Commercial Union Life Assurance Company Limited

Report & Financial Statements 2005

NORWICH UNION
an AVIVA company

Commercial Union Life Assurance Company Limited

Registered in England No. 79678
Registered Office: St Helen's, 1 Undershaft, London, England, EC3P 3DQ

Directors and Officers

Directors

K W Abercromby
J D Ainley
D Barral
M T Kirsch
J R Lister
S A J Mann
C E Riley
G N Withers

Secretary

Aviva Company Secretarial Services Limited

Auditor

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

Commercial Union Life Assurance Company Limited
Contents

The directors present their annual report and audited financial statements for Commercial Union Life Assurance Company Limited (the Company) for the year ended 31 December 2005.

Principal activity

The principal activity of the Company is the transaction of long-term insurance business. The directors consider that this will continue unchanged into the foreseeable future.

Operations and new business

Details of the results are given in the income statement on page 18.

Further details of the annual valuation and distribution of profits are provided in the returns to the Financial Services Authority (FSA).

Major events

On 1 January 2005, the Company transferred its Permanent Health Insurance business to a fellow group undertaking, Norwich Union Life and Pensions Limited. The transfer was undertaken in order to improve and simplify the fund structure within the Norwich Union Life group of companies.

The balance sheet effect of this transaction was a reduction in both assets and liabilities of £117 million. The profit impact was nil.

Dividends

A dividend of £26 million was paid on 23 March 2005 *(2004: £86 million)*.

Directors

The names of the present directors of the Company appear on page 1.

S A J Mann was appointed as a director of the Company on 29 April 2005.

J A Newman resigned as a director of the Company on 1 June 2005.

D Barral and J R Lister were appointed as directors of the Company on 1 September 2005.

P R Hales resigned as a director of the Company on 1 September 2005.

K W Abercromby was appointed as a director of the Company on 28 November 2005.

M N Urmston resigned as a director of the Company on 28 November 2005.

J D Ainley, M T Kirsch, C E Riley and G N Withers served as directors of the Company throughout the year.

Directors' interests

The table below shows 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 Aviva plc. Details of any options and awards held through Aviva plc's share schemes and incentive plans are shown on pages 5 and 6. All the disclosed interests are beneficial.

	At 1 January 2005 (or appointment if later)	At 31 December 2005
	Number	Number
K W Abercromby	-	-
J D Ainley	13,141	11,249
D Barral	2,152	2,152
M T Kirsch	12,525	13,233
J R Lister	6,087	6,191
S A J Mann	2,490	2,502
C E Riley	4,508	4,981
G N Withers	10,863	36,891

Incentive plans

Details of the directors who held office at the end of the financial year, and hold or held options to subscribe for ordinary shares of Aviva plc or hold or held awards over shares in Aviva plc, pursuant to Aviva plc's share based incentive plans, are set out below.

(i) Share options

	At 1 January 2005 (or appointment if later)	Options granted during year	Options exercised or lapsed during year	At 31 December 2005
	Number	Number	Number	Number
J D Ainley				
Savings related options	2,356	-	2,356	-
D Barral				
Executive options	90	-	-	90
M T Kirsch				
Savings related options	2,356	1,904	2,356	1,904
J R Lister				
Executive options	21,936	-	-	21,936
S A J Mann				
Executive options	32,845	-	6,542	26,303
C E Riley				
Savings related options	2,305	-	942	1,363
Executive options	39,837	-	-	39,837
Bonus plan options	300	-	-	300
G N Withers				
Savings related options	4,096	-	-	4,096

(1) *Savings related options* are options granted under the H M Revenue and Customs-approved Save As You Earn (SAYE) Share Option Scheme. Options are normally exercisable during the six-month period following either the third, fifth or seventh anniversary of the relevant savings contract.

(2) *Executive options* are those granted under the Aviva Executive Share Option Scheme, or predecessor schemes. Options, which have been granted on various dates from 1995 to 2000, are normally exercisable between the third and tenth anniversaries of their date of grant. Options granted after 1997 are only exercisable if certain performance conditions are met.

(3) *Bonus plan options* are options granted in 1999 and 2000 under the CGU Deferred Bonus Plan. Participants who deferred their annual cash bonuses and received an award of shares, also received an award over an equivalent number of options. The options, which are not subject to performance conditions, are normally exercisable between the third and tenth anniversary of their grant.

During the year three directors exercised share options.

(ii) Share awards

	At 1 January 2005 (or appointment if later)	Awards granted during year	Awards vested during year	Awards lapsed during year	At 31 December 2005
	Number	Number	Number	Number	Number
J D Ainley					
Aviva Long Term Incentive Plan	127,083	44,781	18,349	20,061	133,454
Aviva Deferred Bonus Plan	46,850	16,314	9,328	-	53,836
D Barral					
Aviva Long Term Incentive Plan	41,621	-	-	-	41,621
Aviva Deferred Bonus Plan	34,760	-	-	-	34,760
M T Kirsch					
Aviva Long Term Incentive Plan	113,845	43,808	12,520	14,304	130,829
Aviva Deferred Bonus Plan	73,204	26,424	19,804	-	79,824
J R Lister					
Aviva Long Term Incentive Plan	48,980	-	-	-	48,980
Aviva Deferred Bonus Plan	34,472	-	-	-	34,472
S A J Mann					
Aviva Long Term Incentive Plan	39,516	-	-	-	39,516
Aviva Deferred Bonus Plan	27,140	-	-	-	27,140
C E Riley					
Aviva Long Term Incentive Plan	111,211	44,781	10,879	12,619	132,494
Aviva Deferred Bonus Plan	42,514	27,728	10,032	-	60,210
G N Withers					
Aviva Long Term Incentive Plan	196,140	72,897	18,132	21,032	229,873
Aviva Deferred Bonus Plan	133,020	24,420	20,560	-	136,880

(1) *Aviva Long Term Incentive Plan* - awards under the Plan are made on an annual basis and the 2005 award was made in March. Awards are subject to the attainment of performance conditions over a three year period.

(2) *Aviva Deferred Bonus Plan* - awards disclosed include those made in lieu of some or all of the cash bonus earned and deferred under Aviva plc's Annual Bonus in 2005 and also the matching awards granted on a one for one basis. The awards are not subject to performance conditions and vest on the third anniversary of their grant.

Other than as disclosed above, none of the directors who held office at 31 December 2005 had any beneficial interests in the Company's shares or the shares of any other company within Aviva plc Group.

Resolutions

On 27 May 1999, the members of the Company passed resolutions to dispense with the holding of Annual General Meetings, the laying of directors' reports, financial statements and auditors' reports before the members in general meeting and the obligation to appoint auditors annually.

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 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 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 a 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 proper accounting records which are intended to disclose with reasonable accuracy, at any time, the financial position of the Company. 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.

Directors' liabilities

Aviva plc, the parent company, 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. This indemnity 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. Such qualifying third party indemnity provision remains in force as at the date of approving the directors' report.

Directors' statement as to disclosure of information to auditors

The directors who were members of the board at the time of approving the Directors' report are listed on page 1 of these financial statements. Having made enquiries of fellow directors and of the Company's auditors, each of these directors confirms that:

- to the best of each director's knowledge and belief, there is no information relevant to the preparation of their report of which the Company's auditors are unaware; and
- each director has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the Company's auditors are aware of that information.

By order of the Board

Aviva Company Secretarial Services Limited *Secretary* *30 March 2006*

Independent auditors' report to the shareholders of Commercial Union Life Assurance Company Limited

We have audited the Company's financial statements for the year ended 31 December 2005 which comprise the Income Statement, Balance Sheet, Statement of Changes in Equity, Cash Flow Statement and the related notes 1 to 31. These financial statements have been prepared under the accounting policies set out on pages 9 to 17.

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 financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRS) as adopted by the European Union as set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements 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 are properly prepared in accordance with the Companies Act 1985. 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 read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

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. 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 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 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.

Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with IFRS as adopted by the European Union, of the state of the Company's affairs as at 31 December 2005 and of its profit for the year then ended; and
- have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP
Registered auditor
London

30 March 2006

Commercial Union Life Assurance Company Limited (the Company), a limited company incorporated and domiciled in the United Kingdom (UK), transacts life assurance and long-term savings business.

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

(A) Basis of presentation

This is the Company's first set of full year results prepared in accordance with International Financial Reporting Standards (IFRS) accounting policies and its previously reported 2004 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 financial statements have been prepared in accordance with IFRS applicable at 31 December 2005. The International Accounting Standards Board (IASB) issued an amendment to IAS 39, *The Fair Value Option*, in June 2005. Its requirements are applicable for accounting periods beginning on or after 1 January 2006, but the Company 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. The Company 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 the results of the Company. 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 Company accounts for financial guarantee business. In addition, IFRS 6 has been issued during 2005 but is not relevant to the activities of the Company.

In accordance with the standard for Phase I IFRS 4, *Insurance Contracts*, the Company 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 H below.

Unless otherwise noted, the amounts shown in these financial statements are in millions of pounds sterling (£m).

As permitted under IAS 27, *Consolidated and Separate Financial Statements*, the Company has elected not to present consolidated financial statements. These financial statements present information about the Company as an individual undertaking and not about its group. Information on the ultimate controlling parent and immediate parent can be found on page 53.

FRS 27

Financial Reporting Standard 27, *Life Assurance*, (FRS 27) was issued by the UK's Accounting Standards Board (ASB) on 13 December 2004.

Within FRS 27, the ASB acknowledged the difficulty in applying its requirements retrospectively and it is the Company's view that it would be impractical to do so in accordance with IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. 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 as the adjustments reflect changes in balance sheet presentation between unallocated divisible surplus and insurance liabilities, or liabilities for investment contracts. No adjustments have been made 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 Company's IFRS accounting policies and the transitional arrangements above.

(B) Use of estimates

The preparation of financial statements requires the Company to make estimates and assumptions that affect items reported in the 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) 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 in the income statement.

Translation differences on debt securities and other monetary financial assets measured at fair value are included in foreign exchange gains and losses in the income statement. Translation differences on non-monetary items, such as equities, are reported as part of the fair value gain or loss.

(D) Product classification

Insurance contracts are defined as those containing significant insurance risk if, and only if, an insured event could cause an insurer to pay significant additional benefits 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 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.

(E) Premiums earned

Premiums on long-term insurance contracts and participating investment contracts are recognised as income when receivable, except for investment-linked premiums that are accounted for when the corresponding liabilities are recognised. For single premium business, this is the date from which the policy is effective. For regular premium contracts, receivables are taken at the date when payments are due. Premiums are shown before deduction of commission and before any sales-based taxes or duties. Where policies lapse due to non-receipt of premiums, then all the related premium income accrued but not received from the date they are deemed to have lapsed is offset against premiums.

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 F) 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.

(F) Fee and commission income

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 contracts. The front-end fees that relate to the provision of investment management services are deferred and recognised as the services are provided.

(G) Net investment income

Investment income consists of dividends, interest and rents receivable for the year, realised gains and losses, and unrealised gains and losses on financial assets at fair value through profit and loss (as defined in policy Q). 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.

(H) 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.

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 with-profit contracts. From 31 December 2004, the Company 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. Further details can be found in policy A above.

The long-term business provisions are calculated separately for each life operation. Each calculation represents a determination within a range of possible outcomes, where the assumptions used in the calculations depend on the prevailing circumstances. The principal assumptions are disclosed in note 18(b). For with-profit funds, FRS 27 requires liabilities to be calculated on a realistic basis as set out by the FSA, 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.

(I) Non-participating investment contract liabilities

Claims

For non-participating investment contracts with an account balance, claims reflect the difference between the amounts paid and the account balance.

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.

All of the Company's contracts classified as non-participating investment contracts are unit-linked contracts and are measured at fair value.

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.

(J) Reinsurance

The Company accepts and cedes reinsurance in the normal course of business, with retention limits varying by line of business. Premiums on reinsurance accepted are recognised as revenue in the same manner 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 income statement and balance sheet as appropriate.

Reinsurance assets primarily include balances due from both insurance and reinsurance companies for ceded insurance liabilities. Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provisions or settled claims associated with the reinsured policies and in accordance with the relevant reinsurance contract.

Reinsurance contracts that principally transfer financial risk are accounted for directly through the balance sheet and are not included in reinsurance assets or liabilities. A deposit asset or liability is recognised, based on the consideration paid or received less any explicitly identified premiums or fees to be retained by the reinsurer.

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 a reliably measurable impact on the amounts that the Company will receive from the reinsurer.

(K) Subsidiaries

Subsidiaries are stated at their fair values, estimated using applicable valuation models. In respect of subsidiaries writing long-term business, fair value is based on European Embedded Value, and in respect of all other subsidiaries the directors have used a fair value model consistent with IAS 39. Subsidiaries managed on a fair value basis are classified as held at fair value through profit and loss, with movements recognised in the income statement; otherwise, they are classified as available for sale.

Dividends from subsidiaries are recognised when declared and approved.

(L) *Joint ventures*

Joint ventures are stated at their fair values, estimated using applicable valuation models. In respect of joint ventures writing long-term business, fair value is based on European Embedded Value, and in respect of all other joint ventures the directors have used a fair value model consistent with IAS 39. Joint ventures managed on a fair value basis are classified as held at fair value through profit and loss, with movements recognised in the *income statement; otherwise, they are classified as available for sale.*

(M) Property and equipment

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.

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.

(N) Investment property

Investment property is held for long-term rental yields and is not occupied by the Company. 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 Company. Changes in fair values are recorded in the income statement within net investment income.

(O) 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.

(P) 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, 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.

(Q) Financial investments

The Company classifies its investments as financial assets at fair value through profit and loss (FV). The FV category is used as, in most cases, the Company'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 FV category has two sub-categories – those that meet the definition as being held for trading and those the Company chooses to designate as FV (referred to in this accounting policy as 'other than trading'). Fixed maturities, purchased loans and equity securities, which the Company 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 Company commits to purchase or sell the assets, at their fair values less transaction costs. Debt securities are recorded at their fair value, which is initially taken to be amortised cost, with amortisation credited or charged to the income statement. Investments classified as trading and other than trading 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.

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.

(R) Derivative financial instruments

Derivative financial instruments include foreign exchange contracts, interest rate futures, currency and interest rate swaps, currency and interest rate options, 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 re-measured at their fair value. 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 30.

Interest rate and currency swaps

Interest rate swaps are contractual agreements between two parties to exchange periodic payments in the same currency, each of which is computed on a different interest rate basis, on a specified notional amount. Most interest rate swaps involve the net exchange of payments calculated as the difference between the fixed and floating rate interest payments. Currency swaps, in their simplest form, are contractual agreements that involve the exchange of both periodic and final amounts in two different currencies. Exposure to gain or loss on both types of swap contracts will increase or decrease over their respective lives as a function of maturity dates, interest and foreign exchange rates, and the timing of payments.

Interest rate futures, forwards and options contracts

Interest 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.

(S) Loans

Mortgages which back long-term business have been classified at fair value through profit and 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.

Loans not backing the long-term business are held at amortised cost, using the effective interest rate method.

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

(T) Deferred acquisition costs

The costs directly attributable to the acquisition of new business for non-participating insurance contracts are deferred to the extent that they are expected to be recoverable out of future margins in revenues on these contracts. For participating contracts, 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 contracts, incremental acquisition costs and sales enhancements that are directly attributable to securing an investment management service are also deferred.

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 contracts are amortised over the period in which the service is provided.

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.

(U) 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.

(V) Provisions and contingent liabilities

Provisions are recognised when the Company 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 Company 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 Company 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.

(W) 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 principal temporary differences arise from revaluation of property and certain financial assets and liabilities including derivative contracts, and tax losses carried forward: and, in relation to acquisitions, on the difference between the fair values of the net assets acquired and their tax base. The rates enacted or substantively enacted at the balance sheet date are used to determine the deferred tax.

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

In addition to paying tax on shareholders' profits, the Company pays 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.

(X) Share capital

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 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.

Commercial Union Life Assurance Company Limited
Income statement
For the year ended 31 December 2005

	Note	2005 £m	2004 £m
Income	2		
Gross written premiums		**556**	716
Premiums ceded to reinsurers		**(40)**	(68)
Net premiums earned	E	**516**	648
Fee and commission income	F	**10**	29
Net investment income	G	**2,411**	1,438
Other income		**-**	8
		2,937	2,123
Expenses	3		
Claims and benefits paid, net of recoveries from reinsurers		**(1,507)**	(1,241)
Change in insurance liabilities, net of reinsurance		**(381)**	(94)
Change in investment contract provision		**(203)**	(195)
Change in unallocated divisible surplus		**(471)**	(212)
Fee and commission expense		**(48)**	(216)
Other expenses		**(61)**	(36)
Finance costs		**(14)**	(3)
Profit before tax		**252**	126
Tax expense	W & 6	**(229)**	(100)
Profit for the year		**23**	26

The accounting policies (identified alphabetically) on pages 9 to 17 and notes (identified numerically) on pages 22 to 53 are an integral part of these financial statements.

Commercial Union Life Assurance Company Limited
Balance sheet
At 31 December 2005

	Note	2005 £m	2004 £m
Assets			
Investments in subsidiaries	K & 7	**97**	87
Investments in joint ventures	L & 8	**579**	575
Property and equipment	M & 9	**-**	1
Investment property	N & 10	**1,495**	1,320
Loans	S & 11	**70**	3
Financial investments	Q & 12	**13,541**	12,471
Reinsurance assets	J & 13	**1,427**	1,267
Receivables and other financial assets	14	**329**	240
Deferred acquisition costs	T & 15	**36**	41
Prepayments and accrued income	15	**98**	107
Cash and cash equivalents	U & 28	**186**	307
Total assets		**17,858**	16,419
Equity			
Ordinary share capital	X & 16	**3**	3
Retained earnings	17	**35**	38
Total equity		**38**	41
Liabilities			
Gross insurance liabilities	H & 18	**11,389**	11,158
Gross liability for investment contracts	I & 19	**3,860**	3,423
Unallocated divisible surplus	H	**1,844**	1,373
Provisions	V & 23	**-**	1
Deferred tax liabilities	W & 22	**270**	82
Current tax liabilities	W & 22	**59**	101
Payables and other financial liabilities	24	**370**	198
Other liabilities	25	**28**	42
Total liabilities		**17,820**	16,378
Total equity and liabilities		**17,858**	16,419

Approved by the Board on 30 March 2006

J R Lister *Director*

The accounting policies (identified alphabetically) on pages 9 to 17 and notes (identified numerically) on pages 22 to 53 are an integral part of these financial statements.

Commercial Union Life Assurance Company Limited
Statement of changes in equity
For the year ended 31 December 2005

	Note	2005 £m	2004 £m
Balance at 1 January		**41**	101
Profit for the year		**23**	26
Dividends	17	**(26)**	(86)
Balance at 31 December		**38**	41

The accounting policies (identified alphabetically) on pages 9 to 17 and notes (identified numerically) on pages 22 to 53 are an integral part of these financial statements.

Commercial Union Life Assurance Company Limited
Cash flow statement
For the year ended 31 December 2005

The cash flows presented in this statement cover all the Company's activities and include flows from both policyholder and shareholder activities.

	Note	2005 £m	2004 £m
Cash flows from operating activities			
Cash generated from operations	28(a)	**4**	50
Tax paid		**(76)**	(21)
Net cash from operating activities		**(72)**	29
Cash flows from investing activities			
Acquisitions of subsidiaries and joint ventures		**(104)**	(66)
Disposals of subsidiaries and joint ventures		**81**	-
Proceeds on sale of property and equipment		**-**	2
Net cash used in investing activities		**(23)**	(64)
Cash flows from financing activities			
Ordinary dividends paid		**(26)**	(86)
Net decrease in cash and cash equivalents		**(121)**	(121)
Cash and cash equivalents at 1 January		**307**	428
Cash and cash equivalents at 31 December	28(b)	**186**	307

The accounting policies (identified alphabetically) on pages 9 to 17 and notes (identified numerically) on pages 22 to 53 are an integral part of these financial statements.

1. First time adoption of International Financial Reporting Standards

(a) 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.

(i) Comparatives

The Company has not taken advantage of the exemption 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*.

(ii) 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 (i.e. judgements affecting the Company's opening balance sheet have not been revisited for the benefit of hindsight).

(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*.

(i) Reconciliation of equity reported under UK GAAP to equity reported under IFRS

	1 January 2004 £m	31 December 2004 £m
Equity as reported under UK GAAP	101	41
Equity as reported under IFRS	101	41

(ii) 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

(1) Unallocated divisible surplus (UDS)

Adjustments made to the balance sheet of a with-profits life fund as a result of the transition to IFRS will have a corresponding entry in the UDS. The net impact on shareholders' funds from these adjustments will therefore be nil at both 1 January 2004 and 31 December 2004.

The movement in the UDS includes insurance changes (see section 2). The net impact on the UDS for insurance changes is an increase of £135 million at 1 January 2004 and £108 million at 31 December 2004.

(2) Insurance changes

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

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 risks 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 Company 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, 78% of life policy reserves on a modified statutory solvency basis (MSSB) at 1 January 2004, and 76% at 31 December 2004, have been classified as insurance, and 16% at 1 January 2004 and 17% at 31 December 2004 have been classified as participating investment contracts (being those investment contracts containing a discretionary participating feature as defined within IFRS 4), and both classes will continue to be accounted for under the Company's existing (UK GAAP) accounting policies. The remaining 6% at 1 January 2004, and 7% at 31 December 2004 have been classified as non-participating investment contracts and therefore are required to be accounted for under IAS 39 and IAS 18, *Revenue*.

This product classification change results in technical provisions being allocated between insurance and investment contracts. This has resulted in £2,899 million of liabilities at 1 January 2004, and £3,196 million at 31 December 2004, being classified as investment contracts.

Non-participating investment contracts

As noted above, the liability for contracts classified as non-participating investment contract is valued in accordance with IAS 39. The majority of the Company'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, 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.

(3) FRS 27 Life Assurance

FRS 27 requires insurance companies to measure their liabilities on with-profit business, on a 'realistic' basis (i.e. the FSA's definition of a 'realistic' valuation) in its 2004 IFRS balance sheet. 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.

The changes in valuation as a result of FRS 27 are:

	31 December 2004
	£m
Increase in insurance liabilities	689
Increase in liability for investment contracts	228
Reduction in unallocated divisible surplus	(917)
Net change to shareholders' funds	-

(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	26
Profit for the year as reported under IFRS	26

Adjustments made to the income statement of the with-profits life fund, as a result of the transition to IFRS, will have a corresponding entry in the change in unallocated divisible surplus, resulting in nil impact on the profit for the year.

2. Details of income

	2005 £m	2004 £m
Gross written premiums		
Insurance contracts	**307**	419
Participating investment contracts	**249**	297
	556	716
Less: Premiums ceded to reinsurers	**(40)**	(68)
Net premiums earned	**516**	648
Net investment income		
Interest and similar income	**324**	320
Dividend income	**227**	191
Other income from investments classified as trading		
Realised losses	**(18)**	(37)
Unrealised gains/(losses)	**6**	(9)
Other income from investments classified as other than trading		
Realised gains	**701**	281
Unrealised gains	**1,050**	442
Net income from investment properties		
Rent	**105**	108
Gains on disposal	**9**	8
Fair value gains on investment properties	**51**	113
Other net investment income		
Foreign exchange (losses)/gains	**(35)**	33
Other investment expenses	**(9)**	(12)
Net investment income	**2,411**	1,438

3. Details of expenses

	2005 £m	2004 £m
Claims and benefits paid to policyholders on long term business		
Insurance contracts	**1,073**	915
Participating investment contracts	**470**	385
	1,543	1,300
Less: Claim recoveries from reinsurers		
Insurance contracts	**(16)**	(48)
Participating investment contracts	**(20)**	(11)
Claims and benefits paid, net of recoveries from reinsurers	**1,507**	1,241
Change in insurance liabilities	**336**	112
Less: Change in reinsurance asset for insurance provisions	**45**	(18)
Change in insurance liabilities, net of reinsurance	**381**	94
Investment income allocated to investment contracts	**23**	(4)
Other changes in provisions		
Participating investment contracts	**225**	216
Non-participating investment contracts	**-**	(2)
Less: Change in reinsurance asset for investment contract provisions	**(45)**	(15)
Change in investment contract provisions	**203**	195
Change in unallocated divisible surplus	**471**	212
Acquisition costs		
Commission expenses and other acquisition costs for insurance and participating investment contracts	**31**	55
Change in deferred acquisition costs for insurance and participating investment contracts	-	147
Changes in deferred acquisition costs for non-participating investment contracts	**1**	2
Other fee and commission expense	**16**	12
Fee and commission expense	**48**	216
Other expenses	**61**	36
Finance costs	**14**	3
Total expenses	**2,685**	1,997

Under a management agreement, Norwich Union Life Services Limited (NULS), a fellow group undertaking, supplies and makes charges for the provision of operational assets and staff to the Company. The agreement specifies the amounts payable to NULS in respect of acquisition costs and administrative expenses.

The amount of this recharge is £58 million *(2004: £56 million)*.

4. Directors' emoluments

K W Abercromby, J D Ainley, D Barral, P R Hales, M T Kirsch, J R Lister, S A J Mann, J A Newman, C E Riley, M N Urmston, and G N Withers are remunerated by Aviva Employment Services Limited, a fellow subsidiary of the ultimate holding company, Aviva plc. The emoluments of these directors are recharged to NULS, and details of their emoluments are given in the financial statements of that company.

Under a management service agreement, NULS supplies and makes charges for the provision of staff to the Company, which includes an element in respect of directors' emoluments. It is not practical to calculate the exact charge borne by the Company in this respect.

5. Auditors' remuneration

The total remuneration payable by the Company, including VAT, to its principal auditors, Ernst & Young LLP, in respect of the audit of these financial statements is shown below, together with fees payable in respect of other work.

	2005	2004
	£'000	£'000
Audit services		
Statutory audit	**375**	111
Audit-related regulatory and supplementary reporting	**125**	37
Other services	**-**	14
	500	162

Audit fees are included in the management charge from NULS.

6. Tax

(a) Tax charged to the income statement

(i) The total tax charge comprises:

	2005	2004
	£m	£m
Current tax		
For the year	**61**	69
Prior year adjustments	**(21)**	(9)
Total current tax	**40**	60
Deferred tax		
Origination and reversal of timing differences	**189**	40
Total tax charged to income statement (note 6(b))	**229**	100

(ii) Unrecognised tax losses and temporary differences of previous years were used to reduce current tax expense and deferred tax expense by £2 million and £nil respectively (*2004: £3 million and £nil respectively*).

(b) Tax reconciliation

The tax on the Company's profit before tax differs from tax calculated at the standard UK corporation tax rate as follows:

	2005 £m	2004 £m
Profit before tax	**252**	126
Tax calculated at standard UK corporation tax rate of 30% *(2004:30%)*	**76**	38
Different basis of tax for UK life insurance	**176**	74
Adjustment to tax charge in respect of prior years	**(21)**	(9)
Deferred tax assets not recognised	**(2)**	(3)
Total tax charged to income statement (note 6(a))	**229**	100

7. Investments in subsidiaries

Movement in the Company's investments in its subsidiaries is as follows:

Carrying amount	2005 £m	2004 £m
At 1 January	**87**	72
Additions	**-**	7
Fair value gains	**10**	8
At 31 December	**97**	87

The Company's wholly-owned subsidiary is Norwich Union Life (RBS) Limited, incorporated in England, and carries on the business of life assurance.

The Company has a controlling interest in the The Capital Residential Fund Unit Trust. Distributions received during the year amounted to £nil *(2004: £2 million).*

8. Investments in joint ventures

(a) Carrying amount

	2005 £m	2004 £m
At 1 January	**575**	445
Additions	**104**	58
Disposals	**(180)**	-
Fair value gains	**80**	72
At 31 December	**579**	575

(b) Property management undertakings

As part of their investment strategy, the UK 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 UK long-term business shareholder companies hold equity stakes and which themselves hold nominal stakes in the PLPs. The PUTs are managed by a fellow 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.

The principal joint ventures included above are as follows:

Company	PLP proportion held
Ashtenne Industrial Fund Limited Partnership	40.2%
The Global Switch Limited Partnership	8.3%
The Designer Retail Outlet Centres Limited Partnership	30.6%
The Junction Limited Partnership	21.5%
Airport Property Partnership	12.5%
The Parkridge European Distribution Fund	12.5%

All the above entities perform property ownership and management activities, and are incorporated and operate in Great Britain, apart from The Parkridge European Distribution Fund, which is incorporated in Luxembourg and operates in Poland. The Global Switch Limited Partnership has subsidiaries in several European countries which carry out property ownership and management activities locally.

Distributions received from joint ventures during the year amounted to £27 million *(2004: £18 million)*.

The joint ventures have no significant contingent liabilities to which the Company is exposed, nor has the Company any significant contingent liabilities in relation to its interest in the joint ventures.

9. Property and equipment

	Properties under construction £m
Carrying amount	
At 1 January 2004	3
Disposals	(2)
At 31 December 2004	1
Transfer to PLPs (note 8(b))	(1)
At 31 December 2005	-
Carrying amount	
At 1 January 2004	3
At 31 December 2004	1
At 31 December 2005	-

10. Investment property

	Freehold £m	Leasehold £m	Total £m
Carrying amount			
At 1 January 2004	1,073	142	1,215
Additions	83	-	83
Capitalised expenditure on existing properties	17	-	17
Fair value gains	99	14	113
Disposals	(108)	-	(108)
At 31 December 2004	1,164	156	1,320
Additions	223	-	223
Capitalised expenditure on existing properties	11	1	12
Fair value gains	35	16	51
Disposals	(100)	(11)	(111)
At 31 December 2005	**1,333**	**162**	**1,495**

Investment properties are stated at their market values as assessed by qualified external valuers or by local qualified staff of the Aviva Group. 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	**1,333**	1,164
Long leaseholds – over 50 years	**162**	155
Short leaseholds – under 50 years	**-**	1
	1,495	1,320

11. Loans

Carrying amounts	2005 £m	2004 £m
Policy loans	**3**	3
Mortgage loans	**52**	-
Loans to group undertakings	**15**	-
	70	3

Of the above total, £55 million *(2004: £3 million)* is expected to be recovered more than one year after the balance sheet date.

12. Financial investments

(a) Financial investments comprise at 31 December:

	At fair value through profit and loss		2005
	Trading £m	**Other than trading £m**	**Total £m**
Debt securities	-	5,548	5,548
Equity securities	-	6,883	6,883
Other investments			
Unit trusts	-	942	942
Derivative financial instruments	72	-	72
Other	-	96	96
Total financial investments	72	13,469	13,541

	At fair value through profit and loss		2004
	Trading £m	**Other than trading £m**	**Total £m**
Debt securities	-	5,615	5,615
Equity securities	-	6,422	6,422
Other investments			
Unit trusts	-	411	411
Derivative financial instruments	23	-	23
Total financial investments	23	12,448	12,471

Of the above total, £12,175 million *(2004: £11,659 million)* is expected to be recovered more than one year after the balance sheet date.

(b) Stocklending

The Company has entered into stocklending arrangements in the United Kingdom during the year in accordance with established market conventions.

The carrying amount of financial assets received as collateral under stocklending arrangements at 31 December 2005 is £3,763 million *(2004: £4,056 million)*.

13. Reinsurance assets

(a) The carrying amounts at 31 December comprised:

	2005 £m	2004 £m
Long-term insurance contracts	**63**	148
Participating investment contracts	**284**	239
Non-participating investment contracts	**1,080**	880
	1,427	1,267

Of the above total, £1,283 million *(2004: £1,223 million)* is expected to be recovered more than one year after the balance sheet date.

(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.

(c) Movements

The following movements have occurred in the reinsurance asset during the year:

	2005 £m	2004 £m
Carrying amount		
At 1 January	**1,267**	1,138
Expected change in existing business asset	**188**	40
Variance between actual and expected experience	**11**	89
Impact of economic assumption changes	**2**	-
Other movements	**(1)**	-
Change in asset	**200**	129
Business transferred to a fellow group undertaking	**(40)**	-
At 31 December	**1,427**	1,267

The effects of changes in the main assumptions are given in note 21.

14. Receivables and other financial assets

	2005 £m	2004 £m
Amounts owed by contract holders	**31**	10
Amounts due from reinsurers	**12**	10
Amounts due from fellow subsidiaries	**39**	64
Other financial assets	**247**	156
	329	240

Concentrations of credit risk with respect to receivables are limited due to the size and spread of the Company's trading base. No further credit risk provision is therefore required in excess of the normal provision for doubtful receivables.

Included in the amounts due from reinsurers above is £7 million *(2004: £3 million)* due from fellow subsidiaries.

None of the above is expected to be recovered more than one year after the balance sheet date.

15. Deferred acquisition costs and other assets

(a) The carrying amount comprises:

	2005 £m	2004 £m
Deferred acquisition costs in respect of:		
Insurance contracts	-	4
Non-participating investment contracts	**36**	37
	36	41

Of the above total, £35 million *(2004: £40 million)* is expected to be recovered more than one year after the balance sheet date.

(b) The movements in deferred acquisition costs during the year were:

	2005 £m	2004 £m
Carrying amount		
At 1 January	**41**	190
Amortisation	**(1)**	(151)
Impairment losses	-	2
Business transferred to a fellow group undertaking	**(4)**	-
At 31 December	**36**	41

(c) Prepayments and accrued income

Prepayments and accrued income includes £nil *(2004: £nil)* that is expected to be recovered more than one year after the balance sheet date.

16. Ordinary share capital

Details of the Company's ordinary share capital at 31 December are as follows:

	2005 £m	2004 £m
The authorised share capital of the Company was:		
3,175,000 ordinary shares of £1 each	**3**	3
The allotted, called up and fully paid share capital of the Company was:		
3,175,000 ordinary shares of £1 each	**3**	3

17. Retained earnings

	2005 £m	2004 £m
Balance at 1 January	**38**	98
Profit for the year	**23**	26
Dividends	**(26)**	(86)
Balance at 31 December	**35**	38

18. Insurance liabilities

(a) The carrying amount comprises:

	2005 £m	2004 £m
Participating	**9,473**	9,216
Unit-linked non-participating	**51**	107
Other non-participating	**1,821**	1,804
Outstanding claims provision	**44**	44
	11,389	11,171
Less: PVIF asset recognised in realistic liabilities	**-**	(13)
	11,389	11,158

Of the above total, £10,209 million *(2004: £10,326 million)* is expected to be paid more than one year after the balance sheet date.

(b) Long-term business liabilities

(i) Business description

The Company underwrites long-term business in a "with-profit" fund where the with-profits policyholders are entitled to at least 90% of the distributed profits, the shareholders receiving the balance.

(ii) Methodology

The methodology for the valuation of with-profits business has changed significantly during 2005, as FRS 27 uses the methodology developed for the Realistic Balance Sheet.

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 in this document 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 (GAOs)
- Guaranteed Minimum Pension underpin on Section 32 transfers
- Expected payments under Mortgage Endowment Promise

The cost of future policy related liabilities are determined using a market consistent approach, and in the main this is based on a stochastic model calibrated to market conditions at the end of the reporting period. Non market related assumptions, for example, persistency, mortality and expenses are based on experience, adjusted to take into account future trends.

The with-profits funds contain non-profit policies. The methodology for the valuation of this non-profit business is consistent with the methodology set out for similar business in the non-profit fund.

(iii) Company practice

The long-term business provision is calculated separately for each fund.

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 future investment returns, discount rates, future bonus 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, as detailed below.

(iv) Assumptions – with-profit business

The WPBR is in the main a historic calculation, and hence not affected by assumptions relating to the future.

The principal assumptions underlying the cost of future policy related liabilities are:

(a) 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 – a typical rate as at 31 December 2005 is 4.23% (for a policy with 10 years outstanding).

The volatility of returns are assumed to be distributed as follows:

Class	**Volatility**
Equities	20% (for UK)
Property	15%
Gilts	3.25%
Corporate Bonds	5.25%

(b) Future regular bonuses

Annual bonus assumptions for 2006 have been set consistent with the 31 December 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: the change from one year to the next is limited to a level consistent with past practice.

(c) Persistency

Rates, which will vary between classes of business, are based on experience adjusted to take into account future trends. Where policyholders have valuable guarantees, options or promises the Company assumes that persistency improves in the future.

(d) GAO take-up rates

The rates used vary between the funds based on fund-specific experience, plus an assumption that the level of take-up will increase in the future since the option is valuable to the policyholder.

(e) Future expenses

Where expense charges are subject to a defined fee arrangement, the expense assumption reflects a continuation of that defined basis. For other expenses assumptions are based on experience adjusted to take into account future trends.

(f) 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.

	Mortality tables used 2005 and 2004
Assurances, pure endowments and deferred annuities before vesting	Nil or AM92/AF92 adjusted
Pensions business after vesting and pensions annuities in payment	PCMA00/PCFA00 or PMA80/PFA80 adjusted plus allowance for future mortality improvement

(v) Assumptions – non-profit business in the with-profit funds

The gross premium method is used for all material classes of business. All contracts are assumed to continue for the contractual term.

For unit-linked business, the provisions are valued initially 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. 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 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%**	3.2%
Pensions conventional non-profit	**3.6%**	4.0%
Deferred annuities		
Non-profit – in deferment	**3.6%**	4.0%
Non-profit – in payment	**3.6%**	4.0%
Annuities in payment		
Conventional annuities	**4.2%**	4.9%

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.

	Mortality tables used 2005 and 2004
Assurances	AM92/AF92 or TM92/TF92 adjusted for smoker status
Pure endowments and deferred annuities before vesting	Nil or AM92/AF92 adjusted
General annuity business after vesting	IML00/IFL00 adjusted plus allowance for future mortality improvement
Pensions business after vesting improvement	PCMA00/PCFA00 adjusted plus allowance for future mortality improvement
Annuities in payment	
General annuity business	IML00/IFL00 adjusted plus allowance for future mortality improvement
Pensions business	PCMA00/PCFA00 adjusted plus allowance for future mortality improvement

(vi) Movements

The following movements have occurred in the long-term business provisions during the year:

	2005	2004
	£m	£m
Carrying amount		
At 1 January	**11,158**	10,356
Provisions in respect of new business	**302**	208
Expected change in existing business provisions	**(1,141)**	(428)
Variance between actual and expected experience	**784**	140
Impact of operating assumption changes	**66**	24
Impact of economic assumption changes	**325**	165
Other movements	**-**	3
Change in liability recognised as an expense	**336**	112
Business transferred to a fellow group undertaking	**(105)**	-
Effect of adjusting to FRS 27 realistic basis	**-**	690
At 31 December	**11,389**	11,158

The effect of changes in the main assumptions is given in note 21.

19. Liability for investment contracts

(a) The carrying amount comprises:

	2005	2004
	£m	£m
Participating contracts	**2,761**	2,536
Non-participating contracts	**1,099**	887
	3,860	3,423

Of the above total, £3,502 million *(2004: £3,331 million)* is expected to be paid more than one year after the balance sheet date.

(b) Long-term business investment liabilities

Investment contracts included under long-term business 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 practice for long-term business liabilities as described in note 18. The liability in respect of participating investment contracts of £2,761 million *(2004: £2,536 million)* has been calculated in accordance with actuarial principles. These contracts 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 fair value is likely to be. 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 the unallocated divisible surplus. Guarantees on long-term investment products are discussed in note 20.

Investment contracts that do not contain a discretionary participation feature are referred to as non-participating contracts and the liability is measured at fair value.

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, 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 15 and the deferred income reserve is shown in note 25.

(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	**2,536**	2,093
Reserves in respect of new business	**17**	27
Expected change in existing business provisions	**(96)**	29
Variance between actual and expected experience	**195**	144
Impact of operating assumption changes	**-**	(4)
Impact of economic assumption changes	**109**	20
Change in liability recognised as an expense	**225**	216
Effect of adjusting to FRS 27 realistic basis	**-**	227
At 31 December	**2,761**	2,536

The effect of changes in main assumptions is given in note 21.

(ii) Non-participating investment contracts

	2005 £m	2004 £m
Carrying amount		
At 1 January	**887**	807
Expected change in existing business provisions	**185**	29
Variance between actual and expected experience	**22**	51
Impact of economic assumption changes	**5**	-
Change in liability	**212**	80
At 31 December	**1,099**	887

The effect of changes in main assumptions is given in note 21.

20. Financial guarantees and options

As a normal part of operating activities, the Company has given guarantees and options, including investment return guarantees, in respect of certain long-term insurance products.

(a) 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 has minimum maturity values reflecting the sums assured plus declared annual bonus.

(ii) No market value 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) GAOs – UK with-profit funds have written individual and group pensions which contain 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 Company also has exposure to GAOs and similar options on deferred annuities.

(iv) Guaranteed minimum pension – Company with-profit funds also have certain policies which contain a guaranteed minimum level of pension as part of the condition of the original transfer from state benefits to the policy.

The Company has announced its intention that payments on with-profits mortgage endowment policies may, if necessary, be topped up at maturity (subject to certain conditions) where there is a shortfall between the closing value and the amount originally targeted.

(b) Non-profit business in the with-profits fund

FRS 27 requires the non-profit liabilities to be evaluated by reference to local statutory reserving rules.

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.

21. Effect of changes in assumptions and estimates during the year

The following estimates and assumptions used in determining liabilities for insurance and investment contract business were changed, and had the following effect on the unallocated divisible surplus (UDS) recognised for the year, both gross and net of reinsurance:

	Effect on UDS before and after reinsurance 2005 £m
Assumptions	
Long-term insurance business	
Interest rates	237
Persistency rates	21
Mortality for assurance contracts	8
Mortality for annuity contracts	37
Other assumptions	88
	391
Investment contracts – Participating	
Interest rates	53
Other assumptions	56
	109
Investment contracts – Non-participating	
Interest rates	3
Total increase as a result of changes in assumptions and estimates	503

22. Tax assets and liabilities

(a) General

Included within the tax liability figure is an asset of £2 million recoverable in more than one year *(2004: £nil)*.

(b) Deferred tax

(i) The balance at 31 December comprises:

	2005 £m	2004 £m
Unrealised gains on investments	**336**	210
Provisions and other timing differences	**(34)**	(42)
Unused losses and tax credits	**(32)**	(86)
Net deferred tax liability	**270**	82

(ii) The movement in the net deferred tax liability was as follows:

	2005	2004
	£m	£m
Net liability at 1 January	**82**	42
Amounts charged to profit (note 6(a))	**189**	40
Transferred to a fellow group undertaking	**(1)**	-
Net liability at 31 December	**270**	82

Deferred tax assets are recognised for tax losses carried forward to the extent that realisation of the related tax benefit through future taxable profits is probable. The Company has unrecognised tax losses of £47 million *(2004: £63 million)* to carry forward against future taxable income.

23. Provisions

	Vacant property provision
	£m
At 1 January 2004 and 1 January 2005	1
Released during the year	(1)
At 31 December 2005	-

24. Payables and other financial liabilities

	2005	2004
	£m	£m
Payables arising out of direct insurance	**51**	117
Payables arising out of reinsurance operations	-	4
Amounts due to fellow subsidiaries	**100**	46
Other financial liabilities	**219**	31
	370	198

Of the above total, £5 million *(2004: £5 million)* is expected to be paid more than one year after the balance sheet date.

25. Other liabilities

	2005	2004
	£m	£m
Deferred income	**28**	24
Other liabilities	-	18
	28	42

Of the above total, £24 million *(2004: £24 million)* is expected to be released more than one year after the balance sheet date.

26. Contingent liabilities and other risk factors

(a) Guarantees on long-term savings products

Note 20 gives details of guarantees and options given by the Company as a normal part of operating activities in respect of certain long-term insurance products. In common with other pension and life policy providers, the Company wrote individual and group pension policies in the 1970s and 1980s with a 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 Company'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 Company's reserving practice as a result of the ruling. The directors continue to believe that the existing provisions are sufficient.

(b) Pensions and endowment reviews

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 FSA, has largely been completed. A provision of £14 million *(2004: £16 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 Company's ability to meet the expectations of policyholders or on shareholders.

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 Company'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 Company 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 Company will continue to send these updates annually to all mortgage endowment holders, in accordance with FSA requirements. The Company has made provisions totalling £63 million *(2004: £40 million)* to meet potential mis-selling costs and the associated expense of investigating complaints. It continues to be the directors' view that there will be no material effect either on the Company's liability to meet the expectations of policyholders or on shareholders.

In August 2004, the Company confirmed its intention to introduce time barring on mortgage endowment complaints, under FSA rules, by the end of 2005. The Company is writing to its 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.

27. Commitments

Capital commitments

There are no contractual commitments for acquisitions or capital expenditures of investment property, property and equipment, mortgage loans, and intangible assets, which are not recognised in the financial statements.

28. Cash flow statement

(a) The reconciliation of profit before tax to the net cash inflow from operations activities is:

	2005 £m	2004 £m
Profit before tax	**252**	126
Adjustments for:		
Profit on sale of investment property	**(9)**	(8)
Profit on sale of other financial investments	**(683)**	(244)
Fair value gains on subsidiaries	**(10)**	(8)
Fair value gains on investment property	**(51)**	(113)
Fair value losses on property and equipment	**1**	-
Fair value gains on investments	**(984)**	(393)
Impairment of other assets	**-**	(2)
Amortisation of investments	**(29)**	(19)
Amortisation of deferred acquisition costs	**1**	151
Changes in working capital:		
Increase in reinsurance assets	**(160)**	(129)
Decrease in deferred acquisition costs	**4**	-
(Increase)/decrease in receivables and other financial assets	**(89)**	33
Decrease in prepayments and accrued income	**9**	4
Increase in insurance liabilities	**231**	801
Increase in liability for investment contracts	**437**	525
Increase/(decrease) in unallocated divisible surplus	**471**	(705)
Decrease in other provisions	**(1)**	-
Increase/(decrease) in payables and other financial liabilities	**165**	(25)
Decrease in other liabilities	**(14)**	(3)
Purchases of investment property	**(235)**	(100)
Proceeds on sale of investment property	**120**	116
Net sale of operating assets		
Financial investments	**645**	42
Loans	**(67)**	1
Cash generated from operations	**4**	50

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 for related benefits and claims.

(b) *Cash and cash equivalents in the cash flow statement at 31 December comprised:*

	2005 £m	2004 £m
Cash at bank and in hand	**21**	33
Cash equivalents	**165**	274
	186	307

29. Risk management policies

(a) The Company's approach to risk and capital management

(i) Governance framework

The primary objective of the Company's risk and financial management framework is to protect it from events that hinder the sustainable achievement of the Company's performance objectives, including failing to exploit opportunities. The Company has established a governance framework which has three key elements:

- Clear 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 policy framework which sets out risk appetite, risk management, control and business conduct standards for the Company's operations. Each policy has a member of senior management who is charged with overseeing compliance with the policy throughout the Company.

This governance structure and policy set is regularly reviewed to reflect the changing commercial and regulatory requirement, and our own organisational development.

(ii) Integration of risk and capital management

The Company has developed a framework using Individual Capital Assessment (ICA) principles for identifying the risks to which the Company is exposed, 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 in line with UK FSA regulatory requirements. An ICA has been developed combining the results of financial and operating experience tests with the Company's risk reporting model.

The Company also uses Financial Condition Reports (FCR) to inform decisions on capital management issues. The FCR considers a number of the key performance indicators in addition to solvency and capital requirements. The FCR enables the Company to assess the range of risks to which the business is exposed, their evolution over time, and the impact of the mitigating actions which might be taken.

(iii) Impact of regulatory context on nature of the risks

A significant proportion of the Company's long-term savings business involves insurance products where the majority of investment risks are borne by the Company's policyholders. Risks attributable to policyholders are actively and prudently managed in order to satisfy our policyholders' risk and reward objectives. In addition, our insurance operations are subject to numerous regulatory requirements, which prescribe the type, quality, concentration of investments, and the level of assets to be maintained in order to meet local insurance liabilities. These requirements help to maintain our market risk levels at an acceptable level.

(b) Management of financial and non-financial risks

As explained above, the Company has established a number of policies focusing on the management of financial and non-financial risks. In addition, the Company operates a number of oversight committees at which the aggregation of these risks is monitored and risk management decisions are taken, for example to require further risk mitigating actions. Further details as to the operation of these policies and committees are provided by risk area below.

(i) Life insurance risk

(1) Types of life insurance risk

Life insurance risk within the Company arises through our 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 impact of life insurance risks is monitored by the Company as part of the control cycle of business management. Exposure is monitored through the assessment of liabilities, the asset liability management (ALM) framework, profit reporting, FCR, and the ICA process.

(2) Risk mitigation techniques employed

The Company has developed a policy for the management of life insurance risk and guidelines for the practical application of key areas of life insurance practice.

An Insurance Risk 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. The key points of this framework are as follows:

- Mortality and morbidity – implementing a formal underwriting procedure, and regularly monitoring experience against external benchmarks.
- All risks are managed at product or portfolio level.
- 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 Company selects 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 to credit risk.

Longevity risk is carefully monitored against the latest external industry data and emerging trends.

Expense risk is primarily managed through the assessment of 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 from various life insurance risks. This enables the Company 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 Company writes a diverse mix of business, which are all subject to similar risks (mortality, persistency etc). The Company assesses the relative costs and concentrations of each type of risk through the ICA capital requirements, and addresses material issues escalated to the Life Insurance Risk Committee. This analysis enables us to assess whether accumulations of risk exceed risk appetite.

One key concentration of life insurance risk for the Company is improving longevity risk from pensions in payment and deferred annuities. The Company continually monitors this risk and the opportunities for mitigating actions through reinsurance, improved asset liability matching, or innovative solutions which emerge in the market.

(4) Embedded derivatives within insurance contracts

The Company has exposure to a variety of "embedded derivatives" within 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.

Examples of each key type of embedded derivative 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.

(ii) Asset/liability management (ALM)

The Company has established a policy on ALM for the technical provisions to manage the key ALM risks to which the Company is exposed. The Company monitors adherence to this policy through the ALM Committee.

The 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 which are required. The Company has established strict criteria for matching assets and liabilities for all classes of business, in order to minimise the financial risk from the mismatching of assets and liabilities as investment markets change.

The ALM framework covers a number of areas which are discussed in more detail below.

(iii) Liquidity risk

The Company has a Life Capital Funding and Structure Committee which seeks to determine that it has sufficient financial resources available to meet its obligations as they fall due.

Liquidity risk is managed by the allocation of target ranges of cash together with systems and controls for reporting instances when cash and other liquid assets fall outside these target ranges. When such instances occur processes are in place to return the levels of cash to within the target ranges.

(1) Maturity periods and interest rate risk

The fair value or net asset value of some of the Company's investments is exposed to potential fluctuations in interest rates. Interest rate risk is reduced through close matching of assets and liabilities. Further information on interest rate risk is included in section (iv) market risk.

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:

					At 31 December 2005
	Total	Within 1 year	1-5 years	5-15 years	Over 15 years
	£m	£m	£m	£m	£m
Debt securities	5,548	187	540	2,375	2,446
Loans	70	15	1	3	51

					At 31 December 2004
	Total	Within 1 year	1-5 years	5-15 years	Over 15 years
	£m	£m	£m	£m	£m
Debt securities	5,615	107	428	2,354	2,726
Loans	3	-	1	2	-

(2) Analysis of expected maturity of liabilities

The following shows the gross liability analysed by duration. The total liability is split by duration in proportion to the policy cash flows estimated to arise during that period.

				2005
	Within 1 year	1-5 years	5-15 years	Over 15 years
	£m	£m	£m	£m
Long-term business	1,538	5,619	6,461	1,631

				2004
	Within 1 year	1-5 years	5-15 years	Over 15 years
	£m	£m	£m	£m
Long-term business	924	3,588	6,903	3,166

(iv) Market risk

Market risk is the risk of adverse financial impact due to changes in fair values of financial instruments from fluctuations in interest rates, property prices and equity prices. Market risk arises within the Company due to fluctuations in the relationship between the values of the liabilities and the values of investments held as a result of movements in market prices.

The Company manages market risks within the ALM framework and within local regulatory constraints. The Company is also constrained by the requirements to meet policyholders' reasonable expectations and to minimise or avoid market risk in a number of areas.

For each of the major components of market risk, described in more detail below, the Company has put in place policies and procedures to set out how each risk is to be managed and monitored, and the approach to setting an appropriate risk appetite.

(1) Interest rate risk

Interest rate risk arises primarily from the Company's nominal and rent yield curve exposures within both assets and liabilities.

Interest rate risk also exists in policies which 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 Company manages this risk by adopting close asset liability matching criteria in order to minimise the impact of mismatches between the value of assets and liabilities from interest rate movements. In managing interest rate risk, the Company may use 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.

(2) Property price risk

The Company is subject to property price risk due to holdings of investment properties. The investment in property is managed, and is subject to local regulations on asset admissibility, liquidity requirements, and the expectations of policyholders. The financial impact from changes in property values is examined through stress tests adopted in the ICA and FCR. At 31 December 2005, the Company had not entered into any material derivative contracts to mitigate the effects of changes in property prices.

(3) Equity price risk

The Company is subject to equity price risk due to daily changes in the market values of the equity securities portfolio. The Company's shareholders are exposed to direct equity shareholdings within 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 the interest in the free estate of long-term funds.

Equity price risk is controlled by regularly monitoring and, where necessary, adjusting exposure of each fund's risk appetite. In addition, asset admissibility regulations require that we hold diversified portfolios of assets thereby reducing exposure to individual equities.

The Company actively monitors its directly owned equity assets, which could include some material shareholdings in our strategic business partners, with regular management information presented to the Investment Committee.

The risk of equity price movements is measured through ICA and FCR. The Company actively models 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.

(4) Derivatives risk

Derivatives are used to a limited extent, within policy guidelines agreed by the Aviva Group Derivatives Committee. Derivatives are only used for efficient investment management, risk hedging purposes, or to structure specific retail-savings products. Speculative activity is prohibited unless approval has been obtained from the Group Derivatives Committee. OTC derivative contracts are entered into only with approved counterparties, in accordance with the Company's policies, thereby reducing the risk of credit loss. The Company applies strict requirements to the administration and valuation processes used in order to set a control framework that is consistent with market and industry practice. The Group Derivatives Committee monitors the use of derivatives and approves large or complex transactions on behalf of the Company.

(5) Correlations between market risk and other risks

Lapse behaviour and potential increases in consumer expectations are sensitive to. and interdependent with, market movements. These interdependencies are taken into consideration in the ICA in the aggregation of the financial stress tests with the operational risk assessment. The FCR also considers scenarios involving a number of correlated events.

Certain policyholder participation features contribute to the Company's market risk. The following are the major features identified:

- Guaranteed surrender values
- GAOs
- Minimum surrender and maturity values

The full list of material guarantees and options is set out in note 20.

(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, or changes to the market value of assets caused by changed perceptions of the credit worthiness of such counterparties.

The Company's management of credit risk, through a Life Credit Risk Committee, includes measurement of large individual counterparty exposures using credit ratings by companies such as Standard & Poor's.

Financial assets are graded according to 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. Internal reinsurance assets are not externally rated.

The following table provides information regarding the credit risk exposure of the Company at 31 December.

					Credit rating		2005
	AAA £m	AA £m	A £m	BBB £m	Speculative grade £m	Not rated £m	Total £m
Debt securities	3,410	579	763	502	52	242	5,548
Other investments	-	-	-	-	-	1,110	1,110
Loans	-	-	-	-	-	70	70
Reinsurance assets	-	7	7	-	-	1,413	1,427
	3,410	586	770	502	52	2,835	8,155

					Credit rating		2004
	AAA £m	AA £m	A £m	BBB £m	Speculative grade £m	Not rated £m	Total £m
Debt securities	3,984	288	670	382	54	237	5,615
Other investments	-	-	-	-	-	434	434
Loans	-	-	-	-	-	3	3
Reinsurance assets	-	14	40	-	-	1,213	1,267
	3,984	302	710	382	54	1,887	7,319

The carrying amount of assets included on the balance sheet represents the maximum credit exposure.

(1) Concentrations of credit risk

The long-term business is generally not individually exposed to significant concentrations of credit risk due to regulations limiting investments in individual assets and asset classes. In cases where the business is particularly exposed to credit risk, this risk is translated into a more conservative discount rate used to value the liabilities, creating a greater capital requirement; this credit risk is actively managed. The impact of aggregation of credit risk is monitored as described above.

(2) Reinsurance credit exposures

The Company is exposed to concentrations of risk with individual reinsurers due to the nature of the reinsurance market and the restricted range of reinsurers that the Company deals with who have acceptable credit ratings. The Company operates a policy to manage its reinsurance counterparty exposures. The impact from reinsurer default is measured, among other things, through ICA tests and is managed accordingly.

(vi) Operational risk

Operational risk arises as a result of inadequate or failed internal processes, people or systems; or from external events.

As with other risk categories, line management of business areas have primary responsibility for the effective identification, management, monitoring and reporting of risks to the Board, in accordance with Company policies. A Risk Control and Governance Committee is responsible for implementing the Company 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. In this way, the Board satisfies itself that material risks are being mitigated and reported to an acceptable level.

(c) Sensitivity analysis and capital management

The Company uses a number of sensitivity test based risk management tools to understand the volatility of earnings, the volatility of the Company's capital requirements, and to manage the capital more efficiently. Sensitivities to economic and operating experience are regularly produced on all of the key financial performance indicators as part of the Company's decision making and planning process, and to set the framework for identifying and quantifying the risks to which the Company is exposed.

The nature of long-term business is such that a number of assumptions have been made in compiling these financial statements. Assumptions are made about investment returns, expenses, mortality rates, and persistency in connection with the in force policies, and these vary by business unit. These assumptions are best estimates based on historic and expected experience of the business. A number of the key assumptions are disclosed in note 21.

There is negligible impact on profit and shareholders' equity from the results of sensitivity testing as set out below. For each sensitivity test, the impact of a change in a single factor is measured, 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	The impact of an increase in mortality/morbidity rates for assurance contracts by 5%
Annuitant mortality	The impact of a reduction in mortality rates for annuity contracts by 5%

30. *Derivative financial instruments*

The Company uses non-hedge derivatives to mitigate risk, as detailed below:

			2005			2004
	Contract/ *notional* amount	**Fair value asset**	**Fair value liability**	Contract/ notional amount	Fair value asset	Fair value liability
	£m	**£m**	**£m**	£m	£m	£m
Foreign exchange contracts						
OTC						
Forwards	**1,680**	**-**	**(14)**	1,113	23	-
Total	**1,680**	**-**	**(14)**	1,113	23	-
Interest rate contracts						
OTC						
Interest and currency swaps	**137**	**-**	-	-	-	-
Options	**92**	**64**	**-**	-	-	-
Exchange traded						
Futures	**805**	**-**	**(4)**	359	-	(2)
Total	**1,034**	**64**	**(4)**	359	-	(2)
Equity/index contracts						
Exchange traded						
Futures	**166**	**-**	**(6)**	421	-	(11)
Options	**13**	**8**	**-**	1	-	-
Total	**179**	**8**	**(6)**	422	23	(11)
Totals at 31 December	**2,893**	**72**	**(24)**	1,894	23	(13)

31. Related party transactions

(a) The members of the Board of Directors are listed on page 1 of these financial statements.

Management services have been provided throughout the financial year to the Company by NULS.

Investment management services have been provided to the Company by Morley Fund Management Limited.

During the year, the Company paid a dividend of £26 million *(2004: £86 million)* to its parent.

Details of transactions with joint ventures may be found in note 8.

Accounts receivable from, or payments due to, related parties are disclosed in notes 14 and 24 respectively. The related parties' receivables and payables are not secured, and no guarantees were received in respect thereof. The receivables will be settled in accordance with normal credit terms.

Seed capital provided to fellow group undertakings during the year amounted to £256 million *(2004: £nil)*.

(b) Reinsurance accepted from fellow subsidiaries

	2005 Reinsurance accepted in year £m	2004 Reinsurance accepted in year £m
Premiums	316	455
Claims	878	571
Commission	13	24
Fees	5	-
Share of insurance and investment contract liabilities	6,654	5,975

(c) Reinsurance ceded to fellow subsidiaries

	2005 Reinsurance ceded in year £m	2004 Reinsurance ceded in year £m
Premiums	40	67
Claims	37	59
Share of reinsurance assets	1,415	1,213

(d) Other income receivable from related parties

	2005 Income earned in year £m	2004 Income earned in year £m
Fellow subsidiaries	1	1

(e) Other expenses payable to related parties

	2005 Expense incurred in year £m	2004 Expense incurred in year £m
Fellow subsidiaries	62	68

(f) Key management compensation

The total compensation to those employees classified as key management, including the executive and non-executive directors, is as follows:

	2005 £'000	2004 £'000
Salary and other short-term benefits	**3,739**	2,794
Post-employment benefits	**96**	82
Equity compensation plans	**1,322**	1,313
Total	**5,157**	4,189

Information concerning directors' share interests and transactions is given on pages 4 to 6.

There are no amounts receivable from, or payments due to, members of the Board of Directors.

The directors are remunerated by Aviva Employment Services Limited, a fellow subsidiary of the ultimate holding company, Aviva plc. The emoluments of these directors are recharged to NULS, and details of their emoluments are given in the financial statements of that company.

(g) Parent entity

The immediate holding company is Norwich Union Life Holdings Limited, a company registered in England.

(h) Ultimate controlling entity

The ultimate controlling entity is Aviva plc, a company registered in England. Its Group accounts are available on application to the Group Company Secretary, Aviva plc, St. Helen's, 1 Undershaft, London EC3P 3DQ.