–	–	442	**442**	**5.3%**
5.700% €500 million undated subordinated notes	€	–	–	–	–	–	340	**340**	**5.8%**
6.125% £800 million undated subordinated notes	£	–	–	–	–	–	789	**789**	**6.2%**
		–	–	–	–	–	2,808	**2,808**	
Debenture loans									
9.5% guaranteed bonds 2016	£	–	–	–	–	–	198	**198**	**9.6%**
2.5% subordinated perpetual loan notes	€	–	–	–	–	–	119	**119**	**2.5%**
Other loans	various	–	–	–	–	–	17	**17**	**4.2%**
		–	–	–	–	–	334	**334**	
Amounts owed to credit institutions									
Bank loans	various	35	53	7	13	196	761	**1,065**	
Commercial paper									
Total commercial paper	various	503	–	–	–	–	–	**503**	**3.9%**
Securitised mortgage loan notes									
UK lifetime mortgage business	£	–	–	–	–	–	1,879	**1,879**	**5.6%**
Dutch domestic mortgage business	€	–	–	–	–	–	4,424	**4,424**	**3.1%**
							6,303	**6,303**	
Total		538	53	7	13	196	10,206	**11,013**	

43 – Borrowings continued

									2004
							Contractual repricing or maturity dates		
	Denominated currency	Within 1 year £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	Over 5 years £m	Total £m	Effective interest rate %
Subordinated debt									
6.125% £700 million subordinated notes 2036	£	–	–	–	–	–	689	689	6.3
5.750% €800 million subordinated notes 2021	€	–	–	–	–	–	564	564	5.8
5.250% €650 million subordinated notes 2023	€	–	–	–	–	–	455	455	5.6
5.700% €500 million undated subordinated notes	€	–	–	–	–	–	350	350	6.1
6.125% £800 million undated subordinated notes	£	–	–	–	–	–	789	789	6.3
		–	–	–	–	–	2,847	2,847	
Debenture loans									
9.5% guaranteed bonds 2016	£	–	–	–	–	–	198	198	9.5
8.625% guaranteed bonds 2005	£	200	–	–	–	–	–	200	8.6
2.5% subordinated perpetual loan notes	€	–	–	–	–	–	122	122	7.3
Other loans	Various	4	–	–	–	–	40	44	4.2
		204	–	–	–	–	360	564	
Amounts owed to credit institutions									
Bank loans	various	127	–	4	92	12	370	605	
Commercial paper									
Commercial paper	various	881	–	–	–	–	–	881	3.9
Securitised mortgage loan notes									
UK lifetime mortgage business	£	–	–	–	–	–	1,461	1,461	5.6
Dutch domestic mortgage business	€	–	–	–	–	–	3,732	3,732	3.1
		–	–	–	–	–	5,193	5,193	
Total		1,212	–	4	92	12	8,770	10,090	

(b) 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	2 Oct 2023	2 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%

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 2005 was £4,172 million *(2004: £3,107 million)*.

Notes to the consolidated financial statements continued

43 – Borrowings continued

(ii) Debenture loans

The 9.5% guaranteed bonds were issued by the Company at a discount of £1.1 million. This amount, together with the issue expenses, is 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 Canada, France, the Netherlands and Spain.

Fixed rate borrowings comprise £317 million *(2004: £541 million)* of the total carrying value of £334 million *(2004: £564 million)*. Their fair value at 31 December 2005 was £405 million *(2004: £622 million)*.

(iii) Bank loans

In September 2004, one of the Group's UK long-term business subsidiaries, Norwich Union Life & Pensions Limited (NULAP), entered into a securitisation arrangement with The Royal Bank of Scotland Group plc (RBS), to provide funding to cover initial new business acquisition and administration costs in the period when these exceed accumulated premiums received. Under the arrangement, RBS has provided a loan facility of £200 million to NULAP in respect of selected term assurance policies, secured on future premiums and repayment of commissions due from brokers where a policy has lapsed. The funding is repayable over four years from the date of advance, and interest is charged at a floating rate. The balance drawn on the facility at 31 December 2005 was £191 million *(2004: £91 million)*. RBS has no recourse to the policyholder or shareholders' funds of any companies in the Aviva Group.

As explained in note 17b, 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 £nil *(2004: £57 million)* included in the tables above relate to those PLPs which have been consolidated as subsidiaries.

(iv) Commercial paper

The commercial paper consists of £500 million in the Company *(2004: £870 million)* and £3 million in France *(2004: £11 million)*. All commercial paper is repayable within one year and is issued in a number of different currencies, primarily sterling, euros and US dollars.

(v) Securitised mortgage loan notes

Loan notes have been issued by special purpose securitisation companies in the United Kingdom and the Netherlands. Details of these securitisations are given in note 22.

(c) Movements during the year

Movements in borrowings during the year were:

	2005 £m	2004 £m
New borrowings drawn down, net of expenses	**5,441**	2,623
Repayment of borrowings	**(4,585)**	(1,097)
Net cash inflow	**856**	1,526
Foreign exchange rate movements	**(149)**	27
Borrowings acquired/loans repaid for non-cash consideration	**173**	25
Amortisation of discounts and other non-cash items	**43**	145
Movements in the year	**923**	1,723
Balance at 1 January	**10,090**	8,367
Balance at 31 December	**11,013**	10,090

43 – Borrowings continued

(d) Undrawn borrowings

The Group has the following undrawn committed central borrowing facilities available to it, of which £1,000 million *(2004: £1,000 million)* is used to support the commercial paper programme:

	2005 £m	2004 £m
Expiring within one year	**890**	650
Expiring beyond one year	**1,360**	1,600
	2,250	2,250

44 – Payables and other financial liabilities

	2005 £m	2004 £m
Payables arising out of direct insurance	**1,639**	1,769
Payables arising out of reinsurance operations	**618**	444
Deposits received from reinsurers	**883**	1,519
Loans from associates	**3**	15
Bank overdrafts	**690**	653
Other financial liabilities	**5,748**	2,840
Less: Amounts classified as held for sale	**(96)**	–
	9,485	7,240
Expected to be settled within one year	**7,384**	5,636
Expected to be settled in more than one year	**2,101**	1,604
	9,485	7,240

Bank overdrafts arise substantially from unpresented cheques and amount to £115 million *(2004: £133 million)* in long-term business operations and £369 million *(2004: £518 million)* in general business and other operations. Other financial liabilities include the obligation to repay £467 million *(2004: £240 million)* received under stock repurchase arrangements entered into in the United Kingdom and the Netherlands.

45 – Other liabilities

	2005 £m	2004 £m
Deferred income	**265**	207
Reinsurers' share of deferred acquisition costs	**146**	72
Accruals	**1,096**	1,249
Other liabilities	**1,862**	3,389
Less: Amounts classified as held for sale	**(49)**	–
	3,320	4,917
Expected to be settled within one year	**2,539**	3,760
Expected to be settled in more than one year	**781**	1,157
	3,320	4,917

Notes to the consolidated financial statements continued

46 – Contingent liabilities and other risk factors

(a) Uncertainty over claims provisions

Note 35 gives details of the estimation techniques used in determining the general business outstanding claims provisions and of the methodology and assumptions used in determining the long-term business provisions, which are designed to allow for prudence and the appropriate cost of future policy-related liabilities. Both are estimated 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 for long-term business, or future general business claims inflation differs from that expected, there is uncertainty in respect of this liability.

(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 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 the United Kingdom, Australia and Canada. 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, the Group's net exposure to such liabilities is not significant and, on the basis of current information and having regard to the level of provisions made for general insurance claims, the directors consider that any costs arising are not likely to have a material impact on the financial position of the Group.

(c) Guarantees on long-term savings products

Note 38 gives details of guarantees and options given by various Group companies as a normal part of their operating activities, in respect of certain long-term insurance and fund management products. In the United Kingdom, in common with other pension and life policy providers, the Group wrote individual and group pension policies in the 1970s and 1980s with a guaranteed annuity rate option (GAO). Since 1993, such policies have become more valuable to policyholders, and more costly for insurers, as current annuity rates have fallen in line with interest rates and improving longevity. Reserving policies for the cost of GAOs varied until a ruling by the House of Lords in the Equitable Life case in 2000 which effectively required full reserving by all companies. Prior to the ruling, consistent with the Group's ordinary reserving practice in respect of such obligations, full reserves for GAOs had already been established. No adjustment was made, or was necessary, to the Group's reserving practice as a result of the ruling. The directors continue to believe that the existing provisions 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 £42 million *(2004: £52 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 continue to send these updates annually to all mortgage endowment holders, in accordance with FSA requirements. The Group has made provisions totalling £195 million *(2004: £130 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.

In August 2004, the Group confirmed its intention to introduce time barring on mortgage endowment complaints, under FSA rules, by the end of 2006. The Group is writing to its 1.1 million endowment policyholders as part of its ongoing review, stating that it intends to introduce a time bar on mortgage endowment complaints in the future. 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.

46 – Contingent liabilities and other risk factors continued

(f) Other

In the course of conducting insurance and investment business, various Group companies receive liability claims, and become involved in actual or threatened litigation arising therefrom. 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 subsidiaries and associates. 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.

47 – Commitments

(a) Capital commitments

Contractual commitments for acquisitions or capital expenditures of investment property, property and equipment and intangible assets, which were not recognised in the financial statements, were as follows:

	2005 £m	2004 £m
Investment property	**10**	17
Property and equipment	**169**	180
	179	197

Contractual obligations for future repairs and maintenance on investment properties was £8 million *(2004: £6 million)*.

The Group has capital commitments to its joint ventures in the amount of £34 million *(2004: £15 million)*.

(b) Operating lease commitments

(i) Future aggregate minimum lease rentals receivable under non-cancellable operating leases are as follows:

	2005 £m	2004 £m
Within 1 year	**26**	–
Later than 1 year and not later than 5 years	**44**	–
Later than 5 years	**13**	–
	83	–

(ii) Future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	2005 £m	2004 £m
Within 1 year	**110**	89
Later than 1 year and not later than 5 years	**330**	356
Later than 5 years	**422**	381
	862	826
The total of future minimum sub-lease payments expected to be received under non-cancellable subleases	**143**	132

Notes to the consolidated financial statements continued

48 – Cash flow statement

(a) The reconciliation of profit/(loss) before tax to the net cash inflow from operating activities is:

	2005 £m	2004 £m
Profit before tax	**3,450**	2,025
Adjustments for:		
Share of (profits) losses of joint ventures and associates	**(358)**	(242)
Dividends received from joint ventures and associates	**95**	52
(Profit)/loss on sale of investment property	**(41)**	(89)
(Profit)/loss on sale of property and equipment	**(2)**	(8)
(Profit)/loss on sale of subsidiaries, joint ventures and associates	**(153)**	(34)
(Profit)/loss on sale of investments	**(4,616)**	(1,979)
Fair value (gains)/ losses on investment property	**(1,571)**	(1,154)
Fair value (gains)/ losses on investments	**(8,813)**	(4,197)
Fair value (gains)/ losses on borrowings	**62**	97
Depreciation of property and equipment	**112**	97
Impairment of goodwill on subsidiaries	**43**	41
Impairment of other investments and loans	**19**	3
Impairment of property and equipment	**–**	25
Impairment of acquired value of in-force business and intangibles	**35**	13
Impairment of non financial assets	**38**	–
Amortisation of premium or discount on debt securities	**(93)**	(190)
Amortisation of premium or discount on loans	**(38)**	35
Amortisation of premium or discount on borrowings	**2**	48
Amortisation of acquired value in-force business and intangibles	**83**	79
Change in unallocated divisible surplus	**1,474**	1,330
Interest expense on borrowings	**609**	522
Foreign currency exchange gain/loss	**203**	(31)
Changes in working capital		
(Increase)/decrease in reinsurance assets	**1,192**	(386)
(Increase)/decrease in deferred acquisition costs	**(466)**	248
(Increase)/decrease in insurance liabilities and investment contracts	**18,581**	14,996
(Increase)/decrease in other assets and liabilities	**123**	3,628
Net purchases of operating assets		
Purchases of investment property	**(1,956)**	(1,321)
Proceeds on sale of investment property	**1,292**	1,245
Financial investments	**(6,522)**	(12,803)
Cash generated from operations	**2,784**	2,050

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.

48 – Cash flow statement continued

(b) Cash flows in respect of the acquisition of subsidiaries, joint ventures and associates

	2005 £m	2004 £m
Cash consideration for subsidiaries, joint ventures and associates acquired	**1,438**	540
Less: Cash and cash equivalents acquired with subsidiaries	**(55)**	–
Cash flows on acquisitions	**1,383**	540

(c) Cash flows in respect of the disposal of subsidiaries, joint ventures and associates

	2005 £m	2004 £m
Cash proceeds from disposal of subsidiaries, joint ventures and associates	**448**	327
Net cash and cash equivalents divested with subsidiaries	**–**	(19)
Cash flows on disposals	**448**	308

(d) Cash and cash equivalents in the Cash flow statement at 31 December comprised:

	2005 £m	2004 £m
Cash at bank and in hand	**3,530**	1,631
Cash equivalents	**10,227**	11,148
	13,757	12,779
Bank overdrafts	**(690)**	(653)
	13,067	12,126

Of the total cash and cash equivalents shown above, £25 million has been classified as held for sale (see note 3c).

Notes to the consolidated financial statements continued

49 – Capital statement

FRS27 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[3] £m	Total UK life with-profit fund £m	Other UK life operations £m	Total UK life operations £m	Overseas life operations £m	Total life operations £m	Other operations[4] £m	2005 Total £m	2004 Total £m
Total shareholders' funds	25	22	24	71	2,515	2,586	6,129	8,715	2,377	**11,092**	8,993
Other sources of capital[1]	–	–	–	–	–	–	133	133	2,808	**2,941**	3,016
Unallocated divisible surplus	1,871	1,872	1,633	5,376	–	5,376	3,602	8,978	–	**8,978**	7,549
Adjustments onto a regulatory basis:											
Shareholders' share of accrued bonus	(74)	(78)	(548)	(700)	–	(700)	–	(700)	–	**(700)**	(570)
Goodwill and other intangibles	–	–	–	–	(56)	(56)	(798)	(854)	(2,223)	**(3,077)**	(1,700)
Regulatory valuation and admissibility restrictions[2]	281	125	140	546	(1,221)	(675)	(3,991)	(4,666)	(953)	**(5,619)**	(4,507)
Total available capital resources	2,103	1,941	1,249	5,293	1,238	6,531	5,075	11,606	2,009	**13,615**	12,781
Analysis of liabilities:											
Participating insurance liabilities	8,691	9,475	19,646	37,812	–	37,812	22,146	59,958	–	**59,958**	58,304
Unit-linked liabilities	3,201	51	–	3,252	2,692	5,944	12,055	17,999	–	**17,999**	15,227
Other non-participating life insurance	1,002	1,821	756	3,579	18,116	21,695	14,524	36,219	–	**36,219**	32,798
Total insurance liabilities	12,894	11,347	20,402	44,643	20,808	65,451	48,725	114,176	–	**114,176**	106,329
Participating investment liabilities	4,661	2,761	7,986	15,408	_	15,408	31,850	47,258	–	**47,258**	43,974
Non-participating investment liabilities	10,430	1,099	3,755	15,284	2,664	17,948	12,103	30,051	–	**30,051**	25,581
Total investment liabilities	15,091	3,860	11,741	30,692	2,664	33,356	43,953	77,309	–	**77,309**	69,555
Total liabilities	27,985	15,207	32,143	75,335	23,472	98,807	92,678	191,485	–	**191,485**	175,884

1. Other sources of capital include Subordinated debt of £2,808 million issued by Aviva and £119 million subordinated perpetual loan notes issued by a Dutch subsidiary undertaking.
2. Including an adjustment for minorities
3. Includes the PM with-profit fund.
4. Other operations includes general insurance and fund management business.

49 – Capital statement continued
Analysis of movements in capital
For the year ended 31 December 2005

	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
Opening available capital resources	**1,695**	**1,633**	**1,208**	**4,536**	**1,433**	**5,969**	**4,523**	**10,492**
Movement in liabilities	**(4,671)**	**(400)**	**800**	**(4,271)**	**(4,184)**	**(8,455)**	**(7,238)**	**(15,693)**
Other movements in capital[1]	**5,079**	**708**	**(759)**	**5,028**	**3,989**	**9,017**	**7,790**	**16,807**
Closing available capital resources	**2,103**	**1,941**	**1,249**	**5,293**	**1,238**	**6,531**	**5,075**	**11,606**

1. Includes movement in: outstanding claims provision; other technical provision; and obligations to staff pension schemes transferred to provisions.

A further analysis of the movement in the liabilities of the long-term business can be found in notes 35 and 37.

The main drivers of the variance between actual and expected liability movements are reductions in valuation interest rates for traditional contracts and strong investment return for unit-linked business.

Other movements in capital reflect cashflows for premiums received, benefits paid and the investment return on assets held. This movement also includes the change in the regulatory adjustments and regulatory rules. The only regulatory rule changes having significant impact in the year are a change in the basis for inclusion of non-insurance subsidiaries from market value to a surplus assets basis, and new rules relating to the recognition of pension deficits, requiring a charge to be made based on anticipated additional payments over the next five years instead of the inclusion of the full scheme deficit.

In aggregate, the Group has at its disposal total available capital of £13.6 billion *(2004: £12.8 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 £5.2 billion *(2004: £4.5 billion)* can only be used to provide support for UK with-profits 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 £8.3 billion *(2004: £8.3 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 within these arrangements is a subordinated loan of £200 million from Aviva plc 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

49 – Capital statement continued

	Realistic assets £bn	Realistic liabilities £bn	Realistic orphan estate £bn	Required capital margin £bn	31 December 2005 Excess £bn	31 December 2004 Excess £bn
CGNU Life	**14.0**	**(11.9)**	**2.1**	**0.5**	**1.6**	1.4
CULAC	**14.0**	**(12.1)**	**1.9**	**0.6**	**1.3**	1.2
NUL&P	**25.9**	**(24.7)**	**1.2**	**0.8**	**0.4**	0.2
PM	**2.5**	**(2.5)**	**–**	**–**	**–**	–
Aggregate	**56.4**	**(51.2)**	**5.2**	**1.9**	**3.3**	2.8

1. These realistic liabilities include the shareholders' share of future bonuses of £0.7 billion *(31 December 2004: £0.5 billion)*. Realistic liabilities adjusted to eliminate the shareholders' share of future bonuses are £50.5 billion *(31 December 2004: £47 billion)*.
2. These realistic liabilities make provision for guarantees, options and promises on a market consistent stochastic basis. The value of the provision included within the realistic liabilities is £0.7 billion, £0.9 billion and £3.4 billion for CGNU life, CULAC and NUL&P respectively. *(31 December 2004: £0.6 billion, £0.9 billion and £3.3 billion for CGNU life, CULAC and NUL&P respectively).*
3. The required capital margin (RCM) is 2.7 times covered by the orphan estate *(31 December 2004: 2.6 times)*.

For UK non-participating business, the relevant capital requirement is the minimum solvency requirement determined in accordance with FSA regulations.

For overseas life businesses, the amount shown is the minimum requirement under the locally applicable regulatory regimes.

For UK and overseas general insurance businesses, the relevant capital requirement is the minimum solvency requirement determined in accordance with the local regulator's requirements.

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.

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:

(iii) 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.

(iv) UK non-participating funds – any available surplus held in these is attributable to shareholders. Capital within 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.

(v) 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.

(vi) 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.

50 – Risk management policies

(a) Governance framework

The Group has established a risk and financial management framework whose primary objective is to protect the Group from events that hinder the sustainable achievement of the Group's performance objectives, including failing to exploit opportunities. The Group recognises the critical importance of having efficient and effective risk management systems in place. To this end, the Group has an established governance framework, details of which are given in the corporate governance section of this report on pages 57 to 61. This framework has three 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 executive management committees and senior management; and

– A Group policy framework that sets out risk appetite, risk management, control and business conduct standards for the Group's world wide operations. Each policy has a member of senior management who is charged with overseeing compliance with the policy throughout the Group.

50 – Risk management policies continued

This governance structure and policy set is regularly reviewed and updated to reflect internal and external changes. For example, since the regulatory changes brought about by the FSA's Prudential Sourcebook, which came into effect on 1 January 2004, the Group has placed a greater emphasis on assessment and documentation of risks, controls and an articulation of risk appetite.

(b) The Group's approach to financial risk and capital management

Integration of risk and capital management

The Group has developed a capital management framework using Individual Capital Assessment (ICA) principles for identifying the risks that business units, and the Group as a whole are exposed to, quantifying their impact on economic capital. The ICA estimates how much capital is needed to mitigate the risk of insolvency to a selected remote level of risk applied to a number of tests (both financial and non-financial) on the capital position of the business. The ICA works to a 99.5% confidence level of solvency over one year, in line with UK FSA regulatory requirements. An ICA has been developed for all material parts of the Group, and the results of financial and operating experience tests are linked to the Group's risk reporting model.

In addition the Group is developing a risk-based capital model for its businesses that will provide a more detailed assessment of the capital needs of the business.

The Group also uses Financial Condition Reports (FCRs) to inform decisions on capital management issues. The FCR is a medium-term forecast of the overall financial position of the business under a variety of economic and operating scenarios, allowing for new business. The FCR considers a number of financial performance measures in addition to solvency and capital requirements. FCRs are produced by business units and enable the Group to assess:

– The range of risks to which the business is exposed;

– Their evolution over time; and

– The impact of mitigating actions which might be taken.

Impact of regulatory context on nature of the risks

A large proportion of the Group's long-term savings business involves insurance products where the majority of investment risks are borne by its policyholders. Risks attributable to policyholders are actively and prudently managed in order to satisfy policyholders' risk and reward objectives. In addition, the Group's worldwide insurance operations are subject to numerous local regulatory requirements, that prescribe the type, quality, and concentration of investments, and the level of assets to be maintained in local currency in order to meet local insurance liabilities. These requirements help to maintain the Group's market risk levels at an acceptable level in each of the jurisdictions in which it operates.

(c) Management of financial and non-financial risks

The Group has established policies on the management of financial and non-financial risks. The adoption of these policies throughout the Group enables a broadly consistent approach to the management of risk at business unit level. In addition, the Group operates a number of oversight committees that monitor aggregate risk data and take overall risk management decisions. Further details as to the operation of these policies and committees are provided by risk area below.

The Group also monitors a set of specific risks on a regular basis through the Group risk monitoring framework. Businesses units are required to disclose to the Group risk function all material risks, along with information on likelihood and severity of risks, and the mitigating actions taken or planned. This enables the Group to assess its overall risk exposure and to develop a group-wide risk map, identifying any concentrations of risk that may exist, and to define which risks and what level of risk the Group is prepared to accept. The risk map is refreshed quarterly, and business units are required to escalate material changes intra-quarter.

(i) Insurance Risk

Life Insurance Business

The risk management framework for life insurance business is set out as follows.

1. Types of life insurance 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. The management of life insurance risk is undertaken primarily in business units but is 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, financial condition reporting, and the ICA process. Significant insurance risks will be reported through the Group Risk Monitoring framework and overseen by the Life Insurance Risk Committee. At Group level the overall exposure to life insurance risk is measured through the ICA, FCRs, and other management reporting.

2. Risk management 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.

The Life Insurance Risk committee monitors the risk framework developed and implemented in each business, and receives management information on life insurance risks.

Notes to the consolidated financial statements continued

50 – Risk management policies continued

The committee considers all areas of life insurance risk, but in particular has a remit to monitor mortality, longevity, persistency, 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 businesses adopt a risk management framework to mitigate against any life insurance risk outside local appetite, within the parameters for the overall Group risk appetite. The framework adopted in business units is reviewed in detail and approved twice yearly. The key points of this framework are as follows:

– Mortality and morbidity – businesses must implement an underwriting procedure, and regularly monitor experience against external benchmarks;

– All risks must be managed at product or portfolio level to avoid cross subsidies between product lines and between different funds; and

– A product management cycle must be established to review all aspects of emerging experience, particularly mortality and persistency, at regular intervals.

Mortality and morbidity risks are mitigated by use of reinsurance. The Group allows business units to select reinsurers 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 continually monitors emerging market solutions to mitigate this risk further.

Expense risk is primarily managed by the business units through the assessment of business unit profitability and frequent monitoring of expense levels.

Apart from ICA and FCR, sensitivity testing is widely used to measure the capital required and volatility in earnings due to exposure to life insurance risks. 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.

3. Concentrations of life insurance 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 Risk 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.

4. Embedded derivatives within insurance contracts 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, option to cease premium payment, options for withdrawals free of market value adjustment, annuity option, guaranteed insurability options.

Guarantees: embedded floor (guaranteed return), maturity guarantee, guaranteed death benefit, guaranteed minimum rate of annuity payment.

Other: indexed interest or principal payments, maturity value, loyalty bonus.

50 – Risk management policies continued

General Insurance Business

The risk management framework for general insurance risks is set out as follows:

1. Types of General Insurance 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 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.

The vast majority of the Group's general insurance business is managed and priced in the same country as the domicile of the customer.

2. Risk management Significant insurance risks will be reported through the Group Risk monitoring framework. Additionally, the ICA framework 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.

A General Insurance Risk Committee has been established to monitor and develop the management of risk in the general insurance business units, and to assess the aggregate risk exposure. There are Group policies for underwriting, claims handling, reinsurance and reserving that operate within the Group risk management framework whose implementation is regularly reviewed by this committee.

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 a standard.

Reinsurance Strategy 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. The basis of these purchases is underpinned by extensive financial modelling and actuarial analysis to optimise the cost and risk management 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.

3. Concentrations of general insurance risk Processes are in place to manage catastrophe risk in individual business units and at a Group level. The Group's businesses purchase catastrophe reinsurance to protect against significant natural hazard events. Due to the geographic concentration of some large business units in northern Europe, the Group purchases additional catastrophe reinsurance cover to limit Group retentions in the event of a northern European windstorm event.

For a single realistic catastrophic event (for the Group, this is a northern European windstorm) this maximum amount is approximately £350 million which equates to 3.2% of shareholders' equity on a net basis.

Actuarial Management The adequacy of the Group's general insurance claims provisions is ultimately overseen by the Reserving Committee, which covers both life and general insurance 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 Risk 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 are conducted under the direction of the Aviva General Insurance Actuarial Director and include peer reviews of the business unit's own conclusions as well as independent analysis to confirm the reasonableness of the local reviews. A number of business units also have periodic external reviews by local consultant actuaries (often as part of the local regulatory requirement).

Notes to the consolidated financial statements continued

50 – Risk management policies continued

(ii) Asset/liability management (ALM)

The Group has established a policy on asset liability management that sets out the minimum principles that businesses are expected to adopt to manage the key ALM risks to which the Group is exposed. The Group monitors adherence to this policy and regularly reviews how business units are managing the ALM risks locally, through the Group Investment Committee and ultimately to the Asset Liability Management committee.

The Group policy sets out the 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 in order to manage the financial risk from the mismatching of assets and liabilities as investment markets change. In addition, the local regulatory environment for each business sets out how asset and liabilities are to be matched.

The ALM framework covers a number of areas which are discussed in more detail below.

Liquidity risk

The Group has a strong liquidity position and through the application of a Group Liquidity Management policy seeks to maintain sufficient financial resources to meet its obligations as they fall due. In addition to its strong liquidity position, the Group maintains significant committed borrowing facilities from a range of highly rated banks to further mitigate this risk.

Maturity periods and interest rate risk

Interest rate risk arises primarily from the products sold by the Group and the value of investments. For example, long-term debt and fixed income securities are exposed to fluctuations in interest rates. 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.

Interest rate risk is managed using a variety of derivative instruments, including futures, options and swaps, caps & floors, in order to provide a degree of hedging against unfavourable market movements in interest rates inherent in the assets backing technical liabilities.

On certain categories of long-term business, interest rate risk is reduced through close matching of assets and liabilities. On short-term business such as general insurance business the Group requires a close matching of assets and liabilities by duration to minimise this risk.

Further information on borrowings is included in note 43.

The following table provides an analysis of assets into their relevant maturity groups based on the remaining period at the balance sheet date to their contractual maturities.

31.12.2005 £m	Total	Within 1 year	1-5 years	5-15 years	Over 15 years
Debt securities	**103,917**	**6,827**	**25,672**	**40,503**	**30,915**
Loans	**24,544**	**1,513**	**5,239**	**8,727**	**9,065**

31.12.2004 £m	Total	Within 1 year	1-5 years	5-15 years	Over 15 years
Debt securities	98,719	6,484	24,388	38,478	29,369
Loans	22,055	1,359	4,708	7,842	8,146

Analysis of expected maturity of liabilities

For each main category of insurance and investment business, the following table shows the gross liability at 31 December 2005 analysed by duration. The total liability is split by duration in proportion to the present value of cash-flows estimated to arise during that period.

31.12.2005 £m	Total	Within 1 year	1-5 years	5-15 years	Over 15 years
Long-term business					
Insurance contracts non-linked	**88,586**	**8,113**	**26,066**	**36,651**	**17,756**
Investment contracts non-linked	**42,736**	**3,111**	**11,767**	**16,688**	**11,170**
Linked business	**60,163**	**3,036**	**13,729**	**25,711**	**17,687**
General insurance and health	**18,426**	**8,636**	**7,416**	**2,189**	**185**

31.12.2004 £m	Total	Within 1 year	1-5 years	5-15 years	Over 15 years
Long-term business					
Insurance contracts non-linked	84,640	6,944	25,431	36,707	15,558
Investment contracts non-linked	41,323	2,981	10,710	16,566	11,066
Linked business	49,921	2,105	9,796	21,089	16,931
General insurance and health	17,793	8,174	7,513	1,967	139

50 – Risk management policies continued

(iii) Market risk

Market risk is the risk of adverse financial impact due to changes in fair values of financial instruments from fluctuations in foreign currency exchange rates, interest rates, property prices and equity prices. Market risk arises in business units due to fluctuations in 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 management of market risk is undertaken in both business units and at Group level. Business units manage market risks locally using their ALM 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. At Group level, market risk is the responsibility of the Investment Committee which has a remit to manage a number of investment related risks, in particular those faced by the shareholder funds throughout the Group.

For each of the major components of market risk, described in more detail below, the Group has put in place policies and procedures to set out how each risk should be managed and monitored, and the approach to setting an appropriate risk appetite.

At Group level, 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 ICA and FCR.

Currency risk

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 and sterling. 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 the Group's subsidiaries maintain sufficient assets in their local currencies 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.

At 31 December 2005 the Group's total equity deployment by currency was:

	Sterling £m	Euro £m	Other £m	Total £m
Capital 31.12.2005	**1,772**	**7,458**	**1,862**	**11,092**
Capital 31.12.2004	1,437	6,045	1,511	8,993

Net assets are stated after taking account of the effect of currency swaps and forward foreign exchange contracts.

Interest rate risk

Interest rate risk arises primarily from the Group's investments, long-term debt and fixed income securities.

Interest rate risk also exists in 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. Interest rate risk is also controlled through the use of a variety of derivative instruments, including futures, options and swaps, in order to hedge against unfavourable market movements in interest rates inherent in the underlying assets and liabilities.

The impact of exposure to sustained low interest rates is regularly monitored.

At 31 December 2005, 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 close matching of assets and liabilities.

Property price risk

The Group is subject to property price risk due to holdings of investment properties in a variety of locations worldwide. The 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. At 31 December 2005, no material derivative contracts had been entered into to mitigate the effects of changes in property prices.

Notes to the consolidated financial statements continued

50 – Risk management policies continued

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 both direct equity shareholdings in its shareholder assets, from 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 and from its interest in the free estate of long-term funds.

At business unit level, equity price risk is actively managed through the use of derivative instruments, including futures and options, in order to mitigate anticipated unfavourable market movements where this lies outside the risk appetite of the fund concerned. The Group does not have material holdings of unquoted equity securities. In addition local asset admissibility regulations require that business units hold diversified portfolios of assets thereby reducing exposure to individual equities.

The Investment Committee actively monitors its directly owned equity assets, which may include some material shareholdings in the Group's strategic business partners.

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.

At 31 December 2005, certain business units had entered into various futures and option agreements to mitigate the effects of potential adverse equity price movements.

Derivatives risk

Derivatives are used to a limited extent, within policy guidelines agreed by the Board of Directors. Derivatives are only used for efficient investment management, risk hedging purposes or to structure specific retail-savings products. Derivative transactions are fully covered by either cash or corresponding assets and liabilities. Speculative activity is prohibited, unless approval has been obtained from the Derivatives committee and Group finance director. Over the counter derivative contracts are entered into only with approved counterparties, in accordance with our Group policies, thereby reducing 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. The Derivatives committee monitors this framework, exposure levels and approves large or complex transactions proposed by business units.

Correlations between market risk and other risks

The Group considers 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. FCRs also consider scenarios involving a number of correlated events.

A number of policyholder participation features have an influence on the Group's interest rate risk. The following are the major features identified:

– Guaranteed surrender values;

– Guaranteed annuity options; and

– Minimum surrender and maturity values.

The full list of material guarantees and options is set out in Note 38.

(iv) Credit risk

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's management of credit risk includes monitoring exposures at a Group level and requiring business units to implement local credit risk policies. Large individual counterparty exposures exceeding £25 million are aggregated and monitored at Group level against centrally-set limits reflecting the credit ratings by companies such as Standard & Poor's. In addition, the Group evaluates the concentration of exposures by industry sector and geographic region through the Credit committee.

Financial assets are graded according to current credit ratings issued. AAA is the highest possible rating. Investment grade financial assets are classified within the range of AAA to BBB ratings. 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 concerned.

The following table provides information regarding the aggregated credit risk exposure of the Group at 31 December 2005.

50 – Risk management policies continued

The carrying amount of assets included on the balance sheet represents the maximum credit exposure.

	Credit rating						
	AAA £m	AA £m	A £m	BBB £m	Speculative grade £m	Not-rated £m	Total £m
Debt securities	**56,431**	**19,001**	**15,928**	**7,357**	**511**	**4,689**	**103,917**
Reinsurance assets	**1,967**	**2,238**	**2,416**	**60**	**–**	**449**	**7,130**
Other investments	**351**	**639**	**1,459**	**758**	**10**	**23,210**	**26,427**
Loans	**–**	**–**	**–**	**39**	**351**	**24,154**	**24,544**
	58,749	**21,878**	**19,803**	**8,214**	**872**	**52,502**	**162,018**

Concentrations of credit 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. In cases where the business is particularly exposed to credit risk (e.g. in respect of defaults on mortgages or debt 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 AAA rated Governments the largest aggregated counterparty exposure does not exceed 1.6% of the Group's total financial 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 and the impact from reinsurer default is measured regularly, in particular through the ICA tests, and is managed accordingly. Both the Credit committee and Reinsurance Security committee have a monitoring role over this risk. The Group's largest reinsurance counterparty is National Indemnity Corporation, a member of the Berkshire Hathaway Group. At 31 December the reinsurance asset recoverable from National Indemnity Corporation was £1.3bn. This exposure is monitored on a regular basis with the forecast to completion monitored for any shortfall in the claims history to verify that the contract is progressing as expected and that no further exposure for the Group will arise.

In the event of a catastrophic event the counterparty exposure to a single reinsurer is estimated not to exceed 1.4% of shareholders' equity.

(v) Operational risk

Operational risk arises as a result of inadequately controlled internal processes or systems, human error, or from external events. This definition is intended to include all risks to which the Group is exposed, other than the financial risks described previously, and strategic and Group risks that are considered elsewhere. Hence, operational risks include for example, information technology, information security, human resources, project management, outsourcing, tax, legal, fraud and compliance risks.

In accordance with Group policies, business unit management has primary responsibility for the effective identification, management, monitoring and reporting of risks to the business unit executive management team and to Group. Business unit risk management and governance functions are responsible for implementing the Group risk management methodologies and frameworks to assist line management in this work. They also provide support and independent challenge on the completeness, accuracy and consistency of risk assessments, and the adequacy of mitigating action plans. As a result, the business unit executive management team satisfies itself that material risks are being mitigated and reported to an acceptable level.

Operational risks are assessed according to the potential impact and probability of the event concerned. These impact assessments are made against financial, operational and reputational criteria. All operational risks are reported to Group on a quarterly basis. Risks assessed by business units to be at the two highest impact assessments are escalated to Group intra-quarter. This reporting enables the Group to:

– Assess and monitor overall operational risk exposures;

– Identify any concentrations of operational risk across the Group;

– Monitor progress in mitigating overall operational risk; and

– Verify that aggregate operational risk exposures remain within risk appetites.

Notes to the consolidated financial statements continued

50 – Risk management policies continued

(vi) Sensitivity analysis and capital management

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, FCRs are used, and increasingly ICA. However, sensitivities to economic and operating experience are regularly produced on all of the Group's financial performance measurements as part of the Group's decision making and planning process, and to set the framework for identifying and quantifying the risks that each of its business units, and the Group as a whole are exposed to.

For example, under ICA, an estimate of how much capital is needed to mitigate the risk of insolvency from events occurring within a selected remote level of probability is measured. This high level risk appetite parameter is then used to calibrate a series of core stress and scenario tests of both an economic and operating nature to be examined by each business unit. Business units satisfy themselves that the range and level of these tests is appropriate to their local risk profile, and supplement the core tests where necessary. Business units also perform an assessment of the operational risk; this assessment is subject to central review and challenge by Group to verify consistency across business units and to identify aggregate exposures. The businesses are then able to assess the capital requirements within this risk appetite framework. The Group uses both results at a business unit level and aggregated results to assess the benefits of diversification of risk in the Group, and to assess capital requirements of the types of risk it is exposed to. These results enable the Group to assess whether its risk appetite is appropriate and whether mitigating action is required.

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.

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 development on which the projections are based. As such, in the analysis below, the sensitivity of general insurance claim liabilities is primarily based on the financial impact of changes to the reported loss ratio.

Some results of sensitivity testing for long-term business and general insurance and health business are set out below. For each sensitivity test the impact of a 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 ± 1% (e.g. if a current interest rate is 5%, the impact of an immediate change to 4% and 6%). The test allows consistently for similar changes to investment returns and movements in the market value of backing fixed interest securities.
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%.

The above sensitivity factors are applied using actuarial and statistical models, with the following pre-tax impacts on profit and shareholders' equity at 31 December 2005:

Long-term business – impact on profit before tax (£m)

	Interest rates +1%	Interest rates -1%	Expenses +10%	Assurance mortality +5%	Annuitant mortality -5%
Insurance participating	**5**	**(35)**	**(5)**	**–**	**–**
Insurance non-participating	**60**	**(350)**	**(5)**	**(30)**	**(295)**
Investment participating	**10**	**(50)**	**–**	**–**	**–**
Investment non-participating	**–**	**–**	**–**	**–**	**–**
Total	**75**	**(435)**	**(10)**	**(30)**	**(295)**

50 – Risk management policies continued

Long-term business – impact before tax on shareholders' equity (£m)

	Interest rates +1%	Interest rates -1%	Expenses +10%	Assurance mortality +5%	Annuitant mortality -5%
Insurance participating	**(10)**	**(20)**	**(5)**	**–**	**–**
Insurance non-participating	**20**	**(305)**	**(5)**	**(30)**	**(295)**
Investment participating	**(10)**	**(25)**	**–**	**–**	**–**
Investment non-participating	**(5)**	**–**	**–**	**–**	**–**
Total	**(5)**	**(350)**	**(10)**	**(30)**	**(295)**

The sensitivity to a reduction in market interest rates relates primarily to the effect of interest rate guarantees in the Netherlands, with smaller impacts in the UK and other countries. The different impacts of interest rate changes on shareholders' equity and profit arise from the classification of fixed interest securities as available for sale in some business units, for which movements in unrealised gains would be taken directly to shareholders' equity.

The mortality sensitivities relate primarily to the UK and Irish business units.

General insurance and health business – impact on profit before tax (£m)

	Interest rates +1%	Interest rates -1%	Expenses +10%	Gross loss ratios +5%
Gross of reinsurance	**(275)**	**285**	**(115)**	**(305)**
Net of reinsurance	**(275)**	**285**	**(115)**	**(305)**

General insurance and health business – impact before tax on shareholders' equity (£m)

	Interest rates +1%	Interest rates -1%	Expenses +10%	Gross loss ratios +5%
Gross of reinsurance	**(275)**	**285**	**(30)**	**(305)**
Net of reinsurance	**(275)**	**285**	**(30)**	**(305)**

The sensitivity to a 5% increase in gross loss ratios is the same both net and gross of reinsurance because this increase does not result in any material excess of loss reinsurance limits being reached. For general insurance, the impact of the expense sensitivity on profit also includes the increase in on-going administration expenses, in addition to the increase in the claims handling expense provision.

Limitations of sensitivity analysis

The above tables demonstrate the effect of a change in a key assumption while other assumptions remain unchanged. In reality, such an occurrence is remote, due to correlations 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, the actual impact of a change in the assumptions may not have any impact on the liabilities, whereas assets are held at market value on the balance sheet. 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.

Notes to the consolidated financial statements continued

51 – Derivative financial instruments

The Group uses cash flow, fair value and net investment hedges to mitigate risk, as detailed below.

(a) Cash flow hedges

As explained in note 3(b), the Group hedged the foreign exchange risk that it expected to assume as a result of the sale of its general insurance business in Asia, using currency forwards. At 31 December 2005, currency forwards with an aggregate notional principal amount of £nil *(2004: £199 million)* and a positive fair value of £nil *(2004: £3 million)* were designated as a cash flow hedge of the foreign exchange exposure arising on the US dollar proceeds from the sale of the Asian businesses.

(b) Fair value hedges

The Group had no fair value hedge activity at 31 December 2005.

(c) Net investment hedges

To reduce the Group's exposure to foreign currency risk, the Group has designated a portion of its euro and US dollar denominated debt as a hedge of the net investment in its European subsidiaries. The carrying value of the debt at 31 December 2005 was £1,412 million *(2004: £1,688 million)*. The foreign exchange gain of £22 million *(2004: £5 million)* on translation of the debt to sterling at the balance sheet date was recognised in the hedging investments reserve in shareholders' equity.

(d) Non-hedge derivatives

The Group's non-hedge derivative activity at 31 December 2005 was as follows:

	2005			2004		
	Contract/ notional amount £m	Fair value asset £m	Fair value liability £m	Contract/ notional amount £m	Fair value asset £m	Fair value liability £m
Foreign exchange contracts						
OTC						
Forwards	**5,339**	**12**	**(10)**	1,047	86	–
Interest and currency swaps	**3,348**	**4**	**(34)**	405	–	8
Options	**47**	**–**	**–**	–	–	–
Total	**8,734**	**16**	**(44)**	1,452	86	8
Interest rate contracts						
OTC						
Forwards	**3,592**	**13**	**(6)**	3,701	30	9
Swaps	**5,189**	**67**	**(176)**	2,406	22	61
Options	**94**	**289**	**–**	395	67	2
Exchange traded						
Futures	**(2,757)**	**2**	**(638)**	27	(76)	7
Options	**624**	**19**	**–**	1	344	–
Total	**6,742**	**390**	**(820)**	6,530	387	79
Equity/Index contracts						
OTC						
Forwards	**903**	**1**	**(79)**	–	–	1
Options	**46**	**27**	**–**	8	–	–
Exchange traded						
Futures	**43**	**2**	**419**	102	86	40
Options	**10**	**5**	**(2)**	–	1	–
Total	**1,002**	**35**	**338**	110	87	41
Other	**–**	**26**	**–**	–	57	169
Totals at 31 December	**16,478**	**467**	**(526)**	8,092	617	297

51 – Derivative financial instruments continued

Non-hedge derivative assets have the following maturities:

	2005 £m	2004 £m
Within one year	**17**	22
Between one and two years	**33**	44
Between two and three years	**205**	271
Between three and four years	**–**	–
Between four and five years	**–**	–
After five years	**212**	280
	467	617

52 – Assets under management

The total Group assets under management are:

	2005 £m	2004 £m
Total assets included in the consolidated balance sheet	**263,447**	239,303
Additional value of internally-generated in-force long-term business	**6,454**	5,018
Third party funds under management		
Unit trusts, OEICs, Peps and Isas	**16,188**	10,527
Segregated funds	**30,821**	24,899
Total assets under management	**316,910**	279,747

53 – Related party transactions

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

	2005		2004	
	Income earned in year £m	Receivable at year end £m	Income earned in year £m	Receivable at year end £m
Associates	**47**	**12**	48	4
Joint ventures	**13**	**128**	8	–
Employee pension schemes	**3**	**–**	3	–
	63	**140**	59	4

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 46(f).

There were no services provided by related parties in either 2004 or 2005.

Details of loans made to joint ventures and associates may be found in notes 17 and 18 respectively.

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:

	2005 £m	2004 £m
Salary and other short-term benefits	**24**	18
Post-employment benefits	**1**	1
Equity compensation plans	**9**	6
Total	**34**	25

Information concerning individual directors' emoluments, interests and transactions is given on pages 65 to 74.

Financial statements of the Company
Income statement
For the year ended 31 December 2005

	Note	2005 £m	2004 £m
Income			
Dividends received from subsidiaries		**1,708**	336
Interest receivable from Group companies		**217**	227
Net investment income		**(10)**	19
		1,915	582
Expenses			
Operating expenses	C	**(160)**	(168)
Interest payable to Group companies		**(238)**	(184)
Interest payable on borrowings		**(224)**	(234)
		(622)	(586)
Profit/(loss) before tax		**1,293**	(4)
Tax credit	D	**54**	98
Profit after tax		**1,347**	94

Where applicable, the accounting policies of the Company are the same as those of the Group on pages 78 to 86. The notes (identified alphabetically on pages 194 to 198) 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 93 to 189.

Financial statements of the Company
Company balance sheet
At 31 December 2005

	Note	2005 £m	2004 £m
Assets			
Non-current assets			
Investments in subsidiaries	B	**22,919**	19,538
Investment in joint venture	17c	**22**	22
Loans owed by subsidiaries		**3,612**	3,717
Deferred tax assets	D	**2**	7
Current tax assets		**200**	270
		26,755	23,554
Current assets			
Loans owed by subsidiaries		**869**	1,061
Other assets		**55**	144
Cash and cash equivalents		**2**	31
Total assets		**27,681**	24,790
Equity			
Ordinary share capital	27	**599**	570
Preference share capital	30	**200**	200
Called up capital		**799**	770
Share premium account	27b	**1,167**	1,115
Merger reserve	E	**735**	227
Investment valuation reserve	E	**13,322**	11,801
Equity compensation reserve	E	**43**	21
Retained earnings	E	**1,690**	888
Direct Capital Instrument	31	**990**	990
Total equity		**18,746**	15,812
Liabilities			
Non-current liabilities			
Borrowings	F & 43	**3,006**	3,045
Loans owed to subsidiaries		**3,514**	2,525
		6,520	5,570
Current liabilities			
Borrowings	F & 43	**499**	1,070
Loans owed to subsidiaries		**1,121**	949
Other amounts owed to subsidiaries		**701**	1,294
Other creditors		**94**	95
Total liabilities		**8,935**	8,978
Total equity and liabilities		**27,681**	24,790

Approved by the Board on 1 March 2006.

Andrew Moss, Director

Where applicable, the accounting policies of the Company are the same as those of the Group on pages 78 to 86. The notes (identified alphabetically on pages 194 to 198) 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 93 to 189.

Financial statements of the Company

Statement of recognised income and expense

For the year ended 31 December 2005

	Note	2005 £m	2004 £m
Fair value gains on investments in subsidiaries	B	**1,521**	2,494
Aggregate tax effect	12b	**13**	–
Reserves credit for equity compensation plans	9	**22**	21
Net income recognised directly in equity		**1,556**	2,515
Profit for the year		**1,347**	94
Total recognised income and expense for the year		**2,903**	2,609

Reconciliation of movements in shareholders' equity

For the year ended 31 December 2005

	Note	2005 £m	2004 £m
Balance at 1 January		**15,812**	12,664
Total recognised income and expense for the year		**2,903**	2,609
Dividends and appropriations	14	**(657)**	(570)
Issue of share capital for the acquisition of RAC plc	3a	**530**	–
Other issues of share capital, net of transaction costs	27	**59**	25
Shares issued in lieu of dividends	27	**100**	103
Issue of Direct Capital Instrument, net of transaction costs of £9 million		**–**	981
Other movements		**(1)**	–
Balance at 31 December		**18,746**	15,812

Where applicable, the accounting policies of the Company are the same as those of the Group on pages 78 to 86. The notes (identified alphabetically on pages 194 to 198) 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 93 to 189.

Financial statements of the Company
Cash flow statement
For the year ended 31 December 2005

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.

	2005 £m	2004 £m
Cash flows from financing activities		
Funding provided by subsidiaries	**880**	744
Net drawdown/(repayment) of borrowings	**(370)**	(227)
Preference dividends paid	**(17)**	(17)
Ordinary dividends paid	**(497)**	(450)
Interest paid on borrowings	**(25)**	(27)
Net cash (used in) / from financing activities	**(29)**	23
Net (decrease)/increase in cash and cash equivalents	**(29)**	23
Cash and cash equivalents at 1 January	**31**	8
Cash and cash equivalents at 31 December	**2**	31

Where applicable, the accounting policies of the Company are the same as those of the Group on pages 78 to 86. The notes (identified alphabetically on pages 194 to 198) 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 93 to 189.

Financial statements of the Company
Notes to the company financial statements
For the year ended 31 December 2005

A – First time adoption of International Financial Reporting Standards
(i) The Company has adopted International Financial Reporting Standards (IFRS) for these financial statements for the year ended 31 December 2005. In order to show comparative balances, the year ended 31 December 2004 is also shown under IFRS. The date of transition to IFRS is, therefore, 1 January 2004.

In general, a company is required to determine its IFRS accounting policies and apply these retrospectively to determine its opening balance sheet under IFRS. However, International Financial Reporting Standard 1, *First time adoption of International Financial Reporting Standards,* (IFRS 1) allows a number of exemptions to this general principle upon adoption of IFRS. Where applicable, the Company has taken advantage of the same transitional arrangements as in the Group, as described in note 1(a).

(ii) Reconciliation of equity reported under UK GAAP to equity reported under IFRS

	As at 1 January 2004 £m	As at 31 December 2004 £m
Equity as reported under UK GAAP	10,752	12,937
Adjusted for:		
Dividend recognition (see (1) below)	6	(1,344)
Revaluation of investments in subsidiaries (see (2) below)	1,911	4,200
Pensions (see (3) below)	(4)	(27)
Equity compensation plans (see (4) below)	–	28
Direct Capital Instrument interest	–	6
Other items	(2)	4
	12,663	15,804
Deferred tax impact of above adjustments	1	8
Equity as reported under IFRS	12,664	15,812

(iii) Reconciliation of profit and loss reported under UK GAAP to profit and loss reported under IFRS

	For the year ended 31 December 2004 £m
Profit for the year as reported under UK GAAP	1,469
Adjusted for:	
Dividend recognition (see (1) below)	(1,372)
Pensions (see (3) below)	(23)
Equity compensation plans (see (4) below)	13
	87
Deferred tax impact of above adjustments	7
Profit for the year as reported under IFRS	94

(iv) Adjustments between UK GAAP and IFRS
The basis for the material adjustments between UK GAAP and IFRS is as follows:

(1) Dividend recognition
Under UK GAAP, dividends are accrued in the period to which they relate, regardless of when they are declared and approved. Under IAS 10, *Events after the Balance Sheet Date,* shareholders' dividends are accrued only when declared and appropriately approved. This affects both dividends receivable from subsidiaries and those payable to shareholders, increasing shareholders' funds by £6 million at 1 January 2004 and reducing them by £1,344 million at 31 December 2004. Profit for the year ended 31 December 2004 was similarly reduced by £1,372 million as a result.

(2) Investments in subsidiaries
Under UK GAAP, subsidiaries are stated at current value which, for this purpose, is embedded value for life operations and net asset value for other entities. As a result of applying IAS 39, subsidiaries are stated at their fair values, estimated using applicable valuation models underpinned by the Company's market capitalisation. This uplift in valuation has increased shareholders' funds by £1,911 million at 1 January 2004 and by £4,200 million at 31 December 2004.

A – First time adoption of International Financial Reporting Standards continued

(3) Pensions

As explained in note 1(b)(iii) of the Group accounts, the Group's UK GAAP pension policy was to expense the cost of providing pension benefits using actuarial valuation methods which give a substantially even charge over the expected service lives of employees. This resulted in either a prepayment or an accrual to the extent that this charge did not equate to the cash contributions made into the schemes. Under IAS 19, *Employee Benefits,* the projected benefit obligation is matched against the fair value of the underlying assets and other unrecognised actuarial gains and losses in determining the pension expense for the year in the Group financial statements. As explained in note C(ii) below, the Company now recognises a pension expense equal to its contributions payable in the year and provides for the cost of any unfunded benefits. This has reduced shareholders' funds by £4 million at 1 January 2004 and by £27 million at 31 December 2004. Profit for the year ended 31 December 2004 was similarly reduced by £23 million as a result.

(4) Equity compensation plans

Under IFRS 2, Share-based Payment, the Company has established an equity compensation reserve for all options and awards granted over its shares. The credit to equity as at 31 December 2004 arises because the cost of such options and awards is borne by the participating businesses and the charge to the Company's own income statement is therefore less than the reserve credit. The credit to the 2004 income statement under IFRS reflects the timing difference between charging under UK GAAP and IFRS for these options and awards.

B – Investments in subsidiaries

(i) Movements in the Company's investments in its subsidiaries are as follows:

	2005 £m	2004 £m
Fair value as at 1 January	**19,538**	15,544
Acquisitions	**2,973**	1,500
Disposals	**(1,113)**	–
Movement in fair value	**1,521**	2,494
At 31 December	**22,919**	19,538

(ii) In the table above, "Acquisitions" includes the purchase of the entire share capital of RAC plc on 4 May 2005, full details of which are given in note 3(a)(i) on page 106. On 24 August 2005, this investment was transferred to a subsidiary for the same consideration and is included in the heading "disposals" above.

As part of the ongoing Group restructuring, the Company acquired all the shares in Norwich Union Holdings Limited and Norwich Union Limited from subsidiaries on 12 December and 20 December 2005 respectively. These transactions were carried out at their fair values and are also included in "acquisitions" above.

At 31 December 2005, the Company has four wholly-owned subsidiaries, all incorporated in Great Britain. These are CGNU Holdings (Australia) Limited, General Accident plc, Norwich Union Limited and Norwich Union Holdings Limited. CGNU Holdings (Australia) Limited and Norwich Union Holdings Limited are intermediate holding companies, whilst General Accident plc and Norwich Union Limited no longer carry out this function. The principal subsidiaries of the Aviva Group at 31 December 2005 are listed on page 222.

C – Operating expenses

(i) Operating expenses comprise:

	2005 £m	2004 £m
Staff costs and other employee-related expenditure	**62**	55
Other operating costs	**120**	84
Net foreign exchange (gains)/losses	**(22)**	29
	160	168

(ii) 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, together with changes in provisions for the cost of any unfunded benefits, within staff costs above.

Full disclosure on the Group's pension schemes is given in note 42 on pages 164 to 167.

Financial statements of the Company
Notes to the company financial statements continued

C – Operating expenses continued

(iii) 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 28 on pages 142 to 145. The cost of such options and awards is borne by all participating businesses and, where relevant, the Company bears an appropriate change.

(iv) Auditors' remuneration

Other corporate costs include auditors' remuneration in respect of the Company of £77,000 *(2004: £13,000)*. The higher fees in 2005 reflect additional work carried out in connection with the Company's transition to IFRS for its own financial statements. Audit fees in respect of further assurance services totalled £237,000 *(2004: £747,000)*.

D – Tax

(i) Tax credited/(charged) to income statement:

	2005 £m	2004 £m
Current tax		
For this year	**29**	90
Prior year adjustments	**30**	1
Total current tax	**59**	91
Deferred tax		
Origination and reversal of timing differences	**(5)**	7
Total deferred tax	**(5)**	7
Total tax credited to income statement	**54**	98

(ii) 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:

	2005 £m	2004 £m
Profit/(loss) before tax	**1,293**	(4)
Tax calculated at standard UK corporation tax rate of 30% *(2004: 30%)*	**(388)**	1
Adjustment to tax charge in respect of prior years	**30**	2
Non-assessable dividends	**513**	100
Disallowable expenses	**(23)**	(7)
Disallowed deferred tax asset	**(55)**	–
Other	**(23)**	2
Total tax credited/(charged) to income statement	**54**	98

(iii) The net deferred tax asset comprises:

	2005 £m	2004 £m
Provisions and other timing differences	**2**	7
Net deferred tax asset	**2**	7

(iv) The movement in the net deferred tax asset was as follows:

	2005 £m	2004 £m
Net asset at 1 January	**7**	–
Amounts (charged)/credited to profit	**(5)**	7
Net asset at 31 December	**2**	7

Deferred income tax assets are recognised for tax loss carry forwards to the extent that the realisation of the related tax benefit through the future taxable profits is probable. The Company has unrecognised tax losses of £167 million *(2004: £nil)* to carry forward against future taxable profits.

E – Reserves

	Merger reserve £m	Investment valuation reserve £m	Equity compensation reserve £m	Retained earnings £m
Balance at 1 January 2004	227	9,307	–	1,270
Arising in the year:				
Profit for the year	–	–	–	94
Fair value gains on investments in subsidiaries	–	2,494	–	–
Dividends and appropriations	–	–	–	(570)
Reserves credit for equity compensation plans	–	–	21	–
Shares issued in lieu of dividends	–	–	–	103
Issue of Direct Capital Instrument	–	–	–	(9)
Balance at 31 December 2004	227	11,801	21	888
Arising in the year:				
Profit for the year	–	–	–	1,347
Fair value gains on investments in subsidiaries	–	1,521	–	–
Dividends and appropriations	–	–	–	(657)
Reserves credit for equity compensation plans	–	–	22	–
Shares issued in lieu of dividends	–	–	–	100
Shares issued on acquisition of subsidiary	508	–	–	–
Aggregate tax effect	–	–	–	13
Other movements	–	–	–	(1)
Balance at 31 December 2005	**735**	**13,322**	**43**	**1,690**

F – Borrowings

The Company's borrowings comprise:

	2005 £m	2004 £m
Subordinated debt	**2,808**	2,847
9.5% guaranteed bonds 2016	**198**	198
8.625% guaranteed bonds 2005	**–**	200
Commercial paper	**499**	870
	3,505	4,115
Repayable as follows:		
One year or less	**499**	1,070
After five years	**3,006**	3,045
	3,505	4,115

Further details of these borrowings can be found in note 43.

G – Derivative financial instruments

(i) Non-hedge derivatives

The Company's non-hedge derivative activity at 31 December 2005 was as follows:

	2005			2004		
	Contract/ notional amount £m	Fair value asset £m	Fair value liability £m	Contract/ notional amount £m	Fair value asset £m	Fair value liability £m
Foreign exchange contracts						
OTC						
Forwards	**40**	**–**	**(1)**	170	–	(1)
Total	**40**	**–**	**(1)**	170	–	(1)
Interest rate contracts						
OTC						
Swaps	**–**	**–**	**–**	65	–	(5)
Total	**–**	**–**	**–**	65	–	(5)

Financial statements of the Company
Notes to the company financial statements continued

H – Contingent liabilities
Details of the Company's contingent liabilities are given in note 46(f).

I – Risk management policies
The business of the Company is managing its investments in subsidiary 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 50.

J – Related party transactions
The Company receives dividend and interest income from subsidiaries and pays interest to those subsidiaries in the normal course of business. These activities are reflected in the table below.

Loans to and from subsidiaries, associates and joint ventures are made on normal arm's length commercial terms. The maturity analysis of the related party loans is as follows:

		Contractual repricing or maturity dates							
Payables	Denominated currency	Within 1 year £m	1 – 2 years £m	2 – 3 years £m	3 – 4 years £m	4 – 5 years £m	Over 5 years £m	Total £m	Effective interest rate %
2005	**£/€**	**1,121**	**120**	**1,697**	**202**	**–**	**1,495**	**4,635**	**5.12%**
2004	£/€	949	177	124	527	202	1,495	3,474	4.89%
Receivables									
2005	**£/€**	**869**	**75**	**420**	**210**	**–**	**2,907**	**4,481**	**4.55%**
2004	£/€	1,060	65	–	583	188	2,882	4,778	4.71%

Other related party balances comprise dividend and interest receivable and payable, as well as inter-company balances for transactions in the normal course of business.

Services provided to related parties

	Income earned in year 2005 £m	Receivable at year end 2005 £m	Income earned in year 2004 £m	Receivable at year end 2004 £m
Subsidiaries	**1,925**	**4,481**	563	4,778

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 46(f).

Services provided by related parties

	Expense incurred in year 2005 £m	Payable at year end 2005 £m	Expense incurred in year 2004 £m	Payable at year end 2004 £m
Subsidiaries	**238**	**5,336**	184	4,767

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 53.

Independent auditors' report to the directors of Aviva plc on the alternative method of reporting long-term business profits

We have audited the alternative method of reporting long-term business on pages 200 to 221 in respect of the year ended 31 December 2005, which comprises a European Embedded Value basis Summarised Consolidated Income Statement, Consolidated Statement of Recognised Income and Expense, Consolidated Statement of Changes in Equity, Summarised Consolidated Balance Sheet and the related notes on pages 200 to 221. The alternative method of reporting long-term business has been prepared in accordance with the CFO Forum Principles dated May 2004 as described on, and using the methodology and assumptions set out on, pages 204 to 206.

This report is made solely to the company's directors, as a body. Our audit work has been undertaken so that we might state to the company's directors 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 directors 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 are responsible for preparing the alternative method of reporting long-term business on the above European Embedded Value basis.

Our responsibilities, as independent auditors, in relation to the alternative method of reporting long-term business are established in the UK by the Auditing Practices Board and our profession's ethical guidance. We report to you our opinion as to whether the alternative method of reporting long-term business has been properly prepared in accordance with the European Embedded Value basis. We also report to you if we have not received all the information and explanations we require for our audit of the alternative method of reporting long-term business.

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 alternative method of reporting long-term business. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the alternative method of reporting long-term business, 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 alternative method of reporting long-term business stated on the European Embedded Value basis is 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 the alternative method of reporting long-term business.

Opinion

In our opinion the alternative method of reporting long-term business for the year ended 31 December 2005 has been properly prepared in accordance with the European Embedded Value basis, using the methodology and assumptions set out on pages 204 to 206.

Ernst & Young LLP
Registered Auditor
London
1 March 2006

Alternative method of reporting long-term business

Summarised consolidated income statement – EEV basis
For the year ended 31 December 2005

2005 €m		2005 £m	2004 £m
	Operating profit before tax attributable to shareholders' profits		
2,668	Life EEV operating return	**1,814**	1,611
75	Fund management[1]	**51**	20
2,281	General insurance and health	**1,551**	1,259
	Other:		
88	Other operations[2]	**60**	(41)
(200)	Corporate costs	**(136)**	(188)
(641)	Unallocated interest charges	**(436)**	(437)
4,271	**Operating profit before tax attributable to shareholders' profits**	**2,904**	2,224
(63)	Impairment of goodwill	**(43)**	(41)
(31)	Amortisation and impairment of acquired value of in-force business and intangibles	**(21)**	(3)
–	Financial Services Compensation Scheme and other levies	**–**	(49)
4,124	Variation from longer-term investment return	**2,805**	662
(597)	Effect of economic assumption changes	**(406)**	(318)
225	Profit on the disposal of subsidiaries and associates	**153**	34
(160)	Integration costs	**(109)**	–
–	Exceptional costs for termination of operations	**–**	(40)
7,769	**Profit before tax**	**5,283**	2,469
(1,363)	Tax on operating profit	**(927)**	(618)
(991)	Tax on other activities	**(674)**	(32)
5,415	**Profit for the year**	**3,682**	1,819
	Attributable to:		
5,103	Equity shareholders of Aviva plc	**3,470**	1,641
312	Minority interests	**212**	178
5,415		**3,682**	1,819

All profit is from continuing operations.

1. Excludes the proportion of the results of Morley's fund management businesses and of our French asset management operation Aviva Gestion d'Actifs (AGA) that arises from the provision of fund management services to our life businesses. These results are included within the life EEV operating return.
2. Excludes the proportion of the results of Norwich Union Life Services relating to the services provided to the UK life business. These results are included within the life EEV operating return. Other subsidiaries providing services to our life businesses do not materially impact the Group results.

Earnings per share – EEV basis
For the year ended 31 December 2005

2005	Earnings per share	2005	2004
	Operating profit on an EEV basis after tax, attributable to ordinary shareholders in respect of Aviva plc		
109.6c	Continuing operations	**74.5p**	63.1p
	Profit after tax for the year on an EEV basis, attributable to ordinary shareholders of Aviva plc		
215.1c	Basic (pence per share)	**146.3p**	72.0p
213.4c	Diluted (pence per share)	**145.1p**	71.4p

Summarised consolidated statement of recognised income and expense – EEV basis
For the year ended 31 December 2005

	2005 £m	2004 £m
Fair value gains, on AFS securities and owner-occupied properties, net of transfers to the income statement	**61**	130
Actuarial losses on pension schemes	**(547)**	(145)
Foreign exchange rate movements	**(44)**	119
Equity Compensation Reserve charge for the period	**22**	21
Aggregate tax effect – shareholder tax	**224**	(15)
Net (expense)/income recognised directly in equity	**(284)**	110
Profit for the year*	**3,682**	1,819
Total recognised income and expense for the year	**3,398**	1,929

*Stated before the effect of foreign exchange rate movements, which are reported within the foreign exchange rate movements line.

Reconciliation of movements in consolidated shareholders' funds – EEV basis
For the year ended 31 December 2005

	2005 £m	2004 £m
Balance at 1 January	**14,011**	11,534
Total recognised income and expense for the year	**3,398**	1,929
Dividends and appropriations (note 15)	**(657)**	(570)
Issue of share capital for the acquisition of RAC plc	**530**	–
Other issues of share capital, net of transaction costs	**59**	25
Shares issued in lieu of dividends	**100**	103
Issue of direct capital instrument, net of transaction costs of £9 million	**–**	981
Capital contribution from minority shareholders	**212**	4
Minority share of dividends declared in the year	**(70)**	(41)
Minority interest in acquired/(disposed) subsidiaries	**(36)**	45
Movement in shares held by employee trusts	**–**	1
Other movements	**(1)**	–
Total equity	**17,546**	14,011
Minority interests	**(1,457)**	(1,160)
Balance at 31 December	**16,089**	12,851

Alternative method of reporting long-term business continued

Summarised consolidated balance sheet – EEV basis
As at 31 December 2005

31 December 2005 €m		31 December 2005 £m	31 December 2004 £m
	Assets		
3,296	Goodwill	**2,274**	1,184
1,164	Acquired value of in-force business and intangible assets	**803**	516
9,354	Additional value of in-force long-term business	**6,454**	5,018
3,086	Investments in joint ventures	**2,129**	1,255
1,283	Investments in associates	**885**	873
1,283	Property and equipment	**885**	812
19,239	Investment property	**13,275**	11,057
35,571	Loans	**24,544**	22,055
	Financial investments		
150,604	Debt securities	**103,917**	98,719
75,426	Equity securities	**52,044**	47,291
38,300	Other investments	**26,427**	20,346
10,333	Reinsurance assets	**7,130**	8,503
1,475	Deferred tax assets	**1,018**	908
126	Current tax assets	**87**	–
11,168	Receivables and other financial assets	**7,706**	7,509
5,458	Deferred acquisition costs and other assets	**3,766**	3,189
3,425	Prepayments and accrued income	**2,363**	2,307
19,900	Cash and cash equivalents	**13,732**	12,779
670	Assets of operations classified as held for sale	**462**	–
391,161	**Total assets**	**269,901**	244,321
	Equity		
868	Ordinary share capital	**599**	570
6,432	Capital reserves	**4,438**	3,878
1,209	Other reserves	**834**	736
3,764	Retained earnings	**2,597**	1,709
9,320	Additional retained profit on an EEV basis	**6,431**	4,768
21,593	**Equity attributable to ordinary shareholders of Aviva plc**	**14,899**	11,661
1,725	Preference share capital and direct capital instrument	**1,190**	1,190
2,111	Minority interests	**1,457**	1,160
25,429	**Total equity**	**17,546**	14,011
	Liabilities		
192,177	Gross insurance liabilities	**132,602**	124,122
112,042	Gross liability for investment contracts	**77,309**	69,555
13,012	Unallocated divisible surplus	**8,978**	7,549
4,546	Net asset value attributable to unitholders	**3,137**	2,247
4,167	Provisions	**2,875**	2,125
3,562	Deferred tax liabilities	**2,458**	1,543
1,497	Current tax liabilities	**1,033**	922
15,961	Borrowings	**11,013**	10,090
13,746	Payables and other financial liabilities	**9,485**	7,240
4,812	Other liabilities	**3,320**	4,917
210	Liabilities of operations classified as held for sale	**145**	–
365,732	**Total liabilities**	**252,355**	230,310
391,161	**Total equity and liabilities**	**269,901**	244,321

Approved by the Board on 1 March 2006.

Andrew Moss, Director

Segmentation of summarised consolidated balance sheet – EEV basis
As at 31 December 2005

	Life and related businesses 2005 £m	General business and other 2005 £m	Group 2005 £m	Life and related businesses 2004 £m	General business and other 2004 £m	Group 2004 £m
Total assets before acquired additional value of in-force long-term business	**224,453**	**38,679**	**263,132**	205,498	33,441	238,939
Acquired additional value of in-force long-term business	**315**	**–**	**315**	364	–	364
Total assets included in the statutory IFRS balance sheet	**224,768**	**38,679**	**263,447**	205,862	33,441	239,303
Liabilities of the long-term business	**(215,624)**	**–**	**(215,624)**	(197,054)	–	(197,054)
Liabilities of the general insurance and other businesses	**–**	**(36,731)**	**(36,731)**	–	(33,256)	(33,256)
Net assets on a statutory IFRS basis	**9,144**	**1,948**	**11,092**	8,808	185	8,993
Additional value of in-force long-term business[1]	**6,454**	**–**	**6,454**	5,018	–	5,018
Net assets on an EEV basis[2]	**15,598**	**1,948**	**17,546**	13,826	185	14,011
Equity capital, capital reserves, shares held by employee trusts and other reserves			**5,871**			5,184
IFRS basis retained earnings			**2,597**			1,709
Additional EEV basis retained profit			**6,431**			4,768
Equity attributable to ordinary shareholders of Aviva plc on an EEV basis			**14,899**			11,661
Preference share capital and direct capital instrument			**1,190**			1,190
Minority interests			**1,457**			1,160
EEV basis total equity			**17,546**			14,011

1. The analysis between the Group's and the minority interest's share of the additional value of in-force long-term business is as follows:

	2005 £m	2004 £m	Movement in the year £m
Group's share included in shareholders' funds	**6,431**	4,768	1,663
Minority interest share	**329**	250	79
Movement in available for sale securities	**(306)**	–	(306)
Balance at 31 December	**6,454**	5,018	1,436

2. Analysis of net assets on an EEV basis is made up as follows:

	2005 £m	2004 £m
Long-term business net assets on an EEV basis	**15,598**	13,826
Comprises:		
Embedded value	**15,113**	13,014
RBSG goodwill	**217**	217
Goodwill allocated to long-term business	**631**	595
Notional allocation of IAS 19 pension fund deficit to long-term business[3]	**(363)**	–
Long-term business net assets on an EEV basis	**15,598**	13,826

3. The value of the Aviva Pension Scheme deficit has been notionally allocated between segments, based on current funding and the UK Life proportion has been included within the long-term business net assets on an EEV basis.

Alternative method of reporting long-term business continued

Basis of preparation – EEV basis

The consolidated income statement and balance sheet on pages 200 and 202 present the Group's results and financial position for the life and related businesses on the European Embedded Value (EEV) basis and for its non-life businesses on the International Financial Reporting Standards (IFRS) basis. The EEV methodology adopted is in accordance with the EEV Principles introduced by the CFO Forum in May 2004. In October 2005 the CFO Forum published additional guidance on EEV disclosures applicable for financial reporting for the year ending 31 December 2006 which has been reflected as far as is possible in this report, in accordance with our previous reporting.

In the directors' opinion, the EEV basis provides a more accurate reflection of the performance of the Group's life and related operations year on year than results presented under the IFRS basis. The directors consider that the EEV methodology represents a more meaningful basis of reporting the underlying value of the Group's life and related businesses and the underlying drivers of performance. This basis allows for the impact of uncertainty in the future investment returns more explicitly and is consistent with the way the business is priced and managed.

The Group's approach to establishing economic assumptions (specifically investment returns, required capital and discount rates) was reviewed by Tillinghast, a firm of actuarial consultants, at the time of adopting the EEV principles in 2004. The approach is based on the well established capital asset pricing model theory and is in line with the EEV Principles and Guidance.

The results for 2005 and 2004 have been audited by our auditors, Ernst & Young LLP. Their report in respect of 2005 is included in the Report and Accounts on page 199 of this document.

Covered business

The EEV 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. The adoption of IFRS has resulted in no change to the Group's definition of new business under EEV and so includes contracts that meet the definition of "non-participating investment" contracts under IFRS.

Covered business includes the Group's share of our joint venture operations including our arrangement with The Royal Bank of Scotland Group (RBSG) and our operations in India and China. In addition, the results of Group companies providing significant administration, investment 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".

New business premiums

New business premiums include:

– premiums arising from the sales of new contracts during the year;

– 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.

For products sold to individuals, premiums are generally considered to represent new business in certain circumstances, including 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.

Foreign exchange adjustments

Embedded value and other balance sheet items denominated in foreign currencies have been translated to sterling using the appropriate closing exchange rate. New business contribution and other income statement items have been translated using an average exchange rate for the relevant period. The exchange rates adopted in this announcement are shown on page 106.

EEV methodology

Overview

Under the EEV 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 life business, 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. Profits are then grossed up for tax at the full rate of corporation tax for the UK and at an appropriate rate for each of the other countries based on opening year tax rates.

EEV methodology continued

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 reported net of implicit items permitted on a local regulatory basis to cover minimum solvency margins which are assessed at a local entity basis. The level of required capital for each business, which ranges between 100% and 150% of the EU minimum solvency requirement for our main European businesses, reflects the level of capital considered by the directors to be appropriate to manage the business, allowing for our internal assessment of the level of market, insurance and operating risk inherent in the underlying products. The same definition of required capital is used for both existing and new business. The free surplus comprises the market value of shareholder assets in excess of local statutory reserves and required capital.

Value of in-force covered business

The value of in-force covered business is the present value at the appropriate risk discount rate (which incorporates a risk margin) of the distributable profits to shareholders arising from the in-force covered business projected on a best estimate basis, less a deduction for the cost of holding the required level of capital.

In the UK, shareholders' distributable profits arise when they are released following actuarial valuations. These valuations are carried out in accordance with statutory requirements designed to ensure and demonstrate solvency in long-term business funds. Future distributable profits will depend on experience in a number of areas such as investment return, discontinuance rates, mortality, 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 best estimate assumptions of future experience. In overseas businesses generally, there are similar requirements restricting payments to shareholders from life businesses.

The value of in-force covered business includes an allowance for the impact of financial options and guarantees arising from best estimate assumptions (the intrinsic value) and from additional costs related to the variability of investment returns (the time value). The intrinsic value is included in the underlying value of the in-force covered business using deterministic assumptions. The time value of financial options and guarantees has been determined using stochastic modelling techniques.

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. 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. The time value is determined by deducting the average value of shareholder cash flows under these economic scenarios from the deterministic shareholder value under best estimate assumptions.

The cost of holding required capital is the difference between the required capital and the present value at the appropriate risk discount rate of the projected release of the required capital and investment earnings on the assets deemed to back the required capital. Where the required capital is covered by policyholder assets, for example in the UK with-profit funds, there is no impact of cost of capital on shareholder value. The assets regarded as covering the required capital are those that the operation deems appropriate.

The value of in-force covered business 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.

Risk discount rates

Under the EEV methodology, a risk discount rate (RDR) is required to express a stream of expected future distributable profits as a single value at a particular date (the present value). It is the interest rate that an investment equal to the present value would have to earn in order to be able to replicate exactly the stream of future profits. The RDR is a combination of a risk free rate to reflect the time value of money plus a risk margin to make prudent allowance for the risk that experience in future years may differ from that assumed. In particular, a risk margin is added to allow for the risk that expected additional returns on certain asset classes (eg. equities) are not achieved.

Risk discount rates for our life businesses have been calculated using a risk margin based upon a Group Weighted Average Cost of Capital (WACC). The Group WACC is calculated using a gross risk free interest rate, an equity risk margin, a market assessed risk factor (beta), and an allowance for the gearing impact of debt financing (including subordinated debt) on a market value basis. The market assessed risk factor captures the market's view of the effect of all types of risk on our business, including operational and other non-economic risk.

The RDR is only one component of the overall allowance for risk in EEV calculations. Risk is also allowed for in the cost of holding statutory reserving margins, additional required capital and in the time value of options and guarantees. Hence to derive the RDR the Group WACC is adjusted to reflect the average level of required capital assumed to be held, and to reflect the explicit valuation of the time value of options and guarantees.

Alternative method of reporting long-term business continued

EEV methodology continued
In order to derive risk discount rates for each of our life businesses, the adjusted Group WACC is expressed as a risk margin in excess of the gross risk free interest rate used in the WACC calculation as described above. Business-specific discount rates are then calculated as the sum of this risk margin and the appropriate local gross risk free rate at the valuation date, based on returns on government bonds. A common risk free rate, and hence a common RDR, is used for all of our businesses within the Eurozone. Additional country-specific risk margins are applied to smaller businesses to reflect additional economic, political and business-specific risk for example, risk margins ranging from 3.7% to 8.7% are applied to the Group's eastern European and Asian operations. Within each business, a constant RDR has been applied in all future time periods and in each of the economic scenarios underlying the calculation of the time value of options and guarantees.

At each valuation date, the risk margin is reassessed based on current economic factors and is updated only if a significant change has occurred. In particular, changes in risk profile arising from movements in asset mix are allowed for via the updated risk margin calculation.

Participating business
Future regular bonuses on participating business are projected in a manner consistent with current bonus rates and expected future 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 time value of options and guarantees.

For profit sharing business in continental Europe, where policy benefits and shareholder value depend on the timing of realising gains, apportionment of unrealised gains between policyholders' benefits and shareholders reflect contractual requirements as well as existing practice. Where under certain economic scenarios additional shareholder injections are required to meet policyholder payments, the average additional cost has been included in the time value of options and guarantees.

Consolidation adjustments
The effect of transactions between our life companies such as loans and reinsurance arrangements has been included in results split by territory in a consistent manner. No elimination is required on consolidation.

As the EEV 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 EEV basis.

The capitalised value of the future profits and losses from such service companies are included in the embedded value and new business contribution calculations for the relevant territory, 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.

Components of life EEV return
The life EEV return comprises the following components:

– new business contribution written during the period including value added between the point of sale and end of the period;

– the profit from existing business equal to:

  • the expected return on the value of the in-force covered business at the beginning of the period,

  • experience variances caused by the differences between the actual experience during the period and expected experience based on the operating assumptions used to calculate the start of year value,

  • the impact of changes in operating assumptions including risk-margins;

– the expected investment return on the shareholders' net worth, based upon assumptions applying at the start of the year;

– investment return variances caused by differences between the actual return in the period and the expected return based on economic assumptions used to calculate the start of year value; and

– the impact of changes in economic assumptions in the period.

Components of life EEV return continued
The life EEV operating return comprises the first three of these components and is calculated using economic assumptions as at the start of the year and operating (demographic, expenses and tax) assumptions as at the end of the year.

Life EEV return	2005 £m	2004 £m
New business contribution (after the effect of required capital)	**612**	516
Profit from existing business		
– expected return	**895**	819
– experience variances	**(39)**	(15)
– operating assumption changes	**17**	(7)
Expected return on shareholders' net worth	**329**	298
Life EEV operating return before tax	**1,814**	1,611
Investment return variances	**2,288**	501
Effect of economic assumption changes	**(406)**	(318)
Life EEV return before tax	**3,696**	1,794
Tax on operating profit	**(566)**	(490)
Tax charge on other ordinary activities	**(579)**	(58)
Life EEV return after tax	**2,551**	1,246

There were no separate development costs reported in these periods.

New business contribution
The following tables set out the premium volumes and contribution from new business written by the life and related businesses, consistent with the definition of new business set out on page 204.

The contribution generated by new business written during the period is the present value of the projected stream of after tax distributable profit from that business. New business contribution before tax is calculated by grossing up the contribution after tax at the full corporation tax rate for UK business and at appropriate rates of tax for other countries. New business contribution has been calculated using the same economic assumptions as those used to determine the embedded value as at the start of the year and operating assumptions used to determine the embedded value as at the end of the year, and is rolled forward to the end of the financial period. New business contribution is shown before and after the effect of required capital, calculated on the same basis as for in-force covered business.

New business sales are expressed on two bases: annual premium equivalent (APE) and the present value of future new business premiums (PVNBP). The PVNBP calculation is equal to total single premium sales received in the year 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. 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 new business contribution, so the components of the new business margin are on a consistent basis.

	Annual premium equivalent[1]		Present value of new business premiums		New business contribution before the effect of required capital		New business margin before the effect of required capital[2]	
	2005 £m	2004 £m	2005 £m	2004 £m	2005 £m	2004 £m	2005 %	2004 %
Life and pensions								
United Kingdom	**1,142**	1,166	**9,053**	9,172	**265**	269	**2.9%**	2.9%
France	**384**	307	**3,530**	2,782	**135**	95	**3.8%**	3.4%
Ireland	**100**	86	**665**	561	**16**	19	**2.4%**	3.4%
Italy	**252**	198	**2,294**	1,799	**59**	48	**2.6%**	2.7%
Netherlands (including Belgium and Luxembourg)	**271**	261	**2,407**	2,168	**88**	80	**3.7%**	3.7%
Poland	**42**	37	**285**	241	**14**	11	**4.9%**	4.6%
Spain	**240**	248	**2,013**	2,110	**175**	143	**8.7%**	6.8%
Other Europe	**121**	124	**739**	804	**7**	5	**0.9%**	0.6%
Continental Europe	**1,410**	1,261	**11,933**	10,465	**494**	401	**4.1%**	3.9%
International	**193**	171	**1,260**	1,024	**49**	36	**3.9%**	3.4%
Total (before the effect of required capital)	**2,745**	2,598	**22,246**	20,661	**808**	706	**3.6%**	3.4%

1. United Kingdom APE has been restated to include NUER APE volumes of £37 million *(2004: £48 million)*.

2. New business margin represents the ratio of new business contribution before the effect of required capital to PVNBP, expressed as a percentage.

Alternative method of reporting long-term business continued

New business contribution continued

New business contribution before the effect of required capital includes minority interests in 2005 of £156 million *(2004: £121 million)*. This comprises minority interests in France of £19 million *(2004: £7 million)*, Italy £35 million *(2004: £27 million)*, Netherlands £10 million *(2004: £10 million)*, Poland £2 million, *(2004: £2 million)*, Spain £89 million *(2004: £75 million)* and Other Europe £1 million *(2004: nil)*.

	Present value of new business premiums		New business contribution after the effect of required capital		New business margin after the effect of required capital[1]	
	2005 £m	2004 £m	2005 £m	2004 £m	2005 %	2004 %
Life and pensions						
United Kingdom	**9,053**	9,172	**213**	215	**2.4%**	2.3%
France	**3,530**	2,782	**91**	54	**2.6%**	1.9%
Ireland	**665**	561	**13**	16	**2.0%**	2.9%
Italy	**2,294**	1,799	**36**	34	**1.6%**	1.9%
Netherlands (including Belgium and Luxembourg)	**2,407**	2,168	**57**	43	**2.4%**	2.0%
Poland	**285**	241	**13**	9	**4.6%**	3.7%
Spain	**2,013**	2,110	**155**	121	**7.7%**	5.7%
Other Europe	**739**	804	**2**	–	**0.3%**	–
Continental Europe	**11,933**	10,465	**367**	277	**3.1%**	2.6%
International	**1,260**	1,024	**32**	24	**2.5%**	2.3%
Total (after the effect of required capital)	**22,246**	20,661	**612**	516	**2.8%**	2.5%

1. New business margin represents the ratio of new business contribution after deducting the effect of required capital to PVNBP, expressed as a percentage.
2. The reduction in the level of required capital in respect of UK annuities from 200% to 150% of the EU minimum has increased the 2005 amount by £13 million (2004 has not been restated).

New business contribution after the effect of required capital includes minority interests in 2005 of £120 million *(2004: £94 million)*. This comprises minority interests in France of £10 million *(2004: £1 million)*, Italy £21 million *(2004: £19 million)*, Netherlands £7 million *(2004: £8 million)*, Poland £2 million *(2004: £2 million)*, Spain £79 million *(2004: £64 million)* and Other Europe £1 million *(2004: nil)*.

EEV basis – new business contribution before the effect of required capital, tax and minority interest

	Annual premium equivalent		Present value of new business premiums		New business contribution[1]		New business margin[2]	
	2005 £m	2004 £m	2005 £m	2004 £m	2005 £m	2004 £m	2005 %	2004 %
Analysed between:								
– Bancassurance channels	**710**	587	**6,075**	4,976	**311**	242	**5.1%**	4.9%
– Other distribution channels	**2,035**	2,011	**16,171**	15,685	**497**	464	**3.1%**	3.0%
Total	**2,745**	2,598	**22,246**	20,661	**808**	706	**3.6%**	3.4%

1. Stated before the effect of required capital.
2. New business margin represents the ratio of new business contribution before the effect of required capital to PVNBP, expressed as a percentage.

EEV basis – new business contribution after the effect of required capital, tax and minority interest

	Annual premium equivalent		Present value of new business premiums[1]		New business contribution[2]		New business margin[3]	
	2005 £m	2004 £m	2005 £m	2004 £m	2005 £m	2004 £m	2005 %	2004 %
Analysed between:								
– Bancassurance channels	**387**	328	**3,238**	2,728	**93**	74	**2.9%**	2.7%
– Other distribution channels	**1,997**	1,978	**15,815**	15,353	**248**	223	**1.6%**	1.5%
Total	**2,384**	2,306	**19,053**	18,081	**341**	297	**1.8%**	1.6%

1. Stated after deducting minority interests.
2. Contribution stated after deducting the effect of required capital, tax and minority interests.
3. New business margin represents the ratio of new business contribution after deducting the effect of required capital, tax and minority interests to PVNBP after deducting the minority interests, expressed as a percentage.

Experience variances

Experience variances include the impact of the difference between expense, demographic and persistency assumptions, and actual experience incurred in the year. Also included are variances arising from tax, where such variances are due to management action.

	2005 £m	2004 £m
United Kingdom	**(93)**	(81)
France	**32**	22
Netherlands (including Belgium and Luxembourg)	**(8)**	12
Rest of Europe	**21**	23
International	**9**	9
	(39)	(15)

Operating assumption changes

Changes in operating assumptions are made when the assumed future levels of expenses, mortality or other operating assumptions are expected to change permanently.

	2005 £m	2004 £m
United Kingdom	**(57)**	(58)
France	**14**	35
Netherlands (including Belgium and Luxembourg)	**47**	21
Rest of Europe	**11**	(4)
International	**2**	(1)
	17	(7)

Further disclosures on experience variances and operating assumption changes on an EEV basis are provided on pages 211 and 212.

Geographical analysis of life EEV operating return

	2005 £m	2004 £m
United Kingdom	**585**	551
Continental Europe		
France	**321**	286
Ireland	**20**	40
Italy	**96**	79
Netherlands (including Belgium and Luxembourg)	**318**	277
Poland	**128**	93
Spain	**214**	180
Other Europe	**33**	22
International	**99**	83
	1,814	1,611

Life EEV operating return includes minority interests in 2005 of £216 million *(2004: £186 million)*. This comprises minority interests in France of £24 million *(2004: £9 million)*, Italy £52 million *(2004: £43 million)*, Netherlands £17 million *(2004: £26 million)*, Poland £18 million *(2004: £16 million)*, Spain £103 million *(2004: £90 million)* and Other Europe £2 million *(2004: £2 million)*.

Analysis of movement in life and related businesses embedded value

The following tables provide an analysis of the movement in embedded value for the life and related businesses for 2005 and 2004. The analysis is shown separately for net worth and the value of in-force covered business, and includes amounts transferred between these categories. The transfer from life and related businesses to other segments consists 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.

Alternative method of reporting long-term business continued

Analysis of movement in life and related businesses embedded value continued
All figures are shown net of tax.

			2005
	Net worth £m	Value of in-force £m	Total £m
Embedded value at the beginning of the year – Free surplus	**1,894**		
– Required capital[1]	**4,362**		
Total	**6,256**	**6,758**	**13,014**
New business contribution (after the effect of required capital)	**(536)**	**955**	**419**
Expected return on existing business – return on VIF	**–**	**624**	**624**
Expected return on existing business – transfer to net worth	**929**	**(929)**	**–**
Experience variances and operating assumption changes	**96**	**(115)**	**(19)**
Expected return on shareholders' net worth	**225**	**–**	**225**
Investment return variances and economic assumption changes	**785**	**517**	**1,302**
Life EEV return after tax	**1,499**	**1,052**	**2,551**
Exchange rate movements	**(54)**	**(45)**	**(99)**
Embedded value from business disposed of	**(19)**	**(19)**	**(38)**
Amounts injected into life and related businesses	**266**	**–**	**266**
Amounts released from life and related businesses	**(751)**	**–**	**(751)**
Transfer from life and related businesses to other segments	**23**	**–**	**23**
UK Life pension fund deficit transferred to analysis of net assets on an EEV basis[2]	**–**	**147**	**147**
Embedded value at the end of the year – Free surplus	**2,772**		
– Required capital[1]	**4,448**		
Total	**7,220**	**7,893**	**15,113**

1. Required capital is shown net of implicit items permitted by local regulators to cover minimum solvency margins.
2. Reflecting CFO Forum guidance the pension scheme deficit is now being accounted for on an IAS 19 basis. Consequently, the element that had previously been included in the Life EEV analysis, being the present value of agreed deficit funding payments, has been removed from the Life EEV analysis.

The embedded value of business disposed of in 2005 of £38 million represents the embedded value of the business in Portugal and Delta Lloyd's stake in ENNIA Caribe, a Dutch Antilles and Aruba based insurer.

Required capital has increased in the year by £86 million. The movement comprises an increase of £557 million in relation to new business written, a reduction of £415 million in relation to in-force business and a reduction of £56 million in relation to movements in foreign exchange rates. The reduction in the in-force required capital includes a release of £245 million arising from the restructure of the UK non-profit funds and a release of £295 million arising from the reduction in the level of required capital for UK annuities. The underlying increase in the in-force required capital of £125 million which reflects the effect of the reduction in long-term interest rates, which has increased statutory reserves, and therefore capital requirements and has more than off-set the reduction in capital in respect of business run-off.

			2004
	Net worth £m	Value of in-force £m	Total £m
Embedded value at the beginning of the year – Free surplus	1,721		
– Required capital[1]	4,114		
Total	**5,835**	**5,916**	**11,751**
New business contribution (after the effect of required capital)	(520)	875	355
Expected return on existing business – return on VIF	–	576	576
Expected return on existing business – transfer to net worth	738	(738)	–
Experience variances and operating assumption changes	(98)	79	(19)
Expected return on shareholders' net worth	208	–	208
Investment return variances and economic assumption changes	167	(41)	126
Life EEV return after tax	**495**	**751**	**1,246**
Exchange rate movements	51	68	119
Embedded value of businesses acquired	79	23	102
Amounts injected into life and related businesses	324	–	324
Amounts released from life and related businesses	(576)	–	(576)
Transfer from life and related businesses to other segments	48	–	48
Embedded value at the end of the year – Free surplus	**1,894**		
– Required capital[1]	4,362		
Total	6,256	6,758	13,014

1. Required capital is shown net of implicit items permitted by local regulators to cover minimum solvency margins.

The embedded value of business acquired in 2004 of £102 million represents the total embedded value of Antarius, the bancassurance joint venture with Crédit du Nord in France.

Segmental analysis of the components of life EEV operating return

Year ended 31 December 2005	UK £m	France £m	Ireland £m	Italy £m	Netherlands £m	Poland £m	Spain £m	Other Europe £m	International £m	Total £m
New business contribution (after the effect of required capital)	**213**	**91**	**13**	**36**	**57**	**13**	**155**	**2**	**32**	**612**
Profit from existing business										
– expected return	**424**	**122**	**29**	**30**	**139**	**48**	**48**	**22**	**33**	**895**
– experience variances:										
Maintenance expenses	**12**	**3**	**(2)**	**(2)**	**3**	**5**	**(2)**	**1**	**(4)**	**14**
Exceptional expenses[1]	**(148)**	**–**	**(5)**	**–**	**(12)**	**–**	**(2)**	**(3)**	**–**	**(170)**
Mortality/Morbidity[2]	**86**	**29**	**(1)**	**2**	**16**	**16**	**5**	**–**	**5**	**158**
Lapses[3]	**(78)**	**(4)**	**(9)**	**(4)**	**2**	**6**	**1**	**(6)**	**9**	**(83)**
Other[4]	**35**	**4**	**(4)**	**4**	**(17)**	**8**	**2**	**11**	**(1)**	**42**
	(93)	**32**	**(21)**	**–**	**(8)**	**35**	**4**	**3**	**9**	**(39)**
– operating assumption changes:										
Maintenance expenses	**(21)**	**–**	**1**	**(3)**	**25**	**2**	**1**	**(4)**	**(9)**	**(8)**
Exceptional expenses	**(4)**	**(3)**	**–**	**–**	**(2)**	**–**	**–**	**1**	**–**	**(8)**
Mortality/Morbidity[5]	**19**	**1**	**(4)**	**4**	**(25)**	**7**	**–**	**2**	**5**	**9**
Lapses[6]	**(130)**	**–**	**(8)**	**–**	**(10)**	**–**	**(2)**	**(2)**	**4**	**(148)**
Other[7]	**79**	**16**	**–**	**–**	**59**	**13**	**(2)**	**5**	**2**	**172**
	(57)	**14**	**(11)**	**1**	**47**	**22**	**(3)**	**2**	**2**	**17**
Expected return on shareholders' net worth	**98**	**62**	**10**	**29**	**83**	**10**	**10**	**4**	**23**	**329**
Life EEV operating return before tax	**585**	**321**	**20**	**96**	**318**	**128**	**214**	**33**	**99**	**1,814**

1. Exceptional expenses in the UK reflect £47 million relating to ongoing transformation of the life business and £101 million of other exceptional and project costs associated with regulatory change and strategic initiatives.
2. Mortality experience continues to be better than assumed across most of our businesses, and particularly for protection business in the UK, AFER and unit-linked business in France and group business in the Netherlands.
3. Lapse experience in the UK has been worse than assumed and mainly relates to bonds and pension business. In Ireland, the adverse persistency has mainly arisen on unit-linked pensions business.
4. In the UK, other experience profits includes better than assumed default experience on corporate bonds and commercial mortgages.
5. Mortality assumptions have been revised in the Netherlands following the publication of new annuitant mortality tables used for group business.
6. In the UK, the adverse lapse assumption change reflects a more prudent allowance for future persistency experience in the UK following recent experience. In Ireland, the lapse assumption change mainly relates to unit-linked pension business. Lapse assumption changes in the Netherlands largely relate to group business in the intermediary division.
7. Other operating assumption changes in the UK primarily relate to the change in annuitant required capital to 150% of required minimum margins which results in a £110 million one-off benefit. In France other operating assumptions represent an allowance for further tax benefits arising from dividends from subsidiaries. In the Netherlands, they reflect a variety of changes including increased annual management fees on unit-linked contracts, favourable change in asset mix, and the reduction of future guaranteed returns on group pensions business in Belgium. In Poland it was previously assumed that the introduction of new individual pension products would lead to significant conversion of existing policies. The prudent allowance made for this is no longer required.

Alternative method of reporting long-term business continued

Segmental analysis of the components of life EEV operating return

Year ended 31 December 2004	UK £m	France £m	Ireland £m	Italy £m	Netherlands £m	Poland £m	Spain £m	Other Europe £m	International £m	Total £m
New business contribution (after the effect of required capital)	215	54	16	34	43	9	121	–	24	516
Profit from existing business										
– expected return	367	112	30	29	141	45	40	24	31	819
– experience variances:										
Maintenance expenses[1]	31	(2)	(1)	2	(9)	5	–	1	1	28
Exceptional expenses[2]	(153)	–	–	–	(12)	–	(1)	(3)	(1)	(170)
Mortality/Morbidity[3]	49	21	7	–	17	8	1	2	5	110
Lapses[4]	(50)	5	(1)	(5)	(2)	5	2	(4)	6	(44)
Other[5]	42	(2)	–	3	18	–	2	–	(2)	61
	(81)	22	5	–	12	18	4	(4)	9	(15)
– operating assumption changes:										
Maintenance expenses[6]	77	–	(6)	(3)	–	14	3	1	4	90
Exceptional expenses[7]	(34)	(2)	–	–	(72)	–	–	–	–	(108)
Mortality/Morbidity	2	–	(2)	7	5	(2)	–	1	(1)	10
Lapses[8]	(110)	–	(16)	(3)	9	–	1	1	(1)	(119)
Other[9]	7	37	–	1	79	2	3	(6)	(3)	120
	(58)	35	(24)	2	21	14	7	(3)	(1)	(7)
Expected return on shareholders' net worth	108	63	13	14	60	7	8	5	20	298
Life EEV operating return before tax	**551**	**286**	**40**	**79**	**277**	**93**	**180**	**22**	**83**	**1,611**

1. Maintenance expenses in the UK reflect the benefit of cost saving initiatives undertaken.
2. Exceptional expenses in the UK reflect costs of £65 million for the restructuring of the business services division and one-off project costs of £88 million associated with the pace of regulatory change.
3. Mortality experience across our major businesses continues to be better than our assumptions for protection and annuity business in the UK and protection business in continental Europe.
4. Lapse experience in the UK has been adverse and mainly relates to bonds, protection schemes and pension products.
5. In the UK, other experience profits include £29 million of profits arising from better than assumed default experience on corporate bonds and commercial mortgages.
6. Maintenance expense assumption changes in the UK reflect the benefit of cost saving initiatives coming through.
7. The UK and the Netherlands include capitalised additional future project expenses.
8. Adverse lapse assumption changes in the UK relates to unitised with-profit bonds and unit-linked bonds. In Ireland, lapse assumption changes have been made on unit-linked pensions business following recent experience.
9. Other operating assumptions in the Netherlands relates to positive changes in asset mix and tax reflecting, in part, the fact that the embedded value of Delta Lloyd was previously assessed using a blended average tax rate of 25%, which is below the local corporation tax rate. The calculation has been refined to tax all future profits at the full corporation tax rate at the beginning of the year of 34.5% and to allow explicitly for the tax benefit arising from investing in the "5% holdings" (investments in Dutch companies where at least 5% of the share capital is owned), on which all investment income is tax free. This change results in a £53 million one-off benefit. France includes the benefit of tax assumption changes. France has historically recorded favourable tax operating experience as a result of better than assumed tax on dividend income. Previously the tax assumptions had been set at full corporation tax for all future profits, whereas in fact dividend income from subsidiaries is tax exempt. In 2004, the calculation has been refined such that the future tax benefit arising from dividend from subsidiaries has now been recognised. This change results in a £39 million benefit.

Segmental analysis of life and related businesses embedded value

31 December 2005	Net worth: Required capital[1] £m	Net worth: Free surplus £m	Value of in-force covered business: Present value of in-force £m	Value of in-force covered business: Cost of required capital £m	Total: Embedded value £m
United Kingdom	**1,120**	**673**	**4,916**	**(396)**	**6,313**
Continental Europe					
France	**1,131**	**133**	**1,009**	**(206)**	**2,067**
Ireland	**144**	**142**	**372**	**(19)**	**639**
Italy	**285**	**317**	**170**	**(56)**	**716**
Netherlands (including Belgium and Luxembourg)	**1,024**	**1,068**	**1,253**	**(321)**	**3,024**
Poland	**104**	**109**	**464**	**(30)**	**647**
Spain	**243**	**19**	**515**	**(52)**	**725**
Other	**90**	**75**	**116**	**(25)**	**256**
International	**307**	**236**	**265**	**(82)**	**726**
	4,448	**2,772**	**9,080**	**(1,187)**	**15,113**

1. Required capital is shown net of implicit items permitted by local regulators to cover minimum solvency margins.

	Net worth 2005 £m	Net worth 2004 £m	Value of in-force covered business 2005 £m	Value of in-force covered business 2004 £m	Embedded value 2005 £m	Embedded value 2004 £m
United Kingdom	**1,793**	1,933	**4,520**	3,681	**6,313**	5,614
Continental Europe						
France	**1,264**	1,121	**803**	698	**2,067**	1,819
Ireland	**286**	281	**353**	334	**639**	615
Italy	**602**	424	**114**	114	**716**	538
Netherlands (including Belgium and Luxembourg)	**2,092**	1,454	**932**	1,023	**3,024**	2,477
Poland	**213**	188	**434**	369	**647**	557
Spain	**262**	222	**463**	362	**725**	584
Other	**165**	149	**91**	64	**256**	213
International	**543**	484	**183**	113	**726**	597
	7,220	6,256	**7,893**	6,758	**15,113**	13,014

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. Required capital, net of implicit items, of £4,448 million at 31 December 2005 *(31 December 2004: £4,362 million)* is included within the net worth.

The value of in-force covered business includes the effect of holding shareholders' capital to support the level of required capital and allowing for projected future releases. This impact reduces the value of in-force covered business at 31 December 2005 by £1,187 million *(31 December 2004: £1,195 million)*.

The embedded value at the end of 2005 includes minority interests of £1,000 million *(2004: £796 million)*. This comprises minority interests in France of £148 million *(2004: £120 million)*, Italy £365 million *(2004: £276 million)*, Netherlands £70 million *(2004: £59 million)*, Poland £106 million *(2004: £90 million)*, Spain £310 million *(2004: £244 million)* and Other Europe £1 million *(2004: £7 million)*.

Alternative method of reporting long-term business continued

Time value of options and guarantees

The following table sets out the time value of options and guarantees relating to covered business by territory at 31 December 2005 and 31 December 2004.

	2005 £m	2004 £m
United Kingdom	**48**	44
Continental Europe		
France	**84**	79
Ireland	**3**	4
Italy	**19**	14
Netherlands (including Belgium and Luxembourg)	**101**	92
Poland	**5**	5
Spain	**8**	9
Other Europe	**19**	18
International	**16**	9
	303	274

The time value of options and guarantees (TVOG) is most significant in the UK, France and the Netherlands. In the UK, this relates mainly to non-market value adjustment (MVA) guarantees on unitised with-profit business and guaranteed annuity rates. In France, this relates mainly to guaranteed crediting rates and surrender values on traditional business including the AFER fund. In the Netherlands, this relates mainly to maturity guarantees on unit-linked products and interest rate guarantees on traditional individual and Group profit sharing business.

The TVOG has increased over the year to £303 million primarily due to the allowance included in new business contribution of £31 million. Also included is an increase of £15 million due to the 40 basis points fall in bond yields in continental Europe during 2005, which have largely been offset by the favourable impacts of investment returns and exchange rates.

Minority interest in life and related businesses' EEV results

			2005	2004
	Shareholders' interest £m	Minority interest £m	Group £m	Group £m
New business contribution before effect of required capital	**652**	**156**	**808**	706
Effect of required capital	**(160)**	**(36)**	**(196)**	(190)
New business contribution including effect of required capital	**492**	**120**	**612**	516
Life EEV operating return before tax	**1,598**	**216**	**1,814**	1,611
Life EEV return before tax	**3,456**	**240**	**3,696**	1,794
Attributed tax	**(1,065)**	**(80)**	**(1,145)**	(548)
Life EEV return after tax	**2,391**	**160**	**2,551**	1,246
Closing life and related businesses' embedded value	**14,113**	**1,000**	**15,113**	13,014

Principal 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. The same margins are applied on a consistent basis across the Group to gross risk free yields to obtain investment return assumptions for ordinary shares and property and to produce risk discount rates. Additional country-specific risk margins are applied to smaller businesses to reflect additional economic, political and business specific risks, which result in the application of risk margins ranging from 3.7% to 8.7% in our eastern European and Asian business operations. Expense inflation is derived as a fixed margin above a local measure of long-term price inflation. Risk free rates and price inflation have been harmonised across territories within the euro currency zone, except for expense inflation in Ireland where significant differences remain. Required capital is shown as a multiple of the EU statutory minimum solvency margin.

Principal economic assumptions – deterministic calculations continued
Investment return assumptions are generally derived by major product class, based on hypothecating the assets at the valuation date. Future assumed reinvestment rates are consistent with implied market returns at 31 December 2006. Rates have been derived using rates from the current yield curve at a duration based on the term of the liabilities, or directly from forward yield curves where considered appropriate. Assumptions about future investment mix are consistent with long-term plans. In most cases, the investment mix is assumed to continue unchanged throughout the projection period. The changes in assumptions between reporting dates reflect the actual movements in risk free yields in the UK, the Eurozone and other territories. The principal economic assumptions used are as follows:

			UK			France
	2005	2004	2003	2005	2004	2003
Risk discount rate	**6.8%**	7.3%	7.5%	**6.0%**	6.4%	7.0%
Pre-tax investment returns:						
Base government fixed interest	**4.1%**	4.6%	4.8%	**3.3%**	3.7%	4.3%
Ordinary shares	**7.1%**	7.6%	7.8%	**6.3%**	6.7%	7.3%
Property	**6.1%**	6.6%	6.8%	**5.3%**	5.7%	6.3%
Future expense inflation	**3.2%**	3.3%	3.4%	**2.5%**	2.5%	2.5%
Tax rate	**30.0%**	30.0%	30.0%	**34.4%**	34.9%	35.4%
Required Capital (% EU minimum)	**150%/ 100%**	200%/ 100%	200%/ 100%	**115%**	115%	115%

			Ireland			Italy
	2005	2004	2003	2005	2004	2003
Risk discount rate	**6.0%**	6.4%	7.0%	**6.0%**	6.4%	7.0%
Pre-tax investment returns:						
Base government fixed interest	**3.3%**	3.7%	4.3%	**3.3%**	3.7%	4.3%
Ordinary shares	**6.3%**	6.7%	7.3%	**6.3%**	6.7%	7.3%
Property	**5.3%**	5.7%	6.3%	**5.3%**	5.7%	6.3%
Future expense inflation	**4.0%**	4.0%	4.0%	**2.5%**	2.5%	2.5%
Tax rate	**12.5%**	12.5%	12.5%	**38.3%**	38.3%	39.8%
Required Capital (% EU minimum)	**150%**	150%	150%	**115%**	115%	115%

			Netherlands			Poland
	2005	2004	2003	2005	2004	2003
Risk discount rate	**6.0%**	6.4%	7.0%	**8.6%**	9.7%	9.7%
Pre-tax investment returns:						
Base government fixed interest	**3.3%**	3.7%	4.3%	**4.9%**	6.0%	6.0%
Ordinary shares	**6.3%**	6.7%	7.3%	**7.9%**	9.0%	9.0%
Property	**5.3%**	5.7%	6.3%	**n/a**	n/a	n/a
Future expense inflation	**2.5%**	2.5%	2.5%	**3.3%**	3.4%	3.4%
Tax rate	**29.1%**	31.5%	25.0%	**19.0%**	19.0%	19.0%
Required Capital (% EU minimum)	**150%**	150%	150%	**150%**	150%	150%

			Spain
	2005	2004	2003
Risk discount rate	**6.0%**	6.4%	7.0%
Pre-tax investment returns:			
Base government fixed interest	**3.3%**	3.7%	4.3%
Ordinary shares	**6.3%**	6.7%	7.3%
Property	**5.3%**	5.7%	6.3%
Future expense inflation	**2.5%**	2.5%	2.5%
Tax rate	**35.0%**	35.0%	35.0%
Required Capital (% EU minimum)	**125%/ 110%**	125%/ 110%	125%/ 110%

Alternative method of reporting long-term business continued

Principal economic assumptions – deterministic calculations continued
For service companies, expense inflation relates to the underlying expenses rather than the fees charged to the life company. Future returns on corporate fixed interest investments are calculated from prospective yields less an adjustment for credit risk. Required capital in the United Kingdom is 150% EU minimum for Norwich Union Annuity Limited and 100% for other companies. Required capital in Spain is 125% EU minimum for Aviva Vida y Pensiones and 110% for bancassurance companies.

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 and Aviva's medium-term bonus plans. The distribution of profit between policyholders and shareholders within the with-profit funds assumes that the shareholder interest in conventional with-profit business in the UK and Ireland continues at the current rate of one ninth of the cost of bonus.

Principal economic assumptions – stochastic calculations
The time value of options and guarantees calculation allows for expected management and policyholder actions in response to varying future investment conditions. The management actions modelled include changes to asset mix and bonus rates. Modelled policyholder actions are described under "Other assumptions".

This section describes the models used to generate future investment simulations, and gives some sample statistics for the simulations used. Two separate models have been used, for the UK businesses and for the Europe (excluding UK) and International businesses, as each of these models better reflect the characteristics of the businesses.

United Kingdom
Model
Overall asset returns have been generated assuming that the portfolio total return has a lognormal distribution. The mean and standard deviation of the overall asset return have been calculated using the evolving asset mix of the fund and assumptions over the mean and standard deviation of each asset class, together with correlations between them.

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.

Summary Statistics
The following table sets out the means and standard deviations (StDev) of future returns at 31 December 2005 for the three most significant asset classes. Interest rates are assumed to have a lognormal distribution with an annualised standard deviation of 13% p.a. for the natural logarithm of the interest rate.

	Mean[1]	StDev[2]
Equities	7.1%	20%
Property	6.1%	15%
Government Bonds	4.1%	3.25-4.75%[3]

1. Means have been calculated by accumulating a unit investment for the required number of years in each simulation, averaging the accumulation across all simulations, and converting the result to an equivalent annual rate (by taking the nth root of the average accumulation minus 1).
2. Standard deviations have been calculated by accumulating a unit investment for the required number of years in each simulation, taking the natural logarithm of the result, calculating the variance of this statistic, dividing by the projection period (n years) and taking the square root. This makes the result comparable to implied volatilities quoted in investment markets.
3. Depending on the duration of the portfolio

For the UK, the statistics are the same over all projection horizons. Assumptions are also required for correlations between asset classes. These have been set based on an assessment of historical data. Returns for corporate fixed interest investments in each scenario are equal to the return on Government bonds plus a fixed additional amount, based on current spreads less a margin for credit risk.

Principal economic assumptions – deterministic calculations continued

Europe (excluding UK) and International

Model

Government nominal interest rates are generated by a model that projects a full yield curve at annual intervals. The model assumes that the logarithm of the short rate follows a mean reverting process subject to two normally distributed random shocks. This ensures that nominal interest rates are always positive, the distribution of future interest rates remains credible, and the model can be calibrated to give a good fit to the initial yield curve.

The total annual return on equities is calculated as the return on one-year bonds plus an excess return. The excess return is assumed to have a lognormal distribution. The model also generates property total returns and real yield curves, although these are not significant asset classes for Aviva outside the UK.

Asset Classes

The most important assets are fixed rate bonds of various durations. In some businesses equities are also an important asset class.

Summary Statistics

The following table sets out the means and standard deviations of future euro returns at 31 December 2005 for the three most significant asset classes: equities, short-term bonds (defined to be of one-year duration) and long-term bonds (defined to be 10-year zero coupon bonds). In the accumulation of 10-year bonds, it is assumed that these are held for one-year, sold as 9-year bonds then the proceeds are reinvested in 10-year bonds, although in practice businesses follow more complex asset strategies or tend to adopt a buy and hold strategy. Correlations between asset classes have been set using the same approach as described for the UK.

	5-year return		10-year return		20-year return	
	Mean[1]	StDev[2]	Mean[1]	StDev[2]	Mean[1]	StDev[2]
Short Government Bonds	3.0%	1.5%	3.2%	2.9%	3.5%	5.3%
Long Government Bonds	3.5%	3.8%	3.7%	3.0%	3.9%	3.3%
Equities	6.2%	19.5%	6.4%	19.3%	6.5%	19.0%

1. Means have been calculated by accumulating a unit investment for the required number of years in each simulation, averaging the accumulation across all simulations, and converting the result to an equivalent annual rate (by taking the nth root of the average accumulation minus 1).
2. Standard deviations have been calculated by accumulating a unit investment for the required number of years in each simulation, taking the natural logarithm of the result, calculating the variance of this statistic, dividing by the projection period (n years) and taking the square root. This makes the result comparable to implied volatilities quoted in investment markets.

Other assumptions

Taxation

Current tax legislation and rates have been assumed to continue unaltered, except where changes in future tax rates have been announced.

Demographic assumptions

Assumed future mortality, morbidity and lapse rates have been derived from an analysis of Aviva's recent operating experience. Where appropriate, 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.

Expense assumptions

Management expenses and operating expenses of holding companies attributed to life and related businesses have been included in the EEV 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 businesses included in the European Embedded Value calculations, the value of profits or losses arising from these services have been included in the embedded value and new business contribution.

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.

Alternative method of reporting long-term business continued

Principal economic assumptions – deterministic calculations continued

Valuation of Debt

Borrowings in the EEV consolidated balance sheet are valued on an IFRS basis, consistent with the primary financial statements. At 31 December 2005 the market value of the Groupís external debt, subordinated debt, preference shares including General Accident plc preference shares of £250 million (classified as minority interests) and direct capital instrument was £5,868 million *(31 December 2004: £5,953 million)*.

	2005 £m	2004 £m
Borrowings per summarised consolidated balance sheet – EEV basis	**11,013**	10,090
Less: Securitised mortgage funding	**(6,303)**	(5,193)
Borrowings excluding non-recourse funding – EEV basis	**4,710**	4,897
Less: Operational financing by businesses	**(900)**	(598)
External debt and subordinated debt – EEV basis	**3,810**	4,299
Add: Preference shares (including General Accident plc) and direct capital instrument	**1,440**	1,440
External debt, subordinated debt, preference shares and direct capital instrument - EEV basis	**5,250**	5,739
Effect of marking these instruments to market	**618**	214
Market value of external debt, subordinated debt, preference shares and direct capital instrument	**5,868**	5,953

Sensitivity analysis – economic assumptions

The tables below show the sensitivity of the embedded value as at 31 December 2005 and the new business contribution before the effect of required capital for 2005 to:

– One percentage point increase and decrease in the discount rates;

– One percentage point increase and decrease in interest rates, including all consequential changes (including assumed investment returns for all asset classes, market values of fixed interest assets, risk discount rates);

– One percentage point increase and decrease in the assumed investment returns for equity and property investments, excluding any consequential changes to the risk discount rate;

– 10% rise and fall in market value of equity and property assets (not applicable for new business contribution); and

– Decrease in the level of required capital to 100% EU minimum (or equivalent) (not applicable for new business contribution).

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.

Embedded value (net of tax) 31 December 2005	As reported on page 213 £m	1% increase in discount rates £m	1% decrease in discount rates £m	1% increase in interest rates £m	1% decrease in interest rates £m
United Kingdom	**6,313**	**(450)**	**535**	**(300)**	**345**
Continental Europe					
France	**2,067**	**(125)**	**140**	**(75)**	**60**
Ireland	**639**	**(30)**	**35**	**(30)**	**30**
Italy	**716**	**(20)**	**20**	**25**	**(40)**
Netherlands (including Belgium and Luxembourg)	**3,024**	**(130)**	**160**	**(165)**	**(410)**
Poland	**647**	**(30)**	**35**	**(5)**	**5**
Spain	**725**	**(45)**	**50**	**(35)**	**35**
Other	**256**	**(10)**	**10**	**10**	**(35)**
International	**726**	**(30)**	**30**	**(20)**	**5**
	15,113	**(870)**	**1,015**	**(265)**	**(5)**

Sensitivity analysis – economic assumptions continued

Embedded value (net of tax) 31 December 2005	As reported on page 213 £m	1% increase in equity/ property returns £m	1% decrease in equity/ property returns £m	10% rise in equity/ property market values £m	10% fall in equity/ property market values £m	EU minimum capital (or equivalent) £m
United Kingdom	**6,313**	**220**	**(225)**	**395**	**(400)**	**90**
Continental Europe						
France	**2,067**	**70**	**(65)**	**125**	**(135)**	**35**
Ireland	**639**	**20**	**(20)**	**35**	**(35)**	**5**
Italy	**716**	**10**	**(5)**	**15**	**(15)**	**5**
Netherlands (including Belgium and Luxembourg)	**3,024**	**275**	**(310)**	**335**	**(335)**	**100**
Poland	**647**	**5**	**(5)**	**5**	**(5)**	**10**
Spain	**725**	**20**	**(25)**	**15**	**(15)**	**5**
Other	**256**	**5**	**(10)**	**10**	**(10)**	**10**
International	**726**	**5**	**(5)**	**5**	**(5)**	**15**
	15,113	**630**	**(670)**	**940**	**(955)**	**275**

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. The interest rate sensitivity will vary significantly by territory, depending on the type of business written: for example, where non-profit business is well matched by backing assets, the favourable impact of reducing the risk discount rate is the dominant factor.

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% movement in the interest rate for the Netherlands, where there is a significant amount of business with investment return guarantees. The reduction of 40 basis points to the assumed pre-tax investment returns at 31 December 2005 has significantly increased this sensitivity, reflecting the level of the guarantees relative to the interest rate assumption.

Sensitivities to a 1% movement in the equity/property return will only impact the value of the in-force covered business, whereas a 10% movement in equity/property values may impact both the net worth and the value of in-force, depending on the allocation of assets.

New business contribution before required capital (gross of tax) 2005	As reported on page 207 £m	1% increase in discount rates £m	1% decrease in discount rates £m	1% increase in interest rates £m	1% decrease in interest rates £m
United Kingdom	**265**	**(58)**	**70**	**(28)**	**35**
Continental Europe					
France	**135**	**(13)**	**15**	**(1)**	**(3)**
Ireland	**16**	**(4)**	**5**	**4**	**–**
Italy	**59**	**(2)**	**3**	**4**	**(8)**
Netherlands (including Belgium and Luxembourg)	**88**	**(11)**	**14**	**22**	**(50)**
Poland	**14**	**(1)**	**1**	**–**	**–**
Spain	**175**	**(12)**	**14**	**(8)**	**9**
Other	**7**	**(3)**	**1**	**1**	**(5)**
International	**49**	**(7)**	**8**	**(6)**	**3**
	808	**(111)**	**131**	**(12)**	**(19)**

Alternative method of reporting long-term business continued

Sensitivity analysis – economic assumptions continued

New business contribution before required capital (gross of tax) 2005	As reported on page 207 £m	1% increase in equity/ property returns £m	1% decrease in equity/ property returns £m
United Kingdom	**265**	**25**	**(25)**
Continental Europe			
France	**135**	**6**	**(6)**
Ireland	**16**	**3**	**(3)**
Italy	**59**	**1**	**(1)**
Netherlands (including Belgium and Luxembourg)	**88**	**16**	**(16)**
Poland	**14**	**–**	**–**
Spain	**175**	**1**	**(1)**
Other	**7**	**1**	**(1)**
International	**49**	**1**	**(1)**
	808	**54**	**(54)**

One of the key assumptions underpinning the new business contribution is the appropriate level of required capital supporting different types of products. The effect of the assumptions relating to levels of required capital is most significant in relation to annuity business written in the UK. Following a review of the Individual Capital Assessment results in the third quarter of 2005, Aviva concluded that the appropriate level of capital required to support the risks for this business is equivalent to 150% *(2004: 200%)* of the EU required minimum margins (RMM), notwithstanding the prudent margins incorporated in the technical provisions. This brings the required capital used to report business performance closer in line with the economic capital required to support the business.

Changing the assumption of the required capital backing annuities to 100%, increases the reported value of new business contribution reported after the effect of required capital for 2005 by £13 million and increases the embedded value by £90 million, as shown on page 219.

Sensitivity analysis – non-economic assumptions

The tables below show the sensitivity of the embedded value as at 31 December 2005 and the new business contribution before the effect of required capital for 2005 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);
- 10% decrease in both mortality and morbidity rates.

Sensitivity analysis – non-economic assumptions continued

No future management actions are modelled in reaction to the changing non-economic assumptions. In each sensitivity calculation, all other assumptions remain unchanged.

Embedded value (net of tax) 31 December 2005	As reported on page 213 £m	10% decrease in maintenance expenses £m	10% decrease in lapse rates £m	10%/5% decrease in in mortality/ morbidity rates £m
United Kingdom	**6,313**	**205**	**70**	**(120)**
Continental Europe				
France	**2,067**	**35**	**30**	**35**
Ireland	**639**	**10**	**10**	**5**
Italy	**716**	**5**	**–**	**5**
Netherlands (including Belgium and Luxembourg)	**3,024**	**70**	**10**	**(65)**
Poland	**647**	**20**	**35**	**15**
Spain	**725**	**10**	**30**	**15**
Other	**256**	**5**	**5**	**–**
International	**726**	**10**	**10**	**20**
	15,113	**370**	**200**	**(90)**

New business contribution before required capital (gross of tax) 31 December 2005	As reported on page 207 £m	10% decrease in maintenance expenses £m	10% decrease in lapse rates £m	10% decrease in in mortality/ morbidity rates £m
United Kingdom	**265**	**22**	**19**	**11**
Continental Europe				
France	**135**	**6**	**6**	**6**
Ireland	**16**	**2**	**2**	**1**
Italy	**59**	**2**	**3**	**2**
Netherlands (including Belgium and Luxembourg)	**88**	**8**	**4**	**2**
Poland	**14**	**1**	**2**	**3**
Spain	**175**	**4**	**17**	**9**
Other	**7**	**–**	**1**	**(1)**
International	**49**	**3**	**4**	**4**
	808	**48**	**58**	**37**

The demographic sensitivities shown above represent a standard change to the assumptions for all products. Different products will be more or less sensitive to the change, and impacts may partially offset.

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
BSM Group plc
CGNU Life Assurance Limited
CGU Bonus Limited
CGU Insurance plc
CGU International Insurance plc
CGU Underwriting Limited
Commercial Union Life Assurance Company Limited
General Accident plc
Gresham Insurance Company Limited
Haven Insurance Policies Limited
Lex Employee Benefit Trustees Limited
Lex Transfleet Limited
London & Edinburgh Insurance Group Limited
Morley Fund Management International Limited
Morley Fund Management Limited
Morley Pooled Pensions Limited
Morley Properties Limited
Norwich Union Annuity Limited
Norwich Union Collective Investments Limited
Norwich Union Consumer Products Limited
Norwich Union Equity Release Limited
Norwich Union Healthcare Limited
Norwich Union Insurance Limited
Norwich Union Investment Funds Limited
Norwich Union Insurance Services Limited
Norwich Union Life & Pensions Limited
Norwich Union Life Direct Limited
Norwich Union Linked Life Assurance Limited
Norwich Union Personal Finance Limited
Ocean Marine Insurance Company Limited, The
RAC Brand Management Limited
RAC Financial Holdings Limited
RAC Financial Services Limited
RAC Holdings Limited
RAC Insurance Limited
RAC Investments Limited
RAC Motoring Services
RAC plc
Travellers' Insurance Association Limited
World Auxiliary Insurance Corporation Limited, The

Australia
Aviva Australia Holdings Limited and its principal subsidiaries:
- Norwich Union Life Australia Limited
- Navigator Australia Limited
- Portfolio Partners Limited

Belgium
Delta Lloyd Life N.V.

Bermuda
Curepool Limited

Canada
Aviva Canada Inc and its principal operating subsidiary:
- Aviva Insurance Company of Canada

Czech Republic
Aviva zivotni pojist'ovna, a.s.

France
Aviva Participations SA and its principal subsidiaries:
- Aviva Assurances SA
- Aviva Courtage SA
- Aviva Direct SA
- Aviva France SA
- Aviva Gestion d'Actifs S.A.
- Aviva Vie SA
- Eurofil S.A.
- RAC France SA
- Société d'Epargne Viagére SA (75.0%)
- Union Financière de France Banque (Banking) (76.3%)

Germany
Delta Lloyd Deutschland AG and its principal subsidiary:
- Berlinische Lebensversicherung AG (99.5%)

Hong Kong
Aviva Life Insurance Company Limited

Hungary
Aviva Életbiztosító Részvénytársaság

Ireland
Hibernian Group plc and its principal subsidiaries:
- Hibernian General Insurance Limited
- Hibernian Investment Managers Limited
- Hibernian Life & Pensions Limited
- RAC School of Motoring Ltd

Italy
Aviva Italia Holding SpA and its principal subsidiaries:
- Aviva Assicurazioni SpA (50.0%)
- Aviva Italia SpA
- Aviva Life SpA (50.0%)
- Aviva SpA (51.0%)
- Aviva Previdenza SpA (50.0%)
- Aviva Vita SpA (25.5%)
- Eurovita Assicurazioni SpA (41.5%)

Luxembourg
Commercial Union International Life SA

Netherlands
Delta Lloyd NV and its principal subsidiaries:
- Delta Lloyd ABN AMRO Verzekeringen Holding BV (51.0%)
- Delta Lloyd Asset Management NV
- Delta Lloyd Bankengroep NV (Banking)
- Delta Lloyd Levensverzekering NV
- Delta Lloyd Schadeverzekering NV
- Delta Lloyd Zorgverzekering NV
- OHRA Schadeverzekeringen NV
- OHRA Levensverzekeringen NV

Poland
Commercial Union Polska Towarzystwo Ubezpieczen Ogolnych SA (90.0%)
Commercial Union Polska Towarzystwo Ubezpieczen na Zycie SA (90.0%)
Commercial Union Powszechne Towarzystwo Emerytalne BPH CU WBK SA (75.0%)

Romania
Aviva Asigurari de Viata SA

Singapore
Aviva Limited

Spain
Aseguradora Valenciana SA, de Seguros y Reaseguros (50.0%)
Aviva Vida y Pensiones, Sociedad Anonima de Seguros y Reaseguros
Bia Galicia, de Seguros y Reaseguros SA (50.0%)
Caja Espana Vida, Compania de Seguros y Reaseguros (50.0%)
General Vida, Sociedad Agencia de Seguros, S.L. (25.0%)
Unicorp Vida, Compania de Seguros y Reaseguros (50.0%)

Turkey
Aviva Hayat ve Emeklilik A.S
Aviva Sigorta AS (98.6%)

United States
Aviva USA Corporation and its principal operating subsidiary:
- Aviva Life Insurance 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 2005 are set out in notes 17 and 18 on pages 131 to 133.

United Kingdom
RBS Life Investments Limited (49.99%)
RBSG Collective Investments Limited (49.99%)
British Aviation Insurance Company Limited (38.1%)
The Group also has interests in several UK property limited partnerships. Further details are provided in note 17 on page 131.

China
AVIVA – COFCO Life Insurance Company Limited (50.0%)

France
ProCapital SA (43.5%)
Antarius (50.0%)

India
Aviva Life Insurance Company India Private Limited (26.0%)

Shareholder services

Managing your shareholding
Shareholders who have any queries in respect of their shareholding should contact the Company's Registrar, Lloyds TSB Registrars. Contact details can be found on page 225. In addition to assisting with general queries, the Registrar can help with the following:

Amalgamating different share accounts
Shareholders receiving more than one copy of this Annual Report, could have more than one record for their shareholding on the share register. To avoid duplicate mailings, the Registrar can arrange for accounts to be amalgamated.

Dividend payments direct to your bank account
As an alternative to having dividends paid by cheque, shareholders can, if they wish, have them credited directly into their bank or building society account on the dividend payment date. For overseas shareholders, a TAPS (Transcontinental Account Payment) service is available, which allows shareholders in many countries to have dividends credited direct to their bank accounts in local currencies.

Consolidated Tax Vouchers
Private shareholders who currently receive dividends paid directly into their bank or building society account receive one consolidated tax voucher each year instead of a voucher with each dividend payment, unless they inform the Registrar otherwise.

Scrip dividend
The Aviva Scrip Dividend Scheme (the "Scheme") provides shareholders with the opportunity to receive their dividends in the form of new ordinary shares instead of cash. Shareholders who have not joined the Scheme but wish to do so should contact Lloyds TSB Registrars and request a mandate form. The mandate form will need to be received by Lloyds TSB Registrars no later than 25 April 2006 in order to be effective for the 2005 final dividend.

A range of shareholder frequently asked questions is available online at www.aviva.com/shareholders

Shareholders with disabilities
Alternative versions of this publication (including braille, large print and audio-tape) are available on request.

E-communications
Shareholders may choose to receive their communications from the Company (for example, the Notice of Meeting and Annual Review) electronically. This enables a faster receipt of documents and also has the effect of reducing the Company's printing, paper and postage costs and the associated environmental impacts. To receive communications electronically, log onto www.aviva.com/shareholders and register for shareholder e-communications. We have arranged with The CarbonNeutral Company Limited that, for the first 10,000 shareholders electing to receive communications electronically, a tree will be planted in an area selected for reforestation in the United Kingdom. Further details can be found in the enclosed leaflet.

Share Dealing
We have arranged the following services that can be used to buy or sell Aviva shares. Alternatively, if shareholders hold a share certificate they can also use any bank, building society or stockbroker offering share dealing facilities. Shareholders in any doubt about buying or selling their shares should seek professional financial advice.

Share dealing facilities for UK shareholders/share account members
– To buy or sell shares over the telephone or internet, shareholders can contact Shareview Dealing, arranged through Lloyds TSB Registrars. For telephone purchases or sales call 0870 850 0852* between 8.00am and 4.30pm, Monday to Friday and for internet purchases or sales log on to www.shareview.co.uk/dealing

– To buy or sell shares over the telephone, shareholders can contact Barclays Stockbrokers** on 0870 549 3002* (for shareholders with a share certificate) or 0870 549 3001* (for shareholders with a share account statement).

– NatWest Stockbrokers provide a Share Dealing Service via the telephone or at certain NatWest branches for Aviva Share Account holders only. For more information or to find your nearest NatWest share dealing branch, contact NatWest Stockbrokers on 0845 122 0689. NatWest Stockbrokers Limited is operated by a joint venture between The Royal Bank of Scotland Group plc and The Toronto-Dominion Bank. Registered Number: 1959479 England. Registered Office: Waterhouse Square, 138-142 Holborn, London EC1N 2TH. Member of the London Stock Exchange and OFEX. Authorised and regulated by the Financial Services Authority.

Shareholder services continued

Share Dealing continued

Share dealing facilities for overseas shareholders

To sell Aviva shares over the telephone, shareholders can contact Barclays Stockbrokers on +44 (0)141 352 3959. Non-UK residents will need to provide documentation to use this service and details will be provided on registration. Regulations prevent this service from being offered to US residents. Settlement proceeds will be sent to either a UK sterling bank account or by sterling cheque.

ShareGift

The Orr Mackintosh Foundation operates a voluntary charity share donation scheme for shareholders who wish to dispose of small numbers of shares whose value makes it uneconomical to sell them. Details of the scheme are available from ShareGift at www.sharegift.org or can be obtained from the Company's Registrar. During the year the Company operated a postal Share Dealing Service to shareholders holding 750 or less shares. This service gave shareholders the option to donate their shares or any proceeds from the sale of these shares to ShareGift and resulted in donations to ShareGift in excess of £170,000.

Share price

Shareholders can access the current share price of Aviva ordinary shares at www.aviva.com or alternatively can call 0906 843 2197[†].

Shareholder profile

The categories of ordinary shareholders and the range and size of shareholdings as at 31 December 2005 are set out below:

Analysis of shareholders	No. of shareholders	%	No. of shares	%
Individuals	660,781	97.37	259,136,465	10.82
Banks and nominee companies	13,242	1.95	2,029,487,492	84.71
Pension fund managers and insurance companies	98	0.01	120,670	0.01
Other corporate bodies	4,512	0.67	106,949,061	4.46
Total	678,633	100.00	2,395,693,688	100.00

Range of shareholdings	No. of shareholders	%	No. of shares	%
1 – 1,000	629,017	92.69	168,395,687	7.03
1,001 – 5,000	44,847	6.60	81,473,511	3.40
5,001 – 10,000	2,224	0.33	15,280,678	0.64
10,001 – 250,000	1,908	0.28	99,789,971	4.17
250,001 – 500,000	185	0.03	65,449,722	2.73
500,001 and above	452	0.07	1,965,304,119	82.03
Total	678,633	100.00	2,395,693,688	100.00

Group financial calendar for 2006

Announcement of first quarter long-term savings new business figures	27 April
Annual General Meeting	10 May
Announcement of unaudited six months' interim results	9 August
Announcement of third quarter long-term savings new business figures	26 October

Ordinary Shares

Ex-dividend date	8 March
Record date	10 March
Scrip dividend price available	15 March
Dividend payment date	17 May

Preference Shares

First dividend payment for 8⅜% cumulative irredeemable preference shares	31 March
First dividend payment for 8¾% cumulative irredeemable preference shares	30 June
Second dividend payment for 8⅜% cumulative irredeemable preference shares	30 September
Second dividend payment for 8¾% cumulative irredeemable preference shares	31 December

Useful contact details

Detailed below are various addresses that shareholders may find useful if they have a query in respect of their shareholding. Please quote Aviva plc, as well as the name and address in which the shares are held, in all correspondence.

General shareholding queries	Lloyds TSB Registrars	The Causeway Worthing West Sussex BN99 6DA	0870 600 3952*
Corporate and single company Peps	Barclays Stockbrokers Limited	Tay House 300 Bath Street Glasgow G2 4LH	0870 514 3263*
Individual Savings Accounts ("ISAs")	Lloyds TSB Registrars (ISA Manager)	The Causeway Worthing West Sussex BN99 6DA	0870 242 4244*

Internet sites

Aviva owns various internet sites, most of which interlink with each other.

Aviva Group	www.aviva.com
UK long-term savings and general insurance	www.norwichunion.com
Fund management	www.morleyfm.com
Aviva worldwide internet sites	www.aviva.com/websites

* All 0870 numbers are charged at national rates, and are only available if you are calling from the UK.

**To check instructions and maintain high quality service standards, Barclays Stockbrokers may record and monitor calls. New Business Development hours are 8.00am to 6.00pm Monday to Friday, excluding Bank Holidays.

† Calls are currently charged at 60 pence per minute at all times. The average time to access the share price is approximately one minute.

Aviva plc

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Registered in England Number: 2468686

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