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DEPARTMENT OF ENTERPRISE TRADE AND INVESTMENT
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Annual Report & Accounts 2003

Contents

Visit **www.royalsunalliance.com** for more information.
This Annual Report & Accounts contains forward looking statements as defined in the US Private Securities Reform Act.
For a discussion of factors that could affect future results, reference should be made to 'cautionary statements' on page 96.

Financial Highlights

	2003	Restated 2002
Revenue		
General business[1] net premiums written	**£6,630m**	£8,635m
Life business net premiums written	**£1,473m**	£1,882m
Results*		
Group operating result[2] (based on LTIR)	**£140m**	£226m
Group operating profit/(loss)[3] (based on LTIR)	**£196m**	£(655)m
Balance sheet at 31 December		
Total capital[4]	**£4,115m**	£3,409m
Shareholders' funds[5] (after derecognition of embedded value)	**£3,001m**	£2,231m
Net asset value per share[6]	**108p**	130p
Tangible net asset value per share (including embedded value)	**125p**	175p
Dividend		
Total dividend for the year per ordinary share (after adjusting for rights issue)	**4.5p**	4.8p

* For an explanation of 'results', look in the Group Finance Director's Report.

Guide to terms

1 General business net premium
The amounts receivable from policy holders, less the amounts payable to our own reinsurers, in respect of policies that have commenced in the year

2 Group operating result (based on longer term investment return)
The Group's general business underwriting result plus the long run investment return arising on the related capital and technical provisions, together with the life and other activities results which are also calculated on long run investment returns

3 Group operating profit/(loss)
The profit on ordinary activities before exceptional items and tax, excluding short term investment fluctuations

4 Total capital
The assets invested in the business by (1) shareholders (2) minority shareholders in part owned subsidiaries (3) subscribers to dated loan capital issued

5 Shareholders' funds
The assets invested in the business by shareholders of ordinary and preference shares

6 Net asset value per share
Net assets attributable to holders of ordinary shares, adjusted for statutory provisions; the derecognition of the embedded value; and the rights issue; stated as the assets per ordinary share in issue

Chairman's Statement

'Your Board is determined to address the fundamental issues and requirements of the Company.'

John Napier, Chairman

This is my first opportunity, having been appointed Chairman in March 2003, to report formally on the progress of your Company. This year has been one of significant change for many aspects of the Company and has included:

- the appointment of a new Group Chief Executive, Andy Haste, who took up his role in April;
- changes to the Board, which have involved the retirement of six non-executive directors and two executive directors;
- additional to the appointment of a new Chairman and Group Chief Executive, the appointment of a new Chief Financial Officer, George Culmer, new non-executive Chairmen of the Audit & Compliance and Remuneration Committees, Edward Lea and John Maxwell respectively, and the appointment of Noel Harwerth and Malcolm Le May as non-executive directors;
- the progressive strengthening of the executive management team, with additional appointments at a Group level in the areas of human resources, business processes, risk and compliance, and changes in the executive leadership of the US and other areas;
- a major emphasis on management reporting and risk management processes with the intent of reinforcing a management performance and accountability culture; and
- the execution of a fundamental review of the Company, which sought to determine:
  - the attractiveness and long term viability of our business operations, taking into account product and service fit, market share and competitive elements;
  - the requirement of, and scope for, sustainable profit and performance improvement; and
  - balance sheet issues, financial resources and capital considerations.

The findings and actions arising from this review are dealt with in more detail in the Group CEO's Review. The main outcomes were to:

- identify a more coherent geographic and business fit necessary to achieve an improved combined operating ratio (COR) and increased rate of return on investment over the insurance cycle;
- use of expert external advisors, to advise on best estimate provisions in key risk areas and activities, particularly in the US;
- identify any necessary restructuring costs and other one time costs of expense reduction programmes needed to achieve the improved rates of return required;
- strengthen our capital position vis a vis rating agencies and regulatory requirements;
- allow scope to grow the business in profitable areas and reduce the use of quota share reinsurance;
- extend and continue a related disposal programme of non core activities;
- address the finance requirements of the above elements with a rights issue which successfully raised a net £960m and had a 92% acceptance level from shareholders; and
- negotiate a three year bank loan facility totalling £400m.

The number of required changes and actions summarised in outline above reflect the interplay of two sets of factors relating to the Company. The first has been the determination of your Board to address the fundamental issues and requirements of the Company. The second is to deal with an overhang of a number of legacy issues related to past decisions and poor management of the business, made more crucial and time critical by delay and adverse external stock market changes and industry circumstances.

We have made encouraging progress in 2003 with a Group operating result based on longer term investment return (LTIR) of £140m. However, the full result was impacted by prior year items of £665m. As expected, the largest element of this, £563m, relates to the use of some of the proceeds from the rights issue to strengthen our claims reserves and includes £96m of the £300m contingent liability for future adverse claims development established at the nine months. We continue to carry the remaining £200m contingent liability and will review the need to establish this as a claims reserve each quarter, as indicated at the third quarter results. However, the stronger balance sheet and better financial basis of the Company is, in itself, not a solution to all the management issues. It allows a greater executive focus on key management areas, principally:

- the implementation of the strategic business plan;
- related restructuring and profit improvement programmes to deliver the combined ratio targets;
- risk assessment and compliance processes;
- improved accounting, capital management and management reporting processes;
- ongoing disposal of non core activities; and
- the transformation of the management culture.

It is against that background, where much depends upon the quality, energy and performance of management, that the Board has considered the effectiveness of current senior management incentive schemes. It is necessary to ensure management is properly rewarded for performance and its objectives are closely aligned with the interests of shareholders. The Remuneration Committee and Board have recommended that we develop an interim two year scheme, following a first year of significant management progress, under which senior executives will be granted an additional award of shares, which have a market value equal to 33% of their annual bonus, and which will be deferred for a period of two years. In addition, we propose those shares will be increased by a 1 to 3 ratio based on performance at mean to upper decile level compared to TSR performance on two comparator groups. Long term incentive payments will be made on the achievement of measurable objectives linked to the improved performance and management of the Company.

In terms of medium term prospects, although significant progress has been made in 2003, there are still substantial management tasks to complete as we look ahead. In the short run the improved equity markets will give some benefit but there is now reduced exposure and less upside to be gained from this area. In any event, benefits from changes in investment value need to be assessed separately from the need to focus on the detail of the performance of the underlying businesses.

There is also the question of longer term changing regulatory and accounting requirements, on which the industry is involved in active discussion. There is debate over detail and timings, partly driven by the Financial Services Authority (FSA) and European legislation. A strengthened FSA is keen to progress those areas and other aspects related to consumer protection generally. Given the long term need, and increased demand, for effective insurance services in a developing world economy, such developments, which both improve policyholder confidence and are sustainable by the industry, should be welcome. They should also help maintain and improve the essential role insurance plays in the modern economy. If these outcomes, particularly sustainability, are not achieved, there could be difficulties for the industry.

The year 2004 will be a demanding year for the management and all employees as we actively seek to continue our business and profit improvement plans and performance enhancement programmes. As already announced, there will be some loss of employment due to the effect of our profit improvement plans and relocation. It is necessary to balance that against the challenge for ongoing operations to achieve a COR of 100% on average over the cycle. It is both ambitious, and necessary, to restore the reputation of, and investor confidence in, the Company. Royal & SunAlliance has a united and strengthened Board and executive team which, together with an improved balance sheet and actions taken to date, allows complete focus on the tasks ahead which, although substantial, are considered deliverable, however such an outcome cannot be guaranteed.

In these circumstances, the Board has considered carefully the question of dividend and dividend policy. Our policy is to at least maintain the current dividend, after adjustment for the rights issue, in real terms. We will also be introducing a dividend scrip alternative to shareholders, the enabling resolution for which will be put to shareholders at our Annual Meeting. The final dividend recommended is 2.9p per share, which brings the total dividend per share for the year, after adjustment for the rights issue, to 4.5p per share.

Finally, I would like to thank on the Board's behalf all management and staff for their efforts in carrying out the Strategic Review and helping to develop and support the necessary change programmes and processes essential to improve performance and results. We look forward to continued progress in 2004.

John Napier, Chairman

Group CEO's Industry Overview

'The concern for the industry must be to ensure that pricing and terms and conditions are at a level where there is an expectation of underwriting profit every year, and not just at the top of the cycle.'

2003 was another challenging year for the insurance industry worldwide. There were fewer catastrophe losses and investment markets began to recover but changes in regulation, legacy issues such as asbestos, legal reforms, both proposed and enacted, and the reappearance of some price competition, were all factors that needed to be addressed.

The FTSE 100 climbed nearly 12% over the year and the Dow Jones by over 21%, giving some uplift to balance sheets that had been hit hard over the last few years. However, an estimated US$160bn was lost from the global insurance industry's balance sheets due to equity weakness between the end of 2000 and 2003, mostly hitting European insurers who historically have held much higher levels of equities than their US counterparts, and the capital lost will take years to rebuild. These factors, which were compounded by the third year running of more downgrades than upgrades being actioned by the major rating agencies in the UK and US, combined to ensure that companies could not afford to lose pricing discipline.

The low interest rate environment was another factor in the continued underwriting discipline of companies worldwide. For a number of years now companies have needed to underwrite for profit with no ability to hide poor performance behind profits earned on investments. The concern for the industry must be to ensure that pricing and terms and conditions are at a level where there is an expectation of underwriting profit every year, and not just at the top of the cycle.

Against this background, it was encouraging that, even as price competition began to reappear in the short tail classes, particularly the large individually underwritten commercial property risks, there did not seem to be a wholesale disregard for the disciplines learnt over the last few years. We have seen comments from companies, from brokers and from Lloyd's, that all point to continued basing of underwriting in economic reality during the important January 2004 renewal season.

2003 was another year of significant reserve strengthening across the industry, including by many of the largest household names in Europe and the US. These reserve additions were driven largely by developments in claims for long tail liabilities such as those relating to asbestos. Given the continued depleted state of many companies' balance sheets, it is not surprising that the year also saw a large number of companies raise capital, both in the equity and debt markets.

Current negotiations in the UK on the future of employers' liability covers, are giving consideration to separating the long tail disease claims. From the insurers' perspective, we do need this split, as it is extremely difficult to predict the number and cost of long tail claims and, as a result, they are very capital intensive. This is demonstrated by the introduction in the UK under Solvency 1 of additional capital charges for liability business. Royal & SunAlliance supports the view that disease claims generally need to be resolved outside the insurance mechanism and we continue to play a full and active role at industry level to achieve that separation and to support the associated workstreams that the UK government has instigated, for example to reduce legal costs and improve the use of rehabilitation.

The need to find a new mechanism to deal with asbestos related claims was also recognised in the US during 2003 and various attempts were made to bring legislation acceptable to all the interested parties before the US Congress. The US insurance industry also increased pressure on government to find a way of resolving the tort crisis resulting from the compensation culture that is endemic in the US. It needs to be recognised that this is becoming an increasing problem in the UK, and potentially the rest of Europe, with significant potential economic implications.

Changes in regulation are by no means a new thing for the industry but the pace and scale of change has increased significantly over the last couple of years. During 2003 we were preparing for the introduction of several consultation papers, CP181, CP190, CP195, CP204 and CP207, among others, all of which have major implications for the capital structure of companies and the levels of capital that they will require to operate going forward. I give a fuller list of the consultation papers released over the last couple of years on page 15, and the impact of regulation is a major topic within this year's report.

Group CEO's Review

'My goal is to make Royal & SunAlliance a stronger, higher performing business, one that delivers to shareholders and customers and one that employees can be proud of.'

Andy Haste, Group CEO

I joined as Group Chief Executive in April 2003 with one main goal, to make Royal & SunAlliance a stronger, higher performing business, one that delivers to shareholders and customers and one that employees can again be proud of.

I had no doubt about the size of the challenge ahead and my immediate priorities were to:

- get a firm grip on the business and our key operational and financial issues;
- deliver on the commitments we made to reshape the Group, achieve significant business improvements and cost efficiencies, and strengthen our capital position;
- establish a rigorous review process to constantly reassess our plans and progress in view of changing business and/or market conditions;
- embed a strong performance culture throughout the organisation, focussing on delivery, results and personal accountability; and
- start looking ahead at what else we should be doing to ensure we deliver improved performance and results.

Review of business

As a first step, I led a thorough review of our businesses. This assessed each market by profitability and our long term ability to compete, and covered the geographic and business mix we need going forward. It gave me a comprehensive picture of our businesses and markets and their long term viability and attractiveness.

It told me that we had an opportunity to build on our stronger market positions and improve the scale and quality of services by focussing on areas of market strength, addressing issues of business weakness, poor performance and longer term strategic uncertainties, and strengthening the balance sheet.

As a result of the review we refined our strategy in some areas, but it reinforced our determination to concentrate upon general insurance. We are creating a more focussed business with commercial lines continuing to be weighted more towards property and the focal point for personal lines being direct distribution and selected intermediated lines. In personal lines, in particular, we are driving down the cost of delivery.

Successful general insurance operations need to have a significant position in their markets to be able to lead and influence trends in underwriting, pricing and claims actions. This has implications for where we operate, what business we write and how we do business.

We have also identified further operating improvements in underwriting, claims and expenses and set in place a programme of actions to achieve them.

Changes throughout 2003

In practice this meant that a lot of things changed in 2003. Three of the most significant areas that have been reshaped: structure and business focus; management; and the balance sheet, I detail in later sections.

Structure and business focus

We've made fundamental changes to the structure and organisation of the Group. A lot of this has come about as a result of the actions that we are taking to resolve problem areas and maximise on our areas of strength.

'The operational review, and the actions that we have already successfully taken within the business, lead us to believe that going forward we can achieve a combined ratio of 100% on average across the insurance cycle for our ongoing businesses.'

Looking at the shape of the business our strategic review identified three distinct areas: good, consistent performers, with profitable growth potential; businesses that still need work but have realisable potential; and finally businesses that simply can't be made to work for us within the resources we are willing to allocate to turning them around.

Many of our businesses are good, we can see a clear growth story for them and will be targeting capital to allow them to do just that.

The smaller operations in International include a number of good businesses and all these operations will be managed for profit and to maximise shareholder value. We expect that over time the countries in which we operate will be fewer in number as we refocus our International portfolio.

Two sizeable parts of our business that haven't performed well over the last couple of years are UK personal and Canada. Both are improving but neither is producing the required results or returns yet. The shape of both businesses will alter with more of a focus on direct business, and intermediated business being cut back to profitable arrangements.

The story for our US operations is different and I've taken action. For the last few years, the Group had been trying to position our US commercial lines business to compete effectively but had been constrained by a restricted capital position and adverse reserve developments in certain business lines. It had become clear that it would be difficult for much of the US commercial lines business to produce adequate returns, over a long term period, commensurate with the risk profile and capital requirements of the business that was being written.

As a result, in September we announced plans to restructure the US business including a renewal rights arrangement with The Travelers Indemnity Company for our standard personal lines business and the majority of our commercial lines business, which together accounted for net premiums of around £1bn. During the last quarter of the year, we entered into a number of other renewal rights deals for further parts of the US business, which together accounted for net premiums of over $200m (£110m) in 2002.

The remaining business in the US principally comprises our non standard personal motor line. We estimate that total US premium income will reduce to around $500m from nearly £2bn in 2002. Our intention throughout is to ensure that we keep a tight grip on all aspects of the restructuring process. What is clear, however, is that the US result will be challenged in 2004 as we transition the business to its smaller size but still have to carry a significant level of expenses associated with the business that we are shedding.

We've made a significant number of disposals over the year outside the US and withdrawn from writing a number of lines of business – detail is given in the Operating Reviews and the Group Finance Director's Report.

Two important milestones were the successful Initial Public Offering of our businesses in Australia and New Zealand in May and the sale of RSUI, our US specialty lines insurer, which completed in July. Taken together with the disposal of our UK healthcare operation they meant that we freed up some £1bn of capital during the second quarter of the year, improving our risk based capital position to a surplus of £300m by the end of that quarter, from a deficit of some £700m at the end of 2002, and further improving our regulatory capital position.

Capital

By September it was clear that, despite these substantial improvements in our capital base, we needed to do more to allow us to realise our potential and, with our interim results, we launched a rights issue to raise £960m, net of expenses.

Along with our existing capital surplus and that to be released from our ongoing premium reduction plans, the rights issue was needed to allow us to: effect the restructuring of our US business; establish further general insurance loss reserves following work undertaken by Tillinghast-Towers Perrin (Tillinghast); grow further in selected business lines; and reduce the Munich Re quota share from 2004 onwards.

Reserving actions

One of the major uses of funds from the rights issue, along with our existing capital surplus, was to strengthen our reserves to address legacy issues. In September we indicated that work by the consulting actuaries Tillinghast had identified that, to reach their best estimate, we needed to increase our reserves.

In accordance with our desire to reduce risk and uncertainty, we determined to take a more prudent position on reserving and to ensure greater consistency in reserving practice across the Group.

We continued to review our claims provisions taking into account the work that we had detailed in the rights issue prospectus, which had led us to indicate provisions increases of up to £800m. Following this review, in November we announced that we had established an additional

£500m of claims provisions and taken account of the balance of £300m as a contingent liability for adverse claims development that may arise in the future. This £300m was in excess of local best estimates and was not attributable to any specific operation. Net of attributable tax, this is deducted in determining our risk based capital position. With our year end results we indicated that some £96m of this contingent liability has now been set up as additional claims provisions, bringing the total prior year claims provision increases post the review to £563m, on an exchange rate adjusted basis. The balance of contingent liability at the end of 2003 was £200m. The contingent liability will be reviewed quarterly and used to address future adverse claims development (such as the outcome of court cases) when it arises.

Targets

The operational review, and the actions that we have already successfully taken within the business, lead us to believe that going forward we can achieve a combined operating ratio (COR) of 100% on average across the insurance cycle for our ongoing businesses. The results of the ongoing business are stated after excluding the results of business which has been disposed of, transferred or closed. This target emphasises the importance of concentration on those markets where we can focus on underwriting and claims and achieve value for those actions.

The new target has given a very strong message to all our underwriters. It's also appropriate in the current environment of low investment returns.

The results of our ongoing businesses in 2003 support our view that this target is achievable, with COR below 100% everywhere except UK personal lines and Canada. In the UK as a whole, we produced a COR of 94.8%. Looking at the ongoing commercial lines this looks even stronger with a COR of 91.2% and an underwriting profit of £157m. UK personal intermediated lines produced a COR of 101.1%, while MORE TH>N™ achieved 103.2%, both having been impacted by subsidence. The ongoing business in the US, which is primarily non standard auto, produced a COR of 94.2%, Scandinavia 99.3% and International (ex Canada) 94.8%.

Premium rates continued to rise during 2003, although we have seen a slow down in the overall level of increase for some lines. We are seeing this trend continue in 2004 with some rates beginning to plateau. What we have to do is deliver the sustainable expense, claims and underwriting savings that we've targeted while the environment remains favourable and while we're carrying the earned benefit of those rate increases through 2005.

Results

The reserving actions that have been necessary, plus lower investment returns and our disposal programme, have impacted our result for the year and, at £140m, the Group operating result (based on longer term investment return) is £86m down from the 2002 equivalent.

For the year, the UK, which is our most significant market and key to our success going forward, produced a COR of 99.4% in total.

UK commercial had another strong, profitable year with an underwriting profit of £77m and a COR of 95.8%. Reserve strengthening of £50m in the second half added nearly 3 points to the COR.

Overall the UK personal result for 2003 of 103.7% was nearly 7 points better than 2002, but there is still work to do. The underwriting result improved by £93m but the actions that have been taken throughout the year to improve the overall quality of the book, primarily within personal intermediated, reduced premium by 28% resulting in an expense overhang, which hit the COR. Personal intermediated produced a COR of 105.5% for the year mainly reflecting the increase in subsidence related claims that resulted from the hot, dry summer. MORE TH>N™ performed slightly better at 103.2%, again showing the effect of subsidence. MORE TH>N™'s expense ratio was over 10 points better than in 2002 at 27.7%.

In Scandinavia, we produced CORs of below 100% across the board in Denmark and in Swedish commercial, helped by benign weather throughout the year. Swedish personal lines produced a COR of 108.0% for the year primarily following the third quarter prior year claims provision increases of £10m for motor third party liability. We are continuing to achieve rate driven premium growth.

The 140.5% US COR is primarily a result of provisions for deteriorating prior year claims following the Tillinghast review. These provisions amounted to £518m, after adjusting for exchange rate movements, mainly in workers' compensation and general liability. Together these reserve movements added around 31 points to the COR.

International Businesses, excluding Canada, produced an underwriting profit of £36m for the year and a COR of 95.2%. This is after we strip out the results of our Australian and New Zealand operations prior to the IPO in May.

Canada's COR of 102.9% for the year was an improvement on 2002, but still needs work. The underwriting result for the year improved by C$166m to a loss of C$42m. Personal lines managed a COR of 100.9% for the year with household producing substantially better results than motor with a 95.3% COR. The commercial result wasn't as good, partly as a result of the expense overhang following the 34% reduction in premium levels as we restructured a number of portfolios of business. Reserve strengthening added around 1 point to the combined ratio. The poor results of the Facilities Association (FA) involuntary pool business also impacted the result. Our share of the FA business is determined by our overall market share and this will have reduced in 2004. Johnson, our direct business, which now accounts for some 25% of business in Canada, continued to perform strongly.

'We're going to become a Company with a culture where going the extra mile and tackling difficult issues head on is standard practice. Out of this will come a decisive organisation that can act more quickly and with more energy.'

Shareholder communication
I've already discussed many of the developments in the stockmarket, and particularly for the insurance sector, in my industry overview. One area of particular interest and importance to me, however, is improving our communication with shareholders. We already have meetings with the majority of our institutional shareholders, particularly those with a holding of more than 1% of the Group. We'll also be showcasing our major operations as part of our quarterly reporting process during the year to let shareholders see for themselves the changes that are happening to our way of doing business.

Management
I have made new appointments to my management team and substantially changed some of the existing roles. One particularly significant change is the appointment of George Culmer as Chief Financial Officer, succeeding Julian Hance. George has joined us from Zurich Financial Services and his successful track record and proven ability to take the tough decisions that bring about change mean that he is ideally suited to join Royal & SunAlliance.

Performance management
As I've already said, turning the Company around isn't just a question of rationalising where we do business and what business we do, key to it all is how we do it.

It is also important to determine where we have the skills and capability to ensure high levels of performance in our chosen businesses and where we have gaps to be addressed. Clearly, there are some areas where we need to upgrade skills. We won't shy away from investing in this area, both in terms of training and, where appropriate, additional recruitment.

I'm very results oriented. I believe in setting clear objectives and demanding targets, and making people fully accountable for delivery. I also believe in a strong performance management culture where feedback is candid and where people take responsibility for the consequences of their actions. I have been working with the senior management team to drive this strong performance culture throughout the Group.

Work is ongoing to forge a much stronger link between remuneration and performance against targets. Perhaps most importantly, the culture of the Group has changed with all staff recognising that improving the performance of the business is their personal responsibility and that accountability for their actions will be a fact of life going forward. Royal & SunAlliance is going to be a more demanding, but more rewarding, place to work – precisely the sort of environment that I believe appeals to the highly motivated, high quality people that I want to have working with me.

Role of the Centre
One of my specific areas of review has been the role of the Corporate Centre and the way that it interacts with the rest of the Group. What was clear to me was that the 'hands off' model that had been in use for a number of years simply wasn't working effectively.

There is now a defined process for interaction between the Corporate Centre and the operating companies based on clear accountabilities and well defined operating principles. Processes have been identified, including the production of both strategic and detailed operating plans. An engaging process of monitoring and interactive quarterly review meetings now forms a consistent review process through which corrective action can be applied.

In addition, reporting lines have been set up between Corporate Centre functions and operating business functions including finance, human resources (HR), risk, information systems (IS) and communications, which now report on a secondary line basis to the central function heads. Primary reporting remains at a Regional level, but central function heads are consulted on recruitment and retention of key staff, objective setting, appraisal and give input to the application of policy and remuneration decisions.

These processes give the Corporate Centre more control, but also give the Regions more direction and foster a more open and two way communication process.

One thing that is clear from the review is that we will no longer require the sort of space that our current head office in Berkeley Square provides. We will vacate the building as soon as it has been disposed of.

Regulatory environment
The regulation of the industry continued to develop throughout 2003 and confirmed that a wide range of changes to solvency requirements in the UK can be expected between 2004 and 2006. This has obvious implications for our capital position and is discussed in more detail in the Group Finance Director's report.

In January 2004 we saw the introduction of Solvency 1. We expect this to reduce our regulatory solvency by around £400m. We have been granted a waiver, valid until September 2004, by the FSA that will enable us to continue to recognise £400m of benefit in respect of our discounted claims reserves in our solvency calculation. All waivers are for a limited period. We currently expect to apply for a renewal when the waiver expires.

Although our strategic focus is on general insurance, the proposals within CP207, Treating With Profits Customers Fairly, are being addressed by our UK Life operation and the principles that we will adopt will be published in 2004.

We no longer actively operate in the UK long term savings market, in particular having ceased to offer advice, but recognise the importance of restoring consumer confidence and acknowledge the value of improving education in the field of personal finance.

As part of our preparations for the introduction of CP204 (and as flagged in the rights issue prospectus) we are reviewing our debt capital position to ensure that it has the optimal structure for the prospective regulatory environment.

Risk
Within the full Annual Report & Accounts, the Risk Management section of the Corporate Governance Report includes considerable detail on our approach to Group Risks. Rightly, much of the activity has centred on the risks inherent in transacting insurance business and ensuring that we have rigorous and consistent processes around the world for both rating risks and for working with our customers to improve their risk profiles.

All of our premium rates are set

Reshaping For The Future

on the basis of achieving technical price, ie charging the right price for the right risk, but beyond that, we have spent a great deal of time identifying the customers who provide the best returns for us and then ensuring that we have the right products and services to satisfy their needs. We also spend considerable time and energy on surveying and managing the risks that our clients face, providing technical support and advice on loss prevention and mitigation, as well as Health and Safety issues.

The FSA has recently published reforms that will require all insurers to undertake an Internal Capital Assessment (ICA). The ICA requires a firm to maintain adequate financial resources and to demonstrate that its own systems and controls are able to identify the major sources of risk. To meet this requirement, we have established the Capital and Risk Management Transformation (CRMT) programme, which is now designing and implementing an economic capital model that creates value across the organisation. This will be achieved by upgrading our risk management processes and capabilities by using risk as a basis for capital allocation. The programme will have global scope and apply to general and life business. A robust and comprehensive capital and risk management framework that is consistent across the Group will enable us to achieve full Prudential Sourcebook compliance. Various workstreams have been created to facilitate this process and the CRMT programme is closely linked to a number of other Corporate Centre and Regional initiatives.

Looking ahead

During 2004, I have a number of major priorities, two of which boil down to delivering on promises that we've made to the market.

Firstly, we have major operational improvements and restructuring plans to finish implementing. Annualised expense savings are already running at £144m, well on the way to our £270m target, which gives me confidence we'll succeed. The US restructuring is making good progress but will be a key operational challenge for us in 2004.

Secondly, we're going to become a Company with a culture where going the extra mile and tackling difficult issues head on is standard practice. Out of this will come a decisive organisation that can act more quickly and with more energy.

I made a promise to investors that in future we wouldn't just talk delivery we'd actually do it. Much has been done in 2003 but I won't pretend that we are achieving everything that we can, and should, yet.

Andy Haste, Group CEO

We are focussing on three areas to help reshape our Group for future growth:

1 Our structure & business focus

We have reviewed the business to make sure we are writing the right risks in the right markets, and at the right price

2 Our management

There has been significant change to the management team since Andy Haste's appointment

3 Our balance sheet

We've strengthened the balance sheet in a number of ways, including the rights issue, but challenges remain

Reshaping Our Structure & Business Focus

'The review had many findings but one of the most important was its confirmation that our well established strategy of focussing on general insurance was the right thing for the Group.'

When I was appointed as Group CEO I immediately set about reviewing the business to make sure that we were not only operating in the right markets but that we were writing and retaining the right risks.

Structure

We progressively changed our structure over the second half of 2003 to reflect the developments in our geographic focus. Following the IPO of our operations in Australia and New Zealand, the sale and renewal rights deals for much of our US business and the other disposals in the Americas, the old groupings of Americas, Asia Pacific and EMEA were no longer relevant. We needed a structure that reflected where the focus of our effort and growth plans was going to be in future.

The major change arising from this was the creation of International, which during most of 2003 grouped all of our businesses outside the UK, US, Canada and Scandinavia. These are predominantly small operations but include a number of good businesses. Towards the end of the year, our Canadian operation began to report through the International line. However, because of its significance to the Group, for financial reporting purposes, it continued to be identified separately throughout 2003.

The International businesses will be managed for profit and to maximise shareholder value but we do expect the number of countries that we operate in will continue to reduce as we refocus the portfolio.

Over the last 12 months we've reduced our countries of operation from 41 to 35; three years ago we were in 52. That doesn't mean that we've lost the ability to transact and service business worldwide – we retain the ability to do that in over 130 countries through our network partners. A list of the major disposals between 2001 and January 2004 can be found on page 30.

Business focus

The review had many findings but one of the most important was its confirmation that our well established strategy of focussing on general insurance was the right thing for the Group. During 2003 we continued to sell life businesses, including the operation in Chile, to free up capital to reinvest in the general business.

We also completed the IPO of our general and life insurance operations in Australia and New Zealand during a time of challenging equity market conditions. This unlocked significant value that, certainly in the couple of years leading up to the IPO, had not been reflected in the share price at the Group level. The sale of the UK Healthcare & Assistance business also achieved good value from the sale of a specialist business that was not strategic to us.

That said, we did need to refine the strategy and performance objectives in a number of areas.

We're going to continue to weight our commercial business towards property lines – historically they're less volatile and have been consistently more profitable.

We're going to focus more on direct distribution of personal lines – we'll still work with intermediaries but we'll be much more disciplined about only continuing the profitable relationships. In the UK this has meant reducing our general intermediary agents from 22,500 in 1999 to 2,500 at the end of 2003, contributing to loss ratios on ongoing motor business being nearly 35% better than those on discontinued business.

We're going to drive down the cost of doing business, particularly in personal lines. During 2003 we reduced MORE TH>N™'s expense ratio by 10 points to 27.7% – it still needs to improve but it's moved a long way in the right direction. Our target remains 20-25% by the end of 2005 and below 20% after that.

To ensure that we are at the forefront of developments, we are implementing operational excellence in underwriting and claims management through the introduction of tighter processes and new systems. Good progress is being made. We've selected our implementation partner and together we have nearly 500 people mobilised full time onto the programme.

We're seeking to ensure that the risk profile of our business is appropriate for our capital base. The nature and amount of risk that we underwrite in our different markets needs to reflect a proper balance between risk and profitability. RSUI, the US specialty lines operation that we sold in July 2003, while profitable, had a seasonally uneven risk profile and represented about 60% of our US operation's Florida wind event exposure. Selling the business significantly reduced the volatility and catastrophe exposure of our US business – as well as freeing up nearly £200m of risk based capital.

We're instilling a performance management culture by improving management controls and introducing new review procedures that have a clear focus on accountability and that target delivery. During 2004 we're going to be introducing stronger and more direct links between the level of remuneration, including any salary increase, bonus and share options, that employees get and their contribution to the achievement of the Group's overall performance goals.

Reshaping Our Management

'Looking at the Group as a whole, one of my priorities is to develop a stronger performance culture. Part of that is making sure we have in place the right people with the right capabilities.'

During 2003 I've made a number of new appointments to my senior team and substantially changed some of the existing roles. I now have a stronger combination of existing and new, quality and experience to draw upon.

I have made senior management changes in our key markets, including appointing John Tighe as CEO of our US operations in October 2003.

John will be responsible for the transition arrangements of the personal and commercial lines business to Travelers and also for managing the remaining US business going forward. He has accepted the role of leading the business through what will clearly be challenging times.

We have also introduced a new Regional structure and I appointed Simon Lee as CEO of the newly established International Businesses. He has strong experience of managing a broad spread of international businesses having worked with NatWest in a variety of international roles based in the UK and overseas. With the establishment of Scandinavia as a discrete entity the role of Jens Erik Christensen changed to focus exclusively on our businesses there.

Early in 2004 we announced the appointment of George Culmer as Chief Financial Officer. George has extensive experience in the general insurance industry with Zurich and Prudential and of major change management programmes.

The Group Finance team will also be strengthened by the addition of a new Group Financial Controller, Pat Regan, previously Finance and Claims Director of AXA's UK general insurance business. A key focus will be to ensure rigorous control, planning and result delivery, working closely with the businesses. The capital management function has also been strengthened.

With our increased focus on driving forward the restructuring programme and developing a stronger performance culture, we have dedicated senior management resource to both these vitally important areas. I appointed Andy Nelson, Director, Strategic Change and IS; and Paul Whittaker, Group HR Director, to head these up. Andy has broad experience of change management – in both a consultancy capacity and inhouse roles – coupled with 20 years' experience in IT. I have worked with Paul for several years. He was an integral part of teams that helped me refocus and restructure other businesses and improve performance. Paul was previously in HR roles with AXA and GE Capital.

Strategic change and IS combines programme and change management with information technology and services. A primary focus is to drive and monitor progress for the change programmes. The Group IS team works closely with country Chief Information Officers to set strategy, implement IT security and share best practices. It also provides support to the Corporate Centre.

The new role for HR is to develop a top quartile leadership team to deliver top level performance. HR are focussed on raising leadership capability and performance and driving the culture change necessary to make us more customer focussed, operationally effective and accountable for delivery.

A new Group Risk structure will institute, and ensure compliance with, rules and guidelines for the whole range of business risk and will be strengthened by an upgraded regulatory and compliance risk capability to cover large scale projects, such as Prudential Sourcebook.

In January 2004, I appointed Neil Macmillan as Group Chief Auditor. Neil reports directly to me, and also to the Group Audit & Compliance Committee, and is responsible for providing the Board and the executive team with independent assurance on the risk management and control processes across the Group. Internal audit has a critical role to play in ensuring that the major business risks that we face as an organisation are managed effectively.

In the communications arena, Richard Emmott's priorities are to ensure that the external reputation of the Group develops in parallel with the process of change and also to ensure that our internal communications processes engage our people properly while we are going through a period of major change.

All of my direct reports are members of the Executive Committee which is the senior executive decision making body for the Group and which I lead. It is responsible for all business strategies and operational policies.

As illustrated, nine out of 12 of my team are either new appointments or have seen major changes to their role since my arrival. We now have a stronger mix of experience and capability – some from within the insurance industry, some new to the sector. But this doesn't mean that I won't make further changes. As the Group itself changes and evolves, there is always the possibility that people may choose to opt out and move on, or that new people may need to be brought in. It depends on many different factors – changing business priorities, the need to upgrade skills in certain areas, attitude, and even personal chemistry. Then, of course, there's the question of performance.

Performance management

I judge my team's performance no differently from the way the Board judges mine. Looking at the Group as a whole, one of my priorities is to develop a stronger performance culture. Part of that is making sure we have in place the right people with the right capabilities.

I will be working with Paul Whittaker to drive us towards a performance culture and away from the entitlement culture that is evident in some parts of the business. Our focus will be from the top down. Everyone will be included.

There has to be meaningful differentiation so that people who perform well are properly rewarded for their efforts and people who don't are not. You'll hear a lot more about our efforts to develop a culture of continuous improvement and rigorous performance management. And you will also see a stronger focus on the consequences of poor performance.

Reshaping Our Balance Sheet

The regulatory changes being introduced will affect the whole insurance industry and they have some major implications.

Since I joined, one of my major focusses has been the balance sheet – I wanted to make sure that I fully understood the risks both in and to the business. A lot of actions were taken during 2003 to strengthen the capital position but we also identified a number of areas that required additional capital support. As discussed elsewhere, there was also significant development on the regulatory front, which will have consequences for the balance sheet and our capital position going forward. We ended the year in a stronger position but the work is by no means complete.

Capital additions
There were two main ways in which we increased our capital during the year:

- we were successful in implementing our disposal programme during 2003, releasing over £1bn of risk based capital; and
- we completed the one for one rights issue in October, raising £960m.

But these weren't the only areas of activity. We have been active in matching our investment assets to our liabilities. We continued to reduce our exposure to equities during the first half of the year with the aggregate value of holdings in the general insurance operations at the end of 2003 being approximately £1.15bn, in line with our policy target.

We also continue to explore ways to release capital from our UK Life operations. Following changes in the Phoenix Fund, we are now able to recognise £321m of surplus held in that fund as available to support general business.

The actions taken to restructure our US operations should, over time, release capital as the premium income that we write reduces and claims provisions are settled. Any capital release will be subject to compliance with US regulatory requirements.

We also negotiated a new £400m three year banking facility, repaying borrowings of £166m.

Capital usage
As explained in the rights issue prospectus, there were a number of areas where we needed to use the capital that we had raised or released.

When I joined the Group I commissioned an independent review by Tillinghast of our general insurance loss (or claims) reserves and of the capital requirements and risks of our UK with profits life funds.

The general insurance review covered our total claims reserves in the UK, US, Scandinavia, Canada and Ireland as at 31 March 2003. Although, as confirmed by Tillinghast, the existing Group reserves at 30 June were within a reasonable range of estimates, Tillinghast's review concluded that there was a shortfall between our reserves and their best estimate as of 31 March. I wanted to be in a more prudent position and so we took action. During the second half of the year we established further provisions for adverse claims development of £563m (on an exchange adjusted basis). The contingent liability of £300m that we identified at the third quarter reduced to £200m at the year end.

The detailed analysis of the UK with profits funds looked at the solvency of the funds in light of the introduction of the 'realistic' methodology by the FSA and the waivers we've already been granted. Those waivers have allowed us to cancel the financial reinsurance treaty and to lapse the future profits waiver that we had in force. We've concluded that the existing capital, together with an amount of up to £200m available under the existing contingent loan arrangements, should be sufficient to meet solvency requirements in a range of adverse scenarios, eg interest rate and exchange rate fluctuation. However, the funds are also exposed to certain unresolved regulatory issues, including CP207, Treating With Profits Policyholders Fairly, that could increase the capital requirements by up to £300m above this level.

We also reviewed our FRS17 pension fund position. We made additional contributions in the UK of £50m net of tax in 2003 and will put aside £30m net of tax annually for the next nine years. We're also introducing employee contributions in April 2004. We continue to believe that this route is valid, given the long term nature of pension liabilities. The US restructuring charge deducted from risk based capital allows for funding a large element of the US FRS17 pension liability.

We wanted to reduce the level of our quota share arrangement, from the end of 2003, to retain more of the profits being generated at this point in the insurance cycle. The lower level in 2004 means that the capital that we need to support the amount of premium we write will increase, even if premium doesn't grow from 2003 levels.

And of course there are some good, profitable areas of the business where we are aiming to grow and that will need capital to support that growth.

Regulation

We discuss the implications for our balance sheet of changes in regulation in detail elsewhere. The fact is that the changes being introduced will affect the whole insurance industry – they aren't specific to the Group – and they have some major implications. To give some idea of the scale of the potential change, I've listed the most important ones of the last two years below. Some of these, but by no means all, have already been implemented. I don't expect the pace of regulatory development to slow any time soon.

Consultation Paper	Title
CP136 – May 2002	Individual capital adequacy standards
CP142 – July 2002	Operational risk systems and controls
CP144 – July 2002	A new regulatory approach to insurance firms' use of financial engineering
CP145 – July 2002	The interim sourcebook: insurers and friendly societies (Guidance on insurance group solvency)
CP181 – April 2003	The interim prudential sourcebooks for Insurers and Friendly Societies: Implementation of the Solvency 1 Directives
CP190 – July 2003	Enhanced capital requirements and individual capital assessments for non-life insurers
CP195 – August 2003	Enhanced capital requirements and individual capital assessments for life insurers
CP200 – September 2003	Regulation of long term care
CP201 – September 2003	Implementation of the insurance mediation directive for long term insurance business
CP202 – September 2003	Insurance regulatory reporting: changes to the publicly available annual return for insurers
CP204 – October 2003	Financial groups
CP207 – December 2003	Treating with profits policyholders fairly

Operating Review
UK

UK

£m	2003	2002
General business		
Net premiums written	**2,849**	3,421
Underwriting result[1]	**21**	(148)
General business result	**309**	216
Return on capital employed	**18%**	11%
Life business		
Net premiums written	**908**	955
Life business result	**111**	110
Shareholders' interest	**539**[2]	338

[1] As announced at our year end results on 11 March 2004. The major difference between this and the breakdown on page 88 relates to reorganisation costs.

[2] The shareholders' interest includes the contingent loan utilised of £146m.

Overview of major strategies

Over the next three to four years we will be continuing to invest in our business to deliver significant changes in our processes and systems. We believe that these changes will further improve our core areas of underwriting, claims and customer management, while improving efficiency.

UK Commercial aims to differentiate itself in the market through focussed value propositions for specific customer and broker segments. We will concentrate on our three customer facing segments of small, corporate and risk solutions, supported by a series of specialist businesses *including ProFin, marine and* engineering. We aim to be market leading in customer management, underwriting and claims effectiveness.

In UK Personal, we intend to create sustainable value by distributing the core products of motor, household and pet through MORE TH>N™ and selected intermediaries. Our relationship with intermediaries will be either as a sole supplier or on a limited panel as a preferred partner. We will do this via a new low cost operational platform and leveraging our existing superior servicing capability.

The UK underwriting teams are developing more modern systems to support underwriters in the business units. These new systems will help us to improve the quality of decision making around risk acceptance and to deliver more sophisticated, actuarially derived, prices. They will also complement our activity to continually raise underwriting standards and will provide us with a more effective risk management environment.

We are making a major investment in our claims core competency, which will drive significant benefits through reduced leakage (ie whenever more is paid in settlement of a claim than is necessary, through delays, lack of process consistency or human error), increased efficiency and an improved and more consistent customer service. This is a step change with new claims management strategies, reengineered processes and a streamlined structure. Our customer proposition will be centred around an enhanced rapid response capability and the further development of our core claims and specialist and large operations, each with a focus on taking active control of claims and speed of settlement.

We are developing proactive strategies for each claim type with a focussed and segmented structure to drive the critical components of claims management. We will adopt a state of the art technology platform allowing us to improve efficiency and effectiveness. Our culture will be focussed on driving the outcome of claims through accountability and performance.

We will continue to manage the closed Life company efficiently to release capital while continuing to treat customers fairly. The closed funds are managed, along with the Group's other funds, by ISIS, a top ten investment house, and our outsourcing arrangement with Unisys has ensured that quality service standards are in place, as well as ensuring administration costs per policy are fixed.

We will continue to improve our overall customer management performance, in particular focussing on understanding the value of customers and ensuring that we are delivering robust propositions to our chosen customer segments.

Business progress against strategies

The UK is our biggest business and will continue to be key to the success of the Group going forward.

We have moved to a single company approach that allows us to drive efficiency benefits through our UK wide business services and has improved technical capabilities through single underwriting and claims operations.

We have worked hard to deliver on the commitments we made in 2002 and 2003 to: reshape the UK business; achieve significant business improvements and cost efficiencies; and strengthen our capital position. Work to embed a high performance culture throughout the UK continues.

2003 has also seen a marked improvement in customer analysis techniques, which is allowing us to tailor propositions and focus effort on our most valuable customers and future prospects.

Underwriting

The underwriting function was given a more separate and independent role within the UK business in 2003 and was charged with continuing to develop underwriting as a core competence of the Company. In particular, they are working to ensure that, as a minimum, we are achieving technical price ie that we are charging the right price for the right risk.

Activity has focussed on instilling a more rigorous control and monitoring system over all underwriting processes while at the same time delivering more sophisticated pricing, risk acceptance and risk assessment techniques to our underwriters in both personal and commercial lines. Our 160 strong team of surveyors continues to add value for our customers, managing and improving risk by undertaking over 33,000 surveys a year and issuing and implementing risk improvement programmes. The benefit of this work will ultimately be reflected in improved loss ratios.

Claims

A primary focus for UK claims in 2003 has been the household account. A range of initiatives have been undertaken including: a streamlined building repair network supported by the training programme 'HOUSE'; a range of new commodity supply arrangements; and a revised best practice handling methodology for subsidence claims. In total the programme is forecast to deliver annualised benefits of £38m from 2004.

The establishment of specialist and large claims centres of excellence during 2003 has ensured that the proper skills and focus can be applied to all complex and high value claims. In addition, this segmented approach to large claims handling has allowed the development of consistent best practice and an entrepreneurial approach to settlement that is supported by advanced technical and negotiation skills training.

Commercial

UK Commercial continues to perform strongly, with current year results benefiting from the programme of actions over the last few years, as well as 2003's benign weather. Actions in previous years include exits from inwards reinsurance, financial solutions and certain specialist business areas, including offshore energy and credit. We have also reshaped our proposition to large and multinational clients in the UK and Europe. Building upon this, a comprehensive review of the key segments and market positioning has helped confirm and shape our strategy.

We will leverage our underwriting and claims expertise, while continuing to improve our overall customer management. We continue to enhance the tools and control procedures that support our technical pricing strategy. However, profit remains our key driver and in order to protect it we will sacrifice revenue if necessary.

Building on the UK wide customer management initiatives, we have developed a positive win back campaign in our middle market corporate segment, and have also reorganised in order to create a fully customer aligned business model. This has seen the creation of 'risk solutions', designed to enable the delivery of appropriate propositions to the large customer segment, complemented by the retention of marine, ProFin and engineering specialist businesses, which continue to distribute products across all customer segments.

Personal lines

MORE TH>N™

MORE TH>N™ continues to produce excellent levels of new business, demonstrating the success of our investment in the brand over the last few years. It is rapidly being recognised as one that stands out from the competition. Core product sales are up by over 35% compared to 2002 and are more than double 2001 levels; within that our web sales in 2003 were more than double those in 2002. We now generate one in three sales from our existing customer base, and a similar ratio of sales from recommendations. We will continue to take action to reduce the cost base and have reduced the expense ratio to 27.7% this year from 38.2% in 2002. Our distribution strategy is to grow our MORE TH>N™ business without compromising on profitability.

Personal intermediated

In the intermediated market we have segmented our business and exited a number of unprofitable relationships. We will only continue to operate in those segments and with those intermediaries where we believe we can consistently deliver our target returns.

A combination of planned exits from certain areas of business, and rating increases across all of our intermediated channels, has reduced motor exposures significantly. For example, our motor exposures with brand brokers have dropped from around 350,000 at the end of 1999, to around 50,000 at the end of 2003. During 2004 household exposures will also fall as the HBoS exit works through the account.

We also withdrew from creditor, extended warranty and DMI business, which resulted in a much simpler, more focussed, business model.

The reshaping of the book is,

UK continued

however, now substantially complete and we intend to selectively grow the business from this base. We have already taken action to adjust our expenses following the reduction in the size of this book, for example by exiting four of the seven locations supporting intermediated business, but recognise that we still have more to do. Plans to continue to drive down our expense ratio via our strategic change programme include: systems rationalisation onto a single platform, giving productivity and service advantages; an offshore pilot; and driving down our support services cost.

Life

Early in 2003 we announced that, effective from 1 May, Unisys, one of the UK's leading life and pensions outsourcing specialists, would undertake the processing and administration of the life and pension policies of our closed UK Life business. Policyholders in closed funds have the same right to expect good service as investors in funds open to new business, and we are extremely pleased with the clear improvements in customer service that have resulted from this outsourcing.

However, the Life business's financial and regulatory responsibilities remain firmly with the Group and we have established a senior Life governance team to manage the relationship with Unisys and to ensure that these financial, regulatory and customer responsibilities are met.

In March 2003, we were notified by the Financial Services Authority (FSA) of a £950,000 fine in relation to deficiencies in our mortgage endowment sales process between January 1997 and July 1999. The FSA acknowledged that we have devoted substantial resources to our mortgage endowment review and have acted proactively in the case of short term contracts. However, the shortcomings identified are a matter of much regret.

UK change programme

We have made significant progress on our performance improvements, delivering on the promises we made to the market. Much of this work has involved restructuring, producing annualised savings of around £95m, and improving underperforming areas of our business. We have embarked on a programme to create new claims, policy and underwriting platforms for the majority of our UK general insurance business. The programme will result in further significant improvements in efficiency in claims and policy processing, to the extent that, as part of the increased expense savings target for the Group, we are now aiming for a total annualised target in excess of £200m from the UK. We are also targeting significant improvements in claims and underwriting leakage.

We have met and exceeded our targets for rationalising our property estate, exiting over 50 properties during 2003, achieving the long term benefits of more efficient space utilisation and lower overall costs.

In terms of our information systems (IS) infrastructure, we have been through an extensive exercise which has resulted in a major outsourcing of our applications development services in March 2004, which will enhance our ability to meet the future needs of our business and customers.

We have begun the process of implementing a UK desktop transformation programme. This is a major change initiative delivering significant benefits to our business through performance improvements, cost savings, flexible working, and more efficient and effective application support.

The creation of our Human Resources (HR) services centre has helped us to improve our response to the needs of our people at a time of change. This has been particularly important in the context of the restructures of our personal lines and claims businesses.

As a result of the actions we took in 2003, and have planned for 2004, we have already reduced the number of roles in the UK by approximately 5,000 and plan a further 1,000 in 2004. This includes the TUPE transfer of 3,700 roles to other organisations, around 900 of which we expect to transfer in 2004. We have fully consulted with union representatives on these matters and this will continue. Wherever possible, affected employees will be offered redeployment opportunities within the Group and a proportion will be achieved through natural turnover.

We continue to work in partnership with the Unions and have reached an agreement with them on the HR practices that we will follow as we implement the UK change programme.

Market and economic conditions

2003 has proven to be another challenging year in the insurance sector. We have seen a market with a firm rating environment, the prospect of increased regulation and the continuing pressure of increasing regulatory capital requirements.

Within UK Commercial, we continued to achieve price increases throughout 2003 and, while the market is showing some signs of softening, with the return of some competition in the motor and property classes of business, we expect liability business in particular to continue to attract rate increases in the light of strong claims inflation. Our business is well placed because of our strong broker relationships and diversified book of business. In addition, our

'We do not underestimate the scale of the challenges we face, but have made a good start in transforming the UK business into a modern, well controlled, competitive vehicle, making good returns for shareholders.'

strategy of not following the market has been clearly articulated both internally and out in the marketplace. We are prepared to sacrifice premium in order to maintain profitability and build long term sustainability.

Within UK Personal, the hot and dry summer resulted in an increase in subsidence claims, but this was almost completely offset by the benign weather experienced throughout the year. We are determined to write profitable business and will continue to take the actions necessary to deliver appropriate returns for our shareholders. To this end, we have continued to lead the way with the price increases that the industry needs in order to generate long term sustainable profits. This is particularly the case in the household market.

Acquisitions, disposals and investments

During 2003 we sold our Healthcare & Assistance business to a management buy out team and sold the renewal rights on our UK credit insurance business. We also sold our UK estate agency operations, Sequence, and our online employee benefits business, youatwork.co.uk. Following the reduction in our shareholding of Global Aerospace from 50% to 10%, we reduced our interest in the aerospace insurance pool that it manages, decreasing risk aggregation for the Group and reducing 2003 premium by around £110m.

During the year we also announced our intention to stop underwriting offshore energy business and withdrew from creditor, extended warranty and DMI business.

All of these disposals and exits were part of our plan to focus the UK business on our strategically core areas, where we have the critical mass to take an influential position in profitable segments. The rationalisation is now substantially complete.

Outlook

We aim to build a UK general insurance business that delivers a COR of 100% on average across the cycle on ongoing business, and where business is priced at its technical price, as a minimum. We remain focussed on reducing underwriting and claims leakage and achieving high business retention rates.

Within UK Commercial, we will continue with our pricing strategy and our drive for increased claims efficiency and improved customer management throughout 2004. We have identified the key customers to retain and win back through our 'target trades' work and are confident this will give an opportunity for selected growth at the right price.

In UK Personal, we will continue to drive down expenses and pursue our stated aim of improving our operational efficiency and flexibility, while delivering excellent service to our customers. We expect to see the benefit of the action we have taken on pricing in 2003 flow through in 2004. We will also continue to refine our pricing and account rationalisation techniques throughout 2004.

We will pursue aggressively our goal of profitably growing our MORE TH>N™ business.

We do not underestimate the scale of the challenges we face, but have made a good start in transforming the UK business into a modern, well controlled, competitive vehicle, making good returns for shareholders.

2003 premium income by business segment (£m)*

* Excluding Australia/New Zealand and Group Re.

Scandinavia

Scandinavia

£m	2003	2002
General business		
Net premiums written	**1,167**	952
Underwriting result*	**(4)**	(86)
General business result	**96**	23
Return on capital employed	**15%**	4%
Life business		
Net premiums written	**346**	284
Life business result	**38**	71
Shareholders' interest	**316**	324

* See note 1 on page 16.

Overview of major strategies

Scandinavia Region comprises market leading businesses in Denmark, Sweden, Latvia and Lithuania. The Region became a separate reporting entity in the second half of the year as part of the Group's restructuring.

Codan Group includes Trygg-Hansa (Sweden), Lietuvos Draudimas (Lithuania) and Balta (Latvia). It acquired Trekroner Forsikring (Denmark) in 2002.

Underwriting strategy has focussed on strengthening our proposition to customers while seeking to deliver a profitable result to the Group.

Our multi distribution network gives us a strong position in the Nordic marketplace and we continue to respond to changes in the way that insurance products are distributed.

Following Jens Erik Christensen's change of role to Chief Executive Scandinavia, we launched an aggressive business improvement programme to review our pricing strategy, improve processes, seek greater administrative efficiencies and so maximise our competitive advantage.

At the same time, we put in place a Nordic integration plan. Central to this was the creation of a Nordic management team, facilitating closer cooperation between local management through knowledge and resource sharing.

Business progress against strategies

2003 saw significant improvement in performance from our disciplined approach to underwriting and pricing. Results also benefited from relatively benign weather in 2003 compared to previous years, particularly in Denmark.

In Sweden, premium growth came largely from substantial rate increases, along with a case by case review of our entire business portfolio. In Denmark, commercial lines performed well with premium rate increases and the successful acquisition of new business at terms reflecting the true nature of the risk. We believe that we will achieve further rate increases throughout 2004. Danish personal lines also grew as a result of premium rate increases. Strengthening for prior years on personal injury claims, primarily in our Swedish motor business, negatively impacted the Region's result.

We made progress in reorganising our business to exploit synergies and become a leaner and better managed business. We put in place a pan Nordic marine organisation and restructured our IS, HR, finance and communications functions. We also finalised the IS integration of acquisitions in 2001 and 2002.

We are implementing a Regional business improvement programme plan, which will we believe further improve the profitability, efficiency and focus of our business.

We are developing our technical core skills of underwriting and claims handling and becoming more sophisticated in how we price our business. We recognise the need to develop different propositions for our customers and are working with loyalty programmes in both Denmark and Sweden.

We extended our new claims handling service concept in Denmark, from house contents to motor. It is built around a system that allows insureds to replace stolen or damaged items at a discounted price and, by increasing the flow through this system, we will be better placed to utilise our purchasing power. We launched a similar system in Sweden for contents and plan to expand it to additional types of claims.

In Sweden, direct sales are increasingly being transacted through the Internet. As a result, during the year we closed one of our call centres.

Codan's new pensions product, Time Pension, launched in September 2002 to broad critical acclaim, has had a very satisfactory first full year, with premium growth of over 400% and a good technical result, confirming our confidence in it. With premiums of DKK223m it is now outselling our core unit linked pension product.

Market and economic conditions

Scandinavian insurance markets are highly consolidated. In Sweden, the top five players control 90% of the market and in Denmark 75%. There is limited scope for entry of new players.

During 2003 premium rates have been hardening, especially in commercial lines, following several years of unsatisfactory underwriting results. Scandinavian interest rates remained at a low level, which led to low investment returns and underlined the need for profitable underwriting results to repair weakened balance sheets.

There has been increasing pressure from consumer organisations for insurers to offer policies that run for less than one year, and we have built this into a number of our products.

The market for broker business, although relatively small, is moving towards quoting on a net pricing basis, a practice we plan to implement during 2004.

We still use multiple brands in our primary markets. Our main brands, Trygg-Hansa and Codan, have very high prompted awareness, with close to 100% having heard of each company in its home market. Trygg-Hansa was cited in the public relations media as having the third strongest overall brand in Sweden.

Acquisitions, disposals and investments

During 2003 we altered our interest in two subsidiaries of our 53% owned subsidiary, Lietuvos Draudimas. The life operation, Lietuvos Draudimo Gyvybes Draudimas, was sold and we reduced our shareholding in Lietuvos Draudimas's subsidiary credit insurance company to 49%.

Outlook

In 2004, we have embarked upon the second phase of the Nordic integration; that of business units. Management has undergone a significant restructure and review, to ensure the integration's smooth implementation. Poul Mortensen was appointed Chief Operating Officer, reporting to Jens Erik Christensen, responsible for the commercial, personal and claims handling business units in Denmark and Sweden.

Management remain committed to continuing the remedial work of 2002 and 2003, particularly improving our core capabilities in pricing, underwriting and claims handling, which we believe can give further improvements in 2004. We seek further efficiency improvements from the second phase of the Nordic integration and the implementation of best practices across the Region.

Our focus remains on markets and businesses where we have sufficient market share and a promising prospect of profitable, sustainable growth.

International

International – ex Canada

£m	2003	2002
General business		
Net premiums written	**765**	1,079
Underwriting result*	**36**	(108)
General business result	**108**	(1)
Return on capital employed	**21%**	0%
Life business		
Net premiums written	**147**	434
Life business result	**7**	11
Shareholders' interest	**25**	167

Canada

£m	2003	2002
General business		
Net premiums written	**503**	527
Underwriting result*	**(18)**	(82)
General business result	**35**	(25)
Return on capital employed	**10%**	(12)%

* See note 1 on page 16.

Overview of major strategies
International Businesses comprises mainly profitable operations in more than 20 countries. It was formed during the second half of 2003 as part of the Group's restructuring. Towards the end of the year, Canada started to report through International, but in 2003 its results continued to be published separately because of its size and significance.

Following Simon Lee's appointment as Chief Executive International Businesses, we undertook a fundamental strategic and operational review. We evaluated the environment each business operates in, the market growth and profit potential and its risks, as well as the performance and market share of the businesses. The findings were used to assess each operation's relative risk when compared to other Group businesses.

Our strategic aim is to enhance shareholder value focussing on markets with profitable growth prospects and where we are well positioned. Many of the businesses are small and we are focussing on ensuring that the risk control environment is robust and well structured. We aim to ensure that circumstances will not arise which could expose the Group to unnecessary and disproportionate risks.

Business progress against strategies
A new central leadership team and business reporting lines have already resulted in tough decisions being taken and significant changes made to improve profitability and efficiency.

We took steps towards refocussing our portfolio including a number of disposals, aiming always to maximise shareholder value.

Canada reshaped its business portfolio and took decisive action on pricing and claims handling, and is beginning to see the benefit. Commercial strategy in Canada continues to move from a generalist to a specific segment approach, targeting customised middle market and small business.

Personal's focus has moved to segments and provinces that we believe have the best prospects for profitability, eg our subsidiary Agilon has entered into a strategic alliance with Expert Travel Financial Security Inc. that will make us one of Canada's top travel insurance underwriters.

Johnson Corporation, Canada's direct business, continues to deliver strong results, with 44% growth in net written premiums over the year. A leading insurance and benefits provider, Johnson's distinct competitive advantage comes from disciplined underwriting and risk selection, a low cost base, use of technology, and good customer service.

Canada has developed a new web service, WebBusiness, which lets personal lines brokers process new business and policy changes online at their own offices. We expect it to handle at least 70% of eligible transactions by the end of 2004.

Ireland produced a sound financial result and made excellent progress in its business wide transformation programme. We invested in self service capabilities, which allow intermediaries to access and reconcile accounts online and view customer claims progress. The high legal costs associated with claims were addressed by establishing inhouse legal services. We expect significant financial and service benefits from this.

Italy again delivered strong growth and profitability, through its agents and corporate client business, and has reviewed its broker business to reduce exposure to potentially volatile risks.

Middle East has a proven track record of profitability and achieved controlled growth through the consolidation of a portfolio acquired in the UAE, Oman and Bahrain in 2002, and premium rate increases.

In Latin America we continued to reduce the volatility of performance through disposals in the Caribbean that will further reduce exposure to natural catastrophes. We have maintained focus on the development of our underwriting and claims skills and made progress on initiatives that underpin our strategies relating to: control and governance; people development; process improvement; and technology. Our success has been reflected in encouragingly strong financial results, as well as good feedback from customer surveys and industry awards.

In Asia, we produced good results with year on year improvement. Our Indian associate signed distribution deals with two major banks, giving access to over three and a half million customers in total.

Our customer service was recognised in a number of markets. For example, Colombia was rated third in general and first in life business by the local association of brokers and agencies and Italy was ranked number two in the market for the quality of its online motor quotation system by a leading independent consultancy.

Market and economic conditions
Each insurance market within International Businesses is at a different stage of evolution and yet they face a number of common forces. In Ireland and Italy the strong rating environment has either ended or shows clear signs of starting to soften, while in Canada increases continue. Motor insurance reform has become a political issue in Canada, and we see it being accompanied by underwriting and rating restrictions, posing challenges for the industry.

During 2003, the weakness of the US dollar impacted Latin American exchange rates. However the Argentine, Brazilian and Chilean currencies strengthened against the pound, with Argentina rebounding from the crisis of 2002.

Acquisitions, disposals and investments
We have disposed of a number of businesses in 2003, in particular our operations in Australia and New Zealand via an Initial Public Offering in May.

We sold Eurolife, our Dublin based European life and investment company, our operation in Puerto Rico and our Chilean life subsidiary, La Construcción. We largely completed the closure of our French domestic commercial lines operation, which is in run off. We sold the renewal rights on our intermediated personal insurance business in Quebec. We ceased to write business in Korea. In February 2004 we announced the sale of our interests in Peru and agreed to sell our shares in Mutual & Federal, subject to regulatory approval.

US

US

£m	2003	2002
General business		
Net premiums written	**1,090**	1,895
Underwriting result*	**(651)**	(428)
General business result	**(469)**	(201)
Return on capital employed	**(52)%**	(21)%

* See note 1 on page 16.

Overview of major strategies

The US operation is undergoing a fundamental reorganisation designed to protect the value of the Group's investment in the US, safeguard assets appropriately and minimise the risk of volatility in the overall Group operating results.

This transition includes a significant reduction in the scale of our operations, particularly in the commercial segment, through the sale of the renewal rights for the majority of our businesses to other companies. We have also significantly increased claims reserves, implemented aggressive expense reduction measures and eliminated infrastructure. Of the overall Group reserve additions during the second half of 2003, £495m was in the US, mainly relating to workers' compensation and general liability.

At the same time we are seeking to ensure that this restructuring does not negatively impact the quality of service that we provide to customers, whether those for business that we are retaining or, while it is still on our books, that being transferred elsewhere.

Our restructuring will result in a smaller organisation built around our profitable non standard auto business. It will also be responsible for winding down the business remaining from our transferring operations.

Our ultimate goal is to achieve operational stabilisation through six critical drivers:

- claims management – meeting our policyholder obligations and providing stewardship over our corporate assets;
- expense management – ensuring that our expense base is commensurate with our operational needs;
- transition of resources and assets – managing the consolidation of our US operations to a stabilised, cost effective, functionally aligned structure that can support continuing obligations;
- legal – providing proper management and resolution of claims, corporate litigation and regulatory risk;
- investment management – optimising our asset type and maturity mix so that expected liability outflows are matched with equivalent investment asset inflows; and
- reinsurance recoverables – maximising the cash available to our operations through aggressive reinsurance collections and cash management.

Business progress against strategies

We have put in place a transitional plan to manage the restructuring of our US operation, including the appointment of a new management team headed by John Tighe, who will be responsible for overseeing its implementation.

An integral part of this plan has been an exit from the majority of our businesses, primarily through the sale of renewal rights to The Travelers Indemnity Company, a subsidiary of Travelers Property Casualty Corp, announced on 4 September. Included in the Travelers sale were our standard & preferred personal lines and parts of our commercial business. 2002 net written premiums for these businesses were $1.5bn. We will retain current policies in force until renewal, as well as all historical liabilities associated with these policies.

Among the other businesses sold in 2003 was Royal Specialty Underwriting, Inc. (RSUI), our US excess and surplus lines business. The transaction significantly reduced our catastrophe exposure in the US and released around £200m of risk based capital. As part of the agreement we will provide a fronting arrangement for admitted business, which will continue until June 2004.

Other businesses exited in 2003, and the early part of 2004, are detailed under the Acquisitions, Disposals and Investments section of this report.

We completed an expense management programme to cut controllable expenses by $122m between November 2002 and mid year 2003. This included a headcount reduction of 843 employees. During the final quarter of the year, the workforce was reduced by a further 1,249 employees, many through transfer to the acquiring companies in our renewal rights sales. In total we reduced headcount by 2,500 during the year. Around $95m of the targeted savings had been achieved by the end of 2003; we aim to realise the remainder in early 2004.

Expense management is seen as a key driver for the organisation for 2004 and beyond, and the Company is committed to managing its expense base effectively through the transition.

We have instituted a number of control mechanisms to ensure that we make orderly progress on our restructuring. These include the creation of a new financial risk manager role within our senior team. The Region has also strengthened its governance structure consistent with the restructure and redirection of the US operation. Finally, management and employee incentive plans have been modified to include a control environment objective.

We have launched more than 20 projects to support our strategic redirection and move our six critical drivers forward. Examples of projects include the:

- Business Insurance Transition Plan, which will move Business Insurance from a business segment to a functional unit model;
- Claims File and Office Transition, which will design a transition strategy to balance US indemnity obligations with expense considerations; and
- Performance Management, which will help enable all US employees to meet specific corporate objectives.

'We have instituted a number of control mechanisms to ensure that we make orderly progress on our restructuring. These include the creation of a new financial risk manager role within our senior team.'

All projects are due to be completed over the next 12 to 18 months.

Our largest ongoing business is non standard auto, a leading provider of personal automobile insurance to low income, low wealth customers. It offers flexible term policies and traditional six month policies through a network of approximately 8,000 independent agents in 27 states. In 2003, for the third year running, it applied double digit premium rate increases, achieving an average increase of 14% for the full year. Additionally, 99% of its new business is now submitted via AutoLink[SM], a leading edge point of sale and service technology, which has dramatically reduced overhead expenses. Financial results for the year were strong, with the business reporting net written premium of $387m and a 94.1% combined operating ratio.

The downward revisions of the US operation's credit rating by Standard & Poor's and AM Best during the second half of the year have not adversely affected non standard auto, and new business continues at expected levels.

Claims initiatives implemented by non standard auto at the beginning of 2003 have positively affected claims results, with severity decreasing by 5% this year. All key claims indicators, such as subrogation, salvage and claims expenses, have also improved this year.

Market and economic conditions

The hard market in the US continued, but with a deceleration in the rate of premium increases compared to 2002. Solid industry results for the year stemmed from growing premiums and improved underwriting. However, financial uncertainties remain, as evidenced by the fact that AM Best downgrades outpaced upgrades for the third consecutive year: 188 vs 57 for the 12 months ending July 2003.

On the legislative front, there have been substantive negotiations in the US Congress for federal legislation to limit exposure to asbestos claims. The latest bill includes a 27 year payout period for insurers, a 46% industry payout share (vs 50% in a prior bill) and a ground up reserve analysis. The bill is expected before the Senate during the first half of 2004, where prospects are uncertain, but the Majority Leader is supportive of the industry position. Congressional consideration is also expected on class action tort reform to consolidate actions from the state courts to federal court.

With regard to terrorism insurance, industry lobbying efforts are commencing to seek extension of the federal Terrorism Risk Insurance Program, which is set to expire at year end 2005. Congress and the Treasury Department are monitoring conditions in the market, and prospects for extension are uncertain.

Acquisitions, disposals and investments

In 2003, our US operation sold:

- renewal rights to its middle market segments, RM&G casualty, marine and standard & preferred personal lines businesses to a subsidiary of Travelers Property Casualty Corp.;
- RSUI business and assets to Alleghany Insurance Holdings LLC.;
- DPIC and RM&G global property renewal rights to XL America Inc.;
- Grocers Insurance Company renewal rights to Argonaut Group Inc.;
- financial services business and assets to American National Property and Casualty Company; and
- flood protection programme business and assets to Harleysville Mutual Insurance Company.

We also transferred our REMi, Asia Branch and SJA Agency businesses to other companies and began the wind down of Artis, our alternative risk transfer insurance strategies operation.

Outlook

The restructuring and consolidation of the US operations will continue in 2004, with a focus on maximising and protecting the Group's assets in the Region. Enhanced project management discipline has been developed to drive the transition. Key risks have been identified and the overall control environment emphasised, in part through the new Financial Risk Office. Finally, retention of critical staff is being addressed through a new incentive plan.

2004 is expected to be a very challenging year, particularly in regard to financial results, given the costs associated with exiting certain lines of business and the overall implementation of the US restructuring. We therefore do not expect good financial returns as a result of various fixed and unavoidable expenses. We anticipate that the position will begin to improve in 2005 as expenses begin to reduce to be more in line with our new premium base level.

'Expense management is seen as a key driver for the organisation for 2004 and beyond, and the Company is committed to managing its expense base effectively through the transition.'

Corporate Responsibility

We have been assisting customers in their hour of need for almost 300 years, recognising that, in traumatic times, an additional level of responsiveness to customers and the community is something that frequently sets us apart.

We make our most significant contributions to corporate responsibility in the course of our general insurance operations. We take the opportunity to use advanced underwriting and risk management techniques to help our clients minimise the risk of incidents that could adversely impact the environment.

We are committed to maintaining high standards of integrity and fair dealing in our relationships with all our stakeholders. Whenever we have a market presence around the world, we seek to make a positive contribution to the communities and environment we are part of.

Royal & SunAlliance is a constituent of the FTSE4Good UK Index, which measures the performance of companies that meet globally recognised corporate responsibility standards. The Company is also a member of the FORGE group, which is comprised of insurers and banks and supported by the Association of British Insurers and British Bankers' Association. The Group has previously published guidance on environmental management and corporate social responsibility and is exploring the issue of trust in financial services, with a publication planned for 2004.

Investment

Since 1 January 2003, an investment process called 'Responsible Engagement Overlay' (REO) has been applied to the Royal & SunAlliance funds managed by ISIS Asset Management.

The ISIS REO philosophy is that companies which manage their social, environmental and ethical (SEE) risks effectively are protecting shareholder value. This means that fund managers have no restrictions as to which companies they invest in, but once an investment has been made, specialists from the ISIS Governance & Socially Responsible Investment team engage with those companies to ensure they operate to good standards in managing their SEE risks.

During 2003, ISIS engaged with over 700 companies on issues including corporate governance, bribery and corruption, climate change, human rights and labour standards.

The Trustee of the Royal & SunAlliance UK Pension Scheme 2002 has approved the introduction of an ISIS ethical investment fund option, which will allow members to elect for their contributions to be invested in companies that satisfy the ISIS REO criteria.

Workplace issues

We work to provide all employees with fair terms of employment and safe conditions at work. The risk management of the health, safety and wellbeing of our employees, contractors and members of the public is recognised as a Board level issue.

In 2003, we were recognised as a 'Beacon of Excellence in Stress Prevention' by the UK Health & Safety Executive. The Company takes a participative approach to identifying areas of concern by conducting an annual employee survey in most territories.

Employees are frequently the first individuals to recognise malpractice or wrongdoing in the workplace, but they are often reluctant to voice their suspicions. We believe that employees should be able to report any incidents of malpractice or wrongdoing without fear of recrimination, provided that any such reports are based on genuine concerns and made without malice or bad faith. The global whistleblowing policy enables employees to raise serious concerns within a controlled environment offering such safeguards and support as may be necessary to protect their personal integrity and, where possible, identity.

Community

At the end of 2002, following extensive consultation with staff, it was agreed that the focus of the UK's community investment strategy should be the education of young people aged 14 to 25. We have since announced a new three year partnership with Samaritans. Samaritans are not only there in times of crisis, but also work with communities to minimise the risk of a crisis happening in the first place. Our partnership with Samaritans will involve education in the workplace, schools and colleges, offering coping skills for difficult situations and information on where to get help.

The Group also supports charitable giving by employees, offering a 'Give As You Earn' scheme in the UK through which £284,564 was donated in 2003, and matching employee donations to a value of £100 per donor per month. In the US and Canada, similar charitable giving programmes were operated, such as the 'United Way'. Donations from the US totalled US$184,098 and from Canada C$104,638 in 2003.

Each business across the Group is responsible for its own community engagement programme. Some examples of current activity are outlined below:

- Much of Ireland's community activity focusses on the education and development of young people. We sponsor the 'Children of Ireland' awards, honouring children for outstanding courage in dealing with serious illness, or for giving selflessly to others. The Group contributed €30,000 to the last event.
- Trygg-Hansa, our subsidiary in Sweden, helps to fund the purchase and upkeep of life buoys around the country, saving many lives every year. The company donated over 5,500 life buoys in 2003 at a cost of £225,000.
- In Canada we sponsor the 'Safety Tips for Kids' programme, which is dedicated to reducing the incidence of missing and exploited children. The company funds the production and distribution of brochures giving advice to children.
- The US continues to be a key sponsor of 'Project Connecticut' – a programme to help communities prepare for major disasters. The business provides instructors as well as funding for the scheme.

It is not Group policy to make donations to political parties. However, following the enactment of the Political Parties, Elections and Referendums Act 2000 (PPER), which defines EU political organisations very widely, in 2003 the Group sought shareholder approval to allow donations of up to £100,000 to EU political organisations. This will ensure that the Group avoids any inadvertent infringement of PPER when making donations intended for charitable, or similar, purposes and allows staff time off to participate in Trade Union activities.

Environment

The Group's overarching environmental principles are to have regard for our environmental impacts, including the resources we use and, as insurers, to promote risk reduction. This is underpinned by our existing Group Statement of Environmental Policy.

We use the annual UK Business in the Environment Index of Environmental Engagement as a benchmarking exercise. This survey addresses two major aspects of corporate environmental activity – management and performance. The results of the seventh annual survey were announced in March 2003 and we ranked 41st out of 168 participating FTSE companies.

In March 2003, Royal & Sun Alliance Insurance (Thailand) Limited sponsored the Thailand Wildlife Fund's Pang Ma Mountain project, to teach young people about the environmental benefits of reforestation.

Risk

The consolidation of corporate responsibility policy setting and strategic oversight under the remit of the central risk management function (Group Risk), complementing previous practice on environmental issues, has ensured that these matters are embedded in business processes. Once policies are implemented, internal and external challenge processes ensure that an effective system is in place to manage SEE risks.

SEE and other risks are considered within the emerging risk process, also managed by Group Risk. This process involves allocation of issues of concern to individual staff members, where it forms part of their performance appraisals. Staff then utilise internal data and external research to compile periodic assessments that are submitted to the Board Risk Committee, which makes decisions on the appropriate actions.

Further details on some of our corporate responsibility activities can be found on our website www.royalsunalliance.com. This year, we have changed our environmental and social reporting cycle to align with the financial reporting cycle. A standalone report is available from our website or in hard copy from the Group Company Secretary at 30 Berkeley Square, London W1J 6EW and complements the information in this Annual Report & Accounts.

By November 2003, we had negotiated contracts for the supply of electricity from renewable sources to over 99% of sites in the UK.

Board of Directors

[E] Executive Director
[A] Member of Audit & Compliance Committee
[N] Member of Nomination Committee
[R] Member of Remuneration Committee

John Napier [N,R]
Chairman

Age 61. Director of the Group from January 2003 and Chairman of the Group from March 2003. Non-executive Chairman of Kelda Group plc (water utility). Former Executive Chairman and Chief Executive of Kelda Group plc. Former Chairman of Booker plc (cash and carry). Former Managing Director of Hays plc (business services). Former Managing Director of AGB plc (international market research and information services).

Andy Haste [E]
Group Chief Executive

Age 42. Director and Group Chief Executive from April 2003. Former Chief Executive of AXA Sun Life plc and director of AXA UK plc (life and pensions). Former President and Chief Executive Officer of Global Consumer Finance Europe at GE Capital UK, Western Europe and Eastern Europe (financial services). Former President of National Westminster Bank's US Consumer Credit Business (retail banking).

Bob Ayling [A,N,R]

Age 57. Director of the Group from April 1993. Director of Dyson Limited. Chairman of Holidaybreak plc (leisure). Former Chief Executive of British Airways. Former Chairman of The New Millennium Experience Company. Former Under Secretary at the Department of Trade.

Julian Hance [E]

Age 48. Group Finance Director from October 1998. Former Group Chief Accountant and Finance Director of Life and Investment Operations.

Stephen Hill [A,R]

Age 43. Director of the Group from August 2000. Chief Executive of The Sporting Exchange Limited (leisure). Non-executive director of Psion plc (electronics). Former Chief Executive Officer of the Financial Times Group Limited (newspapers & publishing). Former Chief Executive Officer of the Financial Times Newspaper and Westminster Press and Head of Strategy for Pearson plc (media company).

Susan Hooper [R]

Age 44. Director of the Group from August 2001. Former Vice President of Avis Europe plc (car rental) in Europe, Africa, Middle East and Asia. Former Regional Director Europe, Africa and Middle East of Pepsico International and non-executive director of Courtaulds plc.

Edward Lea [A]

Age 62. Director of the Group from July 2003. Chairman of the Audit & Compliance Committee from October 2003. Director Redbourn Group plc (property management and investment). Director of IDC Plugs Limited (electrical services). Director of MacIntyre Care (charity). Previously a director of The British United Provident Association (BUPA).

John Maxwell [A,R]

Age 59. Director of the Group from July 2003. Chairman of the Remuneration Committee from October 2003. Director of Provident Financial plc (financial services). Director of The Big Food Group plc (food retailer). Director of Parity Group plc (IT services). Governor of the Royal Ballet School. Chairman of the Institute of Advanced Motorists. Previously an executive director of Prudential Group plc. Previously Director General (Chief Executive Officer) of The Automobile Association Limited.

Financial Review: Group Finance Director's Report

Analysis of result

	2003	Restated 2002
General business result[1]	**£83m**	£89m
Long term business result[2]	**£168m**	£227m
Other activities (including associated undertakings)[3]	**£(111)m**	£(90)m
Group operating result (based on LTIR)	**£140m**	£226m
Other movements[4]	**£56m**	£(881)m
Group operating profit/(loss) (based on LTIR)*	**£196m**	£(655)m
Short term investment fluctuations	**£(34)m**	£(551)m
Profit/(loss) on disposal of subsidiaries	**£(308)m**	£253m
Loss on ordinary activities before tax	**£(146)m**	£(953)m

* For full details see the Profit and Loss Account on page 62.

Guide to terms

1 General business result
Comprises the underwriting result on all general insurance, together with the allocated longer term investment return (LTIR) including that on risk based capital. The LTIR is intended to recognise the total investment return arising over time while avoiding the distortions of short term investment market fluctuations.

2 Long term business result
Is the profit generated on the Group's life insurance operations on a modified statutory basis.

3 Other activities (including associated undertakings)
The result for other activities comprises a number of elements:
- the operating result from non insurance activities;
- income from associates and a number of Group expenses; and
- interest charges on debt, other than dated loan capital, and finally the surplus or deficit of longer term investment return on risk based capital, after allocation to the general insurance business result.

4 Other movements
Other movements include the change in equalisation provisions, reorganisation costs (including losses on terminated business), amortisation of purchased goodwill (including goodwill in acquired claims provisions and amortisation of purchased value of long term business) and dated loan capital interest.

'Our actions in 2003 considerably improved the Group's capital position; however, regulatory developments will continue to exert pressure.'

Julian Hance, Group Finance Director

Group financial position

During 2003 the Group went through a period of fundamental change. Positive management action was taken to address, among other things, the need to strengthen our balance sheet following the cumulative effects of disasters and depressed stockmarkets over the last three years. This was achieved both through the rights issue completed in October and the programme of disposals, transfers and closures, which continued throughout the year. This section of the report explains our view of the key financial indicators for the Group and the insurance industry and will discuss our financial results and outlook.

As a consequence of these actions, the Group's capital position has been considerably improved. It is clear, however, that external developments will continue to exert strong pressures on the Group capital position. The principal such developments are expected to come from changes in regulatory requirement. Some analysis is provided in this report, however, the situation is rapidly developing and is difficult to predict with any certainty. What can be expected is that regulatory requirements will become more onerous and will converge with our own views of capital requirements and those of the rating agencies. Provided this convergence is allowed to take place over a reasonable time frame, this is a welcome development. There are, however, risks that could arise from sudden or unexpected regulatory changes.

Financial framework

The financial framework within which these results are prepared comprises the Group's accounting policies together with the regulatory requirements.

In respect of the accounting policies, 2003 has been a year of preparation for major change in 2004 and subsequent years. At the end of the year the ABI issued a revised Statement of Recommended Practice on Accounting for Insurance Business. This will come into effect in 2004; however, the Group has sought to adjust its accounting approach in 2003 to anticipate the main requirements. One such area of change concerns the derecognition of the embedded value of life business. The Group has derecognised the embedded value of life business from the balance sheet and this is now set out in a note to the accounts. It should be emphasised that this is a change of accounting policy largely brought about to ensure consistency with other industries and does not represent any change of view of the economic value of the life business to the Group.

Ongoing business results – combined operating ratio %

	As published	**Excluding specific reserve strengthening**		
	%	Pre strengthening result %	Closed, transferred & sold %	*Ongoing* %
UK	99.4	98.3	115.7	94.8
Scandinavia	99.3	98.2	–	98.2
US	140.5	109.0	113.4	94.2
Canada	102.9	102.2	–	102.2
International	95.2	95.2	109.8	94.7
Australia/New Zealand	95.7	95.7	95.7	–
Total	**108.0**	**100.3**	**111.8**	**96.1**

Significant disposals since 2001

Date	Name	Country	Profit/(loss) on disposal	RBC release
2004				
January	Royal & SunAlliance Seguros Fenix Royal & SunAlliance Vida	Peru	£1m	£8m
January	Mutual & Federal	South Africa	£20m	£20m
2003				
December	SJA Agency	US	–	£3m
December	DPIC	US	–	£24m
December	Grocers	US	–	£18m
December	La Construcción	Chile	£(24)m	£45m
October	Sequence	UK	£(13)m	nil
September	Sale of renewal rights to Travelers	US	£14m	£282m
July	HBoS	UK	–	£160m
June	Royal & SunAlliance (Puerto Rico)	Puerto Rico	£7m	£10m
June	RSUI	US	£57m	£198m
May	Promina	Australia & New Zealand	£(123)m	£540m
April	Healthcare & Assistance	UK	£114m	£247m
2002				
December	Securitas (life and general)	Germany	£(7)m	£50m
July	Group Risk	UK	£15m	£250m
June	RSAIFS	Isle of Man	£10m	£140m
May	Royal & SunAlliance Schadeverzekering NV Royal & SunAlliance Levensverzekering NV	Benelux	£1m	£30m
April	RSAIM	UK	£202m	£140m
January	Italy Direct	Italy	£(28)m	nil
2001				
July	Royal & SunAlliance SA Royal & SunAlliance Vida Regal Insurance Club SA	Spain	£66m	£113m
June	Canada Life	Canada	£42m	£110m
Total			**£354m**	**£2,388m**

2003 has also been a year of development of International Financial Reporting Standards (IFRS). It is expected that, in common with all quoted companies in the EU, the Group will be required to adopt IFRS in 2005. An IFRS specific to insurance is expected to be issued in 2004 and the Group has a project underway to ensure compliance. At this stage it is accordingly difficult to be categoric as to the impact of the IFRS on the Group's results. The Group strongly supports the underlying principle adopted by the International Accounting Standards Board of a fair value approach to asset and liability measurement, however, there are many important issues that remain outstanding and which will influence how the results drawn up under these principles will appear.

The transition from UK GAAP to IFRS represents a significant change for the Group. It introduces complex technical issues, changes in systems and different financial reporting requirements. During 2003, the Group set up a project to enable the transition to IFRS in 2005 to be completed in an orderly and timely manner. The project is being managed by a team of individuals with the necessary expertise of existing accounting methodology and of IFRS. Resource has been drawn from the Group Corporate Centre and the major operations. A project manager has been appointed and the project plan, milestones and deliverables agreed. Detailed work has commenced and the project is on schedule to deliver the requirements of the Group in its financial reporting in 2005.

Results

The operating results of the Group in 2003 are addressed in detail in the Chairman's Statement and Group CEO's Review and accordingly in this Financial Review the focus is on the accounting and financial aspects.

At the end of 2002 we indicated that we would reduce our longer term investment return assumptions adopted in calculating our Group operating result based on longer term investment return (LTIR). The use of long term assumptions means that the short term market value volatility of investments is excluded from the Group operating result (based on LTIR).

For 2003 we reduced the assumed returns on equities and fixed interest investments from 9% and 6% respectively to 7.5% and 5%. For comparative purposes the LTIR for the full year 2002 would have been around £158m lower.

As indicated in the previous section, the other principal change in our accounting approach is the derecognition of the embedded value of the life business. This has reduced published Group shareholders' funds, but is a presentational change and does not reflect a loss of economic value and also does not affect the regulatory position. The embedded value continues to be published in note 45 to the full Annual Report & Accounts.

A major feature of the results for the year has been the strengthening of prior year claims provisions. In many cases these provisions are being established as estimates in respect of liabilities that have yet to be advised to the Group and which will not be settled for many years.

This emphasises the importance of estimation techniques in the calculation of an insurance company's accounts and the inevitable uncertainties that accordingly arise. The Group's approach to estimation and uncertainty issues is set out in more detail on pages 56 to 59 of the full Annual Report & Accounts and is particularly important. Copies of the full Annual Report & Accounts are available via either our website or the Investor Relations team. Details of both are given in the Shareholder Information section.

General business result

The Group has made significant progress this year in restructuring operations through closure and renewal transfer.

As part of our quarterly results announcements we now include an analysis of the Group's general business underwriting result separating ongoing operations from those that have been disposed or closed. The result is split with effect from 1 January 2003, thereby giving a clear indication of underlying performance for the ongoing business for the year. The table on page 29 sets out a summary of this split for 2003.

A major feature of the 2003 result has been the additional claims provisions established in respect of prior years. Following analysis by Tillinghast and subsequent work by our own actuaries, £500m was initially set up for prior year claims, with an additional £300m earmarked as a contingent liability. The contingent liability was set up in respect of those areas where we believed there was the potential for adverse development but, pending the occurrence of future events (such as the outcome of court cases or more information becoming available), there was not sufficient cause to establish an actual liability.

Part of the original £300m indicated at the nine months was established pending completion of further actuarial analysis. This analysis has now been completed and £96m of the contingent liability has now been established as an actual provision. After adjusting for exchange movements in the fourth quarter, a contingent liability of £200m is carried forward at the year end and will be reviewed each quarter.

Life business result

The life profit reflected in the Group operating result (based on LTIR) is unaffected by the change in the accounting treatment of the embedded value. The movement in embedded value was previously taken directly to shareholders' funds.

The largest life fund remaining in the Group is that of Phoenix Assurance plc. This actually comprises two funds and developments over the course of the last two years have meant that it is now possible to identify more clearly the ownership of the surplus. One fund is a participating fund in which the policyholders have a 100% interest while the surplus in the other, non participating fund, is entirely owned by shareholders.

With the ownership of the surplus clarified, it is now appropriate to recognise that part attributable to shareholders on the Group balance sheet. This gave rise to a one off surplus at the beginning of 2003 of £444m pre tax, £310m post tax, which has been taken through the Profit and Loss Account. After taking into account movements in the year the impact on our capital position is a release of £321m.

For the with profit funds, the life profit represents the shareholders' share of surplus transferred out of the life funds, often arising as a set percentage of bonus declarations in the year.

'A major feature of the results for the year has been the strengthening of prior year claims provisions. In many cases these provisions are being established as estimates in respect of liabilities that have yet to be advised to the Group and which will not be settled for many years.'

Returns on equity (restated for derecognition of embedded value)

%	2003	Restated 2002	Restated 2001
Accounting basis	**(3.3)**	(32.2)	(16.5)
Tangible net assets basis	**0.4**	(46.1)	(21.1)

The life profit included in the Group operating result (based on LTIR) of £168m (2002: £227m) shows a decline over that of 2002. This is attributable to a number of factors including the disposal of the Australasian and Chilean life operations, a one off profit that was realised in Denmark in 2002 and generally lower bonuses as a result of lower investment returns.

Other activities

The result for other activities included in the Group operating result (based on LTIR) comprises a number of elements. Firstly, the operating result from non insurance activities such as our UK estate agency chain Sequence, which was sold in October 2003. In 2002 it also included Royal & SunAlliance Investments, our asset gathering and management arm, which we sold to ISIS (formerly Friends Ivory and Sime) in April 2002.

Secondly, it includes income from associates and a number of Group charges: our central Group expenses, any interest charges on debt, other than dated loan capital, and any surplus or deficit of longer term investment return on RBC after allocation to the general insurance business result.

During 2003 there has been an increase in central expenses due to costs arising from an increase in the Directors and Officers insurance charge and an increase in pension contribution.

The other activities result also includes a surplus of £23m (2002: £56m) in respect of the balance of LTIR. The primary reason for the reduction compared to the prior period is the use of lower investment returns. As indicated above, equity returns are now calculated at 7.5% (2002: 9%) and fixed at 5% (2002: 6%) per annum.

Capital position

As indicated in the introduction, 2003 saw a number of major developments in the Group's capital position.

The overall objective that determines the management of the Group's capital position is to ensure that available capital equals or exceeds the capital requirements. The capital requirements can be assessed in a number of ways. Over the last few years the Group has developed and reported on its capital requirements using a risk based capital (RBC) model developed internally. The RBC approach remains a valid and essential tool in the management of the Group's capital position.

The other ways in which the capital requirements of the Group are assessed are rating agency assessments and regulation. In 2003, the dominant development has been in respect of regulatory capital requirements. The FSA, together with many overseas regulators, have embarked on radical changes in the regulatory environment. The FSA have published many consultation papers that set out how the regulatory capital requirements may change over the next few years. Some detail of these is provided in subsequent sections of this report. In overall terms it is becoming apparent that, depending on how they are going to be applied, it is possible that the regulatory capital requirements are going to be more onerous than RBC or rating agency requirements and will therefore dominate capital management. This in turn makes the issue of how the regulatory requirements are going to be applied absolutely critical. There are many different ways in which regulatory requirements can be applied and this will have a major impact on the insurance industry. It is critically important that the FSA introduce the changes in a gradual and clearly notified manner. The following sections deal with the regulatory developments in more detail.

Regulatory developments – general insurance

The regulatory environment is subject to significant change over the next few years, in particular in respect of solvency requirements. This is in part attributable to the implementation of EU Directives but is also the response of the Regulators to the challenging market conditions that have prevailed over the last few years.

The changes that can be expected in the solvency requirements in the UK are generally anticipated to arise in 2004 through 2006. Inevitably, until the requirements are specified, there will be uncertainty as to the implications for Group solvency and the impact of such developments could materially increase our solvency requirements. We believe that, following the actions announced, including the rights issue, we are better positioned to comply with these potential regulatory developments. However, there remain considerable uncertainties regarding these developments and potential outcomes as detailed on pages 56 to 59 of the full Annual Report & Accounts.

The requirements of Solvency 1 came into effect on 1 January 2004. As has been indicated in earlier statements, this increases the solvency requirements within the existing regulatory framework. The Group successfully applied to the FSA for a waiver relating to the ability to continue our present practice of discounting very long dated general insurance claims liabilities. We believe this approach is appropriate and is consistent with the longer term direction of regulatory requirements as well as IFRS and the principles of fair value. The value of the waiver is £400m.

Other changes to be introduced by

'There are many different ways in which regulatory requirements can be applied and this will have a major impact on the insurance industry. It is critically important that the FSA introduce the changes in a gradual and clearly notified manner.'

Solvency 1 can be expected to reduce our regulatory solvency by around £300m. These primarily relate to additional capital charges for liability business. The overall impact is £400m.

The FSA have indicated that Solvency 1 is a transitional arrangement and they want to adopt a more radical solvency regime for general insurance, starting in 2005. This has been set out in CP190, which establishes principles for determining the ECR, or Economic Capital Requirement, for a general insurer. To this requirement will be added an individual capital requirement that is more specifically related to the risk circumstances of the particular company.

The ECR is based on the principle of there being a capital charge for the various types of risk that an insurer faces, such as underwriting, adverse claims development and credit risk. The ECR sets out capital charge percentages for particular lines of insurance business and for particular assets and liabilities.

The Group has made some estimates of the likely impact, and, for Royal & Sun Alliance Insurance plc, the principal regulated entity, in its present form, the calculation shows an increase from the present required minimum margin of around £700m at the end of 2003, to an ECR of £1,700m.

Clearly this is a major change in regulatory capital requirement bringing it much closer to the levels established by the rating agencies and RBC calculations.

The implications of an increase of this amount will crucially depend on how the FSA then apply the requirement and in particular whether further buffers and margins will be necessary in addition to the ECR itself.

In certain circumstances it is apparent that the regulatory requirement could be significantly greater than the equivalent rating agency or RBC level.

Regulatory developments – life insurance

During the year, the UK regulator, the FSA, issued a consultation paper CP195, proposing a new regime for UK life insurance company solvency for late 2004. This regime will have two 'pillars'.

For larger with profits funds, the first pillar will require capital to be held sufficient to meet the larger of guaranteed benefits valued on a market consistent basis and policyholders' reasonable expectation of future bonus, both in present circumstances and in the event of a prescribed, simultaneous worsening of several investment and other factors. An adjusted version of the current statutory solvency basis will remain as an underpin.

For other funds, the first pillar continues to be the current statutory solvency basis.

Under the second pillar, all companies will prepare an individual capital assessment, which will identify the additional capital, if any, which each company needs to hold based on a full and individual analysis of the risks to which it is exposed and the controls that it has in place.

The FSA have already allowed larger with profits funds to move a large part of the way to measuring capital requirements on a 'pillar 1' basis via the introduction of 'realistic balance sheet' reporting and so called 'Tiner' waivers from the current statutory solvency basis.

The effect of these interim changes has been beneficial overall to our two main closed UK with profits funds, as we have been able to cancel an expensive financial reinsurance treaty previously necessary to meet the statutory solvency requirements. Our solvency is also now less sensitive to future asset value falls.

We expect to publish our 'Principle and Practices of Financial Management' in the first half of 2004, which will set out how we will ensure that we continue to treat with profits customers fairly as our funds run off.

The solvency of the UK Life funds is sensitive to changes in investment conditions and will therefore rise and fall. To provide for this, arrangements have been in place for a number of years now in respect of both of the UK with profit life funds whereby the shareholders can provide them with loan finance that will count towards their statutory or realistic solvency. Such loan finance, which is interest bearing, is repayable by the with profits funds provided their statutory or realistic solvency exceeds a preset level of £50m each. At 31 December 2003 the loan finance utilised by the UK Life funds amounted to £146m.

Regulatory developments – Group

A further development is set out in CP204, which amends the implementation of the Groups' Directive. This looks at the capital requirements for financial groups as distinct from the regulated entities themselves. As with CP190 and CP195, the implementation of CP204 could have a major impact on the Group. One requirement will be for the Group's existing subordinated debt, which is borrowed at the Group holding company level, to qualify as capital under the regulatory requirements. It is regarded as capital by the Group and by the rating agencies but a number of technical details need to be changed in order for it to meet the regulatory requirements which have been introduced since it was borrowed.

As with CP190, the anticipated introduction of CP204 is on 1 January 2005.

Overall, the consultation papers mean that the management of an insurance group's balance sheet will become similar to that of a banking group. In particular, it is expected that there will be a wider range of types of capital that insurance companies will utilise, including various forms of debt that are able to be treated as capital.

Capital

£m	2003	Restated 2002	Restated 2001
Shareholders' equity	**2,876**	2,106	3,334
Non equity shareholders	**125**	125	125
Equity minority interests	**346**	405	399
Dated loan capital	**768**	773	784
	4,115	3,409	4,642

Total capital – key elements of movement

	2003 £m
Capital brought forward 1 January 2003	**4,221**
Prior year adjustment (embedded value)	**(812)**
Capital brought forward 1 January 2003 – restated	**3,409**
Profit/(loss) for the year after tax and minorities	**(58)**
Rights issue	**960**
Exchange	**(12)**
Dividends	**(120)**
Minority interests	**(59)**
Dated loan capital (net change)	**(5)**
Capital 31 December 2003	**4,115**

Rating agencies
Rating agencies such as Standard & Poor's, AM Best and Moody's Investors Service provide insurer financial strength ratings for the Group and its principal subsidiaries. These ratings are based on the detailed financial modelling of the Group and regular review of the Group's strategic direction. The current ratings are 'A-' from Standard & Poor's, 'A-' from AM Best and 'Baa2' from Moody's Investors Service.

Following the announcement of our third quarter results in November 2003, AM Best affirmed our 'A-' excellent rating and changed the outlook from 'under review with developing implications' to 'negative'. Standard & Poor's affirmed the Group rating as 'A-' 'with a negative outlook'. The Group is committed to returning its rating with all of the major agencies to 'A'.

2003 capital developments
As set out in the Capital table, the Group's capital comprises both equity (including minority interests) and dated loan capital. Although the level of capital at the end of 2003 was similar to that at the beginning of the year, this masks a number of major developments as illustrated in the risk based capital table below.

The Total capital table on page 33 shows the key elements of the overall movement.

In response to these changing capital requirements, the Group made considerable progress in improving its capital position in 2003.

Fundamentally the capital position can be improved in two ways. The amount of available capital can be increased and/or the capital requirements can be reduced. 2003 saw action in both.

Increases in available capital
In addition to the rights issue, which increased capital by £960m, the Group increased its available capital by disposing of non core activities, such as life insurance operations in Australia, New Zealand and Chile, and also disposed of a number of non strategic operations at a profit. These included the UK health operation and the US surplus lines business.

Reductions in capital requirement
The reductions in capital requirement were significant in 2003 and arose primarily from the disposal or closure of non life operations. The principal events were in Australasia where the operations were disposed by way of an IPO, and disposals of operations in the US and Puerto Rico. Disposal or closure of general insurance operations means that the Group is no longer exposed to their underwriting or investment risks and therefore the Group capital requirement reduces.

An indication of the scale of change in 2003 is provided by the table opposite, which compares the risk based capital position at the end of 2002 and 2003.

This shows that over the course of the year, on a RBC basis, the Group moved from a capital shortfall of £754m, to a surplus of £727m.

It can be seen that the majority of the improvement came in the reduction in general business capital requirement. This is also reflected in the reduction in net written premium (NWP) of the Group. In 2002 the Group wrote £8.6bn of NWP. At the end of 2003 the annualised level of NWP had reduced to around £5.3bn, reflecting the disposal and closure programme.

Prospective capital developments
As indicated earlier in this Financial Review, it is expected that regulatory capital measures will gradually move towards a risk based approach and will gradually converge with RBC and rating agency considerations as a common measure of capital adequacy.

As such, the future direction of the Group's capital management will be more dependent on the external influence of regulation. This makes predictions of future developments less certain, however it is likely that the Group's actions of disposing of non core operations and focussing on the core general insurance businesses, as carried out for the last few years, will continue.

An unfortunate fact is that insurance regulation is not standardised on a worldwide basis. In this respect insurance does not follow international banking regulation where the Basel Accords ensure a good degree of global consistency.

This lack of standardisation and consistency may lead to difficulties in ensuring fair competition and is open to the abuse of regulatory arbitrage.

Another feature of the year was the redeployment of the Group's shareholders' funds, with a significant increase in the UK proportion.

Other

Investment policy
The significant reductions in equity investment exposures that the Group has made over the last few years have continued in 2003, although at a more modest level, in respect of both the life and general insurance operations. The aggregate value of holdings in the general insurance operations at the end of 2003 was approximately £1.15bn. This is in line with our policy target.

Historically the general insurance funds possessed a high equity weighting such that assets representing all of shareholders' funds, together with 5% of technical reserves, were invested in equity securities. Over a period of years this policy has significantly altered to reduce equity exposure and consequently the capital requirement of the Group. There has been a significant reduction in the risk exposure of the Group with total equity disposals from the general insurance

Risk based capital

£m	**2003**	2002
Available tangible capital	**4,122**	4,120
Committed to life insurance activities	**(880)**	(1,774)
Other commitments (contingent liabilities and future reorganisation costs)	**(395)**	(100)
Available to meet general insurance requirements	**2,847**	2,246
General business requirements	**2,120**	3,000
Surplus/(shortfall)	**727**	(754)

funds from the start of 1998 to the end of December 2003 amounting to £5bn. Over the period from 31 December 1998 to 31 December 2003 equity exposure has fallen from 37% to approximately 8%. The proceeds raised through these disposals of equities have been withdrawn from the portfolios to meet corporate cash requirements, reinvested into bonds or retained as cash.

The risk averse nature of our investment strategy has also been reflected in our approach to the management of our bond exposures. While bonds represent a significantly lower risk to the balance sheet than equities their value can be negatively impacted by rising interest rates. With bond yields having fallen dramatically over recent years there has been a reluctance to commit the proceeds raised from recent equity sales to the bond market, where losses in value may potentially be realised in the event of interest rate rises. As a result, a considerable part of the proceeds of the equity sales and proceeds from the disposals of subsidiaries has been retained in a cash form.

Within all operations bonds are held to provide a broad match of insurance liabilities both by currency and duration. As a result, the substantial majority of bond holdings are in the local currency of the operations. In addition, the bonds are typically of a relatively short term to maturity, reflecting the preponderance of short tail business within the global general insurance operations, and of high quality.

The average yield of the fund stood at 3.61% at 31 December 2003. Exposure to bonds rated AA and above continued to stand at approximately 83% of total bond exposure while exposure to non investment grade bonds was less than 1%.

Bank arrangements

At the end of December 2002 the Group's banking facilities comprised a syndicated loan facility for £800m expiring in October 2003, of which £566m was drawn.

On 7 October 2003 the Group announced the successful completion of negotiations for a new three year facility of £400m, repaying borrowings of £166m.

Pension update

Note 7 to the full Report & Accounts provides more detail on the position of the Group's pension funds. In common with many companies, the last few years' declines in equity values have had a major impact on the Group's pension funds, especially in the UK.

FRS17 provides a basis for setting out the surplus or shortfall in the pension funds as well as a methodology for determining the appropriate charge to profit and loss for the cost of the pensions benefit.

FRS17 provides a sensible basis for determining the charge to profit and loss and the Group is applying this in its financial projections. The FRS17 calculation of surplus or shortfall is also valid, provided it is recognised as being an inherently volatile comparison of market values of investments with the discounted value of long term liabilities.

Any shortfall identified by the FRS17 approach represents a requirement that will change with investment market movements, however, it is appropriate for the Group to anticipate how any shortfall will be funded. In the case of the UK pension funds, the indicated shortfall, net of tax relief, is around £300m.

Subject to market developments, and the impact of the employee contributions of 2.5%, which will be introduced in April 2004 and will increase to 5% in 2005, this shortfall will be funded by additional contributions from the Group, over and above those required by FRS17, amounting to around £30m, net of tax, per annum for the next nine years.

Risk analysis

The overall Group approach to the identification, evaluation and management of risk is dealt with in the Corporate Governance report. As indicated earlier, the reliance in the results on estimation techniques and the inherent uncertainty in an insurance operation makes understanding of these issues particularly important.

Dividend

The proposed final dividend is 2.9p, which represents a dividend for the year, adjusted for the rights issue, of 4.5p. Subject to shareholder approval, it is intended to offer a scrip alternative for the final dividend with an extended option period.

Summary

The main focus of this report has been on capital developments, both the actions in 2003 that the Group has undertaken, and the prospective changes being introduced by the Regulators. The Group continues to respond to these changes so as to maintain its financial position in equilibrium.

Julian Hance, Group Finance Director

'It is expected that regulatory capital measures will gradually move towards a risk based approach, and will gradually converge with RBC and rating agency considerations as a common measure of capital adequacy.'

Geographic spread of shareholders' funds

£m	2003	Restated 2002
UK	**1,484**	115
Scandinavia	**1,223**	1,086
US	**856**	1,325
International	**401**	388
Canada	**440**	376
Australia/New Zealand	**–**	606
Other (includes borrowings/minorities)	**(289)**	(487)
	4,115	3,409

Sensitivity Analysis

Sensitivity
The Group's financial position can be analysed in terms of its sensitivity to change in certain economic and operating parameters. The table below summarises the principal sensitivities.

Movement	by	Change in	by
Investments			
Equities	FTSE 100 points (or equivalent)	Net assets	£23m
Gilts	Interest rate 100 BPS	Net assets	£(227)m
Currencies – against sterling			
US Dollar	10c change	Net assets	£37m
Danish Kroner	1 Kr change	Net assets	£60m
Euro	10c change	Net assets	£19m
Underwriting			
Operating ratio	Reduction by 1%	General business net of tax ROC	2.0%
Investment returns			
Equities	Long term return 1% higher	Group operating result	£28m
Gilts	*Long term return 1% higher*	Group operating result	£100m

Share and Shareholder Analysis

Royal & SunAlliance is listed on both the London Stock Exchange and the New York Stock Exchange, in each case under the code RSA. On the New York Stock Exchange, the stock is traded in the form of American Depository Shares (ADSs) each of which represents, in dollar denomination, five ordinary sterling issue shares.

The average total daily trading volume on the London Stock Exchange during 2003 was approximately 31.6m ordinary shares.

The opening middle market price on 2 January 2003 was 103.38p[1] and the closing middle market price at 31 December 2003 was 88.25p. The highest daily closing price was 128.63p[1] on 16 July 2003 and the lowest daily closing price was 45.43p[1] on 12 March 2003.

Further details of the share capital are found in note 28 on page 80.

[1] Restated for the rights issue that completed on 16 October 2003.

Shareholdings by size

Grouping	Shareholders	%	Shares	%
1 – 25,000	61,794	97.24	145,345,724	5.05
25,001 – 100,000	895	1.41	42,678,252	1.48
100,001 – 500,000	432	0.68	103,779,709	3.60
500,001 – 1,000,000	136	0.21	96,452,018	3.35
1,000,001 – 2,000,000	109	0.17	155,043,076	5.38
more than 2,000,001	184	0.29	2,336,900,552	81.14
Total	**63,550**	**100.00**	**2,880,199,331**	**100.00**

Dividend per ordinary share (after adjusting for the rights issue)

	Annual dividend					Dividend on
	Interim p	Final p	Total p	Change %	Special dividend p	ordinary shares £m
1997	5.77	11.19	16.96	10.53		325
1998	6.30	12.28	18.58	9.52		360
1999	6.78	13.17	19.95	7.39	38.77	1,104
2000	7.11	13.89	21.00	5.26		372
2001	7.11	5.81	12.92	(38.46)		227
2002	3.23	1.62	4.85	(62.50)		86
2003	**1.60**	**2.90**	**4.50**	**(7.50)**		**111**

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Accounts contents

Directors' Report

The directors of Royal & Sun Alliance Insurance Group plc present their report and the audited financial statements of the Company, for the year ended 31 December 2003.

Principal activity
The Company is the holding company of the Royal & SunAlliance Group of companies whose principal activity is the transaction of personal and commercial general insurance business. During 2003, the Group operated in over 30 countries worldwide.

Review of the year and future developments
These are outlined in the Chairman's Statement and Group CEO's Review and the Operating Review beginning on page 2. The Group's profit, appropriations and financial position are shown on pages 60 to 65.

Dividends
The Company completed a rights issue on 16 October 2003. As stated in the prospectus, ordinary shares issued in respect of this rights issue did not qualify for the interim dividend of 2.0p per share paid on 28 November 2003.

The directors recommend a final dividend of 2.9p per share which, if approved, will be due for payment on 3 June 2004 to holders of ordinary shares on the register at the close of business on 19 March 2004. This, together with the interim dividend of 1.6p per share (restated to reflect the bonus element of the rights issue) will make a total dividend for the year of 4.5p per share.

The preferential dividend at the rate of 3.6875% for the period from 1 October 2003 to 31 March 2004 is to be paid on 1 April 2004 to holders of preference shares on the register at the close of business on 19 March 2004.

Employment policy
The Group's employment policies reflect our belief in achieving competitive advantage in product design and service excellence through the quality, diversity, skills, motivation and commitment of employees at all levels in the organisation.

Business Units worldwide subscribe to an Equal Opportunity and Diversity Policy which involves treating all employees fairly, accepting and valuing differences, communicating clear objectives and operating recruitment, training, pay and incentive programmes free of gender bias and other forms of stereotyping. Particular attention is paid to risk assessment, the health, safety and security of employees and the accommodation of people with impaired vision, hearing or mobility.

The Group is constantly updating its skill development programmes, making increased use of technology to aid delivery, as well as its procedures for identifying and developing exceptionally talented employees and candidates for succession to executive positions in each of its operations.

We recognise the vital role in maintaining the commitment of employees of clear communication and consultation. A wide range of media is used including Intranet, house magazines and regular management meetings and team briefings. The Group attaches considerable importance to fostering a constructive relationship with independent Trade Unions wherever they are recognised, ensuring regular dialogue on business issues and early discussion and consultation on changes affecting the workforce.

An annual employee survey is conducted in most territories in which the Group operates to measure organisational effectiveness and the impact of employment policies. In 2004 the measures will be harmonised to provide a common benchmark and the survey extended to all of the Group's operations worldwide.

The Group actively encourages employees to become involved and to support their local communities, both through the recognition of charitable efforts or fundraising by individual employees or teams and formal partnerships or corporate sponsorships. In 2003 a total of £128,000 was raised for the International Red Cross by Royal & SunAlliance employees worldwide.

Environmental policy
The Corporate Responsibility report on pages 24 and 25 includes details of how to obtain a copy of the Group Statement of Environmental Policy.

Corporate Governance
A report on corporate governance appears on pages 40 to 44.

Supplier payment policy
It is the Group's policy to agree appropriate terms and conditions in advance with its suppliers and to make payment in accordance with those terms and conditions, provided that the supplier has complied with them. In most cases, agreements for the supply of goods or services are made under standard terms of contract that lay down payment terms. In the UK these are available on request from UK Purchasing, Leadenhall Court, 1 Leadenhall Street, London EC3V 1PP.

The Company's outstanding indebtedness to trade creditors on 31 December 2003 amounted to £3.1m corresponding to 10 days' payment when averaged over the year.

Share capital
263,427 ordinary shares of 27.5p each were issued in satisfaction of the exercise of employee share options for a total consideration of £0.18m during the year. 1,439,990,771 ordinary shares of 27.5p each were issued on 16 October 2003 under the terms of the rights issue announced on 4 September 2003, for a net consideration of £960.2m. An authority from the shareholders for the Company to purchase up to 143,994,513 of its own ordinary shares (representing 10% of its issued share capital as at 3 March 2003) remained in force at 31 December 2003.

Substantial share interests
As at 10 March 2004, Brandes Investment Partners LLC, FMR Corp. and Fidelity International Limited (and their direct and indirect subsidiaries) and Legal & General Group plc had declared an interest in ordinary shares of 27.5p each in the Company representing 7.0%, 8.8% and 3.2% respectively of the issued ordinary share capital, in accordance with Part VI of the Companies Act 1985.

Directors
Members of the Board of Directors are listed on pages 26 and 27.

Sir Patrick Gillam retired from the Board on 31 March 2003. Bob Gunn resigned from the Board on 2 April 2003. Andy Haste was appointed to the Board on 2 April 2003. Edward Lea and John Maxwell were appointed to the Board on 10 July 2003. John Baker, Nicholas Barber and Carole St. Mark retired from the Board on 30 September 2003.

At the 2004 Annual General Meeting, Edward Lea and John Maxwell, who became directors on 10 July 2003, being eligible, will offer themselves for reappointment under Article 110. As previously announced, Julian Hance, Stephen Hill and Susan Hooper will be resigning from the Board later in 2004, but before the AGM.

Charitable and political contributions
The Company and its subsidiaries worldwide made charitable donations of £793,000 during the year. The Group did not make any donations to European Union (EU) political organisations, nor to political parties outside the EU during 2003, and it is not the Group's policy to do so.

Directors' Report (continued)

Annual General Meeting
The Annual General Meeting will be held at the Hotel Inter-Continental, One Hamilton Place, Hyde Park Corner, London W1V 0QY on Friday 28 May 2004 at 10.30am.

Enclosed with this report is a letter from the Chairman to shareholders. Attached to the letter is the Notice convening the meeting which will include items of ordinary and special business that are explained in the letter.

Auditors
PricewaterhouseCoopers LLP have confirmed their willingness to continue in office as auditors of the Company and a resolution for their re-appointment will be proposed at the Annual General Meeting.

By order of the directors
J V Miller
Group Company Secretary
London, 10 March 2004

J V Miller

Corporate Governance

Compliance with the provisions of the Combined Code
The Group complied throughout 2003 with the provisions of section 1 of The Combined Code Principles of Good Governance and Code of Best Practice (the Combined Code) other than A.2.1 (appointment of senior independent director).

John Baker, who retired as Deputy Chairman on 30 September 2003, was also the senior independent director. The Board has since entered a period of significant restructuring.

The Board
The Board is responsible for organising and directing the affairs of the Company and the Group in a manner that is in the best interests of both shareholder and regulatory requirements and is consistent with the Memorandum and Articles of Association and corporate governance practices.

The Board is also ultimately responsible to the Financial Services Authority (FSA) for ensuring compliance with the Group's regulatory obligations. Adherence to the FSA solvency regime is monitored at a Group level.

The principal matters reserved to the Board, which follow, include items which are delegated to committees, but ultimately require Board approval:

- approval of the Group's long term objectives and commercial strategy;
- changes to the Group's management and control structure;
- approval of the Group's overall risk appetite;
- annual review of internal control arrangements;
- reviewing corporate governance arrangements;
- approval of the annual operating and capital budgets;
- changes to the Group's capital structure and approval of all significant capital and other expenditure;
- approval of proposals to raise finance from external sources, including the setting of limits on the Group's external borrowings;
- approval of treasury policy;
- approval of the Group's preliminary and quarterly results, including interim and final dividends; and
- approval of any significant changes to accounting practices or policies.

The Company has arranged appropriate insurance cover in respect of legal action against its directors.

The division of responsibilities between John Napier, the Chairman, and Andy Haste, the Group Chief Executive, have been clearly established by way of written job specifications, which have been approved by the Board.

The Articles of Association of the Company require directors to submit themselves for re-election every three years. The Board met 13 times during 2003. Ten Board meetings were scheduled before the start of 2003 and three Board meetings were arranged on an 'ad hoc' basis.

Committees
Details of the chairmen and membership of the Audit & Compliance, Nomination and Remuneration committees are set out in the Audit Committee Report, the Nomination Committee Report and the Remuneration Report respectively. The Board also has a Risk Committee (the BRC), chaired by Andy Haste. The BRC manages all aspects of risk faced by the Group in accordance with the Board approved risk appetite, which is set out in policies, control limits and other mechanisms in relation to such risks. Further details about the BRC can be found in the Risk section of this report.

Independent directors
The Board considers that all of the non-executive directors who have served during the year were independent. At all times during the year, at least half of the Board was comprised of non-executive directors.

Professional development
On appointment, new directors are subject to a full, formal induction programme and receive appropriate training and guidance on their duties and responsibilities. Continuing professional development is offered to established directors; for example, directors attended a course devised by the Group on the FSA's approved persons regime.

Resources
Directors have access to the services and advice of the Group Company Secretary, and may take additional independent professional advice at the Group's expense in furtherance of their

duties. The terms of reference of the Audit & Compliance, Nomination and Remuneration committees have been considered by their members with a view to ensuring that there are available adequate resources to discharge their duties.

Risk management and internal control

The Board has overall responsibility for the Group's systems of risk management and internal control and for reviewing their effectiveness. The systems are designed to manage rather than eliminate risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material financial misstatement or loss.

Executive management has the responsibility for establishing and implementing appropriate systems and controls in their own areas of remit. To ensure that risk management and control is embedded throughout the Group, a central risk management function (Group Risk) has been established.

The Group risk policy defines risk as the possibility that an action, inaction, event or failure will prevent or hinder the Group from achieving its strategic objectives or, ultimately, from maximising shareholder value with full and proper regard for the protection of policyholders and other stakeholders. Recognising this definition, the risk management framework uses the following principles in managing risk:

- culture – the Group fosters a corporate culture, which accepts risk taking as fundamental to its business. However, risk identification, measurement, monitoring and control are indispensable for the continuing strength of the organisation;
- education – the Group promotes risk awareness among all its employees. It is committed to embedding risk management practices in the day to day management of its business through increasing the employees' awareness of risk;
- enterprise – the Group's perspective of risk extends to all activities within the organisation and covers both existing and emerging risks;
- consistent standards – the Group recognises the importance of adhering to consistent high standards of governance and risk management throughout its worldwide operations; and
- risk ownership – the Group recognises that ultimate responsibility for the management of risk lies with the Board, but day to day responsibility for the management of risk rests with the management of each business area. Management have authority and flexibility to act and make decisions in order to manage risk in their area, but they must do so within a strict set of Group policies and standards.

The BRC is formed of members of the Board and executive management. Its purpose is to define the Group's risk appetite, agree policy and minimum standards and provide oversight and challenge of the Group's risk management processes. The BRC achieves these objectives by considering reports from risk specialists both internal and external to the Group, and by reviewing Group level risk management information. The Board, through the Audit & Compliance Committee considers that these reports give it sufficient information upon which to review the effectiveness of the systems of internal control as required by provision D.2.1 of the Combined Code.

Group risk appetite

In order to establish the parameters within which risk must be managed the Group has established a clear statement of 'Group risk appetite'. The current statement sets out macro parameters of management, sets business volumes for certain higher risk insurance classes, stipulates loss retention limits, reinsurance protection, and other appropriate measures.

Governance

The Group has adopted a risk management model known as the 'three lines of defence' governance model. The framework for the oversight and management of risk is as follows:

- Management – the first line of defence, in setting strategy, performance, measurement, establishment and maintenance of internal control and risk management in the business.
- Risk assessment – the second line, formal risk management framework within which the Group policies and minimum standards are set and objective oversight and challenge of risk management across the Group is achieved. This includes the BRC, supported by Group and Regional risk functions.
- Independent assurance – the third line of defence, providing independent and objective assurance of the effectiveness of the Group's systems of internal control established by the first and second lines of defence. This is the Audit & Compliance Committee, supported by internal audit.

Delegated executive authority

In order to implement the above model, individual executives need to have clear levels of authority. To this end the Group Chief Executive has issued a series of licences to all of his direct reports within the business. The purpose of these licences is to communicate authorities delegated from the Group Chief Executive to each Regional chief executive and Corporate Centre direct reports.

Each executive then has the responsibility of documenting formal delegation of these authorities, which define the parameters under which their staff can commit the Group to risk.

Group risk policy statements

Group risk policy statements set out the minimum standards to be maintained by the Group's operations in order to manage their risks.

All the policy statements are approved by the BRC and are mandatory policies that business units must comply with. Breaches which are identified by Regions, or through monitoring activity, must be escalated to the appropriate level, with material breaches being reported to the BRC.

In the 2002 Corporate Governance report we stated that we had produced an overview Group risk policy and that there was considerable further progress scheduled in 2003. There are now a number of policy statements covering business continuity, delegated authority (executive licences), delegated authority (insurance), Group risk, multinational, operational outsourcing, pure fronting, reinsurance, reinsurance credit risk and underwriting and claims.

Accompanying these policies there are a number of detailed documents setting out best practice in key areas of these policies. Further work is scheduled for 2004 to create further policies and to review and update existing ones, as appropriate.

Risk categories

Within the Group the risk elements are viewed under the following headings:

- Insurance (underwriting, claims and reinsurance) risk.
- Operational risk.
- Credit, market and liquidity risk.

Detailed sub classifications are being developed but the following details some of the key current practices, tools and other arrangements for each risk category.

Insurance risk
The Group's general insurance activities are primarily concerned with the pricing, acceptance and management of risks from our customers. In understanding and accepting risk the Group is committing its Balance Sheet to the payment of claims and therefore these risks must be adequately understood and controlled.

The management of the underwriting and claims risks uses a number of key tools, including the licensing of countries to write certain higher risk classes of business, reviewing the performance and management of all the individual insurance portfolios throughout the Group and the investigation of potential emerging insurance risks.

Territorial underwriting licences
This was introduced in 2003 for all 'higher risk' classes of insurance. These classes of business are clearly defined in the underwriting and claims policy statement and are those classes that we consider to require additional expertise and knowledge within the relevant country or region, in order to manage them correctly.

Licences must be applied for annually by each business that plans to write these classes. In deciding whether to issue a licence, the insurance risk team takes into account the Group's appetite to write this class of business, the expertise of the operation(s) concerned to control the associated risks, past results and the future potential for profit. Going forward, capital utilisation will also form an explicit consideration within every application.

The terms of the licence, amongst other conditions, set the maximum gross and net risk acceptance and the maximum gross and net written premium for the class of cover in that territory.

The portfolio review process
This is a mandatory process that was introduced in 2001 requiring in depth reviews of each portfolio to be carried out twice a year. The portfolio review requires each operation, in conjunction with Group Risk to look not only at the past and current results for the given portfolio but also to look at the business plans, the market conditions, audit reports, the relevant experience of the staff and succession plans. Altogether some 225 reviews are generated each cycle. Ultimately a detailed country review is produced by Group Risk, which is sent to the relevant executive officer and overall summary reports are presented to the BRC.

Emerging risks
These are risks that have been identified as potentially affecting the Group but for which the amount of risk has not yet been identified. Existing or potential future risk exposures are investigated in a structured way, using internal and external resources and appropriate proposals for actions to mitigate, contain or remove these risks are made to the BRC.

Reinsurance
Where investigations suggest that a genuine risk exists in a future book of business that is beyond the Group's risk appetite, an underwriting directive is developed in partnership with the businesses and communicated to the senior Regional risk and underwriting directors.

The Group's reinsurance strategy and appetite is set and agreed by the BRC and published and disseminated via the Group reinsurance policy statement.

A central Group reinsurance team manages the purchase of Groupwide reinsurance treaty contracts and additionally all Regional operations have to apply for and obtain authority from the BRC for treaty reinsurance placements.

All treaty purchases are analysed using a number of sophisticated analytical modelling tools to analyse the Group's exposure to risk. These tools allow us to produce financial projections from a number of likely outcomes and not just the expected outcome, providing a much greater understanding of the potential exposures.

Operational risk
Operational risk exists in every facet of an organisation, including those areas that are not viewed as 'operating units'. As such, all areas of the Group and major outsource providers are involved in addressing and controlling operational risk.

The Group is in the process of developing an operational risk management framework, the objective of which is to effectively, systematically and proportionately identify, assess and contain operational risks throughout the Group. There is to be greater emphasis on unusual risks that can threaten the organisation and ordinary risks that, if allowed to escalate, could weaken and similarly threaten the organisation. Specifically, this translates into:

- ensuring that statistically average operational losses ('expected losses') are understood and monitored, remain within tolerance levels, and are properly priced for and/or provisioned. Examples would include common transactional processing errors; and
- ensuring that statistically unusual potential losses ('unexpected losses') are identified, examined, subjected to scenario testing, quantified to the extent possible, and protected against through capital. An example would be the loss of a mainframe platform.

A Groupwide loss database of operational losses greater than £10,000 is under development along with a standardised set of risk indicators and a Groupwide remedial actions tracking system. The risk review visits mentioned earlier are used to challenge business units' reported losses, risk assessments, metrics and remedial action progress.

The Group has introduced a process end software to assess risks from both a 'ground up' and a 'top down' approach, known as business risk appraisal process (BRAP). This is a Groupwide risk assessment process and has three main elements:

- a high level risk assessment, which reviews risks from the 'top down';
- a detailed, 'ground up' risk self assessment, which is completed using the software tool RSA@Risk; and
- an external events and material change assessment, which reviews risks during times of significant change to the organisation, infrastructure and business operating environment.

Credit, market and liquidity risks
The primary sources of credit risk within the Group are reinsurance counterparties' credit risk inherent within insurance contracts, including 'economically triggered contracts' (ETCs), treasury and investment activities and premium debtors.

Over the past year, work has focussed on the further development and implementation of a Group reinsurance credit risk policy, which includes requirements on the use of approved reinsurance counterparties for other than 'de minimis' transactions. Group Risk has also focussed closely on the management of risks arising from ETCs and has instituted controls over these exposures and active monitoring, including reporting to the BRC.

With regard to credit risk and other risks arising from treasury and investment management activities, a range of counterparty limits and other controls are in place to restrict exposure to these risks. The global investment strategy team oversees the execution of the Group's investment strategy, including approval of investment criteria and limits within delegated authority set by the BRC. A life investment strategy team has been formed from the Royal & Sun Alliance Life Holdings Limited board.

Risk review visits
In addition to setting policy and standards Group Risk undertakes an annual cycle of risk review visits to Regional operations, reviewing regional risk management practices. These reviews cover insurance, operational, credit market and liquidity risks.

The reviews are conducted through an on site visit to the country or operation and take two to four days each to complete, depending on the size of the operation.

These visits base themselves on the requirements and obligations of the Group's policy statements and are intended to assess the application of risk management processes by the 'first line of defence'. In addition, they cover the financial performance of the operation, as relevant to risk management.

The main operations of the Group will be reviewed annually, whilst the smaller operations of our International Region will be reviewed once every two years. Primary markets such as the UK, US, Canada and Scandinavia all require separate visits. For the smaller countries such as those in Latin America and Asia, one meeting may be sufficient to cover several countries.

The FSA Prudential Source Book (PSB)
The FSA has produced a number of consultation papers in its build up to the launch of its PSB. In order to ensure compliance with the PSB in time for its implementation in late 2004 we have a specific project looking at both a 'gap analysis' of the requirements and a full capital and risk management transformation programme. This ensures PSB compliance but also ensures that our risk management capabilities are 'fit for purpose' and that we embed economic capital management principles within all levels of the organisation.

Annual General Meeting (AGM)
AGM notices are despatched to shareholders at least 20 working days before the relevant meeting and contain separate resolutions on each issue, including a resolution to receive the Annual Report & Accounts. At AGMs, the Chairman of the Group and the chairmen of the Audit & Compliance, Nomination and Remuneration committees make themselves available to take questions from shareholders.

The Company has put arrangements in place with its registrars to ensure that all proxy votes are received and accurately accounted for. The level of proxies lodged on each resolution, including votes for, against and abstained are published on the Group's website at www.royalsunalliance.com after each AGM.

Directors' responsibilities
The directors are required to ensure that adequate accounting records are maintained so as to disclose at any time, and with reasonable accuracy, the financial position of the Group. They are also responsible for taking reasonable steps to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

They must present financial statements for each financial year which give a true and fair view of the state of affairs of the Company and Group and of the profit or loss for that period. In preparing such financial statements, they are required to:

- select suitable accounting policies and apply them on a consistent basis using reasonable and prudent judgement;
- state whether or not applicable accounting standards have been followed and explain any material departures; and
- use the going concern basis unless it is inappropriate to do so.

Basis of accounts
The directors have satisfied themselves that the Group has adequate resources to continue in operation for the foreseeable future having given consideration to the uncertainties and contingencies disclosed in the financial statements and have therefore prepared the financial statements on a going concern basis.

Report of the Audit & Compliance Committee

Membership
During the year, the following directors served on the Audit & Compliance Committee:

Edward Lea, Chairman (appointed 9 October 2003), Bob Ayling, Stephen Hill, John Maxwell (appointed 9 October 2003), John Baker, Chairman (retired 30 September 2003) and Nicholas Barber (retired 30 September 2003).

All members of the Committee are independent non-executive directors. Both Edward Lea and John Maxwell have recent and relevant financial experience.

Principal duties
The Committee's principal duties are as follows:

- to coordinate and have oversight of the financial reporting process;
- to monitor compliance;
- to have oversight of the internal and external audit functions;
- to manage the Group's systems of internal controls;
- to review the Group's financial performance;
- to review all matters relating to the legal integrity of the Group; and
- to provide assurance on the effectiveness of the Group's risk management arrangements.

In addition, adherence to the FSA solvency regime is monitored at a Group level. In this respect the oversight and challenge of the operational, financial and risk management processes of the Group's regulated entities in the UK is also the responsibility of the Committee.

The terms of reference of the Audit & Compliance Committee, which explain its role and the authority delegated to it by the directors, are available on the Company's website at www.royalsunalliance.com or on request from the Group Company Secretary.

Internal audit
The Group has an internal audit function, whose activities are monitored and reviewed by the Committee. The Committee is responsible for approving the appointment and removal of the Group Chief Auditor, and for ensuring that adequate access to information and resources is given to the holder of that position.

External auditors
The Committee meets regularly with internal and external auditors without management present. The partner of the Group's external auditors who is responsible for the audit attends all meetings. Each year, the Committee considers the performance of the external auditors prior to proposition of a resolution on their re-appointment and remuneration at the AGM.

During the year, PricewaterhouseCoopers LLP were, on a number of occasions, engaged as advisors. Such appointments are only made in accordance with a protocol developed by the Board (available on the Company's website). This gives guidance to businesses within the Group on the appropriateness of engaging external auditors as advisors. The Committee is satisfied that this protocol has been followed and there are no matters that would compromise the independence of the auditors or affect the performance of their statutory duties. PricewaterhouseCoopers LLP have also considered their position and have confirmed their independence to the Company in writing.

The Board has accepted the Committee's recommendation that a resolution be put to the 2004 AGM for the re-appointment of PricewaterhouseCoopers LLP as external auditors.

Whistleblowing
The Company's UK whistleblowing policy was incorporated into a global whistleblowing policy during the year, and it is the Committee's responsibility to keep the procedures laid out in that policy under review. The global whistleblowing policy enables employees who wish to raise serious concerns to do so in good faith within a controlled environment. Employees will be offered such safeguards and support as may be necessary to protect their personal integrity and, where possible, identity.

Report of the Nomination Committee

Membership
During the year, the following directors served on the Committee:

John Napier, Chairman (appointed 5 March 2003), Bob Ayling, Sir Patrick Gillam, Chairman (retired 31 March 2003), John Baker (retired 30 September 2003) and Carole St. Mark (retired 30 September 2003).

All of the non-executive directors on the Committee were determined by the Board to be independent.

Principal duties
The Committee's principal duties are to review the structure, size and composition of the Board and to evaluate the directors' skills, knowledge and experience. It has access to external recruitment consultants and can undertake open advertisement to fill vacancies if this is considered appropriate. The Committee considers the leadership needs and succession planning of the Group when making decisions on new appointments.

Resolutions to re-appoint directors whose retirement by rotation falls due at an AGM are not proposed automatically, but are subject to the approval of the Board, taking into account the recommendations of the Committee.

The terms of reference of the Committee, which explains its role and the authority delegated to it by the directors, are available on the Company's website at www.royalsunalliance.com or on request from the Group Company Secretary.

Executive directors are not permitted to take on more than one non-executive directorship of another FTSE 100 company. None of the executive directors currently holds any directorships of another FTSE 100 company.

By order of the directors
J V Miller
Group Company Secretary
London, 10 March 2004

Remuneration Report

The following report by, and recommendations of, the Remuneration Committee have been approved by the Board, for submission to shareholders. The report also repeats a number of important disclosures made in the 2002 Remuneration Report, in respect of leaving settlements for Julian Hance and Bob Gunn. The 2002 Remuneration Report was approved by shareholders at the last Annual General Meeting. Full details of these arrangements were also included in the rights issue prospectus isssued on 4 September 2003.

Membership
During the year, the following directors served on the Committee:

John Maxwell, Chairman (appointed 9 October 2003), Bob Ayling, Stephen Hill (appointed 9 October 2003), Susan Hooper, John Napier (appointed 5 March 2003), Nicholas Barber, Chairman (retired 30 September 2003), John Baker (retired 30 September 2003), Sir Patrick Gillam (retired 31 March 2003) and Carole St. Mark (retired 30 September 2003).

All of the non-executive directors on the Committee were determined by the Board to be independent.

The Remuneration Committee
The Committee has delegated responsibility from the Board for the determination of the conditions of employment and pay and benefits of each of the executive directors and the Chairman. The Committee also has delegated responsibility from the Board for the exercise of certain powers under the terms of the Group's share option and other cash or share based incentive schemes including the application of relevant performance criteria and the phasing of awards. The Committee also considers and advises the Board on the Group's remuneration policy in relation to senior executives reporting to the Group Chief Executive.

Members of the Committee have no personal financial interest other than as shareholders in the Committee's decisions and they have no conflicts of interest arising from cross directorships.

In its constitution and operation the Committee complies fully with the Combined Code as appended to the Listing Rules of the UK Listing Authority.

Details of the executive directors' individual remuneration are set out on pages 48 and 49 under the heading 'Remuneration (auditable part)' and their share interests on pages 50 and 51 under the heading 'Directors' Interests'.

Advisors
In developing remuneration and reward strategy the Committee actively seeks advice and obtains survey data from various independent consultants. During the year the Committee obtained advice from Watson Wyatt and New Bridge Street Consultants. Watson Wyatt are also the appointed actuaries of one of the Company's UK defined benefit pension schemes. All the remuneration consultants were selected and appointed as advisors by the Committee independently.

The Group Chief Executive is invited to attend all meetings of the Committee, except those when his own contract and remuneration are being discussed, to inform the Committee on matters relating to Company performance and senior executive pay strategy.

Remuneration policy principles
The Committee has as its objective the development of reward policies to support the Group business strategy, align the remuneration of the directors and senior managers with shareholder interests and promote a high performance culture.

The strategy aims to ensure that:

- the Group is able to attract and retain high calibre people by offering competitive total rewards in all of the markets in which it operates;
- a high proportion of the overall package of its senior executives is conditional on the achievement of business and financial objectives which deliver long term shareholder value; and
- the Group operates remuneration policies and plans which are fully transparent to shareholders.

Elements of remuneration
Remuneration for executive directors and other senior executives in 2003 consisted of four principal elements, of which only base salary is pensionable:

- base salary;
- annual performance bonus;
- executive share options; and
- pension provision and other benefits.

Where appropriate the Group encourages directors and senior managers to accept – subject to the approval of the Chairman and the Group Chief Executive – an invitation to join the Board of another company in a non-executive capacity, recognising the value of such wider experience. In these circumstances, managers are permitted to retain the remuneration from the non-executive appointment.

Base salary
The Committee believes that individual remuneration levels should be appropriate to the scale of responsibility and performance of each individual as well as being market competitive. In deciding appropriate levels the Committee's policy is to relate base salaries to the mid market pay levels of companies of similar size and complexity operating in the UK and internationally in insurance and related financial services. Salaries are reviewed annually based on an assessment of personal performance and contribution and taking account of any significant movement in median salaries amongst the comparator group as well as the increase policy for salaries generally within the Group. In 2003 the overall salary increase budget was around 3.5%.

Annual performance bonus
Each of the executive directors and all other direct reports to the Group Chief Executive are entitled to participate in an annual performance bonus plan. If stretching financial and business targets are met, participants are entitled to a bonus of up to 50% of base salary. For outstanding performance an award of up to 100% of salary is achievable. The principal performance measure, accounting for just over half of the bonus, is the Group's combined operating ratio (COR) as reflected in its targeted return on risk based capital (RORBC). The measure was chosen because it reflects most accurately success in managing the major factors in an insurance business including the effective use of capital, underwriting discipline and claims and expense management.

Secondary measures accounting for the balance of the annual bonus include a balanced scorecard of additional financial, customer service, expense control and people related objectives and evidence of appropriate management style and behaviours.

Annual bonuses for senior executives with Regional business responsibility are based 70% on the performance of their Region and 30% on Group results.

Significant progress was made during 2003 in strengthening the Group's capital position and improving underlying performance. Details of the bonuses to be paid to executive directors in respect of 2003 are included in the tables of directors' emoluments on pages 48 and 49.

Long term incentive plans

Executive Share Option Scheme (ESOS scheme)
The Group currently offers a single long term incentive plan to executive directors and other senior executives and managers outside the US, based on the phased award and vesting of executive share options, if specific performance criteria are met.

Under the current ESOS scheme, executive directors and other senior managers participating in the ESOS scheme are entitled to an award of share options, the scale of which is directly related to an assessment by the Chairman and members of the Remuneration Committee of their personal performance and contribution to the successful implementation of the Group's business and financial strategies. Awards of up to one times base salary per year – or more in exceptional cases – can be made, which vest in full if at the end of the third year following the year of grant and if the Group has achieved a net real rate of return on capital (ROC) of at least 6% pa when averaged over the period. One retest is allowed at the end of the fourth year following the year of grant, but if the performance criterion has not been met over the full four year period, the options lapse. This follows a change in the rules approved by shareholders in May 2003, prior to which the test could be repeated on an annual basis over the ten year life of the option.

Options granted between October 1996 and September 1998 were subject to the performance condition that the average total shareholder return (TSR) of the Group must be equal to, or better than, the median of the companies in the FTSE 100 Index, over a consecutive period of three years between the third and tenth anniversary of grant.

No options are granted at an exercise price below market value on the date of grant. The ESOS scheme is funded through a combination of new issue and shares purchased in the market. Dilution levels are held strictly within ABI limits (10% over ten years for all schemes and 5% for executive schemes).

US long term incentive plan
In 2000 shareholders approved an alternative share option scheme for US managers based on established US market practice. Grants of options over American Depositary Shares (ADSs) – equivalent to five ordinary shares in the Group – are made no more than twice a year, and are subject to a higher overall value ceiling than for UK directors and senior managers. Options vest incrementally between the first and seventh anniversary of grant proportionately to the achievement of a ROC by the US operations over a one year period in excess of 6%. All outstanding options vest at the end of seven years.

Following the announcement in September 2003 of the restructuring of the US businesses and the sale of renewal rights on most commercial lines business to the Travelers Corporation, the Committee exercised its discretion under the US long term incentive plan to vary the performance conditions for future grants, so that the plan could be used as part of a retention programme for key employees, to incentivise the achievement of financial, claims control and reinsurance recovery targets appropriate to the changed business objectives of the Group in the US.

Share ownership guidelines
The executive directors and other senior executives participating in the Group long term incentive plans are currently required to build and to retain a minimum shareholding of Royal & Sun Alliance Insurance Group plc shares as the result of the exercise of their executive share options over a period of five years equal in value to at least one times their base salary.

Pension and other benefits
Andy Haste and Julian Hance are members of the SAL Pension Scheme, one of three defined benefit schemes in the UK. In addition, Andy Haste receives an age related taxable monthly allowance to enable him to make his own provision for retirement above the earnings cap. During 2003 he was paid an allowance of 24% of base salary for this purpose.

Julian Hance, who as already announced, will be leaving the Group in 2004, accrues a pension at the rate of 1/60th of base salary per year of service, on a non contributory basis. He is not currently subject to the pensionable earnings cap. From 1 April 2004 the UK defined benefit schemes will become contributory for existing members.

In addition, the executive directors participate in a number of benefits available to other executive and senior managers including life assurance at the rate of four times base salary, permanent health and private medical insurance, and participation in the Royal & Sun Alliance International Sharesave (SAYE) Plan. They also have a choice between a company car and a monthly cash car allowance.

Service contracts
The Committee's policy on executive directors' service contracts is that they should contain a maximum notice period of one year. However, in the event of termination on performance grounds the Committee's policy in all cases would be to seek and apply mitigation, including the phasing of any severance payments.

Andy Haste's service contract commenced on 2 April 2003 and continues until terminated by the Company or by Andy Haste on 12 months' notice. Exceptionally, when Andy Haste was appointed Group Chief Executive, the Committee agreed that, in the event of termination other than on grounds of gross misconduct, he would be entitled, within the first three years following his appointment or within two years of a change in control occurring before the third anniversary of his appointment, to liquidated damages equal to one year's base salary, the average of any annual bonuses paid during the previous two years and one year's pension contributions and other taxable benefits.

Julian Hance's service contract commenced on 1 April 1997 and, had he not given six months' notice, would also have continued and been terminable by the Company on 12 months' notice.

Bob Gunn was employed under a Canadian employment agreement, dated 2 May 1973, that did not provide for notice. Termination provisions were a matter for mutual agreement in the context of Canadian employment law and practice.

Non-executive directors
Until 2003, directors appointed to non-executive roles did not have service agreements. Non-executive directors are not entitled to bonus payments or pension arrangements, nor do they participate in the Group's long term incentive plans.

Under the Group's Articles of Association, the remuneration paid to non-executive directors is determined by the Board, within limits set by shareholders. The fee for 2003 was £35,000 per annum, with an additional fee of £10,000 per annum for chairing the Audit & Compliance or Remuneration committees. With the exception of the Chairman, non-executive directors' fees have remained unchanged for four years.

John Napier's letter of appointment was effective from 9 January 2003 and is for an initial period of three years. It may be terminated earlier by the Chairman on three months' notice to the Company. While he was a non-executive director, his fees were £60,000 per annum pro rata. From 17 March 2003, when he took over as

Chairman, the fee payable to John Napier has been at the rate of £250,000 per annum. This figure was agreed by the Board, having taken advice from the Group's independent remuneration consultants that it was comparable to that paid for similar appointments in international and financial services companies.

Edward Lea and John Maxwell both have letters of appointment which are effective from 10 July 2003, and request one month's notice should they wish to resign.

Historical Total Shareholder Return (TSR) performance

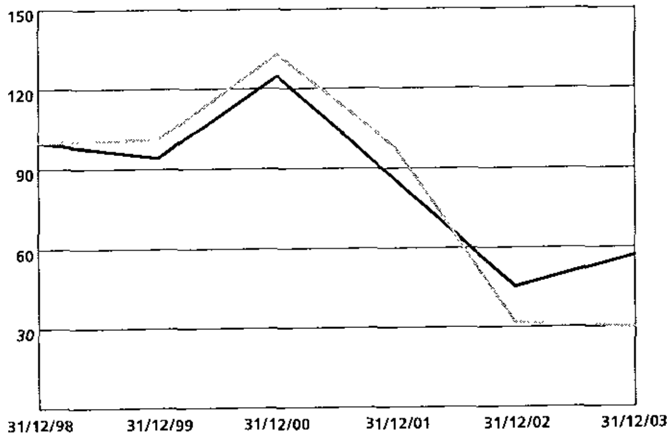
The graphs opposite are included in the report of the Committee as a requirement of Schedule 7A to the Companies Act 1985.

The first graph shows the TSR of the Group by reference to the FTSE World Europe Insurance Index and the second the TSR of the Group by reference to the FTSE 100 Index. The FTSE World Europe Insurance Index comprises the range of European life and general insurance businesses which most closely match our trading competitor peer group.

TSR reflects the change in value of ordinary shares in a company over time, as represented by the evolution of a notional initial investment of £100 in the shares and including any distribution of dividends.

The graphs opposite show the change in value of the Group's shares over the five years from 31 December 1998 relative to the two comparator groups.

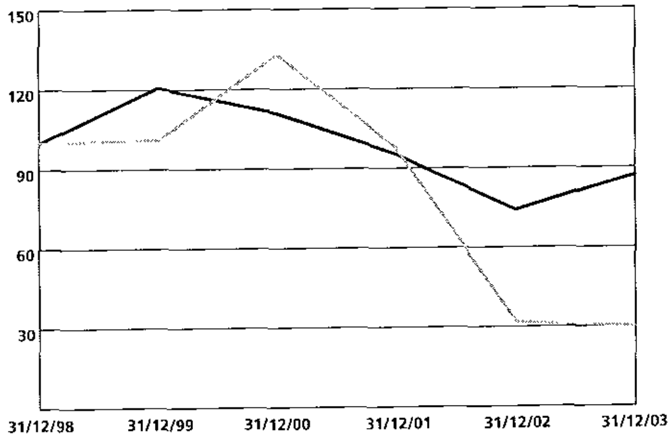
Total Shareholder Return for Royal & SunAlliance and FTSE World Europe Insurance Index



Royal & SunAlliance Index
● FTSE World Europe Insurance Index

For information, the Royal & SunAlliance line as above is also compared with the total FTSE 100 Index.

Total Shareholder Return for Royal & SunAlliance and FTSE 100 Index



Royal & SunAlliance Index
● FTSE 100 Index

Directors' Emoluments

Remuneration (auditable part)
Remuneration for the year ended 31 December, was as follows:

	Base salary and fees £000	Allowances and benefits £000	Bonuses £000	Total 2003 £000	Total 2002 £000
Executive directors (note 1)					
Julian Hance (note 2)	436	29	471	936	538
Andy Haste (appointed 2 April 2003) (note 3, 4)	450	359	570	1,379	–
Non-executive directors *(note 1)*					
Bob Ayling (note 5)	35	30	–	65	35
Stephen Hill	35	–	–	35	35
Susan Hooper	35	–	–	35	35
Edward Lea (appointed 10 July 2003)	19	–	–	19	–
John Maxwell (appointed 10 July 2003)	19	–	–	19	–
John Napier (appointed 9 January 2003)	210	–	–	210	–
Directors who left during 2003 (note 1)					
John Baker (retired 30 September 2003)	53	–	–	53	61
Nicholas Barber (retired 30 September 2003)	34	–	–	34	45
Sir Patrick Gillam (retired 31 March 2003)	44	–	–	44	175
Bob Gunn (retired 2 April 2003) (note 6)	450	154	–	604	995
Carole St. Mark (retired 30 September 2003)	26	–	–	26	35

Notes:

1. Directors who were appointed or who left during the year were paid their base salary or fees pro rata.
2. As reported in the 2002 Remuneration Report, approved by shareholders at the previous Annual General Meeting, under pre existing contractual arrangements a retention and continuity bonus of £250,000 became payable to Julian Hance on 31 December 2003. He also received an annual performance bonus of £220,500 in respect of bonus year 2003. Additionally, he received car benefits worth £25,000, medical benefits worth £500 and accommodation benefits worth £4,000.
3. Andy Haste received an annual performance bonus of £570,000 in respect of bonus year 2003. His allowances include £224,000 as compensation for a bonus lost on leaving his prior employment, and a percentage of basic salary as a retirement allowance, paid monthly. The percentage rate of the retirement allowance increases each year from the month in which he attains the next age. During 2003, the rate of allowance was 24% and the amount paid was £108,000. Benefits do not include any provision for accommodation. Additionally, he also received car benefits worth £26,000 and medical benefits worth £1,000.
4. Andy Haste's salary was for nine months of the year, following his appointment in April 2003.
5. Bob Ayling received an allowance of £30,000 in 2003, which related to his additional work towards the successful IPO of Promina, the Group's former businesses in Australia and New Zealand.
6. In accordance with the pre existing termination arrangements, reported in full in the 2002 Remuneration Report, £150,000 of Bob Gunn's 2003 salary was payable prior to his resignation from the Board on 2 April 2003; the remaining £300,000 related to his employment with the Group until 30 September 2003. As an expatriate director Bob Gunn was provided with accommodation at a Group owned residential facility that was available also to other expatriates or visiting staff members. The value of this benefit was £134,000. He also received car benefits worth £14,000 and medical, life and disability benefits worth £6,000.
7. Directors who left during 2002 received the following emoluments during the year:

   Anthony Forbes (retired 15 May 2002) received £23,000 in fees. Paul Spencer (resigned 31 March 2002) received £922,000 in total emoluments. The transfer value of Paul Spencer's total accrued pension at 31 December 2002 was £1,258,163. Bob Mendelsohn (resigned 11 September 2002) received £2,457,000 in total emoluments. The transfer value of Bob Mendelsohn's pension at 31 December 2002 was £3,851,774.

Pension benefits (auditable part)

Non-executive directors are not entitled to any pension benefits. The pension benefits earned by the executive directors, as members of Group defined benefit schemes, were as follows:

	Change in accrued pension in year £	Total accrued pension at 31 December 2003 or date of retirement £	Transfer value of total accrued pension at 31 December 2003 £	Transfer value of total accrued pension at 31 December 2002 £	Difference in transfer values less member's contributions (note 1) £
Julian Hance (note 3, 6, 12)	15,168	159,252	1,424,700	1,420,656	4,044
Andy Haste (appointed 2 April 2003) (note 3, 7, 8, 11)	1,239	1,239	8,906	–	5,194
Directors who left during 2003					
Bob Gunn (retired 2 April 2003) (note 4, 5, 10)	31,269	486,155	6,629,406	4,636,595	1,531,158

Notes:

1. The difference in transfer values reflects the difference between the two transfer values calculated using relevant information on the respective dates and is not necessarily the actuarial increase of the underlying pension. For Bob Gunn the figures are also impacted by movements in exchange rates.
2. The figures set out in the table above provide information as required by the Directors' Remuneration Report Regulations 2002. The Listing Rules require the change in accrued pension to be shown excluding the effects of inflation and the transfer value of this increase. These figures are shown in the notes below.
3. The accrued pension figures shown are the annual amounts of member's pension payable from normal retirement age. Increases to pensions when in payment are applied in accordance with the relevant scheme rules or on the same discretionary basis as applies to the membership of the relevant scheme as a whole. On the death of the member leaving a surviving spouse and/or children, spouses and/or children's pensions are payable in accordance with scheme rules.
4. Bob Gunn is a member of a Canadian pension scheme whose benefits are denominated in Canadian dollars. The figures shown in sterling have been calculated by taking the appropriate Canadian figure and converting this into sterling at the exchange rate at 31 December 2003 or 31 December 2002 as applicable.
5. For Bob Gunn the increase in his accrued pension during the year, excluding the effects of inflation, was £18,532 pa. The increase in his early retirement pension, excluding the effects of inflation, was £55,942 and the transfer value in respect of this was £762,848 at 31 December 2003.
6. For Julian Hance the increase in his accrued pension during the year, excluding the effects of inflation, was £11,133 pa and the transfer value in respect of this was £99,250 at 31 December 2003.
7. As Andy Haste joined on 2 April 2003, inflation on previously accrued benefits does not arise and the increase in his accrued pension excluding the effects of inflation and the transfer value thereof are the same as stated in the table above.
8. Andy Haste is required to contribute to the scheme. Messrs Gunn and Hance are not required to contribute to the schemes and, with the exception of Bob Gunn, they all have the option of paying additional voluntary contributions (AVCs). Neither the voluntary contribution nor the resulting benefits are included in the table.
9. Transfer values have been calculated in accordance with the guidance note GN11 published by the UK Institute of Actuaries and Faculty of Actuaries.
10. Following the appointment of Andy Haste as Group Chief Executive on 2 April 2003, Bob Gunn stepped down from the Board and retired from the Group on 30 September 2003 at which date, under the rules of the schemes, he would have been entitled to an early retirement pension of £448,097 pa but he was granted a pension of £486,155 pa shown in the table above. Of the transfer value shown in the table £518,969 relates to the additional early retirement pension he was granted over the early retirement pension ordinarily available. Between his retirement date and 31 December 2003, he received pension payments amounting to £81,026, of which £6,343 relates to the additional early retirement pension he was granted. The transfer values shown at 31 December 2003 and the increases in transfer values do not include these payments.
11. The benefits shown above in respect of Andy Haste relate to his membership of a defined benefit pension scheme up to the earnings cap.
12. Julian Hance is due to leave the Company in April 2004. At that time, and based on his current pensionable remuneration, he will be entitled to a pension from his normal retirement age (62) of £161,700 pa which is an increase of £2,448 pa over the total accrued pension at 31 December 2003 shown in the table above. The pension will be revalued between his date of leaving and normal retirement age in accordance with scheme rules. The pension could commence earlier than normal retirement age, and if so, would normally be subject to an actuarial reduction, but as part of his severance terms, he is to be allowed to take the pension from age 50 without the application of any actuarial reduction. The transfer value at his date of leaving, allowing the early retirement from age 50 on an unreduced basis, and using the transfer value basis in force at 31 December 2003, is £3,261,600 and the difference between this and the transfer value at 31 December 2003 is £1,836,900. Of this amount, £1,792,000 relates to the value of being able to take the pension at age 50 on an unreduced basis compared with the value of the pension ordinarily available from normal retirement age.

Directors' Interests

Shareholdings (non auditable part)
The interests of directors in ordinary shares of 27.5p each of the Company, as declared and recorded in accordance with the Companies Act 1985, are as follows:

	Shares held at 1 January 2003 (or on appointment)	Shares held at 31 December 2003 (or on leaving)
Executive directors		
Julian Hance (note 1)	30,227	60,454
Andy Haste (appointed 2 April 2003) (note 1)	25,000	50,578
Non-executive directors		
Bob Ayling	545	1,090
Stephen Hill	–	–
Susan Hooper	–	7,414
Edward Lea (appointed 10 July 2003)	6,550	13,100
John Maxwell (appointed 10 July 2003)	–	138,300
John Napier (appointed 9 January 2003)	–	260,000
Directors who left during 2003		
John Baker (retired 30 September 2003)	4,218	21,083
Nicholas Barber (retired 30 September 2003)	6,667	16,467
Sir Patrick Gillam (retired 31 March 2003)	11,260	11,260
Bob Gunn (retired 2 April 2003) (note 1)	67,735	67,735
Carole St. Mark (retired 30 September 2003)	6,501	6,501

Notes:

1. In addition to the interests shown above, the directors indicated, in common with the employees, had a beneficial interest as at 31 December 2003 in 3,038,894 (2002 697,200) ordinary shares of 27.5p each held in the Royal & SunAlliance ESOP Trust No. 2.
2. On 10 March 2004, the directors' interests remained unchanged.

Options (auditable part)
Movements in option holdings during 2003 were as follows:

		Options held at 1 January 2003 (or on appointment)	Options granted during the year	Options exercised during the year	Options lapsed during the year	Adjustment to options during the year (note 1)	Options held at 31 December 2003 (or on leaving)
Bob Gunn (retired 2 April 2003)	ESOS	385,649	–	–	–	–	385,649
	SAYE	875	–	–	–	–	875
Julian Hance (note 3, 4)	ESOS	419,090	40,000	–	–	109,302	568,392
	SAYE	3,683	–	–	2,808	208	1,083
Andy Haste (appointed 2 April 2003) (note 2, 3, 5)	ESOS	–	3,764,454	–	–	587,162	4,351,616
	SAYE	–	5,917	–	–	–	5,917

Options granted following the AGM in May 2003 are potentially exercisable if, at the end of the third year following the year of grant, the Group has achieved a ROC of at least 6% pa when averaged over the period. One retest is allowed at the end of the fourth year, but if the performance criterion has not been met over the full four year period, the options lapse. Options granted between September 1998 and May 2003 are also subject to a performance condition that the Group must achieve a ROC of at least 6% when averaged over a consecutive three year period, but if the measure is not satisfied at the end of the third business year following the date of grant, the test can be repeated on an annual basis over the ten year life of the option. Options granted between October 1996 and September 1998 were subject to a different performance condition linked to TSR. For options to be eligible for exercise, the Group's TSR has to be at or above the median of companies in the FTSE 100 Index over a consecutive period of three years between the year of grant and the ten year life of the option. The test is conducted twice per year, at the end of March and September, by independent external specialists. Options granted prior to October 1996 were not subject to performance conditions. None of the terms or conditions of any of the existing options over shares of the Group were varied during the year.

Full details of all directors' shareholdings and options to subscribe for shares are recorded in the Group's Register of Directors' Interests which is open to inspection in accordance with the provisions of the Companies Act 1985.

The official closing middle market price at its highest during the year was 159.25p per share (adjusted to 128.63p due to the rights issue) and at its lowest was 56.25p per share (adjusted to 45.43p due to the rights issue); on the last dealing day of the year it was 88.25p per share.

Options (auditable part) (continued)

Options held during 2003 in respect of the ordinary shares of the Company as a result of executive and SAYE share option schemes are as follows:

	Number of options at 31 December 2002	Number of options at 31 December 2003 (or on leaving)	Original exercise price (pence)	Adjusted exercise price (pence) (note 1)	Dates exercisable From	To
Bob Gunn (retired 2 April 2003)	32,158	32,158	311.6	–	01.06.98	02.04.04
	11,415	11,415	438.0	–	17.04.00	02.04.04
	80,482	80,482	497.0	–	15.09.01	02.04.04
	12,390	12,390	550.8	–	31.03.02	02.04.04
	26,643	26,643	505.0	–	15.09.02	02.04.04
	39,000	39,000	345.0	–	27.03.03	02.04.04
	38,076	38,076	458.0	–	12.09.03	02.04.04
	28,350	28,350	505.0	–	12.03.04	12.09.04
	30,929	30,929	482.0	–	14.08.04	14.02.05
	86,206	86,206	290.0	–	11.03.05	11.09.05
	875	875	82.0	–	03.04.03	02.10.03
Julian Hance (note 3, 4)	4,089	5,062	344.0	277.8	14.04.97	13.04.04
	23,507	29,103	343.0	277.0	13.04.98	13.04.05
	14,150	17,519	424.0	342.5	17.10.99	16.10.06
	1,343	1,662	525.7	424.6	10.09.00	09.09.07
	2,808	–	430.0	–	01.11.02	01.05.03
	54,304	67,234	497.0	401.4	15.09.01	14.09.08
	42,291	52,359	550.8	444.9	31.03.02	30.03.09
	49,504	61,291	505.0	407.9	15.09.01	14.09.09
	50,724	62,802	345.0	278.7	27.03.03	26.03.10
	38,209	47,306	458.0	370.0	12.09.03	11.09.10
	34,653	42,904	505.0	407.9	12.03.04	11.03.11
	39,937	49,445	482.0	389.3	14.08.04	13.08.11
	66,379	82,183	290.0	234.2	11.03.05	10.03.12
	875	1,083	82.0	66.0	01.12.05	31.05.06
	–	49,522	141.2	114.1	04.06.06	03.06.13
Andy Haste (appointed 2 April 2003) (note 2, 3, 5)	–	3,052,915	73.0	59.0	02.04.06	01.04.13
	–	1,298,701	–	92.4	16.10.06	15.10.13
	–	5,917	–	75.0	01.12.08	31.05.09

Notes:

1. The Group completed a one for one rights issue during the year, following which adjustments were made to the number of shares under option and to exercise prices in accordance with the rules of the relevant share option schemes. Further details are shown in Share Capital, note 28 to the accounts on page 80.
2. It was agreed that on joining the Company Andy Haste would receive an initial grant of executive share options of three times his base salary, to be followed by a further grant equal to two times his base salary after August 2003.
3. Options granted to directors on 2 April 2003, 4 June 2003 and 16 October 2003 under the ESOS scheme were granted at option prices of 59.0p, 114.1p and 92.4p respectively, which was not less than the average of middle market quotations for the shares of the Group on the five business days prior to the date of grant. The grants in April and June were originally made at 73.0p and 141.2p respectively, being the prices prior to the rights adjustment. All of the above options were granted for nil consideration.
4. On 1 May 2003, Julian Hance allowed 2,808 SAYE to lapse unexercised. The exercise price was 430.0p.
5. On 16 October 2003 and 22 December 2003 SAYE were granted at exercise prices 75.0p and 70.0p respectively.

John Maxwell
Chairman of the Remuneration Committee,
on behalf of the Board
London, 10 March 2004

Independent Auditors' Report to the Members of Royal & Sun Alliance Insurance Group plc

We have audited the financial statements which comprise the Consolidated Profit and Loss Account, the Statement of Total Recognised Gains and Losses, the Movements in Shareholders' Funds, the Consolidated Balance Sheet, the Parent Company Balance Sheet, the Consolidated Shareholders' Cash Flow Statement and the related notes including the Accounting Policies, Estimation Techniques, Uncertainties and Contingencies, Segmental Information, the statements of the Principal Subsidiary Companies and the Principal Associated Undertakings and Other Significant Shareholdings which have been prepared in accordance with the Accounting Policies. We have also audited the disclosures required by Part 3 of Schedule 7A to the Companies Act 1985 contained in the Remuneration Report (the auditable part).

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the Remuneration Report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements and the auditable part of the Remuneration Report in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the auditable part of the Remuneration Report are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and 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. The other information comprises only the Financial Highlights, the Chairman's Statement, the Industry Overview, the Chief Executive's Review, the Board of Directors, the Group Finance Director's Report, the Sensitivity Analysis and the Share and Shareholder Analysis, the Directors' Report, the Corporate Governance Statement, the unaudited part of the Remuneration Report and the Five Year Financial Review.

We review whether the Corporate Governance statement reflects the Company's compliance with the seven provisions of the Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or to form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

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 and the auditable part of the Remuneration Report. 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 and the auditable part of the Remuneration Report 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.

Equalisation reserves

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 2003, and the effect of the movement in those reserves during the year on the General Business Technical Account and loss on ordinary activities before tax, are disclosed in note 9.

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 2003 and of the loss and cash flows of the Group for the year then ended; the financial statements have been properly prepared in accordance with the Companies Act 1985; and those parts of the Remuneration Report required by Part 3 of Schedule 7A to the Companies Act 1985 have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Southwark Towers, London, 10 March 2004

Accounting Policies

Financial statements
The financial statements are prepared in accordance with applicable UK accounting standards and the Statement of Recommended Practice (SORP) issued by the Association of British Insurers in December 1998. As noted in the investment accounting policy the true and fair override has been adopted in respect of the valuation of the Group's investment properties and no depreciation is provided.

Changes in accounting policy
During the year the directors considered the accounting policy on the recognition of the value of long term insurance business. The revised SORP was issued by the Association of British Insurers in November 2003 for application by insurance companies to financial statements for accounting periods beginning on or after 1 January 2004. The revised SORP recommends that the internally generated value of long term insurance business should not be recognised. The existing version of the SORP makes no recommendation on the recognition of the internally generated value of long term insurance business.

During 2003 the International Accounting Standards Board issued an exposure draft, ED5 – Insurance Contracts. ED5 proposed that the continuation of an existing accounting policy that recognises the internally generated value of long term insurance business should be permitted but placed constraints on adopting a new accounting policy that recognises such value.

The directors reviewed the Group's existing policy in the light of the requirement to change the accounting policy in 2004 and the likelihood that the new policy will continue on adoption of International Financial Reporting Standards (IFRS) in 2005. The directors concluded that it would be appropriate to make the change in the 2003 financial statements and to derecognise the internally generated value of long term insurance business. The financial impact of this accounting policy change is described in note 1 and the comparatives have been restated.

Group accounts
The consolidated accounts of the Group include the results of all subsidiaries drawn up to 31 December.

The Consolidated Profit and Loss Account and Consolidated Balance Sheet are drawn up in accordance with the provisions of section 255A of, and schedule 9A to, the Companies Act 1985. The Parent Company Balance Sheet is drawn up in compliance with the provisions of section 226 of, and schedule 4 to, the Companies Act 1985. As permitted by section 230 of the Companies Act 1985, the Parent Company Profit and Loss Account has not been included in these financial statements.

Subsidiaries acquired during the year are consolidated from the effective date of acquisition.

The Consolidated Shareholders' Cash Flow Statement has been drawn up in accordance with Financial Reporting Standard 1 (Revised) which requires the Cash Flow Statement to exclude the cash flows of the long term policyholders' funds.

Principal associated undertakings are accounted for by the equity method in the consolidated financial statements. The figures included for interests in principal associated undertakings are for the accounting periods indicated in the list of Principal Associated Undertakings and Other Significant Shareholdings.

Translation of foreign currencies
Assets and liabilities including dated loan capital and results of both businesses and associates denominated in foreign currencies are translated into sterling at rates ruling at the year end and the resulting differences are taken to reserves or in the case of long term business are included within the Long Term Business Technical Account. Transactions denominated in foreign currencies are translated at the prevailing rate at the date of the transaction and the resulting exchange differences are included within the Profit and Loss Account.

Derivatives
Interest rate and currency swaps in relation to the Group's dated loan capital are treated as hedges. The underlying hedged dated loan capital is carried at cost and accordingly the swaps have not been marked to market. The interest payable or receivable on interest rate swaps is included in interest paid. Other derivatives are included within the category to which the contract relates and are valued at market value.

General Business Technical Account
General business is accounted for on an annual basis. Premiums written are accounted for in the year in which the contract is entered into and include estimates where the amounts are not determined at the balance sheet date. Premiums written exclude taxes and duties levied on premiums. An allocation of the investment return has been made to the General Business Technical Account from the Non-Technical Account on the longer term rate of return basis. The commission and other acquisition costs incurred in writing the business are deferred and amortised over the period in which the related premiums are earned.

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

The balance on the General Business Technical Account is arrived at after taking account of changes in the equalisation provisions.

Long Term Business Technical Account
Premiums and annuity considerations are accounted for when due except premiums in respect of linked business which are accounted for when the policy liabilities are created. Single premiums are those relating to products issued by the Group where there is a contractual obligation for the payment of only one premium. Annual premiums are those where there is a contractual obligation for the payment of premium on a regular basis. Claims arising on maturity are recognised when the claim becomes due for payment. Death claims are accounted for on notification. Surrenders are accounted for at the earlier of the payment date or the date at which the policy ceases to be included in the long term business provision or the technical provisions for linked liabilities.

Acquisition costs comprise direct and indirect costs of obtaining and processing new business. These costs are deferred as an explicit deferred acquisition cost asset, gross of tax relief and amortised over the period in which they are expected to be recovered out of margins in matching revenues from related policies. At the end of each accounting period, deferred acquisition costs are reviewed for recoverability by category, against future margins from the related policies in force at the balance sheet date.

The profits on long term insurance business represent the transfer from the long term funds to shareholders following the actuarial valuation of liabilities, investment income arising on shareholders' funds attributable to the long term business based on the longer term investment return, and the movements in certain reserves attributable to shareholders held within the long term funds. Profits are shown in the Non-Technical Account grossed up for tax at the effective rate of corporation tax applicable in the period. For business transacted overseas, results have been included in accordance with local generally accepted accounting principles where they are consistent with UK practice.

New business premiums are recognised when the policy liability is established. New single premiums include recurrent single premium contracts including DSS rebates and increments under group pension schemes. Where products are substituted by the policyholder or pension contracts are vested, these transactions are reflected as new business only to the extent that they give rise to incremental premiums.

Reversionary bonuses are recognised when declared; terminal bonuses are recognised when payable.

Shareholders' accrued interest for long term business represents the excess of accumulated profit recognised under the modified statutory basis of reporting over the statutory transfers made from the long term funds to shareholders. The amount of profit recognised as shareholders' accrued interest is credited to the Profit and Loss Account within capital and reserves.

Investment return

Income from investments is included in the Profit and Loss Account on an accruals basis. Dividend income on ordinary shares is recognised when the related investment goes 'ex dividend'. Realised and unrealised gains and losses on investments attributable to long term business are dealt with in the Long Term Business Technical Account. Realised and unrealised gains and losses on other investments, including the Group's share of realised and unrealised gains and losses of associated undertakings, are dealt with in the Non-Technical Account. Realised gains and losses on investment disposals represent the difference between net sale proceeds and cost of acquisition. Unrealised gains and losses on investments represent the difference between the carrying value at the year end and the carrying value at the previous year end or, in the case of investments purchased in the year, the cost of acquisition.

Group operating result and profit (based on longer term investment return) are presented including investment return on the longer term rate of return basis. The longer term rate of return basis reflects both historical experience and the directors' current expectations for investment returns. The rates of longer term return are set with the objective of ensuring that, in aggregate over time, the return recognised in operating profit (based on longer term investment return) does not exceed or fall below the actual returns achieved. Short term investment fluctuations represent the difference between the actual investment return in the year and that determined on the longer term rate of return basis.

Group operating result and profit (based on longer term investment return)

Group operating result (based on longer term investment return) is analysed between general business, long term business and other activities as an additional disclosure. Group operating result (based on longer term investment return) excludes interest on dated loan capital, short term investment fluctuations, the change in the equalisation provisions, amortisation and impairment of goodwill and of goodwill in acquired claims provisions and other items including reorganisation costs. Group operating profit (based on longer term investment return) excludes short term investment fluctuations.

Taxation

Taxation in the Non-Technical Account and Long Term Business Technical Account is based on profits and income for the year as determined in accordance with the relevant tax legislation, together with adjustments to provisions for prior years. UK tax in respect of overseas subsidiaries and principal associated undertakings is based on dividends received. Taxation in the Non-Technical Account includes the tax by which the balance on the Long Term Business Technical Account has been grossed up.

Deferred tax is provided in full and consists of the estimated taxation or relief from taxation which is expected to arise from material timing differences using rates based on tax rates and laws that have been substantively enacted by the balance sheet date. Provision is made for taxation which might arise on the distribution of profits retained by overseas subsidiaries or associated undertakings only to the extent that dividends have been accrued as receivable. Credit is taken for relief for trading and other losses only to the extent that the directors anticipate that suitable profits will absorb such losses in future periods.

Deferred tax balances that derive from undiscounted cash flows and for which the impact of discounting is material have been discounted using appropriate rates.

Goodwill

Goodwill, being the difference between the cost of an acquisition and the fair value of the net tangible assets acquired, arising on the acquisition of subsidiary companies and associated undertakings, is capitalised in the balance sheet and amortised to the Profit and Loss Account on a straight line basis. The cost of acquisition is the amount of cash paid and the fair value of other purchase consideration given together with associated expenses. The period of amortisation, which does not exceed 20 years, is determined by an assessment of the useful economic life of the goodwill, this being the period over which the value of the businesses acquired are expected to exceed the value of their underlying assets. Goodwill arising prior to 31 December 1997 has been eliminated against reserves in accordance with the Group accounting policy at the date of acquisition.

In the event of the disposal of a business acquired prior to this date, the related goodwill is charged to the Profit and Loss Account in the year of sale.

Goodwill is reviewed for impairment at the end of the first full year following an acquisition and when events or changes in circumstances indicate that the carrying amount may not be recoverable.

The present value of the shareholders' interest in the acquired value of in force long term business is included as part of the fair value of the acquired net tangible assets in the goodwill calculation and is dealt with as described below.

The fair value of general business claims provisions relating to businesses acquired is established after making allowance for future investment income. The discount, being the difference between the fair value and the undiscounted value at which they are accounted for on consolidation, is capitalised as goodwill in acquired claims provisions and amortised to the Profit and Loss Account over the expected run off period of the related claims.

Investments

Investments and assets held to cover linked liabilities are shown at market value, for which purpose unlisted investments, mortgages and loans are included at directors' valuation and properties at professional valuation. For listed securities the stock exchange values are used except that fixed income securities held for long term business in certain overseas operations are included on an amortised cost basis. Properties are valued annually at open market value.

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

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

Investments in subsidiaries are included in the Parent Company Balance Sheet at net asset value and unrealised gains and losses are dealt with in the revaluation reserve.

Acquired value of long term business
This represents the value of the shareholders' investment in the long term business not already recognised under the modified statutory principles of profit recognition at the date of acquisition less amounts charged to the Profit and Loss Account.

The present value of in force long term business existing at acquisition is amortised in the Long Term Business Technical Account on a systematic basis over the anticipated periods of the related contracts in the portfolios as the profit on these acquired contracts is recognised.

Tangible assets and depreciation
Tangible assets, other than land and buildings in the Parent Company Balance Sheet, comprise fixtures, fittings and equipment (including computers and motor vehicles) which are stated at cost and depreciated over periods not exceeding their estimated useful lives (between three and ten years) after taking into account residual value.

Own shares
The shares held by the Royal & SunAlliance ESOP Trusts are recognised as assets under the heading 'Own shares' at original cost, less provision for diminution in value, in the Consolidated Balance Sheet until such time as the shares vest unconditionally with the relevant executive director or employee. Any profit that may arise in the Trusts upon exercise of the options will be recognised at the exercise date.

Fund for future appropriations
Certain long term funds comprise either participating, or both participating and non participating long term business contracts, where policyholders have a contingent interest in the excess of assets over liabilities in the fund. Accordingly the excess of assets over liabilities within these funds is not allocated between policyholders and shareholders and is taken to the fund for future appropriations.

Dated loan capital
Dated loan capital comprises subordinated bonds and loans. Subordinated bonds and loans are stated at the fair value of consideration received after deduction of unamortised issue costs and discount. Issue costs together with discount allowed on issue of bonds and loans are amortised to investment expenses and charges within the Non-Technical Account on an annual basis over the term of the bonds and loans.

Dated loan capital is presented as a component of the Group's capital base as it is in the nature of long term capital financing. As such, the cost of such capital is treated as a financing item and is not deducted in arriving at Group operating result (based on longer term investment return).

Technical provisions
The provision for unearned premiums in respect of general business represents the proportion of premiums written relating to periods of insurance subsequent to the balance sheet date, calculated principally on a daily pro rata basis.

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

General business provisions for claims outstanding, and related reinsurance recoveries, are discounted where there is a particularly long period from incident to claims settlement and where there exists a suitable claims payment pattern from which to calculate the discount. In defining those claims with a long period from incident to claims settlement, those categories of claims where the average period of settlement is six years or more from the balance sheet date, has been used as a guide.

Claims provisions relating to long term permanent disability claims in the US, Canada and Scandinavia are determined using recognised actuarial methods.

Differences between the estimated cost and subsequent settlement of claims are dealt with in the appropriate technical account for the year in which they are settled or re estimated.

Provision is made, based on information available at the balance sheet date, for any estimated future underwriting losses relating to unexpired risks after taking into account future investment income on relevant technical provisions. The unexpired risk provision is assessed in aggregate for business classes which, in the opinion of the directors, are managed together.

The long term business provision is derived from actuarial valuation. For with profits business, the calculation includes explicit allowance for vested bonuses (including those vesting following valuation at the balance sheet date). No explicit provision is made for future reversionary or terminal bonuses except on certain accumulating with profits contracts.

Equalisation provisions are established in accordance with the requirements of legislation in certain countries and are in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the balance sheet date.

The technical provisions for linked liabilities are the repurchase value of units allocated to in force policies including any liability in respect of deferred tax at the balance sheet date, where the policy benefits are wholly or partly related to investments of any description or to indices of the value of investments.

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

Pension costs
The Group operates a number of defined benefit pension schemes for its employees. The cost of providing these pension benefits is accounted for over the employees' working lives on a systematic basis as advised by qualified actuaries. The effects of variations from regular cost are spread over the expected remaining service lives of members of the schemes. Contributions to defined contribution pension plans are charged as they become payable.

Estimation Techniques, Uncertainties and Contingencies

Introduction

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

The uncertainty inherent in insurance is inevitably reflected in the financial statements of insurance companies. The uncertainty in the financial statements principally arises in respect of the technical provisions of the company.

The technical provisions include the provision for unearned premiums and unexpired risks, the provision for outstanding claims and the long term business provision. The provisions for unearned premiums and unexpired risks represent the amount of income set aside by the company to cover the cost of claims that may arise during the unexpired period of risk of insurance policies in force at the balance sheet date. The provision for outstanding claims represents the company's estimate of the cost of settlement of claims that have occurred by the balance sheet date but have not yet been finally settled. The long term business provision covers similar liabilities to the above in respect of long term business.

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

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

Estimation techniques

In general business, claims and unexpired risks provisions are determined based upon previous claims experience, knowledge of events and the terms and conditions of the relevant policies and on interpretation of circumstances. Particularly relevant is experience with similar cases and historical claims payment trends. The approach also includes the consideration of the development of loss payment trends, the levels of unpaid claims, judicial decisions and economic conditions.

The Group employs a variety of statistical techniques and a number of different bases to determine these provisions. These include methods based upon the following:

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

In addition, the Group uses other methods such as the Bornhuetter-Ferguson method, which combines features of the above methods. The Group also uses bespoke methods for specialist classes of business.

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

Where possible the Group adopts multiple techniques to estimate the required level of provisions. This assists in giving greater understanding of the trends inherent in the data being projected. The projections given by the various methodologies also assist in setting the range of possible outcomes. The most appropriate estimation technique is selected taking into account the characteristics of the business class and the extent of the development of each accident year.

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

The general business claims provisions are subject to annual independent review by external advisors. In addition, for major classes where the risks and uncertainties inherent in the provisions are greatest, regular and ad hoc detailed reviews are undertaken by advisors who are able to draw upon their specialist expertise and a broader knowledge of current industry trends in claims development. As an example, the Group's exposure to asbestos and environmental pollution is examined at least triennially on this basis. The results of these reviews are considered when establishing the appropriate levels of provisions for outstanding claims and unexpired periods of risk.

It should be emphasised that the estimation techniques for the determination of general insurance business liabilities involve obtaining corroborative evidence from as wide a range of sources as possible and combining these to form the overall estimate. This technique means that the estimate is inevitably deterministic rather than stochastic. A stochastic valuation approach, whereby a range of possible outcomes is estimated and probabilities assigned thereto, is only possible in a limited number of situations.

Long term business technical provisions are computed using statistical or mathematical methods, which are expected to give approximately the same results as if an individual liability was calculated for each long term contract. The computations are made by suitably qualified personnel (who are usually employed by the Group) on the basis of recognised actuarial methods, with due regard to the actuarial principles laid down in European law and by actuarial best practice in the individual territory. The methodology takes into account the risks and uncertainties of the particular classes of long term business written and the results are certified by the professionals undertaking the valuations.

The value of long term business includes the shareholders' share of the net of tax future cash flows arising from the in force long term business policies and has been calculated in accordance with industry practice. This has been calculated using a projection technique that is sensitive to the assumed investment returns and discount rate. The principal assumptions for the UK long term business are set out in note 45.

The pension asset and pension and post retirement liabilities calculated in accordance with Financial Reporting Standard 17 (FRS17) are disclosed in note 7. These assets, liabilities, and profit and loss account charge, calculated in accordance with FRS17, are sensitive to the assumptions set out in that note.

The longer term investment return is determined with the objective of ensuring that, in aggregate over time, the return recognised in operating profit does not exceed or fall below the actual returns achieved, as set out in the accounting policies. The pre tax returns are applied to an estimation of the value of investments after adjustment to reduce the effect of short term fluctuations. The principal assumptions are disclosed in note 12.

Uncertainties and contingencies

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

- uncertainty as to whether an event has occurred which would give rise to a policyholder suffering an insured loss;
- uncertainty as to the amount of insured loss suffered by a policyholder as a result of the event occurring;
- uncertainty over the timing of a settlement to a policyholder for a loss suffered.

The degree of uncertainty will vary by policy class according to the characteristics of the insured risks. For certain classes of policy (eg term assurance) the value of the settlement of a claim may be specified under the policy terms while for other classes (eg motor insurance) the cost of a claim will be determined by an actual loss suffered by the policyholder.

There may be significant reporting lags between the occurrence of the insured event and the time it is actually reported to the Group. Following the identification and notification of an insured loss, there may still be uncertainty as to the magnitude and timing of the settlement of the claim. There are many factors that will determine the level of uncertainty such as inflation, judicial trends, legislative changes and claims handling procedures.

The establishment of technical provisions is an inherently uncertain process and, as a consequence of this uncertainty, the eventual cost of settlement of outstanding claims and unexpired risks can vary substantially from the initial estimates. The Group seeks to provide appropriate levels of claims provision and provision for unexpired risks taking the known facts and experience into account. However, by their nature the quantification of the provisions must remain very uncertain.

Contingent liability

As announced with the six months results, the Group commissioned an independent review of its general business claims provisions from Tillinghast, the consulting actuaries, during the year. This review confirmed that the existing Group claims provisions were in a reasonable range, however, the Tillinghast estimate was some £800m higher. Following the review, more work was undertaken by internal and external actuaries in validating the claims position. This work continued through the nine months up to these financial statements.

At 31 December 2003, the Group has increased its general business claims provisions as a result of this work. In addition, a contingent liability of £200m has been identified in respect of potential adverse claims development. This reflects the inherent uncertainty in determining some aspects of general business claims provisions, in particular very long tail business and claims dependent on court judgements.

Asbestos and environmental claims

The estimation of the provisions for the ultimate cost of claims for asbestos and environmental pollution is subject to a range of uncertainties that is generally greater than those encountered for other classes of business. A significant issue is the long delay in reporting losses, since the onset of illness and disability arising from exposure to harmful conditions may only become apparent many years later. For example, cases of mesothelioma can have a latent period of up to 40 years. There may also be complex technical issues that give rise to delays in notification arising from unresolved legal issues on policy coverage and the identity of the insureds. As a consequence, traditional techniques for estimating claims provisions cannot wholly be relied upon and the Group employs specialised techniques to determine provisions using the extensive knowledge of both internal asbestos and environmental pollution experts and external legal and professional advisors.

Financial enhancement products

In the UK, US and Korea the Group has exposures to financial enhancement products which provide surety to banks, lending institutions and credit facilities that insure principal and interest repayment on debt securities. The Group no longer writes such business; however, the nature of such contracts is normally that the Group is on risk for more than one year and therefore liabilities remain for an extended period. During 2002 a reinsurance arrangement was entered into, for which a premium of £124m was ceded, which has reduced the Group's exposure in relation to these products in the UK. Further information on financial enhancement products in the US is discussed below.

US financial enhancement products

Within the financial enhancement portfolio of Financial Structures Limited, a subsidiary of the US Group, are a variety of credit default product exposures including collateralised debt obligations (CDO), credit enhancement and residual value insurance contracts for which the majority of premium has not been earned and losses are provided on an arising basis. These products are no longer written. Losses during 2003 amounted to £50m. Claims provisions of £69m, after payments of £13m in 2003, have been established at 31 December 2003 in addition to £58m of unearned premium provision on these products. The ultimate loss estimate over the life of the CDO products is £165m based on a model, which utilises S&P's historical average default patterns and recovery values. However, the ultimate losses from this business will depend upon the performance of underlying debt obligations.

Litigation, mediation and arbitration

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

Reinsurance

The Group is exposed to disputes on, and defects in, contract wordings and the possibility of default by its reinsurers, including from the credit risk taken in fronting arrangements. The Group monitors the financial strength of its reinsurers, including those to whom risks are no longer ceded. Allowance is made in the financial position for non recoverability due to reinsurer default by requiring operations to provide, in line with Group standards, having regard to companies on the Group's 'Watch List'. The 'Watch List' is the list of companies whom the directors believe will not be able to pay amounts due to the Group in full.

Potential misselling of life products

The Group and its UK insurance subsidiaries continue to be in discussion with the Financial Services Authority (FSA) in relation to the sale and accounting treatment of regulated life products. These products include the sale of mortgage backed endowments, the treatment of life guaranteed annuity options and the potential effect on holders of policies not subject to such options. These discussions have not been concluded and could result in significant financial consequences for the Group including the provision of further financial support for subsidiaries, changes in the calculation of policyholder liabilities and the possible imposition of penalties by the FSA. In March 2003 the FSA levied a fine of £950,000 on the Group in respect of mortgage endowment sales practices. Based on the information currently available, the directors consider they have made appropriate provisions for such costs and they do not believe that any further costs will have a material adverse effect on the Group's financial position.

Rating agencies
The ability of the Group to write certain types of general insurance business is dependent on the maintenance of the appropriate credit ratings from the rating agencies. The Group has the objective of maintaining single 'A' ratings from Standard & Poor's (S&P) and from AM Best. At the present time the ratings are 'A-' from S&P and 'A-' from AM Best. The actions announced by the Group during 2002 and 2003 are intended to improve its capital position and regain the target ratings. Any worsening in the ratings would have an adverse impact on the ability of the Group to write certain types of general insurance business.

Regulatory environment
The regulatory environment is subject to significant change over the next few years, in particular in respect of solvency requirements. This is in part attributable to the implementation of EU Directives but is also the natural response of the regulators to the challenging market conditions that have prevailed over the last few years. The Group continues to have discussions with the FSA on the regulatory capital position of its UK insurance subsidiaries, the progress of the actions announced on 7 November 2002 and 4 September 2003 to improve that position, the implementation of the EU Financial Conglomerates Directive and its interrelationship with the overall capital of the Group. In December 2003 the FSA granted a waiver in respect of the claims discounting provisions within Solvency 1. All waivers are for a limited period. The directors currently expect to apply for a renewal when the waiver expires. There is however a risk that the waiver may not be renewed in which event other options would need to be considered to ameliorate the adverse solvency impact.

The changes that can be expected in the solvency requirements in the UK are generally anticipated to arise in 2004 through 2006, although it is possible that the FSA will bring forward some developments. Inevitably, until the requirements are specified, there will be uncertainty as to the implications for Group solvency and the impact of such developments could materially increase our solvency requirements. The directors believe that, following the actions announced, including the rights issue, the Group are better positioned to comply with these potential regulatory developments. However, there remain considerable uncertainties regarding these developments and potential outcomes.

UK Life
The regulatory solvency of the UK Life funds is sensitive to change in investment and other conditions. The reduction in equity exposures of the funds and other actions taken over the last two years to mitigate our risks in these funds, together with the introduction of the new regulatory solvency requirements, have reduced the volatility of capital requirements to investment market fluctuations. However, the Life funds remain exposed to fluctuations in equity values, interest rates and property values and to adverse movements in euro/sterling rates.

In 2003 we commissioned an external review of the capital requirements of the main UK with profits Life funds. Taking into account the conclusions of the review, the directors believe that, although the funds retain some exposures to these fluctuations and to certain insurance and operational risks, the funds' existing capital, together with an amount of up to £200m under the contingent loan arrangements discussed below, should be sufficient to meet the funds' solvency requirements in a range of adverse scenarios relating to these matters.

The funds are also exposed to regulatory uncertainty that could increase the capital requirements significantly above this level, dependent on the outcome of discussions with the FSA in relation to the management of the Group's with profit business, in particular relating to potential non Guaranteed Annuity Rate (GAR) misselling and the target percentage of asset shares in the calculation of bonuses. The directors estimate that this additional capital requirement could be up to £300m, in the event that an adverse conclusion by the FSA is coincidental with a combination of a number of other factors having an adverse impact on the funds.

The aggregate amount of £500m of potential requirement includes the buffers and margins currently notified to us as being required by the FSA.

Based on the foregoing a Group company has agreed, in certain circumstances, to make loans of up to £650m to the Life funds in order to support their solvency position, should the need arise. £320m of this facility has been drawn at 31 December 2003. The companies are required to maintain capital sufficient to meet the higher of the statutory solvency or estimated realistic position introduced by the FSA early in 2003. On this basis, £146m (31 December 2002 £25m) was required by the Life funds to meet their requirements. The loans are expected to be repaid.

During the year the Group received permission to adopt, for two of its with profits Life funds, Tiner waivers which resulted in a decreased capital requirement under statutory solvency reserving. This approach improves the capital position of these funds and has enabled Sun *Alliance and London Assurance Company Limited to terminate* its reinsurance, which was previously providing solvency relief.

The FSA proposes to apply to life insurers a framework for individual capital adequacy standards, which will entail the individual self assessment by firms of their capital needs and the giving of individual capital guidance by the FSA. Individual capital guidance will apply to with profits and non profit business and may result in guidance that a life insurer should hold more capital than either the 'realistic' requirement or the minimum requirement calculated pursuant to the EU Life Directive, which are prescribed by the rules. The FSA currently proposes to implement the new rules in the second half of 2004.

UK Life capital requirements are dependent on the outcome of the FSA discussions and the implementation of the capital adequacy standards.

US regulatory capital
The consolidated US regulatory capital and surplus position as at 31 December 2003 is $1,433m. Declines in regulatory capital could trigger action by the insurance regulators. There can be no certainty as to whether, in the light of the other uncertainties affecting the US based operations, or for other reasons, the regulatory position may deteriorate and, if this occurs, what action the US regulators might take.

World Trade Center
The estimated cost of the insurance losses associated with the terrorist action of 11 September 2001 is a gross loss in excess of £1bn, reduced to £279m net of reinsurance. This was an unprecedented event, which still has many unresolved issues in respect of both the gross loss and consequent extent of the reinsurance recoveries. The loss estimate has been prepared on the basis of the information currently available as to the magnitude of the claims, including business interruption losses. Most major exposures have now been reserved at policy limits. The estimate of quantum continues to be based on the assumption that the industry position,

that the destruction of the World Trade Center towers represents one occurrence rather than two, is correct. However, this is subject to litigation in the US and, as a consequence, there is uncertainty as to the eventual decision. The final cost may be different from the current estimate due to the uncertainties outlined above and it is not possible to reliably estimate the quantum. Nevertheless, the directors believe their estimate of the gross and net loss is appropriate based on the information available to them and that there will be no material adverse effect on the Group's financial position.

Student Finance Corporation

In early 2002, issues arose in connection with a series of credit risk insurance policies covering loans made to students in various post secondary trade schools, primarily truck driving schools. At 31 December 2003, the loan portfolio had a face value of approximately $501m. In June and July 2002, Royal Indemnity Company, a US subsidiary, filed lawsuits in Texas state court, seeking among other things rescission of these policies in response to a systematic pattern of fraud, misrepresentation and cover up by various parties, which among other things concealed default rate of the loans. As Royal Indemnity's lawsuits seek rescission of these policies, all the Group's financial accounting entries associated with the transactions have been reversed. The ultimate outcome of the suit is uncertain.

The foregoing rescission actions gave rise to other related lawsuits filed in Delaware by MBIA Insurance Corporation (MBIA) and various banks, seeking to enforce the Royal Indemnity credit risk insurance policies. Plaintiffs in the Delaware actions were Wells Fargo Bank Minnesota, NA (Wells Fargo), in its capacity as trustee of a number of securitisations that were collateralised by student loans, MBIA which insured the obligations issued through these securitisations and PNC Bank and Wilmington Trust, both of which provided interim financing prior to securitisation. These actions are all pending in US district court, District of Delaware. Plaintiffs in the Delaware actions moved for summary judgement. On 30 September 2003, the court granted summary judgement to MBIA and Wells Fargo. The court then entered a Judgement on 10 October 2003 which was superseded by a corrected judgement entered on 27 October 2003. Royal Indemnity filed its notice of appeal from the judgement on 29 October 2003. The summary judgement motions by PNC Bank and Wilmington Trust were still pending at 31 December 2003. It is possible that the court will decide the Wilmington Trust motion before 31 March 2004, and the PNC Bank motion before 30 September 2004, to avoid having to report the motions as 'pending for more than a year'. In the event that the court grants summary judgement to PNC Bank and/or Wilmington Trust, Royal Indemnity plans to appeal from those rulings as well.

The court's corrected judgement filed on 27 October 2003 awarded MBIA and Wells Fargo approximately $360m. This amount consists of approximately $270m in original claims, $67m in claims accruing from the date the suit was filed to 27 October 2003, and $23m in prejudgement interest accruing to 27 October 2003. If the court were to grant summary judgement to PNC Bank and Wilmington Trust on the same basis as MBIA/Wells Fargo, the awards would be approximately $121m to PNC Bank and $14m to Wilmington Trust.

The ultimate outcome of these lawsuits is necessarily uncertain. In the event Royal Indemnity's lawsuits do not result in complete rescission of all applicable policies, any loss on the loan portfolio will be reduced to the extent of reinsurance available to Royal Indemnity, recoveries from the original borrowers on the defaulted loans, and reserves, if any. Any losses may be further offset by recoveries from other third parties. To that end, Royal Indemnity has filed recovery actions against certain trucking school entities. However, there can be no assurance that the outcome of these lawsuits, the availability of reinsurance recoveries, the extent and amount of recoveries from the borrower under the respective loan programmes and/or reserves, if any, among other factors, will be resolved in favour of Royal Indemnity.

Based on current knowledge of the circumstances, legal advice received and the range of other actions available to the Group to manage any insurance exposure, the directors believe that the resolution of the legal proceedings in respect of these credit risk insurance policies will not have a material adverse effect on the Group's financial position.

Strategic and operational review

The programme of strategic and operational improvements is complex and involves a restructuring of, and the implementation of substantial changes to, a significant portion of the Group's operations. In addition, the programme contemplates actions being taken in a number of businesses and jurisdictions simultaneously. Implementation of the planned improvements and realisation of the forecast benefits will be challenging within the timeframe contemplated by the Group. In addition, successful implementation of this programme will require a significant amount of management time and, thus, may affect or impair management's ability to run the business effectively during the period of implementation. This is particularly so in relation to our US operation where a new management team has recently been appointed.

The restructuring plans in the US are complex and are subject to particular risks. Our US subsidiaries are subject to government regulation in their states of domicile and also in each of the jurisdictions in which they are licensed or authorised to do business. In the US, the conduct of insurance business is regulated at the state level and not by the federal government. The implementation of our restructuring plan in the US will be subject to the approval of insurance regulators in many jurisdictions applying differing insurance regulations. The outcome of such proceedings and approvals may lead to conflicting pronouncements and amendments to our restructuring plan that may have a material impact on our financial condition and business prospects.

Some events or transactions comprised in the restructuring plans may give rise to risks and/or liabilities which, individually or taken together, are sufficiently material to require the provision of additional capital, or the implementation of alternative transactions, to meet legal or regulatory obligations.

Consolidated Profit and Loss Account
Technical Account – General Business

For the year ended 31 December 2003

	Notes	2003 £m	2002 £m
Gross premiums written		9,929	11,959
Outward reinsurance premiums		(3,299)	(3,324)
Premiums written, net of reinsurance		6,630	8,635
Change in the gross provision for unearned premiums		658	(368)
Change in the provision for unearned premiums, reinsurers' share		13	140
Earned premiums, net of reinsurance	10	7,301	8,407
Allocated investment return transferred from the Non-Technical Account	12	767	962
Claims paid			
Gross amount		(6,841)	(8,382)
Reinsurers' share		1,570	1,886
		(5,271)	(6,496)
Change in the provision for claims			
Gross amount		(602)	(601)
Reinsurers' share		130	342
		(472)	(259)
Unwind of discount in respect of claims outstanding		(63)	(53)
Claims incurred, net of reinsurance		(5,806)	(6,808)
Acquisition costs		(1,928)	(2,382)
Change in deferred acquisition costs		(167)	83
Administrative expenses		(655)	(810)
Reinsurance commissions and profit participation		400	566
Net operating expenses	3	(2,350)	(2,543)
Amortisation of goodwill in acquired claims provisions	17	(19)	(25)
Underwriting result		(811)	(916)
Longer term investment return allocated to the General Business Technical Account		767	962
Unwind of discount in respect of claims outstanding		(63)	(53)
Balance on the technical account before change in the equalisation provisions		(107)	(7)
Change in the equalisation provisions	9	(24)	1
Balance on the Technical Account for General Business		(131)	(6)

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

The Accounting Policies and the Notes on the Accounts form part of these financial statements.

Consolidated Profit and Loss Account
Technical Account – Long Term Business

For the year ended 31 December 2003

	Notes	2003 £m	2002 £m
Gross premiums written		1,579	2,289
Outward reinsurance premiums		(106)	(407)
Earned premiums, net of reinsurance		1,473	1,882
Investment income	11	1,715	1,460
Unrealised gains on investments		521	–
Total technical income		3,709	3,342
Claims paid			
Gross amount		(3,244)	(3,822)
Reinsurers' share		48	76
		(3,196)	(3,746)
Change in the provision for claims			
Gross amount		(4)	3
Reinsurers' share		1	9
		(3)	12
Claims incurred, net of reinsurance		(3,199)	(3,734)
Change in long term business provision			
Gross amount		1,975	118
Reinsurers' share		(705)	486
		1,270	604
Change in technical provisions for linked liabilities, net of reinsurance		(301)	1,331
Change in other technical provisions, net of reinsurance		969	1,935
Acquisition costs		(87)	(219)
Change in deferred acquisition costs		(26)	(58)
Administrative expenses		(220)	(207)
Net operating expenses	3	(333)	(484)
Investment expenses and charges	11	(65)	(68)
Unrealised losses on investments		–	(1,851)
Tax attributable to the long term business	14	(193)	(4)
Other technical charges – amortisation and write off of acquired value of in-force business	2, 19	(66)	(13)
Total technical charges		(2,887)	(4,219)
Technical income less charges		822	(877)
Allocated investment return transferred (to)/from the Non-Technical Account		(13)	22
Transfers (to)/from the fund for future appropriations		(432)	999
Balance on the Technical Account for Long Term Business	5	377	144

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

The Accounting Policies and the Notes on the Accounts form part of these financial statements.

Consolidated Profit and Loss Account Non-Technical Account

For the year ended 31 December 2003

	Notes	2003 £m	Restated 2002 £m
Balance on the General Business Technical Account		(131)	(6)
Balance on the Long Term Business Technical Account		377	144
Tax credit attributable to balance on the Long Term Business Technical Account		169	65
Balance on the Long Term Business Technical Account gross of tax		546	209
Investment income	11	1,172	1,146
Allocated investment return transferred from/(to) the Long Term Business Technical Account		13	(22)
Investment expenses and charges	11	(127)	(146)
Unrealised losses on investments		(395)	(638)
Allocated investment return transferred to the General Business Technical Account	12	(767)	(962)
Income from other activities		120	215
Charges from other activities	2, 3	(151)	(241)
Central expenses	3	(94)	(48)
Amortisation and impairment of goodwill	17	(24)	(713)
Total Group operating profit/(loss)		133	(1,202)
Share of results of associated undertakings		29	(4)
Profit/(loss) on ordinary activities before exceptional items and tax		162	(1,206)
Analysis of profit/(loss) on ordinary activities before exceptional items and tax			
General business result	31	83	89
Long term business result	5	168	227
Other activities (including associated undertakings)		(111)	(90)
Group operating result (based on longer term investment return)		140	226
Interest on dated loan capital		(53)	(52)
Change in the equalisation provisions	9	(24)	1
Amortisation and impairment of goodwill	17	(24)	(713)
Amortisation of goodwill in acquired claims provisions	17	(19)	(25)
Exceptional gain on UK long term insurance business	5	444	–
Reorganisation costs and other items	2	(268)	(92)
Group operating profit/(loss) (based on longer term investment return)		196	(655)
Short term investment fluctuations		(34)	(551)
Profit/(loss) on ordinary activities before exceptional items and tax		162	(1,206)
(Loss)/profit on disposal of subsidiary undertakings	24	(308)	253
Loss on ordinary activities before tax		(146)	(953)
Tax (charge)/credit on loss on ordinary activities	14	(217)	91
Loss on ordinary activities after tax		(363)	(862)
Attributable to equity minority interests		(19)	(9)
Loss for the financial year attributable to shareholders		(382)	(871)
Dividends	15	(120)	(95)
Transfer from retained profits		(502)	(966)
Earnings per ordinary share	16	(19.6)p	(49.8)p
Diluted earnings per ordinary share	16	(19.6)p	(49.8)p
Group operating earnings after tax per ordinary share (based on longer term investment return)	16	2.5p	4.6p

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

The Accounting Policies and the Notes on the Accounts form part of these financial statements.

Statement of Total Recognised Gains and Losses

For the year ended 31 December 2003

	Notes	2003 £m	Restated 2002 £m
Loss for the financial year		(382)	(871)
Exchange:			
Group		(23)	(257)
Share of associates		11	(8)
Shareholders' consolidated recognised losses arising in the year		(394)	(1,136)
Prior year adjustment	1	(812)	
Shareholders' consolidated recognised losses since 31 December 2002		(1,206)	

Exchange includes a gain of £5m (2002 £11m) on exchange relating to foreign currency borrowings.

Movements in Shareholders' Funds

For the year ended 31 December 2003

	Notes	Share capital/ premium £m	Capital redemption reserve £m	Other reserves £m	Profit and loss account £m	2003 £m	Restated 2002 £m
Shareholders' funds at 1 January (as reported)		732	8	881	1,422	3,043	4,691
Prior year adjustment	1	–	–	(881)	69	(812)	(1,232)
Shareholders' funds at 1 January (as restated)		732	8	–	1,491	2,231	3,459
Shareholders' recognised losses		–	–	–	(394)	(394)	(1,136)
Issue of share capital	28	396	–	–	–	396	–
Increase in share premium	28	564	–	–	–	564	2
Goodwill written back	24	–	–	–	324	324	1
Dividends	15	–	–	–	(120)	(120)	(95)
Shareholders' funds at 31 December		1,692	8	–	1,301	3,001	2,231

The Accounting Policies and the Notes on the Accounts form part of these financial statements.

Consolidated Balance Sheet

As at 31 December 2003

	Notes	Shareholder consolidated 2003 £m	Shareholder consolidated Restated 2002 £m	Combined consolidated 2003 £m	Combined consolidated Restated 2002 £m
ASSETS					
Intangible assets	17	216	306	216	306
Investments					
Land and buildings	18	698	483	3,118	2,975
Interests in associated undertakings	22	122	166	122	166
Other financial investments					
Shares and other variable yield securities and units in unit trusts		1,862	1,775	4,883	5,888
Debt securities and other fixed income securities		11,021	10,832	30,752	29,878
Loans and deposits with credit institutions		801	1,079	969	1,607
	18	13,684	13,686	36,604	37,373
Value of acquired long term business	19, 45	–	86	–	86
Deposits with ceding undertakings		53	166	62	179
Total investments		14,557	14,587	39,906	40,779
Assets held to cover linked liabilities	18	–	–	3,874	4,169
Reinsurers' share of technical provisions					
Provision for unearned premiums		583	654	583	654
Long term business provision		–	–	120	820
Claims outstanding	31	4,200	4,425	4,203	4,493
Technical provisions for linked liabilities		–	–	6	6
		4,783	5,079	4,912	5,973
Debtors					
Debtors arising out of direct insurance operations	20	2,173	2,919	2,216	2,980
Debtors arising out of reinsurance operations		1,122	1,072	1,125	1,090
Deferred taxation		29	145	61	207
Other debtors	20	1,656	1,489	614	539
		4,980	5,625	4,016	4,816
Other assets					
Tangible assets	21	132	193	139	221
Cash at bank and in hand		362	525	503	957
Own shares	28	15	15	15	15
		509	733	657	1,193
Prepayments and accrued income					
Accrued interest and rent		192	201	500	517
Deferred acquisition costs – long term		–	–	20	254
Deferred acquisition costs – general		701	972	701	972
Other prepayments and accrued income		133	137	147	155
		1,026	1,310	1,368	1,898
Total assets		26,071	27,640	54,949	59,134

The Shareholder Consolidated Balance Sheet represents the shareholder and general insurance business assets and liabilities.
The Combined Consolidated Balance Sheet includes long term business assets and liabilities relating to long term business policyholders.

The Accounting Policies and the Notes on the Accounts form part of these financial statements.

	Notes	Shareholder consolidated 2003 £m	Shareholder consolidated Restated 2002 £m	Combined consolidated 2003 £m	Combined consolidated Restated 2002 £m
LIABILITIES					
Capital and reserves					
Ordinary share capital		792	396	792	396
Preference share capital		125	125	125	125
Called up share capital	28	917	521	917	521
Share premium account		775	211	775	211
Capital redemption reserve		8	8	8	8
Profit and loss account		1,301	1,491	1,301	1,491
Equity shareholders		2,876	2,106	2,876	2,106
Non-equity shareholders		125	125	125	125
Shareholders' funds		3,001	2,231	3,001	2,231
Equity minority interests in subsidiary undertakings		346	405	346	405
Subordinated liabilities					
Dated loan capital	29	768	773	768	773
Total capital, reserves and dated loan capital		4,115	3,409	4,115	3,409
Fund for future appropriations		–	–	2,104	1,669
Technical provisions					
Provision for unearned premiums		3,888	5,155	3,888	5,155
Long term business provision	30	–	–	22,212	24,661
Claims outstanding	31	14,654	15,123	14,782	15,371
Equalisation provisions	9	319	293	319	293
		18,861	20,571	41,201	45,480
Technical provisions for linked liabilities		–	–	3,873	4,168
Provisions for other risks and charges	32	275	286	402	389
Deposits received from reinsurers		250	137	250	137
Creditors					
Creditors arising out of direct insurance operations		369	429	378	463
Creditors arising out of reinsurance operations		545	800	554	834
Debenture loans	33	12	103	12	105
Amounts owed to credit institutions	33	422	597	422	597
Other creditors including taxation and social security	34	676	831	1,054	1,361
Proposed dividend	15	83	29	83	29
		2,107	2,789	2,503	3,389
Accruals and deferred income		463	448	501	493
Total liabilities		26,071	27,640	54,949	59,134

Except for certain debenture loans and amounts owed to credit institutions shown in note 33, all creditors are payable within a period of five years.

The Accounting Policies and the Notes on the Accounts form part of these financial statements.

Parent Company Balance Sheet

As at 31 December 2003

	Notes	2003 £m	Restated 2002 £m
Fixed assets			
Tangible assets	21	12	20
Investments	25	3,453	2,648
		3,465	2,668
Current assets			
Amounts owed by Group undertakings		723	1,326
Other debtors		97	5
Cash at bank and in hand		8	5
		828	1,336
Creditors – amounts falling due within one year			
Amounts owed to Group undertakings		(400)	(591)
Amounts owed to credit institutions		–	(256)
Other creditors including taxation and social security		(41)	(124)
Proposed dividend	15	(83)	(29)
		(524)	(1,000)
Net current assets		304	336
Total assets less current liabilities		3,769	3,004
Creditors – amounts falling due after more than one year			
Dated loan capital	29	768	773
Capital and reserves			
Ordinary share capital		792	396
Preference share capital		125	125
Called up share capital	27, 28	917	521
Share premium account	27	775	211
Revaluation reserve	27	1,239	1,478
Capital redemption reserve	27	8	8
Profit and loss account	27	62	13
Equity shareholders		2,876	2,106
Non-equity shareholders		125	125
Shareholders' funds		3,001	2,231
Total capital, reserves and dated loan capital		3,769	3,004

The Accounting Policies and the Notes on the Accounts form part of these financial statements.

The financial statements were approved on 10 March 2004 by the Board of Directors and are signed on its behalf by:

Julian Hance
Group Finance Director

Consolidated Shareholders' Cash Flow Statement

For the year ended 31 December 2003

	Notes	2003 £m	2002 £m
Operating activities			
Net cash inflow from general business		143	63
Shareholders' net cash inflow from long term business		160	94
Contingent loan finance to long term business funds		(160)	(160)
Other operating cash flows attributable to shareholders		(13)	(6)
Net cash inflow/(outflow) from operating activities	38	130	(9)
Dividends from associates		8	3
Servicing of finance			
Dividends paid on non-equity shares		(9)	(9)
Dividends paid to minorities		(12)	–
Interest paid on dated loan capital		(56)	(58)
		(77)	(67)
Taxation (paid)/refunded		(6)	53
Capital expenditure			
Purchases less sales of tangible assets		(39)	(63)
Acquisitions and disposals			
Acquisition of interests in associated undertakings		–	(1)
Disposal of interests in associated undertakings		44	9
Acquisition of subsidiary undertakings	23, 42	(1)	(32)
Acquisition of minority interests in subsidiary undertakings	23	(9)	(2)
Disposal of subsidiary undertakings	43	831	666
		865	640
Dividends paid on equity shares		(57)	(160)
Financing			
Issue of ordinary share capital	28, 41	960	2
Cash available for investment		1,784	399
Cash flows were invested as follows:			
Movement in cash holdings	39, 41	(184)	108
Net portfolio investments	39, 40, 41		
Land and buildings		228	(30)
Shares and other variable yield securities		(266)	(1,006)
Loans, debt securities and other fixed income securities		1,618	1,143
Deposits with credit institutions		131	(196)
Borrowings		257	380
		1,968	291
Net investment of cash flows		1,784	399

The Cash Flow Statement does not include any amounts relating to the long term business except cash transactions between the long term business and shareholders.

The Accounting Policies and the Notes on the Accounts form part of these financial statements.

Notes on the Accounts

1. Impact of changes arising from accounting policy changes

There is no impact (2002 profit £69m) on the loss on ordinary activities arising from the change in accounting policy to no longer recognise the internally generated value of the long term insurance business. The impact on the Statement of Total Recognised Gains and Losses is to decrease the shareholders' funds by £812m being the effect of not recognising the value of the internally generated long term insurance business at 31 December 2002.

2. Reorganisation costs and other items

Reorganisation and other items within the Non-Technical Account include:

	General business		Long term business		Other activities	
	2003 £m	2002 £m	2003 £m	2002 £m	2003 £m	2002 £m
Reorganisation costs	171	71	–	5	31	3
Amortisation and write off of the present value of acquired in-force business	–	–	66	13	–	–

Reorganisation costs comprise employee redundancy costs and vacant lease accruals mainly in the UK and US.

3. Net operating expenses and other charges

	General business		Long term business	
	2003 £m	2002 £m	2003 £m	2002 £m
a. Net operating expenses in the technical accounts include:				
Depreciation	49	64	21	10
Operating lease rentals – premises	87	93	2	6
Operating lease rentals – other assets	14	18	–	–

b. Charges from other activities in the Non-Technical Account include depreciation of £5m (2002 £7m), operating lease rentals – premises of £9m (2002 £11m) and operating lease rentals – other assets of £nil (2002 £1m).

c. Central expenses in the Non-Technical Account include depreciation of £4m (2002 £3m), operating lease rentals – premises of £5m (2002 £3m).

d. During the year, a fine of £950,000 was levied by the Financial Services Authority in respect of mortgage endowment sales practices.

4. Exchange rates

In respect of the major overseas currencies the rates of exchange used in these financial statements are US Dollar 1.79 (2002 1.61), Canadian Dollar 2.31 (2002 2.54) and Danish Kroner 10.57 (2002 11.40).

5. Long term insurance business

	Gross		Net	
	2003 £m	2002 £m	2003 £m	2002 £m
New business premiums written during the year were as follows:				
Annual premiums	102	135	100	129
Single premiums	550	960	519	613
	652	1,095	619	742

Total reversionary and terminal bonuses included within the Long Term Business Technical Account are £356m (2002 £536m).

During 2003, the attribution of accumulated surpluses in the non-participating element of one of the Group's UK insurance companies, Phoenix Assurance plc (Phoenix), was determined. As a result the surplus attributable to shareholders was transferred to shareholders' funds in accordance with the Group's Accounting Policies.

This has resulted in the recognition of an exceptional profit before taxation on UK long term insurance business during 2003 of £444m (2002 £nil). This profit is recognised in the Balance on the Long Term Business Technical Account gross of tax within the Consolidated Profit and Loss Account Non-Technical Account.

After the deduction of the attributable taxation on this profit, the increase in shareholders' funds arising from this exceptional profit amounted to £310m (2002 £nil).

6. Employee information

	2003 £m	2002 £m
Staff costs for all employees comprise:		
Wages and salaries	889	1,142
Social security costs	61	75
Pension costs	108	94
	1,058	1,311

	As at 31 December		Average for year	
	2003 Number	2002 Number	2003 Number	2002 Number
The number of employees of the Group during the year was as follows:				
UK	13,045	20,696	17,017	21,574
Scandinavia	7,671	7,994	7,857	7,947
US	3,898	6,424	5,226	6,727
Canada	2,668	2,736	2,568	2,782
International	4,698	5,031	4,450	5,614
Australia and New Zealand	–	6,045	2,039	5,835
	31,980	48,926	39,157	50,479

7. Retirement benefits

a. Pension costs

The Group operates both funded defined benefit and funded defined contribution pension schemes. The funded defined contribution schemes are in the UK, Denmark and Sweden. Overseas schemes are administered in accordance with local law and practice. The major pension schemes in the UK, US, Denmark and Sweden together cover the majority of scheme members throughout the Group and the assets of these schemes are mainly held in separate trustee administered funds. Each of the major defined benefit schemes is subject to regular valuation using the projected unit or other appropriate method which is the basis of the pension cost in the Consolidated Profit and Loss Account, the cost being spread over employees' working lives. In April 2002, the UK schemes were effectively closed to new entrants following the introduction of a new defined contribution scheme. In 2004 members of the UK defined benefit schemes have the option of paying contributions, initially at the rate of 2.5% of pensionable salaries, to maintain future benefit accrual on the current basis, or pay no contributions and have a reduced rate of future benefit accrual.

The total pension cost for the Group in 2003 was £108m (2002 £94m) of which £48m (2002 £43m) related to defined benefit schemes in the UK and £12m (2002 £9m) related to schemes in the US. Contributions of £3m were made to the defined contribution schemes in the UK and £28m (2002 £20m) were made to the defined contribution scheme in Denmark and Sweden.

Independent qualified actuaries carry out valuations of the major schemes. At the most recent formal actuarial valuations of the major defined benefit schemes (the two main UK schemes 31 March 2002 and 30 June 2002 respectively, and the US scheme 1 January 2003), for the purpose of assessing pension costs, the market value of the assets of these schemes was £3,793m (2002 £3,858m). Of this amount, £3,568m related to the two UK schemes and on their valuation dates were sufficient to cover 110% and 101% respectively of the benefits accrued to members of each of those schemes, after allowing for projected increases in earnings and pensions. The valuations for the two major UK schemes were based on assumptions that salaries increase by 4.3% and 4.0% plus allowances for promotional salary increases, pensions increase by 2.9% and 2.5% and investment returns are 7.1% pa pre retirement and 5.6% post retirement for one scheme and 6.5% for the other.

For the two main UK schemes, the level of contributions in 2003 were 23% and 20% of salaries respectively with arrears of contribution at these rates back to the respective valuation dates, plus an amount of £20m in respect of one of the schemes where there was a deficit on the valuation funding basis. In 2004, contributions will continue at the rates of 23% and 20% respectively plus an amount of £43m will be paid. Further valuations are due in 2004 when the position will be reviewed. The amounts charged to the Profit and Loss Account were the equivalent of 13.9% and 20% respectively of relevant UK earnings. This charge reflected a regular cost of £57m (2002 £73m) and a credit of £11m (2002 £34m). The credit arises from the amortisation of the actuarial surpluses in the funds (after taking account of interest on balances between the Group and the funds). For one scheme an actuarial surplus from the valuation is being applied to reduce pension costs by a level percentage of payroll over the estimated working lives of members of the respective schemes.

There are no significant contributions outstanding or prepaid as at 31 December 2003 except that included in prepayments is an amount of £10m (2002 £81m provision) resulting from the difference between the amounts charged to revenue and the amounts contributed to schemes in the UK, and in provisions an amount of £8m (2002 £8m) in respect of overseas schemes.

b. Other post retirement benefits

The Group provides post retirement healthcare benefits to certain current and retired US and Canadian employees. The estimated discounted present values of the unprovided accumulated obligations are calculated in accordance with the advice of independent qualified actuaries.

7. Retirement benefits (continued)

At 31 December 2003 the unprovided accumulated obligation in the US is estimated at £4m (2002 £15m). The assumptions used for the charge to the profit and loss account assume a pre 65 premium inflation for medical care initially of 10% reducing over eight years to 5% and a post 65 premium inflation of 12% reducing over ten years to 5% (2002 13% reducing over 11 years to 4.25%) and a discount rate of 6% (2002 6.5%). The unprovided accumulated obligation in Canada is estimated at £5m (2002 £5m) assuming a premium inflation for drugs of 8% (2002 8%) reducing over ten years to 5% (2002 4%), 4% pa for hospital and 3% for medical care for one scheme, and 10% (2002 10%) decreasing by 0.5% per year to 5% per year (2002 0.5% per year to 5%) for the other scheme. For dental care, premium inflation of 4% and 5% is assumed for the respective schemes (2002 4% and 5%) and a discount rate of 6.5% for both schemes (2002 6.75% for both schemes).

The benefits are accounted for on a systematic basis over the remaining service lives of current employees, the cost in the year being £9m (2002 £6m). In Canada the costs of meeting the liability for these benefits are expected to attract taxation relief when paid. The total provision included in the Combined Consolidated Balance Sheet is £43m (2002 £42m).

c. Alternative accounting treatment (Financial Reporting Standard 17)

The Accounting Standards Board issued Financial Reporting Standard 17 (FRS17) 'Retirement Benefits' in November 2000.

The components of the pension cost that would be included within operating profit if FRS17 had been fully adopted in the financial statements is as follows:

	UK schemes £m	US schemes £m	Other schemes £m	Total 2003 £m	Total 2002 £m
Current service cost	85	11	6	102	112
Past service cost	49	4	1	54	16
Curtailment (gains)	(20)	(20)	–	(40)	(10)
Settlement (gains)	(6)	–	–	(6)	–
Total charge/(credit) to be included in Group operating result	108	(5)	7	110	118
Expected return on assets	(184)	(16)	(11)	(211)	(288)
Interest cost	198	25	11	234	256
Total financing charge/(income) to be included in Group operating loss	14	9	–	23	(32)
Amounts to be recognised within Statement of Total Recognised Gains and Losses:					
Actual return/(deficit) on assets in excess of expected	229	18	9	256	(712)
Experience (losses)/gains on liabilities	(60)	9	(1)	(52)	113
Change in actuarial assumptions	(221)	(33)	4	(250)	62
Movement in irrecoverable surplus	–	–	–	–	2
Actuarial (loss)/gain	(52)	(6)	12	(46)	(535)

	UK schemes %	US schemes %	Other schemes %	Total 2003 %	Total 2002 %
Difference between expected and actual return as a percentage of scheme assets	6.5	7.3	6.3	6.5	(19.6)
Experience (losses)/gains as a percentage of scheme liabilities	(1.5)	2.1	(0.6)	(1.1)	2.6
Other as a percentage of scheme liabilities	(5.5)	(7.8)	2.5	(5.4)	1.4
Total actuarial (gain)/loss to be recognised in Statement of Total Recognised Gains and Losses as a percentage of scheme liabilities	(1.3)	(1.4)	7.6	(1.0)	(12.3)

Movement in net deficit during the year	2003 £m	2002 £m
Deficit at 1 January	(724)	(195)
Exchange	18	19
Total operating charge	(110)	(118)
Employer contribution	201	56
Total financing (charge)/income	(23)	32
Actuarial loss	(46)	(535)
Disposal of subsidiaries	9	17
Deficit at 31 December	(675)	(724)

7. Retirement benefits (continued)

The value of the liability that would be included in the Combined Consolidated Balance Sheet at 31 December if FRS17 had been fully adopted in the financial statements is as follows:

	UK schemes £m	US schemes £m	Other schemes £m	Total 2003 £m	Total 2002 £m	Total 2001 £m
Equities	1,742	136	80	1,958	1,707	2,994
Bonds	1,516	102	58	1,676	1,594	838
Other	275	7	4	286	334	388
Fair value of assets held by pension schemes	3,533	245	142	3,920	3,635	4,220
Present value of pension and post retirement schemes liabilities	(4,014)	(423)	(158)	(4,595)	(4,359)	(4,415)
Net deficit	(481)	(178)	(16)	(675)	(724)	(195)
Unrecognised past service costs	–	–	1	1	–	–
Surplus not recoverable	–	–	–	–	–	(2)
Related deferred tax asset	144	–	5	149	230	69
Net pension and post retirement liability	(337)	(178)	(10)	(525)	(494)	(128)
Analysed						
Pension asset	–	–	–	–	3	28
Pension and post retirement liability	(337)	(178)	(10)	(525)	(497)	(156)
Net pension and post retirement liability	(337)	(178)	(10)	(525)	(494)	(128)

The full valuation dates for the main UK schemes were 31 March 2002 and 30 June 2002 respectively and the US schemes were 1 January 2003. These valuations have been updated at 31 December 2003 to take account of changes in the fair value of the assets and financial assumptions. The main assumptions are as follows:

	UK schemes			US schemes			Other schemes		
	2003 %	2002 %	2001 %	2003 %	2002 %	2001 %	2003 %	2002 %	2001 %
Assumptions									
Annual rate of general inflation	2.5	2.3	2.5	2.5	3.0	3.0	2.0	2.2	2.1
Annual rate of increase in salaries	4.0	3.8	4.0	4.8	4.5	4.5	4.0	4.2	4.0
Annual rate of increase for pensions in payment and deferred pensions	2.5	2.3	2.5	–	–	–	2.0	1.8	1.9
Interest rate used to discount liabilities	5.4	5.5	5.7	6.0	6.5	7.0	6.5	6.2	5.9
Expected rate of return to be assumed for each class									
Equities	7.3	7.0	7.5	9.0	9.0	9.0	9.5	8.6	8.8
Bonds	4.8	4.6	5.0	6.0	6.0	6.0	6.0	5.7	5.7
Other	6.3	6.0	6.3	2.0	2.0	2.0	3.0	4.7	4.0

As at 31 December 2003, the valuation of liabilities for post retirement benefits in the US assumes a pre 65 premium inflation rate of 9% decreasing to 5% by 2011 and a post 65 premium inflation rate of 11% decreasing to 5% by 2013. The valuation of liabilities in Canada assumes 8% decreasing to 5% in nine years for drugs, 4% pa for hospital and 3% pa for other. The valuation of liabilities for post retirement benefits at 31 December 2002 assumed a premium inflation rate for medical care of 11% decreasing to 5% by 2008 (2001 12% decreasing to 5% by 2008).

Reconciliation of pro forma profit and loss account reserve on a FRS17 basis:

	Profit and loss account reserve 2003 £m	Restated 2002 £m
Profit and loss account reserve as reported at 31 December	1,301	1,491
Less pension and post retirement FRS17 liabilities net of tax	(525)	(494)
	776	997
Add pension and post retirement liabilities that would be reversed on the implementation of FRS17 net of tax	37	88
Profit and loss account reserve on FRS17 basis at 31 December	813	1,085

Included in the pro forma profit and loss account reserve is a pension and post retirement reserve on a FRS17 basis at 31 December 2003 of £(397)m (2002 £(342)m).

8. Directors' emoluments

	2003 £000	2002 £000
The aggregate emoluments of the directors, including amounts received from subsidiaries, were as follows:		
Executive directors		
Emoluments	2,919	2,863
Gains on the exercise of share options	–	135
Fees and other payments to non-executive directors	540	444
Compensation for loss of office	–	2,049
	3,459	5,491

Details of directors' remuneration and pension benefits, including that of the highest paid director (Andy Haste), are included in the Directors' Emoluments. Details of directors' interests in the Parent Company are shown in the Directors' Interests.

A pension payment of £22,080 (2002 £22,776) was paid by a subsidiary to a former director in respect of services other than as a director.

9. Equalisation provisions

Equalisation provisions are established in accordance with the Financial Services Authority's rules for insurers in the UK and with similar legislation in overseas countries. These provisions, notwithstanding that they do not represent liabilities at the balance sheet date as they are over and above the anticipated ultimate cost of outstanding claims, are required by Schedule 9A to the Companies Act 1985 to be included within technical provisions in the balance sheet and any change in the provisions during the year is required to be shown in the General Business Technical Account.

The effect of including the provisions is as follows:

	2003 £m	2002 £m
Provisions at 1 January	293	331
Exchange movement on non UK provisions	2	5
Charged/(credited) to the General Business Technical Account and in the profit on ordinary activities before tax	24	(1)
Disposal of subsidiaries	–	(42)
Provisions at 31 December	319	293

The cumulative impact of equalisation provisions on shareholders' funds at 31 December 2003 is £308m (2002 £287m).

10. Quota share reinsurance treaty

During 2003, the Group entered into a 15% quota share reinsurance programme which covers the majority of the Group's general business written in the UK, Denmark, Ireland, US and Canada. The total amount of premiums ceded in 2003 was £678m (2002 £698m). Earned premiums reflect £343m (2002 £312m) in respect of an opening portfolio adjustment which has been paid, and £291m (2002 £327m) of closing portfolio adjustment receivable at 31 December 2003, which is included in debtors arising out of reinsurance operations.

As from 1 January 2004, the Group entered into a 8% quota share reinsurance programme covering the majority of the general business written in the UK, Denmark, Ireland and Canada.

11. Investment income, expenses and charges

	Technical Account Long Term Business		Non-Technical Account	
	2003 £m	2002 £m	2003 £m	2002 £m
Investment income				
Income from associated undertakings				
Profit before gains on the realisation of investments	–	–	25	10
Gains on the realisation of investments	–	–	2	9
	–	–	27	19
Other investment income				
Income from land and buildings	190	182	23	18
Income from other investments	1,311	1,383	640	747
Gains/(losses) on the realisation of investments	214	(105)	482	362
	1,715	1,460	1,145	1,127
	1,715	1,460	1,172	1,146
Investment expenses and charges				
Interest on bank loans and overdrafts	–	–	(29)	(46)
Interest on dated loan capital	–	–	(53)	(52)
Interest on other loans	(25)	(20)	(19)	(19)
Investment management expenses	(40)	(48)	(26)	(29)
	(65)	(68)	(127)	(146)
Net investment income	1,650	1,392	1,045	1,000

12. Methodology for calculations of longer term rate of return and comparison over a longer term

The rates of investment return used for the longer term rate of return basis are reviewed annually and are set out below:

	2003 %	2002 %
Pre tax returns assumed		
Fixed interest returns (nominal)	5.00	6.00
Equity returns (nominal)	7.50	9.00
Inflation	2.50	3.00

These returns are applied to the average, over the year, of the investments directly attributable to shareholders and the general insurance technical provisions. In each case, the element of shareholders' funds has been determined by reference to the risk based capital that the directors judge is necessary to support the business. The values of the investments are adjusted to reduce the effect of short term fluctuations, while recognising such changes over the longer term.

The aggregate amount of investment return recognised under the longer term basis since 1 January 1994 amounts to £10.7bn. The total investment return that arose in this period was £11.1bn.

13. Auditors' remuneration

	2003 £000	2002 £000
Audit of Group accounts		
PricewaterhouseCoopers LLP	2,731	3,409
Other	348	287
	3,079	3,696
Other statutory audit		
PricewaterhouseCoopers LLP	1,222	1,191
Other	37	34
	1,259	1,225
	4,338	4,921

Remuneration for audit includes £16,000 (2002 £16,000) in respect of the Parent Company.

Non audit fees of £6,222,000 (2002 £7,535,000) in the UK during the year were payable to PricewaterhouseCoopers LLP. Of these £4,256,000 (2002 £1,476,000) were for assurance services (of which £2,692,000 were in respect of the rights issue), £1,084,000 (2002 £1,751,000) were for tax advisory services and £882,000 (2002 £4,308,000) were for other non audit services. In 2002 this included £2,002,000 payable to PwC Consulting which in 2003 is no longer owned by PricewaterhouseCoopers LLP.

14. Taxation

The tax on loss on ordinary activities charged/(credited) in the profit and loss account is as follows:

	Technical Account Long Term Business		Non-Technical Account	
	2003 £m	2002 £m	2003 £m	2002 £m
Current tax				
UK corporation tax	62	118	(17)	11
Double taxation relief	(1)	(1)	(13)	(8)
Overseas taxation	12	111	29	(51)
Taxation surplus (release)/addition	–	–	(20)	14
Prior year items	(3)	(5)	(34)	28
	70	223	(55)	(6)
Tax attributable to long term business	–	–	169	65
Current tax for the year	70	223	114	59
Deferred tax				
Timing differences – origination and reversal	144	(271)	102	(179)
Movement in discount	(21)	52	1	29
Tax charge/(credit)	193	4	217	(91)
Analysed				
Parent and subsidiaries	193	4	202	(94)
Associated undertakings	–	–	15	3

UK corporation tax for the current year in the Non-Technical Account is based on a rate of 30% (2002 30%). Further details of current and deferred tax are given in notes 32, 34 and 35.

The tax charge for UK corporation tax in the Technical Account – Long Term Business is provided at rates between 20% and 30% (2002 between 20% and 30%) computed in accordance with the rules applicable to life assurance companies.

Factors affecting the current tax charge – Non-Technical Account

The current tax charge for the years 2003 and 2002 is more than 30% due to the items set out in the reconciliation below:

	2003 £m	Restated 2002 £m
Loss on ordinary activities before tax	(146)	(953)
Tax credit at 30%	(44)	(286)
Factors affecting charge		
Disallowed expenditure	92	71
Goodwill	108	208
Tax exempt income and investment gains	(90)	(117)
Tax losses not recognised	135	–
Non deductible movement in US claims discounting	105	–
Adjustment for non UK tax rates	(31)	(37)
Adjustment to prior year provisions	(54)	41
Other timing differences other than on long term business	(107)	179
Current tax charge for the year	114	59

15. Dividends

	2003 p	Restated 2002 p	2003 £m	2002 £m
Ordinary				
Interim paid (restated)	1.6	3.2	28	57
Final proposed	2.9	1.6	83	29
	4.5	4.8	111	86
Preference			9	9
			120	95

Full provision has been made for the proposed final dividend. The dividend per ordinary share in 2002 and the interim dividend per ordinary share in 2003 have been restated to reflect the bonus element of the rights issue in October 2003.

16. Earnings per ordinary share

The earnings per ordinary share shown in the Consolidated Profit and Loss Account is calculated by reference to the loss attributable to the equity shareholders of £391m (2002 restated £880m) and the weighted average of 1,994,092,282 (2002 restated 1,767,426,890) shares in issue during the year.

In accordance with Financial Reporting Standard 14 (FRS14), 'Earnings per Share' the numbers of ordinary and potential ordinary shares outstanding prior to the rights issue in 2003 and during 2002 have been calculated to take account of the bonus element of the rights issue in October 2003. The basic and diluted earnings per ordinary share and Group operating earnings after tax per ordinary share (based on longer term investment return) in 2002 have been restated to take account of the recalculations. Similarly the earnings per ordinary share, Group operating earnings after tax per ordinary share, total return to shareholders, dividend per ordinary share and the net assets per ordinary share in the Five Year Financial Review have been restated.

	2003 £m	Restated 2002 £m
Loss for the financial year attributable to shareholders	(382)	(871)
Preference dividends	(9)	(9)
Loss for the financial year attributable to equity shareholders	(391)	(880)

When calculating the diluted earnings per ordinary share there is no adjustment to the loss attributable to equity shareholders and there are no dilutive potential ordinary shares.

Group operating earnings after tax per ordinary share (based on longer term investment return) attributable to shareholders includes tax on the allocated longer term investment return at a notional rate of 31% (2002 32%). It is the opinion of the directors that this measure provides a better indication of the underlying performance of the business of the Group.

The reconciliation of Group operating earnings after tax (based on longer term investment return) per ordinary share to earnings per ordinary share is as follows:

	2003 p	Restated 2002 p
Earnings per ordinary share	(19.6)	(49.8)
Short term investment fluctuations	1.7	31.2
Change in the equalisation provisions	1.2	(0.1)
Amortisation and impairment of goodwill	1.2	40.3
Amortisation of goodwill in acquired claims provisions	1.0	1.4
Loss/(profit) on disposal of subsidiary undertakings	15.4	(14.3)
Other items	(1.8)	4.1
Tax	3.4	(8.2)
Group operating earnings after tax (based on longer term investment return) per ordinary share	2.5	4.6

17. Intangible assets

	Goodwill in acquired claims provisions £m	Goodwill arising on acquisition £m	Total £m
Cost			
At 1 January 2003	219	1,044	1,263
Exchange	(6)	(29)	(35)
Additions	–	1	1
Disposal of subsidiary undertakings	–	(216)	(216)
At 31 December 2003	213	800	1,013
Amortisation			
At 1 January 2003	(126)	(831)	(957)
Exchange	6	45	51
Charge for the year	(19)	(24)	(43)
Disposal of subsidiary undertakings	–	152	152
At 31 December 2003	(139)	(658)	(797)
Net book value			
At 31 December 2003	74	142	216
At 31 December 2002	93	213	306

18. Investments

	Shareholder consolidated		Combined consolidated	
	2003 £m	2002 £m	2003 £m	2002 £m
Land and buildings				
Freehold	668	454	2,903	2,746
Long leasehold	13	8	198	208
Short leasehold	17	21	17	21
Total land and buildings	698	483	3,118	2,975
Of which Group occupied	342	273	444	384
Other financial investments				
Shares and other variable yield securities and units in unit trusts	1,862	1,775	4,883	5,888
Debt securities and other fixed income securities:				
British government securities	1,771	1,478	7,692	6,906
Other government securities	4,992	3,462	8,541	7,062
Local authority securities	217	630	224	652
Corporate bonds	3,792	5,036	14,046	15,032
Preference shares	249	226	249	226
Loans secured by mortgages	62	118	82	272
Other loans (see below)	63	60	73	79
Deposits with credit institutions	676	901	814	1,256
Total other financial investments	13,684	13,686	36,604	37,373
Listed investments				
Included in total investments are the following:				
Interests in associated undertakings	94	71	94	71
Shares and other variable yield securities and units in unit trusts	1,472	1,636	4,316	5,465
Debt securities and other fixed income securities	5,332	5,414	24,796	24,168
Total listed investments	6,898	7,121	29,206	29,704

In addition, within the Combined Consolidated Balance Sheet, debt securities held in North America amounting to £4,161m (2002 £4,814m) at market value are freely traded in an approved securities market but are not listed within the meaning of the Companies Act.

Other financial investments in the Combined Consolidated Balance Sheet include securities valued on an amortised cost basis of £1m (2002 £368m) with a historical cost of £1m (2002 £340m), a market value of £1m (2002 £384m) and a redemption value of £1m (2002 £378m).

Other loans shown above for the Combined Consolidated Balance Sheet include amounts of £10m (2002 £19m) relating to policyholder loans.

18. Investments (continued)

The historical cost of total investments (excluding value of long term business) included in the Combined Consolidated Balance Sheet is £37,674m (2002 £37,817m). The historical cost of assets held to cover linked liabilities is £3,531m (2002 £4,324m).

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

19. Acquired value of long term business

Amortisation charged to the Long Term Business Technical Account amounted to £5m (2002 £13m). The cumulative unamortised acquired value of long term business at 31 December 2003 amounted to £nil (2002 £86m), after write off of £61m (2002 £nil).

	2003 £m
Cost	
At 1 January 2003	123
Exchange	10
Disposal of subsidiary undertakings	(35)
At 31 December 2003	98
Amortisation	
At 1 January 2003	(37)
Exchange	(4)
Charge for the year	(66)
Disposal of subsidiary undertakings	9
At 31 December 2003	(98)
Net book value	
At 31 December 2003	–
At 31 December 2002	86

20. Debtors

Debtors arising out of direct insurance operations are analysed as follows:

	Shareholder consolidated		Combined consolidated	
	2003 £m	2002 £m	2003 £m	2002 £m
Due from policyholders	1,018	1,151	1,061	1,211
Due from intermediaries	1,155	1,768	1,155	1,769
	2,173	2,919	2,216	2,980

Other debtors in the Shareholder Consolidated Balance Sheet include £1,179m (2002 £1,057m) relating to intercompany balances with the life funds. This includes shareholders' accrued interest, shareholders' net assets of certain overseas long term business operations and a loan to the UK Life fund.

21. Tangible assets

	Parent Company			Combined consolidated
	Land and buildings £m	Other £m	Total £m	£m
Cost				
At 1 January 2003	3	26	29	699
Exchange	–	–	–	3
Additions	–	–	–	48
Disposals	(3)	–	(3)	(88)
Disposals of subsidiary undertakings	–	–	–	(114)
At 31 December 2003	–	26	26	548
Depreciation				
At 1 January 2003	–	(9)	(9)	(478)
Exchange	–	–	–	(1)
Charge for the year	–	(5)	(5)	(79)
Disposals	–	–	–	74
Disposals of subsidiary undertakings	–	–	–	75
At 31 December 2003	–	(14)	(14)	(409)
Net book value				
At 31 December 2003	–	12	12	139
At 31 December 2002	3	17	20	221

The land and buildings in the Parent Company Balance Sheet comprises freehold property £nil (2002 £3m).

22. Interests in associated undertakings

The companies shown in the list of Principal Associated Undertakings and Other Significant Shareholdings are those, not being subsidiaries, in which Royal & Sun Alliance Insurance Group plc and its subsidiaries held at 31 December 2003 a participating interest and which are associated undertakings as defined in the Companies Act 1985. All holdings are of equity shares.

Interests in associated undertakings comprise:

	2003 £m	2002 £m
Shares at cost		
At 1 January	253	314
Exchange	4	(1)
Acquisitions	–	1
Disposals/transfers	(80)	(61)
At 31 December	177	253
Adjustment to valuation	(55)	(87)
Net book value	122	166

Balances due from associated undertakings at 31 December 2003 amounted to £5m (2002 £5m).

During the year the Group disposed of its interest in RACI Pty Limited and Global Aerospace Underwriting Managers Limited.

23. Acquisitions of subsidiary undertakings

During the year, acquisitions of subsidiary undertakings which had a book value of £nil on acquisition were made for a total cash consideration of £1m. Goodwill of £1m arising on those acquisitions has been capitalised and is being amortised. The amortisation period for Group acquisitions and the minority purchases made during the year is 10 years, being the period over which the value of the businesses acquired are expected to exceed the value of their underlying assets.

During the year, the Group acquired for £9m further minority interests in existing subsidiaries.

The Group has used the acquisition method to account for all acquisitions.

24. Disposal of subsidiary undertakings

During the year, disposals of subsidiary undertakings were made for a total consideration of £796m. The disposals of subsidiaries and books of business gave rise to an exceptional pre tax profit of £16m prior to write off of goodwill of £324m. Group disposals during the year comprise:

1. The UK Healthcare & Assistance business was sold on 4 April 2003. The transaction generated proceeds, net of costs, of £121m and generated an exceptional pre tax profit of £114m.
2. The Group disposed of its Australian & New Zealand general and life businesses on 11 May 2003 through an Initial Public Offering. The transaction generated proceeds, net of costs, of £507m and generated an exceptional pre tax loss of £123m.
3. The Group disposed of its interests in Royal Specialty Underwriting Inc on 9 June 2003 and Landmark American Insurance Company on 30 September 2003 and on 31 August 2003 sold certain renewal rights to the Travelers Group. These transactions generated proceeds, net of costs of £92m and generated an exceptional pre tax profit of £71m.
4. Royal & Sun Alliance Insurance (Company of Puerto Rico) Inc was sold on 8 October 2003. The transaction generated proceeds, net of costs, of £36m and generated an exceptional pre tax profit of £7m.
5. Sequence (UK) Limited, the Group's UK estate agency operation, was sold on 22 October 2003. The transaction generated proceeds, net of costs, of £(4)m and generated an exceptional pre tax loss of £13m.
6. The Group disposed of its 51% interest in Compañia de Seguros de Vida La Construcción on 3 December 2003. The transaction generated proceeds, net of costs, of £40m and generated an exceptional pre tax loss of £24m.
7. A number of other disposals were made during the year for net sales proceeds of £4m which generated in aggregate, an exceptional pre tax loss of £16m.
8. Goodwill of £324m relating to disposals that had previously been written off directly to reserves has been written back through the profit and loss account.

Whilst all of the above disposals had completed at 31 December 2003, the directors' estimates of actual profits/losses on disposal are subject to subsequent adjustment in relation to the specific terms, conditions and warranties contained within the related disposal agreements.

The amount of profit or loss recognised during the year relating to businesses disposed of during the year is disclosed in the segmental information.

25. Investments (Parent Company Balance Sheet)

	Shares in subsidiary undertakings £m	Loans to subsidiary undertakings £m	Deposits £m	Total £m
At 1 January 2003 (restated)	2,619	29	–	2,648
Additions	960	–	5	965
Revaluations	(160)	–	–	(160)
At 31 December 2003	3,419	29	5	3,453

The historical cost of the shares in subsidiary undertakings is £2,180m (2002 £1,220m).

The Group's principal subsidiaries at 31 December 2003 are set out in the list of Principal Subsidiary Undertakings. The companies are all principally engaged in the transaction of insurance or related business. The countries shown are those of incorporation and principal operation.

26. Capital commitments

The estimated amount of capital commitments contracted but not provided for in these financial statements is £48m (2002 £210m). The Parent Company has no unprovided capital commitments.

27. Shareholders' funds

Group

The movements in the Group's capital and reserves are detailed in the Statement of Movements in Shareholders' Funds.

The amount of goodwill written off directly to the profit and loss account prior to 1 January 1998 and remaining written off is £183m (2002 £507m).

Parent

Movements in the Parent Company capital and reserves were as follows:

	Share *capital/* premium £m	*Revaluation* reserve £m	Capital *redemption* reserve £m	Profit and loss account £m	2003 £m	Restated 2002 £m
Shareholders' funds at 1 January (as reported)	732	2,290	8	13	3,043	4,691
Prior year adjustment	–	(812)	–	–	(812)	(1,232)
Shareholders' funds at 1 January (as restated)	732	1,478	8	13	2,231	3,459
Transfer	–	(79)	–	79	–	–
Shareholders' recognised (losses) and gains	–	(160)	–	90	(70)	(1,135)
Issue of share capital	396	–	–	–	396	–
Increase in share premium	564	–	–	–	564	2
Dividends	–	–	–	(120)	(120)	(95)
Shareholders' funds at 31 December	1,692	1,239	8	62	3,001	2,231

Refer to note 1 for explanation of restatement.

28. Share capital

	2003 £m	2002 £m
Authorised		
3,923,636,364 *(2002 2,000,000,000) ordinary* shares of 27.5p each	1,079	550
300,000,000 (2002 300,000,000) preference shares of £1 each	300	300
Issued and fully paid		
2,880,199,331 (2002 1,439,945,133) ordinary shares of 27.5p each	792	396
125,000,000 (2002 125,000,000) preference shares of £1 each	125	125
	917	521

On 16 October 2003 the Company completed a one for one rights issue following which 1,439,990,771 ordinary shares of 27.5p each were issued for a total cash consideration of £1,008m less expenses of £48m. 263,427 ordinary shares of 27.5p were issued on the exercise of employee share options for a total cash consideration of £180,000. The total nominal value of ordinary shares issued during the year was £396m.

The preference shares carry a right to a fixed cumulative preferential dividend of 7.375% pa, payable in half yearly instalments, and are irredeemable. On a return of capital on a winding up, the holders are entitled, in priority to holders of all other shares of the Company, to receive out of the surplus assets of the Company any arrears and accruals of the dividend together with the greater of the price at which the gross yield on each preference share is equal to the mean gross yield on 3.5% War Loan or such Government Stock as may be agreed (but not exceeding twice the nominal amount of the preference share) and the nominal amount of the share together with any premium paid on issue. The holders of preference shares have the right to vote at a General Meeting of the Company only if at the date of the notice of the meeting the dividend payable on the shares is in arrears or otherwise on a resolution to vary *the rights attaching to the preference shares.*

The Royal & SunAlliance ESOP Trust holds ordinary shares in the Company which may subsequently be transferred to employees (other than the executive directors). At 31 December 2003 the Trust held 12,371,801 ordinary shares (2002 11,541,409) in the Company with a nominal value of £3,402,245 (2002 £3,173,887) and a market value, based on the mid market value of the Company's shares at the close of *business on* 31 December 2003 as shown in the Official List of the London Stock Exchange, of £11m (2002 £14m).

The Royal & SunAlliance ESOP Trust No 2 holds ordinary shares in the Company which may subsequently be transferred to employees including executive directors. At 31 December 2003 the Trust held 3,038,894 ordinary shares (2002 697,200) in the Company with a nominal value of £835,696 (2002 £191,730) and a market value, based on the mid market value of the Company's shares at the close of business on 31 December 2003 as shown in the Official List of the London Stock Exchange, of £3m (2002 £1m).

The Trustee of each Trust has waived its rights to dividends in excess of 0.01p on shares held by the Trusts. The Trustee did not exercise its rights under the one for one rights issue during the year. When computing the earnings per share, the shares held by the Trusts have been ignored in the calculation as, under FRS14 'Earnings per Share', they are treated as if they were cancelled.

28. Share capital (continued)

Post rights issue adjustment to share options

The Company completed a one for one rights issue on 16 October 2003, following which adjustments were made to the number of shares under option and to exercise prices, in accordance with the rules of the relevant share option schemes. After consultation with the Company's auditors and the Inland Revenue, a method of adjustment was established. As a result, numbers of shares under option were adjusted by a factor of 1.2380952381 and exercise prices were adjusted by a factor of 0.8076923077.

Employee savings related share option schemes

At 31 December 2003, under employee savings related share option schemes, employees held options over 40,148,839 ordinary shares at option prices ranging from 66.2p – 361.0p per share. Under the schemes, options are granted with an option price set at a discount of 12% to 20% of the market value of the ordinary shares in the period immediately preceding the date of grant. The options are normally exercisable within six months of the respective exercise date, which is set at three to seven years after the date of grant. The Group makes use of the exemption in UITF abstract 17 (revised 2000) and accordingly recognises no cost for the options.

Number of shares	Adjusted option price per share	Year of exercise
1,665,843	237.4p – 354.5p	2003
1,729,494	319.0p – 361.0p	2004
6,766,649	66.2p – 354.5p	2005
9,271,083	75.0p – 328.7p	2006
8,148,107	66.2p – 250.3p	2007
12,035,536	75.0p – 77.5p	2008
532,127	70.0p	2009

Executive share option schemes

At 31 December 2003, under executive share option schemes, options over 66,570,939 ordinary shares were held at option prices ranging from 59.0p – 439.4p. The options are potentially exercisable between three and ten years after grant, with the exception of the US scheme in which the exercise of options can be accelerated by the performance of the US subsidiary. These options are potentially exercisable between one and three years. Options outstanding are as follows:

Number of shares	Adjusted option price per share	Year of exercise
206,131	182.5p – 277.9p	1997
410,907	251.7p – 277.0p	1998
683,298	182.5p – 342.5p	1999
3,635,201	251.7p – 424.6p	2000
6,188,754	401.4p – 439.4p	2001
8,074,420	298.9p – 393.5p	2002
10,909,668	278.7p – 369.9p	2003
8,917,480	312.6p – 407.9p	2004
8,059,477	234.2p	2005
19,485,603	59.0p – 114.1p	2006

29. Dated loan capital

	Parent Company		Combined consolidated	
	2003 £m	2002 £m	2003 £m	2002 £m
Subordinated guaranteed US$ bonds	272	303	272	303
Subordinated guaranteed Euro bonds	350	324	350	324
Subordinated guaranteed loan	146	146	146	146
	768	773	768	773

The subordinated guaranteed US$ ($500m) bonds have a redemption date of 15 October 2029. The rate of interest payable on the US$ bonds is 8.95% although the Company manages the overall interest cost through the use of derivative contracts. At 31 December 2003 derivative contracts were in place which have the effect of converting the interest payable to a floating rate on US$25m until October 2004. Additionally, banks have the right to convert US$50m to a floating rate on any interest payment date of the bonds.

The subordinated guaranteed Euro bonds (€500m) have a redemption date of 15 October 2019. €200m of the Euro bonds bear interest at a fixed rate of 6.875% until 15 October 2009 and a floating rate thereafter. €300m of the Euro bonds bear interest at a floating rate from the date of issue. The Company has the option to repay the Euro bonds on specific dates from 15 October 2009.

The subordinated guaranteed loan has a redemption date of 18 February 2030. The loan (JPY25bn) is denominated in yen but interest is payable at 5.14% in US dollars. Derivative contracts are in place which convert the loan and interest payments to sterling at a fixed rate of 6.99%. Derivative contracts were also in place to reduce the fixed cost on £75m of the loan; the counterparties have the option to cancel some of these contracts which may result in the Company paying a floating rate of interest in the future.

The bonds and the loan are contractually subordinated to all other creditors of the Company such that in the event of a winding up or of bankruptcy, they are to be repaid only after the claims of all other creditors have been met.

30. Long term business provision

The principal assumptions used to calculate the UK long term business provision for the main classes of business are:

		2003	2002
Interest rates			
Life	– with profit	2.75% to 3.60%	3.15% to 3.60%
Pensions	– with profit	4.15% to 5.00%	4.00% to 4.75%
Annuities	– in payment	5.00% to 5.50%	5.20% to 5.50%
Mortality rates			
Life	– with profit	AM80, AF80 with adjustments	AM80, AF80 with adjustments
Pensions	– with profit	AM80, AF80 with adjustments	AM80, AF80 with adjustments
Annuities	– in payment	PMA92/PFA92 (c=2020) with adjustments	PMA92/PFA92 (c=2020) with adjustments

The valuation has been carried out principally using a gross premium method.

During the year the FSA has granted the two principal with profits companies waivers from certain aspects of the liability valuation rules, which inter alia, enabled them to use the gross premium method and has reduced their liabilities on the statutory solvency basis, with a corresponding increase in the Fund for Future Appropriations.

Generally accepted actuarial tables are used as appropriate in overseas long term business operations.

On 11 February 2003, the Group entered into an agreement with Unisys for the provision of administration services and support related functions to all of its UK Life subsidiaries. This agreement was effective from 1 May 2003. Accordingly, the costs set out in this agreement, together with the costs associated with non outsourced functions within the UK Life Operation, form the basis of the expense assumptions within the long term business provision in each of the UK Life subsidiaries.

31. Claims provisions

Claims outstanding include claims less reinsurance recoveries on certain classes of business which have been discounted. The total value of outstanding claims provisions less related reinsurance recoveries before discounting amounted to £11,241m (2002 £11,529m).

Claims are discounted, as follows:

	Category	Discount rate		Average period to settlement	
		2003 %	2002 %	2003	2002
UK	Asbestos & Environmental	5.00	5.00	7 years	8 years
Scandinavia	Disability	2.92	3.10	12 years	12 years
US	Asbestos & Environmental	5.00	5.00	11 years	11 years
	Disability	5.00	5.00	15 years	15 years
Canada	Asbestos & Environmental	5.00	6.00	6 years	6 years
Australia & New Zealand	Asbestos & Environmental	–	6.15	–	16 years

In determining the average period to ultimate claims settlement, estimates have been made based on the underlying claims settlement patterns.

Claims incurred in the General Business Technical Account include amounts in respect of accident years prior to 2003 of £653m (2002 £625m). This amount comprises changes to reported claims from prior accident years as well as increases in provisions for claims incurred in prior accident years but not reported at the balance sheet date. The majority was incurred in respect of liability business, including bodily injury claims on motor portfolios, in Canada, Scandinavia and Ireland, speciality general liability including asbestos in the US, asbestos claims in the UK, workers compensation claims in the US and Denmark and the discontinued inwards reinsurance book in the UK.

32. Provisions for other risks and charges

	Reorganisation provisions £m	Deferred taxation £m	Pensions and post retirement benefits £m	Other provisions £m	Total £m
At 1 January 2003	101	82	131	75	389
Exchange adjustments	(1)	6	(2)	–	3
Charged	202	226	67	131	626
Utilised	(172)	–	(130)	(94)	(396)
Transferred to other debtors/prepayments	–	(146)	(10)	–	(156)
Disposal of subsidiary undertakings	–	(53)	(5)	(6)	(64)
At 31 December 2003	130	115	51	106	402

Reorganisation provisions comprise costs relating to reorganisations mainly within the US general business and UK life and general business. This provision primarily comprises severance and property costs and is part of a programme to achieve business improvement and expense savings to be substantially achieved by year end 2006.

Other provisions include various litigation provisions of £6m, the payment of which is dependent upon legal processes. In addition, there are provisions of £57m held relating to vacant property leases, dilapidations and refurbishments, the costs relating to which will be borne across the period over which the leases expire, which is up to 20 years.

33. Borrowings

	Shareholder consolidated		Combined consolidated	
	2003 £m	2002 £m	2003 £m	2002 £m
Debenture loans				
Secured (note 3)				
5% (2002 10.47%) mortgage loans	12	13	12	15
Unsecured				
9.625% subordinated bonds 2003	–	90	–	90
Total debenture loans	12	103	12	105
Amounts owed to credit institutions – unsecured	422	597	422	597
Total borrowings	434	700	434	702
Repayable as follows:				
1 year or less	102	683	102	683
Between 1 and 2 years	85	1	85	1
Between 2 and 5 years	234	2	234	2
After 5 years	13	14	13	16
	434	700	434	702

Notes:

1. Interest payable on amounts repayable within five years was £28m (2002 £45m) and after five years £1m (2002 £2m).
2. Loans from credit institutions of £400m (2002 £566m) under committed credit facilities have been classified by reference to the earliest date on which repayment may be demanded by the lender. At 31 December 2003 total committed credit facilities available to the Group were £400m (2002 £1,454m), of which £83m (2002 £1,454m) expire within one year, £83m (2002 £nil) expire within one to two years, and £234m (2002 £nil) expire within two to five years. Additional borrowings are subject to covenants in respect of the Group's shareholders' funds.
3. The secured debenture loans are secured on certain properties of the Group.
4. The Parent Company has borrowings of £nil (2002 £256m).

34. Other creditors

Other creditors including taxation and social security in the Combined Consolidated Balance Sheet includes a liability of £85m (2002 £168m) in respect of corporation tax payable.

35. Deferred taxation

	Shareholder consolidated		Combined consolidated	
	2003 £m	2002 £m	2003 £m	2002 £m
Unrealised investment gains	(123)	(274)	(164)	(260)
Other timing differences	114	344	71	336
	(9)	70	(93)	76
Discount	3	4	26	7
	(6)	74	(67)	83
Pension costs	13	42	13	42
Deferred tax asset/(provision)	7	116	(54)	125

Deferred tax assets that cannot be recovered against deferred tax liabilities have been recognised only to the extent that the directors believe that there will be suitable taxable profits to absorb them in the foreseeable future. Net deferred tax assets are principally attributable to discounting of claims reserves and unclaimed capital allowances in the UK.

No credit has been taken in the deferred tax provision for UK tax losses with an estimated tax value of £135m. This amount comprises capital losses that arose prior to the merger of the Royal Insurance and Sun Alliance groups, the use of which is severely restricted by UK tax law. The recoverability of any associated deferred tax asset is therefore considered unlikely.

A deferred tax asset has not been recognised in respect of UK capital losses with an estimated value of £43m, or for non UK tax losses and other tax assets with a value of £226m (including £212m in respect of the US) as it is not considered likely that suitable profits will arise to absorb these losses in the near future.

Deferred tax assets and liabilities are discounted at rates reflecting post tax yields to maturity that can be obtained at the balance sheet date on government bonds with maturity dates and in currencies similar to those of the deferred tax assets and liabilities. The discount rates used are within the range of 1% to 5%.

36. Operating leases

	Land and buildings		Other	
	2003 £m	2002 £m	2003 £m	2002 £m
Annual commitments under non cancellable operating leases which expire:				
1 year or less	7	10	2	4
Between 2 and 5 years	24	40	6	11
After 5 years	50	60	–	–
	81	110	8	15

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

37. Managed funds

The Group administers the funds of a number of group pension funds in its own name but on behalf of others. The assets, as shown below, and corresponding liabilities of these funds have been included within the Combined Consolidated Balance Sheet.

	2003 £m	2002 £m
Land and buildings	66	65
Shares and other variable yield securities and units in unit trusts	260	302
Debt securities and other fixed income securities	107	85
Cash at bank and in hand	9	14
	442	466
Debtors	2	2
Creditors	(1)	(2)
Net assets	443	466

38. Reconciliation of total Group operating profit/(loss) before tax to net cash inflow

	2003 £m	2002 £m
Total Group operating profit/(loss)	133	(1,202)
Unrealised and realised gains/(losses)	(87)	276
Change in technical provisions and equalisation provisions	(112)	539
Profits relating to long term business	(546)	(209)
Contingent loan finance to long term business funds	(160)	(160)
Cash received from long term business	160	94
Depreciation	58	74
Amortisation and impairment of goodwill and goodwill in acquired claims provisions	43	738
Interest on dated loan capital	53	52
Change in debtors less creditors	588	(211)
Net cash inflow/(outflow) from operating activities	130	(9)

39. Movements in opening and closing portfolio investments net of financing

	2003 £m
Net cash outflow for the period	(184)
Increase in net portfolio investments	1,711
Decrease in borrowings	257
Issue of share capital	(960)
Movement arising from cash flows	824
Movement in long term business	(1,127)
Acquisitions and disposals of subsidiary undertakings	(1,466)
Changes in market values and exchange rates	17
Other	(15)
Total movement in portfolio investments net of financing	(1,767)
Portfolio investments net of financing	
At 1 January 2003	39,098
At 31 December 2003	37,331

40. Portfolio investments

	2003 £m	2002 £m
Purchase of portfolio investments		
Land and buildings	270	16
Shares and other variable yield securities	5,583	978
Loans, debt securities and fixed income securities	19,345	27,087
	25,198	28,081
Sale of portfolio investments		
Land and buildings	(42)	(46)
Shares and other variable yield securities	(5,849)	(1,984)
Loans, debt securities and fixed income securities	(17,727)	(25,944)
	(23,618)	(27,974)
Net increase/(decrease) in deposits with credit institutions	131	(196)
Net portfolio investments	1,711	(89)

41. Movements in cash, portfolio investments and financing

	At 1 January 2003 £m	Cash flow £m	Long term business £m	Acquisitions and disposals of subsidiary undertakings (excl cash) £m	Market value and currency £m	Transfers/ other £m	At 31 December 2003 £m
Land and buildings	2,975	228	(72)	(2)	(17)	6	3,118
Shares and other variable yield securities	5,888	(266)	(1,091)	(12)	132	232	4,883
Loans, debt securities and fixed income securities	30,229	1,618	542	(1,124)	(131)	(227)	30,907
Deposits with credit institutions	1,256	131	(217)	(336)	2	(22)	814
Net cash at bank and in hand	957	(184)	(291)	–	25	(4)	503
Share capital/premium	(732)	(960)	–	–	–	–	(1,692)
Borrowings	(702)	257	2	8	1	–	(434)
Dated loan capital	(773)	–	–	–	5	–	(768)
Total	39,098	824	(1,127)	(1,466)	17	(15)	37,331

42. Analysis of the net outflow of cash in respect of acquisitions of subsidiary undertakings

	2003 £m	2002 £m
Cash consideration	(1)	(32)
Cash at bank and in hand acquired	–	–
Net outflow of cash in respect of acquisitions of subsidiary undertakings	(1)	(32)

43. Disposal of subsidiary undertakings

	2003 £m
Net assets disposed of:	
Intangible assets	64
Investments	1,474
Value of long term business	26
Cash at bank	16
Other assets	944
Other liabilities	(254)
Technical provisions for general business	(1,490)
Profit on disposal before write off of goodwill	16
Total disposal consideration	796
Consideration in respect of prior year disposals	51
Total cash consideration	847

44. Transactions with related parties

A number of the directors, other key managers, their close families and entities under their control have general and/or long term insurance policies with subsidiary companies of the Group. Such policies are on normal commercial terms except that executive directors and key managers are entitled to special rates which are also available to other members of staff. The Board has considered the financial effect of such insurance policies and other transactions with Group companies and has concluded that they are not material to the Group or the individuals concerned and, if disclosed, would not influence decisions made by users of these financial statements.

The Board has also concluded that there are no transactions with other directors or key managers that are material to their own financial affairs.

45. Shareholders' interest in long term business

The total shareholders' interest in long term business represents those assets which the directors assess to be the amount maintained in support of the long term business and comprises:

	UK £m	Scandinavia £m	International £m	2003 £m	Restated 2002 £m
Shareholders' accrued interest	321	–	–	321	71
Value of long term business	–	–	–	–	86
Shareholders' funds	372	316	25	713	905
	693	316	25	1,034	1,062
Less attributed to general business				(300)	(100)
				734	962

As described in note 1, in 2003 the Group changed its accounting policy on the recognition of the internally generated value of long term insurance business. The value of the long term insurance business at 31 December 2003 was £501m (2002 £898m), excluding shareholders accrued interest of £321m (2002 £71m). This represents the amount considered by the directors, based on internal actuarial advice, to be a prudent value of the shareholders' interest in the long term business funds not already recognised under the modified statutory principles of profit recognition. The principal assumptions used to calculate the value of the UK long term business are:

	2003 %	2002 %
Investment return:		
Fixed interest	4.84	4.50
UK equities	7.34	7.00
Overseas equities	7.34	7.00
Expense inflation	3.50	3.00
Discount rate (including risk margins)	8.40	8.20
Risk margin included within discount rate	5.00	5.00

The investment returns represent the underlying long term assumptions implicit in the calculation of the value of long term business.

Segmental Information

	Total		General business		Personal		Commercial		Long term business	
	2003 £m	2002 £m	2003 £m	2002 £m	2003 £m	2002 £m	2003 £m	2002 £m	2003 £m	2002 £m
Net premiums written (note 6)										
UK (note 12, 13)	3,730	4,381	2,822	3,426	1,152	1,647	1,670	1,779	908	955
Scandinavia (note 2)	1,513	1,236	1,167	952	618	525	549	427	346	284
US (note 3, 14)	1,090	1,895	1,090	1,895	460	470	630	1,425	–	–
Canada (note 3)	503	527	503	527	374	348	129	179	–	–
International (note 4, 9)	912	1,513	765	1,079	370	530	395	549	147	434
Australia & New Zealand (note 5)	355	965	283	756	197	502	86	254	72	209
	8,103	10,517	6,630	8,635	3,171	4,022	3,459	4,613	1,473	1,882
Underwriting result/balance on the technical account – long term business (note 7)										
UK (note 12, 13)	479	(67)	(76)	(177)	(69)	(181)	(7)	4	555	110
Scandinavia (note 2)	25	(23)	(11)	(94)	(38)	(42)	27	(52)	36	71
US (note 3, 15)	(748)	(454)	(748)	(454)	21	(31)	(769)	(423)	–	–
Canada (note 3)	(23)	(88)	(23)	(88)	(12)	(51)	(11)	(37)	–	–
International (note 4, 10)	–	(128)	35	(130)	27	(62)	8	(68)	(35)	2
Australia & New Zealand (note 5)	2	53	12	27	6	35	6	(8)	(10)	26
	(265)	(707)	(811)	(916)	(65)	(332)	(746)	(584)	546	209
Group operating result (based on longer term investment return) (note 8)										
UK (note 12, 13)	389	305	278	195	52	(21)	226	216	111	110
Scandinavia (note 2)	134	94	96	23	23	21	73	2	38	71
US (note 3, 16)	(469)	(201)	(469)	(201)	51	11	(520)	(212)	–	–
Canada (note 3)	35	(25)	35	(25)	19	(19)	16	(6)	–	–
International (note 4, 11)	115	11	108	–	60	–	48	–	7	11
Australia & New Zealand (note 5)	47	132	35	97	21	80	14	17	12	35
	251	316	83	89	226	72	(143)	17	168	227
Other activities (note 17)	(111)	(90)								
Group operating result (based on longer term investment return)	140	226								
Interest on dated loan capital	(53)	(52)								
Change in the equalisation provisions	(24)	1								
Amortisation and impairment of goodwill	(24)	(713)								
Amortisation of goodwill in acquired claims provisions	(19)	(25)								
Exceptional gain on UK long term insurance business	444	–								
Reorganisation costs and other items	(268)	(92)								
Group operating profit/(loss) (based on longer term investment return)	196	(655)								

Notes:

1. The segmental analysis above has been changed from previous years to reflect the new geographic focus of the Group; the key outcome of this was the creation of the International segment to include all markets outside of the UK, Scandinavia, the US and Canada.

   The comparative figures for 2002 shown above have been reanalysed to reflect the new segmental reporting. The change had no effect on the net premiums written, the underwriting result or the Group operating result (based on longer term investment return).

2. Scandinavia was reported in previous years under EMEA.

3. The US and Canada were reported in previous years under Americas.

4. International was created on 1 May 2003 and comprises businesses in other Europe and Middle East (previously reported under EMEA), Latin America and the Caribbean (previously reported under Americas) and Asia (previously reported under Asia Pacific).

5. In May 2003 the Group disposed of its general insurance businesses and life and asset accumulation businesses in Australia and New Zealand by way of an Initial Public Offering under the Promina brand. Australia and New Zealand were previously reported under Asia Pacific. In 2003 the results prior to disposal are shown under Australia and New Zealand.

6. Net premiums written by destination do not differ materially from net premiums written by source.

7. The balance on the Long Term Business Technical account is gross of tax.

8. Group operating result (based on longer term investment return) is a measure used for internal purposes in the management of the Group's business segments.

9. Included within International in general business is net premiums written of £11m (2002 £277m) relating to the Royal & Sun Alliance Insurance Company of Puerto Rico business disposed during the year (2002 Securitas Bremer Algemeine Versicherungs AG, Royal & SunAlliance Schaderverzekering NV and Italy Direct Branch and the comparative relating to the 2003 disposal). Included in long term business is net premiums written of £95m (2002 £384m) relating to the Compañia de Seguros de Vida La Construcción and Royal & Sun Alliance Eurolife Ltd businesses disposed during the year (2002 Securitas Lebensversicherung AG, Royal & SunAlliance Levensverzekering NV, Royal & SunAlliance International Financial Services Ltd and the comparative relating to the 2003 disposals).

10. Included within International in general business is an underwriting loss of £2m (2002 £28m) relating to the Royal & Sun Alliance Insurance Company of Puerto Rico business disposed during the year (2002 Securitas Bremer Algemeine Versicherungs AG, Royal & SunAlliance Schaderverzekering NV and Italy Direct Branch and the comparative for the 2003 disposal). Included in long term business is an underwriting loss of £33m (2002 profit of £5m) relating to the Compañia de Seguros de Vida La Construcción and Royal & Sun Alliance Eurolife Ltd businesses disposed during the year (2002 Securitas Lebensversicherung AG, Royal & SunAlliance Levensverzekering NV, Royal & SunAlliance International Financial Services Ltd and the comparative for the 2003 disposals).

11. Included within International in general business is an operating result of £nil (2002 profit £7m) relating to the Royal & Sun Alliance Insurance Company of Puerto Rico business disposed during the year (2002 Securitas Bremer Algemeine Versicherungs AG, Royal & SunAlliance Schaderverzekering NV and Italy Direct Branch and the comparative for the 2003 disposal). Included in long term business is an operating profit of £8m (2002 £14m) relating to the Compañia de Seguros de Vida La Construcción and Royal & Sun Alliance Eurolife Ltd businesses disposed during the year (2002 Securitas Lebensversicherung AG, Royal & SunAlliance Levensverzekering NV, Royal & SunAlliance International Financial Services Ltd and the comparative for the 2003 disposals).

12. Included within UK in long term business is net premiums written of £nil (2002 £(150)m) relating to the disposed Group risk business.

13. Included within UK in general business is net premiums written of £(102)m (2002 £245m) after the transfer of unearned premium reserves through a reinsurance agreement, an underwriting profit of £5m (2002 £26m) and an operating result of £7m (2002 £34m), all relating to the disposal of UK Healthcare & Assistance.

14. Included within US in general business is net premiums written of £52m (2002 £320m), after the transfer of unearned premium reserves through a reinsurance agreement relating to the Royal Specialty Underwriting Inc and Landmark American Insurance Company businesses disposed of during the year.

15. Included within US in general business is an underwriting profit of £52m (2002 £133m) relating to the Royal Specialty Underwriting Inc and Landmark American Insurance Company businesses disposed of during the year.

16. Included within US in general business is an operating result of £72m (2002 £181m) relating to the Royal Specialty Underwriting Inc and Landmark American Insurance Company businesses disposed of during the year.

17. Included within other activities is a loss of £13m (2002 £14m) in relation to non insurance activities.

Segmental Information (continued)

	Total		General business		Long term business	
	2003 £m	Restated 2002 £m	2003 £m	Restated 2002 £m	2003 £m	Restated 2002 £m
Total capital, reserves and dated loan capital						
UK	1,484	115	791	(223)	693	338
Scandinavia (note 2)	1,223	1,086	907	761	316	325
US (note 3)	856	1,325	856	1,325	–	–
Canada (note 3)	440	376	440	376	–	–
International (note 4)	401	388	376	222	25	166
Australia & New Zealand (note 5)	–	606	–	373	–	233
	4,404	3,896	3,370	2,834	1,034	1,062
Associated undertakings	122	166				
Other businesses (note 18)	(411)	(653)				
Total capital, reserves and dated loan capital	4,115	3,409				

Notes:

18. The capital, reserves and dated loan capital attributed to other businesses include those of non insurance businesses and Group borrowings.

19. Dated loan capital consists of £272m (2002 £303m) in US dollars, £350m (2002 £324m) in euros and £146m (2002 £146m) in sterling.

20. The directors consider that in relation to reporting of profit and loss account information the reportable segments of the general business are personal and commercial. Such a segmentation is not considered appropriate in relation to the Group's total capital where risk based capital modelling is used to allocate capital to regions and operations. There are differences between actual regional total capital and that considered to be required on a risk based capital basis due to regulatory requirements at the individual operation level.

21. Refer to note 1 of the Notes on the Accounts for an explanation of the restatement.

Principal Subsidiary Companies

As at 31 December 2003

		Principal activity
United Kingdom	Royal Insurance Holdings plc (note 2)	Holding company
	Royal & Sun Alliance Insurance plc	General insurance
	British Aviation Insurance Company Limited (57.1%)	General insurance
	The Globe Insurance Company Limited	General insurance
	The London Assurance	General insurance
	The Marine Insurance Company Limited	General insurance
	Phoenix Assurance plc	Composite insurance
	Royal International Insurance Holdings Limited	General insurance
	Royal & Sun Alliance Reinsurance Limited	General insurance
	Royal & Sun Alliance Life & Pensions Limited	Life insurance
	Royal & Sun Alliance Linked Insurances Limited	Life insurance
	Sun Alliance and London Insurance plc	General insurance
	Sun Alliance and London Assurance Company Limited	Life insurance
	Royal & Sun Alliance Life Holdings Limited	Holding company
	Sun Insurance Office Limited	General insurance
Argentina	Royal & Sun Alliance Seguros (Argentina) SA	General insurance
Brazil	Royal & Sun Alliance Seguros (Brasil) SA	General insurance
Canada	Roins Financial Services Limited	Holding company
	Compagnie d'Assurance du Quebec (99.8%)	General insurance
	The Johnson Corporation	General insurance
	Royal & Sun Alliance Insurance Company of Canada	General insurance
	Western Assurance Company	General insurance
Chile	Royal & Sun Alliance Seguros (Chile) SA (97.5%)	General insurance
Colombia	Royal & Sun Alliance Seguros (Colombia) SA (86.3%)	General insurance
	Royal & Sun Alliance Seguros de Vida (Colombia) SA (86.3%)	Life insurance
Denmark	Codan A/S (71.7%)	Holding company
	Codan Forsikring A/S (71.7%)	General insurance
	A/S Forsikringsselskabet Codan Pension (71.7%)	Life insurance
	Codan Pensionforsikring A/S (71.7%)	Life insurance
Guernsey	Insurance Corporation of the Channel Islands Limited	General insurance
Hong Kong	Royal & Sun Alliance Insurance (Hong Kong) Limited	General insurance
Isle of Man	Tower Insurance Company Limited	General insurance
Mexico	Royal & SunAlliance Seguros (Mexico) SA	General insurance
Netherlands Antilles	Royal & Sun Alliance Insurance (Antilles) NV (51.0%)	General insurance
Saudi Arabia	Royal & Sun Alliance Insurance (Middle East) Limited E.C. (50.01%)	General insurance
Singapore	Royal & Sun Alliance Insurance (Singapore) Limited	General insurance
Sweden	Trygg-Hansa Försäkrings AB, Publikt (71.7%)	General insurance
United States of America	Royal & Sun Alliance USA, Inc	Holding company
	Royal Indemnity Company	General insurance
	Royal Insurance Company of America	General insurance
	Guaranty National Insurance Company	General insurance
	Viking Insurance Company of Wisconsin	General insurance
Uruguay	Royal & Sun Alliance Seguros (Uruguay) SA	General insurance
Venezuela	Royal & Sun Alliance Seguros (Venezuela) SA (99.0%)	General insurance

Notes:

1. All UK companies are incorporated in Great Britain and are registered in England.
2. 100% direct subsidiary of Royal & Sun Alliance Insurance Group plc.
3. Except where indicated, all holdings are of equity shares and represent 100% of the nominal issued capital.
4. Some subsidiaries have been omitted from this statement to avoid providing particulars of excessive length but none materially affects the results or assets of the Group.

Principal Associated Undertakings and Other Significant Shareholdings

As at 31 December 2003

	Country	Holding
Principal associated undertakings (see notes below)		
Royal & Sun Alliance Insurance (Malaysia) Bhd	Malaysia	45.0%
Royal Sundaram Alliance Insurance Ltd	India	26.0%
Syn Mun Kong Insurance Public Company Ltd (30.9.03)	Thailand	20.0%
Other significant shareholdings (see notes below)		
Rothschilds Continuation Holdings AG (merchant banking group)	Switzerland	21.5%

Notes:

1. Associated undertakings: where the figures included in the accounts are not for the year ended 31 December 2003, the relevant accounting date is shown in brackets.

2. The countries shown are those of incorporation and principal operation.

3. Unless otherwise stated, all companies are engaged in the transaction of insurance or related business. All are owned by subsidiaries of the Group.

4. The Group's participating interest in Rothschilds Continuation Holdings AG, is accounted for as an investment in view of the disposition of the other shareholdings. The aggregate amount of the capital and reserves at 31 March 2003, the company's year end, was £544m. The profit for the year ended 31 March 2003 was £55m.

5. In January 2004 the Group announced its disposal of its 37.5% interest in Mutual & Federal Insurance Company Ltd, a South African undertaking.

6. In February 2004 the Group announced its disposal of its 14.5% interest in Rimac-Internacional Compañia de Seguros y Reaseguros, a Peruvian undertaking.

Five Year Financial Review

Consolidated Profit and Loss Account	Convenience translation (note 1) 2003 $m	2003 £m	Restated 2002 £m	Restated 2001 £m	Restated 2000 £m	Restated 1999 £m
Net premiums written						
General business	11,868	6,630	8,635	8,813	8,372	7,159
Long term business	2,637	1,473	1,882	2,899	3,439	3,284
Total	14,505	8,103	10,517	11,712	11,811	10,443
Balance on the technical accounts						
General business	(234)	(131)	(6)	(181)	101	231
Long term business gross of taxation	977	546	209	173	239	235
Investment income net of investment expenses and charges	1,894	1,058	978	1,137	1,212	1,582
Unrealised losses on investments	(707)	(395)	(638)	(1,013)	(161)	(645)
Allocated investment return transferred to the general business technical account	(1,373)	(767)	(962)	(1,142)	(1,119)	(1,007)
Income/(charges) from other activities/ central expenses	(224)	(125)	(74)	(54)	(47)	(15)
Amortisation and impairment of goodwill	(43)	(24)	(713)	(58)	(56)	(14)
General business result	149	83	89	(11)	290	301
Long term business result	301	168	227	186	252	243
Other activities (including associated undertakings)	(199)	(111)	(90)	(159)	(80)	11
Group operating result (based on longer term investment return)	251	140	226	16	462	555
Change in the equalisation provisions	(43)	(24)	1	(46)	(24)	(12)
Exceptional gain on UK long term insurance business	794	444	–	–	–	–
Reorganisation costs and other items	(651)	(364)	(882)	(263)	(289)	(96)
Group operating profit/(loss) (based on longer term investment return)	351	196	(655)	(293)	149	447
Short term investment fluctuations	(61)	(34)	(551)	(845)	20	(80)
Profit/(loss) on ordinary activities before exceptional items and tax	290	162	(1,206)	(1,138)	169	367
(Loss)/profit on disposal of subsidiaries less provisions for losses on subsidiaries to be sold	(551)	(308)	253	(72)	(128)	–
(Loss)/profit on ordinary activities before tax	(261)	(146)	(953)	(1,210)	41	367
Tax on (loss)/profit on ordinary activities	(388)	(217)	91	353	(128)	(71)
(Loss)/profit on ordinary activities after tax	(649)	(363)	(862)	(857)	(87)	296
Attributable to equity minority interests	(34)	(19)	(9)	5	1	(22)
(Loss)/profit for the financial year attributable to shareholders	(683)	(382)	(871)	(852)	(86)	274
Earnings per ordinary share	(35.1)c	(19.6)p	(49.8)p	(48.8)p	(5.4)p	14.4p
Group operating earnings after tax per ordinary share (note 2)	4.5c	2.5p	4.6p	(3.3)p	14.1p	20.0p

Notes:

1. Included is a translation of the data for the year ended 31 December 2003, from sterling into US dollars, for the convenience of our US shareholders. The translation rate is US$1.79, the closing rate at 31 December 2003.

2. Earnings per ordinary share and Group operating earnings after tax per ordinary share have been restated to reflect the bonus element of the rights issue in October 2003.

3. Prior years have been restated. Refer to note 1 of the Notes on the Accounts for explanation of restatement.

Five Year Financial Review (continued)

Statement of Total Recognised Gains and Losses	Convenience translation (note 1) 2003 $m	2003 £m	Restated 2002 £m	Restated 2001 £m	Restated 2000 £m	Restated 1999 £m
(Loss)/profit for the financial year attributable to shareholders	(683)	(382)	(871)	(852)	(86)	274
Exchange	(21)	(12)	(265)	(68)	160	43
Shareholders' consolidated recognised (losses)/gains	(704)	(394)	(1,136)	(920)	74	317
Movements in Shareholders' Funds						
Shareholders' funds at 1 January (as restated)	3,993	2,231	3,459	4,433	4,637	5,392
Shareholders' consolidated recognised (losses)/gains	(704)	(394)	(1,136)	(920)	74	317
Issue of share capital/increase in share premium	1,718	960	2	14	19	15
Dividends	(215)	(120)	(95)	(236)	(381)	(1,113)
Other reserve movements (including write off of goodwill not capitalised up to 1997)	580	324	1	168	84	26
Shareholders' funds at 31 December	5,372	3,001	2,231	3,459	4,433	4,637
Total return to shareholders (note 3, 4)	(36.1)c	(20.2)p	(64.8)p	(52.7)p	3.7p	16.8p
Dividend per ordinary share (note 3, 4)	8.1c	4.5p	4.8p	12.9p	21.0p	58.7p

Notes:

1. We have included a translation of the data for the year ended 31 December 2003, from sterling into US dollars, for the convenience of our US shareholders. The translation rate is US$1.79, the closing rate at 31 December 2003.

2. Net assets per share is calculated on equity shareholders' funds and the number of ordinary shares in issue at the end of the year.

3. Net assets per share, total return to shareholders and dividend per ordinary share have been restated to reflect the bonus element of the rights issue in October 2003.

4. Prior years have been restated. Refer to note 1 of the Notes on the Accounts for an explanation of the restatement.

Combined Consolidated Balance Sheet

	Convenience translation (note 1) 2003 $m	2003 £m	Restated 2002 £m	Restated 2001 £m	Restated 2000 £m	Restated 1999 £m
Assets						
Intangible assets	387	216	306	1,086	1,086	1,035
Investments						
Land and buildings	5,581	3,118	2,975	2,937	2,699	2,386
Interests in associated undertakings	218	122	166	233	242	222
Other financial investments						
Shares and other variable yield securities and units in unit trusts	8,741	4,883	5,888	11,632	17,780	18,742
Debt securities and other fixed income securities	55,046	30,752	29,878	26,967	25,673	24,646
Loans and deposits with credit institutions	1,735	969	1,607	2,056	1,422	1,396
	65,522	36,604	37,373	40,655	44,875	44,784
Value of long term business	–	–	86	103	126	158
Deposits with ceding undertakings	111	62	179	91	131	115
Total investments	71,432	39,906	40,779	44,019	48,073	47,665
Assets held to cover linked liabilities	6,934	3,874	4,169	7,631	8,783	8,429
Reinsurers' share of technical provisions	8,792	4,912	5,973	5,417	4,800	4,066
Debtors	7,189	4,016	4,816	5,038	4,605	4,336
Other assets	1,176	657	1,193	1,093	1,058	1,119
Prepayments and accrued income	2,449	1,368	1,898	1,986	1,970	1,988
Total assets	98,359	54,949	59,134	66,270	70,375	68,638
Liabilities						
Capital and reserves						
Called up share capital and share premium	3,029	1,692	732	730	712	688
Capital redemption reserve	14	8	8	8	8	8
Profit and loss account	2,330	1,301	1,491	2,721	3,713	3,941
Shareholders' funds	5,373	3,001	2,231	3,459	4,433	4,637
Equity minority interests in subsidiary undertakings	619	346	405	399	406	411
Dated loan capital	1,375	768	773	784	784	610
Total capital, reserves and dated loan capital	7,367	4,115	3,409	4,642	5,623	5,658
Fund for future appropriations	3,766	2,104	1,669	2,642	3,585	4,884
Technical provisions						
Provision for unearned premiums	6,960	3,888	5,155	5,087	4,685	4,476
Long term business provision	39,759	22,212	24,661	25,101	27,854	25,874
Claims outstanding	26,459	14,782	15,371	15,625	14,519	13,941
Equalisation provisions	571	319	293	331	283	259
	73,749	41,201	45,480	46,144	47,341	44,550
Technical provisions for linked liabilities	6,933	3,873	4,168	7,619	8,726	8,318
Provisions for other risks and charges	720	402	389	605	1,217	1,343
Borrowings	777	434	702	1,084	382	676
Other creditors	4,150	2,319	2,824	2,977	3,017	2,827
Accruals and deferred income	897	501	493	557	484	382
Total liabilities	98,359	54,949	59,134	66,270	70,375	68,638
Net assets per ordinary share (note 2, 3)	179c	100p	118p	187p	243p	255p

Shareholder Information

Cautionary statements
This document contains forward looking statements as defined in the US Private Securities Litigation Reform Act of 1995. It contains forward looking statements and information relating to the Company's financial condition, results of operations, business, strategy and plans, based on currently available information. These statements are often, but not always, made through the use of words or phrases such as 'expects', 'should continue', 'believes', 'anticipates', 'estimated' and 'intends'. The specific forward looking statements cover, among other matters: industry outlook, the timing of our disposal programme, the appropriateness of the level of our claims provisions, regulatory approval of the release of surplus solvency capital, reduction in expenses in the UK Life operations and the prospect for improving results. Such statements are inherently subject to certain risks and uncertainties. Actual future results and trends could differ materially from those set forth in such statements due to various factors. Such factors include general economic conditions, including in particular economic conditions in the United Kingdom; the frequency, severity and development of insured loss events arising out of catastrophes; as well as man made disasters; the availability, pricing and ability to collect reinsurance; the ability to exclude and to reinsure the risk of loss from terrorism; mortality and morbidity experience and trends; policy renewal and lapse rates; fluctuations in interest rates; returns on and fluctuations in the value of fixed income investments, equity investments and properties; fluctuations in foreign currency exchange rates; rating agency actions; changes in laws and regulations; judicial decisions and rulings and general competitive factors, and other risks and uncertainties, including those detailed in the Company's filings with the US Securities and Exchange Commission and the UK Listing Authority. The Company does not assume any obligation to update any forward looking statements, whether as a result of new information, future events or otherwise. Past performance cannot be relied on as a guide to future performance.

Registrar
Lloyds TSB Registrars, PO Box 3679, 54 Pershore Road South, Birmingham B22 1AH. Shareholder Helpline Telephone: +44 (0)870 600 3988
Shareholders with a text phone facility should use +44 (0)870 600 3950
Internet address: www.lloydstsb-registrars.co.uk

There is now a range of shareholder information on line at www.shareview.co.uk. Shareholders can check holdings and find practical help on transferring shares or updating details and register their email address to receive shareholder information and Annual Report & Accounts electronically.

Royal & SunAlliance has appointed Lloyds TSB Registrars as its registrar to manage the shareholder register, ensuring that all information held about the Group's shareholders is kept up to date, and to pay dividends.

As a shareholder of the Group, you will be sent information about Royal & SunAlliance. It is important to ensure that Lloyds TSB Registrars are kept up to date about any changes to your personal details, such as your name and home address. Further details can be found in the Frequently Asked Questions section.

Scrip dividends
Subject to shareholder approval at the AGM on 28 May 2004, the Company is offering shareholders the opportunity to take new ordinary shares, credited as fully paid, in lieu of cash dividends, by participating in a Scrip Dividend Scheme.

Participation in the Scrip Dividend Scheme will enable shareholders to increase their holdings in the Company without incurring dealing costs or stamp duty. At the same time, the Company will benefit by retaining the cash for reinvestment that would otherwise be paid out as dividends.

Details of the proposed Scrip Dividend Scheme were mailed to shareholders on 15 March 2004. If you are a shareholder and did not receive this mailing, or wish to obtain further details, please contact Lloyds TSB Registrars on 0870 241 3018 (+44 121 415 7047 if you are calling from overseas) or look at their website.

The Scrip Dividend Scheme will be operated on a mandate basis. If a mandate form is completed, all future dividends will automatically be paid in the form of an allotment of the Company's shares. Shareholders who wish to continue to receive cash dividends on their shares need take no further action.

The Dividend Reinvestment Plan which the Company currently operates will cease to be effective following the implementation of the Scrip Dividend Scheme.

Personal Equity Plans (PEPs)
New investments in PEPs have not been permitted since 5 April 1999 when the Government replaced PEPs with Individual Saving Accounts (ISAs). Investors who hold shares in an existing Royal & SunAlliance Corporate PEP or Royal & SunAlliance Single Company PEP managed by Halifax Investment Services Limited can obtain full details of their investment from: Halifax Investment Services Mellon House, Ingrave Road, Brentwood, Essex CM15 8TA. Telephone: +44 (0)870 606 6418

Share dealing service
We have established an execution only share dealing service, through Cazenove & Co. Ltd, for private investors who wish to buy or sell Royal & Sun Alliance Insurance Group plc shares. Further details can be obtained from: Royal & SunAlliance Share Dealing Service, Cazenove & Co. Ltd, 20 Moorgate, London EC2R 6DG. Telephone: +44 (0)20 7155 5155

Shareholder Information (continued)

ShareGIFT
If you only have a small number of shares which are uneconomic to sell, you may wish to consider donating them to charity under ShareGIFT; a charity share donations scheme administered by the Orr Mackintosh Foundation. A ShareGIFT transfer form may be obtained from Lloyds TSB Registrars. Further information about the Scheme can be found on the ShareGIFT website at www.sharegift.org.

Capital gains tax
The market value at 31 March 1982 of each post consolidation ordinary share of 27.5p in the Company, for capital gains tax purposes after relevant adjustments, was 146.41p (25p shares 133.1p) for former Royal Insurance shareholders and 57.97p (25p shares 52.7p) for former Sun Alliance shareholders. An adjustment to tax cost is required to take account of the 2003 rights issue according to whether the rights were taken up or sold. Similarly, for former Royal Insurance shareholders, an adjustment to tax cost is required to take account of the 1993 rights issue according to whether the rights were taken up or sold.

Internet
The Annual Report & Accounts, interim statements and other useful information on the Company are available through the Internet at www.royalsunalliance.com.

Annual General Meeting
We welcome the views of shareholders and hope that you will be able to attend the Company's Annual General Meeting, which will be held in the Grand Ballroom, Hotel Inter-Continental London, One Hamilton Place, Hyde Park Corner, London W1V 0QY at 10.30am on 28 May 2004. The Notice of the Meeting and the Proxy Card accompany this document. If you are unable to attend the Annual General Meeting to ask a question in person, you may write to us at 30 Berkeley Square, London W1J 6EW or contact us through our Group website at www.royalsunalliance.com.

Disabled shareholders
Royal & SunAlliance are committed to providing a quality service to all their shareholders. Please let us know if you would like documentation to be provided to you in a special format and we will do our best to meet your request.

American depositary shares (ADSs)
Each ADS represents five ordinary shares.

The Group is subject to the informational requirements of the US securities laws applicable to foreign companies and files an annual report on Form 20-F and other information with the US Securities and Exchange Commission.

Any enquiry relating to ADS holdings should be addressed to, Citibank NA, Shareholder Services, PO Box 2502, Jersey City, NJ 07303
Telephone: + 1 877 248 4237, Internet address: www.citibank.com/adr

ADS holders receive the annual reports issued by the Group.

ADS dividends
ADS holders are eligible for all dividends or other entitlements accruing on the underlying Royal & Sun Alliance Insurance Group plc shares and receive all cash dividends in US dollars. These are usually paid twice a year. Dividend cheques are mailed directly to the ADS holder on the payment date if ADSs are registered with the Company's US Depositary Citibank NA. Dividends on ADSs that are registered with brokers are sent to the brokers, who forward them on to ADS holders.

ADS voting
Holders of ADSs will receive a Voting Instruction Form and details of the business of the Company to be raised at the forthcoming Annual General Meeting. Registered ADS holders who wish to instruct the ADS Depositary to vote their ADSs at the Annual General Meeting should return their completed Voting Instruction Form to Citibank NA no later than 10.00am (New York time) on 21 May 2004.

Shareholder information
For further information about Royal & SunAlliance, please contact our Investor Relations team at, Royal & Sun Alliance Insurance Group plc, 30 Berkeley Square, London W1J 6EW. Telephone: +44 (0)20 7569 6136
Internet address: www.royalsunalliance.com

The Group's share price is shown on Ceefax BBC1 page 230 and BBC2 page 223 and on Teletext Ch4 page 515. It is also available on the Group's website www.royalsunalliance.com (this price is delayed by twenty minutes).

Registered Office and Group Corporate Centre
30 Berkeley Square, London W1J 6EW
Telephone: +44 (0)20 7636 3450
Registered in England No. 2339826.

Frequently Asked Questions

Q I have recently moved house, who should I tell?

A You need to notify Lloyds TSB Registrars in writing at the address on page 96. Remember to state clearly your old address. If you hold shares in joint names, the shares will be registered in the name of the person who appears first on your share certificate and the letter must be signed by them.

Q What do I do if I change my name?

A To ensure the shares are registered in your new name you will need to write to Lloyds TSB Registrars. You will need to enclose evidence of the change, for example a marriage certificate or change of name deed (please don't send the original), together with your share certificates and any uncashed dividend cheques. New documents can then be issued in the right name.

Q My share certificate has been lost/stolen. How do I get a replacement?

A You should inform Lloyds TSB Registrars immediately. They will require you to pay an administration charge and they will send you a form of indemnity. The indemnity is required to protect Royal & SunAlliance from the potential misuse of the missing share certificate and must be returned before a new certificate can be issued.

Q I would like to transfer shares to someone I know, how do I arrange this?

A As these transactions do not involve a stockbroker, you can use a stock transfer form. You can get a form from Lloyds TSB Registrars or print it from their website.

Q My partner/relative has died, what should I do about their shareholding?

A Contact Lloyds TSB Registrars and they will guide you through what you need to do.

Q I have lost my dividend tax voucher, what do I do?

A To get a replacement you need to contact Lloyds TSB Registrars. A fee will be payable for this service.

Q I would like to receive future communications electronically, how can I arrange this?

A You will need to register at www.shareview.co.uk and create your own portfolio. You will need your shareholder account number to access this service.

Q I receive multiple sets of information whenever you send anything to me. How can I make sure that in future I only get one set?

A If you have acquired shares on more than one occasion your holding may have been recorded on the share register with slightly different details. As a result, two or more accounts may have been set up for you. Sometimes we need to maintain more than one account, for example if you hold shares in your own name and also in joint names with your partner. However, sometimes multiple accounts can be amalgamated.

Please notify Lloyds TSB Registrars of any accounts you believe should be amalgamated. They will do so if it is possible. You can find a form on their website for this purpose.

Q Having my dividends paid directly into my bank or building society account sounds like a good idea. What do I need to do to arrange this?

A You need to supply Lloyds TSB Registrars with details of the account that you would like future dividends to be paid into. You will find a form to do this on previous dividend advices and also on their website. Alternatively you can phone the Lloyds TSB Registrars shareholder helpline and they will post a form to you.

Financial Calendar

11 March 2004
Announcement of results for 2003 and of recommended final ordinary dividend and first 2004 preference dividend

17 March 2004
Ex dividend date for final ordinary dividend for 2003 and first 2004 preference dividend

19 March 2004
Record date for final ordinary dividend for 2003 and first 2004 preference dividend

01 April 2004
Payment of first 2004 preference dividend

13 May 2004
Announcement of results for 3 months ending 31 March 2004

28 May 2004
Annual General Meeting

03 June 2004
Payment of final ordinary dividend for 2003

12 August 2004
Announcement of results for six months ending 30 June 2004 and of interim ordinary dividend and second preference dividend for 2004

01 September 2004
Ex dividend date for second 2004 preference dividend

01 October 2004
Payment of second 2004 preference dividend

03 November 2004
Ex dividend date for interim ordinary dividend for 2004

05 November 2004
Record date for interim ordinary dividend for 2004

11 November 2004
Announcement of results for nine months ending 30 September 2004

30 November 2004
Payment of interim ordinary dividend for 2004

March 2005
Announcement of results for 2004 and of recommended final ordinary dividend

Notes

Notes

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