27202

# THE OCEAN MARINE INSURANCE COMPANY LIMITED
# ANNUAL REPORT AND FINANCIAL STATEMENTS
# 2011

# The Ocean Marine Insurance Company Limited

## Contents

# The Ocean Marine Insurance Company Limited

## Directors and officer

### Directors:

C J Abrahams
D J Clayden
D J R McMillan

### Officer - Company Secretary:

R H Spicker
St Helen's
1 Undershaft
London
EC3P 3DQ

### Auditor:

Ernst & Young LLP
Statutory Auditor
1 More London Place
London
SE1 2AF

### Registered office:

St Helen's
1 Undershaft
London
EC3P 3DQ

### Company number:

Registered in England and Wales No 27204

### Other information:

The Ocean Marine Insurance Company Limited ("the Company") is a member of the Association of British Insurers and the Financial Ombudsman Service, and is authorised and regulated by the Financial Services Authority ("FSA")

The Company is a member of the Aviva plc group of companies ("the Group")

# The Ocean Marine Insurance Company Limited

**Registered in England and Wales No. 27204**

## Directors' report

### For the year ended 31 December 2011

The directors present their annual report and financial statements for the Company for the year ended 31 December 2011

### Directors

The names of the current directors of the Company appear on page 1

Those in office since 1 January 2011 have been as follows

C J Abrahams and D J R McMillan served as directors throughout the period

S Egan resigned as a director on 24 February 2012

D J Clayden was appointed as a director on 24 February 2012

### Principal activity

The principal activity of the Company during the year continued to be the run-off of general insurance claims The Company ceased to accept business in the London Market in 1995 However, under an insurance business transfer on 14 November 2011 described on page 3, the Company's claims have increased during the year by £355 million All business is wholly reinsured through reinsurance agreements entered into with National Indemnity Company in 2000

On completion of the insurance business transfer detailed above, the Company completed an Adverse Reserve Deterioration ("ARD") Agreement with its parent company, Aviva Insurance Limited This agreement provides an extra £1 billion of reinsurance cover to protect against circumstances in which the reinsurance with National Indemnity Company is exhausted or otherwise fails to satisfy claims Together these arrangements provide substantial protection in excess of current gross liabilities

### Business review

**Basis of preparation**

This business review is addressed to, and written for, the members of the Company with the aim of providing a fair review of the business development, performance during the financial period and position both at the end of the financial period and at the current time In providing this review, the aim is to present a view that is both balanced and comprehensive and is consistent with the size and complexity of the business

**Objectives and future developments**

The strategy of the Group is determined by the board of Aviva plc, and a summary of these are shown in its financial statements The directors expect that the nature of the Company's principal activity of general insurance business run-off will continue unchanged into the foreseeable future

**Financial position and performance**

The financial position of the Company at 31 December 2011 is shown in the statement of financial position on page 15, with the results shown in the income statement on page 14 and the statement of cash flows on page 17

In the light of the principal activity detailed above, the directors do not consider it appropriate to detail key performance indicators

The Company made a loss before tax of £69 million (2010 £nil) during the year which relates to a reinsurance premium of £69 million, as described overleaf within the "major events"

# The Ocean Marine Insurance Company Limited

## Directors' report (continued)

### Business review (continued)

**Principal risks and uncertainties**

A description of the principal risks and uncertainties facing the Company and the Company's risk management policies are set out in notes 14 and 16 to the financial statements

### Major events

On 14 November 2011, assets and liabilities relating to business written in the London Market, including reinsurance through a reinsurance agreement entered into with National Indemnity Company, were transferred to the Company at carrying value by the way of an insurance business transfer under Part VII of the Financial Services and Markets Act 2000, from certain Group companies The carrying value of the net assets and liabilities transferred to the Company was £28 million See note 19 to the financial statements for further details

On 14 November 2011, the Company was acquired by Aviva Insurance Limited as a consequence of the insurance business transfer described above

On completion of the insurance business transfer detailed above, the Company completed an Adverse Reserve Deterioration ("ARD") Agreement with its parent company, Aviva Insurance Limited This agreement provides an extra £1 billion of reinsurance cover to protect against circumstances in which the reinsurance with National Indemnity Company is exhausted or otherwise fails to satisfy claims In consideration of Aviva Insurance Limited entering into the ARD agreement, the Company paid a one-off premium of £69 million, which was settled through the intercompany account

### Changes in share capital

On 14 November 2011, the Company settled the intercompany account with Aviva Insurance Limited with funds raised from the issuance of 2,760,000 ordinary shares of £25 each to its parent company, Aviva Insurance Limited

### Going concern

After making enquiries, the directors have a reasonable expectation that the Company has 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 financial statements

### Financial instruments

The business of the Company includes the use of financial instruments Details of the Company's risk management objectives and policies and exposures to risk relating to financial instruments are set out in note 16 to the financial statements

# The Ocean Marine Insurance Company Limited

## Directors' report (continued)

### Dividends

No interim dividend for the year was paid (2010 £ nil) The directors do not recommend the payment of a final dividend for the year (2010 £ nil)

### Overseas branches

The Company had a branch office in France which was opened and closed during the year

### Employees

All staff are employed by a fellow subsidiary undertaking of Aviva plc, Aviva Employment Services Limited Disclosures relating to employees may be found in the annual report and financial statements of Aviva Employment Services Limited

### Auditor

Following a competitive tender process by the Company's ultimate parent company, Aviva plc, PricewaterhouseCoopers LLP are to be appointed as auditor to the Company Ernst & Young LLP will resign as auditor with effect from the signing of the Company's annual report and financial statements for the year ended 31 December 2011, and the directors will appoint PricewaterhouseCoopers LLP as auditor to the Company in accordance with the provisions of the Companies Act 2006

### Directors' liabilities

Aviva plc, the Company's ultimate parent, has granted an indemnity to the directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies Act 1985, which continue to apply in relation to any provision made before 1 October 2007

This indemnity was granted in 2004 and the provisions in the Company's articles of association constitute "qualifying third party indemnities" for the purposes of sections 309A to 309C of the Companies Act 1985 These qualifying third party indemnity provisions remain in force as at the date of approving the Directors' Report by virtue of paragraph 15, Schedule 3 of The Companies Act 2006 (Commencement No 3, Consequential Amendments, Transitional Provisions and Savings) Order 2007

### Disclosure of information to the auditor

Each person who was a director of the Company on the date that this report was approved confirms that, so far as the director is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing his report, of which the auditor is unaware Each director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the auditor is aware of that information

# The Ocean Marine Insurance Company Limited

## Directors' report (continued)

### Statement of directors' responsibilities

The directors are required to prepare financial statements for each accounting period that comply with the relevant provisions of the Companies Act 2006 and International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU"), and which present fairly the financial position, financial performance and cash flows of the Company 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 financial statements on the going concern basis, unless it is inappropriate to presume that the Company 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'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 financial statements

The directors are responsible for maintaining adequate accounting records which are intended to disclose with reasonable accuracy, at any time, the financial position of the Company at that time They are also ultimately responsible for the systems of internal control maintained for safeguarding the assets of the Company and for the prevention and detection of fraud and other irregularities

By order of the Board 23 MARCH 2012

Richard H. Spicker

R H Spicker
Company Secretary

# The Ocean Marine Insurance Company Limited

## Independent auditor's report

### To the members of The Ocean Marine Insurance Company Limited

We have audited the financial statements of The Ocean Marine Insurance Company Limited for the year ended 31 December 2011, which comprise the Income Statement, the Statement of Financial Position, the Statement of Changes in Equity, the Statement of Cash Flows and the related notes 1 to 19 The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of part 16 of the Companies Act 2006 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 auditor's report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company 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 auditor**

As explained more fully in the Statement of Directors' Responsibilities set out on page 5, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

**Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error This includes an assessment of whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements In addition, we read all the financial and non-financial information in the Directors' report to identify material inconsistencies with the audited financial statements If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

**Opinion on financial statements**

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2011 and of its loss for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006

**Opinion on other matter prescribed by the Companies Act 2006**

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

# The Ocean Marine Insurance Company Limited

## Independent auditor's report (continued)

### To the members of The Ocean Marine Insurance Company Limited

**Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit

Ernst & Young LLP

Clifford Houghton (Senior statutory auditor)
for and on behalf of Ernst & Young LLP - Statutory Auditor
London

23 March 2012

# The Ocean Marine Insurance Company Limited

## Accounting policies

The Company is a limited liability company incorporated and domiciled in Great Britain, and transacted insurance and reinsurance business in the London Market until 1995 Since that date the business has been in run-off and in 2000 all business was reinsured with National Indemnity Company In 2011, assets and liabilities relating to business written in the London Market, including reinsurance through a reinsurance agreement entered into with National Indemnity Company, were transferred to the Company at carrying value by the way of an insurance business transfer under Part VII of the Financial Services and Markets Act 2000, from certain Group companies

The principal accounting policies adopted in the preparation of these financial statements are set out below

**(A) Basis of presentation**

The financial statements have been prepared in accordance with IFRS and International Accounting Standards ("IAS") as endorsed by the EU, applicable at 31 December 2011

There are no recently issued pronouncements effective for the 2011 financial statements that materially impact the Company's financial reporting

IFRS 9 *Financial Instruments* is effective in future years and awaiting endorsement The Company is currently reviewing the potential impact on the financial statements

IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IFRS 12 *Disclosure of Interests in Other Entities*, IFRS 13 *Fair Value Measurement*, and amendments to IAS 27 *Separate Financial Statements*, IAS 28 *Investments in Associates and Joint Ventures*, and IAS 19 *Employee Benefits* were issued in May 2011 and are effective from 1 January 2013 and awaiting endorsement Amendments to IAS 1 *Presentation of Financial Statements* was issued in June 2011 and is effective from 1 July 2012 and awaiting endorsement The Company has not early adopted any of the above new standards, amendments to existing standards and interpretations, and is currently reviewing their potential impact on the financial statements

Other external reporting developments continue to be proactively monitored

In accordance with IFRS 4, *Insurance Contracts*, the Company has applied existing accounting practices for insurance contracts, modified as appropriate to comply with the IFRS framework and applicable standards Further details are given in policy E below

The financial statements are stated in pounds 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")

The Company is exempt from preparing group accounts by virtue of Section 400 of the Companies Act 2006, as it is a subsidiary of an EU parent (note 18(c)) The financial statements present information about the Company as an individual company and not about its group

**(B) Use of estimates**

The preparation of financial statements requires the Company to make estimates and assumptions that affect items reported in the statement of financial position and income statement and the disclosure of contingent assets and liabilities at the date of the financial statements This is particularly so in the estimation of amounts for insurance liabilities, for which further details are given in policy G overleaf and in note 9 to these 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 may ultimately differ from those estimates, possibly significantly

# The Ocean Marine Insurance Company Limited

## Accounting policies (continued)

### (C) Subsidiaries

Subsidiaries are those entities (including Special Purpose Entities) in which the Company, directly or indirectly, has power to exercise control over financial and operating policies in order to gain economic benefits

In the statement of financial position, subsidiaries are stated at their fair values These investments are classified as available for sale ("AFS") financial assets, with changes in their fair value being recognised in other comprehensive income and recorded in a separate investment revaluation reserve within equity Where the cumulative changes recognised in equity represent an unrealised loss, the investments are reviewed to test whether an impairment exists Where there is objective evidence that such an asset is impaired, such as the financial difficulty of the subsidiary or a prolonged decline in their fair value below cost, the unrealised loss recorded in equity is reclassified and charged to the income statement Any subsequent increase in fair value of the impaired investment is recognised in other comprehensive income and recorded in the investment revaluation reserve

### (D) Foreign currency translation

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 as net investment income in the income statement

### (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 or service contracts

Accounting for insurance contracts, under IFRS 4, is determined in accordance with the Statement of Recommended Practice issued by the Association of British Insurers, the most recent version of which was issued in December 2005 and amended in December 2006

### (F) Net investment income

Investment income consists of dividends, interest receivable and foreign exchange gains and losses for the year Interest income is recognised as it accrues, taking into account the effective yield on the investment

A gain or loss on a financial investment is only realised on disposal or transfer, and is the difference between the proceeds received, net of transaction costs, and its original cost or amortised cost as appropriate Unrealised gains and losses, arising on financial investments which have not been derecognised as a result of disposal or transfer, 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 Ocean Marine Insurance Company Limited

## Accounting policies (continued)

### (G) Insurance contract liabilities

*Claims*

Insurance claims incurred include all losses occurring during the year, whether reported or not, loss adjustment expenses, a reduction for the value of salvage and other recoveries, and any adjustments to claims incurred in previous years

Loss adjustment expenses include internal and external costs incurred in connection with the negotiation and settlement of claims Internal costs include all direct expenses of the claims handling department and any part of the general administrative costs directly attributable to the loss adjustment function

*Outstanding claims provisions*

Insurance outstanding claims provisions are based on the estimated ultimate cost of all claims incurred but not settled at the statement of financial position date, whether reported or not, together with related loss adjustment expenses Significant delays are experienced in the notification and settlement of certain types of general insurance claims, particularly in respect of liability business, including asbestos and environmental pollution exposures, the ultimate cost of which cannot be known with certainty at the statement of financial position date Any estimate represents a determination within a range of possible outcomes Further details of estimation techniques are given in note 9(c)

Provisions for latent claims are discounted, using rates based on the relevant swap curve, in the relevant currency at the reporting date, having regard to the expected settlement dates of the claims. The discount rate is set at the start of the accounting period with any change in rates between the start and end of the accounting period being reflected as an economic assumption change within claims Unwind of discount is shown as a finance cost The range of discount rates used is described in note 9(b)

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

# The Ocean Marine Insurance Company Limited

## Accounting policies (continued)

**(H) Reinsurance**

The Company cedes reinsurance in the normal course of business The cost of reinsurance is earned over the risk profile underlying reinsured policies, using assumptions consistent with those used to account for these policies Where insurance liabilities are discounted, any corresponding reinsurance assets are also discounted using consistent assumptions

Reinsurance assets primarily include balances due from 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

If a reinsurance asset is impaired, the Company 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 Company may not receive all amounts due to it under the terms of the contract, and the event has an impact that can be reliably measured on the amounts that the Company will receive from the reinsurer

**(I) 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

(i) the rights to receive cash flows from the asset have expired,

(ii) 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

(iii) 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, cancelled or expires Financial assets and liabilities are offset and the net amount reported in the statement of financial position 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

# The Ocean Marine Insurance Company Limited

## Accounting policies (continued)

**(J) Cash and cash equivalents**

Cash and cash equivalents consist of cash at banks and in hand, deposits held at call with banks, treasury bills and other short-term highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value Such investments are those with less than three months' maturity from the date of acquisition, or which are redeemable on demand with only an insignificant change in their fair values

**(K) Financial guarantee contracts**

Financial guarantees are recognised initially at their fair value They are subsequently measured at the higher of the expected receivable or liability under the guarantee and the amount initially recognised less any accumulated amortisation A liability is recognised for amounts payable under the guarantee if it is more likely than not that the guarantee will be called upon and a receivable is recognised if it is virtually certain

**(L) Contingent liabilities**

Contingent liabilities are disclosed if there is a possible future obligation as a result of a past event, or if there is a present obligation as a result of a past event but either a payment is not probable yet still possible or the amount cannot be reliably estimated

**(M) 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 financial statements The rates enacted or substantively enacted at the statement of financial position date are used to determine the deferred tax

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised

# The Ocean Marine Insurance Company Limited

## Accounting policies (continued)

**(N) Share capital and dividends**

*Equity instruments*

An equity instrument is a contract that evidences a residual interest in the assets of an entity after deducting all of 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 will not be settled by delivery of a variable number of shares or is a derivative that can be settled other than for a fixed amount of cash, shares or other financial assets

*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

**(O) Insurance business transfers**

Where an insurance business transfer is carried out under Part VII of the Financial Services and Markets Act 2000 between entities that are under common control, assets and liabilities are transferred at carrying value, for no consideration Transfers from a parent company to a subsidiary company are accounted for as a capital contribution, with the excess of assets over liabilities recognised in a capital reserve Transfers from a subsidiary company to its parent company are accounted for as a distribution The income statement of the transferee company includes the results of the insurance business transferred from the effective date of the transfer, the transferor company excludes the results of the insurance business transferred from the effective date of the transfer Corresponding amounts for the previous year are not restated

# The Ocean Marine Insurance Company Limited

## Income statement
## For the year ended 31 December 2011

| | Note | 2011 £m | 2010 £m |
|---|---|---|---|
| **Income** | | | |
| Premiums ceded to reinsurers | | (69) | - |
| Net investment income - dividend income, arising from insurance business transfer | 6(b) | 11 | - |
| **Expenses** | 1 | | |
| Claims paid, net of reinsurance | | - | - |
| Change in claims provisions, net of reinsurance | | - | - |
| Impairment of investments in subsidiary | 6(b) | (11) | - |
| **Loss before tax** | | (69) | - |
| Tax credit | 5 | 18 | - |
| **Loss for the year** | | (51) | - |

The Company has no recognised income and expenses other than that included in the results above and therefore a statement of comprehensive income has not been presented

The accounting policies on pages 8 to 13 and the notes on pages 18 to 37 form an integral part of these financial statements

# The Ocean Marine Insurance Company Limited

## Statement of financial position
## As at 31 December 2011

| | Note | 2011 £m | 2010 £m |
|---|---|---|---|
| **ASSETS** | | | |
| Investment in subsidiary | 6 | - | - |
| Reinsurance assets | 7 | 628 | 314 |
| Receivables | 8 | 53 | 41 |
| Current tax asset | 10 | 18 | - |
| Cash and cash equivalents | 15 (b) | 41 | 23 |
| **Total assets** | | 740 | 378 |
| **LIABILITIES** | | | |
| Insurance liabilities | 9 | 628 | 314 |
| Payables and other financial liabilities | 11 | 2 | - |
| **Total liabilities** | | 630 | 314 |
| **Net assets** | | 110 | 64 |
| **EQUITY** | | | |
| Ordinary share capital | 12 | 128 | 59 |
| Capital reserve | | 28 | - |
| Retained earnings | | (46) | 5 |
| **Total equity** | | 110 | 64 |

The accounting policies on pages 8 to 13 and the notes on pages 18 to 37 form an integral part of these financial statements

Approved by the Board on 23 MARCH 2012

C J Abrahams
Director

# The Ocean Marine Insurance Company Limited

## Statement of changes in equity
## For the year ended 31 December 2011

| | Ordinary share capital | Capital reserve | Retained earnings | Total equity |
|---|---|---|---|---|
| | £m | £m | £m | £m |
| **Balance at 1 January 2010** | 59 | - | 5 | 64 |
| Total comprehensive income for the year | - | - | - | - |
| Total movements in the year | - | - | - | - |
| **Balance at 31 December 2010** | 59 | - | 5 | 64 |
| Total comprehensive income for the year | - | - | (51) | (51) |
| Issue of share capital | 69 | - | - | 69 |
| Capital reserve, arising from insurance business transfer | - | 28 | - | 28 |
| Total movements in the year | 69 | 28 | (51) | 46 |
| **Balance at 31 December 2011** | 128 | 28 | (46) | 110 |

The accounting policies on pages 8 to 13 and the notes on pages 18 to 37 form an integral part of these financial statements

# The Ocean Marine Insurance Company Limited

## Statement of cash flows
## For the year ended 31 December 2011

| | Note | 2011 £m | 2010 £m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net cash outflow to operating activities | 15(a) | (16) | - |
| *Net cash used in operating activities* | | (16) | - |
| **Cash flows from investing activities** | | | |
| Cash acquired from insurance business transfer | 19 | 34 | - |
| *Net cash from investing activities* | | 34 | - |
| **Net increase in cash and cash equivalents** | | 18 | - |
| Cash and cash equivalents at 1 January | | 23 | 23 |
| **Cash and cash equivalents at 31 December** | 15(b) | 41 | 23 |

The accounting policies on pages 8 to 13 and the notes on pages 18 to 37 form an integral part of these financial statements

## Notes to the financial statements

### 1. Details of expenses

| | 2011 | 2010 |
|---|---|---|
| **Claims paid, net of reinsurance** | **£m** | **£m** |
| Claims paid to policyholders | 28 | 20 |
| Less Claims recoveries from reinsurers | (28) | (20) |
| | - | - |
| **Change in claims provisions, net of reinsurance** | | |
| Change in gross claims provisions | (76) | (29) |
| Change in reinsurance asset for claims provisions | 76 | 29 |
| | - | - |

### 2. Employee information

All staff are employed by a fellow subsidiary undertaking of Aviva plc, Aviva Employment Services Limited Disclosures relating to employees may be found in the annual report and financial statements of Aviva Employment Services Limited

### 3. Directors

All directors of the Company are remunerated as employees by Aviva Employment Services Limited This remuneration is recharged to all operating divisions of the Group under management service agreements However, no cost is borne by the Company for the services of the directors in their capacity as directors

### 4. Auditor's remuneration

The total remuneration payable by the Company, excluding VAT, to its auditor, Ernst & Young LLP, in respect of the audit of these financial statements, is shown below The Company is exempt from disclosing other fees payable to its auditor in respect of other work, by virtue of regulation 5(1)(b) of The Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008, as it is disclosed within the Annual Report and Accounts of Aviva plc , the Company's ultimate controlling entity (note 18(c))

| | 2011 | 2010 |
|---|---|---|
| | **£000** | **£000** |
| Audit services | | |
| Statutory audit of the Company's financial statements | 70 | 35 |

Audit fees are paid by Aviva Central Services UK Limited, a fellow Group company, and recharged as appropriate to the Company and fellow Group companies

# The Ocean Marine Insurance Company Limited

## Notes to the financial statements (continued)

### 5. Tax

**(a) Tax credited to the income statement**

| The total tax credit comprises | 2011 | 2010 |
|---|---|---|
| | £m | £m |
| **Current tax:** | | |
| For the current year | 18 | - |
| Total tax credited to income statement | 18 | - |

**(b) Tax reconciliation**

The tax on the Company's loss before tax is the same as the theoretical amount that would arise using the tax rate in the United Kingdom ("UK") as follows

| | 2011 | 2010 |
|---|---|---|
| | £m | £m |
| Loss before tax | (69) | - |
| Tax calculated at standard UK corporation tax rate of 26 5% (2010 28 %) | 18 | - |
| Non-assessable dividends | 3 | - |
| Impairment of subsidiary | (3) | - |
| Tax credited for the period (note 5(a)) | 18 | - |

A reduction in the UK corporation tax rate from 28% to 26% was substantively enacted in March 2011 and is effective from 1 April 2011 A further reduction from 26% to 25% was substantively enacted in July 2011 and will be effective from 1 April 2012 Accordingly, these rates have been applied in the measurement of the Company's deferred tax assets and liabilities as at 31 December 2011

In addition, a further 1% reduction in the UK corporation tax rate to 24%, effective from 1 April 2012, was announced in the 2012 Budget on 21 March 2012 On the same day it was announced that the UK corporation tax rate would reduce to 23% from 1 April 2013 and to 22% from 1 April 2014 There is no impact to the Company's net assets from the reduction in the rate as the Company has no net deferred tax asset or liability

# The Ocean Marine Insurance Company Limited

## Notes to the financial statements (continued)

### 6. Investment in subsidiary

(a) The investment in shares in its subsidiary, which is registered in England and Wales, comprises

| Company | Type of business | Class of share | Proportion held |
|---|---|---|---|
| The World Auxiliary Insurance Corporation Limited | Non-trading | Ordinary | 100% |

(b) Movement in the Company's investment in its subsidiary

| | 2011 |
|---|---|
| | £m |
| **Fair value** | |
| At 1 January | - |
| Additions | 11 |
| Impairment | (11) |
| At 31 December | - |

On 14 November 2011, as part of the insurance business transfer under Part VII of the Financial Services and Markets Act 2000, the Company acquired The World Auxiliary Insurance Corporation Limited As part of the transfer, The World Auxiliary Insurance Corporation Limited transferred its net assets and liabilities of £11 million to the Company, which The Company accounted for as dividend income As a consequence, the Company has fully impaired the fair value of its investment in the subsidiary

### 7. Reinsurance assets

**(a) Carrying amounts**

The following is a summary of the reinsurance assets and related insurance provisions as at 31 December

| | | | 2011 | | | 2010 |
|---|---|---|---|---|---|---|
| | Gross insurance liabilities | Reinsurance assets | Net | Gross insurance liabilities | Reinsurance assets | Net |
| | £m | £m | £m | £m | £m | £m |
| Outstanding claims provisions | 414 | 414 | - | 234 | 234 | - |
| Provisions for claims incurred but not reported | 214 | 214 | - | 80 | 80 | - |
| **Total** | 628 | 628 | - | 314 | 314 | - |

Of the above total, £555 million (2010 £296 million) of the reinsurance assets is expected to be recovered in more than one year after the statement of financial position date

The reinsurers' share of outstanding claims provisions and provisions for claims incurred but not reported is reduced by £118 million (2010 £75 million) as a result of the discounting of latent claims

**(b) Assumptions**

The assumptions, including discount rates, used for reinsurance contracts follow those used for insurance contracts shown in note 9(b) and 9(c)

Reinsurance assets are valued net of any provisions for their recoverability

# The Ocean Marine Insurance Company Limited

## Notes to the financial statements (continued)

### 7. Reinsurance assets (continued)

**(c) Movements**

Reinsurers' share of claims provisions

| | 2011 | 2010 |
|---|---|---|
| | £m | £m |
| **Carrying amount at 1 January** | 314 | 322 |
| Insurance business transfer (note 19) | 355 | - |
| Impact of changes in discount rate assumptions | 27 | - |
| Reinsurers' share of claims losses and expenses incurred in prior years | (48) | (9) |
| Reinsurers' share of incurred claims losses and expenses | (21) | (9) |
| Less | | |
| Reinsurance recoveries received on claims incurred in prior years | (28) | (20) |
| Unwind of discount | 8 | 8 |
| Change in reinsurance asset | (41) | (21) |
| Foreign exchange rate movements | - | 13 |
| **Carrying amount at 31 December** | 628 | 314 |

On 14 November 2011, assets and liabilities relating to business in the London Market were transferred to the Company at carrying value by way of an insurance business transfer under Part VII of the Financial Services and Markets Act 2000 from certain Group companies The carrying value of reinsurance assets transferred to the Company was £355 million

Reinsurance assets held in United States dollars have been revalued at the year end rate as described in note 9(d)

## Notes to the financial statements (continued)

### 8. Receivables

| | 2011 | 2010 |
|---|---|---|
| | £m | £m |
| Amounts due from reinsurers | 9 | - |
| Amount due from related parties (note 18(a)(ii)) | 44 | 41 |
| Total | 53 | 41 |
| Expected to be recovered in less than one year | - | - |
| Expected to be recovered in more than one year | 53 | 41 |

All receivables are carried at amortised cost, which approximates to fair value

### 9. Insurance liabilities

**(a) Carrying amount**

Gross insurance liabilities at 31 December comprise

| | 2011 | 2010 |
|---|---|---|
| | £m | £m |
| Provisions for outstanding claims | 414 | 234 |
| Provisions for claims incurred but not reported | 214 | 80 |
| Total | 628 | 314 |

**(b) Provisions for outstanding claims**

Delays occur in the notification and settlement of claims and a substantial measure of experience and judgement is involved in assessing outstanding liabilities, the ultimate cost of which cannot be known with certainty at the statement of financial position date The reserves 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 claims payments, except for the following class of business for which discounted provisions are held·

| | Discount rate | | Mean term of liabilities | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Latent claims | 3 24% to 0 68% | 4 43% to 0 44% | 12 years | 11 years |

# The Ocean Marine Insurance Company Limited

## Notes to the financial statements (continued)

### 9. Insurance liabilities (continued)

**(b) Provision for outstanding claims (continued)**

The gross outstanding claims provisions before discounting are £746 million (2010 £389 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

Loss reserves are only established for losses that have already occurred

**(c) 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, taking into account all available information and correspondence regarding the circumstances of the claim, such as medical reports, investigations and inspections Claims technicians set case estimates according to documented claims department policies and specialise in setting estimates for certain lines of business or types of claim Claims above certain limits are referred to senior claims handlers for authorisation

No adjustments are made to the claims technicians' case estimates included in booked claims provisions, except for rare occasions when the estimated ultimate cost of a large or unusual claim may be adjusted, subject to internal reserve committee approval, to allow for uncertainty regarding, for example, the outcome of a court case 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 along with other actuarial methods to deal with the unique attributes of latent claims The main assumption underlying these techniques is that the 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 claims 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 Claims development is separately analysed for each line of business Certain lines of business are also further analysed by claims type or type of coverage In addition, large claims are usually separately assessed, either by being reserved at the face value of loss adjuster estimates, or separately projected in order to reflect their future development

In most cases no explicit assumptions are made regarding future rates of claims inflation or loss ratios Instead, the assumptions used are those implicit in the 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 loss adjustment procedures, in order to arrive at the estimated ultimate cost of claims, that represent the most likely outcome, from the range of possible outcomes, taking account of all the uncertainties involved The range of possible outcomes does not, however, result in the quantification of a reserve range

Where discount rate assumptions are based on current market yields on fixed interest securities, allowance is made for default risk implicit in the yields on the underlying assets

# The Ocean Marine Insurance Company Limited

## Notes to the financial statements (continued)

### 9. Insurance liabilities (continued)

**(c) Assumptions (continued)**

The level of uncertainty associated with latent claims is considerable due to the relatively small number of claims and the long-tail nature of the liabilities Mesothelioma claims account for a large proportion of the Company's latent claims The key assumptions underlying the estimation of these claims include claims numbers, the base average cost per claim, future inflation in the average cost of claims, legal fees and the life expectancy of potential sufferers However, in 2000 all the Company's business was reinsured as the Company is party to a reinsurance agreement entered into with the National Indemnity Company

On completion of the insurance business transfer on 14th November 2011, the Company completed an Adverse Reserve Deterioration ("ARD") agreement with its parent company, Aviva Insurance Limited This agreement provides an extra £1 billion of reinsurance cover to protect against circumstances in which the reinsurance with National Indemnity Company is exhausted or otherwise fails to satisfy claims

**(d) Movements**

| The following changes have occurred in the claims provisions during the year | 2011 | 2010 |
|---|---|---|
| | £m | £m |
| **Carrying amount at 1 January** | 314 | 322 |
| Insurance business transfer (note 19) | 355 | - |
| Impact of changes in discount rate assumptions | 27 | - |
| Claims losses and expenses incurred in prior years | (48) | (9) |
| Incurred claims losses and expenses | (21) | (9) |
| Less | | |
| Payments made on claims incurred in prior years | (28) | (20) |
| Unwind of discount | 8 | 8 |
| Changes in gross claims | (41) | (21) |
| Foreign exchange rate movements | - | 13 |
| **Carrying amount at 31 December** | 628 | 314 |

On 14 November 2011, assets and liabilities relating to business in the London Market were transferred to the Company at carrying value by way of an insurance business transfer under Part VII of the Financial Services and Markets Act 2000 from certain Group Companies The carrying value of insurance liabilities transferred to the company was £355 million

**Discount rate**

The discount rate that has been applied to latent claims reserves is based on the relevant swap rate, in the relevant currency, having regard to the expected settlement dates of the claims The range of discount rates used depends on the duration of the claims and is given in the table in section (b) p 22 The duration of the claims spans over 20 years, with the average duration 12 years (2010 11 years) Any change in discount rates between the start and the end of the accounting period is reflected as an economic assumption change

**Exchange rates**

Assets and liabilities denominated in United States dollars have been translated at the year end rate of £1 = US$ 1 55 (2010 £1 = US$ 1 57)

# The Ocean Marine Insurance Company Limited

## Notes to the financial statements (continued)

### 9. Insurance liabilities (continued)

**(d) Movements (continued)**

**Effect of changes in estimates in the year**

During the year, gross prior years' claims provisions of £48 million, £nil net of reinsurance (2010 £9 million, £nil net of reinsurance) were released to the income statement This movement is mainly due to the release of claims provisions in the United States for asbestos and environmental pollution and the UK for marine business.

**(e) Loss development tables**

The Company ceased to write business in the London Market in 1995 In 2000, all business was wholly reinsured with the National Indemnity Company

| | Gross | | | Net of reinsurance | | |
|---|---|---|---|---|---|---|
| | Prior years | 2002 | Total | Prior years | 2002 | Total |
| | £m | £m | £m | £m | £m | £m |
| Outstanding claims provisions (undiscounted) | 310 | - | 310 | - | - | - |
| Effect of discounting | (37) | - | (37) | - | - | - |
| Acquired claims, at acquisition and at year end | | | | | | |
| Outstanding claims provisions (undiscounted) | 434 | 2 | 436 | - | - | - |
| Effect of discounting | (81) | - | (81) | - | - | - |
| Present value recognised in the statement of financial position | 626 | 2 | 628 | - | - | - |

On 14 November 2011, assets and liabilities relating to business in the London Market, including reinsurance through a reinsurance agreement entered into with National Indemnity Company, were transferred to the Company at carrying value by the way of an insurance business transfer under Part VII of the Financial Services and Markets Act 2000 from certain Group Companies The carrying value of insurance liabilities transferred to the Company was approximately £355 million, before reinsurance recoveries of £355m

The table above includes information on asbestos and environmental pollution claims provisions The total gross claims provisions in respect of this business are £355 million at 31 December 2011 (2010 £176 million) The net claims provisions in this respect are £nil (2010 £nil)

# The Ocean Marine Insurance Company Limited

## Notes to the financial statements (continued)

### 10. Tax assets and liabilities

**Current tax**

| | 2011 | 2010 |
|---|---|---|
| Tax asset | £m | £m |
| Expected to be recoverable in more than one year | 18 | - |
| Tax asset recognised in statement of financial position | 18 | - |

### 11. Payables and other financial liabilities

| | 2011 | 2010 |
|---|---|---|
| | £m | £m |
| Other financial liabilities | 2 | - |
| Expected to be settled in less than one year | 2 | - |

All payables and other financial liabilities are carried at amortised cost, which approximates to fair value

### 12. Ordinary share capital

Details of the Company's ordinary share capital are as follows

| | 2011 | 2010 |
|---|---|---|
| | £m | £m |
| **Allotted, called up and fully paid** | | |
| 5,140,000 (2010 2,380,000) Ordinary shares of £25 each | 128 | 59 |

The Companies Act 2006 abolished the requirement for a company to have an authorised share capital and the articles of association adopted by the Company on 22 June 2010 reflect this Directors will still be limited as to the number of shares they can at any time allot as the allotment authority continues to be required under the Act, save in respect of employee share schemes 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

## Notes to the financial statements (continued)

### 13. Financial guarantees and options

With the approval of the FSA, Aviva International Insurance Limited, a Group company, and certain of its UK insurance subsidiaries transacting general insurance business, of which the Company is one, have mutually agreed to discharge all liabilities attaching to their respective policies The guarantee enables a company, if it is unable to pay policyholder claims, to seek financial support from one or more of the guarantors The guarantors are not obliged to make the payment if in so doing they would breach their own solvency requirement If any payments are made under the guarantee, the guarantors are also entitled to seek repayment from the company benefiting from the guarantee The guarantee cannot be relied upon by any other person, including without limitation the holder of any contracts of insurance issued by a party to the guarantee There is no maximum amount the Company would have to pay under the guarantee but, in the opinion of the directors, the fair value of the guarantee above is not material and no material loss would arise therefrom

### 14. Contingent liabilities and other risk factors

**Uncertainty over claims provisions**

Note 9(c) gives details of the estimation techniques used in determining the outstanding claims provisions which are designed to allow for prudence These 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 future claims inflation differs from that expected, there is uncertainty in respect of this liability

**Levy schemes**

The Company pays contributions into levy schemes in the UK in which it operates Given the economic environment, there is a heightened risk that the levy contributions will need to be increased to protect policyholders if an insurance company falls into financial difficulties The directors continue to monitor the situation but are not aware of any need to make provisions at the statement of financial position date

### 15. Statement of cash flows

| (a) The reconciliation of loss before tax to the net cash outflow to operating activities is: | 2011 | 2010 |
|---|---|---|
| | £m | £m |
| Loss before tax | (69) | - |
| Changes in working capital | | |
| (Increase) / decrease in reinsurance assets | 41 | 8 |
| (Increase) / decrease in receivables and other financial assets | 66 | 10 |
| Increase / (decrease) in insurance liabilities | (41) | (8) |
| Increase / (decrease) in payables and other financial liabilities | (13) | (10) |
| Net cash outflow to operating activities | (16) | - |

"Increase/(decrease) in receivables" is stated after eliminating £69 million (2010 £nil) of reinsurance premium settled by the issuance of 2,760,000 ordinary shares of £25 each to its parent company, Aviva Insurance Limited

## Notes to the financial statements (continued)

### 15. Statement of cash flows (continued)

**(b) Cash and cash equivalents in the statement of cash flows at 31 December comprise:**

| | 2011 | 2010 |
|---|---|---|
| | £m | £m |
| Cash at bank and in hand | 1 | - |
| Cash equivalents | 40 | 23 |
| | 41 | 23 |

**(c) Cash flows in respect of insurance business transfer**

| | 2011 | 2010 |
|---|---|---|
| | £m | £m |
| Cash and cash equivalents acquired from insurance business transfer (note 19) | 34 | - |

### 16. Risk management

The ultimate parent company, Aviva plc, and its subsidiaries, joint ventures and associates, (collectively known as "the Group"), operate a risk management framework ("RMF"), which is the collection of processes and tools that have been put in place to ensure that the risks to which it is exposed are identified, measured, managed, monitored and reported on a continuous basis The RMF is designed to facilitate a common approach to, and language regarding, the management of risk across the Group The key instruments of the RMF include the risk management policies, risk reports, risk models, the governance and oversight infrastructure and the risk appetite framework The RMF has been adopted in the UK Aviva businesses ("the UK Region") including the Aviva businesses collectively referred to as "UKGI" (including this Company and the UK general insurance business carried out within Aviva Insurance Limited and Aviva International Insurance Limited)

Risks usually grouped by risk type market, credit, general insurance, liquidity and operational risk Risk falling within these types may affect a number of key metrics including those relating to strength within the statement of financial position, liquidity and profit They may also affect the performance of the products that the Company delivers to customers and the service to customers and distributors, which can be categorised as risks to the Company's franchise value

The Group has a set of formal risk policies that facilitate a consistent approach to the management of all the Group's risks across all businesses and locations in which the Group operates These risk policies define the Group's appetite for different, specific risk types and set out risk management and control standards for the Group's worldwide operations

UKGI sets limits to manage material risks to ensure the risks stay within risk appetite (the amount of risk UKGI is willing to accept) UKGI assesses the size and scale of a risk by considering how likely it is that the risk will materialise and the potential impact the risk could have on its business, customers and other stakeholders Where risks are outside of appetite, actions are agreed to mitigate the exposure Impact assessments are considered against financial, operational and reputational criteria and take into account underlying factors such as economic conditions, for example, UK economic growth and inflation

# The Ocean Marine Insurance Company Limited

## Notes to the financial statements (continued)

### 16. Risk management (continued)

The UK Region has an established governance framework, which has the following key elements

- defined terms of reference for the legal entity Boards and the associated executive management and other committees across the UK Region including the UK Region Board, UK Region Risk Committee and UK Region Audit Committee,
- a clear organisational structure with documented delegated authorities and responsibilities from the legal entity Boards to executive management committees and senior management, and
- adoption of the Group risk management framework that defines risk appetite measures and sets out risk management and control standards for the Group's worldwide operations The risk management framework also set out the roles and responsibilities of businesses, regions, policy owners and risk oversight committees

UKGI operates a three lines of defence risk management model Primary responsibility for risk identification and management lies with business management (the first line of defence) Support for and challenge on the completeness and accuracy of risk assessment, risk reporting and adequacy of mitigation plans are performed by specialist risk functions (the second line of defence) Independent and objective assurance on the robustness of the risk management framework and the appropriateness and effectiveness of internal control is provided by Group Audit (the third line of defence)

Risk models are an important tool in UKGI's measurement of risk and are used to support the monitoring and reporting of the risk profile and in the evaluation of alternative risk management actions UKGI carries out a range of stress (where one risk factor is assumed to vary) and scenario (where combinations of risk factors are assumed to vary) tests to evaluate their impact on the business and the management actions available to respond to the conditions envisaged Monthly assessments are made of the economic capital available within the business and the economic capital required to cover the current risk profile of the business and these assessments are included in the regular reporting to the risk committees

In addition to monitoring regulatory Solvency under applicable FSA regulations, the FSA also requires UKGI to assess its economic capital requirements to ensure that it adequately reflects the risks facing the business

UKGI has developed economic capital models that support the measurement, comparison and further understanding of its risks The results of the modelling are incorporated into key strategic planning and decision-making processes These models show the relative impact to economic capital from the risks faced In turn this supports the assessment of appropriate and effective mitigating strategies where risks are outside of agreed risk limits

# The Ocean Marine Insurance Company Limited

## Notes to the financial statements (continued)

### 16. Risk management (continued)

### (a) Financial risk management

**(i) Market risk**

Market risk is the risk of adverse financial impact due to changes in fair values or future cash flows of financial instruments due to fluctuations in interest rates, equity prices, property prices, and foreign currency exchange rates Market risk arises due to credit spread widening and fluctuations in both the value of liabilities and the value of investments held

UKGI manages market risk locally within its market risk framework, within local regulatory constraints and in line with established Group policy, including minimum principles for matching liabilities with appropriate assets UKGI's market risk appetite is set by the UKGI Asset and Liability Committee

The Company has assets and claims liabilities in foreign currency, principally United States dollars, and so has exposure to foreign exchange rates However, there is no material net exposure to exchange rate fluctuations due to the reinsurance that has been put in place

On 10 June 2011, the Board approved the transfer of The World Auxiliary Insurance Corporation Limited by the Company as part of the insurance business transfer carried out during the year. The acquisition was effective on 14 November 2011 The fair value of the Company's investment in subsidiary at 31 December 2011 is £nil

Derivatives are used within policy guidelines agreed by the Aviva plc Board of Directors Derivatives are only used for efficient portfolio management or risk hedging purposes The Company did not have any derivatives during the year or at the year-end

The management of market risk is overseen by the UKGI Asset and Liability Committee

**(ii) 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

UKGI's management of credit risk is carried out in accordance with Group credit risk processes, which include setting exposure limits and monitoring exposures in accordance with ratings set by credit ratings agencies such as Standard & Poor's Exposure levels are reported to, and reviewed by, the UKGI Asset and Liability 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 and the type of exposure

# The Ocean Marine Insurance Company Limited

## Notes to the financial statements (continued)

### 16. Risk management (continued)

### (a) Financial risk management (continued)

**(ii) Credit risk (continued)**

The following table provides information regarding the aggregated credit risk exposure of the Company "Non-rated" assets captures assets not rated by external ratings agencies

| 31 December 2011 | Credit rating AAA | AA | A | BBB | Speculative grade | Non-rated | Carrying value in the statement of financial position |
|---|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m | £m |
| Reinsurance assets | - | 628 | - | - | - | - | 628 |
| Amounts due from reinsurers | - | 9 | - | - | - | - | 9 |
| Cash and cash equivalents | - | 27 | 14 | - | - | - | 41 |

| 31 December 2010 | Credit rating AAA | AA | A | BBB | Speculative grade | Non-rated | Carrying value in the statement of financial position |
|---|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m | £m |
| Reinsurance assets | - | 314 | - | - | - | - | 314 |
| Cash and cash equivalents | - | 10 | 13 | - | - | - | 23 |

Of the Company's receivables of £53 million (2010 £41million), £44 million (2010 £41 million) is due from other Group companies and details are set out in note 18

At 31 December 2011 and 31 December 2010, no financial assets were impaired or overdue

The Company also has a significant exposure to the National Indemnity Company amounting to £628 million (2010 £314 million) in respect of reinsurance arrangements

The management of credit risk is overseen by the UKGI Asset and Liability Committee

**(iii) General insurance risk**

The Company is in run-off and considers insurance risk within its general insurance activity to be the management of claims and the adequacy of reserving

UKGI has developed mechanisms that identify, quantify and manage accumulated exposures to contain them within the limits of the appetite of UKGI UKGI has in place various developments to manage effectively exposures arising from specific perils

## Notes to the financial statements (continued)

### 16. Risk management (continued)

### (a) Financial risk management (continued)

**(iii) General insurance risk (continued)**

The adequacy of UKGI's general insurance claims provisions is overseen by the UKGI Reserve Committee Actuarial claims reserving is conducted by the UKGI's actuaries, with periodic independent external reviews by consulting actuaries

Risk-based capital models are being used to support the quantification of risk under the Individual Capital Assessment ("ICA") framework UKGI undertakes a quarterly review of insurance risks, the output from which is a key input into the ICA and risk-based capital assessments

All business is reinsured as the Company is party to a reinsurance agreement entered into with National Indemnity Company in 2000, which provides substantial protection in excess of current gross liabilities

On completion of the insurance business transfer on 14 November 2011, the Company completed an Adverse Reserve Deterioration agreement with its parent company, Aviva Insurance Limited This agreement provides an extra £1 billion of reinsurance cover to protect against circumstances in which the reinsurance with National Indemnity Company is exhausted or otherwise fails to satisfy claims

The management of insurance risk is overseen by specific UKGI senior management committees, namely the Underwriting and Pricing Groups, the Reserve Committee and the Projections Committee

**(iv) Liquidity risk**

Liquidity risk is the risk than an entity will encounter difficulty in meeting obligations as they fall due

UKGI has set its investment strategy to ensure it has sufficient liquid funds to meet its expected obligations on an expected basis and under adverse circumstances In extreme circumstances, the Company would approach the Group for additional short-term borrowing whilst the Company liquidated other assets The Group maintains significant committed borrowing facilities from a range of highly rated banks to mitigate this risk further

The following table provides an analysis, by maturity date of the principal, of the carrying value of financial and reinsurance assets which are available to fund the repayment of liabilities as they crystallise

| 31 December 2011 | Within 1 year | 1 to 5 years | 5 to 15 years | Over 15 years | No fixed terms | Total |
|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m |
| Reinsurance assets | 73 | 196 | 220 | 139 | - | 628 |
| Receivables | - | - | 9 | - | 44 | 53 |
| Current tax asset | - | 18 | - | - | - | 18 |
| Cash and cash equivalents | 41 | - | - | - | - | 41 |
| | 114 | 214 | 229 | 139 | 44 | 740 |

| 31 December 2010 | Within 1 year | 1 to 5 years | 5 to 15 years | Over 15 years | No fixed terms | Total |
|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m |
| Reinsurance assets | 18 | 63 | 118 | 115 | - | 314 |
| Receivables | - | - | - | - | 41 | 41 |
| Cash and cash equivalents | 23 | - | - | - | - | 23 |
| | 41 | 63 | 118 | 115 | 41 | 378 |

For reinsurance assets, the analysis above is based on the estimated timing of future cash flows The other assets above are analysed in accordance with the earliest possible redemption date of the instrument at the initiation of the Company

# The Ocean Marine Insurance Company Limited

## Notes to the financial statements (continued)

### 16. Risk management (continued)

### (a) Financial risk management (continued)

**(iv) Liquidity risk (continued)**

The following table shows the Company's financial liabilities

| 31 December 2011 | Within 1 year | 1 to 5 years | 5 to 15 years | Over 15 years | No fixed terms | Total |
|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m |
| Insurance liabilities | 73 | 196 | 220 | 139 | - | 628 |
| Payables and other financial liabilities | 2 | - | - | - | - | 2 |
| | 75 | 196 | 220 | 139 | - | 630 |

| 31 December 2010 | Within 1 year | 1 to 5 years | 5 to 15 years | Over 15 years | No fixed terms | Total |
|---|---|---|---|---|---|---|
| | £m | £m | £m | £m | £m | £m |
| Insurance liabilities | 18 | 63 | 118 | 115 | - | 314 |

For insurance contracts, the analysis of liabilities above is based on the estimated timing of future cash flows

The management of liquidity risk is overseen by the UKGI Asset and Liability Committee

### (b) Strategic risks

UKGI is exposed to a number of strategic risks UKGI's strategy supports its vision, purpose and objectives and is responsive to both the external and internal environment, for example, changes in the competitive landscape arising from economic conditions, customer demands and competitor activity, regulatory changes, merger and acquisition opportunities and emerging trends (such as climate change and pandemic events)

Strategic risk is explicitly considered throughout UKGI's strategic review and planning process Developments are assessed during the quarterly performance management process where all aspects of the risk profile are considered

UKGI actively engages with external bodies to share the benefit of its expertise in supporting responses to emerging risks, as well as challenging developments that could be damaging to the business and the industry as a whole

### (c) Operational risk management

Operational risk is the risk of loss, resulting from inadequate or failed internal processes, people and systems or from external events Operational risks include taxation, reputation and regulatory risks, such as compliance Only financial instrument risk requires quantification under IFRS and consequently no quantification of this risk is provided

Operational risk is managed in accordance with control standards set out in Group risk management framework

The management of operational risk is overseen by the UKGI Operational Risk Committee

# The Ocean Marine Insurance Company Limited

## Notes to the financial statements (continued)

### 16. Risk management (continued)

### (d) Risk and capital management

UKGI uses a number of risk management tools to understand the volatility of its capital requirements, and to manage its capital more efficiently Primarily, risk-based capital models and ICA are used. Sensitivities to economic and operating experience are regularly produced on all of UKGI's financial performance measurements to inform the UKGI's decision-making and planning processes, and as part of the framework for identifying and quantifying the risks to which UKGI is exposed

General insurance claims 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, the sensitivity of general insurance claims liabilities is primarily based on the financial impact of changes to the reported loss ratio

The Company's activities are the run-off of general insurance business, which is fully reinsured and the Company has no material interest rate risk As such, no sensitivity analysis is presented

### 17. Capital structure

The Company maintains an efficient capital structure from equity shareholder's funds, consistent with the Company's overall risk profile and the regulatory and market requirements of the business This note describes the way the Company manages capital and shows where this is employed

### (a) General

IFRS underpins the Company's capital structure and accordingly, the capital structure is analysed on this basis UKGI uses risk management tools to assess its internal economic capital requirements

The Company as a regulated company is required to hold sufficient capital to meet acceptable solvency levels based on applicable FSA regulations The Company's ability to declare dividends from distributable profits to its parent company is therefore restricted to the extent that these amounts form part of UK regulatory capital

### (b) Capital management

In managing its capital, the Company seeks to

(i) match the expected cash inflows from its assets with the expected cash outflows from the Company's insurance liabilities as they fall due,

(ii) maintain financial strength to satisfy the requirements of its policyholders and regulators,

(iii) retain financial flexibility by maintaining strong liquidity, and

(iv) allocate capital efficiently and repatriate excess capital where appropriate

The Company considers not only the traditional sources of capital funding but the alternative sources of capital including reinsurance, as appropriate, when assessing its deployment and usage of capital

# The Ocean Marine Insurance Company Limited

## Notes to the financial statements (continued)

### 17. Capital structure (continued)

### (c) Different measures of capital

The Company measures its capital on a number of different bases These include measures which comply with the regulatory regime within which the Company operates and those which the directors consider appropriate for the management of the business The measures which the Company uses are

**(i) Accounting basis**

The Company is required to report its results on an IFRS basis

**(ii) Regulatory bases**

Relevant capital and solvency regulations are used to measure and report the Company's financial strength These measures are based on the FSA's current regulatory requirements under Solvency I and the ICA regime The regulatory capital tests verify that the Company retains an excess of solvency capital above the required minimum level calculated using a series of prudent assumptions about the type of business that is underwritten

The Company fully complied with these regulatory requirements during the year

**(iii) Economic bases**

Notwithstanding the required levels of capital laid out by the FSA, UKGI also measures its capital using various risk-based management tools that take into account a more realistic set of financial and non-financial assumptions Note 16, Risk management, gives further details

### (d) Capital structure

| | IFRS net assets 2011 | IFRS net assets 2010 |
|---|---|---|
| | £m | £m |
| General insurance | 110 | 64 |
| **Total capital employed** | 110 | 64 |
| **Financed by** | | |
| Equity shareholder's funds | 110 | 64 |

# The Ocean Marine Insurance Company Limited

## Notes to the financial statements (continued)

### 18. Related party transactions

(a) The Company had the following related party transactions in 2011 and 2010

**(i) Insurance business transfer**

On 14 November 2011, assets and liabilities relating to business in the London Market were transferred to the Company at carrying value by way of an insurance business transfer under Part VII of the Financial Services and Markets Act 2000 from certain Group companies The carrying value of the net assets and liabilities transferred to the Company was £28 million See note 19 for further details

**(ii) Services provided to related parties**

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | Income earned in year | Receivable at year end | Income earned in year | Receivable at year end |
| | £m | £m | £m | £m |
| Parent | - | 44 | - | 39 |
| Fellow subsidiary | - | - | - | 2 |
| | - | 44 | - | 41 |

The related parties' receivables are not secured and no guarantees were received in respect thereof

**(iii) Services provided by related parties**

On completion of the insurance business transfer on 14 November 2011, the Company completed an Adverse Reserve Deterioration ("ARD") agreement with its parent company, Aviva Insurance Limited This agreement provides an extra £1 billion of reinsurance cover to protect against circumstances in which the reinsurance with National Indemnity Company is exhausted or otherwise fails to satisfy claims In consideration of Aviva Insurance Limited entering into the ARD agreement, the Company paid a one-off premium of £69 million, which was settled by intercompany account

On 14 November 2011, the Company settled the intercompany account with Aviva Insurance Limited with funds raised from the issuance of 2,760,000 ordinary shares of £25 each to its parent company, Aviva Insurance Limited

# The Ocean Marine Insurance Company Limited

## Notes to the financial statements (continued)

### 18. Related party transactions (continued)

**(iv) Key management compensation**

The directors and key management of the Company are considered to be the same as for Aviva Insurance Limited, the immediate parent company Information on key management compensation may be found in the related party transactions note in the financial statements of Aviva Insurance Limited

### (b) Immediate parent company

On 14 November 2011, Aviva Insurance UK Limited transferred its entire shareholding in the issued share capital of the Company to Aviva Insurance Limited, a fellow Group undertaking Aviva Insurance Ltd is registered in Scotland

### (c) Ultimate controlling entity

The ultimate controlling entity is Aviva plc Its Annual Report and Accounts are available on application to the Group Company Secretary, Aviva plc , St Helen's, 1 Undershaft, London EC3P 3DQ

### 19. Insurance business transfer

On 10 June 2011, the Board approved the transfer of insurance business to the Company from certain Group companies The transfer was effective from 14 November 2011 Assets and liabilities relating to business in the London Market were transferred at carrying value by way of an insurance business transfer under Part VII of the Financial Services and Markets Act 2000 from the following Group companies.

| | **Net assets/ (liabilities ) transferred** |
|---|---|
| | **£m** |
| London and Edinburgh Insurance Company Limited | (3) |
| Aviva Insurance Limited | (186) |
| Aviva International Insurance Limited | 206 |
| The World Auxiliary Insurance Corporation Limited | 11 |
| | 28 |

The total assets and liabilities transferred were as follows·

| | **£m** |
|---|---|
| **Assets** | |
| Reinsurance assets | 355 |
| Receivables | 9 |
| Cash and cash equivalents | 34 |
| **Total assets** | 398 |
| **Liabilities** | |
| Insurance liabilities | (355) |
| Payables and other financial liabilities (net) | (14) |
| Other liabilities | (1) |
| **Total liabilities** | (370) |
| **Total assets less liabilities** | 28 |

All assets and liabilities were transferred at carrying value for £nil consideration