Guardian

Guardian Royal Exchange plc

1998 Report and Accounts

Registered Office: Royal Exchange, London EC3V 3LS
Registered Number: 1821312

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Directors' Report

Directors
G M Wood *Chairman*
A C Homer
A L Owen
P E Owen
J V F Roberts

Directors' Report for 1998
The directors of Guardian Royal Exchange plc (the Company) present their annual report together with the audited accounts of the Company for the year ended 31 December 1998.

Principal activities
The principal activity of the Company during the period was as a holding company for the Guardian Royal Exchange Group (the Group) which carried on insurance, healthcare, financial services and investment business in the United Kingdom and throughout the world.

Post Balance Sheet event
On 1 February 1999, the directors of the Company recommended to its shareholders that they accept an Offer for their shares from Sun Life and Provincial Holdings plc ("SLPH"), a subsidiary of the AXA Group. The Offer was declared unconditional in all respects on 10 May 1999 and, pursuant to the compulsory acquisition procedures under section 429 of the Companies Act 1985, the Company became a wholly owned subsidiary of SLPH on 12 July 1999. The Company's ultimate parent company at the date of this report is AXA, a company incorporated in France.

Directors
The names of the directors of the Company at the date of this Report appear above.

Peter Owen was appointed a director on 24 February 1998. Mark Wood, Les Owen, Andy Homer and Julian Roberts were appointed directors on 12 May 1999 and on that date Mark Wood was elected Chairman. Unless otherwise stated, the following (who all served as directors throughout the year) resigned as directors of the Company on 12 May 1999: Lord Hambro, Julian Sheffield, Edward Adeane, Volker Bremkamp, Caroline Burton, Sir Colin Chandler, Sir Brian Hayes (retired 5 May 1999), James Morley, Sir Paul Newall, Ray Pierce, Sir Peter Reynolds, John Robins, John Sinclair (retired 30 April 1999), Sir Anthony Tennant and Victor Yerrill.

Details of directors' interests in the share capital of the Company are set out in note 28 on pages 34 to 36.

Share capital
Details of the share capital of the Company are set out in note 18 on page 28.

Dividends
The directors do not recommend the payment of a final dividend for the year ended 31 December 1998 (1997: 7.6p net per share). An interim dividend of 4.3p net per share (1997: 3.9p) was paid on 4 January 1999. The transfer to reserves is shown on page 9.

Year 2000

The Group is taking appropriate steps to ensure that business processes and procedures of all companies within the group are Year 2000 compliant.

Plans have been developed to achieve the Group's aim of being able to operate without severe disruption. The necessary internal changes are being made and any partners, intermediaries, suppliers, or other parties whose interface with the Company is business critical have been contacted and prompted to seek to ensure that such interface will not prejudice the Group's operations. The Group is also adopting a policy of preparing contingency plans where there appears to be doubt that compliance by other parties can be effected.

The Group's total compliance cost is expected to be approximately £72m. This includes both external and internal costs; the latter being principally the cost attributable to employees working on the project. As at 31 December 1998 expenditure of £48m had been incurred.

The Company also faces the risk of increased claims notifications arising from the impact of Year 2000 failures on its policyholders. Due to the uncertainties surrounding the Year 2000 problem it is not possible to quantify the potential magnitude of Year 2000 claims that may be notified in the future. To minimise potential losses, the Group has reviewed likely areas of exposure and, where appropriate, introduced specific exclusion clauses into policy wordings.

Given the nature and scale of the problem and the interaction with third parties, there is no certainty that the Company will not be materially affected by problems associated with Year 2000.

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 communication, 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 meetings of the Group Forum for employee representatives of the worldwide Group were held during 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.

Directors' Report continued

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 1998 represented a credit period of 25 days (1997: 29 days).

Donations

Donations made by the Group during 1998 to charitable organisations within the United Kingdom amounted to £625,716 (1997: £424,331). No political donations were made during the year (1997: £50,000).

Auditors

Following the merger of Price Waterhouse and Coopers & Lybrand from 1 July 1998, Price Waterhouse resigned as auditors in favour of the new firm, PricewaterhouseCoopers, and the Directors appointed PricewaterhouseCoopers to fill the casual vacancy. A resolution to re-appoint the auditors, PricewaterhouseCoopers, and to authorise the directors to fix their remuneration will be proposed at the Annual General Meeting.

By order of the Board.

JRWClayton

J R W Clayton
Company Secretary

27 July 1999

Directors' Responsibilities for the Financial Statements

The directors are responsible for ensuring that reasonable steps are taken to safeguard the Company's assets and to prevent and detect fraud and other irregularities.

The directors are required to maintain proper accounting records and to prepare financial statements in respect of each accounting period which give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period in accordance with the provisions of the Companies Act 1985 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 used on a consistent basis. The directors have also ensured that where necessary the accounts are supported by reasonable and prudent judgements and estimates.

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

Auditors' Report

Auditors' report to the members of Guardian Royal Exchange plc

We have audited the financial statements on pages 7 to 36 which have been prepared on the basis of accounting policies set out on pages 15 to 18.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Annual Report, including as described on page 5 the financial statements. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board and our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

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

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 amount set aside at 31 December 1998, and the effect of the movement in those reserves during the year on the general business technical result and profit before tax, are disclosed in the accounting policies and pages 7 and 11 of the Financial Statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and the Group at 31 December 1998 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.

PricewaterhouseCoopers

PricewaterhouseCoopers
Chartered Accountants and Registered Auditors
London

27 July 1999

Consolidated Profit and Loss Account

for the year ended 31 December 1998

General business technical account	1998 £m	£m	£m	1997 restated £m
Gross written premiums				
Acquisitions	629		–	
Other continuing operations	2,629		2,754	
	3,258		2,754	
Discontinued operations	262		382	
		3,520		3,136
Outward reinsurance premiums		(292)		(282)
Net written premiums		3,228		2,854
Change in provision for unearned premiums				
– gross amount	1		11	
– reinsurers' share	(14)		(4)	
		(13)		7
Earned premiums, net of reinsurance		3,215		2,861
Allocated investment return transferred from non-technical account		283		281
Other technical income		84		79
Total technical income		3,582		3,221
Claims paid – gross amount	(2,740)		(2,385)	
– reinsurers' share	175		167	
	(2,565)		(2,218)	
Change in outstanding claims provision				
– gross amount	(42)		15	
– reinsurers' share	42		10	
	–		25	
Claims incurred, net of reinsurance		(2,565)		(2,193)
Change in other technical provisions net of reinsurance		(20)		7
Net operating expenses *(note: 1e)*		(1,050)		(902)
Amortisation of goodwill in acquired claims provisions		(5)		–
Operating result before movement in equalisation reserves		(58)		133
Change in equalisation reserves		(16)		(30)
Balance on the general business technical account		(74)		103

The general business operating result before movement in equalisation reserves represents:	1998 £m	1997 restated £m
Operating result – continuing operations	(3)	110
– acquisitions	24	–
– discontinued operations	(40)	23
Reorganisation provision – continuing operations	(39)	–
	(58)	133

In accordance with accounting policy IIg and as detailed in note 5, investment return attributable to insurance operations is now calculated by reference to long term rates of return. Comparative figures have been restated accordingly.

Consolidated Profit and Loss Account continued

for the year ended 31 December 1998

Long term business technical account	£m	1998 £m	£m	1997 restated £m
Gross written premiums				
Acquisitions	99		–	
Other continuing operations	734		741	
	833		741	
Discontinued operations	40		65	
		873		806
Outward reinsurance premiums		(40)		(23)
Earned premiums, net of reinsurance		833		783
Investment income *(note: 2d)*		1,165		956
Unrealised investment gains		451		627
Other technical income, net of reinsurance		5		4
Claims paid – gross amount	(944)		(798)	
– reinsurers' share	24		13	
	(920)		(785)	
Change in the provision for claims				
– gross amount	–		3	
– reinsurers' share	1		–	
	1		3	
Claims incurred, net of reinsurance		(919)		(782)
Change in other technical provisions				
Long term business provision:				
– gross amount	(935)		(734)	
– reinsurers' share	15		18	
	(920)		(716)	
Other technical provisions net of reinsurance	(449)		(382)	
		(1,369)		(1,098)
Net operating expenses *(note: 2e)*		(149)		(138)
Investment expenses and charges *(note: 2f)*		(18)		(16)
Tax attributable to the long term business		(65)		(69)
Transfer (to)/from fund for future appropriations		80		(249)
Balance on the long term business technical account		14		18

Non-technical account	£m	1998 £m	£m	1997 restated £m
Balance on the general business technical account		(74)		103
Balance on the long term business technical account	14		18	
Tax credit attributable to the balance on the long term business technical account	10		11	
		24		29
Income from interests in joint venture and associated undertakings *(notes: 3a & 3b)*		21		22
Other investment income *(note: 4a)*	926		640	
Unrealised investment gains	–		428	
Investment expenses and charges *(note: 4b)*	(52)		(44)	
Unrealised investment losses	(265)		–	
Investment return allocated to the general business technical account	(283)		(281)	
Amortisation of goodwill	(12)		–	
Other charges	(24)		(25)	
Corporate investment profit/(loss)		290		718
Operating profit comprising:				
Continuing operations				
Acquisitions		23		–
Other continuing business		300		854
		323		854
Discontinued operations		(46)		48
Movement in claims equalisation reserves		(16)		(30)
		261		872
Profit on disposal of operations		131		–
Profit on ordinary activities before tax		392		872
Tax on profit on ordinary activities *(note: 6)*		(73)		(240)
Profit on ordinary activities after tax		319		632
Equity minority interests		(5)		(30)
Non-equity minority interests		(2)		(4)
Profit for the financial year		312		598
Dividends		(38)		(106)
Retained profit for the financial year		274		492
Earnings per ordinary share		35.5p		65.5p
Fully diluted earnings per ordinary share		34.9p		64.5p

The pre-tax profit for 1998 is stated after charging exceptional costs of £39m. These costs relate to the integration of the acquired businesses.

The calculation of earnings per ordinary share is based on a profit of £312m (1997: £598m) and on a weighted average of 879,683,218 (1997: 913,407,154) ordinary shares after adjusting for partly paid shares.

Details of the calculation of fully diluted earnings per share are set out in note 25.

Consolidated Balance Sheet

as at 31 December 1998

Assets	£m	1998 £m	£m	1997 £m
Intangible assets *(note: 16)*				
Goodwill	513		–	
Present value of acquired in-force business *(note: 2i)*	8		–	
		521		–
Investments				
Land and buildings *(note: 7)*	918		790	
Interest in joint venture *(notes: 7 & 9)*				
Share of gross assets	98		–	
Share of gross liabilities	(33)		–	
Interests in associated undertakings *(notes: 7 & 9)*	112		97	
Other financial investments *(notes: 7 & 9)*	14,669		13,807	
Deposits with ceding companies	14		26	
		15,778		14,720
Assets held to cover linked liabilities		3,596		3,228
Reinsurers' share of technical provisions				
Provision for unearned premiums	71		78	
Long term business provision	114		70	
Claims outstanding	414		349	
		599		497
Debtors				
Debtors arising out of direct insurance operations *(note: 10)*	897		611	
Debtors arising out of reinsurance operations	68		59	
Other debtors	473		411	
		1,438		1,081
Other assets				
Tangible fixed assets *(note: 8)*	73		50	
Stocks	1		20	
Cash at bank and in hand	304		146	
		378		216
Prepayments and accrued income				
Accrued interest and rent	185		172	
Deferred acquisition costs	380		310	
Other prepayments and accrued income	23		17	
		588		499
Total Assets		22,898		20,241

Liabilities and reserves	£m	1998 £m	£m	1997 £m
Capital and reserves				
Called up share capital *(note: 18a)*		46		46
Share premium account *(note: 18b)*		54		221
Other reserves *(note: 19)*	864		1,145	
Profit and loss account *(note: 19)*	1,823		1,257	
		2,687		2,402
Equity shareholders' funds		2,787		2,669
Minority interests				
Equity minority interests	134		138	
Non-equity minority interests	17		15	
		151		153
Fund for future appropriations		1,268		1,302
Technical provisions				
Provision for unearned premiums	1,431		1,087	
Long term business provision	7,801		6,749	
Claims outstanding	3,734		3,369	
Equalisation provision	137		115	
Other technical provisions	20		–	
		13,123		11,320
Technical provisions for linked liabilities		3,596		3,193
Provisions for other risks and charges *(note: 11)*		466		478
Deposits received from reinsurers		64		57
Creditors				
Creditors arising out of direct insurance operations	100		75	
Creditors arising out of reinsurance operations	59		43	
Amounts owed to credit institutions *(note: 13)*	240		256	
Non-convertible debenture loans *(note: 13)*	148		–	
Other creditors including taxation and social security *(note: 12)*	788		624	
		1,335		998
Accruals and deferred income		108		71
Total liabilities and reserves		22,898		20,241

Parent Company Balance Sheet
as at 31 December 1998

		1998		1997
	£m	£m	£m	£m
Fixed assets				
Investments				
Shares in subsidiary undertakings	567		216	
Ordinary stocks and shares	–		3	
Cash and deposits	14		57	
		581		276
Current assets				
Debtors				
Amounts due from subsidiary undertakings	231		536	
Loans to subsidiary undertakings	371		–	
Taxation	5		11	
Sundry debtors	2		–	
	609		547	
Creditors: amounts falling due within one year				
Interim ordinary dividend	38		36	
Proposed final dividend	–		70	
Amounts due to subsidiary undertakings	393		5	
Other creditors including tax and social security	7		8	
	438		119	
Net current assets/(liabilities)		171		428
Total assets less current liabilities		752		704
Creditors: amounts falling due after more than one year				
Debenture loan		147		–
Provision for other risks and charges				
Deferred taxation		4		–
Net assets		601		704
Representing:				
Share capital *(note: 18a)*		46		46
Share premium *(note: 18b)*		54		221
Revaluation reserve		–		1
Capital redemption reserve		189		–
Profit and loss account		312		436
Equity shareholders' funds		601		704

The accounts on pages 7 to 36 were approved by the directors and signed on 27 July 1999.

Mark Wood
Chairman

Julian Roberts
Finance Director

Cash Flow Statement – General Insurance and Corporate

for the year ended 31 December 1998

		1998		1997 restated
	£m	£m	£m	£m
Operating activities				
Net cash inflow from operating activities *(note: 24a)*		8		215
Dividends from joint venture and associated undertakings		16		2
Returns on investments and servicing of finance				
Interest paid	(37)		(29)	
Dividends paid by subsidiaries to minorities	(5)		(4)	
		(42)		(33)
Taxation paid		(96)		(96)
Capital expenditure				
Purchases less sales of fixed assets		(27)		(17)
Acquisitions and disposals				
Acquisition of subsidiary undertakings *(note: 24e)*	(1,112)		–	
Deferred purchase consideration relating to subsidiary acquired in 1996	(1)		(9)	
Disposal of subsidiary undertakings *(note: 24f)*	281		–	
		(832)		(9)
Equity dividends paid		(106)		(91)
Financing				
Issue of ordinary share capital	16		19	
Return of capital to shareholders	(189)		–	
Shares issued by subsidiary undertakings	9		–	
Increase/(decrease) in borrowings	24		(15)	
		(140)		4
Cash available for investment		(1,219)		(25)
Invested as follows:				
Increase in cash balances		148		24
Portfolio investments *(note: 24b)*				
Ordinary and preference shares	(1,319)		(234)	
Fixed income securities	340		(12)	
Property	(30)		(20)	
Increase/(decrease) in deposits with credit institutions	(358)		217	
		(1,367)		(49)
Net cash invested		(1,219)		(25)

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

Dividends from associates are now shown separately as required by Financial Reporting Standard No. 9. Comparative figures have been restated accordingly.

Statement of Recognised Gains and Losses

for the year ended 31 December 1998

	1998 £m	1997 £m
Profit for the financial year	312	598
Exchange gains/(losses) on translation of overseas net assets not in profit and loss account	17	(73)
Total gains and losses relating to the year	329	525
Prior year adjustment relating to the inclusion of claims equalisation reserves as liabilities	–	(75)
	329	450

Reconciliation of Movements in Group Shareholders' Funds

for the year ended 31 December 1998

	1998 £m	1997 £m
Profit for the financial year	312	598
Dividends	(38)	(106)
Profit and loss account transfer to reserves	274	492
Exchange gains/(losses) on translation of overseas net assets	17	(73)
Issue of ordinary share capital	16	19
Return of capital to shareholders	(189)	–
	118	438
Shareholders' funds at beginning of year	2,669	2,231
Shareholders' funds at end of year	2,787	2,669

Accounting Policies

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 Statement of Recommended Practice on accounting for insurance business (SORP) 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 and joint ventures are accounted for in accordance with the equity basis of accounting and gross equity basis, respectively.

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 in addition to the provisions required to meet the ultimate cost of settling claims outstanding at balance sheet date.

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. Business which the directors consider is managed together is 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 long term rate of return on those investments which support the general insurance business. Previously, the investment return included in the technical account was based on the actual return earned in the period on those investments. The impact of the change in policy is set out in note 5.

h) Administration contracts

Insurance contracts which provide mainly administrative services and which, because of retrospective premium adjustments to reflect claims experience, there is little transfer of insurance risk are now accounted for as contracts of insurance in the profit and loss account.

Previously, these arrangements were dealt with as non-insurance activities through other income in the general business technical account. The change in policy has no impact on the results for either 1998 or 1997. The impact on premium income is disclosed in note 1c and comparative figures have been restated to reflect the change.

III Long term 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 to 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. An allocation is made from the life technical account to the non-technical account of the difference between the longer term rate of return and the actual return on those investments within the life funds which are directly attributable to shareholders.

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 acquisitions is capitalised and amortised on a straight line basis over a period appropriate to the business acquired but, in any case, no longer than 20 years.

Acquired general business claims provisions are stated on an undiscounted basis. The difference between this and their fair value is included as a separate component of goodwill and amortised over the anticipated run-off period of the acquired provisions.

The present value of in-force contracts (PVIF) arising on the acquisition of life business is recognised as an asset. To the extent that the acquired PVIF will be recognised as profit over the life-time of the related contracts, it is amortised on a basis which is designed to match the unwind of the discount which emerges over the lifetime of those contracts. The PVIF carrying value is tested annually for impairment.

Accounting Policies continued

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.

Notes on the Financial Statements

1 General insurance business

a) Geographical analysis

	1998			1997		
	Net written premiums £m	**Underwriting result £m**	**Pre tax result £m**	Net written premiums £m	Underwriting result £m	Pre tax result £m
United Kingdom – continuing business	**944**	**(141)**	**(31)**	1,020	(69)	53
– acquired business	**452**	**(1)**	**14**	–	–	–
– discontinued business	**60**	**(38)**	**(32)**	72	2	9
Republic of Ireland	**235**	**(12)**	**14**	222	(19)	17
Continental Europe	**442**	**(34)**	**14**	482	(22)	25
The Americas – continuing business	**354**	**(29)**	**(8)**	379	(38)	(15)
– acquired business	**138**	**2**	**12**	–	–	–
– disposed business	**165**	**(18)**	**(8)**	264	(4)	14
South Africa – continuing business	**163**	**(7)**	**(2)**	189	–	6
– acquired business	**23**	**(2)**	**(2)**	–	–	–
Asia	**44**	**(10)**	**(4)**	52	(9)	(4)
Other, including central reinsurance	**208**	**(7)**	**14**	174	11	28
	3,228	**(297)**	**(19)**	2,854	(148)	133

The general business pre-tax result comprises underwriting result and allocated investment return but excludes the movement in equalisation reserves, reorganisation costs and amortisation of goodwill in acquired claims provisions.

The territorial results are stated after central reinsurance protection. The 'Other' result includes this reinsurance in respect of the following territories:

	1998		1997	
	Net written premiums £m	**Underwriting result £m**	Net written premiums £m	Underwriting result £m
United Kingdom	**132**	**10**	102	(8)
Republic of Ireland	**3**	**(3)**	2	1
Continental Europe	**24**	**(4)**	10	3
The Americas	**28**	**(12)**	40	4
South Africa	**4**	**(1)**	7	(9)
Asia	**2**	**(3)**	4	3
	193	**(13)**	165	(6)

b) Class of business analysis

	1998		1997	
	Net written premiums £m	**Underwriting result £m**	Net written premiums £m	Underwriting result £m
Property	**782**	**(68)**	843	(41)
Motor	**1,254**	**(194)**	1,285	(131)
Liability	**183**	**13**	196	8
Other	**467**	**(38)**	453	22
Total excluding healthcare	**2,686**	**(287)**	2,777	(142)
Short term healthcare	**542**	**(10)**	77	(6)
Total general business	**3,228**	**(297)**	2,854	(148)

Notes on the Financial Statements continued

c) Insurance contracts which provide mainly administrative services

As stated in accounting policy IIh and as permitted by the ABI Statement of Recommended Accounting Practice, insurance contracts which provide mainly administrative services are now accounted for by reference to their legal form rather than the substance of the transaction. This has increased premium income for 1998 and 1997 by £94m and £92m, respectively, with corresponding increases in incurred claims. The change in accounting policy has no impact on the results for either year.

d) Funded business

In accordance with accounting policy IIf the funded basis of accounting is used for inwards reinsurance, marine and aviation business. For this business, information of sufficient accuracy is not available to enable a result to be determined annually.

e) Analysis of net operating expenses

	1998	1997
Acquisition costs	727	638
(Increase)/decrease in deferred acquisition costs	(32)	3
Administrative expenses	341	248
Reinsurance commissions and profit participation	14	13
	1,050	902

2 **Life business**

a) Geographical analysis

	1998 Net written premiums £m	1998 Pre-tax result £m	1997 Net written premiums £m	1997 Pre-tax result £m
United Kingdom and Republic of Ireland:				
Continuing business	420	25	456	22
Acquired business	92	(7)	–	–
Continental Europe	259	7	242	5
Asia	22	–	21	–
Other	40	(1)	64	2
	833	24	783	29

b) Class of business analysis

	1998 Net written premiums £m	1998 Pre-tax result £m	1997 Net written premiums £m	1997 Pre-tax result £m
Long term healthcare	100	(5)	7	–
Other long term business	733	29	776	29
	833	24	783	29

c) New business

	Regular premiums 1998 £m	Regular premiums 1997 £m	Single premiums 1998 £m	Single premiums 1997 £m
Continuing business	53	48	239	196
Discontinued business	3	3	26	37
	56	51	265	233

d) Investment income

	1998 £m	1997 £m
Income from property	47	37
Income from other investments	552	570
Realised investment and foreign exchange gains	566	349
	1,165	956

Income from other investments includes £438m (1997: £449m) in respect of listed investments.

e) Net operating expenses

	1998 £m	1997 £m
Acquisition costs	69	63
Decrease in deferred acquisition costs	8	10
Administrative expenses	72	65
	149	138

f) Investment expenses and charges

	1998 £m	1997 £m
Interest expense *(note: 4c)*	5	5
Investment management expenses	13	11
	18	16

g) Tax attributable to shareholders

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

h) 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.

i) Present value of acquired in-force business

The value arises from the acquisition of a portfolio of long term insurance business in 1998. The amortisation charged for the year was not material.

3 Income from joint venture and interests in associated undertakings

a) Income from joint venture

The pre-tax operating result arising from the PPP Columbia Hospitals joint venture was £5m with a related taxation charge of £2m. The joint venture is not an insurance operation and does not, therefore, impact Group premium income.

b) Summary of income from joint venture and associates

	1998			1997		
	Net written premiums £m	Underwriting result £m	Pre tax result £m	Net written premiums £m	Underwriting result £m	Pre tax result £m
United Kingdom – continuing business	–	–	–	–	1	2
– acquired business	–	–	5	–	–	–
Continental Europe	25	–	7	28	(1)	9
Asia	10	–	1	16	1	2
	35	–	13	44	1	13
Balance of investment return			8			9
Group share of pre-tax result			21			22

4 **Corporate Investment**

a) Other investment income

	1998 £m	1997 £m
Income from property	12	9
Income from other investments	362	348
Realised investment gains	552	283
	926	640

Realised investment gains include foreign exchange losses of £19m (1997: gains £7m)

Income from other investments includes £268m (1997: £305m) from listed investments

b) Other expenses and charges

	1998 £m	1997 £m
Interest expense *(note: 4c)*	37	29
Investment management expenses	15	15
	52	44

c) Interest Expense

	General insurance and corporate 1998 £m	General insurance and corporate 1997 £m	Life 1998 £m	Life 1997 £m
On loans repayable within five years:				
Bank loans and overdrafts	21	15	–	–
Other loans	12	14	5	5
On loans repayable beyond five years:				
Non Bank loans	4	–	–	–
	37	29	5	5

d) Other charges

Other charges of £24m (1997: £25m) represent the costs of the corporate centre.

5 **Investment return allocation between technical and non-technical accounts**

As stated in accounting policy IIg, the allocation of investment return to the general business technical account is now based on longer term rates of return, details of which are given in note 5a. Previously, the allocation was based on actual returns and comparative figures have been amended to reflect the change in policy. The change has no impact on the pre-tax results for years 1998 and 1997. The impact of the change in policy has been to reduce the 1997 investment return credited to general business from £454m to £281m, with a corresponding change to the Corporate Investment result. Had the change not been made, the 1998 credit to the technical account would have been £364m.

So far as life business is concerned, the difference between the actual return on investments within the life funds which are directly attributable to shareholders and the longer term return on those investments is not material.

a) Longer term investment returns

The longer term investment return is based on historical real rates of return and current inflation expectations, adjusted for economic and investment forecasts. The return is calculated by applying the long term rate to a notional portfolio deemed to support the insurance operations.

The principal rates used are:

	Equities		Fixed Interest	
	1998	1997	**1998**	1997
	%	%	**%**	%
UK	**9.0**	9.0	**6.5**	6.5
Republic of Ireland	**10.0**	10.0	**4.5**	7.0
Germany	**8.5**	8.5	**4.5**	4.5
USA	**9.0**	9.0	**5.5**	5.5

Comparison of longer term return with actual returns

Actual average rates of return attributable to shareholders for the last two years are:

	Equities		Fixed Interest	
	1998	1997	**1998**	1997
	%	%	**%**	%
UK	**9.9**	23.0	**13.8**	12.0
Republic of Ireland	**32.2**	53.6	**11.7**	11.5
Germany	**15.6**	38.2	**10.0**	8.8
USA	**23.0**	29.6	**7.9**	8.1

6 Taxation

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

	1998	*1997*
	£m	£m
Current taxation:		
United Kingdom taxation		
Corporation tax at rate of 31% (1997: 31.5%)	**(83)**	(69)
Tax relating to franked investment income	**(10)**	(14)
Advance corporation tax written off	**–**	1
	(93)	(82)
Double tax relief	**12**	35
Overseas taxation	**(61)**	(63)
	(142)	(110)
Deferred Taxation	**84**	(115)
Taxation attributable to shareholders' life business profits	**(10)**	(11)
Share of associate companies' and joint venture taxation	**(5)**	(4)
Taxation charged in profit and loss account	**(73)**	(240)

Balance Sheet provisions for deferred taxation represent:

	Provided		Unprovided	
	1998	1997	**1998**	1997
	£m	£m	**£m**	£m
Unrealised investment gains	**206**	277	**265**	225
Other short term timing differences	**3**	10	**(34)**	(17)
Losses and surplus ACT available for offset	**–**	(5)	**(1)**	–
Deferred taxation provisions *(note: 11)*	**209**	282	**230**	208

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. Taxation relief attributable to exceptional items is £12m. (1997: nil)

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

7 **Consolidated balance sheet as at 31 December 1998**

	General and Corporate 1998 £m	General and Corporate 1997 £m	Life 1998 £m	Life 1997 £m	Consolidated 1998 £m	Consolidated 1997 £m
Intangible assets	521	–	–	–	521	–
Land and buildings						
Company occupied	95	90	39	57	134	147
Other	101	87	683	556	784	643
	196	177	722	613	918	790
Associated undertakings and joint venture	177	97	–	–	177	97
Other financial investments						
British Government Securities	790	460	1,358	1,214	2,148	1,674
Overseas Government, municipal and public Boards	1,328	1,289	933	677	2,261	1,966
Debentures and Debenture Stocks	965	482	1,900	1,751	2,865	2,233
	3,083	2,231	4,191	3,642	7,274	5,873
Preference and guaranteed stocks and shares	78	86	8	22	86	108
Ordinary stocks and shares	2,460	3,419	2,685	2,407	5,145	5,826
	2,538	3,505	2,693	2,429	5,231	5,934
Mortgages and loans	391	342	1,197	1,110	1,588	1,452
Deposits with credit institutions	432	403	144	145	576	548
Deposits with ceding companies	14	26	–	–	14	26
Total Investments	6,831	6,781	8,947	7,939	15,778	14,720
Assets held to cover linked liabilities	–	–	3,596	3,228	3,596	3,228
Reinsurers' share of technical provisions	483	426	116	71	599	497
Debtors	1,452	1,105	159	127	1,438	1,081
Other assets	356	202	22	14	378	216
Prepayments and accrued income	359	268	229	231	588	499
TOTAL ASSETS	10,002	8,782	13,069	11,610	22,898	20,241
Capital and Reserves						
Share capital	46	46	–	–	46	46
Share premium	54	221	–	–	54	221
Non-distributable shareholders' interest in life funds	–	–	12	48	12	48
Other reserves	2,675	2,354	–	–	2,675	2,354
Equity shareholders' funds	2,775	2,621	12	48	2,787	2,669
Minority interests	151	153	–	–	151	153
Fund for future appropriations	–	–	1,268	1,302	1,268	1,302
Technical provisions	5,282	4,532	7,841	6,788	13,123	11,320
Technical provisions for linked liabilities	–	–	3,596	3,193	3,596	3,193
Other Liabilities and provisions	1,794	1,476	352	279	1,973	1,604
Total Liabilities and shareholders' funds	10,002	8,782	13,069	11,610	22,898	20,241

The equity shareholders' funds of £12m 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.

8 Fixed assets

	Cost £m	Depreciation £m	Net book value £m
At 31 December 1997	160	(110)	50
Exchange	–	–	–
Restated	160	(110)	50
Purchases	32	–	32
Sales	(19)	14	(5)
Other movements	17	15	32
Provision for depreciation	–	(36)	(36)
At 31 December 1998	190	(117)	73

Fixed assets are primarily computer equipment, fixtures and fittings.

9 Investments

The cost price of investments held at 31 December 1998 was £12,489m (1997: 11,680m). The cost price of investments held to cover linked liabilities was £2,668m (1997: £2,398m).

Investments totalling £12,240 (1997: £11,403m) are listed on a recognised stock exchange. Of these £7,146 (1997: £7,289m) are listed on the London Stock Exchange.

Land and buildings includes £143m (1997: £211m) in respect of leasehold properties of which £6m (1997: £7m) related to land held on short lease.

Principal equity holdings of the Group in associated companies and joint ventures at 31 December 1998 were as follows:

	Holding	Country
Columbia Healthcare Holdings Limited (Joint Venture)	50%	United Kingdom
Aviation and General Insurance Company Limited	36%	United Kingdom
Le Foyer Finance S.A.	35%	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.

All companies, with the exception of Columbia Healthcare, are insurance companies. Columbia Healthcare provides hospital facilities within the private healthcare market.

10 Debtors arising out of direct insurance operations

	General and Corporate		Life		Consolidated	
	1998 £m	1997 £m	1998 £m	1997 £m	1998 £m	1997 £m
Due from policyholders	449	251	27	17	476	268
Due from intermediaries	418	341	3	2	421	343
	867	592	30	19	897	611

11 Provisions for other risks and charges

	Pensions	Deferred Taxation	Other	Total
At 1 January 1998	103	282	93	478
Exchange	6	(1)	2	7
Acquisitions and disposals	13	12	15	40
Utilised	–	–	(40)	(40)
Profit and loss account	24	(84)	41	(19)
At 31 December 1998	146	209	111	466

12 Other creditors

	General and Corporate 1998 £m	General and Corporate 1997 £m	Life 1998 £m	Life 1997 £m	Consolidated 1998 £m	Consolidated 1997 £m
Unpaid interim dividend	38	36	–	–	38	36
Proposed final dividend	–	70	–	–	–	70
Taxation	219	111	85	14	304	125
Other creditors	464	391	155	153	446	393
	721	608	240	167	788	624

13 Loans

	General and Corporate 1998 £m	General and Corporate 1997 £m	Life 1998 £m	Life 1997 £m	Consolidated 1998 £m	Consolidated 1997 £m
Secured debenture stock of a subsidiary 10.75% repayable 2006	–	–	1	1	1	1
$6^5/_8$% Company bonds repayable 2023	147	–	–	–	147	
Other secured	–	2	–	–	–	2
	147	2	1	1	148	3
Loans from Bankers						
Secured	–	6	–	–	–	6
Unsecured	240	248	–	–	240	248
	387	256	1	1	388	257
Repayment periods loans other than from bankers						
1 year or less	–	1	–	–	–	1
Between 1 and 2 years	–	1	–	–	–	1
Over 5 years	147	–	1	1	148	1
	147	2	1	1	148	3
Repayment periods loans from bankers						
1 year or less	23	20	–	–	23	20
Between 1 and 2 years	127	21	–	–	127	21
Between 2 and 5 years	90	213	–	–	90	213
	240	254	–	–	240	254

14 Capital expenditure commitments

At 31 December 1998, capital expenditure on equipment amounting to £6m (1997: £18m) had been authorised but had not been provided for in the accounts. Contracts had been placed for £2m (1997: £3m) of the authorised expenditure.

15 Auditors' remuneration

	1998 £000	1997 £000
Remuneration, including expenses, of the auditors of the Company and its subsidiaries for statutory audit work . This includes £115,000 (1997:£110,000) in respect of the audit of the Company.	2,352	2,159

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 £3,226,000 (1997: £5,008,000).

16 Intangible assets

	Goodwill	Goodwill in acquired claims provisions	Purchased in-force businesses	Total
	£m	£m	£m	£m
At 1 January 1998	–	–	–	–
Acquisitions during year	490	47	8	545
Exchange	(7)	–	–	(7)
Amortisation	(12)	(5)	–	(17)
At 31 December 1998	471	42	8	521

17 Staff

a) 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 £16m (1997: £27m), including £4m (1997: £13m) attributable to early retirement costs. It has been assumed that the scheme will remain open to new entrants. New staff join a money purchase arrangement for the period of service up to the age of 30 and have the option of joining the existing defined benefit 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 improvements to the level of protection of pensions in payment have been 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 review, 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. With effect from 1 April, the profit and loss account charge was reduced from 12% to 9.5% of pensionable salaries but the contribution rate remained at 5% of pensionable salaries. The employer defined contribution rate for new employees under age 30 is 5% of basic salary.

In addition to the principal scheme, the accounts contain a further charge of £23m (1997: £21m) in respect of other schemes of which £9m (1997: £14m) relate to the provision of pensions for employees in Germany.

The analysis of provisions for other risks and charges in note 11 includes an amount of £146m (1997: £103m) in respect of staff pension schemes. Of this sum, £96m (1997: £83m) is in respect of provisions for staff pension liabilities in Germany.

b) Staff numbers and cost

	1998 £m	1997 £m
Wages and salaries	**368**	315
Social security costs	**38**	34
Other pension costs	**39**	48
	445	397

The average weekly number of employees, including executive directors, was comprised as follows:

	1998	1997
United Kingdom insurance operations	**8,493**	6,740
United Kingdom investment and corporate centre	**509**	585
Ireland	**834**	842
Continental Europe	**2,417**	2,501
The Americas	**2,571**	2,287
South Africa	**1,299**	1,063
Asia	**595**	525
Other	**113**	140
	16,831	14,683

18 Share capital and share premium

a) Share capital

		1998 Authorised £m	1998 Paid-up £m	1997 Authorised £m	1997 Paid-up £m
Authorised	1,142,859,044 ordinary shares of 5.25p each and 931,707,318 non-cumulative redeemable preference shares of 20.5p each	**251**		60	
Issued:	884,886,177 (1997: 919,879,245 ordinary shares of 5p; restated as 876,075,471 ordinary shares of 5.25p) ordinary shares of 5.25p each, fully paid		**46**		46

On 5 May 1998 the Share Capital was reorganised by the replacement of the 923,130,219 ordinary shares of 5p in issue on that date by 879,171,637 ordinary shares of 5.25p on a 20 new shares for every 21 old shares basis. In conjunction and on the same date 923,130,219 non-cumulative redeemable preference shares (B shares) of 20.5p each were issued to shareholders whose name was on the Register on 1 May 1998. During the course of the year all the issued B shares have been redeemed.

During the year 8,965,514 ordinary shares of 5.25p 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.

During the year options were granted under the Company's share option scheme to Group employees to subscribe for 3,734,477 ordinary shares of 5.25p under the sharesave option scheme and 9,213,012 ordinary shares of 5.25p each under the share option scheme.

There were at 31 December 1998 outstanding options to subscribe for 38,705,374 ordinary shares of 5.25p each under the employee share option schemes exercisable as follows:

Number of Shares	*Period during which options are exercisable*	*Price payable per share*
1,857,500	on or before 29 September 1999	222.5p
24,000	on or before 29 September 2000	189.0p
46,000	on or before 29 September 2001	188.0p
400,000	on or before 19 April 2002	126.0p
714,000	on or before 29 September 2002	125.0p
152,000	on or before 29 September 2003	210.0p
193,000	on or before 29 September 2004	193.0p
400,000	on or before 6 September 2005	228.0p
8,915,474	on or before 29 September 2005	223.0p
131,451	on or before 25 May 1999	150.4p
362,528	on or before 25 May 1999	168.0p
297,382	28 September 1999 to 27 September 2003	252.5p
966,118	28 September 1999 to 27 September 2006	252.5p
2,558,610	26 November 1999 to 25 May 2000	100.0p
924,238	26 November 1999 to 25 May 2000	154.4p
280,186	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
1,568,380	28 September 2000 to 27 September 2007	282.0p
80,120	28 September 2000 to 27 September 2007	313.0p
256,107	26 November 2000 to 25 May 2001	168.0p
1,037,786	26 November 2000 to 25 May 2001	178.4p
645,767	26 November 2000 to 25 May 2001	225.6p
321,639	26 November 2001 to 25 May 2002	154.4p
832,706	26 November 2001 to 25 May 2002	202.0p
264,098	26 November 2002 to 25 May 2003	178.4p
1,610,973	26 November 2002 to 25 May 2003	225.6p
299,765	26 November 2003 to 25 May 2004	202.0p
724,426	26 November 2004 to 25 May 2005	225.6p
2,642,612	31 March 2001 to 30 March 2008	435.75p
6,454,800	27 September 2001 to 26 September 2008	286.0p
1,151,022	26 November 2001 to 25 May 2002	228.8p
1,849,852	26 November 2003 to 25 May 2004	228.8p
706,834	26 November 2005 to 25 May 2006	228.8p
38,705,374		

b) Share premium

	£m
Balance at 1 January 1998	221
Creation of 923,130,219 non-cumulative redeemable preference shares (B shares)	(189)
Issue of ordinary shares	22
Balance at 31 December 1998	54

19 Reserves

	Profit and loss account £m	Capital reserve £m	Other reserves £m	Total £m
Balance at 31 December 1996	1,014	104	875	1,993
Cost of shares issued to employees under 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
Cost of shares issued to employees under a Qualifying Employee Share Trust	(6)		–	(6)
Transfer (to)/from profit and loss account	**572**		**(298)**	**274**
Exchange on translation of overseas net assets			**17**	**17**
Balance at 31 December 1998	**1,823**	**104**	**760**	**2,687**

The capital reserve represents the share premium in respect of 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 employee share option schemes.

Other reserves are non-distributable. They include the capital redemption reserve of the Company of £189m which was created during the year on the redemption of B shares referred to in note 18. The balance arises principally from the revaluation of investments to current values and from profits/losses arising on the translation of overseas net assets to Sterling.

During 1998 Guardian Royal Exchange plc received £22m from the issue of shares arising from the exercise of options awarded under employee share option schemes. Of this amount £16m was paid by employees and the balance was paid by subsidiary undertakings through a Qualifying Employee Share Trust.

20 Geographical Analysis of Net Assets

	1998 £m	1997 £m
United Kingdom	**584**	561
Ireland	**154**	137
	738	698
Continental Europe	**536**	534
The Americas	**648**	457
South Africa	**42**	58
Asia	**54**	60
Others, including corporate centre	**71**	765
	2,089	2,572
Net assets of joint venture and associates	**177**	97
Intangible assets	**521**	–
	2,787	2,669

21 Contingent liabilities

With the approval of HM Treasury 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.

22 Acquisitions

The following acquisitions were made in 1998:

Date	Company	Consideration
22 February	PPP healthcare group plc (PPP)	£407m
27 February	Aegis Insurance Company Limited	£42m
21 May	Medical and Industrial Services Limited (MIS)	£9m
31 August	ING US P&C Corp	£698m
29 December	Groupe Sprinks SA	£18m

a) PPP

The fair values attributed to the assets acquired were:

	Book value £m	Fair value adjust-ments £m	Fair value to the Group £m
Investments	531	(1)	530
Intangibles	–	8	8
Insurance debtors	183	–	183
Cash and deposits	90	–	90
Other assets	92	(13)	79
Technical provisions	(427)	–	(427)
Other liabilities	(208)	(7)	(215)
	261	(13)	248
Net consideration			407
Goodwill (To be amortised over 20 years)			159

The adjustments represent the inclusion of purchased in-force business, the elimination of capitalised software and development costs and an increase in the deferred tax provision for unrealised investment gains.

b) *ING US P&C Corp*

The fair values attributed to the assets acquired were:

	Book value £m	Fair value adjust-ments £m	Fair value to the Group £m
Investments	501	2	503
Insurance debtors	151	–	151
Bank overdrafts	(17)	–	(17)
Other assets	502	(33)	469
Technical provisions	(687)	–	(687)
Other liabilities	(62)	–	(62)
	388	(31)	357
Net consideration			698
Goodwill			341

£47m of the ING US P&C Corp goodwill relates to the difference between the undiscounted value of technical provisions as stated above and their value on a discounted basis. This will be amortised over the anticipated run-off period of the acquired provisions. The balance of the goodwill will be amortised on a straight line basis over 20 years.

The adjustment of £33m related to the elimination of a deferred tax asset.

c) Other acquisitions

The fair values attributed to the assets acquired were:

	Book value £m	Fair value adjustments £m	Fair value to the Group £m
Investments	46	–	46
Insurance debtors	5	–	5
Cash and deposits	1	–	1
Other assets	52	(2)	50
Technical provisions	(64)	–	(64)
Other liabilities	(5)	(1)	(6)
	35	(3)	32
Net consideration			69
Goodwill			37

The fair value adjustments were made to conform accounting policies and to adjust the value of assets and liabilities acquired to reflect the directors' opinion of their fair value to the Group.

The net consideration includes an estimate of £2m in respect of MIS, the payment of which is deferred until 2000. The precise amount to be paid is dependent on the achievement of defined performance criteria but will not exceed £2m.

d) Details of major acquisitions

The prior period details required by Financial Reporting Standard No. 6 are set out below:

	PPP Group £m	ING £m
Results from 1 January 1998 to date of acquisition by the Group		
Premium written	73	307
Operating profit/(loss)	(4)	8
Profit/(loss) before tax	(2)	20
Tax	3	(7)
Profit after tax	1	13

No other gains or losses were recognised in the period.

Profit after tax for the 12 months to 31 December 1997	22	32

The above information is shown on the basis of the accounting policies used by PPP and ING US P&C Corp prior to their acquisition by the Group.

23 Disposals and discontinued business

On 31 August 1998, the Group disposed of its Canadian operations to ING for £225m.

On 18 November 1998, the Group disposed of its New Zealand life subsidiary to Royal & Sun Alliance for £56m.

A summary of the net assets disposed of is set out in note 24f.

In February 1999 the Company's principal UK operating subsidiary announced its withdrawal from London Market marine business. Provision has been made in the accounts for the cost of running off existing liabilities.

24 Notes on cash flow statement

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

	1998 £m	1997 £m
Operating profit	261	872
Exclude:		
Interest expense	37	29
Share of associates' results	(21)	(22)
Investment gains	(281)	(735)
Profit before taxation (excluding investment gains and interest)	(4)	144
Increase/(decrease) in insurance funds, net of reinsurance	(101)	21
Increase in equalisation reserves	16	30
Goodwill written off	17	–
Net increase in debtors and creditors	45	(1)
Depreciation of fixed assets	35	21
Net cash inflow from operations	8	215

b) Purchases and sales of portfolio investments

	£m	1998 £m	£m	1997 £m
Purchases of ordinary and preference shares	870		523	
Sales of ordinary and preference shares	(2,189)		(757)	
		(1,319)		(234)
Purchases of fixed income securities	3,916		2,495	
Sales of fixed income securities	(3,576)		(2,507)	
		340		(12)
Purchases of properties	3		39	
Sales of properties	(33)		(59)	
		(30)		(20)
Net purchases/(sales) of portfolio investments		(1,009)		(266)
Increase/(decrease) in deposits with credit institutions		(358)		217
Movements in portfolio investments arising from cash flows		(1,367)		(49)

c) *Movement in portfolio investments, net of financing*

	£m	1998 £m	£m	1997 £m
Increase in cash balances	148		24	
Cash flow:				
Decrease in portfolio investments	(1,367)		(49)	
(Increase)/decrease in borrowings	(24)		15	
Movement arising from cash flows		(1,243)		(10)
Changes in market values and impact of exchange rate movements		326		498
Movement in life business balances		1,018		731
Acquisitions and disposals of subsidiary undertakings		916		
Movement in portfolio investments, net of financing		1,017		1,219
Portfolio investments, net of financing, at 1 January		14,486		13,267
Portfolio investments, net of financing, at 31 December		15,503		14,486

d) Movement in cash, portfolio investments and financing

	At 1 Jan 1998 £m	Acquired and disposed operations £m	Cash Flow £m	Changes in Life Business £m	Changes in market values and currencies £m	At 31 Dec 1998 £m
Cash	146	–	148	10	–	304
Ordinary and preference shares	5,934	168	(1,319)	264	184	5,231
Fixed income securities	7,326	433	340	636	127	8,862
Properties	789	34	(30)	109	16	918
Deposits with credit institutions	548	389	(358)	(1)	(2)	576
Loans due within one year	(21)	–	(2)	–	–	(23)
Loans due later than one year	(236)	(108)	(22)	–	1	(365)
	14,486	916	(1,243)	1,018	326	15,503

e) Analysis of net cash outflow in respect of acquisitions

	£m
Cash consideration	1,172
Cash acquired (net of cash belonging to life funds of £14m)	60
Net cash outflow	1,112

f) Disposal of Subsidiaries

	£m
Net assets disposed of:	
Portfolio investments	293
Technical provisions	(279)
Other net assets	136
Profit on disposal	131
Net cash inflow in respect of disposal of subsidiaries	281

25 Fully diluted earnings per share

The fully diluted earnings per share is based on a profit of £312m (1997: £598m) and on a weighted average of 894,121,819 ordinary shares (1997: 927,444,742). This makes full allowance for all dilutive shares outstanding under the various share option schemes.

26 Guardian Royal Exchange plc

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 1998, including paid and proposed dividends from subsidiaries, was £102m (1997: £338m). As permitted by section 230 of the Companies Act 1985, the profit and loss account of the Company is not included in these accounts.

27 Post Balance Sheet Event

On 1 February 1999, the Board of the Company recommended that its shareholders accept an offer for their shares in the Company from Sun Life and Provincial Holdings plc (SLPH), a member of the AXA Group. The offer became unconditional on 10 May 1999 from which date the Company became a subsidiary of SLPH and its ultimate holding company became AXA a company incorporated in France.

On 10 May 1999 all overseas operating units, with the exception of the Irish and USA operations, were sold to the AXA Group. The USA operations were sold on 10 May to Liberty Mutual Inc.

Notes on the Financial Statements continued

28 Directors' Emoluments

	1998 £	1997 £
Non-executive directors		
Fees	345,000	278,000
Executive directors		
Salaries and other emoluments	3,353,474	2,323,561
Contributions to money purchase pension schemes	197,270	77,891
Gains arising from the exercise of share options	1,003,830	596,994
Gains arising under long term incentive plan	814,312	–
	5,713,886	3,276,446

No fees waived by directors in 1998 or 1997.

a) Analysis of emoluments by director

	Salary & fees £	Benefits £	Annual bonus £	Share options & long term incentives £	1998 Total £	1997 Total £
Executive						
J V H Robins	441,900	1,198	127,704	208,383	779,185	1,072,674
V Bremkamp	175,513	9,884	292,441	276,577	754,415	391,556
C M Burton	247,887	1,092	85,888	162,365	497,232	312,656
J Morley	274,688	1,497	77,027	837,989	1,191,201	318,175
R F Pierce	246,337	1,497	46,603	109,094	403,531	122,063
P Owen (appointed 24.2.98)	377,042	47,225	82,502	–	506,769	–
J Sinclair	265,080	2,438	59,901	125,029	452,448	303,693
V M Yerrill	321,084	9,961	157,085	98,705	586,835	399,738
Non-Executive						
Lord Hambro	114,000				114,000	93,500
Hon Edward Adeane	31,000				31,000	25,000
Sir Colin Chandler	25,000				25,000	20,000
Sir Brian Hayes	30,000				30,000	24,000
Sir Paul Newall	33,000				33,000	26,500
Sir Peter Reynolds	31,000				31,000	24,000
J Julian L G Sheffield	53,000				53,000	42,500
Sir Anthony Tennant	28,000				28,000	22,500
	2,694,531	74,792	929,151	1,818,142	5,516,616	3,198,555

b) Long term incentives

Executive directors participate in the GRE Long Term Incentive Plan. At 1 January 1998 and 31 December 1998 interests under the GRE Long Term Incentive Plan were as follows:

Director	Entitlement to shares at 31 December 1998	Provisional allocation of shares at 1 January 1998
J V H Robins	**58,167**	176,263
V Bremkamp	**17,688**	53,599
C M Burton	**30,829**	93,421
J Morley	**34,900**	105,758
R F Pierce	**23,267**	70,505
J Sinclair	**34,900**	105,758
V M Yerrill	**27,552**	83,491
	227,303	688,795

The provisional allocation was conditional on the total shareholder return for the shareholders of Guardian Royal Exchange plc having reached levels of comparative performance in excess of that achieved by other comparator companies in relation to the four year period comprising financial years 1 January 1995 to 31 December 1998. For the four years ended 31 December 1998, it has been determined that Guardian Royal Exchange plc ranked third in performance and the resultant entitlements to shares are set out above.

Further details of The GRE Long Term Incentive Plan are disclosed in the report of the Remuneration Committee in the Report and Accounts of Guardian Royal Exchange plc for the year ended 31 December 1997.

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 date, any award will attract interest but will not become payable until 31 December 2001.

c) Share Options

The interests of the directors in the share options of the Company are set out below:

Director	At 1.1.98	Number of options during the year: Granted	Number of options during the year: Exercised	At 31.12.98	Exercise price	Market price at date of exercise	Date from which exerciseable	Expiry date
J V H Robins	4,826			4,826	202.0p		26.11.99	25.05.00
V Bremkamp	20,000		20,000		173.0p	434.0p	30.09.91	29.09.98
	6,000		6,000		222.5p	434.0p	30.09.92	29.09.99
	48,000		48,000		125.0p	434.0p	30.09.95	29.09.02
	200,000			200,000	228.0p		07.09.98	06.09.05
C M Burton	40,000		40,000		173.0p	259.0p	30.09.91	29.09.98
	5,984			5,984	150.4p		26.11.98	25.05.99
	48,000		48,000		222.5p	259.0p	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	442.0p	30.09.93	29.09.00
	200,000		200,000		126.0p	442.0p	20.04.95	19.04.02
P E Owen (appointed 24.2.98)		4,261		4,261	228.8p		26.11.01	25.05.02
		200,000		200,000	435.75p		31.03.01	30.03.08
R F Pierce	9,653			9,653	202.0p		26.11.03	23.05.04
	16,000		11,000	5,000	193.0p	427.0p	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
	24,000			24,000	125.0p		30.09.95	29.09.02
	200,000			200,000	228.0p		07.09.98	06.09.05

No options lapsed during the year. The market price of the shares at 31 December 1998 was 336.5p and the range during 1998 was 230.0p to 475.0p.

Notes on the Financial Statements continued

d) *Transactions involving directors and others*

Mr 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 1998 was £1,093,717 ($1,815,571), on which interest of £67,887 ($112,691) was credited for the 12 months ended 31 December 1998.

No other contract of significance existed at any time during the year in which a director at 31 December 1998 was materially interested or which required disclosure as a related party transaction as defined under Financial Reporting Standard 8.

e) *Interests of directors*

The beneficial interests of 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 1998 and 31 December 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		
Director	At 1.1.98	At 1.1.98 Restated	At 31.12.98	At 1.1.98	At 1.1.98 Restated	At 31.12.98	At 1.1.98	At 1.1.98 Restated	At 31.12.98
Lord Hambro	105,470	100,447	100,447	–	–	–	–	–	–
J Julian L G Sheffield	15,468	14,731	14,731	–	–	–	–	–	–
J V H Robins	144,350	137,474	140,128	9,289	8,846	17,227	15,482	14,744	29,530
Hon. Edward Adeane	5,000	4,761	4,761	–	–	–	–	–	–
V Bremkamp	10,858	10,340	29,054	–	–	–	–	–	–
C M Burton	29,522	28,116	47,954	4,993	4,755	10,917	8,321	7,924	18,633
Sir Colin Chandler	2,122	2,020	2,063	–	–	–	–	–	–
Sir Brian Hayes	1,314	1,251	1,277	–	–	–	–	–	–
J Morley	#15,824	*15,068	231,258	5,546	5,281	9,988	9,243	8,802	17,135
Sir Paul Newall	25,000	23,809	22,380	–	–	–	–	–	–
R F Pierce	2,769	2,637	11,463	2,769	2,637	6,277	4,615	4,395	10,705
Sir Peter Reynolds	12,816	12,205	12,205	–	–	–	–	–	–
J Sinclair	26,364	25,108	20,906	5,044	4,803	9,556	8,407	8,006	16,371
Sir Anthony Tennant	30,000	28,571	28,571	–	–	–	–	–	–
V M Yerrill	13,622	12,973	12,973	–	–	–	–	–	–

includes 200 not beneficially owned
* includes 190 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.

Group Companies

	Country of incorporation	Holding of ordinary shares	
Insurance Companies			
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	England	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%	
PPP healthcare limited	England	100%	
PPP lifetime care plc	England	100%	
Motor Union Seguros SA	Brazil	99%	
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%	
Guardian Insurance 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 National Insurance Company Limited	South Africa	53%	
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)
Denplan Limited	England	100%	
Guardian Investment Holdings Limited	England	100%	(Parent)
Guardian Asset Management Limited	England	100%	
Guardian Mortgage Services Limited	England	100%	
Guardian Properties Limited	England	100%	
Guardian Royal Exchange Services Limited	England	100%	
Guardian Unit Manager Limited	England	100%	
ING US P&C Corp	USA	100%	
The Metropolitan Trust Company Limited	England	100%	
PPP healthcare group plc	England	100%	
Royal Exchange Trust Company Limited	England	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%	
Guardian Royal Exchange Holdings Inc	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 75% of the participating preference shares. The interest of the Group in the net assets of the Albingia companies at 31 December 1998 was 84%.
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.