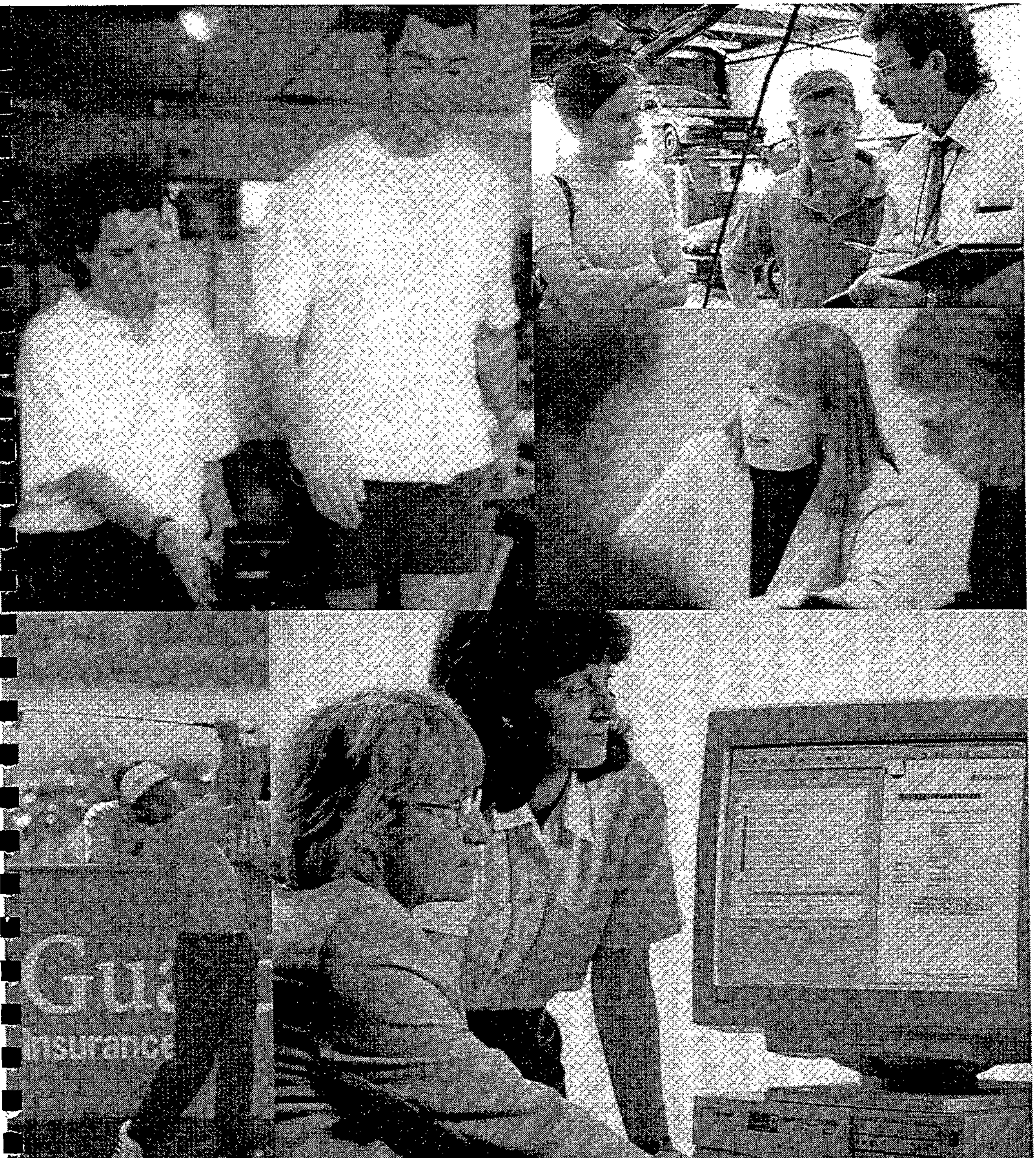
Guardian

Guardian Royal Exchange plc

Annual Report and Accounts 1997



The Group is in business to help commercial and individual customers determine which of their risks require financial cover, and to provide assistance which is above their expectations, in the event of financial, physical or personal loss.

We measure our success by the extent to which we deliver:

- to customers excellent service and value for money
- to shareholders an attractive profit and overall return on capital
- to employees the opportunities and encouragement to fulfil their potential.

Contents

Financial highlights

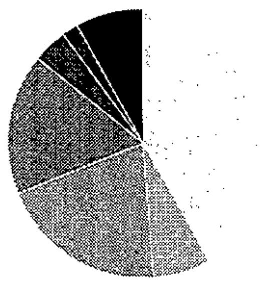
Pre-tax profits were increased by 41 per cent to £872 million and net asset value was improved by 18 per cent. This marked improvement came in a year of intense competition. Sound capital management has led to a recommended return of £189 million to shareholders.

	1997	1996
Written premiums	**£3,545m**	£3,732m
General underwriting result	**(£148m)**	(£71m)
Pre-tax profit	**£872m**	£618m*
Net asset value (including life embedded value)	**£2,930m**	£2,481m*
Net asset value per share (including life embedded value)	**319p**	273p*
Dividend per share	**11.5p**	10.0p
Total assets	**£20,241m**	£18,764m

*restated for revised treatment of equalisation reserves

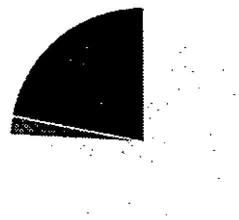
Worldwide premium income Geographical

42% United Kingdom £1,489m
7% Republic of Ireland £237m
20% Continental Europe £724m
17% The Americas £609m
4% South Africa £141m
2% Asia £73m
8% Others £272m



Worldwide premium income General, Health and Life

76% General £2,696m
2% Health £73m
22% Life £776m



The chart below shows the impact that the acquisition of PPP healthcare group would have had on the premium income mix for the enlarged Group for 1997. This is for illustrative purposes only.

Worldwide premium income General, Health and Life

65% General £2,696m
16% Health £663m
19% Life £776m

Chairman's statement

Significant progress has been made in the restructuring of the Group, leading to increased efficiencies and cost reductions. The acquisition of PPP healthcare group gives us a considerable presence in the growing health insurance sector.

I referred last year to the intense market pressures that were present in all our markets. This situation remains and, if anything, the pressures were even greater in 1997, particularly in the motor sector. In addition, the strength of Sterling has had a significant impact on the translation of overseas earnings, resulting in a £57 million reduction in our pre-tax profits.

Although the Group's underwriting result was weaker, we benefited from the excellent performance achieved by our investment division, particularly in the UK. Overall Group investment gains, realised and unrealised, were £711 million (1996: £377 million). The Group achieved a pre-tax profit of £872 million (1996: £618 million) on five per cent lower premium income of £3,545 million (1996: £3,732 million). In local currency terms general premium income was up by one per cent on 1996.

Net asset value (including life embedded value) increased by 18 per cent in the year to £2,930 million.

1997 was a year in which a great deal was achieved in the Group, much of it behind the scenes.

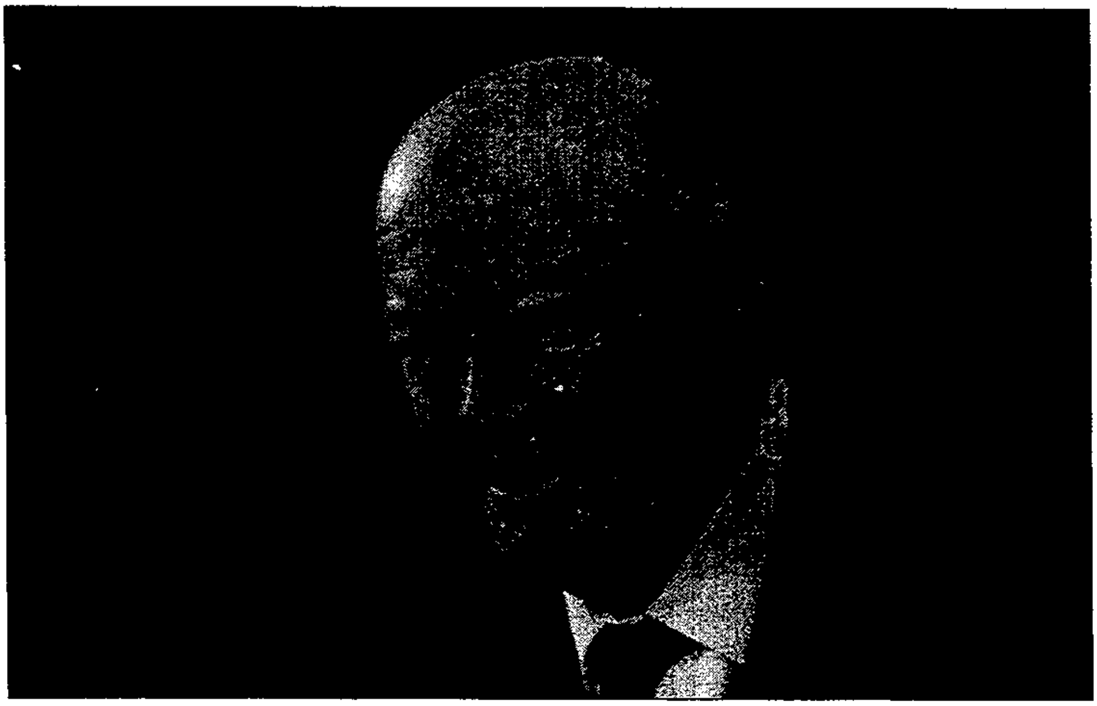
The most notable activity was the acquisition of the PPP healthcare group, which we announced in December. Regulatory approval for this acquisition was obtained on 16 February this year and we completed on 23 February. This is a very exciting development for the Group. It makes us the second largest provider of health insurance in the UK and gives us a firm base from which further to develop in this chosen sector of the insurance market. In addition, it provides us with many more direct clients in the UK to whom we will be able to market other Group products.

The Chief Executive has elaborated on this acquisition and other activities in his review.

Presentation of Accounts

Since 1991, the Group has reported both realised and unrealised investment gains as components in the calculation of pre-tax profit. I am pleased to report that the validity of this approach is reflected in a draft Statement of Recommended Practice on accounting for insurance business, recently published by the Association of British Insurers. It is likely that the industry will adopt our approach when announcing financial results for 1998.

Lord Hambro
Chairman



Following the publication of our 1996 Report and Accounts, the accounting treatment for equalisation reserves has been considered by the Financial Reporting Review Panel (FRRP) in the light of differing interpretations of the requirements of UK company law. After extensive discussions with the FRRP and having regard to the continued evolution of generally accepted accounting principles, the directors have concluded that the Group should change its accounting policy and treat equalisation reserves as if they were liabilities.

Accordingly, the directors have prepared the 1997 consolidated financial statements on this revised basis and have restated the 1996 comparatives. This has reduced 1997 pre-tax profits by £30 million (1996: £33 million). Other effects of this restatement are set out in Note 1d on page 49 and in the statement of recognised gains and losses on page 44.

Return of capital

Following the acquisition of the PPP healthcare group and in the light of the Group's present capital position and likely future capital requirements, the Board has decided that it is appropriate to recommend the return of 20.5 pence per fully paid ordinary share (approximately £189 million) to shareholders. This represents approximately 4.7 per cent of the Group's market capitalisation at the close of business on Tuesday, 24 February 1998.

The Board has decided that it is appropriate to recommend the return of 20.5 pence per fully paid ordinary share (approximately £189 million) to shareholders.

It is intended that this will be effected through a bonus issue of redeemable B shares and a simultaneous reduction in the number of ordinary shares in issue on the basis of 20 new ordinary shares for each 21 existing ordinary shares, based on the middle market quotation, derived from the Stock Exchange Daily Official List for 24 February, of 436.5 pence per existing ordinary share. As these transactions require shareholders' approval, the Board proposes to hold an Extraordinary General Meeting immediately following the AGM on 28 April 1998. The proposals, if approved, will take effect as soon as practicable.

Dividend

In fulfilment of our progressive dividend policy the directors are recommending a final dividend of 7.6p per share, bringing the total dividend for the year to 11.5p per share – an increase of 15 per cent on 1996. As at the interim stage, the final dividend will be paid as a Foreign Income Dividend.

This brings cash flow savings from the timing of Advance Corporation Tax payments and recoveries. These savings have allowed us to raise the total dividend for the year slightly more than might otherwise have been the case.

New directors

Two new Group executive directors have been appointed to the Board since this time last year. Ray Pierce was appointed Group Executive Director – Marketing, a role he assumed on 1 August. Ray has been with the Group since September 1993 and was responsible for the successful launch of Guardian Direct. His appointment reflects the importance we attach to marketing and customer focus throughout the Group.

Peter Owen, the Chief Executive of PPP healthcare group, was appointed to the Board as Group Executive Director – Healthcare with effect from 24 February 1998. Peter has a great deal of experience, not only in the very important health insurance sector, but also in significant management positions in complex international companies.

Peter Dugdale

It is with regret that I must record the death, in March 1998, of Peter Dugdale. Peter joined the Group in 1949. He was appointed General Manager (Overseas) of Guardian Royal Exchange Assurance Limited in 1976 and Managing Director of the Group in 1978, a position he held until 1990. He retired in 1991. He was well known and respected in the insurance industry and will be missed by his many friends.

Staff

I would like to thank all the staff of the Group for the way they have responded to the challenges of the year. The increase in competitive pressures meant that everyone had to work harder to meet the expectations of our policyholders and shareholders. Their hard work and commitment is greatly appreciated and is confirmed in these results.

Lord Hambro
Chairman

Our strategy for growth has been clearly demonstrated during the course of the year. We are investing in chosen sectors where we can demonstrate growth in shareholder value.

The principal action in the year was the acquisition of the PPP healthcare group, taking our share of the UK private medical insurance market from five per cent to 33 per cent.

Strategy

The rapid pace of change within the insurance industry continues, with many powerful multinational groups competing head to head across a wide range of markets. Against this background, the Group is fortunate to possess a series of effective, regionally-focused businesses in different countries with well-established local positions, and the capital strength necessary to enable us to build for the future.

Strategy and the allocation of capital is decided at the centre, but operationally we are a decentralised Group. We believe that the businesses must be free to compete in ways that are most appropriate to their local circumstances. It is because our regional management is close to our customers that they have been able to act with agility and flexibility to changes in local markets.

Objectives for the year

We entered 1997 with a number of important objectives.

- We wanted to expand our presence in 'third sector' insurance – health, long-term care, critical illness – as this is an area with excellent growth prospects for the long term, particularly in the UK.
- We were keen to expand Guardian Direct in the UK and to develop our direct operations into new geographical and product areas.
- We were determined to continue our efforts to drive a customer-led culture right through the Group, in order to ensure that our products meet our customers' needs and, where appropriate, to work with intermediaries to serve our customers' needs to best effect.
- We wanted to continue to improve efficiency and effectiveness.
- We were determined to continue to manage the Group's capital effectively, so as to maximise returns to shareholders.

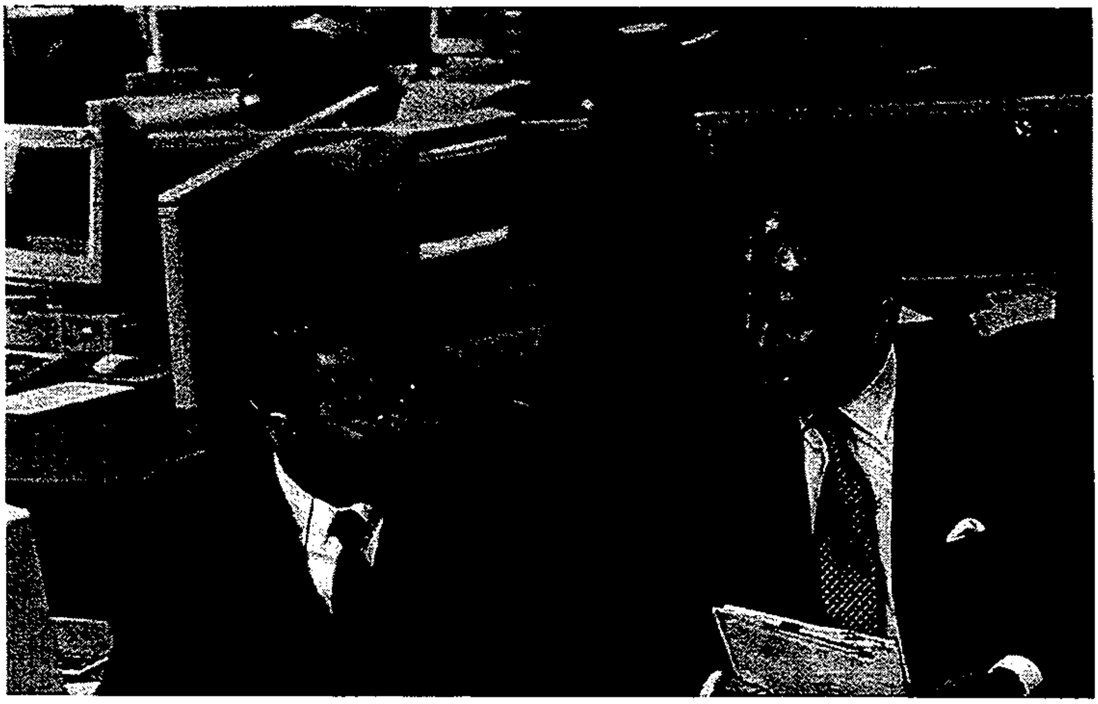
So, how did we do?

Building the businesses

The principal action in the year was the acquisition of the PPP healthcare group, taking our share of the UK private medical insurance (PMI) market from five per cent to 33 per cent. We are now the second largest PMI provider, the largest long-term care insurer and the largest provider of dental health plans. Overall, we are the second largest provider of health insurance in the UK. There are important synergies with Guardian Health, which has been growing very successfully and increased its premium income by 50 per cent in 1997. Our intention is to build on our strong base in the UK and expand in this sector outside the UK.

Last year, I reported the acquisition of RAC Insurance Services. This has now been relaunched as RAC Insurance Direct and continues to grow successfully. We have been working hard to consolidate our position as one of the leading providers of 'direct' insurance. At the year end Guardian Direct and RAC Insurance Direct had 837,000 policyholders and the acquisition costs per policy were reducing. We were also able to increase average motor premiums in our two direct companies by an average of 8–12 per cent in the year while maintaining an encouragingly high retention ratio.

The acquisition of PPP healthcare increases the number of 'direct' clients in the UK by more than 1.3 million, taking the total number of direct clients in the UK to some three million. It also gives us a third strong brand; we are now established as one of the market leaders in the direct telesales market – a crucial distribution



John Robins (right), Group Chief Executive, with Ian Hawes, a sales consultant, at the Guardian Direct call centre in Colchester.

channel for the future. We will invest in more direct books of business as they become available, but only at realistic prices. Acquisitions need tenacity, capital capacity and the ability to move quickly when the situation demands. Our discussions with PPP healthcare took some 20 months to come to fruition – with the RAC, discussions were completed in just 10 weeks.

Having established Guardian Direct in the UK, we are using this Group expertise to expand direct selling both geographically and across the product range. Direct operations were launched in the Republic of Ireland in 1995, and the skills which have been developed in the UK and Ireland have now been transferred to South Africa, where a telephone-based direct sales operation was successfully set up last March.

The Legal & General commercial general insurance business acquired in 1996 is now fully integrated into the UK branch network. The small commercial property segment is one we are particularly keen to develop as it is possible to develop close relationships with clients and intermediaries, improving retention and profitability. We are seeing good growth in the sector not just in the UK, but also in Germany, America and Asia. During 1997 we launched Guardian Risk Services in the UK to enable us to build good relationships with our smaller commercial clients and their intermediaries. This was an immediate success.

Putting customers first

We are determined to build a marketing culture throughout the Group, and we have been making good progress. The appointment of Ray Pierce to the Group Board as our first Group Executive Director – Marketing reflects the importance we attach to this discipline. Marketing spend has been deployed with increasing effectiveness and a number of awards for the introduction of new products and intermediary support have been won during the year.

Beyond simple brand recognition, however, are all the associations in customers' minds about what the brand stands for and products which meet their needs. Behind the scenes, we have been developing sophisticated market segmentation techniques, and the effective management of customer databases enables us to deliver what our customers want, when they want it. I believe that the power of our brand will continue to strengthen as these processes begin to make their full contribution to the range of products and quality of service we provide.

The test of our success is, of course, customer retention. In profit terms, retaining existing customers is as important as winning new ones.

In the past, customer retention has sometimes fallen below acceptable levels, but I am happy to report that we met our targets in 1997. I am confident therefore that we are on the right track for the future.

Improving efficiency, reducing costs and restructuring

Improving customer focus and reducing costs should not be seen as one-off exercises; they are continuous processes. Throughout the Group we need to question constantly the way we do things to ensure continuous improvements in efficiencies. We are determined these processes should be part of our management's attitude of mind.

In August 1996 the integration of our operations in the UK was announced, and was implemented from 1 January 1997. Since then we have effectively carried out our own 'internal merger' of the Life, General, Health and Direct operations, releasing capital and improving operating efficiency. This involved the loss of some 350 positions and a reduction in the number of area offices and branches. We are on target to deliver annual cost savings of £20 million from January 1998, as forecast. The new management structure enables us to be more responsive to our customers and to pay closer attention to our intermediaries' needs in their search for better customer value.

Such action has not been restricted to the UK. A further review to reduce costs was completed and is now being implemented in Germany. In Asia we restructured the management so that we are able to react more quickly to the demands and interests of our customers. We moved our operations centre from Hong Kong to Singapore. Capital employed was reduced and central costs were cut as a result of these changes. In early 1998 we closed our operation in Korea as there were insufficient opportunities for profitable growth. In view of the recent slow down in growth in the Region, these decisions were timely.

Managing capital effectively

Managing capital effectively is one of the Group's prime objectives. The restructuring of our business and our system of determining minimum risk-based capital levels for each of our operations, has

On December 17, the Group announced the acquisition of the PPP healthcare group. At the signing were, left to right, John Sinclair, Group Executive Director – UK & Ireland, John Robins and Peter Owen, Chief Executive of PPP healthcare group.

enabled us to make more effective use of capital and ensures that we continually monitor its use to derive the maximum benefit for our shareholders.

Over the past five years, the total return to shareholders generated by an investment in the Group (share price appreciation plus dividends, assumed to be reinvested) has averaged more than 21 per cent per annum, whereas an equivalent investment in the market (the FTSE All Share Index) has yielded only 17 per cent per annum. A major contribution to this achievement was the performance of our Group Investment Management operation, which had another outstanding year in 1997.

Our successful management of Group capital enables us now to recommend a method which will return capital to shareholders in a tax efficient way. This recommendation is made having taken full regard for the need to have a cushion against possible market downturns and a strong balance sheet to allow us to make appropriate acquisitions to build leading positions in chosen markets. Apart from the PPP healthcare acquisition we looked at a number of other possibilities over the past year and will continue to do so, but only at the right price.

Investing in people

We have the capital strength required to develop our key businesses, and are fortunate to have so many good people to manage these businesses. But just as there is never room for complacency about costs, it is vital that our efforts to improve the training and raise the skills of our people should be similarly unremitting.

In 1997, considerable attention was devoted to ensuring excellent training in core skills throughout the Group. In addition, efforts were redoubled to accelerate the transfer of skills around the Group, especially in such areas as claims management, marketing and information technology, so as to help us strengthen our competitive advantage in key areas. Our 'scholarship' programme continued and 50 young employees from South Africa, Asia and Latin America have now come to the UK for practical work experience in the past two years. Guardian Royal Exchange has businesses all round the world and increasingly we share a common culture.

I would like to join the Chairman in thanking everyone for their contributions to our common endeavour in 1997, and to report my confidence that, with their continuing dedication and commitment, our strategy of building strong market positions in carefully selected areas – getting close to the customer in every case – holds out the prospect of a highly successful future for the Group worldwide.

John Robins

John Robins
Group Chief Executive

John Robins

Operational review

Our Group companies met the year's intense market pressures by more effective marketing, by controlling their cost base and by improving customer service. We entered 1998 with increased confidence for our future.

The direct selling of insurance and other financial services products via the telephone is a rapidly growing market and we are establishing ourselves as one of the most successful groups operating in the sector.

General Insurance

Worldwide premium income was lower in 1997 at £2,762 million (1996: £2,914 million) as we continued to concentrate on our chosen market sectors and refused to take unrealistically priced business. The underwriting loss of £148 million (1996: £71 million) reflects the continuing pressure on rates that was evident in all Regions, but particularly in the United Kingdom and the United States. The private and commercial motor sectors were notably difficult as a result of an increase in both the cost and incidence of claims.

United Kingdom

The written premium increased marginally from £1,039 million in 1996 to £1,048 million for the year ended 31 December 1997, although the underwriting result showed a deterioration to a loss of £67 million from a loss of £24 million. The pre-tax profit was £191 million (1996: £133 million). A satisfactory underwriting performance in household, commercial property and liability business was offset by disappointing results in motor, especially private motor. There is, however, continuing evidence of general upward pressure on motor premium rates; year on year private motor premiums increased by an average of 8-12 per cent in our direct businesses and by eight per cent through intermediaries. The full benefits of these increases will be reflected in the 1998 results.

The reorganisation of our UK activities into a single business, announced last year, has been completed and is delivering the promised improvements in customer service, operations and cost savings. In a market that remains extremely competitive, we continue to put emphasis on only pursuing selected market segments and on providing outstanding service.

To promote a marketing and customer-focused culture, a continuous process of market research, product innovation, training and education is taking place throughout our UK operations, with a strong emphasis on market segmentation, customer retention and service.

The acquisition of the PPP healthcare group was referred to in the Chief Executive's review. By integrating the second-largest supplier of healthcare insurance in the UK with Guardian Health, we will establish a position as a leading supplier of health insurance in the UK. The integration of the two companies is already under way, providing opportunities for cross-selling and annual savings of £14 million.

Guardian Health had another outstanding year. It secured a number of high profile corporate clients, created partnerships with more building societies and banks and introduced a number of new products, including international cover for expatriates, travel health insurance and a range of dental insurance products for the corporate sector. Guardian Health was the first Group company to use the new processing facilities in Bangalore in India to which we refer on page 19.

The direct selling of insurance and other financial services products via the telephone is a rapidly growing market and we are establishing ourselves as one of the most successful groups operating in the sector. Following the acquisition of PPP healthcare, the Group now has three very powerful brands in the direct sector – Guardian Direct, RAC Insurance Direct and PPP healthcare. During the year Guardian Direct opened a new call centre at Watford, working alongside the existing centres in Colchester and Darlington. This allows us to continue to provide first class service to our rapidly increasing number of policyholders. RAC Insurance Direct is achieving very good customer retention ratios and its customer base has grown to over 485,000 at the year end. Business with motor

The Group's risk management services and growing resources in health and long-term care, through Guardian Health and PPP healthcare group, provide customers with business, financial and personal health checks.

manufacturers also grew strongly and the Group is now the largest supplier of motor manufacturers' free insurance schemes in the UK.

Guardian Risk Services was launched in March 1997. This important initiative provides medium-sized and smaller companies, through their intermediaries, with sophisticated risk management advice and a range of precisely tailored products. This new company complements our existing risk management expertise in Germany, South Africa and Asia.

With the help of our Specialty Auto Division in the United States, Orion Personal Insurances was relaunched in the UK as a specialist non-standard motor insurer. The relaunch was very well received; Orion intends, over the medium term, to become a leading player in this sector.

We continued to make increasing use of new technology and 70 per cent of new private car insurance is now handled through Electronic Data Interchange (EDI). In what is believed to be the first instance of its kind, Guardian Insurance settled a claim without the use of any paper at all. Guardian Insurance was notified of the claim from the Netherlands via the internet, confirmed it via EDI and settled it electronically direct to the client's bank account.

During the year the UK businesses began to use the newly established, Group standard, customer database. It gives us an excellent contract administration system, as well as sharpening our marketing and service focus on customer needs by enabling the marketing teams to have a single view of each of our customers across all insurance categories.

The new image-based claims handling computer system in Dublin is dramatically speeding up claims service and improving customer satisfaction.

Right: The Group's scholarship programme gives employees from South Africa, Asia and South America skills training and practical work experience in the UK.

Far right: Guardian Direct in the UK sponsors The Scout Association's Home Safety Proficiency badge. The sponsorship stresses the importance of recognising potential hazards in the home.

Republic of Ireland

Overall premium income was up in underlying terms by nine per cent. In Sterling terms it was very slightly down on 1996 to £222 million (1996: £226 million). The underwriting loss of £19 million compares with a loss of £8 million in 1996. Much of this was caused by storm damage claims in December and an increase in the frequency and severity of motor claims, particularly in the commercial motor account.

We remain the largest provider of motor insurance and the largest general insurer in Ireland. We have been working hard, with the Government and other organisations, to reduce the number of road traffic accidents.

We formed a marketing alliance, announced in June 1997, with Ireland's largest bank – the AIB – and a specially created household insurance policy is being promoted to all their customers. We also took on the Irish policies of Swedish-based Ansvar and offered their customers renewal terms. By the end of the year, an encouraging number of Ansvar customers had converted to PMPA policies.

In March 1997 Guardian PMPA implemented the DARWIN Image and Workflow system. This provides screen-based claims handling for all general insurance as well as the electronic processing of all correspondence, workflow administration and supervision. For the first time, claims can be settled electronically. The system has already produced productivity gains and improved claims controls, and will be adapted for use in other Group companies.

The very strong growth in sales of our new home insurance policy continued during 1997, with written premiums increasing by 30 per cent. Our home insurance market share grew from eight per cent to about 10 per cent.

We formed a partnership with a select group of commercial brokers in order to increase our share of the commercial market. Guardian PMPA provides insurance products, as well as risk management and claims services, and an added-value package of customer services to support the brokers' marketing initiatives to commercial companies. New business volumes have increased as a result of this initiative.

Our marketing focus on customer needs has been heightened by two major surveys.
A customer segmentation study covering the Personal Direct, Personal Broker and Telephone Direct distribution channels was initiated during the year. This will enable us to identify profitable new market segments and to approach them with the right products and the most effective marketing strategies. A customer satisfaction survey, completed during the year, identified

Right: GRE Insurance Group in the USA won the 1997 Showcase of Excellence Award for its Contractors' Program brochure.

Far right: In Germany, Albingia has developed expertise in assessing claims for damaged or faulty computer equipment by setting up its own electronics laboratory.

Albingia is improving its own competitiveness and market presence and winning an increased reputation as a skilled service insurer with a well-trained and highly motivated salesforce.

those service elements that are most important to customers. As a result, every branch now focuses on two national and two branch-specific service priorities, in order to maximise customer satisfaction and enhance retention ratios.

Continental Europe

Very competitive market conditions resulted in only a modest increase in premium income in Continental Europe in local currency terms. The underwriting loss was significantly improved to £22 million. This reflects the success of our customer segmentation and the reduction in costs that has taken place in recent years. Continental Europe made a pre-tax profit of £34 million.

In June 1997 we established a holding company for all our operations in Continental Europe – Guardian Royal Exchange Continental Europe Holding GmbH – to focus better on the management of our capital employed in the Region and to reflect regional management responsibilities.

Germany

The insurance market in Germany remains highly competitive, with persistent downward pressure on motor premiums. In response to this situation, Albingia is improving its own competitiveness and market presence and winning an increased reputation as a skilled service insurer with a well-trained and highly motivated salesforce. The company is winning new business with innovative products designed for, and promoted to, carefully researched and defined market segments. It is building on its strengths in marine and engineering insurance and in commercial insurance for small-to-medium sized companies. In all our chosen market sectors, our growth is in line with overall market development and in the case of marine insurance, we are growing faster than the market as a whole.

In one initiative, Albingia offered safe driving training to 3,000 drivers aged between 18 and 25. The scheme is designed to retain customers, win new ones, reduce claims, motivate intermediaries and gain favourable publicity for the company.

Albingia launched a number of projects during the year, all designed to achieve important strategic objectives, including one on the implementation of an IT strategy which will give us increased customer focus and improved productivity.

Albingia Risk Consultancy Services is making regular presentations, to its commercial customers and brokers, on the importance of new security technology and its impact on all businesses. This is another example of providing first class service to our commercial customers.

The transfer of skills and best practice is a high priority in the Group. Senior management from around the world discussed change management at a series of conferences held in 1997.

Our low-cost motor insurance company 'die Alternative', launched in July 1996, is fulfilling expectations by winning new, price-conscious, customers. Vigorous marketing of 'die Alternative' was mounted during the year, using telephone marketing, direct mail, broker promotions and the internet, from which customers can now get an individual quotation for car insurance and an electronic proposal form.

Elsewhere in Europe, the engineering underwriting offices opened by Albingia in Madrid towards the end of 1996 and in Brussels in January 1997, have been performing to expectation.

The Netherlands

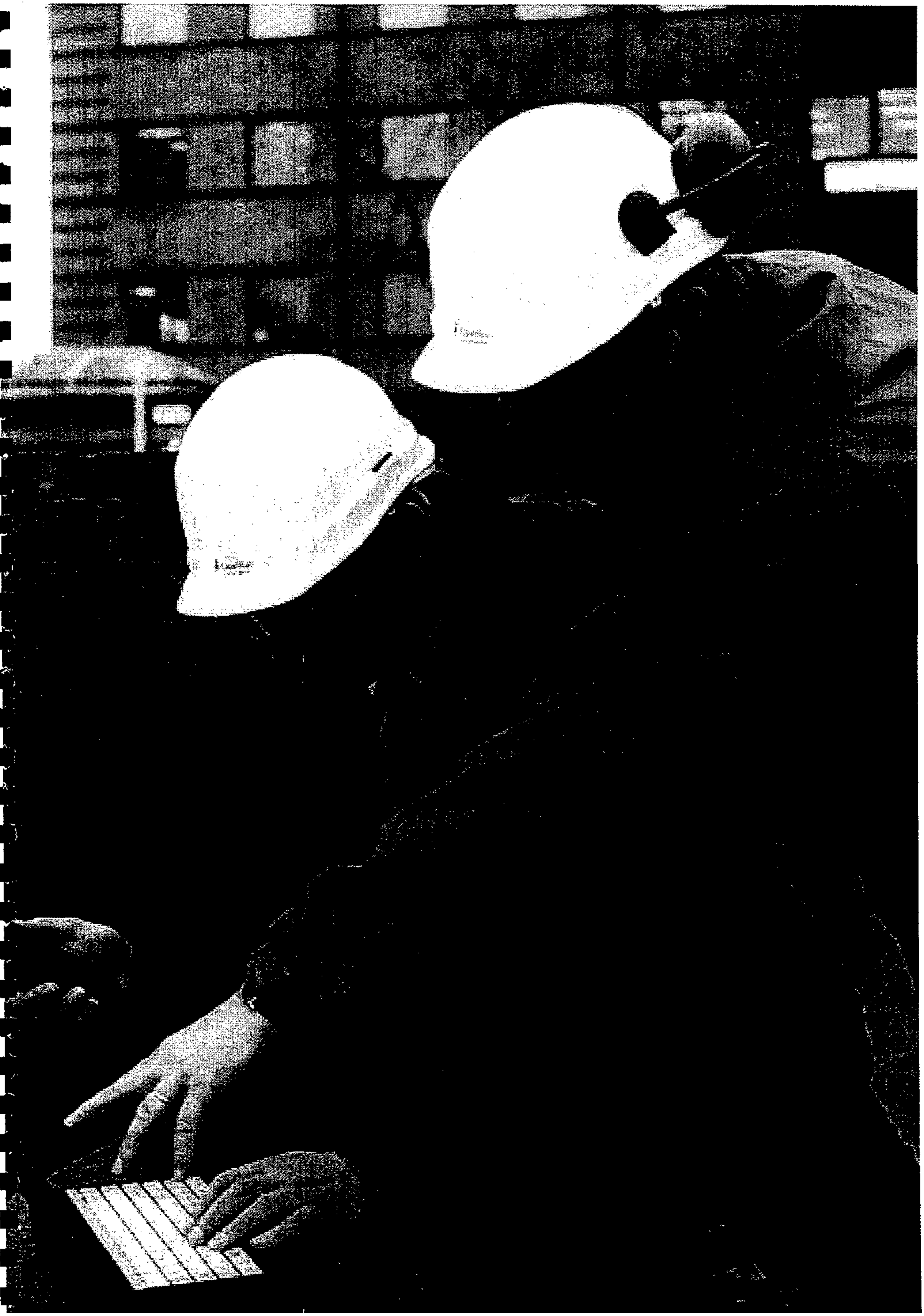
During the year we appointed a new Managing Director and renamed our company 'Guardian Verzekeringen', adopting the Group's branding with the distinctive owl logo. This change, which was very well accepted in the market, was a part of the overall process of restructuring and increasing the company's integration into the Group. Lower than expected claims levels across almost all sectors helped us to achieve a marked improvement in underwriting results.

France

Guardian Risques, our general insurance company, continued to concentrate on its key market sectors of motor fleets and affinity groups. A new call centre supporting affinity group business was operational by the end of 1997 and a first affinity group partner was acquired in December. Negotiations with three further partners are in progress. In pursuit of the key objectives of reducing costs and enhancing customer service, an examination of business processes has been undertaken and the resulting recommendations will be acted on in 1998.

Portugal

Royal Exchange continues to focus on its objectives of forging closer links with brokers and professional agents and improving customer



retention. Its success in both endeavours is illustrated by the growth in premium income, which again comfortably exceeded the market rate, despite increasingly difficult overall market conditions.

The Americas

Extremely competitive market conditions in the North American markets resulted in a reduction in premium income to £609 million (1996: £626 million). The underwriting loss of £45 million reflects increased claims incidence and severity in all motor lines, prior year reserve strengthening in commercial lines and weather-related claims in property and marine lines. The Region returned a pre-tax loss of £3 million (1996: £16 million profit).

Our North American executive team continued to pursue initiatives designed to enhance the efficiency of our operations across the US and Canada, with reduced operational expenses and capital expenditure. Management of IT systems, investment and internal audit functions were further integrated, and skills-sharing projects involved staff from claims, customer services, human resources, marine marketing, planning and finance functions in both countries. Cross-border customer marketing opportunities are also being identified and pursued.

Our US operations focused on improving our understanding of our customers' needs, on marketing and on achieving improved efficiencies through the use of information technology.

Our South American operations were repositioned and new growth opportunities developed.

United States

Following the capital restructuring of GRE Insurance Group, and the operational restructuring of the Specialty Auto Division during 1996, our US operations focused on improving our understanding of our customers' needs, on marketing and on achieving improved efficiencies through the use of information technology.

Our Specialty Auto Division has enhanced its IT system which now provides overall management information, including daily claims status reports, thus improving productivity and quality of service. Underwriters in the Specialty Auto Division are now able to quote target business electronically in agents' offices ahead of renewal dates.

Improving our marketing skills was one of the priorities during the year, and all operations completed a programme of marketing seminars. A major customer and market segmentation study was conducted among 1,600 commercial and personal lines consumers to guide new product development and marketing. Communication with agents and brokers was improved and sales opportunities increased through frequent sales meetings, agent round-table meetings and agency councils. The Property and Casualty Division introduced 'GRE Anytime', a 365-days-a-year claim service for our personal lines customers across the USA. It also launched a successful new product – Home+Business – using direct mail to all homeowner customers as well as a mass electronic teleconference with independent agents to discuss product details. These innovations were extremely well received.

The GRE Insurance Group website was launched and is proving to be a powerful sales and marketing resource, by helping potential customers to evaluate our products and services.

The Marine Division Territorial Agency Manager plan was expanded, and managers are now in place in Pittsburgh, Denver and Charlotte. In a further initiative, marine insurance customers of our branches in Richmond, Chicago and Seattle can now report claims and receive advice and help via a new 24-hour claims hotline – a service that will be extended to all branches.

The development of risk management expertise is one way of providing improved services to commercial customers and intermediaries. Risk management is an increasing area of Group expertise in Germany, South Africa, Asia and the UK. Audits are offered for every type of risk, from small commercial premises to large engineering projects.

Right: Guardian Risk Services conducted a risk management audit at the Liverpool School of Tropical Medicine.

Far right: Guardian Royal Exchange Group provides a total claims handling service to BT plc. BT is one of the largest vehicle fleet operators in Europe.

In Canada, Year 2000 compliance for all insurance and claims applications was achieved, on time and on budget, by December 1997.

Marine Division and Finance function reviews were held during the course of 1997. The reviews led to several proposed recommendations for improving cost effectiveness which are being implemented.

Canada

The major restructuring programme for Guardian Canada, which was started in 1995, was completed with reorganisation of the Quebec region into four branches rather than seven.

In line with Group strategy, each strategic business unit continued to develop and implement more sharply-focused marketing plans during 1997. Brokers are our most important distribution channel, and we further reinforced our close relationships with them through broker councils, which were rolled out in each region during the year. These councils enable us to keep brokers fully informed of our innovations and planning, while gathering feedback from the marketplace. A marketing study using customer focus groups and interviews, and an independent analysis of 2,000 policyholders was carried out during 1997 in order to gain fuller understanding of customer preferences, expectations and brand loyalties.

IT activities included the further development of electronic data interchange (EDI) links with brokers, and we are on target to administer at least 50 per cent of personal lines transactions by EDI during 1998 – an increase of 30 per cent over 1997. Year 2000 compliance for all insurance and claims applications was achieved, on time and on budget, by December 1997. Evaluation of a general insurance computer system, already in use in the UK, was completed and implementation has begun. The system's database architecture will enable us to gain a substantially improved understanding of our customers. These innovations and others will deliver enhanced customer service, lower costs, reduced reliance on paperwork and more accurately-targeted marketing.

The company is launching a number of new products designed to improve customer retention ratios, an important strategic priority. For example, Guard-Plus, which offers attractive incentives to customers holding both home and motor insurance with us, was developed successfully in the Quebec region and is being rolled out through the rest of Canada. Quebec region also launched Commercial Guard-Plus, a flexible, easy-to-use product covering all the basic insurance needs of small and medium-sized commercial customers while promising brokers excellent sales potential, good profitability and very simple administration.

South America

Following our acquisition of a majority stake in the Argentinian insurer Caledonia during

1996, we continued to take initiatives designed to realise the long-term potential of this Region. These include internal training and culture-change programmes, campaigns to raise awareness of the Group in the marketplace, product launches and marketing drives.

Our business in Brazil completed a major restructuring. Fifteen smaller personal lines branches were closed and the business was concentrated in Rio de Janeiro and São Paulo in order to focus on commercial insurance, which offers considerable potential.

Asia

Competitive pressure increased markedly in all major regional markets, and premiums were further reduced by the impact of the economic problems, which the Region experienced in the latter part of the year. These factors resulted in a reduction in premium income to £52 million (1996: £66 million). Pre-tax profits for the Region were up to £10 million (1996: £3 million).

The Asia Regional Centre was transferred to Singapore and has been reorganised. Both central costs and capital employed were reduced as a consequence. A new Asia Executive team has

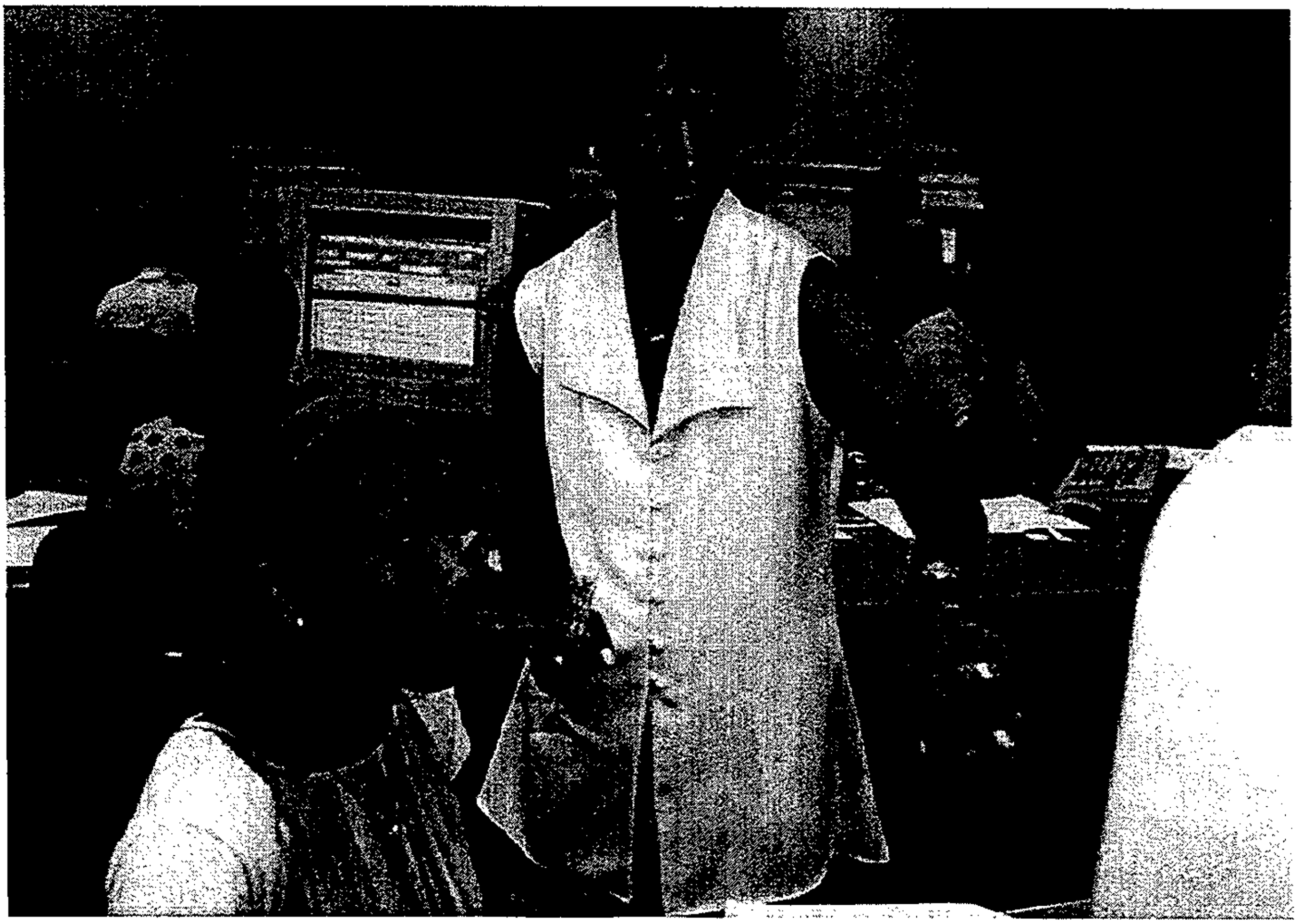
The Group is a sponsor of the PGA European Tour. Golfer Bernhard Langer is seen here playing at the Loch Lomond tournament in Scotland.

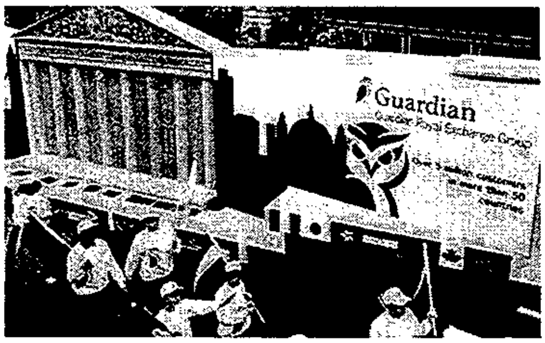
been formed with responsibility for meeting the Group strategic aim in Asia to grow market share in selected markets, and produce a higher percentage of Group profits and return on capital within the next five years. The focus is on markets and customer segments in which we have leading positions.

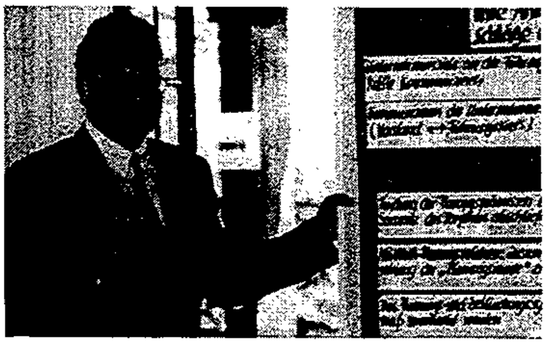
In early 1998 we closed our operation in Korea as there were insufficient opportunities to make profits.

We believe the Asia Region continues to offer long-term growth potential, with large and rapidly-growing insurance markets some of which, until market liberalisation began, were closed to foreigners and dominated by a small number of local companies. In India we signed two Memoranda of Understanding with the Cholamandalam Investment and Finance Co Ltd (CIFCL) as a first step towards the formation of joint venture companies to provide risk management consultancy and, when permitted, to write insurance throughout India. The risk management consultancy will be formed between our existing risk management operations and CIFCL, to serve a range of national and international companies in India and to support other Group companies throughout Asia.

During the year we set up a new corporate risks unit for Asia, which is already developing new business, aided by our established and widespread general insurance presence in Asia. In an important development for the whole Group, we opened a new facility in Bangalore, India, in June







Right: The Group took part in the Lord Mayor of London's annual parade.

Far right: Forward planning and clear objectives, well communicated, are essential to the Group's success.

for the remote processing of proposals and claims documentation. Guardian Health and Guardian Employee Benefits in the UK are the first Group companies to benefit from the significant cost savings and the improved customer service that are being achieved.

South Africa

Net premium income increased by 12 per cent in local currency terms while the Sterling underwriting result remained at break-even after absorbing costs from the direct selling operation, and the impact of several abnormally large fire losses. Pre-tax profits were up to £8 million (1996: £7 million).

In March 1997 Guardian National successfully launched the telesales and broker affinity division. This rapidly growing unit forms an important strategic base from which to grow our South African operations.

In South Africa we are one of the largest general insurers and have a commanding position in the provision of insurance to the largest industrial companies. We have put great emphasis on increasing our penetration of the personal lines and small commercial markets. In March 1997 Guardian National successfully launched the telesales and broker affinity division. This rapidly growing unit forms an important strategic base from which to grow our South African operations.

The Guardian National internet site now provides on-line quotes for car and household insurance. The website also enables a closed-user group of brokers to communicate with Guardian National, to download policy forms, amend policies and obtain the latest rates and manuals. This important new facility saves paperwork, time and costs, both for the company and for brokers.

Our innovative and research-driven FlexiGuard product, launched in 1996, won the Marketing Management Excellence Award of the South African Institute of Marketing in September 1997.

Guardian National's Employment Equity Programme aims to achieve an eventual staff mix that accurately reflects the population make-up of the country – an entirely practical aim given the company's present growth rate. The Company launched the Equity Training Programme, not only to cater for new employees, but to enhance the skills and career prospects of existing staff.

International Agencies

Net written premium for the division in 1997 was £33 million, producing a satisfactory break-even underwriting result. During the year the Guardian Royal Exchange agency in Malta acquired both the Commercial Union and Norwich Union business, making the agency the largest UK insurer on the island. International Agencies are represented in 15 countries by 23 agencies.

Knowledge sharing and technical training to gain key skills are vital for improved expertise and customer service.

Life Assurance

Total worldwide premium income was down marginally to £783 million (1996: £818 million). Our life business increased statutory transfers to shareholders to £34 million (1996: £31 million). The profitability would have been greater but for the impact of stronger Sterling on the translation of overseas profits. At the end of 1997, the value of shareholders' interests in our life funds was £309 million (1996: £302 million), of which £48 million (1996: £52 million) is recorded in the Group's balance sheet.

United Kingdom

In June 1997, Guardian Financial Services (GFS) relaunched its corporate pensions business as Guardian Employee Benefits (GEB) in response to growing demand for sophisticated products in the corporate market. GEB provides independent financial advisers (IFAs) and consultancies with innovative solutions to meet the needs of their clients. In June, GEB relocated its 320 staff to new accommodation within Edinburgh to provide room for a new service centre and improved facilities for the use of the latest technology.

The unique Individual Protection Programme, introduced in the UK in 1997, enables IFAs, on-screen in their offices, to design and price policies precisely tailored to the needs and budgets of individual customers.

GFS also relocated its head office to our new site in Watford, which it shares with Guardian Direct, and has set up a new customer service centre in Lytham, specifically to service its new generation of products. These include the newly-introduced Individual Protection Programme which contributed significantly to the 50 per cent increase in annual premium income from IFAs recorded in the year. This unique product enables IFAs, on-screen in their offices, to design and price policies precisely tailored to the needs and budgets of individual customers.

UK financial services' regulators require all providers and advisers involved in the sale of personal pensions to review every personal pension plan taken out as a result of an individual opting out of or not joining a defined benefit occupational pension scheme. GFS has met, to the satisfaction of its regulator, its deadlines, and remains confident that it will continue to do so. GFS and GEB have also implemented, on time, the changes to systems and service procedures required under the Pensions Act.

Republic of Ireland

The Group achieved excellent new business growth in life assurance in Ireland, with new equivalent annual premium growth of some 30 per cent. New annual premiums resulting from our affinity marketing relationship with EBS, one of Ireland's leading building societies, nearly doubled. Aggressive pricing for term assurance saw premium growth of over 50 per cent, placing the Group as the second largest term assurance provider.

During the year we were awarded the Irish Brokers Association award for the most improved service.

Germany

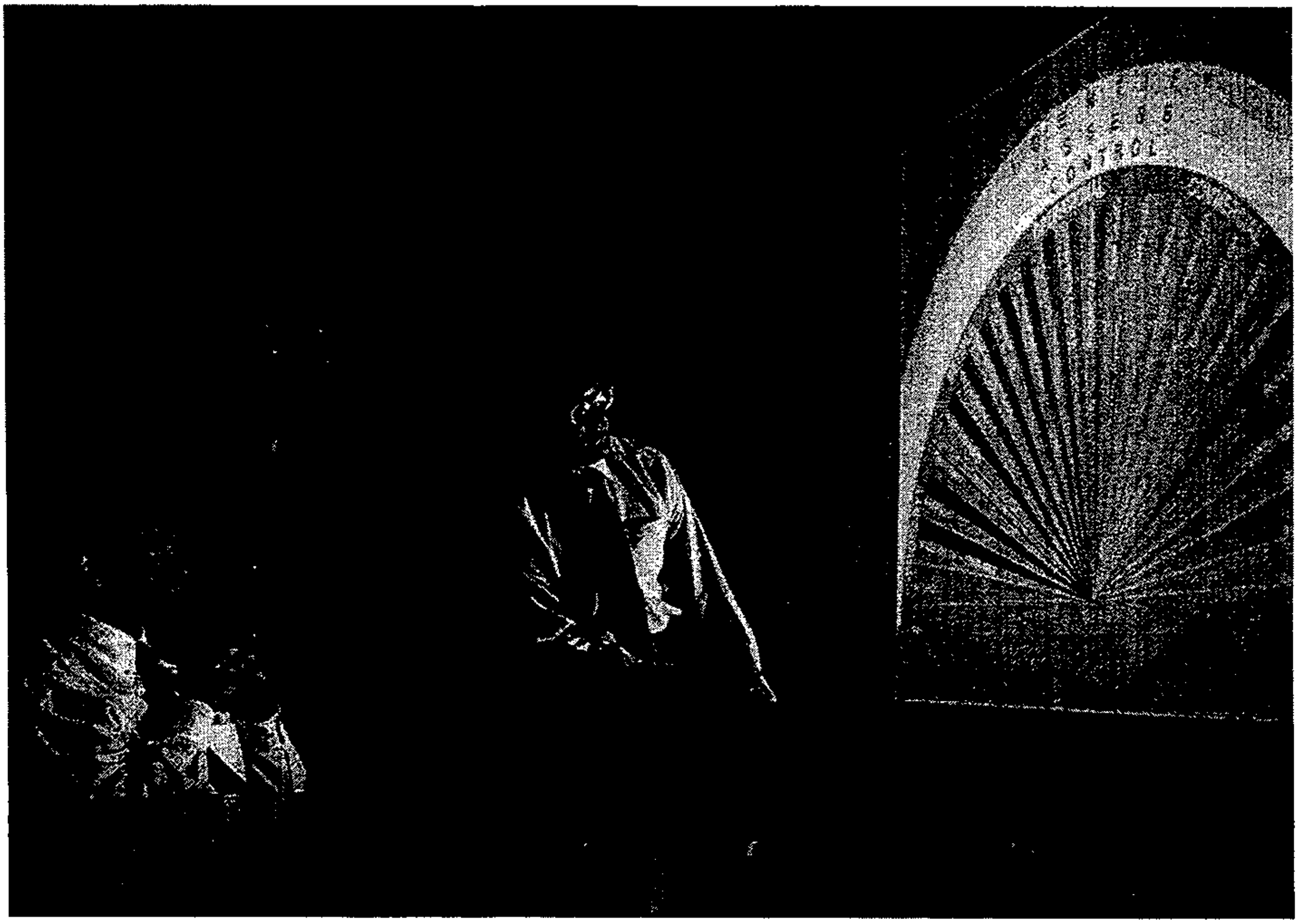
The German life market has seen little overall growth due to low growth levels in disposable incomes and high tax and social contributions. Albingia Life saw its premium income grow to DM462 million (1996: DM447 million).

France

In France, our life company, Guardian Vie, increased its premium income in local currency terms by 21 per cent, which is ahead of the market average. Guardian Vie established a new marketing database to strengthen customer focus and marketing and was voted the number one life company in a survey of independent advisers.

New Zealand

During the year a new investment product was successfully introduced, helping us to maintain our position as the leading fund manager in the



The Spectra Risk Rainbow was created by the Guardian Risk Services team to illustrate all aspects of risk management.

country. Also in the year we began installing a new customer administration system which will enable us significantly to improve our customer service and marketing database management.

Asia

Premium income in Hong Kong in local currency terms was down by three per cent. The underwriting result was the same as in 1996. During the year a new distribution strategy was adopted for our Hong Kong operation. Elsewhere in Asia we have been active in identifying opportunities for the development of our life and health businesses.

Guardian Investment Holdings

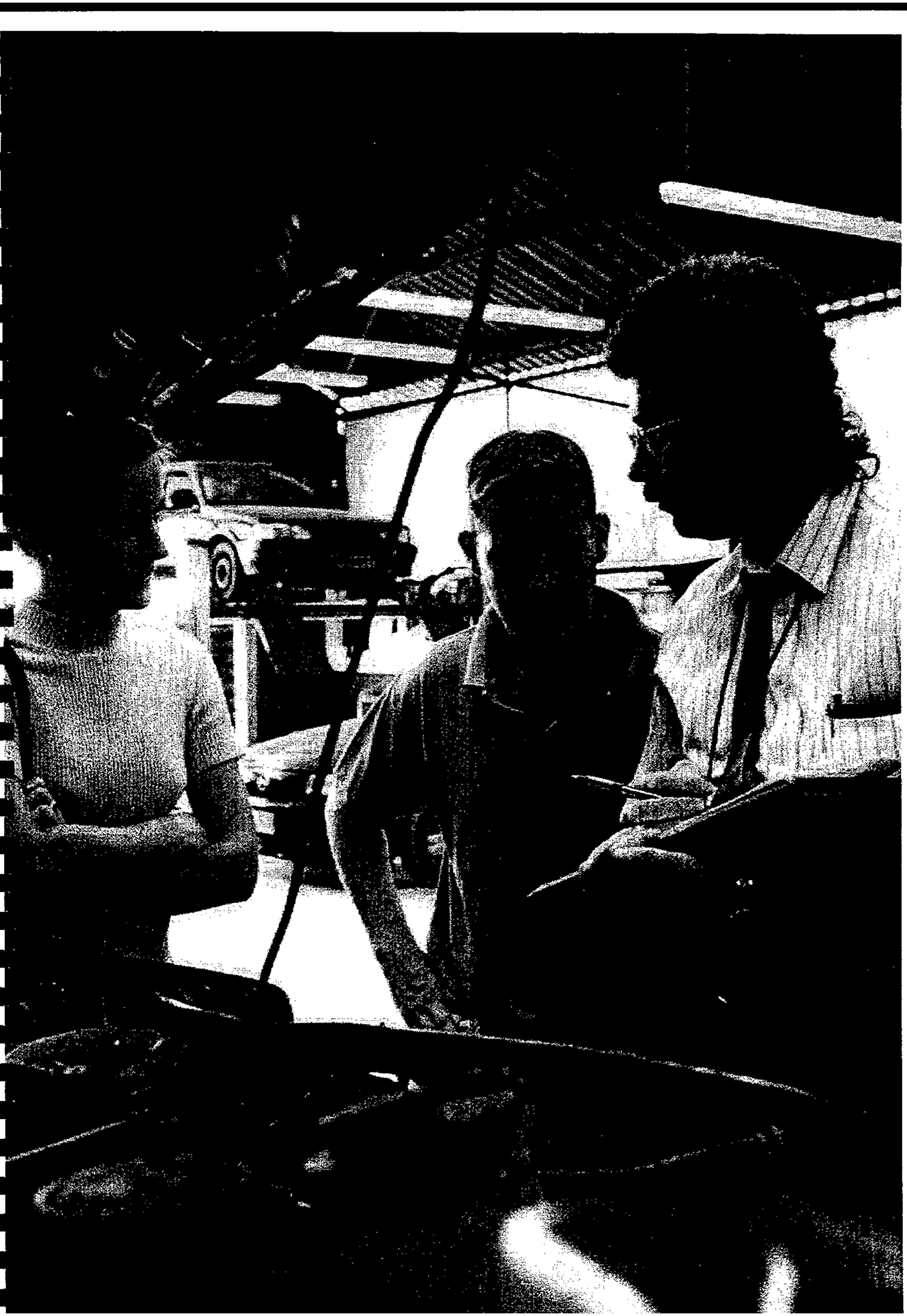
Guardian Investment Holdings (GIH) had another outstandingly successful year. Total funds managed by the Group's investment managers were £28 billion, including those assets held on behalf of third parties.

The distribution of the Group's main investment portfolios and performance achieved against the benchmark indices is shown below:

	Carrying value 31.12.97 £m	Performance in 1997 Actual	Benchmark index
Fixed interest portfolios			
Canadian	301	7.0%	4.9%
German	166	8.8%	6.6%
Irish	382	11.5%	9.0%
UK	609	12.0%	8.1%
US	624	8.1%	6.7%
Equity portfolios	3,419	24.4%	23.6%

Investment returns have exceeded the benchmarks for all major portfolios except the equity portfolio in Germany which is significantly tax constrained.

For the fifth year running Guardian Asset Management delivered a performance superior to that of the relevant UK indices for the Group's UK funds under management.



Guardian Asset Management won a series of Professional Pensions Pooled Awards; in addition Guardian Unit Managers was placed first by Standard & Poors Micropal for the performance, over five years, of the Guardian Gilt & Fixed Interest Unit Trust.

Following the appointment of a marketing director in June, to raise the Company's profile in the investment community generally and to build awareness of its investment performance achievements in particular, a concentrated marketing programme aimed at supporting Guardian Employee Benefits was undertaken. Already results are showing through with a joint team from Guardian Asset Management and Guardian Employee Benefits winning significant new business in the face of stiff competition.

In the age of increasing consumer choice it is essential that we are agile enough to respond to fast-changing market conditions.

Guardian Properties also completed a successful year following the restructuring of the main Life Fund – all portfolios achieved their targets against benchmark. During the year, the company completed the £18 million refurbishment programme on the company's offices in Ipswich.

Guardian Mortgage Services (GMS) also had a good year, securing the administration of a £1 billion housing loan portfolio. The company undertook the biggest re-registration of Certificates of Title ever performed by HM Land Registry.

Royal Exchange Trust Company won a number of prestigious accounts during the year and handled record securities business with total funds of £9.7 billion. It also achieved the Investors in People award. This award was also achieved by GMS. The award recognises public commitment to the training and development of employees to achieve specific business objectives.

Millennium

The company has conducted a thorough review on its state of preparedness for the millennium and its possible impact on computer and other electronic systems. This review also covered the progress made by suppliers and other intermediaries. Essential millennium compliance activities are expected to be completed by the end of 1998, and the estimated total external cost of the reviews and remedial work is expected to be in the order of £40 million.

Summary

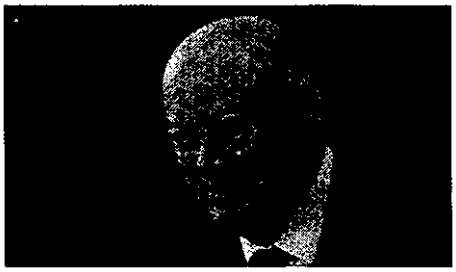
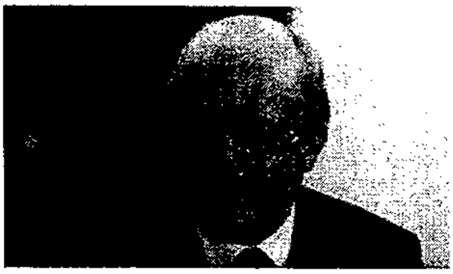
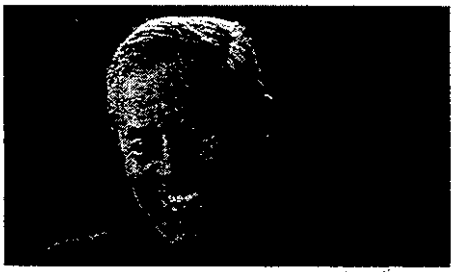
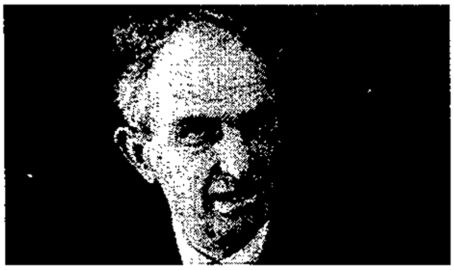
In last year's report we said: 'We will be active only in profitable market segments where we can achieve a leading position; we will manage costs rigorously; we will offer products that customers really want and market them effectively under a strong brand name. These are the ways in which we shall deliver value to our shareholders and security to our employees throughout the world.'

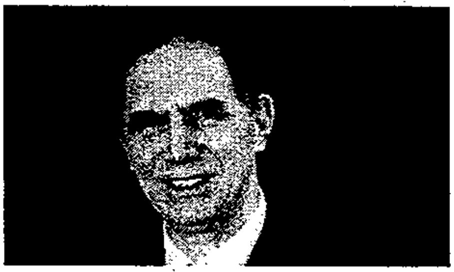
We believe that we have made significant progress on all these fronts. The acquisition of PPP healthcare gives us the number two position in the provision of healthcare insurance in the UK, operating under a well-established name and complementing our Guardian Health operation. We have significantly reduced the cost base in Asia and the UK and made good progress on this front elsewhere. We have appointed a Group Marketing Director to oversee the adoption of sound marketing techniques throughout the Group.

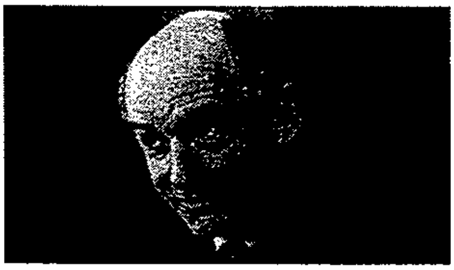
We will pursue the same principles with vigour in the coming years. In the age of increasing consumer choice it is essential that we are agile enough to respond to fast-changing market conditions. We expect these competitive conditions to become tougher in the coming years, but we believe that the Group has the strategy which will enable us to prosper in the future.

In assessing damaged vehicles, service and speed of response are central to providing good customer service.

Directors



Lord Hambro (age 67)
Chairman
Director of Hambros PLC and Chairman from 1983 until 1997, a director of Peninsular & Oriental Steam Navigation Company and San Paolo Bank Holdings SpA. Also Chairman of the Royal National Pension Fund for Nurses.

Julian Sheffield (age 59)
Deputy Chairman
Chairman of Portals Group plc 1979 to 1995. A director of De La Rue plc and Inspec plc. Since 1971 a trustee of Henry Smith's Charities and Chairman since 1997.

John Robins (age 59)
Group Chief Executive
Appointed to the Board in April 1994. Appointed Group Chief Executive on 1 July 1994. He was Group Financial Director at Willis Corroon Group plc from 1984 to 1994, having previously been Group Financial Director of Fitch Lovell plc and Chief Executive of Bally Group (UK) Ltd. A non-executive director of Hyder plc.

The Hon. Edward Adeane (age 58)
Practised at the Bar from 1962 to 1978 and Private Secretary and Treasurer to HRH The Prince of Wales from 1979 to 1985. A director of Hambros PLC (from 1992 to February 1998), English and Scottish Investors plc, and The British Library.

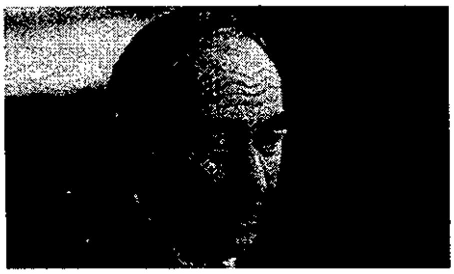
Volker Bremkamp (age 54)
Group Executive Director – Continental Europe
Appointed to the Board on 1 September 1995. Joined Albingia in 1963 and qualified in insurance economies in 1966. Served in Paris and London and held management positions in claims, reinsurance and marketing before becoming Chief Executive of Albingia in 1988. Deputy chairman of the German Atomic Pool and of the German Insurance Employers' Association. He is a German citizen.

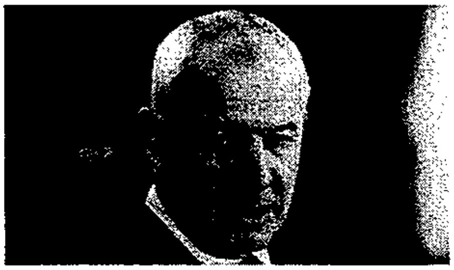
Caroline Burton (age 48)
Group Executive Director – Investment
Appointed to the Board in 1990. Joined Guardian Royal Exchange Group in 1973. Was Investment Manager (Stock Exchange Overseas), and Managing Director of Guardian Asset Management before becoming Investment Director in 1990. A non-executive director of The Scottish Metropolitan Property plc and a member of the Board of the London Pension Funds Authority.

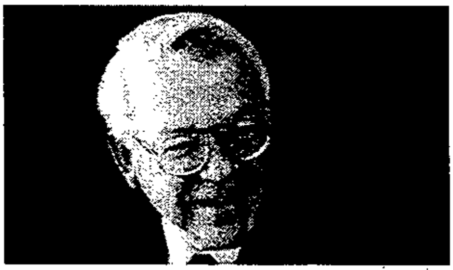
Sir Colin Chandler (age 58)
Group Chairman and Chief Executive of Vickers P.L.C. A director of the TI Group plc. A member of the National Defence Industries Council and a vice president of the Engineering Employers' Federation.

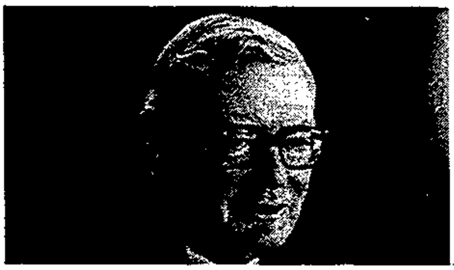
Sir Brian Hayes (age 68)
Permanent Secretary at the Department of Trade and Industry until 1989. A director of Tate & Lyle plc and an advisory director of Unilever plc. He is the Lloyd's Members' Ombudsman.

James Morley (age 49)
Group Executive Director – Finance
Appointed to the Board in 1990. Qualified as an accountant with Arthur Andersen before joining Avis Europe plc and ultimately becoming Finance Director and Deputy Chief Executive. Joined Guardian Royal Exchange Group in 1990 as Finance Director. A non-executive director of The Bankers Investment Trust plc.









Audit Committee
* The Hon. Edward Adeane
* Sir Brian Hayes GCB
* Sir Paul Newall TD, DL
* Sir Peter Reynolds CBE

Investment and Risk Management Committee
* Lord Hambro
* Julian Sheffield
John Robins
Caroline Burton
James Morley
* Sir Paul Newall TD, DL
* Sir Anthony Tennant

Remuneration and Nomination Committee
* Lord Hambro
* Julian Sheffield
* Sir Colin Chandler
* Sir Brian Hayes GCB
* Sir Anthony Tennant

* Non-executive directors

Secretary
John Clayton

Auditors
Price Waterhouse

Solicitors
Slaughter & May

Stockbrokers
Cazenove & Co
Credit Lyonnais Laing

Registrar
Lloyds Bank Registrars

Registered office
Royal Exchange
London EC3V 3LS

Registered number
1821312

Sir Paul Newall (age 63)
Senior adviser to Lehman Brothers, Vice President of The Institute of Export, member of the Advisory Committee of Energy International NV, former allied member of the New York Stock Exchange, Pro-Chancellor and Chairman of the Council of City University and Lord Mayor of London 1993 to 1994.

Peter Owen (age 51)
Group Executive Director – Healthcare.
Group Chief Executive of PPP healthcare group. Appointed to the Board in February 1998. He was employed with British Airways from 1969, being Director of Operations from 1986 to 1990, Chief Executive Officer Europe for Innocan PLC from 1990 to 1994 and Group Chief Executive of Aer Lingus from 1993 to 1994.

Ray Pierce (age 51)
Group Executive Director – Marketing
Appointed to the Board in July 1997. Joined Guardian Royal Exchange Group in September 1993 and is Managing Director of Guardian Insurance and Guardian Direct. He was Chief Executive of Robson Rhodes from 1992 to 1993, was with The Mortgage Corporation for five years, latterly as Chief Executive and was previously a Vice President with American Express Europe.

Sir Peter Reynolds (age 68)
Group Managing Director of Ranks Hovis McDougall PLC from 1972 to 1981 and Chairman 1981 to 1989. Chairman of Pioneer Concrete Holdings PLC and a director of Pioneer International Limited of Australia, Cilva Holdings PLC, Avis Europe Limited and The Boots Company plc.

John Sinclair (age 50)
Group Executive Director – UK and Ireland
Joined UK member company of Guardian Royal Exchange Group in 1967 and qualified as an actuary. Held management positions in marketing, direct selling, financial services, information technology, administration services and field operations before becoming Managing Director for UK operations in 1990. Appointed to the Board in 1990. Chairman of the Board of the Insurance Ombudsman Bureau.

Sir Anthony Tennant (age 67)
Senior Advisor to Morgan Stanley UK Group, Deputy Chairman of Arjo Wiggins Appleton plc. A director of Christie's International plc since 1993 and Chairman 1993 to 1996. A director of BNP UK Holdings Ltd. Group Chief Executive of Guinness plc 1987 to 1989 and Chairman 1989 to 1992.

Victor Yerrill (age 57)
Group Executive Director – The Americas
Appointed to the Board on 1 September 1995. Joined Guardian Royal Exchange Group as Marine Manager in Hong Kong in 1965. Held management positions in Osaka, Tokyo and Toronto before joining USA operations in 1972. Has been Chief Executive Officer of GRE-USA Corporation since 1974. Born in England, he is now a US citizen.

The directors of Guardian Royal Exchange plc (the Company) present their annual report together with the accounts of the Company for the year ended 31 December 1997.

Principal activities and business review

The Company is the holding company of the Guardian Royal Exchange Group (the Group) which carries on insurance, financial services and investment business in the United Kingdom and throughout the world. This report should be read together with the Chairman's statement on pages 2 and 3, the Chief Executive's review on pages 4 to 7 and the Group Executive Director – Finance's review on pages 32 to 34, which describe the Group's business and financial performance during the year.

Directors

The names of the directors at the date of this report are set out on pages 24 and 25, together with biographical details.

Mr R F Pierce was appointed to the Board on 29 July 1997 and Mr P E Owen was appointed to the Board on 24 February 1998 and they will seek re-election at the Annual General Meeting.

The following directors will retire by rotation and seek re-election at the Annual General Meeting: Lord Hambro, Sir Paul Newall, Sir Peter Reynolds and John Sinclair.

The non-executive directors do not have service contracts. Details of the service contracts of the executive directors are set out on page 29.

Details of directors' interests in the share capital of the Company and other transactions with the Company are set out on pages 61 and 62. As permitted by the Companies Act 1985, insurance was effected during the year on behalf of the directors and secretary in respect of liabilities arising in the course of their duties.

Directors' remuneration

The remuneration of executive directors is determined by the Remuneration and Nomination Committee. Their report is given on pages 28 and 29.

The fees and other benefits of non-executive directors are determined by the Board, with the non-executive directors abstaining from the decision. The process takes into account external reviews and surveys of the levels of remuneration in comparable companies.

The Non-executive Pension and Life Assurance Scheme, which was closed to new entrants in 1994, was fully closed on 31 December 1997 and no further service will be accrued after that date.

Corporate governance

The principal Board committees are as follows: Audit Committee, Investment and Risk Management Committee, Remuneration and Nomination Committee.

Details of the membership of these committees are set out on page 25.

The Company has complied with the requirements of the Cadbury Code of Best Practice throughout the period covered by this report. The directors' responsibilities for the financial statements are set out on page 30, together with the required statement on the use of the Going Concern basis in preparing financial statements.

The report of the auditors on corporate governance matters is given on page 31.

Share capital

Details of the share capital of the Company are set out in note 16 on page 56.

Substantial shareholdings

According to the register maintained under section 211 of the Companies Act 1985 in respect of share notifications received by the Company, as at 11 March 1998 only the Schroder group of companies with 135,215,043 shares (representing 14.67 per cent of the issued ordinary shares) and the Prudential Group with 38,911,820 shares (representing 4.22 per cent) held an interest in three per cent or more of the share capital of the Company.

Dividends
The directors recommend a final dividend of 7.6p net per ordinary share (1996: 6.6p) to be paid on 1 July 1998 to holders on the register at the close of business on 27 March 1998. This, together with the interim dividend of 3.9p net per share (1996: 3.4p) paid on 2 January 1998, would make a total dividend for the year of 11.5p per net share (1996: 10.0p). This would represent an increase of 15 per cent on the 1996 total dividend. The transfer to reserves is shown on page 39.

UK employees
In selection for employment, subsequent promotional opportunities and all other employment matters, the Group maintained its commitment to its Equal Opportunities policy.

Particular attention is given to applications for employment from people with disabilities, to ensure full account is taken of their aptitudes and abilities. Whenever possible, an employee who becomes disabled during the course of employment has the opportunity to continue a career with the Group with appropriate retraining and all steps are taken to minimise the difficulties encountered. The Company is a member of the Employers' Forum on Disability. The Company has implemented the requirements of the Disability Discrimination Act.

Where employees have been affected by restructuring within the Group, support services have been provided to minimise the psychological impact and, where appropriate, to assist with the search for alternative employment.

Reflecting its continued commitment to effective two-way communications, the Company has kept employees informed of the Group's performance and development, including the financial and economic factors which influence these matters. Employees and their union representatives have been consulted on a regular basis regarding matters of interest and concern. The first meeting of the Group Forum for employee representatives of the worldwide Group was held in January 1998.

The Group's policy is to encourage employees to associate themselves with Group performance and to establish a clear link between individual performance and remuneration. A variety of incentives is available to individuals and teams. Most employees have benefited from our profit sharing and incentive schemes and many have had the opportunity to participate in share option schemes.

The Annual Incentive Plan reflects performance against strategic targets or achievement of key personal or team milestones, which are linked to performance appraisal objectives.

The employee appraisal system is monitored to ensure all employees receive continuing formal and informal feedback on their performance. Training is provided to enable all employees to fulfil their potential, and self-development is strongly encouraged and supported.

Policy relating to trade suppliers
As a holding company and for commercial convenience, the Company's purchasing is carried out through a subsidiary. Its policy is to settle balances within agreed credit terms, which vary according to trading relationships. Balances outstanding at 31 December 1997 represented a credit period of 29 days.

Donations
Donations made by the Group during 1997 to charitable organisations within the United Kingdom amounted to £424,331. A contribution of £50,000 was made to the Conservative Party.

Annual General Meeting
The Annual General Meeting will take place on 28 April 1998 in Goldsmiths' Hall. Details of the meeting and of the business to be transacted, including the proposed re-appointment of Price Waterhouse as auditors, are set out in the accompanying Notice of Meeting.

By order of the Board.

JRWClayton JRWClayton

J R W Clayton
Secretary
11 March 1998

Remuneration and Nomination Committee report

The Report of the Remuneration and Nomination Committee, the members of which are listed on page 25, is as follows.

The Committee, which is comprised exclusively of non-executive directors, is empowered by the Board to determine and review the remuneration of executive directors taking into account the position of the Company relative to comparable companies and taking independent advice where appropriate. The key objectives of the Group's remuneration policy, which applies to directors in common with other senior executives, are:

- to ensure that individual rewards and incentives are aligned directly with the performance of the Company and the individual, and with the interests of shareholders, and
- to maintain a competitive programme which enables the Company to attract, motivate and retain executives of the highest calibre.

The Company has been in full compliance throughout the period with the Best Practice (Appendix A) provisions which have been introduced into the Listing Rules of The Stock Exchange (the Rules) based on the requirements of the Greenbury Report. The Committee, in framing its policy, has also given full consideration to the matters set out in Appendix B of the Rules.

Basic salary and benefits

The level of basic salary and benefits for each of the executive directors is based on external annual surveys of comparable companies in the relevant country. Individual salaries are reviewed annually by the Committee and adjusted by reference to performance and responsibilities. No element of remuneration apart from basic salary is pensionable.

Incentive plans

As previously reported, the Company has two levels of incentive plan – one on an annual basis and the other long term.

1 Annual variable incentive awards

Awards to executive directors and other managers are considered annually, based on the attainment of defined management objectives and the extent to which the Company has outperformed the other UK composites in the attainment of core financial performance. These awards may be received in cash and, for the purposes of reporting the emoluments of executive directors, are accounted for in respect of the year in which they are earned. However, to encourage share ownership by employees and to foster loyalty, the Company has introduced a bonus co-incentive plan (BIP).

The BIP allows annual award recipients to invest up to half of their post-tax bonus in the Company's shares for a period of three years. As an incentive, the Company will award participants matching shares equal to the pre-tax value of the sum invested. Provided the participants remain with the Company, all their shares will be released at the end of the three-year retention period. If a participant leaves before the end of the period, the matching amount is forfeited.

2 Long-term incentives

The Long-Term Incentive Plan (LTIP) applies to the most senior executives of the Group, including the executive directors. The Plan is currently operating in respect of a Performance Period of four years which commenced on 1 January 1995. Shares will become available for vesting to participating executives early in 1999, subject to the level of Total Shareholder Return (TSR) of the Company relative to that of the four other principal UK composite insurers listed in the FTSE 100: Commercial Union, General Accident, Norwich Union (included with effect from 1 January 1998) and Royal & Sun Alliance (included as two companies prior to their merger in 1996). The TSR is calculated on the basis of the percentage increase in share price during the Performance Period increased by the value of re-invested dividends.

The TSR is calculated for each of the comparator companies over the four year Performance Period, and the performances are then ranked. If the Company's performance is ranked first, the share allocations will vest in full; if the Company is ranked second, two-thirds of the allocations will vest; and if the Company is ranked third, one-third of the allocations will vest, provided in each case that the cumulative TSR exceeds the increase in the Retail Price Index (RPI) for the same period. If the Company is ranked fourth or fifth, or TSR does not exceed RPI, none of the allocations will vest and they will lapse.

The maximum allocation per eligible employee for first rank performance over the four year period is calculated by reference to the number of shares equivalent in value (based on the share price at the beginning of the period) to one year's salary at the date of entry into the Plan. It is anticipated that on any extension of the LTIP, the next Performance Period would commence on 1 January 1999.

Participants in the LTIP are not eligible for any further awards of share options, other than those arising from participation in the Company's Save as You Earn Option Scheme.

3 Directors based outside the UK

Mr V Bremkamp and Mr V M Yerrill participate in the incentive arrangements in place for senior executives in Germany and the USA respectively. They also participate in the Group Annual and Long-Term Incentive Plans, with appropriate adjustments to reflect the local incentive arrangements which are aligned solely to business performance in the territories for which they are responsible.

Pensions

Executive directors participate in the Pension Schemes which exist for employees and other senior executives in the countries in which they are based.

Other benefits

Other benefits including vehicles provided to executive directors reflect market practice in the country in which each is based.

Service contracts

The Company's policy is to limit the notice period for the service contracts of executive directors to 12 months except in special circumstances.

Mr J V H Robins, Ms C M Burton, Mr J Morley, Mr R F Pierce and Mr J Sinclair, being UK-based executive directors, have service contracts which are terminable by either party on 12 months' notice.

Mr P E Owen, who became a director on 24 February 1998 following the acquisition of the PPP healthcare group, has a service contract with PPP healthcare group plc which is terminable on 24 months' notice, this period reducing on a phased basis so that with effect from 24 July 1999 the notice period required will be 12 months.

Mr V M Yerrill (Group Executive Director – The Americas) and Mr V Bremkamp (Group Executive Director – Continental Europe) have service contracts relating to their principal operational responsibilities as, respectively, President and Chief Executive Officer of GRE-USA Corporation and Chairman of the Management Board (Vorstandsvorsitzender) of Albingia Versicherungs AG. Following external remuneration surveys, the terms and duration of appointment are considered to be reasonable and necessary in accordance with the requirements of the local market and practice in the USA and Germany respectively. Separately, each has a UK service contract relating to his additional responsibilities as an executive director of the Company which is terminable on 12 months' notice.

Mr Bremkamp's appointment as Chairman of the Management Board of Albingia is, in accordance with German practice, for a fixed term of five years expiring on 31 December 2002.

Mr Yerrill's appointment in the USA expires on 31 December 2000, extendable by successive periods of 12 months unless notice not to extend is served by 31 December 1998 or successive year ends; it may be terminated by notice of a period varying between two and three years depending upon when the notice is served.

Policy on early termination

As set out above, the Company's policy has been to limit the notice requirement to the minimum period consistent with normal practice in the relevant country. In any case of early termination, the Company would not pay more compensation than was justified by the Company's contractual obligations, based on a fair assessment of the actual performance of the individual director concerned.

Further details

Further details of directors' remuneration and of pension and other benefits are set out in note 23 on pages 60 to 63.

Directors' responsibilities for the financial statements

The directors are responsible for the Group's system of internal financial control and for ensuring that reasonable steps are taken to safeguard the Company's assets and to prevent and detect fraud and other irregularities.
The basis of insurance is the transfer of financial risk from policyholder to insurer with the potential for financial loss by the insurer. As a consequence, the insurance industry is closely monitored in all countries. In the United Kingdom the Department of Trade and Industry regulates insurance companies and similar regulatory bodies exist in the other major territories in which the Group operates. In addition, in the UK, the life and investment activities of the Group are regulated by the Personal Investment Authority (PIA), and the Investment Management Regulatory Organisation (IMRO).

Internal financial control systems are established in order to provide reasonable, but not absolute, assurance that:

- the assets of the company are safeguarded and protected against unauthorised use or disposition
- the financial information used within the business and for external publication is reliable and the accounting records properly maintained.

The directors have identified the following areas as integral parts of the Group's internal financial control procedures:

- clear lines of responsibility with appropriate delegation of authority have been established
- authorisation limits, financial and otherwise, have been established
- the Group Chief Executive meets with the senior executives of the businesses regularly throughout the year to review performance
- underwriting procedures on the acceptance of risks have been established and are reviewed on a regular basis
- procedures have been established for the determination and implementation of investment policies and the monitoring of investment activities
- actual performance is compared against that expected in the annual budgets and strategic plans and reviewed by the Board
- employees are carefully selected and trained for their areas of responsibility.

Additionally internal and external auditors, together with the Group Executive Director – Finance, report regularly to the Audit Committee of the Board.

The effectiveness of the systems of internal financial control is reviewed by a process of structured self-assessment. This involves each business unit identifying the risks within its areas of responsibility and assessing the significance of those risks. Existing controls are then assessed against those risks. These reviews are facilitated by the internal audit department and the results are considered by the external auditors, the Audit Committee and the Board.

The directors are required to maintain proper accounting records and to prepare true and fair financial statements in respect of each accounting period in accordance with the provisions of the Companies Act 1985 (as amended) applicable to insurance companies.

In preparing these financial statements, the directors have ensured that applicable accounting standards have been followed and that suitable accounting policies have been followed on a consistent basis. The directors have also ensured that, where necessary, the accounts are supported by reasonable and prudent judgement and estimates.

After making enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue in operation for the foreseeable future. For this reason, they continue to adopt the Going Concern basis in preparing the financial statements.

Lord Hambro
Chairman

J V H Robins
Group Chief Executive

Report by the auditors to the directors of Guardian Royal Exchange plc on corporate governance matters

In addition to our audit of the financial statements, we have reviewed your statements on pages 26, 27 and 30 concerning the Group's compliance with the paragraphs of the Cadbury Code of Best Practice specified for our review by the London Stock Exchange and the adoption of the Going Concern basis in preparing the financial statements. The objective of our review is to draw attention to non-compliance with Listing Rules 12.43(j) and 12.43(v) of the Code, if not otherwise disclosed.

Basis of opinion

We carried out our review in accordance with guidance issued by the Auditing Practices Board. That guidance does not require us to perform the additional work necessary to, and we do not, express any opinion on the effectiveness of either the Group's system of internal financial control or corporate governance procedures nor on the ability of the Group to continue in operational existence.

Opinion

In our opinion, your statements on internal financial control and on Going Concern on page 30, have provided the disclosures required by the Listing Rules referred to above and are consistent with the information which came to our attention as a result of our audit work on the financial statements.

In our opinion, based on inquiry of certain directors and officers of the Company and examination of relevant documents, your statement on page 26 appropriately reflects the Group's compliance with other aspects of the Code specified for our review by Listing Rule 12.43.

Price Waterhouse

Chartered Accountants
11 March 1998

Southwark Towers
32 London Bridge Street
London SE1 9SY

Accounting matters

The financial statements of composite insurance companies historically have contained many unique features and concepts.

Accounting for Investment Returns has continued to be debated within the industry, but a consensus is now being achieved. The Group has been a strong advocate of, and fully supports, the proposals in the draft Statement of Recommended Practice (SORP), currently under public review.

The treatment of equalisation reserves has developed during the year. Following widespread consultation within the Industry, within the Accounting Profession and with the Financial Reporting Review Panel, the Group has decided to change its accounting policies and treat these reserves as if they were liabilities in the Group consolidated accounts. This change is more fully described in accounting policy IIc on page 45.

The table below adjusts the information contained in the financial statements to a basis which reflects our preferred accounting treatment for investment returns. The table also adjusts life business to an embedded value basis. In both cases, our preferred approach has not been included in the financial statements themselves, pending the resolution of the Statement of Recommended Practice referred to above.

Acquisition of the PPP healthcare group

On 23 February 1998 the Group's agreement to purchase the PPP healthcare group was completed. As the transaction was not completed in 1997, we will not be reporting on the PPP healthcare group financial results until the Group

Summarised financial information

for the year ended 31 December 1997

				1997	1996
	As published		Adjustments	Adjusted	Adjusted
Consolidated profit and loss account (embedded value)	£m	Life £m (note i)	Investment £m (note ii)	£m	£m
Net written premiums – General business	2,762			2,762	2,914
– Life business	783			783	818
	3,545			3,545	3,732
Operating results – General business	319		(173)	146	192
– Life business	29	32	(14)	47	47
– Corporate investment	554		187	741	435
Profit before taxation	902	32		934	674
Equalisation reserves	(30)			(30)	(33)
Taxation	(240)	(14)		(254)	(176)
Minority interests	(34)			(34)	(36)
Earnings	598	18		616	429
Shareholder net assets	2,669	261		2,930	2,481
Earnings per ordinary share	65.5p	2.0p		67.5p	47.3p
Net assets per ordinary share	290p	29p		319p	273p

Note (i) The life results shown in the statutory accounts are stated on a modified statutory basis. The life adjustment shown above brings this on to an embedded value basis.
Note (ii) The investment adjustment modifies the investment return allocated to general and life businesses so as to reflect a long-term rate of return applicable to the investments which support that business in line with the draft Statement of Recommended Practice (SORP) on accounting for insurance business now under public discussion.

reports its half year results in July. Nevertheless we believe that it would be helpful to give an indication of the implications of this transaction and have therefore included two proforma statements on page 35. The first shows the impact that the transaction would have had on the Group's Profit and Loss account if the acquisition had been completed on 1 January 1997 and the second shows the effect of the acquisition on the Group's Balance Sheet as though completion had been effected on 31 December 1997. The Group financed the acquisition by the disposal of some of its equity investments, and for the purpose of these proforma statements the financing cost is assumed to be the long-run return from UK equity investments that would apply under the proposed SORP.

Capital adequacy

The principal businesses of the Group – General Insurance and Life Assurance – are supervised by regulatory authorities whose primary duty is to protect policyholders' interests. Although regulatory requirements differ between jurisdictions, the relationship between premiums written and net assets is frequently used as a reference point, and is referred to as the solvency level. The Group seeks to maintain solvency in individual operations at the lowest sustainable level, while maintaining the Group's solvency at a higher level. Group capital can thus be readily deployed to support our operations wherever appropriate. The solvency of the Group at 31 December 1997, after taking account of the acquisition of the PPP healthcare group with the resultant goodwill deducted from net assets and the return of capital described below, was a satisfactory 72 per cent.

Risk management

The activities of the Group involve the acceptance of two principal types of risk, that arising from insurance contracts and that from investment activities. The Group monitors and adjusts its exposure to these risks to ensure that the aggregate risk profile is acceptable.

Insurance risk is adjusted primarily through underwriting acceptance criteria and reinsurance programmes. Each year Group management agrees with the individual operations the levels and types of business which they intend to accept during the following year and then determines the level of risk to be retained through suitable reinsurance programmes. Internal reinsurance programmes are used to achieve the level of retention of risk appropriate to individual businesses. The level of risk retention appropriate for the Group as a whole is managed through the use of external reinsurance programmes.

Investment risk arising from the composition and mix of the investment portfolios is monitored on a regular basis to ensure that the values of investment in individual securities or classes of security are not excessive given current and anticipated volatility of investment markets. Derivative instruments are only used to protect existing positions and not as investments in their own right. Any use of derivatives requires prior authorisation and exposures are subject to monthly review by the Board.

Foreign exchange

Changes in the rates of exchange between Sterling and other currencies affect the Group in three different areas: the amounts at which the results of overseas operations are included in the consolidated profit and loss account, the values at which the net assets of the overseas operations are included in the consolidated balance sheet, and the amounts at which assets and liabilities arising in a foreign currency are included in the accounts of individual companies. If the exchange rates prevailing in 1996 had continued throughout 1997 then the Group's profit before tax and net assets would have been respectively £57 million and £130 million greater.

The Group's policy is that it is not appropriate to hedge either the exposure to foreign currencies in respect of the results of overseas operations, or the net assets which are deemed to support those operations. The Group does, wherever financially justified, seek to reduce any net asset exposure to foreign currencies in excess of that deemed to support the underlying business activities. This is usually achieved by means of debt.

The Group's policy is that foreign currency liabilities arising within individual companies should be matched by appropriate assets in the same currencies.

Debt

The Group's policy is to use debt for three purposes: on a short-term basis to cover any temporary cash flow imbalances; on a medium-term basis to finance acquisitions and on a long-term basis to help manage the Group's net asset exposure to foreign currencies. For some years, virtually all of the debt carried by the Group has been denominated in foreign currencies to reduce the Group's exposure to foreign exchange fluctuations. Freely deployable cash or short-term assets can be used to repay the outstanding debt should this be desirable. In effect the Group has no net borrowings.

Return of capital

The Group believes in the active management of its capital base. After taking account of its present capital position following the acquisition of the PPP healthcare group and the likely future capital requirements, the directors consider it appropriate to return some capital to shareholders. In the light of the Group's capital structure and the imminent cessation of Advance Corporation Tax, the directors have concluded that the issue of redeemable B shares, capitalised out of the Share Premium Account, is the most efficient means of achieving this return and that an amount of 20.5 pence per existing ordinary share, approximately £189 million, is appropriate to return at this time. Immediately following this return, which represents approximately 4.7 per cent of the Group's market capitalisation on 24 February 1998, it is also proposed that the number of ordinary shares in issue be reduced by a similar percentage.

This procedure will require shareholder approval, and is described more fully on page 59. It will be further described in a circular which will accompany the Notice of Extraordinary General Meeting to be sent to shareholders.

Dividend

The Group's dividend is a central part of the total return to shareholders. The Board has determined that the dividend policy should be progressive, with the dividend increasing steadily over time. In view of the volatility of underwriting and investment gains, the trend in earnings may therefore differ from that for the dividend. In determining the appropriate dividend for any year the Board considers a number of factors, which include the current solvency of the Group, the projected results through the insurance cycle and the future capital needs of the Group.

James Morley
Group Executive Director – Finance

Proforma statement to reflect impact of PPP healthcare acquisition

Profit and loss account for the year ended 31 December 1997	As reported £m	PPP healthcare £m	Financing & goodwill £m	Combined £m
Written premiums	3,545	590		4,135
Underwriting results:				
General business	(148)	(9)		(157)
Life business	29	(11)		18
	(119)	(20)		(139)
Investment return				
Investment income net of expense and interest	313	21	(12)	322
Investment gains	711	53	(24)	740
Share of associates	22	7	–	29
Corporate expenses	(25)	–	–	(25)
Operating profit before tax	902	61	(36)	927
Increase in equalisation reserves	(30)	–	–	(30)
Profit/(loss) before taxation	872	61	(36)	897

Balance sheet as at 31 December 1997	As reported £m	PPP healthcare £m	Financing & goodwill £m	Combined £m
Intangible assets	–	7	152	159
Investments	14,720	539	(402)	14,857
Other assets	5,521	385	–	5,906
Total assets	**20,241**	**931**	**(250)**	**20,922**
Technical provisions	14,513	405	–	14,918
Other liabilities	3,059	276	–	3,335
Total liabilities	**17,572**	**681**	**–**	**18,253**
Net assets	**2,669**	**250**	**(250)**	**2,669**
Representing:				
Share capital	46	100	(100)	46
Share premium	221	–	–	221
Reserves	2,402	150	(150)	2,402
Equity shareholders' funds	**2,669**	**250**	**(250)**	**2,669**
Shareholders' funds including embedded value	**2,930**	**250**	**(250)**	**2,930**

Notes:

(i) Profit and loss account assumes that the PPP healthcare acquisition was made at beginning of 1997. PPP healthcare results have been adjusted to conform with Group accounting policies based on unaudited management accounts for the 12 months to 31 December 1997. A total return of nine per cent has been assumed as the long run financing cost.

(ii) Balance sheet shows effect of the acquisition as if it had taken place on 31 December 1997.

(iii) Intangible assets arise from the PPP healthcare acquisition and represent the present value of PPP healthcare in-force long-term business, together with goodwill arising on the acquisition. No amortisation of this amount has been included in the combined profit before taxation.

(iv) This statement is provided for illustrative purposes only.

Auditors' report to the shareholders of Guardian Royal Exchange plc

We have audited the financial statements on pages 37 to 63 which have been prepared on the basis of the accounting policies set out on pages 45 to 47.

Respective responsibilities of directors and auditors

As described on page 30, the Company's directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the Company's and the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material mis-statement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Our evaluation of the presentation of information in the financial statements has had regard to the statutory requirement for insurance companies to maintain equalisation reserves. The nature of equalisation reserves, the amounts set aside at 31 December 1997, and the effect of the movement in those reserves during the year on the general business technical account and profit before tax, are disclosed in the accounting policies and note 1d to the accounts on page 49.

Opinion

In our opinion, the financial statements give a true and fair view of the state of the affairs of the Company and of the Group as at 31 December 1997 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Price Waterhouse

Chartered Accountants
and Registered Auditors
11 March 1998

Southwark Towers
32 London Bridge Street
London SE1 9SY

Consolidated profit and loss account

for the year ended 31 December 1997

General business technical account	1997 £m	1997 £m	Restated 1996 £m	Restated 1996 £m
Gross written premiums				
Continuing operations	**3,044**		3,197	
Discontinued operation	**-**		50	
		3,044		3,247
Outward reinsurance premiums		**(282)**		(333)
Net written premiums		**2,762**		2,914
(Increase)/decrease in provision for unearned premiums				
– gross	**11**		(67)	
– reinsurers' share	**(4)**		(12)	
		7		(79)
Net earned premiums		**2,769**		2,835
Allocated investment return		**454**		321
Other technical income		**82**		96
Claims paid				
– gross	**(2,298)**		(2,212)	
– reinsurers' share	**167**		183	
	(2,131)		(2,029)	
(Increase)/decrease in outstanding claims provision				
– gross	**15**		(63)	
– reinsurers' share	**10**		7	
	25		(56)	
Claims incurred		**(2,106)**		(2,085)
(Increase)/decrease in other technical provisions net of reinsurance		**7**		(1)
Net operating expenses (note 1c)		**(900)**		(955)
Operating result before movement in equalisation reserves		**306**		211
Change in equalisation reserves		**(30)**		(33)
Balance transferred to non-technical account		**276**		178

As explained in note 1d, equalisation reserves calculated by reference to accounting policy IIc are now included in the accounts. Comparative figures for 1996 have been restated to reflect the change.

Operating result before movement in equalisation provision represents the underwriting result and the investment return allocated to general insurance business:

	1997 £m	1996 £m
Underwriting result	**(148)**	(71)
Allocated investment return	**454**	321
Reorganisation provision	**-**	(39)
	306	211

Consolidated profit and loss account
for the year ended 31 December 1997

Life business technical account	1997 £m	1997 £m	1996 £m	1996 £m
Gross written premiums		**806**		843
Outward reinsurance premiums		**(23)**		(25)
Net written premiums		**783**		818
Investment income (note 2b)		**956**		838
Unrealised investment gains		**627**		239
Other technical income		**4**		3
Claims paid				
– gross	**(798)**		(878)	
– reinsurers' share	**13**		14	
	(785)		(864)	
Movement in outstanding claims provision				
– gross	**3**		(9)	
– reinsurers' share	**–**		–	
	3		(9)	
Claims incurred		**(782)**		(873)
Change in other technical provisions				
Life business provision:				
– gross	**(712)**		(392)	
– reinsurers' share	**18**		3	
	(694)		(389)	
Other technical provisions net of reinsurance	**(382)**		(86)	
		(1,076)		(475)
Bonuses and rebates		**(22)**		(13)
Net operating expenses (note 2c)		**(138)**		(125)
Investment expenses and charges (note 2d)		**(16)**		(20)
Tax attributable to life business		**(69)**		(38)
Transfer to fund for future appropriations		**(249)**		(335)
Balance transferred to non-technical account		**18**		19

Consolidated profit and loss account

for the year ended 31 December 1997

Non technical account	1997 £m	1997 £m	Restated 1996 £m	Restated 1996 £m
Balance transferred from general business technical account		**276**		178
Balance transferred from life business technical account	**18**		19	
Tax credit attributable to the balance on the life business technical account	**11**		12	
		29		31
Income from interests in associate undertakings (note 3)		**22**		40
Other investment income (note 4a)	**640**		512	
Unrealised investment gains	**428**		248	
Investment expenses and charges (note 4b)	**(44)**		(45)	
Investment return allocated to general business	**(454)**		(321)	
Other charges	**(25)**		(25)	
Corporate investment profit		**545**		369
Profit before taxation from:				
Continuing operations	**872**		616	
Discontinued operation	**–**		2	
		872		618
Taxation (note 5)		**(240)**		(166)
Equity minority interests		**(30)**		(32)
Non-equity minority interests		**(4)**		(4)
Profit after taxation and minorities		**598**		416
Dividends		**(106)**		(91)
Transfer to reserves		**492**		325
Earnings per ordinary share		**65.5p**		45.9p

The pre-tax profit for 1996 was arrived at after charging exceptional costs of £39m. These costs related to the restructure of the UK general business operation and the integration of two acquisitions.

The calculation of earnings per ordinary share is based on a profit of £598m (1996: £416m) and on a weighted average of 913,407,154 (1996: 906,155,416) ordinary shares after adjusting for partly paid shares.

Consolidated balance sheet
as at 31 December 1997

Assets	1997 £m	1997 £m	1996 £m	1996 £m
Investments				
Land and buildings (notes 6 & 8)	**790**		761	
Interests in associated undertakings	**97**		92	
Other investments (notes 6 & 8)	**13,807**		12,665	
Deposits with ceding companies	**26**		31	
		14,720		13,549
Assets held to cover linked liabilities		**3,228**		2,900
Reinsurers' share of technical provisions				
Provision for unearned premiums	**78**		83	
Life business provision	**70**		58	
Claims outstanding	**349**		369	
		497		510
Debtors				
Insurance operations (note 9)	**611**		627	
Reinsurance operations	**59**		51	
Other debtors	**411**		410	
		1,081		1,088
Other assets				
Tangible fixed assets (note 7)	**50**		55	
Stocks	**20**		12	
Cash	**146**		113	
		216		180
Prepayments and accrued income				
Accrued interest and rent	**172**		205	
Deferred acquisition costs	**310**		326	
Other	**17**		6	
		499		537
Total assets		**20,241**		18,764

Consolidated balance sheet
as at 31 December 1997

Liabilities and Reserves	1997 £m	1997 £m	Restated 1996 £m	Restated 1996 £m
Capital and reserves				
Called up share capital (note 16)		**46**		45
Share premium		**221**		193
Reserves (note 17)	**1,145**		919	
Retained profits (note 17)	**1,257**		1,074	
		2,402		1,993
Equity shareholders' funds		**2,669**		2,231
Minority interests				
Equity minority interests	**138**		121	
Non-equity minority interests	**15**		14	
		153		135
Fund for future appropriations		**1,302**		1,115
Technical provisions				
Provision for unearned premiums	**1,087**		1,113	
Life business provision	**6,749**		6,250	
Claims outstanding	**3,369**		3,493	
Equalisation reserves	**115**		93	
Other technical provisions	**–**		7	
		11,320		10,956
Technical provisions for linked liabilities		**3,193**		2,840
Provisions for other risks and charges (note 10)		**478**		356
Deposits received from reinsurers		**57**		48
Creditors				
Insurance operations	**75**		74	
Reinsurance operations	**43**		56	
Amounts owed to credit institutions	**256**		268	
Other creditors (note 11)	**624**		624	
		998		1,022
Accruals and deferred income		**71**		61
Total liabilities and reserves		**20,241**		18,764

Comparative figures for 1996 have been restated to reflect the inclusion of equalisation reserves as set out in note 1d.

Parent company balance sheet
as at 31 December 1997

	1997 £m	1997 £m	1996 £m	1996 £m
Fixed assets				
Investments				
Shares in subsidiary undertakings	**216**		402	
Ordinary stocks and shares	**3**		3	
Cash and deposits	**57**		31	
		276		436
Current assets				
Debtors				
Amounts due from life funds	–		1	
Amounts due from subsidiary undertakings	**536**		122	
Taxation	**11**		–	
		547		123
Creditors: amounts falling due within one year				
Interim ordinary dividend	**(36)**		(31)	
Proposed final dividend	**(70)**		(60)	
Amounts due to subsidiary undertakings	**(5)**		(11)	
Amounts due to life funds	**(1)**		–	
Current taxation	**(6)**		(6)	
Sundry creditors	**(1)**		(1)	
		(119)		(109)
Net current assets		**428**		14
Total assets less current liabilities		**704**		450
Provision for liabilities and charges				
Deferred taxation		–		(7)
		704		443
Representing:				
Share capital (note 16)		**46**		45
Share premium		**221**		193
Revaluation reserve		**1**		1
Reserves		**436**		204
Equity shareholders' funds		**704**		443

The accounts on pages 37 to 63 were approved by the directors and signed on 11 March 1998.

Lord Hambro
Chairman

J V H Robins
Group Chief Executive

Cash flow statement – general insurance and corporate

for the year ended 31 December 1997

	1997 £m	1997 £m	Restated 1996 £m	Restated 1996 £m
Operating activities				
Net cash inflow from operating activities (note 20a)		**217**		331
Returns on investments and servicing of finance				
Interest paid	**(29)**		(31)	
Dividends paid by subsidiaries to minorities	**(4)**		(4)	
		(33)		(35)
Taxation paid		**(96)**		(47)
Capital expenditure				
Purchases less sales of fixed assets		**(17)**		(24)
Acquisitions and disposals				
Acquisition of subsidiary undertakings	**–**		(9)	
Deferred purchase consideration relating to subsidiary acquired in 1996	**(9)**		–	
Disposal of subsidiary undertaking	**–**		42	
		(9)		33
Equity dividends paid		**(91)**		(81)
Financing				
Issue of ordinary share capital	**19**		19	
Increase/(decrease) in borrowings	**(15)**		13	
		4		32
Cash available for investment		**(25)**		209
Invested as follows:				
Increase/(decrease) in cash balances		**24**		(29)
Portfolio investments				
Ordinary and preference shares (note 20b)	**(234)**		234	
Fixed income securities (note 20b)	**(12)**		31	
Property (note 20b)	**(20)**		(14)	
Increase/(decrease) in deposits with credit institutions	**217**		(13)	
		(49)		238
Net cash invested		**(25)**		209

The cash flow statement has been prepared in accordance with the requirements of the amended Financial Reporting Statement No. 1. Comparative figures have been amended accordingly.

The cash flow statement does not include amounts relating to life business except cash transactions between life business and shareholders.

Statement of recognised gains and losses

for the year ended 31 December 1997

	1997 £m	Restated 1996 £m
Profit after taxation and minorities	**598**	416
Exchange losses on translation of overseas net assets not in profit and loss account	**(73)**	(147)
Total recognised gains and losses relating to the year	**525**	269
Prior year adjustment relating to the inclusion of claims equalisation reserves as liabilities as set out in note 1d	**(75)**	
Total gains and losses recognised in the year	**450**	

Reconciliation of movements in Group shareholders' funds

for the year ended 31 December 1997

	1997 £m	Restated 1996 £m
Profit after taxation and minorities	**598**	416
Dividends	**(106)**	(91)
Profit and loss account transfer to reserves	**492**	325
Goodwill written off	**–**	(134)
Exchange losses on translation of overseas net assets	**(73)**	(147)
Issue of ordinary share capital	**19**	19
	438	63
Shareholders' funds at beginning of year (originally £2,306m before deducting prior year adjustment, above, of £75m)	**2,231**	2,168
Shareholders' funds at end of year	**2,669**	2,231

I Basis of accounting and consolidation

a) The accounting policies adopted are in accordance with applicable United Kingdom accounting standards to the extent that they are appropriate to insurance companies and are in accordance with the guidance notes on accounting for insurance business issued by the Association of British Insurers.

b) The consolidated accounts are prepared in accordance with the requirements of the Companies Act 1985 as applicable to insurance companies.

c) The balance sheet of the Company is prepared in accordance with provisions applying to companies generally. As permitted by section 230 of the Companies Act 1985, a separate profit and loss account for the Company is not presented.

d) Investments in principal associated companies are valued in accordance with the equity basis of accounting.

II General business

a) Premiums

Premiums are accounted for in the period in which the risk commences. Unearned premiums relating to risks in future periods of account are calculated on a daily pro-rata, or more conservative, basis.

b) Claims

Provision is made for the estimated cost of claims outstanding at the end of the year, including those incurred but not reported at that date, and for the related costs of settlement. Claims incurred comprise amounts paid or provided in respect of claims occurring during the current year, together with the amount by which settlement or reassessment of claims from previous years differs from the provision at the beginning of the year.

c) Equalisation reserves

Equalisation reserves for United Kingdom subsidiary undertakings are calculated in accordance with the Insurance Companies (Reserves) Act 1995. Equalisation reserves for other subsidiaries are calculated by reference to local legislation where required by that legislation. These reserves are required by law to be treated as liabilities, notwithstanding the fact that they are an addition to the provisions required to meet the ultimate cost of settling claims outstanding at balance sheet date.

Previously, equalisation reserves were not included as liabilities in the Group accounts. Details of the impact of the change in policy are set out in note 1d on page 49 and on page 44.

d) Deferred acquisition expenses

Commission and other acquisition costs relating to unearned premiums are deferred and charged in the accounting periods in which those premiums are earned.

e) Unexpired risks

Provision is made for unexpired risks when, after taking account of investment income on insurance funds, it is anticipated that unearned premiums will be insufficient to meet the future claims and expenses of business in force at the end of the year. Classes of business which the directors consider are managed together are aggregated for this purpose.

f) Underwriting results

Underwriting results are recognised principally on an annual accounting basis. For that part of the business where the directors consider that information of sufficient accuracy is not available to permit a result to be determined annually, the recognition of an underwriting result is deferred for a period of one year for proportional reinsurance and for a period of two years for non-proportional reinsurance, marine and aviation business. Anticipated underwriting deficits are provided for as soon as they are foreseen.

g) Investment return
An investment return is included in the general business technical account on a basis which reflects the allocation of the underlying investment portfolio between general insurance business and shareholders' funds. The allocation of the investment return to general business is based on the actual return for the period.

III Life business
a) Premiums
Renewal premiums are accounted for in the period in which the premiums are due. Initial premiums under renewable contracts, single premiums and considerations for annuities are accounted for in the same accounting period as the related policy liabilities are included in the actuary's valuation.

b) Claims and surrenders
Claims and surrenders are accounted for in the accounting period in which: (i) for death claims the notification of death is received, (ii) for maturity claims the maturity date of the endowment policy occurs, and (iii) for surrenders the surrender value of the policy is paid. Annuities are charged in the revenue account of the accounting period in which the annuity becomes due for payment.

c) Deferred acquisition expenses
The costs of acquiring new business and the renewal of existing business which relate to subsequent accounting periods are deferred, to the extent that they are considered to be recoverable out of the future profits of the business concerned.

d) Long-term profit recognition
Long-term business profits are calculated by the use of the "Modified Statutory" method set out in ABI guidance notes. For most business, this produces a result which is very similar to that derived from the shareholders' transfer determined by actuarial valuation and which is known as the "Statutory" method. Profits in excess of the statutory result are not distributable to shareholders.

In determining the modified statutory results, the fund for future appropriations is used to account for reserves derived from long-term business where the allocation of such reserves between policyholders and shareholders has not been determined.

e) Investment return
The total investment return, which includes both realised and unrealised gains, is taken to the life business technical account.

f) Bonuses
Bonuses attributable to the accounting period, other than those included in claims incurred, are included within changes in the life business provision.

IV Investments
a) Investment income
Investment income represents interest, rents and dividends receivable for the year including, where appropriate, related imputed tax credits. Investment income derived from assets supporting life business is credited to the life technical account. All other investment income is credited to the non-technical account.

b) Realised and unrealised investment gains and losses
Realised investment gains and losses are calculated by reference to the net sales proceeds and the original purchase cost. For presentation purposes, as required by legislation, net realised gains are included in investment income and net realised losses in investment expenses and charges.

c) Valuation
Investments are stated at market values for listed securities; open market valuations as appraised by the Group's professionally qualified staff for properties; bid price for unit trusts; redemption values less provisions for mortgages and loans; and directors' valuations for other investments.

Investment properties are not depreciated, as the directors consider that they are held for investment purposes and to depreciate them would not give a true and fair view.

d) Group occupied properties

As required by the Companies Act, properties occupied by the Group are included as investments.

V Land for development and work in progress

Land for development and work in progress is stated at the lower of cost and net realisable value and is shown as stocks in the balance sheet.

VI Goodwill

Goodwill arising on the purchase of subsidiary undertakings is written off to reserves in the year of acquisition.

VII Foreign exchange

Transactions denominated in currencies other than Sterling are recorded at the rates ruling at the date of the transaction. Assets and liabilities denominated in currencies other than Sterling are translated at year-end exchange rates. Exchange gains and losses arising from life business are taken to the life technical account. Other gains and losses are treated as part of the investment return in the profit and loss account.

Assets and liabilities of subsidiary companies and branches are translated into Sterling at year-end rates of exchange with profits and losses for the year translated at average rates. The resulting exchange gains and losses are taken to revaluation reserve.

VIII Taxation

Provision is made for deferred taxation on unrealised gains and other timing differences where it is considered that a liability will arise in the foreseeable future. No provision is made for taxation which would arise if retained earnings of overseas subsidiaries were to be remitted to the United Kingdom.

IX Fixed assets and depreciation

Major items of equipment are capitalised and depreciated over their expected useful lives after taking into account their anticipated residual value. All other items of equipment are written off in the year of purchase.

X Staff pension costs

The Group operates a number of pension schemes around the world to which contributions, determined in accordance with actuarial advice, are made by Group companies in respect of their employees. The charge for pension costs principally represents the costs of providing pension benefits to staff in respect of their service during the year. Pension costs in respect of overseas schemes are calculated in accordance with local regulations which approximate to UK accounting practices.

1 General insurance business

1a Geographical analysis

	Net written premiums £m	Under-writing result £m	1997 Pre-tax result £m	Net written premiums £m	Under-writing result £m	1996 Pre-tax result £m
United Kingdom	**1,048**	**(67)**	**191**	1,039	(24)	133
Republic of Ireland	**222**	**(19)**	**20**	226	(8)	30
Continental Europe – disposed business	**–**	**–**	**–**	50	(4)	(5)
– continuing business	**482**	**(22)**	**34**	576	(30)	34
The Americas	**609**	**(45)**	**(3)**	626	(26)	16
South Africa	**141**	**–**	**8**	140	–	7
Asia	**52**	**(9)**	**10**	66	(4)	3
Other, including central reinsurance	**208**	**14**	**46**	191	25	32
	2,762	**(148)**	**306**	2,914	(71)	250

The general business pre-tax result comprises underwriting result and allocated investment return but excludes the movement in equalisation reserves. The territorial results are stated after central reinsurance protection. The 'Other' result includes this reinsurance in respect of the following territories:

	Net written premiums £m	1997 Under-writing result £m	Net written premiums £m	1996 Under-writing result £m
United Kingdom	**102**	**(8)**	72	6
Republic of Ireland	**2**	**1**	4	2
Continental Europe	**10**	**3**	16	1
The Americas	**40**	**4**	38	6
South Africa	**7**	**(9)**	9	(6)
Asia	**4**	**3**	4	3
	165	**(6)**	143	12

1b Class of business analysis

	Net written premiums £m	1997 Under-writing result £m	Net written premiums £m	1996 Under-writing result £m
Property	**816**	**(41)**	884	(29)
Motor	**1,261**	**(131)**	1,305	(76)
Liability	**172**	**8**	186	14
Other	**513**	**16**	539	20
	2,762	**(148)**	2,914	(71)

1 General insurance business continued

1c Analysis of net operating expenses

	1997 £m	1996 £m
Acquisition costs	**636**	698
(Increase)/decrease in deferred acquisition costs	**3**	(15)
Administrative expenses	**248**	243
Reinsurance commissions and profit participation	**13**	29
	900	955

1d Equalisation reserves

Equalisation reserves contained within the accounts of subsidiary companies were previously excluded from the Group Accounts. In the light of discussions with the Financial Reporting and Review Panel and the continued evolution of generally accepted accounting principles in this area, the directors have concluded that the Group should change its accounting policy so as to treat equalisation reserves as liabilities in the Group Accounts. The 1997 consolidated financial statements have been prepared on the revised basis and 1996 comparative figures have been restated accordingly. The impact of the change in policy on pre-tax profits and on recognised gains and losses is disclosed in the profit and loss account on page 37 and in the statement of recognised gains and losses on page 44. The change has reduced distributable shareholders' funds by £91m (1996: £75m).

2 Life business

2a Geographical analysis

	1997 Net written premiums £m	1997 Pre-tax result £m	1996 Net written premiums £m	1996 Pre-tax result £m
United Kingdom and Republic of Ireland	**456**	**22**	460	21
Continental Europe	**242**	**5**	267	6
Asia	**21**	**–**	21	–
Other	**64**	**2**	70	4
	783	**29**	818	31

2b Investment income

	1997 £m	1996 £m
Income from property	**37**	38
Income from other investments	**570**	565
Realised investment and foreign exchange gains	**349**	235
	956	838

Income from other investments includes £449m (1996: £347m) in respect of listed investments.

2c Net operating expenses

	1997 £m	1996 £m
Acquisition costs	**63**	67
(Increase)/decrease in deferred acquisition costs	**10**	(9)
Administrative expenses	**65**	67
	138	125

2d Investment expenses and charges

	1997 £m	1996 £m
Interest expense (note 4c)	**5**	4
Investment management expenses	**11**	16
	16	20

2 Life business continued

2e Tax attributable to shareholders

Life profits have been grossed up by the effective rate of tax applicable in the territory concerned.

2f Life business provision

The life business provision is calculated initially on a statutory basis, modified to remove certain reserves required by solvency regulations. Where applicable, a net premium valuation method is used which includes an explicit provision for vested bonuses, including those vesting following the current valuation, implicit provision is made for future reversionary bonuses by a reduction in the valuation rate of interest. Some of the costs of writing new business are explicitly determined and deferred to the extent that they are recoverable out of future revenue margins and are disclosed as an asset in the balance sheet.

3 Income from interests in associates

	1997			1996		
	Net written premiums £m	Under-writing result £m	Pre-tax result £m	Net written premiums £m	Under-writing result £m	Pre-tax result £m
United Kingdom	–	1	2	–	–	1
Continental Europe	28	(1)	9	33	2	10
Asia	16	1	2	18	1	3
	44	1	13	51	3	14
Balance of investment return			9			26
Group share of pre-tax result			22			40

4 Corporate investment

4a Other investment income

	1997 £m	1996 £m
Income from property	9	15
Income from other investments	348	368
Realised investment gains	283	129
	640	512

Investment gains include foreign exchange gains of £7m (1996: £17m)

Income from other investments includes £305m (1996: £283m) in respect of listed investments

4b Investment expenses and charges

	1997 £m	1996 £m
Interest expense (note 4c)	29	31
Investment management expenses	15	14
	44	45

4 Corporate investment continued

4c Interest expense

	General insurance and corporate 1997 £m	General insurance and corporate 1996 £m	Life 1997 £m	Life 1996 £m
On loans repayable within 5 years:				
Bank loans and overdrafts	**15**	12	**–**	–
Other loans	**14**	15	**5**	4
On loans repayable beyond 5 years:				
Bank loans and overdrafts	**–**	4	**–**	–
	29	31	**5**	4

4d Other charges

Other charges of £25m (1996: £25m) represent the costs of the corporate centre.

5 Taxation

The taxation (charge)/credit in the profit and loss account is detailed below:

	1997 £m	1996 £m
Current taxation		
United Kingdom taxation		
Corporation tax at rate of 31.5% (1996: 33%)	**(69)**	(33)
Tax relating to franked investment income	**(14)**	(14)
Advance corporation tax written back	**1**	4
	(82)	(43)
Overseas taxation	**(63)**	(55)
Double tax relief	**35**	8
	(110)	(90)
Deferred taxation	**(115)**	(59)
Taxation attributable to shareholders' life business profits	**(11)**	(12)
Share of associate companies' taxation	**(4)**	(5)
Taxation charged in profit and loss account	**(240)**	(166)
Balance sheet provisions for deferred taxation represent:		
Unrealised investment gains	**277**	159
Other short-term timing differences	**(2)**	(8)
Losses and surplus ACT available for offset	**(5)**	(39)
Deferred taxation provisions (note 10)	**270**	112

Deferred taxation on unrealised gains has been provided where it is considered that a liability will arise in the foreseeable future, in accordance with accounting policy VIII. If taxation had been charged on the full amount of unrealised gains, the additional amount required would have been approximately £208m (1996: £245m).

The Company is not a close company within the terms of the Corporation Taxes Act 1988.

6 Consolidated balance sheet as at 31 December 1997

	General & Corporate 1997 £m	General & Corporate 1996 £m	Life 1997 £m	Life 1996 £m	Consolidated 1997 £m	Consolidated 1996 £m
Land and buildings						
Company occupied	**90**	112	**57**	63	**147**	175
Other	**87**	94	**556**	492	**643**	586
	177	206	**613**	555	**790**	761
Interests in associated undertakings	**97**	92	**–**	–	**97**	92
Other financial investments						
British Government Securities	**460**	521	**1,214**	1,514	**1,674**	2,035
Overseas government, municipal and public Boards	**1,289**	1,316	**677**	558	**1,966**	1,874
Debentures and Debenture Stocks	**482**	435	**1,751**	1,289	**2,233**	1,724
	2,231	2,272	**3,642**	3,361	**5,873**	5,633
Preference and guaranteed stocks and shares	**86**	98	**22**	22	**108**	120
Ordinary stocks and shares	**3,419**	3,054	**2,407**	1,948	**5,826**	5,002
	3,505	3,152	**2,429**	1,970	**5,934**	5,122
Mortgages and loans	**342**	382	**1,110**	1,189	**1,452**	1,571
Deposits with credit institutions	**403**	194	**145**	145	**548**	339
Deposits with ceding companies	**26**	31	**–**	–	**26**	31
Total investments	**6,781**	6,329	**7,939**	7,220	**14,720**	13,549
Assets held to cover linked liabilities	**–**	–	**3,228**	2,900	**3,228**	2,900
Reinsurers' share of technical provisions	**426**	450	**71**	60	**497**	510
Debtors	**1,105**	1,088	**127**	158	**1,081**	1,088
Other assets	**202**	177	**14**	3	**216**	180
Prepayments and accrued income	**268**	304	**231**	233	**499**	537
Total assets	**8,782**	8,348	**11,610**	10,574	**20,241**	18,764
Capital and reserves						
Share capital	**46**	45	**–**	–	**46**	45
Share premium	**221**	193	**–**	–	**221**	193
Non-distributable shareholders' interest in life funds	**–**	–	**48**	52	**48**	52
Other reserves	**2,354**	1,941	**–**	–	**2,354**	1,941
Equity shareholders' funds	**2,621**	2,179	**48**	52	**2,669**	2,231
Minority interests	**153**	135	**–**	–	**153**	135
Fund for future appropriations	**–**	–	**1,302**	1,115	**1,302**	1,115
Technical provisions	**4,532**	4,661	**6,788**	6,295	**11,320**	10,956
Technical provisions for linked liabilities	**–**	–	**3,193**	2,840	**3,193**	2,840
Other liabilities and provisions	**1,476**	1,373	**279**	272	**1,604**	1,487
Total liabilities and shareholders' funds	**8,782**	8,348	**11,610**	10,574	**20,241**	18,764

The equity shareholders' funds of £48m under life business arises from the use of the modified statutory basis of reporting and does not include the greater part of the value of the worldwide life funds.

7 Fixed assets

	Cost £m	Depreciation £m	Net Book Value £m
At 1 January 1997	**158**	**(103)**	**55**
Exchange	**(7)**	**4**	**(3)**
Restated	**151**	**(99)**	**52**
Purchases	**28**	**–**	**28**
Sales	**(19)**	**11**	**(8)**
Other movements	**–**	**2**	**2**
Provision for depreciation	**–**	**(24)**	**(24)**
At 31 December 1997	**160**	**(110)**	**50**

8 Investments

The cost price of investments held at 31 December 1997 was £11,680m (1996: £11,165m). The cost price of investments held to support linked liabilities at 31 December 1997 was £2,398m (1996: £2,203m).

Investments totalling £11,403m (1996: £10,523m) are listed on a recognised investment exchange. Of these, £7,289m (1996: £6,673m) are listed on the London Stock Exchange.

Land and buildings includes £211m (1996: £209m) in respect of leasehold properties of which £7m (1996: £4m) related to land held on short lease.

Principal equity holdings of the Group in associated insurance companies at 31 December 1997 were as follows:

	Holding	Country
Aviation and General Insurance Company Limited	36%	UK
Le Foyer Finance S.A.	40%	Luxembourg
Guardian Assurance Company (Thailand) Limited	49%	Thailand
Guardian Royal Exchange Assurance (Malaysia) S.B.	48%	Malaysia

The country shown is that of incorporation and principal operation.

9 Debts in respect of direct insurance operations

	General and Corporate 1997 £m	General and Corporate 1996 £m	Life 1997 £m	Life 1996 £m	Consolidated 1997 £m	Consolidated 1996 £m
Due from policyholders	**251**	238	**17**	16	**268**	254
Due from intermediaries	**341**	370	**2**	3	**343**	373
	592	608	**19**	19	**611**	627

10 Analysis of provisions for other risks and charges

	General and Corporate 1997 £m	General and Corporate 1996 £m	Life 1997 £m	Life 1996 £m	Consolidated 1997 £m	Consolidated 1996 £m
Staff pension and provident funds	**96**	96	**7**	7	**103**	103
Deferred taxation	**270**	112	**12**	10	**282**	122
Other provisions	**89**	129	**4**	2	**93**	131
	455	337	**23**	19	**478**	356

11 Other creditors

	General and Corporate 1997 £m	1996 £m	Life 1997 £m	1996 £m	Consolidated 1997 £m	1996 £m
Unpaid interim dividend	36	31	–	–	36	31
Proposed final dividend	70	60	–	–	70	60
Taxation	111	111	14	2	125	113
Other creditors	391	420	153	158	393	420
	608	622	167	160	624	624

12 Loans

	General Insurance and Corporate 1997 £m	1996 £m	Life 1997 £m	1996 £m	Consolidated 1997 £m	1996 £m
Secured debenture stock of a subsidiary:						
10.75% repayable 2006	–	–	1	1	1	1
Other secured	2	3	–	–	2	3
	2	3	1	1	3	4
Loans from bankers						
Secured	6	10	–	–	6	10
Unsecured	248	258	–	–	248	258
	256	271	1	1	257	272
Repayment periods loans other than from bankers						
1 year or less	1	1	–	–	1	1
Between 1 and 2 years	1	1	–	–	1	1
Over 5 years	–	1	1	1	1	2
	2	3	1	1	3	4
Repayment periods loans from bankers						
1 year or less	20	26	–	–	20	26
Between 1 and 2 years	21	–	–	–	21	–
Between 2 and 5 years	213	242	–	–	213	242
	254	268	–	–	254	268

13 Capital expenditure commitments

At 31 December 1997 capital expenditure on equipment amounting to £18m (1996: £20m) had been authorised but had not been provided for in the accounts. Contracts had been placed for £3m (1996: £15m) of the authorised expenditure.

14 Auditors' remuneration

	1997 £000	1996 £000
Remuneration, including expenses, of the auditors of the Company and its subsidiaries for statutory audit work. This includes £110,000 (1996: £104,000) in respect of the audit of the Company.	2,159	1,818

Remuneration for taxation advice and other non audit services provided by the Company's auditors to the Company and its United Kingdom subsidiaries amounted to £5,008,000 (1996: £5,064,000) of which £682,000 (1996: £862,000) related to taxation advice.

15 Staff

15a Staff pension costs

The principal pension scheme within the Group covers employees in the United Kingdom and comprises defined benefit and defined contribution sections. The funds of the scheme are separate from the Group and are administered by trustees. The total pension cost attributable to this scheme for the year was £27m (1996: £31m) including £13m (1996: £16m) attributable to early retirement costs. It has been assumed that the scheme will remain open to new entrants. From April 1997, new staff join a money purchase arrangement for the period of service up to age 30 and then have the option of joining the existing defined benefit scheme for service thereafter.

Contributions are assessed by the actuary to the fund (who is a Group employee) using the Projected Unit method with a five-year control period. The last full valuation was carried out as at 31 March 1997. Augmentations on early retirement and supplementary improvements to the level of protection of pensions in payment are funded by cash injections to the fund.

The assumptions that have the most significant effect on the results of the valuation are those relating to the rate of return on investments and the rates of increases in salaries and pensions. It was assumed that the investment return would be 8% per annum, dividends would grow by 4.5% per annum, salaries would increase by 4.5% per annum plus shaped promotional scale (which is on average equivalent to 2% per annum) and that present and future pensions would increase by 4% per annum. At the 31 March 1997 valuation, the market value of assets was £992m and the actuarial value of assets represented 118% of the value of accrued liabilities on a projected final salary basis. The contribution rate was reduced from 14% to 5% of pensionable salaries with effect from 1 April 1997. The pension cost charged in the profit and loss account for the year was reduced from 14% to 12% of pensionable salaries with effect from 31 March 1997. With effect from 1 April 1997 cash transfers to the fund were reduced from 14% to 5% of pensionable salaries and as a consequence, a provision of £5.7m is included within provisions for other risks and charges. The employer-defined contribution rate for new employees under age 30 is 5% of pensionable salary.

In addition to the principal scheme, the accounts contain a further charge of £21m (1996: £28m) in respect of other schemes, of which £14m (1996: £18m) relates to the provision of pensions for employees in Germany.

The analysis of provisions for other risks and charges shown in note 10 includes an amount of £103m (1996: £105m) in respect of other staff pension schemes. Of this sum, £83m (1996: £86m) is in respect of provisions for staff pension liabilities in Germany.

15b Staff numbers and cost

	1997 £m	1996 £m
Wages and salaries	**315**	311
Social security costs	**34**	35
Other pension costs	**48**	59
	397	405

The average weekly number of employees, including executive directors, was comprised as follows:		
United Kingdom insurance operations	**6,740**	5,973
United Kingdom investment and corporate centre	**585**	608
Republic of Ireland	**842**	845
Continental Europe	**2,501**	2,523
The Americas	**2,287**	2,188
South Africa	**1,063**	1,004
Asia	**525**	500
Other	**140**	134
Total	**14,683**	13,775

16 Share Capital

		1997 Authorised £m	1997 Paid-up £m	1996 Authorised £m	1996 Paid-up £m
Authorised	1,200,000,000 ordinary shares of 5p each	**60**		60	
Issued:	919,879,245 (1996: 908,349,800) ordinary shares of 5p each of which 106,100 (1996: 110,600) shares were issued 5% paid under the Articles of Association; the remainder are fully paid		**46**		45

During the year 10,538,509 ordinary shares of 5p each were issued as a result of the exercise of options at various prices in accordance with the terms of the Company's employee share option schemes.

On 2 January 1997 457,577 ordinary shares of 5p each were issued fully paid at a price of 258.3p per share to shareholders who elected to take shares rather than cash in respect of the 1996 interim dividend.

On 1 July 1997 533,359 ordinary shares of 5p each were issued fully paid at a price of 280.1p per share to shareholders who elected to take shares rather than cash in respect of the 1996 final dividend.

During the year, options were granted under the Company's share option schemes to Group employees to subscribe for 3,151,020 ordinary shares of 5p each under the sharesave option scheme and 1,766,500 ordinary shares of 5p each under the share option scheme.

There were at 31 December 1997 outstanding options to subscribe for 35,929,657 ordinary shares of 5p each under the employee share option schemes exercisable as follows:

Number of Shares	Period during which options are exercisable	Price payable per share
120,000	on or before 29 September 1998	173.0p
3,157,500	on or before 29 September 1999	222.5p
101,500	on or before 29 September 2000	189.0p
82,000	on or before 29 September 2001	188.0p
600,000	on or before 19 April 2002	126.0p
999,800	on or before 29 September 2002	125.0p
248,000	on or before 29 September 2003	210.0p
358,000	on or before 29 September 2004	193.0p
140,507	on or before 25 May 1998	151.2p
1,394,025	on or before 25 May 1998	100.0p
400,000	7 September 1998 to 6 September 2005	228.0p
13,256,156	30 September 1998 to 29 September 2005	223.0p
342,355	26 November 1998 to 25 May 1999	150.4p
908,413	26 November 1998 to 25 May 1999	168.0p
314,128	28 September 1999 to 27 September 2003	252.5p
1,049,372	28 September 1999 to 27 September 2006	252.5p
2,931,660	26 November 1999 to 25 May 2000	100.0p
1,010,808	26 November 1999 to 25 May 2000	154.4p
314,019	26 November 1999 to 25 May 2000	202.0p
25,848	16 June 2000 to 15 June 2004	295.5p
10,152	16 June 2000 to 15 June 2007	295.5p
1,645,018	28 September 2000 to 27 September 2007	282.0p
85,482	28 September 2000 to 27 September 2007	313.0p
284,837	26 November 2000 to 25 May 2001	168.0p
1,141,893	26 November 2000 to 25 May 2001	178.4p
713,748	26 November 2000 to 25 May 2001	225.6p
345,628	26 November 2001 to 25 May 2002	154.4p
884,432	26 November 2001 to 25 May 2002	202.0p
304,312	26 November 2002 to 25 May 2003	178.4p
1,669,992	26 November 2002 to 25 May 2003	225.6p
332,770	26 November 2003 to 25 May 2004	202.0p
757,302	26 November 2004 to 25 May 2005	225.6p
35,929,657		

17 Reserves

	Retained profits £m	Capital reserve £m	Other reserves £m	Total £m
Balance at 31 December 1995	1,060	104	845	2,009
Equalisation reserves as at 31/12/95 (note 1e)	(60)	–	–	(60)
Revised balance at 31 December 1995	1,000	104	845	1,949
Transfer from profit and loss account	148	–	177	325
Goodwill written off	(134)	–	–	(134)
Exchange on translation of overseas net assets	–	–	(147)	(147)
Balance at 31 December 1996	**1,014**	**104**	**875**	**1,993**
Cost of shares issued to employees through a Qualifying Employee Share Trust	**(10)**	**–**	**–**	**(10)**
Transfer from profit and loss account	**253**	**–**	**239**	**492**
Exchange on translation of overseas net assets	**–**	**–**	**(73)**	**(73)**
Balance at 31 December 1997	**1,257**	**104**	**1,041**	**2,402**

The capital reserve represents the share premium in respect of those ordinary shares of Guardian Royal Exchange Assurance plc which were acquired by the Company under the Scheme of Arrangement in 1984 and acquired since that date on options being exercised to subscribe for ordinary shares under the employee share option schemes.

Other reserves are non-distributable and arise, principally, from the revaluation of investments to current values and from profits/losses arising on the translation of overseas net assets to Sterling.

During 1997 Guardian Royal Exchange plc received £15m from the issue of shares arising from the exercise of options awarded under employee share option schemes. Of this amount £5m was paid by employees and the balance was paid by subsidiary undertakings through a Qualifying Employee Share Trust.

18 Geographical analysis of net assets

	1997 £m	1996 £m
United Kingdom	**561**	498
Republic of Ireland	**137**	123
	698	621
Continental Europe	**534**	453
The Americas	**457**	410
South Africa	**58**	55
Asia	**60**	53
Others, including corporate centre	**765**	547
	2,572	2,139
Share of associates' net assets	**97**	92
	2,669	2,231

1996 analysis has been restated to include equalisation reserves as liabilities.

19 Contingent liabilities

With the approval of the Department of Trade and Industry certain wholly-owned United Kingdom subsidiaries have entered into a mutual guarantee whereby each company guarantees payment of all liabilities incurred by the others in respect of general insurance business.

20 Cash flow statement

20a Reconciliation of profit before tax to net cash inflow from operating activities

	1997 £m	1996 £m
Profit before taxation and minority interests	**872**	618
Exclude:		
Interest expense	**29**	31
Investment gains	**(735)**	(356)
Profit before taxation (excluding investment gains and interest)	**166**	293
Share of associates' results	**(22)**	(40)
Dividends received from associates	**2**	2
Increase in insurance funds, net of reinsurance	**21**	83
Increase in equalisation reserves	**30**	33
Integration and restructuring provision	**-**	39
Net increase in debtors and creditors	**(1)**	(99)
Depreciation of fixed assets	**21**	20
Net cash inflow from operations	**217**	331

20b Purchases and sales of portfolio investments

	£m	1997 £m	£m	1996 £m
Purchases of ordinary and preference shares	**523**		786	
Sales of ordinary and preference shares	**(757)**		(552)	
		(234)		234
Purchases of fixed income securities	**2,495**		3,377	
Sales of fixed income securities	**(2,507)**		(3,346)	
		(12)		31
Purchases of properties	**39**		29	
Sales of properties	**(59)**		(43)	
		(20)		(14)
Net purchases/(sales) of portfolio investments		**(266)**		251
Increase/(decrease) in deposits with credit institutions		**217**		(13)
Movements in portfolio investments arising from cash flows		**(49)**		238

20c Movement in portfolio investments, net of financing

	£m	1997 £m	£m	1996 £m
Increase/(decrease) in cash balances	**24**		(29)	
Cash flow:				
Portfolio investments	**(49)**		238	
(Increase)/decrease in loans	**15**		(13)	
Movement arising from cash flows		**(10)**		196
Changes in market values and impact of exchange rate movements		**498**		(251)
Movement in life business balances		**731**		325
Movement in portfolio investments, net of financing		**1,219**		270
Portfolio investments, net of financing, at 1 January		**13,267**		12,997
Portfolio investments, net of financing, at 31 December		**14,486**		13,267

20 Cash flow statement continued

20d Movement in cash, portfolio investments and financing

	At 1 Jan 1997 £m	Cash flow £m	Changes in life business £m	Changes in market values and currencies £m	At 31 Dec 1997 £m
Cash	113	24	12	(3)	146
Ordinary and preference shares	5,122	(234)	459	587	5,934
Fixed income securities	7,204	(12)	202	(68)	7,326
Properties	761	(20)	58	(10)	789
Deposits with credit institutions	339	217	–	(8)	548
Loans due within one year	(27)	6	–	–	(21)
Loans due later than one year	(245)	9	–	–	(236)
	13,267	(10)	731	498	14,486

21 Post balance sheet events

21a Acquisition of the PPP healthcare group

On 23 February 1998 the Group completed the purchase of the PPP healthcare group. The base purchase consideration was £435m, although the final amount payable is dependent on the value of net assets disclosed in the completion accounts, and goodwill arising on the acquisition is likely to be in the order of £150m. The goodwill will be held as an asset on the Balance Sheet and appropriately amortised in accordance with the requirements of Financial Reporting Standard no. 10.

The pre-tax results of PPP healthcare for the 12 months ended 31 December 1997, adjusted to conform with Group accounting policies and to eliminate non-recurring items, were £61m on premium income of £590m.

21b Return of capital to shareholders

Subject to the approval of shareholders, the Company proposes to return capital by way of a bonus issue of redeemable B shares and a consolidation of ordinary shares. The B shares will be listed and will be non-cumulative redeemable preference shares with a nominal value of 20.5 pence per share. Shareholders will be allotted one B share for each fully paid existing ordinary share held on 1 May 1998. Holders of partly paid existing ordinary shares will be allotted one B share for each 20 existing ordinary shares held, to reflect the fact that the shares are 5% paid.

Simultaneously, with the issue of the B shares, the existing ordinary share capital will be consolidated. Each existing ordinary share will be replaced with a new ordinary share with a nominal value of 5.25 pence.

Approval of shareholders to the proposals will be sought at an Extraordinary General Meeting on 28 April 1998.

22 Parent company

The profit attributable to shareholders which was dealt with in the profit and loss account of Guardian Royal Exchange plc for the year ended 31 December 1997, including paid and proposed dividends from subsidiaries, was £338m (1996: £175m). As permitted by section 230 of the Companies Act 1985, the profit and loss account of the Company is not included in these accounts.

23 Directors' emoluments

23a Directors' remuneration

Remuneration for the year for all directors is set out below:

	1997 £	1996 £
Non-executive directors		
Fees	**278,000**	278,980
Executive directors		
Salaries and other emoluments	**2,323,561**	1,931,821
Contributions to money purchase pension schemes	**77,891**	25,811
Gains arising from the exercise of share options	**596,994**	6,707
	3,276,446	2,243,319

Fees waived by five directors (1996: four) amounted to £88,478 (1996: £76,000).

23b Emoluments of the highest paid director

The total emoluments of the highest paid director, J V H Robins, comprise the remuneration set out in note 23c and the option gain described below.

During the year, J V H Robins exercised options over 523,560 shares at an exercise price of 191p per share, retaining 117,038 shares and selling 406,522 shares at an average market price of 297p per share to fund the exercise price and associated tax liability. The total pre-tax gain represented by the difference between the exercise price and the market value on the dates of the exercise (including the unrealised gain on the retained shares) is £554,974 (1996: nil). He has no other options except those under the Sharesave scheme.

23c Analysis of remuneration by director

	Salary & fees £	Benefits £	Annual bonus £	1997 total £	1996 total £
Executive					
J V H Robins	**380,000**	**23,300**	**114,400**	**517,700**	440,022
V Bremkamp	**281,842**	**9,434**	**100,280**	**391,556**	366,792
C M Burton	**212,083**	**14,168**	**84,105**	**310,356**	245,893
J Morley	**237,500**	**16,425**	**64,250**	**318,175**	267,225
R F Pierce (appointed 29.7.97)	**93,750**	**7,613**	**20,700**	**122,063**	–
J Sinclair	**223,750**	**15,071**	**64,872**	**303,693**	254,967
V M Yerrill	**300,563**	**6,558**	**52,897**	**360,018**	356,922
Non-executive					
Lord Hambro	**93,500**	–	–	**93,500**	88,500
Hon. Edward Adeane	**25,000**	–	–	**25,000**	23,500
Sir Colin Chandler	**20,000**	–	–	**20,000**	19,000
Sir Brian Hayes	**24,000**	–	–	**24,000**	22,500
John Menzies (retired 13.10.96)	–	–	–	–	16,670
Sir Paul Newall	**26,500**	–	–	**26,500**	24,810
Sir Peter Reynolds	**24,000**	–	–	**24,000**	22,500
J Julian L G Sheffield	**42,500**	–	–	**42,500**	40,000
Sir Anthony Tennant	**22,500**	–	–	**22,500**	21,500
	2,007,488	**92,569**	**501,504**	**2,601,561**	2,210,801

23 Directors' emoluments continued

23d Long-term incentives

Executive directors participate in the Long-Term Incentive Plan which is described on page 28. The number of shares provisionally allocated in 1995 is set out below:

	1997 Number of shares	1996 Number of shares
J V H Robins	**176,263**	176,263
V Bremkamp	**53,599**	53,599
C M Burton	**93,421**	93,421
J Morley	**105,758**	105,758
R F Pierce (appointed 29.7.97)	**70,505**	70,505*
J Sinclair	**105,758**	105,758
V M Yerrill	**83,491**	83,491
	688,795	688,795

*At date of appointment.

Mr V M Yerrill participates in a USA scheme under which a cash award will be determined on the basis of the performance of the USA operations for the three years ending 31 December 1999. The maximum award at the end of that period is $300,000. From that day, any award will attract interest but will not become payable until 31 December 2001.

23e Share options

The interests of the directors under the share option schemes of the Company are set out below:

Director	Number of options				Exercise price	Market price at date of exercise	Date from which exercisable	Expiry date
	At 1.1.97	During the year Granted	During the year Exercised	At 31.12.97				
J V H Robins	4,826			4,826	202.0p		26.11.99	25.05.00
	523,560		261,780		191.0p	273.0p	26.04.97	25.04.04
			261,780		191.0p	321.0p	26.04.97	25.04.04
V Bremkamp	20,000			20,000	173.0p		30.09.91	29.09.98
	6,000			6,000	222.5p		30.09.92	29.09.99
	48,000			48,000	125.0p		30.09.95	29.09.02
	200,000			200,000	228.0p		07.09.98	06.09.05
C M Burton	2,359		2,359		178.0p	275.5p	26.11.96	25.05.97
	40,000			40,000	173.0p		30.09.91	29.09.98
	5,984			5,984	150.4p		26.11.98	25.05.99
	48,000			48,000	222.5p		30.09.92	29.09.99
	8,100			8,100	100.0p		26.11.99	25.05.00
	1,930			1,930	202.0p		26.11.99	25.05.00
	2,320			2,320	178.4p		26.11.00	25.05.01
	200,000			200,000	126.0p		20.04.95	19.04.02
J Morley	32,000			32,000	189.0p		30.09.93	29.09.00
	200,000			200,000	126.0p		20.04.95	19.04.02
R F Pierce (appointed 29.7.97)	9,653*			9,653	202.0p		26.11.03	23.05.04
	16,000*			16,000	193.0p		30.09.97	29.09.04
J Sinclair	48,000			48,000	222.5p		30.09.92	29.09.99
	9,000			9,000	100.0p		26.11.99	25.05.00
		1,728		1,728	225.6p		26.11.00	25.05.01
	200,000			200,000	126.0p		20.04.95	19.04.02
	2,525			2,525	154.4p		26.11.01	25.05.02
	3,415			3,415	202.0p		26.11.01	25.05.02
V M Yerrill	44,500			44,500	222.5p		30.09.92	29.09.99
	48,000		24,000	24,000	125.0p	290.5p	30.09.95	29.09.02
	200,000			200,000	228.0p		07.09.98	06.09.05

* Options held at date of appointment.

No options lapsed during the year. The market price of the shares at 31 December 1997 was 339.5p and the range during 1997 was 258.5p to 345.5p.

23 Directors' emoluments continued

23f Transactions involving directors and others

In accordance with section 232 and Schedule 6 of the Companies Act 1985 the information required regarding loans and other transactions with directors and connected persons is set out below:

	Loan outstanding 1 January 1997	Loan outstanding 31 December 1997	Annual rate of interest
C M Burton	£15,001	Nil	8.00% to 8.25%
J Sinclair	£37,000	Nil	4.25% to 6.16%

The loans to executive directors and connected persons were made on terms at or above those ordinarily applicable to staff having loans at varying rates of interest.

V M Yerrill is permitted to defer payment of salary and bonus. The cumulative amount deferred for the period 1 January 1988 to 31 December 1997 was £1,625,107 ($2,681,426) on which interest of £97,935 ($160,613) was credited for the year ended 31 December 1997.

No other contract of significance existed at any time during the year in which a director at 31 December 1997 was materially interested or which required disclosure as a related party transaction as defined under Financial Reporting Standard 8.

23g Interests of directors

The beneficial interests of the directors, including family interests (according to the register maintained under section 325 of the Companies Act 1985), in the share capital of the Company at 1 January 1997 (or at date of appointment*) with corresponding details at 31 December 1997 and 11 March 1998, are set out below:

	Total beneficial interests			Beneficial interests held in Trust under the GRE Employee Share Ownership Plan			Non-Beneficial Conditional interests held in Trust under the GRE Employee Share Ownership Plan		
	At 1.1.97	At 31.12.97	At 11.3.98	At 1.1.97	At 31.12.97	At 11.3.98	At 1.1.97	At 31.12.97	At 11.3.98
Lord Hambro	205,470	105,470	105,470	Nil	Nil	Nil	Nil	Nil	Nil
J Julian L G Sheffield	15,468	15,468	15,468	Nil	Nil	Nil	Nil	Nil	Nil
J V H Robins	20,473	144,350	144,350	Nil	9,289	9,289	Nil	15,482	15,482
Hon. Edward Adeane	5,000	5,000	5,000	Nil	Nil	Nil	Nil	Nil	Nil
V Bremkamp	10,475	10,858	10,858	Nil	Nil	Nil	Nil	Nil	Nil
C M Burton	29,390	29,522	29,533	Nil	4,993	4,993	Nil	8,321	8,321
Sir Colin Chandler	2,048	2,122	2,122	Nil	Nil	Nil	Nil	Nil	Nil
Sir Brian Hayes	1,269	1,314	1,314	Nil	Nil	Nil	Nil	Nil	Nil
J Morley	15,824†	15,824†	15,824†	Nil	5,546	5,546	Nil	9,243	9,243
Sir Paul Newall	25,000	25,000	23,500	Nil	Nil	Nil	Nil	Nil	Nil
R F Pierce (appointed 29.7.97)	Nil*	2,769	2,769	Nil*	2,769	2,769	Nil*	4,615	4,615
Sir Peter Reynolds	12,363	12,816	12,816	Nil	Nil	Nil	Nil	Nil	Nil
J Sinclair	26,159	26,364	26,364	Nil	5,044	5,044	Nil	8,407	8,407
Sir Anthony Tennant	30,000	30,000	30,000	Nil	Nil	Nil	Nil	Nil	Nil
V M Yerrill	Nil	13,622	13,622	Nil	Nil	Nil	Nil	Nil	Nil

†includes 200 not beneficially owned

None of the above directors had any interests in the share capital or debentures of any subsidiary undertaking at any time during the year.

Total beneficial interests include beneficial interests held in Trust under the GRE Employee Share Ownership Plan.

Beneficial interests held in Trust under the GRE Employee Share Ownership Plan are shares which an executive director has elected, under the Bonus Co-incentive Plan, to be purchased with his annual performance-related payment or, in the alternative, has deposited an equivalent amount of already-owned shares. If retained for a minimum of three years, these shares attract additional shares from the Company. These conditional shares are shown above.

23 Directors' emoluments continued

23h Directors' pensions

Name	Age at year end	Normal retirement date	Pensionable service at year end	Increase in accrued pension during the year £	Total accrued pension at year end £
Executive					
V Bremkamp	53	02.03.2009	34 yrs 4 mths	1,561	106,171
C M Burton	47	14.01.2010	24 yrs 3 mths	5,367	84,733
J Morley	48	15.02.2011	7 yrs 11mths	4,419	31,105
R F Pierce (appointed 29.7.97)	51	13.03.2008	7 yrs 5 mths	10,249	25,181
J V H Robins	58	21.02.2001	3 yrs 9 mths	27,529	132,809
J Sinclair	49	01.01.2008	30 yrs 4 mths	5,956	111,255
V M Yerrill*	56	01.02.2003	25 yrs	0	38,394
*V M Yerrill also participates in a defined contribution plan as described in Note 6 below.					
Non-executive					
Hon. Edward Adeane	58	04.10.2009	12 yrs	760	7,400
Lord Hambro	67	24.07.2000	23 yrs 6 mths	1,210	62,330
Sir Brian Hayes	68	05.05.1999	8 yrs 1 mth	960	6,470
Sir Peter Reynolds	68	10.09.1999	12 yrs	890	8,300
Julian Sheffield	59	28.08.2008	9 yrs	1,540	9,620
Sir Anthony Tennant	67	05.11.2000	8 yrs 1 mth	740	5,780

Notes:

1 The Non-executive directors' Pension Scheme was closed with effect from 31 December 1997 and no further service will be accrued after that date. Sir Colin Chandler and Sir Paul Newall were appointed to the Board after 1993, when the Scheme was closed to new entrants.

2 The Total Accrued Pension shown in the above table is that which, at current values, would be paid annually on retirement based on service up to 31 December 1997. No allowance has been made for any increase for inflation or otherwise during the period from the year end up to the date of retirement.

3 The Increase in Accrued Pension during the year is calculated after excluding the effect of inflation during the year.

4 The UK-based executive directors pension arrangements are non-contributory but they have the option of paying Additional Voluntary Contributions; neither the contributions nor the resulting benefits are included in the above table.

5 The UK Pension Scheme in which the UK-based executive directors participate includes the following features:

(a) Pensionable service in the above table includes increases based on any payments received from pension arrangements with previous employers.

(b) Dependant's pensions: on death in retirement a spouse's pension of 50% of the member's pre-commutation pension is available. On death after leaving service before retirement a spouse's pension of 50% of the member's accrued pension is available.

(c) Voluntary Early Retirement: members have the right to take early retirement from age 50. On voluntary early retirement the pension is discounted at a rate recommended by the Actuary, currently 4% p.a. In addition J Sinclair has the right to take benefits in respect of service after 17 May 1990 undiscounted from age 57.

(d) Pension Increases: post retirement increases of 5% or the increase in RPI if less are guaranteed under the scheme.

(e) In the cases of C M Burton, J Morley, R F Pierce and J Sinclair, pensions will be reduced by the amount of the state pension offset, calculated as at the date of retirement.

6 V Yerrill's pension arrangements in the USA consist of a defined benefit scheme the Total Accrued Benefit for which is set out in the above table and two defined contribution schemes, in relation to which the company contributions were £77,891 during the year. The defined benefit scheme is subject to a statutory cap in the USA and no further benefit was accrued during the year. A spouse's pension of 50% of member's pension is available on death in deferment or in retirement. He has the right to take voluntary early retirement from age 55 on a reduced basis. No pension increases apply to these arrangements.

7 V Bremkamp's pension arrangements in Germany include a spouse's pension based on 60% of member's pension and orphan's benefits based on 10% of member's pension on death in deferment or retirement. Pensions in payment may be increased on a discretionary basis in line with German Insurance Industry practice.

8 Under the now closed Non-executives' Pension Scheme, which was non-contributory, a spouse's pension of 50% of member's pension was payable on death, together with a defined lump sum payment on death prior to retirement. Pensions were to be payable on retirement at any time after the age of 60. Increases in retirement would have been paid at the same levels as applicable to UK employees generally under the UK scheme.

Principal subsidiary undertakings

As at 31 December 1997

Insurance Companies	Country of incorporation	Holding of ordinary shares	
Guardian Royal Exchange Assurance plc	England	100%	(Parent)
Guardian Assurance plc	England	100%	
The Royal Exchange Assurance	England	100%	
Atlas Assurance Company Limited	England	100%	
Caledonian Insurance Company	Scotland	100%	
Guardian Direct Limited	England	100%	
Guardian Health Limited	England	100%	
Guardian Insurance Limited	England	100%	
Guardian Linked Life Assurance Limited	England	100%	
Guardian Pensions Management Limited	England	100%	
Orion Personal Insurances Limited	England	100%	
Motor Union Seguros SA	Brazil	99%	
Guardian Insurance Company of Canada	Canada	100%	
Guardian Risques SA	France	100%	
Guardian Vie SA	France	100%	
Albingia Versicherungs-Aktiengesellschaft (note 2)	Germany	86%	
Albingia Lebensversicherungs-Aktiengesellschaft (note 2)	Germany	86%	
Union Insurance Society of Canton Limited	Hong Kong	100%	
Union Insurance Society of Hong Kong Limited	Hong Kong	100%	
PT Asuransi Guardian Royal Exchange Indonesia	Indonesia	64%	
GRE Life Ireland Limited	Ireland	100%	
Guardian PMPA Insurance Limited	Ireland	100%	
Guardian Verzekering Maatschappij N.V.	Netherlands	100%	
Guardian Assurance Limited	New Zealand	100%	
Guardian National Insurance Company Limited	South Africa	51%	
Albany Insurance Company	USA	100%	
American Ambassador Casualty Company	USA	100%	
Atlas Assurance Company of America	USA	100%	
Globe American Casualty Company.	USA	100%	
Mid-American Fire & Casualty Co.	USA	100%	
The Midwestern Indemnity Company	USA	100%	
Tower Insurance Company, Inc	USA	100%	
Other Companies			
Bruton Property Holdings Limited	England	100%	(Parent)
Compass Securities Limited	England	100%	
Guardian Investment Holdings Limited	England	100%	(Parent)
Guardian Asset Management Limited	England	100%	
Guardian Mortgage Services Limited	England	100%	
Guardian Properties (Holdings) Limited	England	100%	
Guardian Royal Exchange Services Limited	England	100%	
Guardian Unit Managers Limited	England	100%	
The Metropolitan Trust plc	England	100%	
Royal Exchange Trust Company Limited	England	100%	
GRE Financial Limited	Canada	100%	
Guardian France SA	France	100%	
Guardian Royal Exchange Continental Europe Holding GmbH	Germany	100%	
GRE Investments (Guernsey) Limited	Guernsey	100%	
Guardian Royal Exchange Holdings (Ireland) Limited	Ireland	100%	
Guardian/PMPA Group Limited	Ireland	100%	
Guardian Royal Exchange International (Holdings) B.V.	Netherlands	100%	
GRE-USA Corporation	USA	100%	
The National Corporation	USA	100%	
Talbot, Bird & Co., Inc.	USA	100%	

Notes:

1. The country of principal operation for each of the above companies is the country of incorporation with the exception of The Royal Exchange Assurance and Caledonian Insurance Company whose principal countries of operation are Portugal and the Republic of Ireland respectively.
2. The Group owns 86% of the ordinary shares of Albingia Versicherungs-Aktiengesellschaft and 74% of the participating preference shares. The interest of the Group in the net assets of the Albingia companies at 31 December 1997 was 83%.
3. Information regarding other subsidiaries is submitted with the annual return.
4. All holdings of ordinary shares are held by a subsidiary unless otherwise stated.

Five-year review

Geographical distribution of profit/(loss) before taxation

		1997 £m	Restated 1996** £m	1995 £m	Restated 1994* £m	1994 £m	1993 £m
United Kingdom	General insurance	**191**	133	272	11	11	220
	Life	**21**	20	21	19	20	21
	Corporate investment	**114**	110	86	(47)	(47)	95
		326	263	379	(17)	(16)	336
Republic of Ireland	General insurance	**20**	30	72	4	4	81
	Life	**1**	1	1	1	1	1
	Corporate investment	**32**	16	31	–	–	36
		53	47	104	5	5	118
Continental Europe	General insurance	**34**	29	37	(31)	(31)	22
	Life	**5**	6	3	(1)	(1)	1
	Corporate investment	**149**	133	44	(1)	(1)	69
		188	168	84	(33)	(33)	92
The Americas	General insurance	**(3)**	16	58	(28)	(28)	27
	Corporate investment	**56**	39	56	(9)	(9)	25
		53	55	114	(37)	(37)	52
South Africa	General insurance	**8**	7	13	2	2	10
	Corporate investment	**7**	19	22	16	16	26
		15	26	35	18	18	36
Asia	General insurance	**10**	3	7	8	9	1
	Corporate investment	**–**	6	2	9	9	6
		10	9	9	17	18	7
Other	General insurance	**46**	(7)	3	(14)	(15)	(2)
	Life	**2**	4	3	6	5	–
	Corporate investment	**187**	46	65	(29)	(20)	112
		235	43	71	(37)	(30)	110
Group	General insurance	**306**	211	462	(48)	(48)	359
	Life	**29**	31	28	25	25	23
	Corporate investment	**545**	369	306	(61)	(52)	369
	Income from associates	**22**	40	16	9	–	–
	Movement in equalisation reserves	**(30)**	(33)	–	–	–	–
	Profit/(loss) before taxation	**872**	618	812	(75)	(75)	751
	Taxation	**(240)**	(166)	(106)	(45)	(45)	(68)
	Minority interests	**(34)**	(36)	(27)	(3)	(3)	(36)
	Profit/(loss) after taxation and minorities	**598**	416	679	(123)	(123)	647
	Dividends	**(106)**	(91)	(79)	(72)	(72)	(66)
	Transfer to/(from) reserves	**492**	325	600	(195)	(195)	581
Earnings/(loss) per ordinary share		**65.5p**	45.9p	77.0p	(14.0)p	(14.0)p	74.5p
Dividend per ordinary share		**11.5p**	10.0p	9.0p	8.25p	8.25p	7.6p

The territorial results are stated after reinsurance protection from Group companies.

*1994 figures have been restated to comply with the requirement of the Insurance Companies Accounts Regulations.

**1996 figures have been restated to include equalisation reserves as liabilities.

Written Premiums

	1997 £m	Restated 1996** £m	1995 £m	Restated 1994* £m	1994 £m	1993 £m
General business						
Geographical distribution:						
United Kingdom	**1,048**	1,039	1,019	1,128	1,128	1,077
Republic of Ireland	**222**	226	214	196	196	173
Continental Europe	**482**	626	689	673	673	565
The Americas	**609**	626	607	573	568	454
South Africa	**141**	140	143	128	123	116
Asia	**52**	66	57	60	65	57
Other, including central reinsurance	**208**	191	169	93	88	100
	2,762	2,914	2,898	2,851	2,841	2,542
Life business:						
Life, capital redemption and permanent health	**569**	615	618	608	608	512
Considerations for annuities	**214**	203	260	254	254	246
	783	818	878	862	862	758
Combined written premiums	**3,545**	3,732	3,776	3,713	3,703	3,300
Total assets						
General insurance	**8,687**	8,292	8,399	7,245	7,088	6,877
Life business	**11,554**	10,472	10,060	8,755	8,421	8,558
	20,241	18,764	18,459	16,000	15,509	15,435
Net assets						
Attributable to ordinary shareholders	**2,669**	2,231	2,228	1,542	1,494	1,681
Life business						
Geographical distribution of funds:						
United Kingdom	**4,792**	4,263	4,095	3,818	6,091	6,530
Republic of Ireland	**140**	144	134	119	221	227
Germany	**1,334**	1,356	1,494	1,233	1,315	1,114
France	**313**	305	291	206	248	152
New Zealand	**66**	84	58	27	166	135
Other	**104**	98	92	80	82	99
	6,749	6,250	6,164	5,483	8,123	8,257
Investments						
Marketable securities	**6,071**	5,331	4,891	4,036	6,074	6,319
Freehold and leasehold properties	**613**	555	564	661	695	705
Mortgages and loans	**1,110**	1,189	1,303	1,162	1,176	1,086
Other	**145**	145	116	55	149	186
	7,939	7,220	6,874	5,914	8,094	8,296
New life business completed (net of reassurance)						
Sums assured	**7,756**	4,637	4,774	4,888	4,888	4,953
Annual premiums	**49**	58	66	76	76	83
Single premiums and purchase monies	**240**	216	245	228	228	217
New annuities per annum	**43**	66	73	62	62	88

Shareholder information

As at 31 December 1997

Shareholdings

	Holdings	%	No. of shares	%
Private shareholders	20,126	79.86	57,889,517	6.29
Bank and nominee companies	4,087	16.22	797,636,684	86.71
Insurance companies	18	0.07	13,807,594	1.50
Pension funds	15	0.06	13,953,243	1.52
Other shareholders	955	3.79	36,592,207	3.98
Total	**25,201**	**100.00**	**919,879,245**	**100.00**

Range of shareholding	No. of shareholders	% of total shareholders	No. of shares	% of ordinary share capital
1 – 1,000	7,531	29.88	3,529,620	0.38
1,001 – 5,000	12,772	50.67	31,132,757	3.38
5,001 – 50,000	4,001	15.88	46,324,927	5.04
50,001 – 100,000	216	0.86	16,193,153	1.76
100,001 – 500,000	421	1.67	97,670,418	10.62
500,001 – 1,000,000	105	0.42	74,223,374	8.07
1,000,001 – 5,000,000	125	0.50	266,241,464	28.94
over 5,000,000	30	0.12	384,563,532	41.81
Total	**25,201**	**100.00**	**919,879,245**	**100.00**

Financial calendar

Announcement of 1997 results	25 February 1998
Dispatch of 1997 Annual Report and Accounts	31 March 1998
Annual General Meeting	28 April 1998
Extraordinary General Meeting	28 April 1998
Qualifying date for 1997 final dividend	27 March 1998
Qualifying date for issue of B shares	1 May 1998
Payment of 1997 final dividend	1 July 1998
Announcement of half-year results	29 July 1998
Payment of 1998 interim dividend	4 January 1999

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