Registered Number: 00093792

ROYAL & SUN ALLIANCE INSURANCE PLC

Annual Report and Accounts

for the year ended 31 December 2013

Contents

Company information

Directors

A P Brown

D Coughlan

R D Houghton

C J R Rash

D A Weymouth

Secretary

Roysun Limited

Registered office

St Mark's Court
Chart Way
Horsham
West Sussex
RH12 1XL

Auditor

KPMG LLP
Chartered Accountants and Statutory Auditor
London

The Company is an important part of RSA Insurance Group plc (the Group) The Company transacts the majority of the UK business, as described in the Annual Report & Accounts of the Group The directors of the Company have considered whether the Group approach to strategy, risk management, performance review and custody of assets fully meets the needs of the Company as a separate regulated entity They have concluded that it does

The directors present their annual report on the affairs of the Company and the audited financial statements for the year ended 31 December 2013

Business review, principal activities and future outlook

The principal activity of the Company, its subsidiaries and overseas branches is the transaction of insurance and related financial services in the United Kingdom and overseas The principal subsidiaries and associated undertakings are listed in note 34 to the financial statements

The results for the Company show a profit on ordinary activities before tax of £128m *(2012 £406m)* for the year, due principally to £435m *(2012 £606m)* of dividend income from subsidiary undertakings and gross premiums written of £4,221m *(2012 £4,293m)* The shareholders' funds of the Company were £3,550m as at 31 December 2013 *(31 December 2013 £4,575m)* The reduction in shareholders' funds is due principally to the payment of the interim dividend and the reduction in value of the subsidiary undertakings

In the United Kingdom, which is the Company's major market, the Company is a leading Commercial insurer and a top five Personal lines insurer through direct and affinity channels In Commercial the Company offers a full suite of products across Property, Liability, Motor and Marine and distributes predominantly through insurance brokers In Personal the Company provides Household, Motor and Pet insurance through insurance brokers and affinity partners as well as MORE TH>N and eChoice, its direct businesses

In the UK we have made further progress on refocusing the business with good performances in Household, Commercial Property and Marine, and an improved result in Commercial Motor However, this was partly offset by the continued challenging conditions in Personal Motor, and the strengthening of reserves in Liability which included an addition of £60m to reserve margin

In UK Personal, premiums were down 1% to £1,311m *(2012 £1,319)* Good growth of 6% in Household was driven by our affinity and broker businesses Motor was down 9% due to our exit from under-performing segments and continuing competitive market conditions Underlying growth in Pet was good and included strong volume from our affinity partnerships, but overall was down 3% due to the adjustment to pipeline premium The underwriting result improved from the 2012 result Household underwriting profits also improved from 2012 whilst Motor made further losses reflecting the impact of lower volumes impacting our expense ratio and some abnormal severity increases in large losses

In UK Commercial we are making good progress on refocusing the business After the £60m addition to margin the result was an underwriting loss although a significant improvement on the prior year Premiums were down 6% mainly reflecting a reduction of 13% in Motor which was driven by targeted reductions we have made throughout the core portfolio as well as the new arrangements for our contract with Motability Property premiums were down 5% as a result of the continued corrective actions as we focus on profit over volume The Property underwriting result reflects favourable large loss experience and the benefit of the corrective actions, whilst in Motor we have seen a much improved underwriting result The underwriting loss in Liability reflects encouraging progress in our core Liability business but this has been more than offset by some specific issues in our Legacy book We have seen increasing frequency of deafness claims and losses in certain segments of our Professional Indemnity book mainly from prior year claims As a result we have strengthened reserves in these two books, including an addition of £60m to margin to reflect ongoing uncertainty

In the UK, the fourth quarter saw a series of weather events, with a net cost to our UK business of approximately £49m

The European Specialty loss reflects continued large loss activity, particularly in Germany, and we are taking corrective action on the affected accounts

In the UK, our focus will continue to be on underwriting profit over volume In UK Commercial we will focus on maintaining the momentum we have generated on remediating the business and in UK Personal we will focus on maintaining growth in Household and Pet whilst reducing our exposure to Motor and driving remedial action

Our capital position has come under pressure We are taking strong action to correct the capital weakness Already in 2014 substantial improvement has come from a £550m Adverse Development reinsurance policy taken out, the sale and leaseback of our Swedish subsidiary's headquarters and the sale of most of the equities in our investment portfolio Selected business disposals are underway and we have a target for 2014 of increasing capital by at least £300m from this There will be other smaller non-core disposals thereafter and a tougher regime throughout the Group of capital discipline, including significant portfolio reductions where target

Business review, principal activities and future outlook (continued)

risk/return metrics are not reached We are sharply increasing our focus on expenses and aim to improve expense ratios across the business with associated restructuring costs for implementation to come There will also be business lines within the Company which we adjust significantly

We will consider further options as the Group stabilises If there are sensible alternatives to further reduce legacy risks or otherwise create value we will examine them

Principal risks and uncertainties

The Company's principal risks and uncertainties are integrated within and managed together with the principal risks of the Group The principal risks and uncertainties of the Group, which include those of the UK business, and hence the Company, are set out in the estimation techniques, risks, uncertainties and contingencies on pages 112 to 115, and in risk management on pages 32 to 35 and 116 to 126 of the Annual Report & Accounts of the Group which do not form part of this report

A discussion of the management of financial risk is set out below

Financial risk management

The Company is exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and insurance liabilities In particular the key financial risk is that the proceeds from the realisation of its financial assets are not sufficient to fund the obligations arising from its insurance contracts

The Company manages its financial assets within a framework that has been developed to seek to ensure the ability to meet its obligations under insurance contracts

The Company reviews the duration of its liabilities and asset portfolios to ensure that they remain broadly matched Investment directives limit permissible duration ranges within the individual portfolios These directives also include objectives for liquidity, asset sector concentration and credit quality The Company is not party to any arrangements for which hedge accounting is used

Credit risk

The primary sources of credit risk within the Company are investment and treasury activities and reinsurance counterparty risk Within the investment management and treasury activities, a range of bank counterparty concentration and credit quality limits together with other controls are in place to ensure that exposure is managed New reinsurance cover is placed with reinsurers that are authorised as Approved Reinsurance Counterparties recommended by the Group Reinsurance Credit Committee

Market risk

Market risk arises within the Company's investment portfolios A Group committee oversees the Company's investment strategy and sets appropriate risk limits to ensure that no significant concentrations to individual companies or sectors arise

Liquidity risk

Liquidity risk is considered to be a low risk category Liquidity is managed such that the Company maintains a minimum level of cash or cash equivalents or highly liquid assets that can be liquidated within a maximum stated period of time Contingency funding plans are prepared and monitored to ensure that these minimum levels are met even in stress conditions

Key performance indicators

The directors of the Group manage the Group s operations on a divisional basis as described in the Annual Report & Accounts of the Group For this reason the Company's directors believe that analysis using key performance indicators (KPIs) for the UK business in aggregate is relevant to the Company

A key measure used by the Company in managing the business is the technical result This measure is calculated by aggregating earned premiums less claims incurred less expenses Other key performance indicators include premium growth and regulatory solvency Details of UK premiums are included within the Business Review above As at 31 December 2013 the Company has an unaudited Solvency 1 surplus of approximately **£0.3bn** *(2012 £1 2bn)* and a coverage ratio of approximately 1 2 times at 31 December 2013 *(2012 1 7 times)*

Key performance indicators (continued)

Further information on financial and non-financial KPIs is detailed in the Annual Report & Accounts of the Group (which do not form part of this report) within the Strategic report on pages 8 to 43 and the Directors' and corporate governance report on pages 50 to 63

Employment policy

The Company's approach and employment policy reflects its belief that motivated and skilled employees are critical to the Company's success

The Company is committed to the promotion of equal opportunities for all employees, creating a working environment that fosters diversity and inclusion The Company seeks to ensure that recruitment, talent selection and development, reward, performance management and internal promotion are all carried out solely on the grounds of ability, and are entirely free from any form of discrimination To do this, all reasonable adjustments are made, where it is appropriate to do so, to the Company's policies, practices, processes and terms and conditions of employment The Company is also committed wherever possible, to employing and developing people who are disabled or become disabled during their career with the Company Diversity and inclusion are encouraged and supported and in 2013 a global Diversity and Inclusion Programme was established to further build the diversity of our workforce

Our key area of focus is to strengthen our pipeline of female employees in senior leadership positions We have a number of initiatives underway, including a global female sponsorship programme, female network events and mentorship programmes Enhanced flexible working opportunities have been introduced, along with a new global recruitment policy and increased intake of females on our global talent programmes In 2013, we entered into a partnership with Mumsnet, a UK social networking site for parents and carers, and RSA is a member of its Family Friendly Employer scheme

The Company is committed to fostering a constructive relationship with recognised independent trade unions, ensuring a regular and open dialogue on business issues and early consultation on changes affecting the workforce In the UK, Unite is formally recognised through a partnership agreement which covers collective consultation and bargaining on behalf of non management employees The Management Association (TMA) represents managerial employees under a separate consultative agreement

The Company is committed to having an engaged and motivated workforce, believing that it has a direct impact on customers' experience and the Company's overall long-term success In 2013 the Group continued to partner with Gallup using their Q12 survey methodology The survey is completed by around three million people globally every year and is open to all employees, with 92% of employees participating in 2013 The results of the 2013 engagement survey place the Group in the top 5% of global organisations with 1,000 or more employees The group also won a range of awards recognising it as a great place to work including being placed in the Top 10 of the UK's Sunday Times Best Big Companies to Work for the second year running

The Group has a long-standing philosophy of encouraging employee share ownership, operating two HMRC-recognised share schemes Sharebuild and Sharesave Currently, a total of 5,635 employees from across the Group participate in Sharesave, contributing an average of £73 38 per month for the three year savings plan and an average of £60 73 for the five year savings plan Sharebuild is offered to UK employees only and currently 2,389 employees participate in it, contributing an average of £77 26 per month

We believe we can create competitive advantage by building and maintaining a performance culture where high achievement is recognised and rewarded and appropriate actions are taken to address underperformance This focus is underpinned by robust performance management processes to enable a rounded assessment of employee performance All employees are set clear annual goals built around three key areas of people, customer and outperformance Alongside these goals we set Group wide expectations of behaviour

As well as assessing current performance we have a rigorous process to support personal development, evaluate future potential and ensure a strong and robust talent pipeline To strengthen our approach in 2013, we initiated a partnership with leading consultancy YSC and implemented a new potential model This model enables us to identify and externally benchmark our highest potential talent and get focused insight to tailor appropriate and stretching development interventions

Employees are kept well informed of our strategy and all changes that affect our people Communications are regularly provided through face to face meetings and presentations, by email, intranet articles and staff publications

Employment policy (continued)

The Company actively encourages employees to become involved in supporting their local communities

By order of the Board

J M Mills
For and on behalf of
Roysun Limited
Secretary
26 February 2014

Dividends

Interim dividends of £400m *(2012 £nil)* were declared and paid during the year The directors do not recommend payment of a final ordinary dividend *(2012 £nil)*

Directors

The names of the current directors are listed on page 1 Mr M Harris served as a director until his resignation on 31 May 2013 Mr S P G Lee served as a director until his resignation on 12 December 2013 Mr R J Clayton, Ms D P Cockrem, Mr I A Craston and Mr W R B McDonnell served as directors until their resignations on 13 February 2013 Mr D A Weymouth, Mr D Coughlan and Mr C J R Rash were appointed directors on 13 February 2013, 23 September 2013 and 8 October 2013 respectively The other directors served throughout the year None of the directors had any interests in the shares of the Company

Information included within the Strategic Review

Information relating to overseas branches, financial risk management, likely future developments and the Company's employment policy is contained within the Strategic Report on pages 2 to 5 and is incorporated into this report by reference

Auditor

Each of the persons who is a director at the date of approval of this report confirms that

- so far as the director is aware, there is no relevant audit information of which the Company's auditor is unaware, and
- the director has taken all steps that he ought to have taken as a director in order to make himself aware of any relevant audit information, and to establish that the Company's auditor is aware of that information

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006

KPMG LLP have confirmed their willingness to continue in office as auditor of the Company for the year ending 31 December 2014 A resolution for their reappointment will be proposed at the 2014 Annual General Meeting

Essential Contracts and change of control

The Company does not consider that it, or any of its subsidiaries, has any significant agreements to which the company is a party that take effect, alter or terminate upon a change of control of the company following a takeover bid that are required to be disclosed pursuant to paragraph 13(2)(j) of Schedule 7 of the Large and Medium Sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended), other than as disclosed below

Under the Company's £500m five year senior committed debt facility, if a change of control occurs, if the majority of lenders require, the facility can be cancelled with immediate effect and all outstanding loans, together with accrued interest become due and payable

Directors' responsibilities

The directors' responsibility statement is included on page 8 of these accounts

Post balance sheet events

Post balance sheet events are set out in note 35 on page 50 of these accounts

Going concern

In considering the appropriateness of the going concern basis, the Board has reviewed the Company's ongoing financial commitments for the next twelve months and beyond The Board's review included strategic plans and updated forecast, capital position, liquidity and credit facilities and investment portfolio As a result of this review the directors have satisfied themselves that it is appropriate to prepare these financial statements on a going concern basis

By order of the Board

J M Mills
For and on behalf of
Roysun Limited
Secretary
26 February 2014

Statement of Directors' responsibilities in respect of the Strategic Report and Directors' Report and the financial statements

The directors are responsible for preparing the Strategic Report and Directors' Report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice)

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and estimates that are reasonable and prudent,
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006 They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities

Independent auditor's report to the members of Royal & Sun Alliance Insurance plc

We have audited the financial statements of Royal & Sun Alliance Insurance plc for the year ended 31 December 2013 set out on pages 10 to 50 The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) having regard to the statutory requirement for insurance companies to maintain equalisation provisions The nature of equalisation provisions, the amounts set aside at 31 December 2013, and the effect of the movement in those provisions during the year on shareholders' funds, the balance on the general business technical account and profit before tax, are disclosed in note 23

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 8, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www frc org uk/auditscopeukprivate

Opinion on financial statements

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2013 and of its profit for the year then ended,
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matter prescribed by the Companies Act 2006

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

Matters on which we are required to report by exception

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

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

Murray Raisbeck

Murray Raisbeck (Senior Statutory Auditor),
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
Canary Wharf
London
E14 5GL
26 February 2014

Profit & loss account
for the year ended 31 December 2013

Technical account – General business

	Notes	2013 £m	2012 £m
Gross premiums written	6	4,221	4,293
Outward reinsurance premiums		(701)	(622)
Premiums written, net of reinsurance		3,520	3,671
Change in the gross provision for unearned premiums		(88)	(225)
Change in the provision for unearned premiums, reinsurers' share		95	15
Earned premiums, net of reinsurance		3,527	3,461
Claims paid			
Gross amount		(2,739)	(2,295)
Reinsurers' share		355	305
		(2,384)	(1,990)
Change in the provision for claims			
Gross amount		(7)	(288)
Reinsurers' share		(40)	(51)
		(47)	(339)
Claims incurred, net of reinsurance		(2,431)	(2,329)
Acquisition costs		(1,033)	(1,038)
Change in deferred acquisition costs		15	23
Administrative expenses		(315)	(289)
Reinsurance commissions and profit participation		36	36
Net operating expenses		(1,297)	(1,268)
Amortisation of renewal rights	15	(5)	(1)
Balance on the technical account before change in equalisation provision		(206)	(137)
Change in the equalisation provision	23	(3)	(30)
Balance on the Technical Account for General Business		(209)	(167)

All amounts relate to continuing operations

The notes on pages 14 to 50 form an integral part of these accounts

Profit & loss account (continued)
for the year ended 31 December 2013

Non-technical account

	Notes	2013 £m	2012 £m
Balance on the Technical Account for General Business		**(209)**	(167)
Investment income	12	**609**	790
Gains on the realisation of investments	12	**-**	47
		609	837
Unrealised (losses)/gains on trading investments / investment property	12	**(135)**	46
Revaluation of subsidiary undertakings	17	**-**	(187)
Investment expenses, charges and interest	12	**(110)**	(122)
Foreign exchange losses		**(6)**	-
Other charges		**(1)**	(1)
Operating Profit		**148**	406
Loss on disposal of subsidiaries		**(20)**	-
Profit on ordinary activities before tax		**128**	406
Taxation on profit on ordinary activities	13	**46**	7
Profit for the financial year attributable to shareholders		**174**	413

Current year discontinued and acquired operations do not form a material part of the figures above

Statement of total recognised gains and losses for the year ended 31 December 2013

	Notes	2013 £m	2012 £m
Profit for the financial year		**174**	413
Foreign exchange losses		**(1)**	(6)
Tax (charge)/credit on foreign exchange losses		**(1)**	1
Movement in valuation of subsidiary and participating interests	17,18	**(650)**	2
Pension fund actuarial losses	10	**(149)**	(160)
UK deferred tax credit attributable to actuarial losses	10	**25**	35
Total recognised gains and losses relating to the year		**(602)**	285

Reconciliation of movement in shareholders' funds

	Notes	Share Capital £m	Share Premium £m	Profit and loss account £m	2013 £m	2012 £m
Shareholders' funds at 1 January		1,128	2,646	801	**4,575**	4,312
Shareholders' recognised (losses)/gains		-	-	(602)	**(602)**	285
Interest on subordinated loan note equity instrument net of tax	21	-	-	(23)	**(23)**	(22)
Dividends paid	14	-	-	(400)	**(400)**	-
Shareholders' funds at 31 December		1,128	2,646	(224)	**3,550**	4,575

The notes on pages 14 to 50 form an integral part of these accounts

Registered Number: 00093792

Royal & Sun Alliance Insurance plc

Balance sheet
as at 31 December 2013

ASSETS	Notes	2013 £m	2012 £m
Intangible assets	15	**19**	26
Investments			
Land and buildings	16	**306**	317
Investments in group undertakings and participating interests			
Investment in subsidiary undertakings	17	**10,229**	10,676
Interests in associated undertakings	18	**15**	14
		10,244	10,690
Other financial investments			
Shares and other variable yield securities and units in unit trusts		**362**	402
Debt securities and other fixed income securities		**3,281**	3,375
Loans and deposits with credit institutions		**74**	76
	16	**3,717**	3,853
Deposits with ceding undertakings		**1**	2
Total investments		**14,268**	14,862
Reinsurers' share of technical provisions			
Provision for unearned premiums		**256**	164
Claims outstanding		**768**	810
		1,024	974
Debtors			
Debtors arising out of direct insurance operations - policyholders		**314**	349
Debtors arising out of direct insurance operations - intermediaries		**1,362**	1,310
Debtors arising out of reinsurance operations		**515**	546
Amounts owed by Group undertakings		**1,563**	1,467
Deferred taxation	25	**240**	186
Other debtors, including taxation	13	**204**	230
		4,198	4,088
Other assets			
Tangible assets	19	**85**	141
Cash at bank and in hand		**203**	222
		288	363
Prepayments and accrued income			
Accrued interest and rent		**53**	55
Deferred acquisition costs		**453**	430
Other prepayments and accrued income		**90**	80
		596	565
		20,393	20,878
Pension fund asset	10	**2**	29
Total assets		**20,395**	20,907

The notes on pages 14 to 50 form an integral part of these accounts

Registered Number: 00093792

Royal & Sun Alliance Insurance plc

Balance sheet (continued)
as at 31 December 2013

LIABILITIES	Notes	2013 £m	2012 £m
Capital and reserves			
Called up share capital	20	**1,128**	1,128
Share premium account		**2,646**	2,646
Profit and loss account		**(224)**	801
Shareholders' funds		**3,550**	4,575
Other capital instruments			
Subordinated loan notes classified as equity instruments	21	**372**	372
Funds attributable to equity holders		**3,922**	4,947
Subordinated liabilities	21	**492**	492
Technical provisions			
Provision for unearned premiums		**2,362**	2,286
Claims outstanding	22	**4,810**	4,804
Equalisation provision	23	**319**	316
		7,491	7,406
Provisions for other risks	24	**45**	95
Deposits received from reinsurers		**3**	3
Creditors			
Creditors arising out of direct insurance operations		**119**	123
Creditors arising out of reinsurance operations		**227**	154
Amounts owed to credit institutions	26	**364**	348
Amounts owed to Group undertakings		**7,223**	6,896
Other creditors including taxation and social security	27	**116**	129
		8,049	7,650
Accruals and deferred income		**203**	171
		20,205	20,764
Pension fund liability	10	**190**	143
Total liabilities		**20,395**	20,907

The notes on pages 14 to 50 form an integral part of these accounts

The financial statements were approved by the Board of Directors on 26 February 2014 and are signed on its behalf by

APB

A P Brown

Director

R Houghton

R D Houghton

Director

1. Accounting Policies

Basis of preparation

The financial statements are prepared in accordance with applicable UK accounting standards and in compliance with the Companies Act 2006, including schedule 3 of the accounting regulations issued under the Act (Schedule 3) and the Statement of Recommended Practice (SORP) on Accounting for Insurance Business issued by the Association of British Insurers in December 2005 (as amended in December 2006), having regard to the statutory requirement for insurance companies to maintain equalisation provisions (see note 23) As noted in the investment accounting policy the true and fair override has been adopted in respect of the valuation of the Company's investment properties and no depreciation is provided The Company has taken advantage of the exemption under Section 400 of the Companies Act 2006 from the requirement to prepare consolidated financial statements as it is a wholly-owned subsidiary of RSA Insurance Group plc, which prepares group accounts The financial statements have been prepared under the current value rules, as permitted by Schedule 3, on the going concern basis

In considering the appropriateness of the going concern basis, the Board has reviewed the Company's ongoing financial commitments for the next twelve months and beyond The Board's review included strategic plans and updated forecast, capital position, liquidity and credit facilities and investment portfolio As a result of this review the directors have satisfied themselves that it is appropriate to prepare these financial statements on a going concern basis

a) Insurance Contracts – product classification

Insurance contracts are those contracts that transfer significant insurance risk at the inception of the contract Insurance risk is transferred when the Company agrees to compensate a policyholder if a specified uncertain future event (other than a change in a financial variable) adversely affects the policyholder Any contracts not meeting the definition of an insurance contract are classified as investment contracts or derivative contracts, as appropriate and measured in accordance with the policies below

b) General insurance business

i. Underwriting result

The underwriting result, being the balance on the technical account before change in equalisation provisions, is accounted for on an annual basis whereby the incurred cost of claims, commission and related expenses are charged against the earned proportion of premiums, net of reinsurance Premiums written are accounted for in the year in which the contract is entered into and include estimates where the amounts are not determined at the balance sheet date Premiums written exclude taxes Duties levied on premiums and directly related expenses, e g commissions are recognised as expenses Premiums are earned as revenue over the period of the contract and are calculated principally on a daily pro-rata basis Commission and other acquisition costs incurred in writing the business are deferred and amortised over the period in which the related premiums are earned

Claims paid represents all payments made during the period whether arising from events during that or earlier periods

The balance on the general business technical account is arrived at after taking account of changes in the equalisation provision

ii. Technical provisions

The provision for unearned premiums represents the proportion of premiums written relating to periods of insurance coverage subsequent to the balance sheet date

Acquisition costs comprise the direct and indirect costs of obtaining and processing new insurance business Deferred acquisition costs are amortised on the same basis as the related premiums earned The reinsurers share of deferred acquisition costs is included within accruals and deferred income

The provision for claims outstanding, whether reported or not, comprises the estimated cost of claims incurred but not settled at the balance sheet date It includes related expenses and a deduction for the expected value of salvage and other recoveries The provision is determined using the best information available of claims settlement patterns, forecast inflation and settlement of claims The provision for claims outstanding relating to long term permanent disability claims is also determined using recognised actuarial methods

1. Accounting Policies (continued)

ii. Technical provisions (continued)

Provisions for claims outstanding, and related reinsurance recoveries, are discounted where there is a particularly long period from incident to claims settlement and where there exists a suitable claims payment pattern from which to calculate the discount In defining those claims with a long period from incident to claims settlement, those categories of claims where the average period of settlement is six years or more from the balance sheet date, has been used as a guide The discount rate used is based upon an investment return expected to be earned by assets, which are appropriate in magnitude and nature to cover the provisions for claims outstanding being discounted, during the period necessary for the payment of such claims

Differences between the estimated cost and subsequent settlement of claims are dealt with in the technical account for the year in which the claims are settled or in which the provisions for claims outstanding are re-estimated

At each balance sheet date an assessment is made of whether the provisions for unearned premiums are adequate A separate provision is made, based on information available at the balance sheet date, for any estimated future underwriting losses relating to unexpired risks The provision is calculated after taking into account future investment income that is expected to be earned from the assets backing the provisions for unearned premiums (net of deferred acquisition costs) The unexpired risk provision is assessed in aggregate for business classes which, in the opinion of the directors, are managed together

Equalisation provisions are established in accordance with the Prudential Regulatory Authority's rules for insurers in the UK These provisions, notwithstanding that they do not represent liabilities at the balance sheet date as they are over and above the anticipated ultimate cost of outstanding claims, are required by Schedule 3 to be included within technical provisions in the balance sheet and any change in the provisions during the year is required to be shown in the general business technical account

iii. Reinsurance ceded

Premiums payable in respect of reinsurance ceded are recognised in the period in which the reinsurance contract is entered into and include estimates where the amounts are not determined at the balance sheet date Premiums are expensed over the period of the reinsurance contract, calculated principally on a daily pro-rata basis

A reinsurance asset (reinsurers' share of insurance contract liabilities) is recognised to reflect the amount estimated to be recoverable under the reinsurance contracts in respect of the provisions for outstanding claims reported under insurance contract liabilities The amount recoverable from reinsurers is initially valued on the same basis as the underlying provisions for outstanding claims The amount recoverable is reduced when there is an event arising after the initial recognition that provides objective evidence that the Company may not receive all amounts due under the reinsurance contract and the event has a reliably measurable impact on the expected amount that will be recovered from the reinsurer

The reinsurers' share of each unexpired risk provision is recognised on the same basis

Annuities purchased by the Company to make payments under structured settlement arrangements are accounted for as reinsurance ceded if the Company remains liable for the settlement in the event of default by the annuity provider Any gain or loss arising on the purchase of an annuity is recognised in the technical account at the date of purchase

c) Translation of foreign currencies

Monetary assets and liabilities denominated in foreign currencies are translated into sterling at rates ruling at the balance sheet date Differences arising on retranslation are included within the profit and loss account Transactions denominated in foreign currencies are translated into sterling using the cumulative average rate for the financial year The resulting exchange differences are included within the profit and loss account Non monetary items are translated at the rate of exchange at the date of the transaction, and are not subsequently retranslated

The results of overseas operations are translated at the average rates for the period and their balance sheets at the rates ruling at the balance sheet date The resulting exchange differences are recognised in the statement of total recognised gains and losses

d) Investment return

Investment return is recognised in the non-technical account and comprises all investment income, realised investment gains and losses and movements in unrealised gains and losses, net of investment expenses Dividends on equity investments are recognised on the date at which the investment is priced 'ex dividend' Interest income is recognised using the effective interest rate method

1. Accounting Policies (continued)

d) Investment return (continued)

Realised gains and losses on investments are calculated as the difference between net sales proceeds and purchase price

Movements in unrealised gains and losses on investments represent the difference between their carrying value at the balance sheet date and their purchase price or their carrying value at the last balance sheet date, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period

e) Pension costs

Retirement Benefits

A defined contribution scheme is a pension scheme under which the Company pays fixed contributions into a separate entity A defined benefit scheme is a pension scheme that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and level of salary

Contributions to defined contribution pension schemes are charged in the period in which the employment services qualifying for the benefit are provided Differences between contributions payable in the year and contributions actually paid are shown as either prepayments or accruals in the balance sheet

The amounts charged (or credited where relevant) in the profit and loss account relating to post retirement benefits in respect of defined benefit schemes are as follows

- the current service cost,
- the past service costs for additional benefits granted in the current or earlier periods,
- the interest cost for the period,
- the impact of any curtailments or settlements during the period, and
- the expected return on scheme assets (where relevant)

The current service cost in respect of defined benefit schemes comprises the present value of the additional benefits attributable to employees' services provided during the period

The present value of defined benefit obligations and the present values of additional benefits accruing during the period are calculated, using the Projected Unit Method

Past service costs arise where additional benefits are granted The cost of providing additional benefits is recognised on a straight line basis over the remaining period of service until such benefits vest The cost of providing additional benefits that vest on their introduction are recognised immediately

The calculation of the present value of accrued benefits includes an actuarial assumption of future interest rates, which is used to discount the expected ultimate cost of providing the benefits The discount rate is determined at each balance sheet date by reference to current market yields on high quality corporate bonds identified to match the currency and estimated term of the obligations The interest cost for the period is calculated by multiplying the discount rate determined at the start of the period by the defined benefit obligations during the period

The change in the present value of the defined benefit obligation and the changes in the fair value of scheme assets resulting from any curtailments and settlements of scheme liabilities during the period are recognised in the profit and loss account Additionally, any previously unrecognised past service costs related to these liabilities are recognised in the gains or losses on settlement and curtailment

The expected return on scheme assets for the period is calculated, based upon the average rate of return (including both income and changes in fair value) net of scheme expenses, expected over the remaining life of the related obligation on the actual assets held by the scheme

Actuarial gains and losses arise from changes to actuarial assumptions when revaluing future benefits, and from actual experience in respect of scheme liabilities and investment performance of scheme assets being different from previous assumptions Actuarial gains and losses are recognised in the statement of total recognised gains and losses

1. Accounting Policies (continued)

e) Pension costs (continued)

The value recognised in the balance sheet for each individual post retirement scheme, is calculated as follows

- the fair value at the balance sheet date of the scheme assets out of which the obligations are to be settled directly,
- minus the present value of defined benefit obligation of the scheme at the balance sheet date,
- minus any past service cost not yet recognised, and
- plus or minus the deferred tax liability or asset respectively relating to the defined benefit asset or liability

Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits The Company recognises termination benefits when it is demonstrably committed to either terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal, or providing termination benefits as a result of an offer made to encourage voluntary redundancy Benefits falling due more than twelve months after the balance sheet date are discounted to present value

f) Share based payment

The value of the employee share options and other equity settled share based payments is calculated at fair value at the grant date using appropriate and recognised option pricing models

Vesting conditions, other than those based upon market conditions, are not taken into account when estimating the fair value of such awards but are taken into account by adjusting the number of equity instruments included in the ultimate measurement of the transaction amount The value of the awards is recognised as an expense on a systematic basis over the period during which the employment services are provided

g) Taxation

Current tax, based on profits and income for the year, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date Timing differences are differences between the Company's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements

A net deferred tax asset is regarded as recoverable and therefore recognised only to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted A deferred tax asset is recognised for relief for trading losses or other losses only to the extent that the directors anticipate that suitable profits will absorb such losses in the future

Deferred tax is not recognised when fixed assets are revalued unless by the balance sheet date there is a binding agreement to sell the revalued assets and the gain or loss expected to arise on sale has been recognised in the financial statements Neither is deferred tax recognised when fixed assets are sold and it is more likely than not that the taxable gain will be rolled over, being charged to tax only if and when the replacement assets are sold

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries and associates only to the extent that, at the balance sheet date, dividends have been accrued as receivable or a binding agreement to distribute past earnings in future has been entered into by the subsidiary or associate

Deferred tax is measured at the tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date Deferred tax is measured on a non-discounted basis

h) Operating leases

Payments made under operating leases are charged on a straight-line basis over the term of the lease

1. Accounting Policies (continued)

i) Goodwill and other intangible assets

Goodwill, being the difference between the cost of an unincorporated business acquisition and the Company's interest in the net fair value of the identifiable assets and liabilities acquired, is initially capitalised in the balance sheet at cost and is subsequently recognised at cost less accumulated amortisation and any impairment losses The cost of the acquisition is the amount of cash paid and the fair value of other purchase consideration given together with directly related expenses Goodwill is regarded as having a limited useful life that does not exceed twenty years and is amortised on a straight-line basis over its useful life

Goodwill is subject to an impairment review at the end of the first full financial year following the initial recognition of the goodwill and, in other periods, if events or changes in circumstances indicate that its carrying value may not be recoverable in full Where the review reveals that the carrying amount is more than the recoverable amount, an impairment is recognised

Other intangible assets comprise renewal rights These assets are carried at cost less accumulated amortisation Amortisation on renewal rights is calculated using the straight line method to allocate the cost over the estimated useful life, which is normally estimated to be between 3 and 12 years

j) Investment property

Investment properties are shown at market value and are valued annually by independent professionally qualified valuers at open market value Unrealised gains and losses are recognised in the non-technical account

The Companies Act requires properties to be depreciated over their expected useful economic lives The directors consider that depreciation of investment properties would not give a true and fair view In accordance with Statement of Standard Accounting Practice 19 'Accounting for Investment Properties', no depreciation is provided on these properties on the basis that depreciation is already reflected in the annual valuations The amounts attributed to this factor by the valuers cannot reasonably be separately identified or quantified

It is the Company's practice to maintain properties occupied by the Company in a continual state of sound repair Accordingly the directors consider that the economic lives of these properties and their residual values, based on prices prevailing at the time of acquisition or subsequent valuation, are such that any depreciation is insignificant and is thus not provided

k) Investments in subsidiaries

Investments in subsidiaries are valued at net asset value Reductions in the recoverable amount of investments in subsidiaries below historic cost and reversals of such reductions are taken to the profit and loss account Other differences between net asset values and book values of investments in subsidiaries are taken to the revaluation reserve A negative revaluation reserve is transferred to retained profits

l) Interests in associates

Associates are entities over which the Company has significant influence but not control generally accompanying a shareholding of between 20% and 50% of the voting rights Investments in associates are accounted as investments in participating interests and are carried in the balance sheet at a directors' valuation (based upon the Company's share of the net current assets of the associate) Changes in the valuation of associates are recognised in the statement of total recognised gains and losses Dividends from associates are accounted for as income in the period in which the Company becomes entitled to receive the dividend

m) Financial assets

A financial asset is initially recognised, on the date the Company commits to purchase the asset, at fair value plus transaction costs that are directly attributable to its acquisition A financial asset is derecognised when the rights to receive cashflows from the investment have expired or have been transferred and the Company has also transferred substantially the risks and rewards of ownership of the asset

Where the following conditions are satisfied, financial assets (other than derivatives and originated loans and receivables) are designated upon initial recognition as at fair value through profit or loss The conditions are that the performance of the assets is evaluated on a total return basis (including the changes in fair values) in accordance with a documented investment strategy and information is provided internally to the Company's key management personnel on this basis

1. Accounting Policies (continued)

m) Financial assets (continued)

On subsequent measurement, investments are measured at fair value with changes in fair value recognised in the non-technical account Originated loans and receivables are measured at amortised cost

n) Estimation of the fair value of financial assets and liabilities other than investments in subsidiaries

The methods and assumptions used by the Company in estimating the fair value of financial assets and liabilities are

- for fixed maturity securities, fair values are generally based upon quoted market prices Where market prices are not readily available, fair values are estimated using either values obtained from quoted market prices of comparable securities or estimated by discounting expected future cash flows using a current market rate applicable to the yield, credit quality and maturity of the investment,
- for equity securities fair values are based upon quoted market prices,
- if the market for a financial asset is not active, the Company establishes fair value by using valuation techniques These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and option pricing models,
- for mortgage loans on real estate and collateral loans, fair values are estimated using discounted cash flow calculations based upon prevailing market rates,
- for cash, short- term investments, commercial paper, other assets, liabilities and accruals carrying amounts approximate to fair value,
- for notes, bonds and loans payable, fair values are determined by reference to quoted market prices or estimated using discounted cash flow calculations based upon prevailing market rates Loan capital is carried at amortised cost and when this is different from fair value this is shown in the relevant note Fair value in this case is based on discounted future cash flows For borrowings that carry a variable rate of interest (other than loan capital), carrying values approximate to fair values, and
- for derivatives, fair values are generally based upon quoted market prices

o) Derivatives

Derivatives are recognised in the balance sheet on a trade date basis and are carried at fair value Derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative All gains and losses arising are taken to the non-technical account The Company does not hold or issue derivative financial instruments for speculative purposes

p) Tangible assets

Tangible assets comprise equipment and computer software These assets are stated in the balance sheet at cost less accumulated depreciation and any impairment losses Depreciation is calculated to write off the cost less the estimated residual value of the tangible fixed assets on a straight line basis over their expected useful lives as follows equipment 3 to 10 years and computer software 3 to 5 years

q) Subordinated loans

Subordinated loans are classified according to their contractual terms

Subordinated loans are classified as a separate class of capital when the terms of the loan contain no obligation on the Company to deliver cash or another financial asset to another entity or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the Company and contain no provision to settle the loan through the issue of equity instruments of the Company Interest paid on such subordinated loans is not recognised in the profit and loss account and is deducted from the profit and loss reserve when paid

Subordinated loans are classified as liabilities when the conditions above are not met Interest costs on such subordinated loans are calculated using the effective interest method and are recognised in the non-technical account

2. Estimation Techniques, Risks, Uncertainties and Contingencies

Introduction

One of the purposes of insurance is to enable policyholders to protect themselves against uncertain future events Insurance companies accept the transfer of uncertainty from policyholders and seek to add value through the aggregation and management of these risks

The uncertainty inherent in insurance is inevitably reflected in the financial statements of insurance companies The uncertainty in the financial statements principally arises in respect of the insurance contract liabilities of the company

The insurance contract liabilities of an insurance company include the provision for unearned premiums and unexpired risks and the provision for outstanding claims Unearned premiums and unexpired risks represent the amount of income set aside by the company to cover the cost of claims that may arise during the unexpired period of risk of insurance policies in force at the end of the reporting period The outstanding claims represent the company's estimate of the cost of settlement of claims that have occurred by the end of the reporting period but have not yet been finally settled

In addition to the inherent uncertainty of having to make provision for future events, there is also considerable uncertainty as regards the eventual outcome of the claims that have occurred by the end of the reporting period but remain unsettled This includes claims that may have occurred but have not yet been notified to the company and those that are not yet apparent to the insured

As a consequence of this uncertainty, the insurance company needs to apply sophisticated estimation techniques to determine the appropriate provisions

Estimation techniques

Claims and unexpired risks provisions are determined based upon previous claims experience, knowledge of events and the terms and conditions of the relevant policies and on interpretation of circumstances Particularly relevant is experience with similar cases and historical claims payment trends The approach also includes the consideration of the development of loss payment trends, the potential longer term significance of large events, the levels of unpaid claims, legislative changes, judicial decisions and economic, political and regulatory conditions

Where possible, the Company adopts multiple techniques to estimate the required level of provisions This assists in giving greater understanding of the trends inherent in the data being projected The Company's estimates of losses and loss expenses are reached after a review of several commonly accepted actuarial projection methodologies and a number of different bases to determine these provisions These include methods based upon the following

- the development of previously settled claims, where payments to date are extrapolated for each prior year,
- estimates based upon a projection of claims numbers and average cost,
- notified claims development, where notified claims to date for each year are extrapolated based upon observed development of earlier years, and
- expected loss ratios

In addition, the Company uses other methods such as the Bornhuetter-Ferguson method, which combines features of the above methods The Company also uses bespoke methods for specialist classes of business In selecting its best estimate, the Company considers the appropriateness of the methods and bases to the individual circumstances of the provision class and underwriting year The process is designed to select the most appropriate best estimate

Large claims impacting each relevant business class are generally assessed separately, being measured either at the face value of the loss adjusters' estimates or projected separately in order to allow for the future development of large claims

Provisions are calculated gross of any reinsurance recoveries A separate estimate is made of the amounts that will be recoverable from reinsurers based upon the gross provisions and having due regard to collectability

The claims provisions are subject to close scrutiny both within the Company's business units and at Group Corporate Centre In addition, for major classes where the risks and uncertainties inherent in the provisions are greatest, regular and ad hoc detailed reviews are undertaken by advisers who are able to draw upon their specialist expertise and a broader knowledge of current industry trends in claims development As an example, the Company's exposure to asbestos related losses is examined on this basis The results of these reviews are considered when establishing the appropriate levels of provisions for outstanding claims and unexpired periods of risk

2. Estimation Techniques, Risks, Uncertainties and Contingencies (continued)

Estimation techniques (continued)

It should be emphasised that the estimation techniques for the determination of insurance contract liabilities involve obtaining corroborative evidence from as wide a range of sources as possible and combining these to form the overall estimate

The pension assets and pension and post retirement liabilities are calculated in accordance with Financial Reporting Standard 17 (FRS 17) The assets, liabilities and profit & loss account charge, calculated in accordance with FRS 17, are sensitive to the assumptions made from time to time, including inflation, interest rate, investment return and mortality FRS 17 compares, at a given date, the current market value of a pension fund's assets with its long term liabilities, which are calculated using a discount rate in line with yields on 'AA' rated bonds of suitable duration and currency As such, the financial position of a pension fund on this basis is highly sensitive to changes in bond rates and will also be impacted by changes in equity markets

Uncertainties and contingencies

The uncertainty arising under insurance contracts may be characterised under a number of specific headings, such as

- uncertainty as to whether an event has occurred which would give rise to a policyholder suffering an insured loss,
- uncertainty as to the extent of policy coverage and limits applicable,
- uncertainty as to the amount of insured loss suffered by a policyholder as a result of the event occurring, and
- uncertainty over the timing of a settlement to a policyholder for a loss suffered

The degree of uncertainty will vary by policy class according to the characteristics of the insured risks and the cost of a claim will be determined by the actual loss suffered by the policyholder

There may be significant reporting lags between the occurrence of the insured event and the time it is actually reported to the Company Following the identification and notification of an insured loss, there may still be uncertainty as to the magnitude and timing of the settlement of the claim There are many factors that will determine the level of uncertainty such as inflation, inconsistent judicial interpretations and court judgments that broaden policy coverage beyond the intent of the original insurance, legislative changes and claims handling procedures

The establishment of insurance contract liabilities is an inherently uncertain process and, as a consequence of this uncertainty, the eventual cost of settlement of outstanding claims and unexpired risks can vary substantially from the initial estimates, particularly for the Company's long tail lines of business The Company seeks to provide appropriate levels of claims provision and provision for unexpired risks taking the known facts and experience into account

The Company has exposures to risks in each class of business within each operating segment that may develop and that could have a material impact upon the Company's financial position The geographic and insurance risk diversity within the Company's portfolio of issued insurance policies mean it is not possible to predict whether material development will occur and, if it does occur, the location and the timing of such an occurrence The estimation of insurance contract liabilities involves the use of judgments and assumptions that are specific to the insurance risks within each territory and the particular type of insurance risk covered The diversity of the insurance risks results in it not being possible to identify individual judgments and assumptions that are more likely than others to have a material impact on the future development of the insurance contract liabilities

The sections below identify a number of specific risks relating to asbestos and environmental claims There may be other classes of risk which could develop in the future and that could have a material impact on the Company's financial position

The Company evaluates the concentration of exposures to individual and cumulative insurance risk and establishes its reinsurance policy to manage such exposure to levels acceptable to the Company

Asbestos and environmental claims

The estimation of the provisions for the ultimate cost of claims for asbestos and environmental pollution is subject to a range of uncertainties that is generally greater than those encountered for other classes of insurance business As a result it is not possible to determine the future development of asbestos and environmental claims with the same degree of reliability as with other types of claims, particularly in periods when theories of law are in flux Consequently, traditional techniques for estimating claims provisions cannot wholly be relied upon and the Company employs specialised techniques to determine provisions using the extensive knowledge of both internal asbestos and environmental pollution experts and external legal and professional advisors

2. Estimation Techniques, Risks, Uncertainties and Contingencies (continued)

Asbestos and environmental claims (continued)

Factors contributing to this higher degree of uncertainty include

- the long delay in reporting claims from the date of exposure (for example, cases of mesothelioma can have a latent period of up to 40 years) This makes estimating the ultimate number of claims the Company will receive particularly difficult,
- issues of allocation of responsibility among potentially responsible parties and insurers,
- emerging court decisions and the possibility of retrospective legislative changes increasing or decreasing insurer liability,
- the tendency for social trends and factors to influence court awards,
- developments pertaining to the Company's ability to recover reinsurance for claims of this nature, and
- for US liabilities from the Company's London market business, developments in the tactics of US plaintiff lawyers and court decisions and awards

Potential change in discount rate for lump sum damages awards

Legislative changes may affect the Company's liability in respect of unsettled claims in the use of predetermined factors used by courts to calculate compensation claims For example, in the UK, standard formulae are used as an actuarial measure by the courts to assess lump sum damages awards for future losses (typically loss of earnings arising from personal injuries and fatal accidents) The calibration of these standard formulae can be updated by the UK Government and the Lord Chancellor may review the methodology to be applied in determining the discount rate to calculate the appropriate settlements, or the discount rate itself, in due course A reduction in the prescribed discount rate would increase the value of future claims settlements

Acquisitions and disposals

The Company makes acquisitions and disposals of businesses as part of its normal operations All acquisitions are made after due diligence, which will include, amongst other matters, assessment of the adequacy of claims reserves, assessment of the recoverability of reinsurance balances, inquiries with regard to outstanding litigation and inquiries of local regulators and taxation authorities Consideration is also given to potential costs, risks and issues in relation to the integration of any proposed acquisitions with existing RSA operations The Company will seek to receive the benefit of appropriate contractual representations and warranties in connection with any acquisition and, where necessary, additional indemnifications in relation to specific risks although there can be no guarantee that these processes and any such protection will be adequate in all circumstances The Company may also provide relevant representations, warranties and indemnities to counterparties on any disposal

These clauses are customary in such contracts and may from time to time lead to the Company receiving claims from counterparties

Contracts with third parties

The Company enters into outsourcing contracts and distribution arrangements with third parties in the normal course of its business and is reliant upon those third parties being willing and able to perform their obligations in accordance with the terms and conditions of the contracts

Litigation, disputes and investigations

The Company, in common with the insurance industry in general, is subject to litigation, mediation and arbitration, and regulatory, governmental and other sectoral inquiries and investigations in the normal course of its business Based on current information the directors do not believe that any current mediation, arbitration, regulatory, governmental or sectoral inquiries and investigations and pending or threatened litigation or dispute will have a material adverse effect on the Company's financial position, although there can be no assurance that losses or financial penalties resulting from any current mediation, arbitration, regulatory, governmental or sectoral inquiries and investigations and pending or threatened litigation or dispute will not materially affect the Company's financial position or cash flows for any period

Reinsurance

The Company is exposed to disputes on, and defects in, contracts with its reinsurers and the possibility of default by its reinsurers The Company is also exposed to the credit risk assumed in fronting arrangements and to potential reinsurance capacity constraints In selecting the reinsurers with whom the Company conducts business, its strategy is to seek reinsurers with the appropriate combination of financial strength, price and capacity The Group Corporate Centre publishes internally a list of authorised reinsurers who pass the Group's selection process and which its operations may use for new transactions

2. Estimation Techniques, Risks, Uncertainties and Contingencies (continued)

Reinsurance (continued)

The Company monitors the financial strength of its reinsurers, including those to whom risks are no longer ceded Allowance is made in the financial position for non recoverability due to reinsurer default by providing, in line with Group standards, having regard to companies on the Group's 'Watch List' The 'Watch List' is the list of companies whom the Group's directors believe will not be able to pay amounts due in full

Investment risk

The Company is exposed to market risk and credit risk on its invested assets Market risk includes the risk of potential losses from adverse movements in market rates and prices including interest rates, equity prices, property prices and foreign exchange rates The Company's exposure to market risks is controlled by the setting of investment limits in line with the Group's risk appetite From time to time the Company also makes use of derivative financial instruments to reduce exposure to adverse fluctuations in foreign exchange rates and equity markets The Company has strict controls over the use of derivative instruments

Credit risk includes the non performance of contractual payment obligations on invested assets and adverse changes in the credit worthiness of invested assets including exposures to issuers or counterparties for bonds, equities, deposits and derivatives Limits are set at both a portfolio and counterparty level based on likelihood of default to manage the Group's overall credit profile and specific concentrations within risk appetite The Company's insurance investment portfolios are concentrated in listed securities with very low levels of exposure to assets without quoted market prices The Company uses model based analysis to verify asset values when market values are not readily available

Rating environment

The ability of the Company to write certain types of insurance business is dependent on the maintenance of the appropriate credit ratings from the rating agencies The RSA Insurance Group has the objective of maintaining single 'A' ratings At the present time the ratings are 'A-' (Developing CreditWatch outlook) from S&P and 'A2' by Moody's A worsening in the ratings, below objective, could have an adverse impact on the ability of the Company to write certain types of general insurance business

In assessing credit risk in relation to reinsurance and investments, the RSA Insurance Group takes into account a variety of factors, including credit rating If any such rating changes, or is otherwise reassessed, this has potential implications for the related exposures

Foreign exchange risk

The Company publishes financial statements in Pounds Sterling Therefore, fluctuations in exchange rates used to translate other currencies, particularly other European currencies and the Canadian dollar, into Pounds Sterling will impact the reported financial position, results of operations from period to period These fluctuations in exchange rates will also impact the Pound Sterling value of and the return on the Company's investments

Income and expenses for each profit & loss account item are translated at average exchange rates Assets and liabilities, as reported in the balance sheet, are translated at closing exchange rates at the end of the reporting period

Regulatory environment

The legal, regulatory and accounting environment is subject to significant change in many of the jurisdictions in which the Company operates, including developments in response to changes in the economic and political environment The Company continues to monitor the developments and react accordingly

Solvency II, the new solvency framework being developed by the EU is intended to achieve greater harmonisation of approach across EU member states to assessing capital resources and requirements The planned implementation date is now 1 January 2016, although there still remains continued uncertainty as to the final rules The Company is actively involved in shaping the outcome through its involvement with European and UK regulators and industry bodies, whilst progressing its implementation plans The directors are confident that the Company will continue to meet all future regulatory capital requirements

3. Risk Management

Introduction

RSA Insurance Group plc (the Group), of which the Company is an important part, is managed along divisional lines The Company transacts the majority of the Group's UK business The directors of the Company have considered whether the Group approach to strategy, risk management, performance review and custody of assets fully meets the needs of the Company as a separate regulated entity They have concluded that it does The following discussion sets out the approach of the Group, and hence of the Company, to risk management

Risk Management

As an insurance company, the Company is in the business of actively seeking risk with a view to adding value by managing it This note summarises the key risks to the Group, and hence the Company, and the steps taken to manage them

The Group's Board of Directors (the 'Board') defines the risk appetite of the organisation The Group employs a comprehensive Risk Management System that includes a full range of risk policies, procedures, measurement, reporting and monitoring techniques and a series of stress tests and scenario analyses to ensure that the risk exposures that arise from operating the Company's business are managed appropriately

For the purpose of managing its risk the Group classifies risks into the following categories

- Insurance
- Credit
- Market
- Liquidity
- Operational
- Reputational
- Strategic

Insurance risk

Underwriting and claims risk

The Company manages these risks through its underwriting strategy, adequate reinsurance arrangements and proactive claims handling The underwriting strategy aims to ensure that the underwritten risks are well diversified in terms of type and amount of risk, industry and geography

Pricing for the Company's products is generally based upon historical claims frequencies and claims severity averages, adjusted for inflation and modelled catastrophes trended forward to recognise anticipated changes in claims patterns While claims remain the Company's principal cost, the Company also makes allowance in the pricing procedures for acquisition expenses, administration expenses, investment income, the cost of reinsurance and for a profit loading that adequately covers the cost of the capital

Underwriting limits are in place to enforce appropriate risk selection criteria The Company generally has the right not to renew individual policies, it can impose deductibles and it has the right to reject the payment of a fraudulent claim In the UK and certain other territories, legislation imposes a minimum amount for which employers can be liable for claims for compensation from employees injured at work These liabilities are usually insured under an employers' liability (or similar) insurance policy All policies issued by the Company comply with minimum statutory requirements

All of the Company's underwriters have specific licences that set clear parameters for the business they can underwrite, based on the experience of the individual underwriter Additionally, the Group has a centrally managed forum looking at Group underwriting issues, reviewing and agreeing underwriting direction and setting policy and directives where appropriate The Group has a quarterly portfolio management process across all its business units, which provides a consistent assessment of each portfolio performance against a set of key performance indicators Under the portfolio management system, key risk indicators are tracked to monitor emerging trends, opportunities and risks and, on an annual basis, a review forum of business and underwriting leaders undertake a detailed review of each portfolio utilising data from the quarterly reviews

The Company has developed enhanced methods of recording exposures and concentrations of risk This means that there is greater control of exposures in high risk areas and enables a prompt response to claims from policyholders should there be a catastrophic event such as an earthquake

Underwriting and claims risk (continued)

Reinsurance arrangements in place include proportional, excess of loss, stop loss and catastrophe coverage The effect of such reinsurance arrangements is that the Company should not suffer total net insurance losses beyond the Company's risk appetite in any one year

Reserve risk

The Company establishes loss reserves to account for the anticipated ultimate costs of all losses and related loss adjustment expenses (LAE) on losses that have already occurred The Company establishes reserves for reported losses and LAE, as well as for incurred but not yet reported (IBNR) losses and unallocated loss adjustment expenses (ULAE) Loss reserve estimates are based on known facts and on interpretation of circumstances including the Company's experience with similar cases and historical claims payment trends The Company also considers the development of loss payment trends, levels of unpaid claims, judicial decisions and economic conditions

The Group has a Group Reserving Committee consisting of the Group Chief Executive Officer, Chief Financial Officer, Group Underwriting and Claims Director, Group Chief Actuary and Group Chief Risk Officer A similar committee has been established in each of the Group's major operating segments The Group Reserving Committee monitors the decisions and judgements made by the business units as to the level of reserves recommended and makes the final decision on the reserves to be included within the financial statements In forming its collective judgement, the Committee considers the following information

- an actuarial indication of ultimate losses together with an assessment of risks and possible favourable or adverse developments that may not have been fully reflected in calculating these indications At the end of 2013 these risks and developments include the possibility of future legislative change having retrospective effect on open claims, changes in claims settlement procedures potentially leading to future claims payment patterns differing from historical experience, the possibility of new types of claim, such as disease claims, emerging from business written several years ago, general uncertainty in the claims environment, the emergence of latent exposures such as asbestos, the outcome of litigation on claims received, failure to recover reinsurance and unanticipated changes in claims inflation
- the views of internal peer reviewers of the reserves and of other parties including actuaries, legal counsel, risk directors, underwriters and claims managers
- how previous actuarial indications have developed

Use of reinsurance

The Company is exposed to both multiple insured losses and losses arising out of a single occurrence, for example a natural peril event such as a hurricane, flood or earthquake

All of the Group's operations are required to purchase reinsurance within agreed local reinsurance appetite parameters The Group Corporate Centre authorises the operations' proposed treaty purchases to check that they at least meet the Group's appetite, for example the '1 in 200 year' standard for catastrophe risk Group Corporate Centre also checks to see that total Group exposures are within the limits set out above and also are consistent with the required risk based capital In addition, local facultative arrangements may be purchased where deemed appropriate

The Company remains primarily liable as the direct insurer on all risks reinsured, although the reinsurer is liable to the Company to the extent of the insurance risk ceded

Credit risk

Credit risk is the risk of loss of value of the financial assets due to counterparties failing to meet all or part of their obligations The Board Risk Committee (BRC) is responsible for ensuring that the Board approved Group credit risk appetite is not exceeded This is done through the setting and imposition of Group policies, procedures and limits In defining its appetite for credit risk the Group looks at exposures at both an aggregate and business unit level distinguishing between credit risks incurred as a result of offsetting insurance risks or operating in the insurance market (e g reinsurance credit risks and risks to receiving premiums due from policyholders and intermediaries) and credit risks incurred for the purposes of generating a return (e g invested assets credit risk)

Limits are set at both a portfolio and counterparty level based on likelihood of default, derived from the rating of the counterparty, to ensure that the Group's overall credit profile and specific concentrations are managed and controlled within risk appetite Financial

Credit risk (continued)

assets are graded according to company standards AAA is the highest possible rating Investment grade financial assets are classified within the range of AAA to BBB ratings For invested assets, restrictions are placed on each of the Group's investment managers as to the level of exposure to various rating categories including unrated securities

The following table provides information regarding the aggregated credit risk exposure for financial assets of the Company as at 31 December 2013

	Credit rating relating to financial assets that are neither past due nor impaired						Total of financial assets that are neither past due nor impaired
	AAA	**AA**	**A**	**BBB**	**<BBB**	**Not rated**	
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Debt securities	**1,185**	**650**	**1,113**	**283**	**35**	**15**	**3,281**
Other financial assets	**1**	**-**	**1**	**-**	**-**	**9**	**11**
Short term investments	**-**	**11**	**49**	**2**	**-**	**1**	**63**
Reinsurance assets	**106**	**190**	**459**	**139**	**23**	**106**	**1,023**
Insurance and reinsurance debtors (1)	**122**	**13**	**1,077**	**122**	**104**	**721**	**2,159**
Derivative assets	**-**	**20**	**38**	**-**	**-**	**-**	**58**
Cash at bank and in hand	**25**	**125**	**43**	**2**	**3**	**5**	**203**

As at 31 December 2012

	Credit rating relating to financial assets that are neither past due nor impaired						Total of financial assets that are neither past due nor impaired
	AAA	AA	A	BBB	<BBB	Not rated	
	£m	£m	£m	£m	£m	£m	£m
Debt securities	1,345	521	1,246	209	39	15	3 375
Other financial assets	1	-	-	-	-	14	15
Short term investments	-	36	24	-	-	3	63
Reinsurance assets	97	236	404	149	36	48	970
Insurance and reinsurance debtors (1)	49	10	1 094	85	102	824	2,164
Derivative assets	-	5	39	-	-	-	44
Cash at bank and in hand	1	176	41	-	3	1	222

Notes

1 The insurance and reinsurance debtors classified as not rated comprise personal policyholders and small corporate customers that do not have individual credit ratings The overall risk to the Company is deemed to be low as the cover could be cancelled if payments were not received on a timely basis

With the exception of AAA rated Government securities, the largest aggregate credit exposure does not exceed 2% of the Company's total financial assets

The Company is exposed to credit and concentrations of risk with individual reinsurers, due to the nature of the reinsurance market and the restricted range of reinsurers that have acceptable credit ratings The reinsurance strategy is to purchase reinsurance in the most effective manner from reinsurers who meet its security standards Reinsurance counterparties are subject to a rigorous internal assessment process on an ongoing basis to ensure that their creditworthiness continues to be satisfactory and the potential impact from reinsurer default is measured regularly and managed accordingly The Group Reinsurance Credit Committee oversees the management of these risks Group standards are set such that reinsurers that have a financial strength rating of less than 'A–' with Standard & Poor's, or a comparable rating, are removed from the Group's authorised list of approved reinsurers unless the Group's

Credit risk (continued)

internal review discovers exceptional circumstances in favour of the reinsurer Collateral is taken to mitigate exposures, where appropriate, to acceptable levels or the size or credit quality of the exposure
The Group regularly monitors its aggregate exposures by reinsurer group against predetermined reinsurer group limits, in accordance with the methodology agreed by the BRC The Company's largest reinsurance exposures to active reinsurance groups are HDI-Gerling, Munich Re and Swiss Re At 31 December 2013 the reinsurance asset recoverable from these groups does not exceed 4% of the Company's total financial assets Stress tests are performed by reinsurer counterparty and the limits are set such that in a catastrophic event, the exposure to a single reinsurer is estimated not to exceed 2% of the Company's total financial assets The Company and certain of its subsidiaries are members of government mandated pools in various parts of the world As of 31 December 2013, the largest pool (by premium volume) is Pool Re operated by the UK Government to provide terrorism cover

There are no material financial assets that would have been past due or impaired had the terms not been renegotiated

The following table provides information regarding the carrying value of financial assets that have been impaired and the ageing of financial assets that are past due but not impaired as at 31 December 2013

	Neither past due nor impaired	**Financial assets that are past due but not impaired**				**Financial assets that have been impaired**	**Carrying value in the balance sheet**	**Impairment losses charged to the P&L**
		0-3 months	**3-6 months**	**6 - 12 months**	**Greater than 12 months**			
	£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Debt securities	**3,281**	-	-	-	-	-	**3,281**	-
Other financial assets	**11**	-	-	-	-	-	**11**	-
Short term investments	**63**	-	-	-	-	-	**63**	-
Reinsurance assets	**1,023**	-	-	-	-	**1**	**1,024**	**(1)**
Insurance and reinsurance debtors	**2,159**	**17**	**7**	**4**	**2**	**2**	**2,191**	**1**
Derivative assets	**58**	-	-	-	-	-	**58**	-
Cash at bank and in hand	**203**	-	-	-	-	-	**203**	-

As at 31 December 2012

	Neither past due nor impaired	Financial assets that are past due but not impaired				Financial assets that have been impaired	Carrying value in the balance sheet	Impairment losses charged to the P&L
		0-3 months	3-6 months	6 - 12 months	Greater than 12 months			
	£m	£m	£m	£m	£m	£m	£m	£m
Debt securities	3,375	-	-	-	-	-	3,375	-
Other financial assets	15	-	-	-	-	-	15	-
Short term investments	63	-	-	-	-	-	63	-
Reinsurance assets	970	-	-	-	-	4	974	-
Insurance and reinsurance debtors	2 164	19	12	2	7	1	2 205	(5)
Derivative assets	44	-	-	-	-	-	44	-
Cash at bank and in hand	222	-	-	-	-	-	222	-

Local operations are responsible for assessing and monitoring the creditworthiness of their counterparties (e g brokers and policyholders) Local credit committees are responsible for ensuring these exposures are within the risk appetite of the local operations Exposure monitoring and reporting is embedded throughout the organisation with aggregate credit positions reported and monitored at Group level

The Company's investments comprise a broad range of financial investments issued principally in the UK

At 31 December 2013, the Company had pledged **£871m** (*2012 £901m*) of financial assets as collateral for liabilities or contingent liabilities and had accepted **£107m** (*2012 £453m*) in collateral The nature of the assets pledged as collateral comprises government securities of **£801m** *(2012 £855m)*, cash and cash equivalents of **£37m** *(2012 £13m)* and debt securities **£33m** *(2012 £33m)* The terms and conditions of the collateral pledged are market standard in relation to letter of credit facilities

Credit risk (continued)

The Company is permitted to sell or repledge collateral held in the event of default by the owner, the fair value of which has been noted above at **£107m** The terms and conditions of the collateral held are market standard The assets held as collateral are readily convertible into cash

At 31 December 2013, the Company had entered into short term sale and repurchase agreements for UK government securities The Company continues to recognise the debt securities on the balance sheet as the Company remains exposed to the risks and rewards of ownership The carrying value of these debt securities recognised on the balance sheet is **£300m** *(2012 £295m)* and the carrying value of the associated liabilities is **£300m** *(2012 £295m)*

The Company enters into derivative transactions under International Swaps and Derivatives Association (ISDA) master netting arrangements In general, under such agreements the amounts owned by each counterparty on a single day in respect of all transactions outstanding in the same currency are aggregated into a single net amount that is payable by one counterparty to the other In certain circumstances, such as a credit default, all outstanding transactions under the agreement are terminated, the termination value is assessed and only a single net amount is payable in settlement of all transactions

The ISDA agreements do not meet the criteria for offsetting in the balance sheet This is because the Company does not have any currently legally enforceable right to offset recognised amounts, because the right to offset is enforceable only on the occurrence of future events

Market risk

The Group is exposed to the risk of potential losses from adverse movements in market prices including those of interest rates, equities, property, exchange rates and derivatives

Exposures are controlled by the setting of investment limits and managing asset-liability matching in line with the Group's risk appetite

The Group Investment Committee (GIC), on behalf of the Group Board, is responsible for reviewing and approving the investment strategy for the Group's investment portfolios It provides approval for all major changes of the Group's investment strategy and, in particular, approves any substantive changes to the balance of the Group's funds between the major asset classes Importantly the GIC also approves the terms of reference of the Group's main operational investment committee, the Group Asset Management Committee (GAMC) The BRC issues GAMC with investment risk limits

Interest rate risk

The fair value of the Company's portfolio of fixed income securities is inversely correlated to changes in the market interest rates Thus if interest rates fall, the fair value of the portfolio would tend to rise and vice versa as set out in the sensitivity analysis on page 30

Equity price risk

The Company's portfolio of equity securities is subject to equity risk arising from changes in market price Thus if the value of equities rises so will the fair value of its portfolio and vice versa as set out in the sensitivity analysis on page 30

The Group sets appropriate risk limits to ensure that no significant concentrations to individual companies arise The Group takes a long term view in selecting shares and looks to build value over a sustained period of time rather than utilising high level of purchase and sales in order to generate short term gains from its equity holdings

The Company makes use of derivative products as appropriate to manage equity exposure and to protect the portfolio from losses outside of its risk appetite

Property price risk

The Company's portfolio of properties is subject to property price risk arising from changes in the market value of properties Thus if the value of property falls so will the fair value of the portfolio as set out in the sensitivity analysis on page 30

A number of the Company's property holdings are Group occupied The Company's investment in investment property is recorded as such and these investments are held as part of an efficient portfolio management strategy

Currency risk

The Company incurs exposure to foreign currency exchange risk in two ways

- Operational currency risk – by underwriting liabilities in currencies other than the currency of the primary environment in which the business units operate (non functional currencies)

- Structural currency risk – by investing in overseas subsidiaries and operating an international insurance group

Operational currency risk is managed within the Company's individual operations by broadly matching assets and liabilities by currency

Structural currency risk is managed at a Group level through currency forward and foreign exchange option contracts within the limits that have been set In managing structural currency risk, the needs of the Group's subsidiaries to maintain net assets in local currencies to satisfy local regulatory solvency and internal risk based capital requirements are taken into account These assets should prove adequate to support local insurance activities irrespective of exchange rate movements

Derivatives

The Company may use derivative financial instruments for the purpose of reducing its exposure to adverse fluctuations in interest rates, foreign exchange rates, equity prices and long term inflation The Company does not use derivatives to leverage its exposure to markets and does not hold or issue financial instruments for speculative purposes Forward contracts and foreign exchange options are used to reduce the risk of adverse currency movements on certain forecast future cash transactions and the reduction of structural currency risk The policy on use of derivatives is approved by the BRC

	Remaining life			**Fair value**		**Notional principal amounts**	
	Less than one year £m	**One to five years £m**	**More than five years £m**	**2013 £m**	2012 £m	**2013 £m**	2012 £m
Cross currency							
Asset	**43**	**-**	**-**	**43**	14	**1,459**	1,323
Liability	**38**	**-**	**-**	**38**	13	**1,204**	1,411
Inflation							
Asset	**-**	**-**	**9**	**9**	21	**See below**	See below
Liability	**-**	**-**	**7**	**7**	24	**See below**	See below
Equity/index							
Asset	**6**	**-**	**-**	**6**	9	**See below**	See below
Liability	**21**	**-**	**-**	**21**	12	**See below**	See below

At 31 December 2013 there were derivative contracts in place to protect the value of the UK, Canadian, European and US equity portfolios of the Group These provided limited protection against declines in market levels whilst also capping participation in any appreciation of the market In total, this strategy covers an underlying equity value up to approximately **£379m** *(2012 approximately £348m)* If UK, Canadian, European and US equity markets decreased by 15%, the impact of these derivatives as at 31 December 2013, would be to decrease the impact of the decline by **£28m** *(2012 £26m)*

The Company is party to a series of swap contracts which collectively provide limited cover against a sharp increase in long term inflation In total the swap contracts provide inflation cover over a nominal value of **£180m** *(2012 £180m)* and are split over different contract terms

At 31 December 2013 the Company holds currency forward contracts and foreign exchange options to reduce structural foreign exchange risk

Sensitivity analysis

The Group uses a number of sensitivity or stress-test based risk management tools to understand the impact of the above risks on earnings and capital in both normal and stressed conditions These stress tests combine deterministic shocks, analysis of historical scenarios and stochastic modelling using the internal capital model to inform the Group's decision making and planning process and also for identification and management of risks within the business units

Sensitivity analysis (continued)

The following tables provides an indication for the Company of some of the single factor changes adopted within the Group

Impact of a 10% change in Pounds Sterling against Danish Krone/Euro, Canadian Dollar or Swedish Krona on shareholders' funds

	10% strengthening in Pounds Sterling against Danish Krone / Euro	10% weakening in Pounds Sterling against Danish Krone / Euro	10% strengthening in Pounds Sterling against Canadian Dollar	10% weakening in Pounds Sterling against Canadian Dollar	10% strengthening in Pounds Sterling against SwedishKrona	10% weakening in Pounds Sterling against Swedish Krona
	£m	£m	£m	£m	£m	£m
Movement in shareholders' funds at 31 December 2013	**(55)**	**67**	**(45)**	**55**	**(36)**	**44**
Movement in shareholders' funds at 31 December 2012	(57)	70	(52)	64	(51)	62

Impact on fair value of investments (note 1 and note 4)

	Increase/(decrease)	
	2013	2012
	£m	£m
Interest rate markets (note 2)		
Impact on fixed interest securities of increase in interest rates of 100bps	**(160)**	(152)
Decrease of equity markets (note 3)		
Direct impact on equities of a 15% fall in equity markets	**(39)**	(38)
Mitigating impact arising from derivatives held	**28**	28
Property markets (note 3)		
Decrease of property markets of 15%	**(46)**	(46)

Notes

1 This analysis assumes that there is no correlation between equity price interest rate and property market rate risks It also assumes that all other assets and liabilities remain unchanged and that no management action is taken This analysis does not represent management's view of future market change, but reflects management's view of key sensitivities

2 The sensitivity of the fixed interest securities of the Company has been modelled by reference to a reasonable approximation of the average interest rate sensitivity of the investments held within each of the portfolios

3 The effect of movements in equity and property markets is reflected as a one time decrease of worldwide equity and property markets on 1 January 2014 and 1 January 2013 which results in a 15% decline in the value of the Company's assets in these investment categories

4 This analysis has not considered the impact of the above market changes on the valuation of the Company's insurance contract liabilities or retirement benefit obligations

5 This analysis is presented gross of the corresponding tax credits/(charges)

Liquidity risk

Liquidity risk is the risk that the Company may unable to pay obligations when due as a result of assets not being available in a form that can be immediately converted into cash The investment risk limits set by the BRC ensure that a large part of the Company's portfolio is kept in highly liquid marketable securities sufficient to meet its liabilities as they fall due based on actuarial assessment and allowing for contingencies The limits are monitored at a Group level as part of the Group Risk exposure monitoring and BRC reporting process In addition the Company has committed credit facilities available as set out in note 26

Maturity periods or contractual repricing

The following table summarises the contractual repricing or maturity dates (whichever is earlier) for financial liabilities that are subject to fixed and variable interest rates Insurance contract liabilities are also presented and are analysed by remaining duration until settlement

	Less than one year	One to two years	Two to three years	Three to four years	Four to five years	Five to ten years	Total	Balance sheet carrying value
	£m	£m	£m	£m	£m	£m	£m	£m
2013								
Financial liabilities								
Subordinated liabilities	-	-	-	-	-	492	492	492
Amounts owed to Group undertakings	7,223	-	-	-	-	-	7,223	7,223
Amounts owed to credit institutions	364	-	-	-	-	-	364	364
Derivative trading liabilities	64	2	-	-	-	-	66	66
Direct insurance creditors	118	1	-	-	-	-	119	119
Reinsurance creditors	226	-	1	-	-	-	227	227
Total	7,995	3	1	-	-	492	8,491	8,491
Interest on subordinated liabilities	46	46	46	46	46	46	276	-

	Less than one year	One to two years	Two to three years	Three to four years	Four to five years	Five to ten years	Total	Balance sheet carrying value
	£m	£m	£m	£m	£m	£m	£m	£m
2012								
Financial liabilities								
Subordinated liabilities	-	-	-	-	-	492	492	492
Amounts owed to Group undertakings	6,896	-	-	-	-	-	6,896	6,896
Amounts owed to credit institutions	348	-	-	-	-	-	348	348
Derivative trading liabilities	49	-	-	-	-	-	49	49
Direct insurance creditors	119	4	-	-	-	-	123	123
Reinsurance creditors	139	9	2	4	-	-	154	154
Total	7,551	13	2	4	-	492	8,062	8,062
Interest on subordinated liabilities	46	46	46	46	46	92	322	-

Operational risk

Operational risk is the risk of direct or indirect losses resulting from human factors, external events and inadequate or failed internal processes and systems Operational risks are inherent in the Company's operations and are typical of any large enterprise Major sources of operational risk can include operational process reliability, information security, outsourcing of operations, dependence on key suppliers, implementation of strategic and operational change, integration of acquisitions, fraud, human error, customer service quality, inadequacy of business continuity arrangements, recruitment, training and retention of staff, and social and environmental impacts

The Company manages operational risk using a range of techniques and tools to identify, monitor and mitigate its operational risk in accordance with Group's risk appetite These tools include Risk and Control Self Assessments, Key Risk Indicators (e g fraud and service indicators), Scenario Analyses and Loss Reporting In addition, the Group has developed a number of contingency plans including Incident Management and Business Continuity Plans Quantitative analysis of operational risk exposures material to the Company is used to inform decisions on the overall amount of capital held and the adequacy of contingency arrangements

Reputational risk

Reputational risk is the current or prospective risk to earnings and capital arising from adverse perception of the image of RSA on the part of customers, counterparties, shareholders, investors or regulators The External Communications team keeps under constant review the threats to RSA's reputation, both internal and external, and the Risk function works with them to promote a culture of responsibility from the front line businesses to the Board The tools used include a reputational risk register, clear and simple processes, training, external threat and perception monitoring and crisis management plans

Strategic risk

Strategic risk is the current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes This risk is a function of the compatibility of an organisation's strategic goals, the business strategies developed to achieve those goals, the resources deployed against these goals, and the quality of implementation The strategic risk profile is kept under continuous review by the Group Executive Committee and forms a key element of quarterly Board Risk Committee meetings

Capital management

The Company is the major UK insurer within the group of companies (the 'Group') controlled by RSA Insurance Group plc and is regulated by the Prudential Regulation Authority ('PRA') and Financial Conduct Authority ('FCA')

Own Risk and Solvency Assessment (ORSA)

The Solvency II directive introduces a requirement for undertakings to conduct an ORSA In anticipation of this requirement the Group has updated its risk and capital management processes

The Group defines its ORSA as a series of inter-related activities by which it establishes

- The quantity and quality of the risks which it seeks to assume
- The level of capital required to support those risks
- The actions it will take to achieve and maintain the desired levels of risk and capital

The assessments of how much risk to assume and how much capital to hold are inextricably linked In some situations, it may be desirable to increase the amount of risk assumed or retained in order to make the most efficient use of capital available or else to return excess capital to capital providers In other situations, where the risk assumed give rise to a capital requirement that is greater than the capital immediately available to support those risks, it will be necessary either to reduce the risk assumed or to obtain additional capital

The assessment of risk and solvency needs is in principle carried out continuously In practice, the assessment consists of a range of specific activities and decisions carried out at different times of the year as part of an annual cycle, supplemented as necessary by ad hoc assessments of the impact of external events and developments and of internal business proposals

Papers are presented to the Board throughout the year dealing with individual elements that make up the ORSA The information contained in those papers and the associated decisions taken are summarised in an annual ORSA report

Capital appetite

The Group and the Company's objective is to maintain sufficient capital, which comprises shareholders' equity and subordinated loan capital, to meet its plan and objectives This represents sufficient surpluses for both regulatory and economic capital as well as sufficient capital to support the Group's and the Company's aim of maintaining single 'A' ratings To assist in managing its capital position, the Group has set internal target coverage ratios for each of the principal capital measures

The Group's regulated entities hold appropriate levels of capital to satisfy applicable local regulations In certain instances this could restrict the subsidiaries' ability to transfer funds to the UK parent where retained earnings form part of the local required regulatory capital Additionally regulation in certain countries in which the Group's subsidiaries operate may also impose other limitations such as foreign exchange control restrictions

Economic capital

Economic capital is the Group's preferred measure of capital sufficiency It is the Group's own assessment of the amount of capital it needs to hold to meet its obligations given the Group's risk appetite Assets and non-insurance liabilities are valued on an economic basis providing the most realistic representation of the Group's financial position

The economic capital analysis compares available capital with the economic capital assessment (ECA) Available capital is the capital (over and above the IFRS insurance liabilities) that is available to absorb losses It includes subordinated debt, but excludes items such as goodwill and other intangible assets, deferred tax items and pension scheme surpluses and deficits ECA is the capital required at a confidence level equivalent to Standard & Poor's long term A rated bond default curve At 31 December 2013, the Group's surplus economic capital calibrated

Economic capital (continued)

to Standard & Poor's long term A rated bond default curve was approximately **£0.7bn** (2012 £0 7bn)

The position was adversely impacted in the year by falling yields and increased acquisitions offset by an improvement in expected future retained profits

The economic capital model is used to support, inform and improve the Group's decision making across the Group It is used to determine the Group's optimum capital structure, its investment strategy, its reinsurance programme and to determine the pricing and target returns for each portfolio The economic capital model is also used for the Group's Individual Capital Assessment (ICA) The only adjustment made is to use the PRA's required calibration

Regulatory solvency position

The Group and Company remain compliant with both the PRA's risk based ICA methodology and Solvency I

As at 31 December 2013 the Group and Company have an unaudited Solvency 1 surplus of approximately **£0.2bn** *(2012 £1 2bn)* and **£0.3bn** *(2012 £1 2bn)* respectively The coverage ratio for the Company stood at approximately 1 2 times at 31 December 2013 *(2012 1 7 times)*

The Group and Company received their latest Individual Capital Guidance (based on their ICA submission) from the PRA in February 2014 and at the request of the PRA remains confidential The ICA is a forward looking, economic assessment of the capital requirements of the Group and Company based on the assessment of the risks to which it is exposed The models used to determine the ICA have been integrated into the Group's business processes and are used to enhance the management of the Group

4. Reorganisation costs and other items

The Technical account includes

	2013 **£m**	2012 £m
Reorganisation costs	**15**	13
Operating lease rentals – equipment	**1**	1
Impairment of tangible assets	**25**	-

Reorganisation costs comprised employee redundancy costs, vacant lease accruals and other restructuring expenses

5. Exchange rates

The rates of exchange used in these accounts in respect of the major overseas currencies are

	2013 Cumulative Average	**2013 End of Period**	2012 Cumulative Average	2012 End of Period
Euro	**1 18**	**1.20**	1 23	1 23
US Dollar	**1 56**	**1.66**	1 59	1 63
Hong Kong Dollar	**12.13**	**12.84**	12 30	12 60
Singapore Dollar	**1.96**	**2.09**	1 98	1 99

6. Segmental information

(a) by class of business

	Accident & Health	Motor	Fire & Property	Marine Aviation & Transport	Third Party Liability	Assistance	Other	Re-insurance	Total
2013	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Gross premiums written	**49**	**1,022**	**1,507**	**395**	**425**	**20**	**270**	**533**	**4,221**
Gross premiums earned	**56**	**967**	**1,511**	**365**	**453**	**21**	**273**	**487**	**4,133**
Gross claims incurred	**(32)**	**(796)**	**(704)**	**(276)**	**(506)**	**(6)**	**(155)**	**(271)**	**(2,746)**
Gross operating expenses	**(15)**	**(231)**	**(614)**	**(77)**	**(170)**	**(7)**	**(92)**	**(146)**	**(1,352)**
Gross technical result	**9**	**(60)**	**193**	**12**	**(223)**	**8**	**26**	**70**	**35**
Reinsurance balance	**-**	**(28)**	**(178)**	**(6)**	**19**	**-**	**(11)**	**(40)**	**(244)**
Net technical result	**9**	**(88)**	**15**	**6**	**(204)**	**8**	**15**	**30**	**(209)**

	Accident & Health	Motor	Fire & Property	Marine Aviation & Transport	Third Party Liability	Assistance	Other	Re-insurance	Total
2012	£m	£m	£m	£m	£m	£m	£m	£m	£m
Gross premiums written	44	1,022	1,565	371	467	27	285	512	4,293
Gross premiums earned	44	984	1,516	364	480	28	268	384	4,068
Gross claims incurred	(13)	(882)	(672)	(283)	(318)	(9)	(160)	(246)	(2,583)
Gross operating expenses	(15)	(197)	(633)	(135)	(191)	(11)	(78)	(133)	(1,393)
Gross technical result	16	(95)	211	(54)	(29)	8	30	5	92
Reinsurance balance	(4)	(10)	(205)	30	(43)	-	1	(28)	(259)
Net technical result	12	(105)	6	(24)	(72)	8	31	(23)	(167)

All of the business above relates to general insurance which is considered to be the only business segment

(b) by geographical segment

	2013	2012
	£m	£m
Gross premiums written for direct business by origin		
UK	**3,168**	3,291
Other EEA	**341**	320
Other	**179**	170
	3,688	3,781

Gross premiums are disclosed by origin There is no material difference between the amounts shown and those by reference to destination (i e location of risk)

Total commissions for direct insurance business accounted for by the Company during the year amounted to **£616m** *(2012 £729m)*

7. Auditors Remuneration

Fees payable to KPMG LLP for the audit of the Company's annual accounts was **£1,030,875** *(2012 Deloitte LLP £40,000)* Details of non-audit fees payable to KPMG LLP are disclosed in the RSA Insurance Group plc 2013 Annual Report & Accounts Audit fees of £154,125 *(2012 Deloitte LLP £171,250)* are also paid by RSAIplc on behalf of certain subsidiary undertakings

8. Directors' emoluments

	2013 £000	2012 £000
The aggregate emoluments of the directors, including amounts received from subsidiaries, were as follows		
Salaries and bonuses	**2,498**	3,896
Allowances, benefits and other awards	**515**	662
	3,013	4,558

The criteria for making bonus awards is based on targeted levels of business sector profit and specific business objectives As at 31 December 2013, there was an interest free loan of £5,000 outstanding to A P Brown under the standard terms of the Group's UK Car Ownership Scheme, which is open to all UK managers within a qualifying salary band At the date of his appointment as a director and at 31 December 2013, C J R Rash had a loan outstanding from the Company of £12,000 The loan was provided to cover personal tax paid but recoverable relating to his employment with a subsidiary of the Company for which the terms of the loan were agreed prior to the appointment of C J R Rash as director The loan has been repaid in January 2014

	2013 £000	2012 £000
The emoluments of the highest paid director (S P G Lee) were		
Salary, bonus, allowances, benefits and other awards	**1,009**	1,516

At 31 December 2013 the highest paid director had accrued annual pension of **£nil** *(2012 £nil)* This figure is based on the amount of annual pension which would be payable on his attaining normal pension age if he had left the Company's service on 31 December 2013

Retirement benefits accrued under defined benefit schemes for C J R Rash who served during the year In 2012 benefits accrued for I A Craston Contributions of **£84,502** *(2012 £108,856)* were made to Group defined contribution schemes during the year in respect of the directors

Four directors have exercised share options and have had share awards which vested during the relevant period

The highest paid director (S P G Lee) exercised share options and shares were received in respect of qualifying services under a long term incentive plan

S P G Lee resigned as a director and his employment ended on 12 December 2013 In line with his contractual agreement, he was entitled to receive a payment in lieu of twelve months' notice, paid in monthly instalments A portion of this payment, £40,144, was paid for the period from 12 December to 31 December 2013 He was also paid £31,693 in lieu of annual leave days not taken during 2013

9. Employees and staff costs

	2013 £m	2012 £m
Wages and salaries	**360**	347
Social security costs	**40**	38
Other pension costs	**49**	16
	449	401

Other pension costs include only those items included within operating costs Items reported elsewhere have been excluded

The average monthly number of persons (including executive directors) employed by the Company during the year was	2013	2012
UK	**7,920**	8,317
Other EEA	**243**	244
Other	**320**	280
	8,483	8,841

10. Retirement benefits

The Company operates defined contribution pension schemes and funded and unfunded defined benefit pension schemes The assets of the funded schemes are held mainly in separate trustee administered funds

In April 2002, the defined benefit schemes were effectively closed to new entrants following the introduction of a new, primarily defined contribution, scheme (the 2002 scheme) However, due to a small defined benefit underpin, the 2002 Scheme is still disclosed as a defined benefit scheme

In 2005, following discussions with the Trustees and consultation with the members, the defined benefit schemes were altered from providing benefits on a final salary basis to benefits on a revalued average salary basis with effect from 1 January 2006 Under the new benefit formula, the accrued benefits of current active members are based on salaries at the date of change and will increase in line with inflation each year (limited to 5% in any year) up to their retirement date Benefits earned in each year from 1 January 2006 are based on salaries in that year and are revalued up to retirement

In addition to these changes, the 2002 scheme (which was the scheme to which new UK employees had been admitted following the closure of the defined benefit schemes to new members) has been closed to further accrual from 1 January 2006 It has been replaced by a stakeholder arrangement and members of the 2002 Scheme and future new employees in the UK accrue future benefits on a defined contribution basis under the stakeholder scheme In 2013 contributions of **£18m** *(2012 £18m)* were made to defined contribution schemes in the United Kingdom

During 2009 the Company entered into arrangements that insured 55% of the retirement obligations relating to pensions in payment in the two main UK schemes The arrangements comprise assets and interest rate swaps combined with an insurance contract that provide for the full payment of the pensions in return for the actual investment return on a segregated portfolio of assets held by the pension funds at the inception of the arrangement The pension schemes continue to benefit from the assets held in the portfolio and retain the obligation to meet the insured pension obligations The assets and pension obligations are therefore not derecognised in the financial statements and an asset (representing the recovery of the insured pension obligations) and a liability (to pay the investment return on the portfolio of assets to the insurer) are recognised

During 2010 changes were made to the benefit structure of the three main UK schemes Changes affected future accrual from 1 March 2010 onwards Accrual rates were reduced, the retirement age was increased, revaluation was subject to a cap of 2 5%, a cap was applied to the salary used for the defined benefit schemes and the schemes contracted back into the State scheme Employees were entitled to join the stakeholder scheme for earnings above the cap

10. Retirement benefits (continued)

For the three main UK defined benefit schemes, the level of contributions in 2013 were **£92m** *(2012 £97m)* of which **£65m** *(2012 £70m)* were additional contributions in line with the plan to reduce their funding deficits Expected contributions to the three schemes for the year ending 31 December 2014 are approximately £83m, including £64m of additional contributions to reduce the deficit Further additional contributions may become due once the results of the March 2015 funding valuations are known (results expected in 2016)

The components of the defined benefit pension cost that are included within profit before tax in the financial statements are as follows

	2013	2012
	£m	£m
Current service cost	**17**	19
Past service cost	**5**	1
Total charge included in profit before tax	**22**	20
Expected return on assets	**(243)**	(288)
Interest cost on pension scheme liabilities	**252**	266
Total financing charge/(credit) included in profit before tax	**9**	(22)

The schemes are effectively closed to new entrants The current service cost, under the projected unit method, measured as a percentage of active members' salaries, is likely to rise as the members' age profile increases

Amounts recognised within the statement of total recognised gains and losses

	2013	2012	2011	2010	2009
	£m	£m	£m	£m	£m
Actual return on assets in excess/(deficit) of expected return on assets	**72**	226	386	244	(413)
Experience (losses)/gains on liabilities	**16**	(28)	(70)	(43)	116
Change in actuarial assumptions underlying the present value of scheme liabilities	**(237)**	(358)	(364)	(82)	(644)
Actuarial (loss)/gain	**(149)**	(160)	(48)	119	(941)
Deferred taxation	**25**	35	10	(35)	263
Recognised in the statement of total recognised gains and losses	**(124)**	(125)	(38)	84	(678)

Movement in deficit during the year	**2013**	2012
	£m	£m
Deficit at 1 January	**(149)**	(89)
Total operating charge	**(22)**	(20)
Employer contribution	**94**	98
Total financing credit	**(9)**	22
Actuarial (loss)/gain	**(149)**	(160)
Deficit at 31 December	**(235)**	(149)

The value of the defined benefit liability that is included at 31 December in the financial statements is as follows

	2013	2012
	£m	£m
Equities	**1,062**	993
Bonds	**4,925**	4,705
Other	**180**	563
Present value of funded obligations fully covered by insurance arrangement	**1,561**	1,544
Value of obligations under insurance arrangement	**(1,721)**	(1,969)
Fair value of assets held by pension schemes	**6,007**	5,836
Present value of pension liabilities	**(6,242)**	(5,985)
Net deficit	**(235)**	(149)
Related deferred tax asset	**47**	35
Pension fund asset	**2**	29
Pension fund liability	**(190)**	(143)
Net pension liability	**(188)**	(114)

10. Retirement benefits (continued)

Included in the profit and loss account reserve is a pension and post retirement reserve on a FRS 17 basis at 31 December 2013 of **£(955)m** *(2012 £(831)m)*

The following is a reconciliation of the Company's retirement benefit obligations

	2013 £m	2012 £m
Retirement benefit obligations at 1 January	**5,985**	5,544
Current service costs	**17**	19
Past service costs	**5**	1
Interest costs	**252**	266
Actuarial loss on obligations	**221**	386
Benefits paid	**(238)**	(231)
Retirement benefit obligations at 31 December	**6,242**	5,985

The following is a reconciliation of the Company's pension schemes' assets

	2013 £m	2012 £m
Pension schemes' assets at 1 January	**5,836**	5,455
Return on schemes assets	**315**	514
Contributions by the employer	**94**	98
Benefits paid	**(238)**	(231)
Pension schemes' assets at 31 December	**6,007**	5,836

Additional information for the current annual period and previous four annual periods

	2013 £m	2012 £m	2011 £m	2010 £m	2009 £m
At 31 December					
Present value of defined benefit obligations	**6,242**	5,985	5,544	5,046	4,835
Fair value of plan assets	**6,007**	5,836	5,455	4,927	4,523
(Deficit)/surplus	**(235)**	(149)	(89)	(119)	(312)
Experience adjustments on plan liabilities	**16**	(28)	(70)	(43)	116
Experience adjustments on plan assets	**72**	226	386	244	(413)

The principal actuarial assumptions used were as follows

	2013 %	2012 %
Assumptions used in calculation of retirement benefit obligation		
Interest rate used to discount liabilities	4 6	4 3
Annual rate of general inflation	3 3	2 5
Annual rate of increase in salaries	3 3	2 6
Annual rate of increase in pensions	3 2	2 5
Assumptions used in calculation of profit & loss account credit/charge in year		
Discount rate	4 3	4 9
Expected return on		
Equities	6 0	8 0
Bonds	3 4	4 3
Other	4 9	4 9

The expected return on schemes' assets are determined for each asset class by considering both market conditions at the beginning of the reporting period and any expectations for longer term changes in current returns All returns are net of investment expenses

Retirement benefit obligations comprise unfunded schemes **£10m** (*2012 £10m*) and funded schemes **£6,232m** (*2012 £5,975m*)

Mortality rate

The mortality assumptions are set following investigations of the main schemes' recent experience by the schemes' actuaries for the funding valuations At the funding valuation in March 2012, the mortality assumptions adopted for the main UK schemes used the

10. Retirement benefits (continued)

Mortality rate (continued)

SAPS Light Normal base table with percentage adjustments to reflect the schemes' recent experience compared with that expected under these tables The next funding valuation has an effective date of March 2015, with results expected in 2016

Reductions in future mortality rates are allowed for using the CMI 2011 tables with a long term rate of 0 85% The weighted average assumptions imply that a current pensioner aged 60 has an expected future lifetime of **27.6** *(2012 27 6)* years (males) and **29.2** *(2012 28 2)* years (females) and a future pensioner aged 60 in 15 years time has a future expected lifetime from age 60 of **28.3** *(2012 28 3)* years (males) and **30 0** *(2012 28 7)* years (females)

Commutation

Each of the UK defined benefit pension schemes has changed its rules to allow for increased commutation following 'A day' in April 2006 In 2012 and 2013, the Group followed the funding valuation assumptions, and an allowance was made for future commutation using the current commutation factors

Sensitivity analysis

The discount rate, the assumed inflation rate and the mortality assumptions all have a significant effect on the FRS 17 accounting valuation A 0 25% increase in the discount rate would reduce the defined benefit obligations in the UK not covered by the insurance arrangement by **£168m** *(2012 £153m)* A 0 25% increase in the inflation rate assumption would increase the defined benefit obligations in the UK not covered by the insurance arrangement by **£120m** *(2012 £110m)* An increase of one year in life expectancy would increase the defined benefit obligations in the UK not covered by the insurance arrangement by approximately **£98m** *(2012 £97m)*

11. Share based payment

The RSA Insurance Group (the Group) has three types of share based payment plans in which employees of the Company participate and which are settled in the form of ordinary shares the Long Term Incentive Plan (LTIP), the Sharesave Plan (SAYE), the Sharebuild Plan Dilution levels for all schemes are held strictly within Association of British Insurers limits Further information on the LTIP scheme is included below and information on the other share schemes can be found in the remuneration report in the Annual Report and Accounts of the Group

The total employment cost recorded in the profit and loss account for all plans is **£6m** in 2013 *(2012 £4m)*

Analysis of share scheme costs (per profit and loss account)

	2013 £m	2012 £m
LTIP	**2**	-
SAYE	**2**	2
Sharebuild	**2**	2
Total	**6**	4

The value of the awards granted during 2013 is **£10m** *(2012 £8m)* of which **£2m** *(2012 £2m)* is charged to the profit and loss account The balance of the value of the awards will be charged to the profit and loss account during the remaining vesting periods

Analysis of new awards costs

	2013		2012	
	Charge for year £m	**Total value £m**	Charge for year £m	Total value £m
LTIP	**2**	**7**	2	6
SAYE	**-**	**1**	-	-
Sharebuild	**-**	**2**	-	2
Total	**2**	**10**	2	8

Long Term Incentive Plan

The Long Term Incentive Plan (LTIP) for Executive Directors and other selected executives was adopted following approval obtained at the Group's 2006 AGM Awards have been made each year since 2006 following shareholder approval

11. Share based payment (continued)

Long Term Incentive Plan (continued)

The structure of the plan allows for a number of different types of awards to be made

Voluntary Invested Deferred Shares are purchased by participants from net bonus payable (limited to a maximum value of 33% of net bonus) Voluntary Invested Deferred Shares are held in trust for three years

In addition, for senior executives, the Remuneration Committee may defer a portion of an individual's gross bonus (limited to 33% of that bonus) into an award over shares referred to for the purpose of the plan as Compulsory Deferred Shares Compulsory Deferred Shares awards are normally forfeited on an employee leaving the Company No further performance conditions apply

The Remuneration Committee may make a conditional award of shares on a 'matched' basis to Voluntary Invested and Compulsory Deferred Shares ('Matching Shares') up to a maximum of 2 1 and these are normally forfeited on an employee leaving the Company

Additionally, the Remuneration Committee may make conditional awards of Performance Shares to senior executives and conditional awards of Restricted Shares to other executives and senior managers

Awards of Performance Shares and Matching Shares related to Compulsory Deferred Shares are subject to a performance condition consisting of a combination of a return on equity target and a total shareholder return target (with performance measured by comparison against other European insurance companies) over a single three year performance period Matching Shares related to Voluntary Invested Deferred Shares are subject only to the return on equity performance condition Restricted Shares are not subject to performance conditions All awards vest on the third anniversary of the date of grant to the extent that the performance conditions have been met Performance Shares and Restricted Shares are normally forfeited on an employee leaving the Company

Further information on the LTIP (including details of a proposed new long term incentive plan) can be found in the Remuneration Report within the Corporate Governance section of the Annual Report and Accounts of the Group Further disclosures in respect of the SAYE and Sharebuild schemes have not been made on the grounds that the schemes are immaterial to the Company

12. Investment income, expenses and charges

	Investment income		**Net realised gains/(losses)**		**Net unrealised gains/(losses)**		**Total investment return**	
	2013 £m	2012 £m	**2013 £m**	2012 £m	**2013 £m**	2012 £m	**2013 £m**	2012 £m
Investment income								
Investment property	**23**	23	**5**	-	**(7)**	(25)	**21**	(2)
Equity securities	**22**	31	**8**	37	**(6)**	(3)	**24**	65
Debt securities	**121**	121	**1**	4	**(111)**	82	**11**	207
Other investments								
Loans to subsidiaries	**3**	3	**-**	-	**-**	-	**3**	3
Other	**3**	2	**-**	-	**-**	-	**3**	2
Deposits, cash at bank and in hand	**1**	3	**-**	-	**(2)**	-	**(1)**	3
Derivatives	**1**	1	**(14)**	6	**(9)**	(8)	**(22)**	(1)
	174	184	**-**	47	**(135)**	46	**39**	277
Dividends from subsidiary undertakings	**435**	606	**-**	-	**-**	-	**435**	606
	609	790	**-**	47	**(135)**	46	**474**	883
Revaluation of subsidiary undertakings	**-**	-	**-**	-	**-**	(187)	**-**	(187)
Investment expenses, charges and interest								
Interest on bank loans and overdrafts							**(3)**	(3)
Interest on other loans							**(97)**	(110)
Investment management expenses							**(7)**	(7)
Unwind of discount							**(3)**	(2)
							(110)	(122)
Net investment return							**364**	574

13. Taxation

The credit for taxation in the profit and loss account comprises

	2013 £m	2012 £m
Current tax		
UK Corporation tax	**(4)**	(6)
Overseas taxation	**4**	7
Adjustments in respect of prior periods	**(7)**	(11)
Total current tax	**(7)**	(10)
Deferred tax		
Timing differences – origination and reversal	**(59)**	(14)
Adjustments in respect of prior periods	**(5)**	3
Adjustment for change in tax rates	**25**	14
Total deferred tax	**(39)**	3
Tax credit	**(46)**	(7)

UK corporation tax for the current year is based on a rate of **23.25%** *(2012 24 5%)*

Factors affecting the current tax (credit)/charge

The current tax (credit)/charge for the year is less than **23.25%** *(2012 less than 24 5%)* due to the items set out in the reconciliation below

	2013 £m	2012 £m
Profit on ordinary activities before tax	**128**	406
Tax at **23 25%** *(2012 at 24 5%)*	**30**	99
Factors affecting (credit)/charge		
Expenses not deductible for tax purposes	**13**	44
Tax exempt income and investment gains/losses	**(106)**	(155)
Fiscal adjustments	**(13)**	(19)
Adjustment to tax charge in respect of previous periods	**(7)**	(11)
Group relief surrendered without payment	**8**	9
Unrelieved foreign tax credits	**1**	8
Other timing differences	**67**	15
Current tax (credit)/charge for the year	**(7)**	**(10)**

Other debtors includes **£29m** *(2012 £34m)* in respect of corporation tax receivable

14. Dividends

	2013 £m	2012 £m
Paid **8.87p** *(2012 Nil)* interim dividend per ordinary share	**400**	-

15. Intangible assets

	Goodwill on acquisition 2013 £m	Renewal rights 2013 £m	Total 2013 £m
Cost			
At 1 January	**28**	**18**	**46**
Additions	**-**	**-**	**-**
At 31 December	**28**	**18**	**46**
Amortisation			
At 1 January	**(10)**	**(10)**	**(20)**
Charge for the year	**(2)**	**(5)**	**(7)**
At 31 December	**(12)**	**(15)**	**(27)**
Net book value			
At 31 December 2013	**16**	**3**	**19**
At 31 December 2012	18	8	26

16. Investments

	2013 £m	2012 £m
Land and buildings		
Freehold	**288**	278
Long leasehold	**18**	37
Short leasehold	**-**	2
Total land and buildings	**306**	317
Of which Group occupied	**20**	11

Movement in the carrying value of land and buildings is detailed below

	2013 £m	2012 £m
Land and buildings at 1 January	**317**	342
Sales	**(36)**	-
Purchases	**32**	-
Fair value losses	**(7)**	(25)
Land and buildings at 31 December	**306**	317

The historical cost of property at 31 December is **£355m** *(2012 £363m)*

	2013 £m	2012 £m
Other financial investments		
Shares and other variable yield securities and units in unit trusts	**362**	402
Debt securities and other fixed income securities		
British government securities	**926**	1,183
Other government securities	**162**	168
Corporate bonds	**2,193**	2,024
At fair value through profit or loss (designated as such upon initial recognition)	**3,643**	3,777
Loans and deposits with credit institutions		
Other loans	**11**	13
Deposits with credit institutions	**63**	63
Loans and receivables	**74**	76
Total other financial investments	**3,717**	3,853

16. Investments (continued)

	2013 £m	2012 £m
Listed investments		
Included in total investments are the following		
Shares and other variable yield securities and units in unit trusts	**287**	311
Debt securities and other fixed income securities	**2,820**	2,828
	3,107	3,139

Included within shares and other variable yield securities and units in unit trusts above are ordinary shares in RSA Insurance Group plc, the Company's ultimate parent, held by the Royal & Sun Alliance ESOP Trust and Royal & Sun Alliance ESOP Trust No 2, which have a carrying value of **£0.2m** (2012 £1m)

The historical cost of total investments is **£4,017m** *(2012 £4,006m)*

The property valuations have been prepared on the basis of open market value at the balance sheet date in accordance with The Royal Institute of Chartered Surveyors' Appraisal and Valuation Manual by Messrs Jones Lang LaSalle, external qualified valuation surveyors

Fair value measurements recognised in the balance sheet

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable

	Fair value hierarchy			
	Level 1	**Level 2**	**Level 3**	**Total**
	2013	**2013**	**2013**	**2013**
	£m	**£m**	**£m**	**£m**
Financial assets at fair value through the profit and loss account				
Equity securities	**303**	**-**	**59**	**362**
Debt securities	**3,188**	**91**	**2**	**3,281**
	3,491	**91**	**61**	**3,643**
Derivative assets	**58**	**-**	**-**	**58**
Derivative liabilities	**(66)**	**-**	**-**	**(66)**
Total	**3,483**	**91**	**61**	**3,635**

	Fair value hierarchy			
	Level 1	Level 2	Level 3	Total
	2012	2012	2012	2012
	£m	£m	£m	£m
Financial assets at fair value through the profit and loss account				
Equity securities	364	-	38	402
Debt securities	3,280	93	2	3,375
	3,644	93	40	3,777
Derivative assets	44	-	-	44
Derivative liabilities	(50)	-	-	(50)
Total	3,638	93	40	3,771

None of the Company's insurance liabilities are measured at fair value There were no transfers between Level 1 and Level 2 during the year

16. Investments (continued)

A reconciliation of Level 3 fair value measurements of financial assets is shown in the table below There are no financial liabilities measured at fair value using Level 3 fair value measurements

	Equity securities £m	Debt securities £m	Total £m
Balance at 1 January 2012	25	3	28
Total gains or losses recognised in the profit and loss account	6	(1)	5
Purchases	7	-	7
Disposals	-	-	-
Balance at 31 December 2012	38	2	40
Total gains or losses recognised in the profit and loss account	(4)	-	(4)
Purchases	25	-	25
Balance at 31 December 2013	**59**	**2**	**61**

There were no transfers into or out of Level 3 during the period Of the total gains or losses for the period (shown in the reconciliation above) included in the profit and loss account, a loss of **£4m** *(2012 £5m)* relates to assets held at the end of the reporting period

17. Investment in subsidiary undertakings

The Company's principal subsidiaries at 31 December 2013 are set out in note 34 The companies are principally all engaged in the transaction of insurance or related business The countries shown are those of incorporation and principal operation The figure for shares in subsidiaries in the balance sheet comprises

	2013 £m	2012 £m
Net asset value:		
At 1 January	**10,676**	10,733
Acquisitions	**243**	130
Disposals	**(38)**	-
Revaluation	**(652)**	(187)
At 31 December	**10,229**	10,676

The historical cost of investments in subsidiaries is **£11,728m** *(2012 £11,523m)*

Acquisitions of £243m in 2013 comprise capital injections of £10m, £6m, £7m and £220m into The Marine Insurance Company Limited, Intouch Insurance Group BV, Westgate Properties Limited and RSA Insurance Ireland Ltd respectively Disposals of £38m relates to the liquidation of Martello Underwriting Limited

18. Interests in associated undertakings

The Company has a 26 0% holding of ordinary shares in Royal Sundaram Alliance Insurance Limited, which operates and is incorporated in India During the year, Royal Sundaram Alliance Insurance Limited undertook a fund raising exercise in which the Company participated fully at a cost of £1 3m, maintaining its 26% holding

	2013 £m	2012 £m
Net asset value:		
At 1 January	**14**	11
Foreign exchange losses	**(2)**	(1)
Acquisitions	**1**	2
Revaluations	**2**	2
At 31 December	**15**	14

The historical cost of interests in associated undertakings is **£19m** *(2012 £17m)*

19. Tangible assets

	Equipment 2013 £m	Computer software 2013 £m	Total 2013 £m
Cost			
At 1 January	**65**	**208**	**273**
Additions	**3**		**3**
Disposals	**-**	**-**	**-**
At 31 December	**68**	**208**	**276**
Depreciation			
At 1 January	**(30)**	**(102)**	**(132)**
Charge for the year	**(8)**	**(26)**	**(34)**
Impairment charge	**-**	**(25)**	**(25)**
Disposals		**-**	
At 31 December	**(38)**	**(153)**	**(191)**
Net book value			
At 31 December 2013	**30**	**55**	**85**
At 31 December 2012	35	106	141

20 Share capital

	2013 £m	2012 £m
Allotted, issued and fully paid up:		
4,511,091,326 *(2012 4,511,091,326)* ordinary class A shares of 25p each	**1,128**	1,128
1 *(2012 1)* ordinary class B share of US$1	**-**	-

The Company has two classes of shares, ordinary Class A shares of 25p each and ordinary Class B share of US$1 Each ordinary Class A share carries the right to one vote at general meetings of the Company, the right to receive dividend payments in accordance with the number of shares held and the right to participate in any distribution of capital of the Company including on a winding-up Each ordinary Class B share carries no voting rights and no right to a dividend, but carries the right on winding-up of the Company to a distribution in priority to the Class A shares equivalent to the US$/£ exchange rate gain as set out in the Articles of Association, payable in sterling or US Dollars

21. Subordinated loan notes

	2013 £m	2012 £m
Subordinated loan note equity instruments	**372**	372
Subordinated liabilities	**492**	492

Subordinated loan note equity instruments
On 1 December 2004, the Company obtained a subordinated loan from RSA Insurance Group plc, its ultimate parent company, of £294m, derived from the issue of £450m of subordinated guaranteed perpetual notes on 23 July 2004 The notes have an annual coupon of 8 50% The claims of the ultimate parent company on the loan are subordinated to the same extent as the claims of the holders of the notes The loan has no specified maturity

On 5 June 2006, the Company obtained a subordinated loan from RSA Insurance Group plc, its ultimate parent company, of £78m, derived from the issue of £375m of step up perpetual guaranteed subordinated capital securities on 12 May 2006 The notes have an annual coupon of 6 701% The claims of the ultimate parent company on the loan are subordinated to the same extent as the claims of the holders of the capital securities The loan has no specified maturity

Interest of **£23m** *(2012 £22m)* net of tax was paid during the year on the subordinated loan note equity instruments and has been recognised in the Reconciliation of movement in shareholders' funds on page 11

21. Subordinated loan notes (continued)

Subordinated liabilities

On 30 June 2009, The Company obtained a subordinated loan from RSA Insurance Group plc, its ultimate parent company, of £492m, derived from the issue of £500m of subordinated guaranteed step-up notes on 20 May 2009 The notes have an annual coupon of 9 375% The claims of the ultimate parent company on the loan are subordinated to the same extent as the claims of the holders of the notes The loan has a maturity date of 20 May 2039 At 31 December 2013 the fair value of the subordinated liabilities is **£589m** *(2012 £572m)*

22. Claims outstanding

Claims outstanding include claims on certain classes of business which have been discounted The total value of outstanding claims provisions less related reinsurance recoveries before discounting amounted to **£4,583m** *(2012 £4,693m)* The total value of gross outstanding claims provisions before discounting amounted to **£5,537m** *(2012 £5,731m)*

Claims are discounted as follows

		Discount rate		Average period to settlement in years	
		2013	2012	**2013**	2012
		%	%		
UK	Asbestos & Environmental	**4.00**	5 00	**12**	12

In the UK certain long tail liabilities are settled by an annuity This is contained within the discounted value of UK and Scandinavian annuities which is shown separately in note 20 of the Annual Report & Accounts of the Group

Prior year claims development

The movement in net incurred claims arising from the difference between the net claims provision at the beginning of the year, and subsequent payments and the claims provision at the end of the year, was a surplus of **£20m** *(2012 £64m)* The positive run-off reflects the Company's approach to setting reserves at a level which is more likely than not to run off favourably over the longer term

23. Equalisation provisions

	2013	2012
	£m	£m
Provision as at 1 January	**316**	286
Charged to the technical account - general business and in the profit on ordinary activities before tax	**3**	30
Provision as at 31 December	**319**	316

As explained in note 1b)ii, the effect of this provision is to decrease shareholders' funds by **£319m** *(2012 £316m)* The increase in the provision during the year had the effect of decreasing the balance on the technical account for general business and the profit on ordinary activities before taxation by **£3m** *(2012 £30m)*

24. Provisions for other risks

	2013 £m	2012 £m
At 1 January	**95**	93
Charged to Profit and Loss Account	**43**	55
Utilised	**(72)**	(43)
Released	**(21)**	(10)
At 31 December	**45**	95

Provisions include provisions of **£10m** *(2012 £39m)* held relating to vacant property leases, dilapidations and refurbishments, the costs relating to which will be borne across the period over which the leases expire, which is up to 20 years Provisions also include Motor Insurance Bureau provision of **£15m** *(2012 £18m)* and reorganisation provisions of **£9m** *(2012 £10m)*

25. Deferred tax

Deferred tax for the current year is based on a rate of 20% *(2012 23%)*

	2013 £m	2012 £m
Unrealised investment gains	**2**	5
Accelerated capital allowances	**71**	67
Other timing differences	**167**	114
Deferred tax asset	**240**	186

	2013 £m	2012 £m
Deferred tax asset at 1 January	**186**	166
Transfer in	**2**	-
Credit for the year – profit and loss account	**77**	34
Charge for the year – statement of total recognised gains and losses	**-**	-
Adjustment for change in tax rate – profit and loss account	**(25)**	(14)
Deferred tax asset at 31 December	**240**	186

At the balance sheet date, the Company had unused tax losses of **£1,990m** *(2012 £1,570m)* and unused tax credits of **£3.5m** *(2012 £2 6m)* available for offset against future profits A deferred tax asset of **£165m** *(2012 £90m)* has been recognised in respect of losses and **£3.4m** *(2012 £2m)* has been recognised in respect of tax credits included within other temporary differences at 31 December 2013 No deferred tax asset has been recognised in respect of the tax losses of **£1,207m** *(2012 £1,177m)* due to the unpredictability of future profit streams The losses may be carried forward indefinitely

Net deferred tax assets of **£287m** *(2012 £219m)*, which are in excess of profits arising from the reversal of existing taxable temporary differences and that relate to tax jurisdictions in which the Company has suffered a loss in either the current or preceding period, have been recognised on the basis that future taxable profits will be available against which these can be utilised The evidence for the future taxable profits is a forecast consistent with the three year operational plans prepared by the relevant businesses, which are subject to internal review and challenge Where relevant, the forecast includes extrapolations of the operational plans using assumptions consistent with those used in the plans

Total net deferred tax assets of **£287m** (*2012 - £221m*) includes **£47m** (*2012 - £35m*) of deferred tax asset in respect of the pension liability The increase in the deferred tax asset during the year in relation to the pension liability is **£12m** (*2012 - £12m*) of which **£(13)m** (*2012 - £(23)m*) is charged to the profit and loss account and **£25m** (*2012 - £35m*) credited to the statement of total recognised gains and losses

26. Borrowings

	2013 £m	2012 £m
Amounts owed to credit institutions	**364**	348

26. Borrowings (continued)

Borrowings comprise secured loans from credit institutions and bank overdrafts which are repayable on demand At 31 December 2013 and 2012 the Company had in place a one billion US Dollar Euro commercial paper programme There were no amounts outstanding at 31 December 2013 *(2012 £nil)*

27. Other creditors

Other creditors including taxation and social security includes **£nil** *(2012 £nil)* in respect of corporation tax payable

28. Operating lease rentals

Lease commitments in 2014, by term of lease

	Land & Buildings		Other	
	2013	2012	**2013**	2012
	£m	£m	**£m**	£m
Operating leases which expire				
Within one year	**9**	1	-	-
Within two and five years	**8**	21	-	-
After five years	**7**	3	-	-
	24	25	-	-

All material leases of land and buildings are subject to rent review periods of between three and five years

29. Capital commitments

The estimated amount of capital commitments contracted but not provided for in these financial statements is **£16m** *(2012 £50m)*

30 Contingent liabilities

Royal & Sun Alliance Insurance plc has guaranteed on behalf of RSA Insurance Group plc the following

- the US $24m 8 95% subordinated guaranteed bonds due 15 October 2029,
- the issue of £450m 8 50% subordinated guaranteed perpetual notes There is an option to call the notes on 8 December 2014 and every five years thereafter,
- the issue of £375m step up perpetual guaranteed subordinated capital securities There is an option to repay the bonds on specific dates starting 12 July 2017,
- the issue of £500m 9 375% subordinated guaranteed step-up notes There is an option to repay the notes on specific dates from 20 May 2019, and
- a £500m committed credit facility, of which £nil has been drawn

31. Cash flow statement

The Company is a wholly-owned subsidiary of RSA Insurance Group plc and the cash flows of the Company are included in the consolidated cash flow statement of RSA Insurance Group plc The Company has thus taken advantage of the exemption permitted by FRS 1 (revised 1996) 'Cash flow Statements' and has elected not to prepare its own cash flow statement

32. Related party transactions

Advantage has been taken of the exemption provided in FRS 8 'Related Party Disclosures' from disclosing details of transactions with RSA Insurance Group plc and its subsidiaries and associated undertakings

33. Parent companies

The Company's immediate parent company is Royal Insurance Holdings plc, which is registered in England and Wales

The Company's ultimate parent company and controlling party is RSA Insurance Group plc, which is registered in England and Wales and is the parent company of the smallest and largest group to consolidate these financial statements A copy of that company's accounts can be obtained from 9th Floor, One Plantation Place, 30 Fenchurch Street, London, EC3M 3BD or from www rsagroup com

34. Principal subsidiary companies

		Principal activity
United Kingdom	British Aviation Insurance Company Limited (57 1%)	General insurance
	The Globe Insurance Company Limited	Holding company
	The Marine Insurance Company Limited*	General insurance
	Royal International Insurance Holdings Limited*	Holding company
	Royal & Sun Alliance Reinsurance Limited*	General insurance
	Sun Insurance Office Limited	General insurance
Argentina	Royal & Sun Alliance Seguros (Argentina) SA	General insurance
	El Comercio Compañía de Seguros SA (96 7%)	General insurance
	Aseguradora de Créditos y Garantías SA (99 9%)	General insurance
Bahrain	Royal & Sun Alliance Insurance (Middle East) BSC (c) (50 0%)	General insurance
Brazil	Royal & Sun Alliance Seguros (Brasil) SA (99 9%)	General insurance
Canada	Roins Financial Services Limited	Holding company
	Quebec Assurance Company	General insurance
	The Johnson Corporation	Holding company
	Royal & Sun Alliance Insurance Company of Canada	General insurance
	Western Assurance Company	General insurance
	Canadian Northern Shield Insurance Company	General insurance
	L'Union Canadienne Compagnie D'Assurances	General insurance
Chile	RSA Seguros (Chile) SA (99 5%)	General insurance
China	Sun Alliance Insurance (China) Limited*	General insurance
Colombia	Royal & Sun Alliance Seguros (Colombia) SA (86 7%)	General insurance
Denmark	Codan A/S	Holding company
	Codan Forsikring A/S	General insurance
Guernsey	Insurance Corporation of the Channel Islands Limited*	General insurance
Isle of Man	Tower Insurance Company Limited	General insurance
Mexico	Royal & SunAlliance Seguros (Mexico) SA de C V	General insurance
Netherlands	RSA Overseas (Netherlands) BV	Holding company
	RSA Overseas Holdings BV	Holding company
	Intouch Insurance Group BV*	Holding company
Poland	Link4 Towarzystwo Ubezpieczen SA	General insurance
Republic of Ireland	RSA Insurance Ireland Limited*	General insurance
Sweden	Trygg-Hansa Forsakrings AB	General insurance
Uruguay	Royal & Sun Alliance Seguros (Uruguay) SA	General insurance

Notes
1 UK companies are incorporated in Great Britain and are registered in England & Wales,
*100% direct subsidiary of Royal & Sun Alliance Insurance plc
2 Except where indicated all holdings are of equity shares and represent 100% of the nominal issued capital
3 Some subsidiaries have been omitted from this statement to avoid providing particulars of excessive length
4 A complete list of subsidiaries will be attached to the Company's Annual Return lodged at Companies House

35. Post Balance Sheet Events

Subsequent to the year end action was taken to strengthen the Company's capital position including

- the sale of the majority of its holdings in equity securities, and
- the purchase of an adverse development cover contract (ADC) The ADC is underwritten by Berkshire Hathaway and covers the insurance liabilities in existence at 31 December 2012 It provides £550m of cover with an attachment point which is £550m above our undiscounted actuarial indication (excluding loss adjustment expenses) The Company retains 20% of the exposure This cover protects shareholders from adverse reserve development and provides significant capital benefits

On 26 February 2014 the Directors of RSA Insurance Group plc, the Company's ultimate parent agreed to seek to raise £775m by way of a rights issue The rights issue has been underwritten on a standby basis by a syndicate of banks

After the year end the Company also suffered losses arising from flooding in the UK of between £45m and £60m