

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 20-F**

- REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**  
OR  
 **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
OR  
 **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number:

**Royal & Sun Alliance Insurance Group plc**

(Exact name of Registrant as specified in its charter)

Not Applicable

(Translation of Registrant's name into English)

England and Wales

(Jurisdiction of incorporation or organization)

**30 Berkeley Square  
London W1J 6EW  
England**

(Address of principal executive offices)

**Securities registered or to be registered pursuant to Section 12(b) of the Act.**

Title of each class	Name of each exchange on which registered
American Depositary Shares (as evidenced by American Depositary Receipts), each representing five (5) ordinary shares, nominal value 27.5p per share . . . . .	New York Stock Exchange
Ordinary shares, nominal value 27.5p per share* . . . . .	New York Stock Exchange

\* Not for trading, but only in connection with the listing of American Depositary Shares, pursuant to the requirements of the Securities and Exchange Commission

**Securities registered or to be registered pursuant to Section 12(g) of the Act.**

None

(Title of Class)

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.**

None

(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

As of September 15, 2000, there were outstanding:

1,432,554,960 ordinary shares, nominal value 27.5p per share, including  
239,699 American Depositary Shares (as evidenced by American  
Depositary Receipts), each representing five (5) ordinary shares  
125,000,000 preference shares, nominal value £1 per share

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

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## PRESENTATION OF INFORMATION

In this registration statement on Form 20-F, unless the context otherwise requires, “Royal & SunAlliance,” “Group,” “we,” “us” and “our” refer to Royal & Sun Alliance Insurance Group plc and its consolidated subsidiaries. Please refer to the glossary beginning on page G-1 for definitions of selected insurance terms.

We publish consolidated financial statements prepared in accordance with accounting principles generally accepted in the United Kingdom (“U.K. GAAP”). U.K. GAAP is based on requirements set forth in the Companies Act 1985 (as amended) of England and Wales (the “Companies Act”), the Statement of Recommended Practice (“SORP”) issued by the Association of British Insurers in December 1998, Statements of Standard Accounting Practice issued by the U.K. Accounting Standards Committee (pre-1990) and Financial Reporting Standards issued by the U.K. Accounting Standards Board (since 1990). Our consolidated financial statements including the notes thereto included in this registration statement have been prepared in accordance with U.K. GAAP. Unless we note otherwise, financial information contained in this registration statement is presented in accordance with U.K. GAAP. U.K. GAAP differs significantly from accounting principles generally accepted in the United States (“U.S. GAAP”). See notes 48 and 49 to our consolidated financial statements for a description of the significant differences between U.K. GAAP and U.S. GAAP, a reconciliation of net income and shareholders equity from U.K. GAAP to U.S. GAAP and condensed consolidated U.S. GAAP financial statements.

We publish our consolidated financial statements in British pounds. Unless we note otherwise, all amounts in this registration statement are expressed in British pounds. As used herein, references to “U.S. dollars,” “dollars” or “\$” and “cents” or “c” are to U.S. currency, references to “British pounds,” “pounds” or “£” and “pence” or “p” are to U.K. currency, references to “euro” or “€” are to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, amended by the Treaty on European Union, and references to “Japanese yen” or “¥” are to Japanese currency. For your convenience, unless otherwise stated, this registration statement contains translations of British pound amounts at the rate of £1.00 per \$1.51, the Noon Buying Rate in New York City for cable transfers in British pounds as certified for customs purposes by the Federal Reserve Bank of New York (the “Noon Buying Rate”) on June 30, 2000. On September 15, 2000, the Noon Buying Rate was £1.00 per \$1.40. See “Item 8—Selected Financial Data” for certain historical exchange rate information regarding the Noon Buying Rate. You should not construe these translations as representations that the amounts referred to actually represent translated amounts or that you could convert these amounts into the translated currency at the rates indicated.

## FORWARD-LOOKING STATEMENTS

The following cautionary statements identify important factors that could cause our actual results to differ materially from those projected in forward-looking statements made in this registration statement. Any statements about expectations, beliefs, plans, objectives, assumptions or future events or performance are not historical facts and may be forward-looking. These statements are often, but not always, made through use of words or phrases such as “will likely result,” “are expected to,” “will continue,” “believe,” “is anticipated,” “estimated,” “intends,” “plans,” “seek,” “projection” and “outlook.” Forward-looking statements are based on management’s current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed. Any forward-looking statements are qualified in their entirety by reference to the factors discussed throughout this registration statement. Among the key factors that have a direct bearing on our results of operations are:

- general economic conditions, including in particular economic conditions in the United Kingdom;
- the frequency, severity and development of insured loss events, including claims arising out of Year 2000 compatibility problems, as well as catastrophes;
- 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;
- changes in laws and regulations; and
- general competitive factors.

Because these and other factors referred to in this registration statement could cause actual results or outcomes to differ materially from those expressed in any forward-looking statement made by us or on our behalf, you should not place undue reliance on any of these forward-looking statements. Further, any forward-looking statement speaks only as of the date on which it is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for us to predict what will arise. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those described in any forward-looking statements.

## ITEM 1. DESCRIPTION OF BUSINESS

### GENERAL

#### Overview

We are one of the world's leading global insurers. We have operations in over 50 countries and cover risks in over 130 countries, thus possessing one of the few truly global networks in the industry. We offer a broad range of property and casualty insurance, life insurance, asset accumulation products (such as pension products, annuities and mutual funds) and related services (such as risk management and claims administration) to both businesses and individuals. Because our primary focus is on customers rather than products, we sell our products and services through multiple distribution channels, reaching the consumer the way the consumer chooses to trade. Our business is geographically diverse with operations in Europe, the Americas and Asia Pacific.

For 1999 we reported:

- property and casualty net premiums written (gross premiums written less premiums reinsured) of £7,159 million, or \$10,810 million;
- life and asset accumulation net premiums written of £3,284 million, or \$4,959 million;
- Group operating result (based on longer term investment return)<sup>1</sup> of £566 million, or \$855 million;
- profit on ordinary activities before tax of £378 million, or \$571 million;
- profit attributable to shareholders of £87 million, or \$131 million;
- total investments of £49,291 million, or \$74,429 million; and
- shareholders' funds of £6,484 million, or \$9,791 million.

We are the product of the 1996 merger of two of the then largest U.K. insurers writing both life and property and casualty business, Royal Insurance Holdings plc and Sun Alliance Group plc. We can trace our history back almost 300 years to the Sun Insurance Office, which is one of the world's oldest insurance companies still writing business today. We also have a long international history, having operated in continental Europe since the early 1800s, in Asia Pacific since 1825 and in the United States and Canada since 1851.

(1) Group operating result (based on longer term investment return) is a measure used for internal purposes in the management of our business segments. It includes the pre-tax profits of our life and asset accumulation business, our property and casualty business and other activities including the Group's share of the results of investments accounted for under the equity method. Both the property and casualty profit and the profit from other activities are determined using a longer term investment return to remove the effect of short term fluctuations in our investment portfolio. Group operating result (based on longer term investment return) is the same as group operating profit (based on long-term investment return) determined in accordance with the Association of British Insurers' SORP, but before charging the following unallocated corporate items: the change in equalization provisions, amortization of goodwill (including goodwill in acquired claims provisions), amortization of the value of long term (life) business, premium paid on the redemption of our convertible bonds, long term subordinated debt interest and reorganization costs and other movements in investments. It also excludes the profit on disposal of subsidiaries and branches. This is the result we use to measure the financial performance of our segments. It is not necessarily directly comparable to similar measurements used by other U.K. insurers. This measure differs from the profit on ordinary activities before tax, which includes each of the above items. See the table in "Summary Results of Operations" for an explanation of the relationship between this result, other results required by U.K. GAAP and profit on ordinary activities before tax.

The merger enabled us to significantly increase our operating and distribution capabilities in the U.K. market and provided a strong base for global expansion and participation in the consolidating global insurance market. Since the merger, we have taken and continue to take significant steps to transform ourselves from a U.K. insurer with overseas operations into a global enterprise headquartered in the United Kingdom.

Our primary focus is on personal and commercial property and casualty coverages, and we write virtually all types with an emphasis on property, casualty, automobile and household insurance. We also offer a broad range of life insurance and asset accumulation products, including unit trusts, a U.K. form of mutual fund, savings and pension products. In addition, we conduct complementary businesses in support of our insurance operations in selected markets such as asset management, primarily in the United Kingdom and Australia, and risk management services such as claims management and loss control services in our major markets around the globe.

### **Multi-channel distribution**

We market our products and services through multiple channels, including brokers and other intermediaries, corporate partnerships and affinity marketing programs, as well as direct to the customer.

Our multi-channel distribution strategy allows us to reach a broad cross-section of personal and commercial customers. In the commercial market, we conduct business with multinational and national companies, as well as middle-market and small businesses. For personal customers, our corporate partnerships complement our broker and direct businesses by enabling us to capitalize on the broad customer bases of our corporate partners, which include banks, mortgage lenders, retailers and affinity groups with widely recognized brands. In addition, we are a leading direct marketer of personal insurance products in Australia and the United Kingdom. In 1999, of our consolidated personal lines property and casualty net premiums written:

- brokers and other intermediaries accounted for 33%;
- corporate partnerships and affinity marketing programs accounted for 26%; and
- direct marketing and direct sales, including exclusive agents, accounted for 41%.

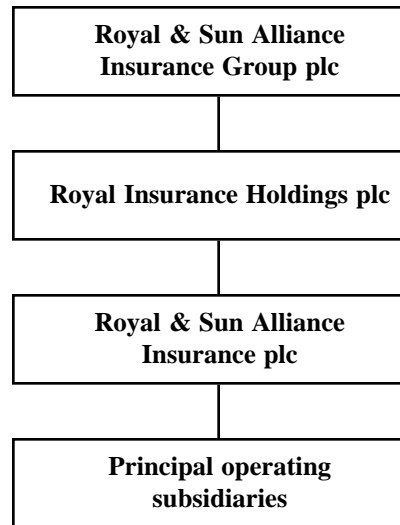
### **Organization**

Our business is organized into four time-zone-based regions:

- *United Kingdom.* The United Kingdom region is comprised of our businesses in the United Kingdom and accounted for 48.7% of our total net premiums written and 55.9% of Group operating result (based on longer term investment return).
- *Other Europe.* The Other Europe region is comprised of our businesses in Continental Europe, the Middle East and Africa, and accounted for 23.0% of our total net premiums written and 8.0% of Group operating result (based on longer term investment return).
- *Americas.* The Americas region is comprised of our businesses in the United States, Canada, Latin America and the Caribbean, and accounted for 18.6% of our total net premiums written and 33.7% of Group operating result (based on longer term investment return).
- *Asia Pacific.* The Asia Pacific region is comprised of our businesses in Asia, Australia and New Zealand, and accounted for 9.7% of our total net premiums written and 0.5% of Group operating result (based on longer term investment return).

We established this time-zone-based structure because we believe that our clients' needs are best served by people who understand local conditions and customer needs. This structure, which has transferred business decision making from a centralized London-based model to a regional and national delegated model, allows local management to offer products and services for their customers based on localized knowledge. At the same time, our regional managers have access to our underwriting capacity and global knowledge base through a network of technical and functional practice groups and support teams which function across regional management lines. In 1998, we established our Worldwide Group Office in London, which is our centralized source for strategic direction, capital allocation, risk analysis and facilitating the transfer of expertise around the Group.

The following chart shows in simplified form our corporate structure:



## Strategy

Previously, Royal Insurance and Sun Alliance were perceived as U.K.-based insurers with overseas operations, primarily within the areas of historic influence of the British Empire. While we had extensive overseas networks, we did not manage our businesses on a truly global basis. In a number of countries we were poorly positioned. We did not manage our capital actively. Accordingly, our long term Group return on capital was satisfactory but volatile. Our businesses were largely product rather than customer focused. The integration process following the merger was designed to bring both companies together as quickly as possible while developing a strategy for the future. We introduced this strategy in January 1998.

Our strategic objective is to deliver superior returns to our shareholders by capitalizing on our extensive global capabilities with a view to achieving a leading position in the markets in which we operate. We seek to achieve that through an intense focus on operating excellence in three areas:

- *Customers*—customer needs and our ability to meet them through a multi-channel distribution strategy;
- *Core competencies*—in underwriting, claims management, loss control and investment management; and
- *Capital management*—using a risk-based capital model to actively manage our capital and operations.

Our customer focus has led us to adopt separate strategies to meet the distinct needs of commercial and personal customers. In the case of commercial customers, we have adopted a global approach based on the business proposition that our broad geographic capabilities and technical competencies are intended to enable us to meet their needs wherever they operate. For personal customers, our strategy is to deliver personal financial services products, including property and casualty insurance and life insurance and asset accumulation products, using a multi-local approach. This means that we focus on the individual circumstances of our operations and of the particular market in which each of them operates. Both approaches are supported by operational initiatives which seek to deliver superior returns through excellence in our core competencies of underwriting, claims management, loss control and investment management.

To implement our strategic objective, we introduced a risk-based capital assessment model in 1998 as our core measure of financial performance. This approach allows us to measure better the relative profitability of our component businesses and to set clear performance targets across our operations, better identifying those operations that we should expand and those that we should review or contract. In addition to evaluating the overall direction of our business, our risk-based capital model also enables us to make specific underwriting and investment management decisions based on returns on capital.

In summary, our strategic goal is to deliver superior returns by allocating capital appropriately and to achieve superior execution through our focus on customer needs and operational excellence.

#### *Focus on customers*

Our dual approach to customers recognizes that the needs of our personal customers are very different from those of our commercial customers. With the internationalization of business, we believe that our commercial customers are likely to increasingly seek seamless coverage in all of the markets where they operate. Accordingly, we anticipate that the ability of an insurer to provide global coverage will be an increasingly important competitive advantage. By adopting this global approach to commercial customers, we believe our local operations can benefit from our building on the relationships, skills and balance sheet strength generated by our worldwide business.

In contrast, global capabilities are much less relevant to our personal customers who seek coverage in local markets from insurers with local knowledge and expertise. Accordingly, our multi-local approach to personal customers means that we evaluate our business for personal customers on a market-by-market basis. This approach reflects the varying nature of products and distribution between markets that is still a feature of personal lines and is attributable in part to differing taxation, social and regulatory environments. The benefit of our global business in addressing the needs of personal customers, therefore, comes largely from our ability to transfer knowledge, experience, products and services from one part of the world to another.

We intend to continue to develop both product and organizational initiatives to address the needs of our customers. In the United States, for example, we market a product, called World Assurance®, which provides international coverages for our middle-market commercial customers. Positive market responses resulted in similar products being introduced elsewhere in the Group. We decentralized our approach to serving multinational commercial customers by moving underwriting for this business from our operations in London to our regional operations. This decentralized approach enables us to make decisions closer to our customers.

In addition, we have reorganized and streamlined our U.K. property and casualty operations by uniting the separate businesses which previously comprised our U.K. commercial business under a single management structure which focuses on our commercial customers. In our U.K. personal financial services business which previously consisted of four separate insurance businesses, each with its own products, systems and priorities, we have streamlined to three operations.

In the commercial markets, we are among the few insurers able to provide for the global needs of large corporations. Through our worldwide network of Group operations and local partners we deliver insurance coverage in over 130 countries. We offer a broad range of coverage options, from customized solutions for large domestic and multinational clients through to standard property and casualty covers for smaller businesses.

### *Brand*

We are among the largest global property and casualty insurers and promote our worldwide reputation through use of the Royal & SunAlliance brand. Royal & SunAlliance is a widely recognized brand among the world's largest insurance brokers and multinational businesses and is the primary brand for our commercial insurance products.

In personal financial services, we promote the Royal & SunAlliance brand only in those businesses where it provides an advantage in the local market. In the majority of operations this is the case; in some countries, however, we promote strong local or national brands such as Orion Auto in the United States, Codan in Denmark, Regal in Spain, and AAMI and Tyndall in Australia. Our Swedish company, Trygg-Hansa, is one of the best known brands in Sweden.

Similarly, we trade under local names in countries where we operate through joint ventures or equity investments such as Mutual & Federal in South Africa.

### *Operational excellence*

We believe that a critical element of an insurer's success in the current business environment is operational excellence. We will seek to improve our performance by building on our expertise in underwriting and claims management as well as by carefully managing our expenses. With prices under pressure, underwriting discipline is vital and we are willing to relinquish business that does not meet our return on risk-based capital requirements.

- *Group practices*

By operating our business through four time-zone-based regions, we are able to work closely with clients in our local markets while preserving the benefits of a global operation with extensive resources and product knowledge. In order to ensure that our regional operations benefit from our global positioning and experience, we have established group practices in each area of our business. Our group practices are teams of experts in a particular field drawn from our operations throughout the world. Some group practices, such as financial products, marine and property, are based on product; others, such as claims management, human resources and information technology, on areas of expertise. Our group practices are linked electronically to share expertise among our operations and to help develop group-wide best practices in our core insurance skills.

- *Expenses*

In addition to focusing on our core insurance skills, we intend to continue to carefully manage our expenses. Expense reduction was one rationale for the merger in 1996, and we achieved our targeted cost savings. We have an ongoing process of review of our businesses with the aim of obtaining additional operational efficiencies. In the United Kingdom, we are targeting reductions in expenses and claims management. Other initiatives implemented or planned include headcount reduction through voluntary early retirement in the United States, Japan, Denmark and Germany, reorganizing and flattening structures, sharing resources and spreading best practice. We are currently realigning our middle-market commercial operations in

the United States. As part of this realignment, we are reducing the number of physical locations from 75 to 32 with resulting reduction in the number of employees by approximately 1,000. We are also implementing a global e-procurement system and the initial rollout is scheduled for the fourth quarter of 2000 beginning in the United Kingdom. The system will improve management of our worldwide purchases of goods and services and we expect that it should produce estimated cost savings, starting in 2001, of £20 million a year.

#### *Electronic business*

We will seek to be a leading player in the rapidly developing e-business world, where we see considerable scope for improved customer service, new product and service development and improved efficiency leading to expense reduction. We are investing in the technology to enable fast, efficient communications, including electronic mail and intranet integrated worldwide and internet access on every desk. We will further develop our global sourcing initiative through e-business and believe that this should help us to lower costs without compromising service levels.

E-business will be an integral part of our multi-channel strategy, enabling customers to do business with us through the channel of their choice, by matching the changing buying habits of our customers. In a number of countries, we offer intermediaries electronic communication links that allow them to input policyholder information, obtain price quotes and issue policies directly through our computer systems. We believe that our multi-channel marketing strategy, particularly our experience in direct marketing via the telephone and direct mail, should make the transition to electronic commerce with those customers easier than for companies that have relied on intermediaries as their source of business.

To coordinate this, we are developing a group-wide e-business strategy and have established an e-business practice group to support and drive e-business initiatives within our existing operations. To avoid possible incompatibility in the future, we are developing a worldwide technical architecture for our e-business initiatives.

We have established an e-business incubator, called global e-ventures, to develop new ideas for new businesses. Global e-ventures will partner with, and make investments in, a range of internet operations including both operations that are complementary to our core businesses as well as others that we believe provide investment opportunities.

#### *Active capital management*

In 1998, we introduced a risk-based capital model as our principal tool for measuring financial performance and now use this model to identify our capital requirements and to actively manage our capital.

We use the principle of return on risk-based capital to allocate capital among our various operations, set financial return targets for those operations and subsequently compare the returns generated by those operations to our target returns. Our management incentive plans are aligned with target returns on risk-based capital by translating the results of our risk-based capital analysis into management performance targets based on combined ratios and insurance operating results.

As a result of analyzing our risk-based capital requirements, we returned £751 million of surplus capital to our shareholders by way of a special dividend in June 1999.

#### *Organic growth and growth through acquisitions*

We intend to further develop our strong position in the global insurance market through both organic growth and through acquisitions that meet our strategic goals and return on risk-based capital requirements.

Although we seek to increase our share of the global insurance market, we have no intention of compromising our focus on underwriting discipline solely to increase market share.

- *Organic growth*

A principal objective in our commercial business is to seek organic growth of our local operations. We seek to do this by building on the advantages of a global commercial network and by developing opportunities through our existing broker relationships. Our largest source of business is through the intermediary channel, consisting of insurance brokers, agents and other third party sales personnel, and we will continue to capitalize on our broker relationships, taking advantage of our size and global reach to provide the service required by the major international brokers.

We aim to achieve growth in certain niche markets. For example, in the U.S. market, we have for some time been developing our capabilities in specialty lines leading to the acquisition of Orion Capital Corporation in 1999. Specialty products provide customized liability and specialized risk insurance coverage for particular classes or groups of customers. In addition, we entered into a joint venture to form Intrepid Re, a Bermuda-based reinsurer focusing on alternative risk transfer business.

In personal financial services business, we operate in more than 35 countries and we expect to continue to develop our multi-channel distribution capabilities in our selected markets. Our two direct marketing operations in Australia have shown strong growth over the last six years, with net premiums written growing to £273 million in 1999 from £108 million in 1994 at constant exchange rates. Of the increase, £26 million was due to assuming 100% of the insurance risk of our Australian direct operation, AAMI, in 1999. We have expanded our direct marketing operations by launching new ventures in Argentina and Japan, based on the Australian model.

In addition, we have developed a number of corporate partnership relationships with leading banks and mortgage lenders in all four of our time-zone-based regions and with retailers, such as pharmacy and supermarket chains in the United Kingdom. We will seek to further develop our corporate partnership channel by expanding the product lines we write for our existing corporate partners and developing new relationships with major retail brands.

- *Acquisition strategy*

We actively evaluate acquisition opportunities worldwide and have recently made a number of acquisitions. For example, in 1998, we acquired Norwich Union Life and Guardian Assurance in New Zealand followed in 1999 by Tyndall Australia Limited in Australia, Trygg-Hansa Försäkrings AB Publikt in Sweden and Orion in the United States. Tyndall has significantly strengthened our position in Australian retirement planning business and our personal financial services product range. Trygg-Hansa is Sweden's fourth largest property and casualty insurer and this acquisition increases our share of the Swedish property and casualty market to approximately 16% based on gross premiums written for the 12 months ended March 31, 2000. It gives us a strong platform within the Nordic and Baltic market from which we aim to grow our business and pursue other development opportunities.

The acquisition of Orion significantly improves our strategic position in the United States, the world's largest insurance market, and extends our penetration into target specialty areas. Orion focuses on providing to niche markets specialty products such as non-standard automobile, directors' and officers' liability and professional indemnity insurance. The deal also doubles our size in the United States, adding mass to both personal and commercial lines and substantially diversifying our product mix and improving the balance of our portfolio.

We exercise a similar discipline in our mergers and acquisitions activity as in our insurance operations, basing our analysis on assessing long-term value creation and return on risk-based capital. In the commercial market, we also evaluate acquisition opportunities as a means of achieving additional economies of scale and the size and scope desirable for operating efficiency in the global insurance market for commercial customers. In the personal financial services market, where global presence is less relevant, we aim to develop local market positions by focusing on acquisitions that we believe can meet our return on capital targets and that offer potential for growth.

- *Disposal strategy*

Our approach to selling businesses is also based on return on risk-based capital and long-term value creation. Our businesses should be able to demonstrate that they can obtain a satisfactory position in their market segments, their critical mass and their operating results. Unless satisfactory performance, or a clear route to achieving it, can be shown, we will look to dispose of the business. In evaluating whether our businesses are performing satisfactorily, we look at, among other things, their return on risk-based capital. For a discussion of our risk-based capital targets, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Capital Management”. This strategy has led us to a number of recent disposals. In early 1999, we sold our direct writing automobile insurers operating in France and Germany because we were not satisfied that they could achieve critical mass and profitability within an acceptable time. Later in the same year, we disposed of our life insurance business in the United States. Although it was achieving a satisfactory return in the current marketplace, we concluded that this business would find it increasingly difficult to compete faced with likely marketplace shifts including the trend towards consolidation. We have also disposed of a number of small European and African businesses where we considered prospects inadequate in light of our strategic priorities.

## Summary Results of Operations

The table below presents a summary of our results of operations for the years ended December 31, 1999, 1998 and 1997.

	Year Ended December 31,								
	1999			1998			1997		
	Total	Property and Casualty Business	Life Business	Total	Property and Casualty Business	Life Business	Total	Property and Casualty Business	Life Business
	(£ in millions)								
Segmental results:									
United Kingdom . . . . .	316	151	165	371	199	172	592	421	171
Other Europe . . . . .	45	26	19	(12)	(38)	26	4	(22)	26
Americas . . . . .	191	156	35	211	184	27	251	228	23
Asia Pacific . . . . .	3	(21)	24	12	7	5	67	56	11
Other activities . . . . .	11	—	—	20	—	—	74	—	—
Group operating result (based on longer term investment return) (1) . . . . .	566	<u>312</u>	<u>243</u>	602	<u>352</u>	<u>230</u>	988	<u>683</u>	<u>231</u>
Amortization of goodwill and other unallocated items (2) . . . . .	(108)			(201)			(145)		
Group operating profit (based on longer term investment return) . . . . .	458			401			843		
Other movements in investments . . . . .	(80)			463			967		
Total Group operating profit . . . . .	290			909			1,770		
Share of results of associated undertakings . . . . .	88			(45)			40		
Profit on ordinary activities before tax . . . . .	<u>378</u>			<u>864</u>			<u>1,810</u>		

- (1) Group operating result (based on longer term investment return) is the result we use to assess the performance of individual segments.
- (2) For a detailed breakdown of the items included in this line, see “Item 9—Management’s Discussion and Analysis of Financial Condition and Results of Operations—Consolidated Results of Operations”.

## *PRINCIPAL MARKETS*

### Overview

We offer a broad range of property and casualty insurance products and life insurance and asset accumulation products in our United Kingdom, Other Europe, Americas and Asia Pacific regions.

The table below presents the distribution of our 1999, 1998 and 1997 consolidated property and casualty net premiums written by region and line of business.

### Property and Casualty Net Premiums Written

	Year Ended December 31,					
	1999		1998		1997	
	£ in millions	% of Total	£ in millions	% of Total	£ in millions	% of Total
<b>United Kingdom:</b>						
Personal . . . . .	1,734	24.2%	1,729	25.2%	1,589	23.7%
Commercial (1) . . . . .	1,407	19.7	1,624	23.6	1,775	26.5
Total United Kingdom . . . . .	<u>3,141</u>	<u>43.9</u>	<u>3,353</u>	<u>48.8</u>	<u>3,364</u>	<u>50.2</u>
<b>Other Europe:</b>						
Personal . . . . .	908	12.7	871	12.7	734	11.0
Commercial . . . . .	532	7.4	525	7.6	490	7.3
Total Other Europe . . . . .	<u>1,440</u>	<u>20.1</u>	<u>1,396</u>	<u>20.3</u>	<u>1,224</u>	<u>18.3</u>
<b>Americas:</b>						
Personal . . . . .	646	9.0	549	8.0	545	8.2
Commercial . . . . .	1,171	16.4	995	14.5	980	14.7
Total Americas . . . . .	<u>1,817</u>	<u>25.4</u>	<u>1,544</u>	<u>22.5</u>	<u>1,525</u>	<u>22.9</u>
<b>Asia Pacific:</b>						
Personal . . . . .	446	6.2	350	5.1	339	5.1
Commercial . . . . .	315	4.4	224	3.3	231	3.5
Total Asia Pacific . . . . .	<u>761</u>	<u>10.6</u>	<u>574</u>	<u>8.4</u>	<u>570</u>	<u>8.6</u>
<b>Total Property and Casualty</b> . . . . .	<u>7,159</u>	<u>100.0%</u>	<u>6,867</u>	<u>100.0%</u>	<u>6,683</u>	<u>100.0%</u>
<b>Total Personal</b> . . . . .	3,734	52.1%	3,499	51.0%	3,207	48.0%
<b>Total Commercial</b> . . . . .	3,425	47.9	3,368	49.0	3,476	52.0
<b>Total Property and Casualty</b> . . . . .	<u>7,159</u>	<u>100.0%</u>	<u>6,867</u>	<u>100.0%</u>	<u>6,683</u>	<u>100.0%</u>

(1) Property and casualty net premiums written in 1997 are shown before giving effect to a premium portfolio transfer in connection with the termination of a reinsurance agreement with The Chubb Corporation which resulted in the transfer to Chubb of £49 million of premiums in 1997.

The table below presents our 1999, 1998 and 1997 property and casualty loss, expense and combined ratios by region and line of business. A loss ratio is the ratio of net incurred losses and loss adjustment expenses to net premiums earned. An expense ratio is the ratio of insurance operating expenses (acquisition and administration costs less reinsurance commissions and profit participations) to net premiums written. A combined ratio is the sum of these two ratios. These ratios are measures of the underwriting profitability of an insurance company. A combined ratio below 100 generally indicates profitable underwriting. A combined ratio over 100 generally indicates unprofitable underwriting. An insurance company with a combined ratio over 100 may be profitable to the extent net investment results exceed underwriting losses.

## Property and Casualty Loss, Expense and Combined Ratios

	Year Ended December 31,								
	1999			1998 (1)			1997 (1)		
	Loss Ratio %	Expense Ratio %	Combined Ratio %	Loss Ratio %	Expense Ratio %	Combined Ratio %	Loss Ratio %	Expense Ratio %	Combined Ratio %
<b>United Kingdom:</b>									
Personal .....	72.1	35.0	107.1	71.1	33.3	104.4	69.8	33.9	103.7
Commercial .....	81.3	30.9	112.2	83.4	27.8	111.2	73.0	27.3	100.3
Total United Kingdom .....	76.2	33.2	109.4	77.3	30.7	108.0	71.5	30.4	101.9
<b>Other Europe:</b>									
Personal .....	84.2	27.0	111.2	82.8	30.7	113.5	85.3	30.3	115.6
Commercial .....	81.9	29.4	111.3	80.5	33.7	114.2	74.3	35.2	109.5
Total Other Europe .....	83.3	27.9	111.2	81.9	31.9	113.8	81.1	32.2	113.3
<b>Americas:</b>									
Personal .....	66.5	32.8	99.3	62.8	33.2	96.0	66.7	32.0	98.7
Commercial .....	77.4	34.4	111.8	75.5	36.7	112.2	69.7	37.1	106.8
Total Americas .....	73.4	33.9	107.3	71.0	35.6	106.6	68.6	34.9	103.5
<b>Asia Pacific:</b>									
Personal .....	74.7	28.3	103.0	73.0	35.4	108.4	75.9	27.9	103.8
Commercial .....	92.7	31.8	124.5	72.4	36.9	109.3	59.0	39.3	98.3
Total Asia Pacific .....	82.0	29.7	111.7	72.7	36.0	108.7	68.5	32.5	101.0
<b>Total Personal</b> .....	<b>74.3</b>	<b>31.9</b>	<b>106.2</b>	<b>72.8</b>	<b>32.6</b>	<b>105.4</b>	<b>72.9</b>	<b>32.2</b>	<b>105.1</b>
<b>Total Commercial</b> .....	<b>81.1</b>	<b>32.0</b>	<b>113.1</b>	<b>79.6</b>	<b>32.0</b>	<b>111.6</b>	<b>71.5</b>	<b>31.8</b>	<b>103.3</b>
<b>Total Property and Casualty</b> .....	<b>77.5</b>	<b>31.9</b>	<b>109.4</b>	<b>76.4</b>	<b>32.7</b>	<b>109.1</b>	<b>72.6</b>	<b>32.0</b>	<b>104.6</b>

(1) Our 1998 and 1997 U.K. loss, expense and combined ratios have been restated due to the reclassification of certain lines of business between our personal and commercial lines.

Our consolidated property and casualty combined ratio for 1999 was 109.4%. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations” for a discussion of the factors contributing to our underwriting loss in 1999 as well as steps we have taken to attempt to improve our underwriting results. Our goal is to achieve a combined ratio of 103%. This goal is based on our return on equity target of a net real return on equity of 10%. For a discussion of our return on equity targets, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Capital Management”.

The table below presents the distribution of our 1999, 1998 and 1997 life and asset accumulation net premiums written by region and line of business. The information presented below for our Americas region includes net premiums written by our U.S. life and asset accumulation business until it was sold in July 1999 for £235 million. Our U.S. life and asset accumulation business accounted for £76 million, £163 million and £203 million of our Americas life and asset accumulation net premiums written in 1999, 1998 and 1997.

## Life and Asset Accumulation Net Premiums Written

	Year Ended December 31,					
	1999		1998 (1)		1997 (1)	
	£ in millions	% of Total	£ in millions	% of Total	£ in millions	% of Total
<b>United Kingdom:</b>						
Individual . . . . .	1,788	54.5%	1,533	53.7%	1,398	54.0%
Group . . . . .	162	4.9	177	6.2	159	6.2
Total United Kingdom . . . . .	<u>1,950</u>	<u>59.4</u>	<u>1,710</u>	<u>59.9</u>	<u>1,557</u>	<u>60.2</u>
<b>Other Europe:</b>						
Individual . . . . .	835	25.4	680	23.8	601	23.2
Group . . . . .	126	3.9	132	4.6	103	4.0
Total Other Europe . . . . .	<u>961</u>	<u>29.3</u>	<u>812</u>	<u>28.4</u>	<u>704</u>	<u>27.2</u>
<b>Americas:</b>						
Individual . . . . .	126	3.8	161	5.6	193	7.4
Group . . . . .	—	—	44	1.6	50	1.9
Total Americas . . . . .	<u>126</u>	<u>3.8</u>	<u>205</u>	<u>7.2</u>	<u>243</u>	<u>9.3</u>
<b>Asia Pacific:</b>						
Individual . . . . .	185	5.6	113	4.0	76	2.9
Group . . . . .	62	1.9	16	0.5	11	0.4
Total Asia Pacific . . . . .	<u>247</u>	<u>7.5</u>	<u>129</u>	<u>4.5</u>	<u>87</u>	<u>3.3</u>
<b>Total Life and Asset Accumulation</b> . . . . .	<u>3,284</u>	<u>100.0%</u>	<u>2,856</u>	<u>100.0%</u>	<u>2,591</u>	<u>100.0%</u>
<b>Total Individual</b> . . . . .	2,934	89.3%	2,487	87.1%	2,266	87.5%
<b>Total Group</b> . . . . .	<u>350</u>	<u>10.7</u>	<u>369</u>	<u>12.9</u>	<u>325</u>	<u>12.5</u>
<b>Total Life and Asset Accumulation</b> . . . . .	<u>3,284</u>	<u>100.0%</u>	<u>2,856</u>	<u>100.0%</u>	<u>2,591</u>	<u>100.0%</u>

(1) Our 1998 and 1997 life and asset accumulation net premiums written in the Americas and Asia Pacific have been restated due to the reclassification of certain business between our individual and group lines.

### Products

A key element of our strategy is customer focus. Accordingly, we offer products tailored to meet the needs of our customers.

#### *Products for Personal Customers*

Our products for personal customers include the following property and casualty products and life insurance and asset accumulation products:

*Household.* Insurance covers against loss of or damage to the buildings and contents of private dwellings with a range of additional features, such as coverage for valuables away from home and liability arising from ownership or occupancy.

*Personal automobile.* Insurance covers for liability for both bodily injury and property damage and for physical damage to an insured's vehicle from collision and various other perils.

*Other personal lines.* Includes:

- *Private medical insurance*—Policies which cover the cost of private medical treatment.

- *Accident insurance*—Policies which provide insured benefits in the event of accidental death or disability.
- *Creditor insurance*—Policies which provide loan, mortgage, and/or credit card repayments in the event of accidental death or disability, illness or unemployment.
- *Travel insurance*—Policies which provide benefits in the event of cancellation and/or curtailment, travel delays, loss of personal baggage and/or money, emergency medical and travel expenses and legal expenses.

*Individual life and asset accumulation products.* In the individual life market, we write periodic premium life products, such as whole life, term insurance, mortgage protection and other products, such as disability, critical illness and permanent health insurance. Our individual asset accumulation products include:

- Mutual funds.
- Unit trusts, a U.K. form of mutual funds, are funds invested in various investment instruments, which are divided into individual units. The funds, managed on behalf of the unitholder, fluctuate in value depending on the overall value of the fund.
- Personal equity plans, which are tax free savings plans in the United Kingdom for equities only which were offered between 1997 and April 1999. Personal equity plans have been replaced by individual savings accounts.
- Life investment bonds and life savings products, which are savings vehicles similar to universal life products.
- Pensions, pensions for the executive and directors market, and immediate and deferred annuities.

#### *Products for Commercial Customers*

Our products for commercial customers include the following property and casualty products and life insurance and asset accumulation products:

*Property.* Insurance covers for loss or damage to buildings, inventory and equipment from natural disasters, including hurricanes, windstorms, earthquakes, floods, hail, explosions, severe winter weather and other events such as theft and vandalism, fires and financial loss due to business interruption resulting from covered losses.

*Casualty/Liability.* Insurance covers for:

- employer's liability, which protect the insured company against claims from employees arising from accident, injury or industrial disease;
- workers' compensation, which provide coverage for employers for specified benefits payable under national or local legislation for workplace injuries to employees;
- public liability, which protect an organization against claims arising from the conduct of its business or its products resulting in injury to or damage to third parties or property;
- professional indemnity, which protect professionals such as architects and accountants against claims of negligence in the services they provide; and
- directors' and officers' liability.

*Commercial automobile.* Insurance covers for businesses against losses incurred from personal bodily injury, bodily injury to third parties, property damage to an insured's vehicle, and property damage to other vehicles and other property resulting from the ownership, maintenance or use of automobiles and trucks in a business.

*Other commercial lines.* Includes:

- *Engineering*—Consists of engineering insurance, inspection and risk management business for machinery, plant and construction.
- *Reinsurance*—Reinsurance of property, liability and engineering risks underwritten by other companies.
- *Specialty lines*—Customized liability and specialized risk insurance covers for particular classes or groups of clients.
- *Marine*—Insurance covers for physical loss or damage to cargo, vessels and offshore oil rigs.
- *Aviation*—Aircraft property damage and liability insurance cover.
- *Transit*—Insurance covers for goods in transit and freight liability for the transportation industry.

*Group life and asset accumulation products.* In the group life market, we offer a broad range of group risk products including critical illness, life and permanent health insurance. Critical illness insurance are policies where the insurer pays the sum insured to the policyholder in the event of diagnosis of a life threatening disease. Group permanent health insurance are policies arranged by employers for their employees, providing for the payment of income during a period of incapacity due to ill health or accident. The benefit is usually payable until retirement.

Our group asset accumulation products include corporate pensions and group personal pensions. Corporate pensions in the United Kingdom are provided as part of an employee's compensation package. Both the employer and employee contribute towards the pension fund investment, and the plan is administered centrally by the employer and a fund manager. Group personal pensions are arrangements in the United Kingdom made for employees of a particular employer to participate in a personal pension plan on a group basis. The employer administers the fund and may provide contributions towards it. Group personal pensions are merely collecting arrangements.

## **United Kingdom**

### *Overview*

We have operated in the United Kingdom since our founding in 1710. We are the second largest property and casualty insurer in the United Kingdom, with leading positions in both personal and commercial lines, based on 1998 gross premiums earned. We are also the 11th largest U.K. life insurer based on 1999 new business annual premium equivalent, excluding group pensions and group risks. New business annual premium equivalent is a measure of sales of life and asset accumulation policies during the year calculated as periodic premiums plus 10% of single premiums. This is a widely recognized measure in the United Kingdom of total sales performance of a life insurer, which reflects the fact, all other things being equal, that a £1 single premium makes a lower value contribution to a company than £1 of new periodic premiums which will continue to be received in subsequent years, while the policy remains in force. In 1999, the United Kingdom region recorded segment operating result (based on longer term investment return) of £316 million, representing 55.9% of our Group operating result (based on longer term investment return). Property and casualty businesses accounted for £151 million, or 47.8%, of our total 1999 United Kingdom segment operating

result (based on longer term investment return) and life and asset accumulation business accounted for £165 million, or 52.2%, of our total 1999 United Kingdom segment operating result (based on longer term investment return). Our United Kingdom region employs approximately 24,900 people in 91 offices.

*United Kingdom Property and Casualty Business*

Our U.K. property and casualty business offers a range of personal and commercial products nationwide. We market our property and casualty products through multiple channels in the United Kingdom. We distribute personal products through corporate partnerships, brokers, agents and direct channels. We market to the public by telephone, mail and electronically. We distribute commercial products through international, national and local brokers, agents and direct to customers. In 1999:

- Property and casualty business in the United Kingdom accounted for £3,141 million, or 43.9%, of our consolidated property and casualty net premiums written; and
- Property and casualty business in the United Kingdom accounted for £151 million, or 26.7%, of our Group operating result (based on longer term investment return).

The table below presents our 1999, 1998 and 1997 property and casualty loss, expense and combined ratios within the United Kingdom by line of business.

	Year Ended December 31,								
	1999			1998			1997		
	Loss Ratio	Expense Ratio	Combined Ratio	Loss Ratio	Expense Ratio	Combined Ratio	Loss Ratio	Expense Ratio	Combined Ratio
	%	%	%	%	%	%	%	%	%
Personal .....	72.1	35.0	107.1	71.1	33.3	104.4	69.8	33.9	103.7
Commercial .....	81.3	30.9	112.2	83.4	27.8	111.2	73.0	27.3	100.3
Total United Kingdom .....	76.2	33.2	109.4	77.3	30.7	108.0	71.5	30.4	101.9

The U.K. property and casualty market is mature and highly competitive in both personal and commercial lines. Competition and over-capacity have led to underwriting losses and difficult pricing conditions for the market in general. Underwriting losses incurred by the U.K. property and casualty insurance market as a whole approximately doubled from £1,031 million to £2,195 million between 1997 and 1998.

In the household market, property premiums have been reduced by insurers to maintain market share and household insurance has been offered at competitive prices. This helped lead to a 5.4% fall in 1998 in gross premiums written in the domestic property sector. In 1998, property accounted for £493 million of the total property and casualty insurance underwriting loss.

The automobile market incurred £1,472 million of the total 1998 underwriting loss. This sector has been adversely affected by an increase in the average claims cost, which has not yet been wholly offset by increased premiums, in part because of the highly competitive nature of the market.

On the commercial insurance side, one of the core concerns in 1998 was the continuation of unfavorable pricing conditions in the commercial sector. A key characteristic across all commercial lines of insurance, with the notable exception of pecuniary loss, has been poor underwriting results due to low premiums. The market is shaped by high levels of competition and excess capacity amongst underwriters, low premiums in reinsurance, increased knowledge of which risks may be retained internally by a company, and increased understanding of alternative risk transfer strategies. The effect of these influences is low, and often falling, premium rates.

In response to this, the insurance industry in the United Kingdom has experienced significant consolidation in recent years. We estimate that, based on 1998 gross premiums earned, the five largest insurance groups now have a combined market share of approximately 51% of the property and casualty market.

Some segments of the property and casualty markets such as private medical insurance and a range of commercial products provided for small businesses have recently been exhibiting moderate expansion. The personal and commercial automobile markets have shown significant price improvements during 1999, while other lines experienced relatively stable but competitive market conditions.

In personal lines, competition is primarily based on price, service, convenience and increasingly, brand recognition. In commercial lines, competition is primarily based on price, but is also based on relationship management, quality of service and availability of value added services. We compete principally with the other insurers writing both life and property and casualty business with major operations in the United Kingdom in all channels as well as with the major international insurers in the broker channel. In personal lines, we have also experienced increasing competition from new entrants, such as retailers using their brands to distribute insurance, although we have taken advantage of this trend to build new corporate partnerships.

The table below presents the distribution of our 1999, 1998 and 1997 property and casualty net premiums written and combined ratios by product group in the United Kingdom.

	Year Ended December 31,								
	1999			1998			1997		
	£ in millions	% of Total	Combined Ratio %	£ in millions	% of Total	Combined Ratio %	£ in millions	% of Total	Combined Ratio %
<b>Personal:</b>									
Household .....	813	25.9%	104.5	916	27.3%	105.7	926	27.5%	101.0
Personal automobile .....	590	18.8	115.2	566	16.9	106.5	457	13.6	112.7
Other .....	331	10.5	99.0	247	7.4	98.2	206	6.1	95.0
Total Personal .....	<u>1,734</u>	<u>55.2</u>	<u>107.1</u>	<u>1,729</u>	<u>51.6</u>	<u>104.4</u>	<u>1,589</u>	<u>47.2</u>	<u>103.7</u>
<b>Commercial:</b>									
Property .....	518	16.5	111.8	680	20.3	110.8	762	22.7	96.0
Casualty .....	224	7.1	102.8	233	6.9	108.2	273	8.1	95.9
Commercial automobile .....	432	13.8	118.7	432	12.9	115.7	410	12.2	111.3
Other .....	233	7.4	112.0	279	8.3	109.8	330	9.8	100.7
Total Commercial (1) .....	<u>1,407</u>	<u>44.8</u>	<u>112.2</u>	<u>1,624</u>	<u>48.4</u>	<u>111.2</u>	<u>1,775</u>	<u>52.8</u>	<u>100.3</u>
<b>Total United Kingdom</b> .....	<u>3,141</u>	<u>100.0%</u>	<u>109.4</u>	<u>3,353</u>	<u>100.0%</u>	<u>108.0</u>	<u>3,364</u>	<u>100.0%</u>	<u>101.9</u>

(1) Property and casualty net premiums written in 1997 are shown before giving effect to a premium portfolio transfer in connection with the termination of a reinsurance agreement with The Chubb Corporation which resulted in the transfer to Chubb of £49 million of premiums in 1997.

In personal lines, we had an 18.8% share of the household market and an 8.0% share of the personal automobile market, based on 1998 gross earned premiums. We distribute our personal lines business through corporate partnerships, brokers, agents and direct marketing to the public by telephone and mail. In 1999, the corporate partnership channel accounted for 46% of our U.K. personal lines business, brokers and professional agents accounted for 35% and direct sales accounted for 19%.

We write personal lines business, primarily household, accident, private medical and creditor insurance, that is marketed under the names of financial services institutions, including banks and mortgage lenders. We call this distribution channel our corporate partnership distribution channel as it involves working

with other companies in the marketing of our products. We also write private medical insurance, travel insurance and other personal lines marketed under the names of non-financial companies with strong brands, such as pharmacy and supermarket chains. Our corporate partnerships give us access to a broader base of consumers than we might otherwise be able to reach by allowing us to exploit the existing broad customer base and brand recognition of our corporate partners. We also have a number of long-standing relationships with major affinity groups, such as automobile clubs through which we write primarily automobile insurance.

We will seek to further develop our corporate partnership channel by expanding the product lines we write for existing clients and developing new client relationships with major retail brands. In the direct markets, we intend to focus our marketing efforts on the more profitable customer groups. In the broker channel, by carefully monitoring relationship profitability, we focus on our more profitable brokers and business lines. Additionally, we intend to focus on opportunities to form relationships with commercial customers to market our products to their employees.

We were the second largest direct insurer in the U.K. personal lines market based on the number of new policies written through the direct channel in 1998 by the Group as compared to the total new policies written through the direct channel in the U.K. market in 1998. We sell household, automobile and other personal policies via the telephone, newspaper advertisements and direct mail campaigns. To serve our direct and corporate partnership customers, we operate call centers during extended operating hours that provide new business quotes, service existing business and deal with claims over the telephone.

The personal lines broker distribution channel consists of brokers, agents and other intermediaries, including major chains such as our subsidiary, Swinton Holdings Limited, groups of brokers operating under common marketing frameworks and smaller firms operating under their own names. The principal personal lines distributed by brokers are personal automobile and household insurance. Swinton, which places business for us as well as for a number of other insurers, is one of the largest intermediaries of personal lines business, principally automobile insurance, in the United Kingdom based on 1998 premium revenue.

In the commercial market, we are the second largest commercial lines insurer based on 1998 gross earned premiums, conducting business with a majority of the companies comprising the U.K. FTSE 100 stock index. We also have a significant presence in the London Market. The London Market is a market for international insurance and reinsurance, comprising mainly high exposure and complex risks. Companies operating in the London Market underwrite specialized risks such as marine, aviation and directors' and officers' liability. In 1999, commercial lines gross premiums written of £1.9 billion accounted for almost 51% of our U.K. property and casualty business. Our principal competitors are the large U.K. and European insurers writing both life and property and casualty business although the commercial market is increasingly seeing competition from major U.S. insurers.

We were the second largest U.K. insurer of commercial automobile and public and general liability and the second largest commercial property insurer, all based on 1998 gross earned premiums. We have a 16.6% share of the commercial property market, a 17.7% share of the commercial automobile market and a 12.6% share of the public and general liability market, all based on 1998 gross earned premiums. We also have significant shares of the marine, engineering and transit markets.

Our commercial customers range from individual traders and small businesses to large multinational companies in such diverse industries as construction, financial services, manufacturing and the arts. Our commercial business is managed by five regional areas and is supported by over 30 commercial service centers and approximately 6,000 people. We have structured our operations to target the needs of these diverse customer groups by arranging our commercial business into three customer segments:

- *Small Enterprise*—which is comprised of small business customers with annual gross revenues of up to £1 million who are largely price and process oriented;

- *Core*—which is comprised of mid-market customers with annual gross revenues of between £1 million and £100 million; and
- *Risk Managed*—which is comprised of large U.K. multinational companies with annual gross revenues of over £100 million who require customized products and service.

We distribute our U.K. commercial lines business nationwide, and, consistent with our strategy of providing global coverage for our commercial customers, we also offer international products to our clients with global operations. We believe our competitive advantage in the commercial market consists of our ability to underwrite a broad range of commercial products, our nationwide network, our quality-accredited claims performance and our relationship management skills.

We distribute our commercial lines business through international, national and regional brokers, independent intermediaries, agents and direct to customers. In 1999, brokers and independent agents accounted for approximately 95% of our commercial lines net premiums written in the United Kingdom. We distribute commercial lines business through a network of approximately 8,000 brokers and independent agents located throughout the United Kingdom. Direct business accounted for approximately 5% of our U.K. commercial lines net premiums written.

In the commercial market we intend to maintain our strong position in the property and casualty market by building our relationships with large U.K. corporations and developing relationships with affinity groups. We renewed our contract for a six year term in 1998 with Motability Finance Limited, a company which provides lease financing on behalf of the Motability charity to enable disabled people to remain mobile. Under the Motability Finance Limited contract, we write automobile insurance that is included in the package offered to persons leasing automobiles through Motability. In 1999, Motability business accounted for 16% of our net automobile premiums written in the United Kingdom.

#### *United Kingdom Life and Asset Accumulation Business*

We began writing life and asset accumulation business in the United Kingdom in 1720 through The London Assurance and, based on 1999 new business annual premium equivalent excluding group pensions and group risks, are the 11th largest life insurer in the United Kingdom. We are the market leader in the U.K. group life market based on 1999 new business annual premium equivalent and the ninth largest in the U.K. individual life market based on 1998 net premiums written. Our U.K. life and asset accumulation business offers a range of individual and group life insurance and asset accumulation products nationwide through Independent Financial Advisers, or IFAs, direct marketing, a national real estate agency as well as through corporate partners. In the United Kingdom, IFAs advise and recommend life and asset accumulation products to individual clients but are not agents for any product provider. Many IFAs are part of a regional or national network.

On September 6, 1999, we announced our strategic proposal for our U.K. life and asset accumulation operations. The new strategy is intended to address the rapidly changing financial services marketplace and builds on our strengths. Major initiatives in the United Kingdom include:

- an increased commitment to and focus on the IFA distribution channel;
- development of group products, with a greater emphasis on marketing to employers;
- exit from the commissioned direct sales market and exclusive agency business;
- creation of a small salaried field force to develop business from existing customers;
- ongoing development with our U.K. property and casualty operations of integrated insurance and financial products; and
- a reduction in the number of our life insurance products from 65 to 17.

This strategy focuses on an increased commitment to the IFA channel, which had been the most successful method of marketing our life and asset accumulation products in the United Kingdom, reinforced by a withdrawal from the U.K. direct sales force and exclusive agency channels. Recognizing that certain customers prefer to buy financial products through non-intermediate channels, we are investigating the best way to develop new sources of direct life sales in the United Kingdom in the future. This includes evaluating a range of integrated customer offerings in collaboration with our property and casualty business. We are also aiming to enhance our already strong position in group risks, where we market life insurance products to employers almost exclusively through IFAs.

As part of this strategic review of our business in 1999, we determined that we sold numerous products that generated very small amounts of income. Many of these products were similar in nature, although designed for different specific circumstances. As a result, we had to cover considerable overhead costs, such as processing, administration, training and literature production costs, to maintain this large number of products. We decided to focus on those products that produced sufficient volumes of new business. We stopped selling those products that only produced marginal amounts. As a result, we anticipate that the small amounts of income lost from this reduction will be far outweighed by the advantages of our more streamlined portfolio of products.

Our United Kingdom region offers a range of products throughout the United Kingdom, including products for individuals and group customers. In 1999:

- Life and asset accumulation business in the United Kingdom accounted for £1,950 million, or 59.4%, of our consolidated life and asset accumulation net premiums written; and
- Life and asset accumulation business in the United Kingdom accounted for £165 million, or 29.2%, of our Group operating result (based on longer term investment return).

The table below presents the distribution of our 1999, 1998 and 1997 life and asset accumulation net premiums written by product group in the United Kingdom.

	Year Ended December 31,					
	1999		1998		1997	
	£ in millions	% of Total	£ in millions	% of Total	£ in millions	% of Total
<b>Individual:</b>						
Periodic premium products:						
With-profit (participating) contracts . . . . .	480	24.6%	521	30.5%	522	33.5%
Unit-linked (separate account) products . . . . .	188	9.7	157	9.1	114	7.3
Non-participating products . . . . .	152	7.8	131	7.7	156	10.0
Total periodic premium products . . . . .	820	42.1	809	47.3	792	50.8
Single premium products:						
With-profit (participating) contracts . . . . .	664	34.0	479	28.0	411	26.5
Unit-linked (separate account) products . . . . .	219	11.2	152	8.9	123	7.9
Non-participating products . . . . .	85	4.4	93	5.4	72	4.6
Total single premium products . . . . .	968	49.6	724	42.3	606	39.0
Total Individual . . . . .	1,788	91.7	1,533	89.6	1,398	89.8
<b>Group:</b>						
General account products . . . . .	162	8.3	177	10.4	159	10.2
<b>Total</b> . . . . .	1,950	100.0%	1,710	100.0%	1,557	100.0%

The table below presents the distribution of our 1999, 1998 and 1997 life and asset accumulation new business premiums by product group and new business annual premium equivalent in the United Kingdom.

	Year Ended December 31,					
	1999		1998		1997	
	£ in millions	% of Total	£ in millions	% of Total	£ in millions	% of Total
<b>Individual:</b>						
Periodic premium products:						
With-profit (participating) contracts . . . . .	30	2.8%	35	4.1%	26	3.6%
Unit-linked (separate account) products . . . . .	27	2.5	27	3.3	14	2.0
Non-participating products . . . . .	21	1.9	15	1.8	29	4.0
Total periodic premium products . . . . .	<u>78</u>	<u>7.2</u>	<u>77</u>	<u>9.2</u>	<u>69</u>	<u>9.6</u>
Single premium products:						
With-profit (participating) contracts . . . . .	664	60.9	479	57.0	411	57.7
Unit-linked (separate account) products . . . . .	219	20.1	152	18.1	123	17.3
Non-participating products . . . . .	85	7.8	93	11.1	72	10.1
Total single premium products . . . . .	<u>968</u>	<u>88.8</u>	<u>724</u>	<u>86.2</u>	<u>606</u>	<u>85.1</u>
Total Individual . . . . .	1,046	96.0	801	95.4	675	94.7
<b>Group:</b>						
General account products . . . . .	44	4.0	39	4.6	38	5.3
<b>Total new business premiums . . . . .</b>	<u>1,090</u>	<u>100.0%</u>	<u>840</u>	<u>100.0%</u>	<u>713</u>	<u>100.0%</u>
<b>New business annual premium equivalent . . . . .</b>	<u>215</u>	<u>100.0%</u>	<u>188</u>	<u>100.0%</u>	<u>168</u>	<u>100.0%</u>

The U.K. life insurance market, measured on the basis of gross premiums written in 1998, is the third largest in the world and accounted for approximately 10% of life insurance gross premiums written worldwide. In 1998, individual retirement products represented 33% of new business annual premium equivalent in the U.K. market, individual life products represented 39%, group pension products represented 15% and collective investment schemes, such as unit trusts, represented 13%.

The U.K. market for life and pension products, excluding group pensions and group risks, is highly fragmented and competitive. The five largest insurers accounted for approximately one-third of 1999 new business annual premium equivalent in the United Kingdom, while nearly half of the 50 largest insurers have market shares of 1% or less. Competitors are differentiated primarily by distribution channel, and to some extent by brand. Recently, we have faced competition from new entrants to the market, such as retailers offering insurance to their own customer bases. Three companies, including Royal & SunAlliance, write a majority of the group pensions and group risks business.

IFAs are the largest channel of distribution for the sale of life insurance products in the United Kingdom, accounting for 52% of new business annual premium equivalent in 1998. Direct sales forces, which consist of individuals directly managed by the insurers, together with exclusive agencies accounted for 45%, and direct marketing accounted for 3%.

In the individual life insurance market, we write regular premium life, such as whole life, term assurance and mortgage protection products, and other products, such as disability, critical illness and permanent health insurance. In the group life market, we offer a broad range of group risk products including critical illness, life and permanent health insurance. Our individual asset accumulation products include unit trusts, open ended investment companies, personal equity plans, individual savings accounts, life investment bonds, life savings products, mortgage endowment products, personal pensions, pensions for the executive and

directors markets, and immediate and deferred annuities. Our group asset accumulation products include corporate pensions and group personal pensions.

We are shifting the balance of our life and asset accumulation business with the aim of taking advantage of the growing opportunities in the asset accumulation sector. We are shifting our focus because of a number of external factors, including the aging of the population that is causing the U.K. government to rethink the framework of welfare provision in favor of private savings programs. As a result, we believe the asset accumulation sector is likely to experience significant growth and that we are well placed to capitalize on this growth due to our investment performance.

The development of the market is being stimulated by a change in pensions legislation which will take effect in April 2001. The new pensions legislation provides for the introduction of stakeholder pensions and a new defined contribution tax regime. Stakeholder pensions are a vehicle created by the U.K. Government to encourage individuals to provide for their retirement by offering favorable tax benefits. Holders of stakeholder pensions will be permitted to make low levels of contributions and will benefit from lower charges. However, we expect that the size of the market will increase following the new legislation.

We will seek to be a significant player in the defined contribution pensions market. Employers will play a pivotal role in this market and we believe that our strong relationships with group customers in this market should help to allow us to participate in any growth.

In 1999, individual life insurance and savings products accounted for 57% of our new business annual premium equivalent in the United Kingdom, individual retirement products accounted for 23% and group life and retirement products accounted for 21%. In addition, deposits on retail investments sold direct to the general public, such as unit trusts and personal equity plans, amounted to £147 million in 1998.

With-profit companies represented 73% of our U.K. life and asset accumulation actuarial liabilities as of December 31, 1999. With-profit policies are participating individual retirement products and individual life products offered by many life insurance companies in the United Kingdom. Under with-profit policies, the policyholder is entitled to participate in the earnings or surplus of the insurance company that issued the policy. This participation occurs through the distribution of dividends, referred to as bonuses in the United Kingdom, to policyholders.

Bonuses on with-profit contracts are recommended by the issuing company's actuary and approved by its board of directors. We declare bonuses out of surplus after taking account of actuarial valuations and considering a long-term view of the anticipated performance of the fund and the policyholders' reasonable expectations. A defined minimum proportion of the surplus is allocated as a bonus to the policyholders of with-profit policies. The remainder of the surplus is allocated to the issuing company's shareholders.

At least ninety percent of our with-profit business surplus is allocated to policyholders as bonuses. This allocation is required under the Articles of Association of our subsidiary, Sun Alliance & London Assurance Company Limited. As we consider policyholders' reasonable expectations in determining the level of bonuses, Royal & Sun Alliance Life & Pension Limited, our other U.K. writer of with-profit policies, generally follows the same allocation practice because our products have been marketed on that basis.

There are two main types of bonus paid from the surplus in our with-profits business, regular bonuses and terminal bonuses. Regular bonuses are credited to the policyholder at regular intervals, generally on an annual basis, and vary from product to product. Once a regular bonus has been declared, it represents a permanent addition to the guaranteed benefits under the contract, and is payable at the same time as the originally guaranteed benefits under the policy, typically at death or maturity. Historically, regular bonuses have represented a partial return of investment income. Regular bonus rates generally have not fluctuated

significantly from year to year, however, we reduced the rates in 1999 due to the impact of generally lower interest rates and bond returns.

Terminal bonuses are designed to provide policyholders with their share of total investment performance, including investment income and realized and unrealized gains and losses, and other company experience, including expenses, mortality experience and taxes. For longer term contracts held to maturity, terminal bonuses have historically represented a significant portion, often exceeding 50%, of the total amount paid at maturity. The terminal bonus payable on a policy is determined at the time of payment.

The level of bonuses paid, in addition to reflecting investment performance and company experience, has reflected our judgment as to the overall financial position of the issuing company and profits on the company's other business. In setting bonuses, we also consider policyholders' reasonable expectations and fairness among holders of contracts with different terms and maturity dates. With-profit business is marketed on the basis that payouts under policies will avoid the fluctuations in investments that would arise if payouts were linked directly to changing asset values. Therefore, in order to be consistent with policyholders' reasonable expectations, we have generally determined bonus rates so as to avoid undue changes in payouts from one year to the next.

Unit-linked, or separate account, policies are life and retirement products where the policyholder is entitled to the value of the units purchased. Policyholders choose the fund in which they wish to purchase units. We offer various funds with different investment strategies such as equity, fixed-interest or balanced. The value of a unit increases over time to reflect the investment return on the assets in the fund. The assets in the fund are recorded on our balance sheet. The amount payable to the policyholder at the time of claim is the value of the unit at the time of payment, minus charges. Our income from unit-linked policies is derived from the charges levied on the policies. Expenses are incurred out of these charges.

We distribute our life insurance and asset accumulation products in the United Kingdom through IFAs, our owned real estate agencies and direct marketing. IFAs accounted for 64% of our 1999 U.K. life and asset accumulation annualized new business premiums, direct sales force for 14%, exclusive agencies for 12%, real estate agencies for 7%, direct marketing for 2% and other distribution channels, including corporate partnerships, for 1%. During 1999, we decided to concentrate on sales from IFAs and to close distribution through exclusive agents and our direct sales force.

We have a team of approximately 100 IFA consultants operating out of 17 branches in the United Kingdom, who support the development and sale of life insurance and asset accumulation products through IFAs.

In addition, our subsidiary, Royal & Sun Alliance Property Services, is one of the largest chains of real estate agents selling and leasing properties in the United Kingdom. Royal & Sun Alliance Property Services consists of over 420 real estate agencies which operate under locally recognized names. We have a dedicated salaried sales force of over 330 insurance agents that offer our products to our real estate agency customers. We also distribute life and asset accumulation products through corporate partnerships as well as a direct investment operation that advertises and services customers directly.

## **Other Europe**

### *Overview*

Our Other Europe region is comprised of our businesses in Continental Europe, the Middle East and Africa. Through our Other Europe region, we offer a broad range of property and casualty products and life insurance and asset accumulation products. Our principal property and casualty businesses are in Scandinavia, Germany, Ireland, Italy and Spain and our principal life and asset accumulation businesses are in Denmark, Isle

of Man, Italy and Spain. We believe these businesses are well positioned in their local markets. To further assist our insurance customers, we offer insurance-related products and services to our clients in selected markets, including risk management services such as claims management and loss control services.

In Continental Europe, we write property and casualty business in 15 countries and life and asset accumulation business in 11 countries through owned operations, equity investments, representative offices and branches. In Denmark we are the third largest property and casualty insurer based on 1999 net premiums earned and in Ireland we are the fourth largest property and casualty insurer based on 1998 net premiums written. In the Middle East we offer property and casualty products in three countries through subsidiaries, representative offices and branches. In Africa, we offer property and casualty products in five countries through equity investments, including a 38% interest in Mutual & Federal Insurance Co Ltd, a leading property and casualty insurer in South Africa.

In 1999, our Other Europe region recorded segment operating result (based on longer term investment return) of £45 million, representing 8% of our Group operating result (based on longer term investment return). Property and casualty businesses accounted for £26 million, or 57.8%, of our total 1999 Other Europe segment operating result (based on longer term investment return) and life and asset accumulation business accounted for £19 million, or 42.2%, of our total 1999 Other Europe segment operating result (based on longer term investment return). Our Other Europe region employs approximately 8,200 people.

#### *Other Europe Property and Casualty Business*

Our Other Europe region conducts property and casualty business in Denmark, Italy, Germany, Ireland, Spain and 18 other countries in Continental Europe, the Middle East and Africa. In 1999:

- Property and casualty business in Other Europe accounted for £1,440 million, or 20.1%, of our consolidated property and casualty net premiums written; and
- Property and casualty business in Other Europe accounted for £26 million, or 4.6%, of our Group operating result (based on longer term investment return).

The table below presents our 1999, 1998 and 1997 property and casualty loss, expense and combined ratios within our Other Europe region by line of business.

	Year Ended December 31,								
	1999			1998			1997		
	Loss Ratio %	Expense Ratio %	Combined Ratio %	Loss Ratio %	Expense Ratio %	Combined Ratio %	Loss Ratio %	Expense Ratio %	Combined Ratio %
Personal . . . . .	84.2	27.0	111.2	82.8	30.7	113.5	85.3	30.3	115.6
Commercial . . . . .	81.9	29.4	111.3	80.5	33.7	114.2	74.3	35.2	109.5
Total Other Europe . . . . .	83.3	27.9	111.2	81.9	31.9	113.8	81.1	32.2	113.3

Our principal commercial customers in Other Europe are small to mid-sized companies, as well as our multinational clients. We also insure some large commercial risks and market our personal lines to individual customers as well as to the customers of our corporate partners.

Competitive conditions vary considerably among the various European, Middle Eastern and African markets. Distribution methods still depend to a large extent upon the individual markets in which we operate. However, distribution in Other Europe continues to be predominantly via intermediaries. As in the United Kingdom, the European market has experienced significant consolidation in recent years, both among insurers and among distribution channels such as brokers and banks. Overcapacity and difficult pricing conditions

remain a factor in many of the markets in which we operate. Our main competitors in Continental Europe are the large international insurance companies, as well as the locally-based insurers.

The table below presents the distribution of our 1999, 1998 and 1997 property and casualty net premiums written and combined ratios by line of business in Continental Europe, the Middle East and Africa.

	Year Ended December 31,								
	1999			1998			1997		
	£ in millions	% of Total	Combined Ratio %	£ in millions	% of Total	Combined Ratio %	£ in millions	% of Total	Combined Ratio %
<b>Personal:</b>									
Scandinavia . . . . .	292	20.3%	109.3	219	15.7%	102.8	200	16.3%	109.2
Italy . . . . .	228	15.8	118.4	246	17.6	123.4	185	15.1	125.0
Ireland . . . . .	93	6.5	91.3	92	6.6	106.2	67	5.5	105.1
Germany . . . . .	68	4.7	105.4	81	5.8	120.9	64	5.2	122.5
Spain . . . . .	160	11.1	120.4	151	10.8	116.9	134	11.0	115.8
Others . . . . .	67	4.7	107.2	82	5.9	109.2	84	6.9	114.6
Total Personal . . . . .	<u>908</u>	<u>63.1</u>	<u>111.2</u>	<u>871</u>	<u>62.4</u>	<u>113.5</u>	<u>734</u>	<u>60.0</u>	<u>115.6</u>
<b>Commercial:</b>									
Scandinavia . . . . .	173	12.0	106.5	152	10.9	94.6	137	11.1	99.5
Italy . . . . .	57	4.0	104.6	56	4.0	115.9	54	4.4	133.8
Ireland . . . . .	70	4.9	115.5	73	5.2	135.9	77	6.3	105.3
Germany . . . . .	71	4.9	92.2	82	5.9	116.4	77	6.3	114.3
Spain . . . . .	19	1.3	105.5	15	1.1	108.0	19	1.6	137.2
Others . . . . .	142	9.8	127.8	147	10.5	122.6	126	10.3	105.1
Total Commercial . . . . .	<u>532</u>	<u>36.9</u>	<u>111.3</u>	<u>525</u>	<u>37.6</u>	<u>114.2</u>	<u>490</u>	<u>40.0</u>	<u>109.5</u>
<b>Total Other Europe . . . . .</b>	<u><u>1,440</u></u>	<u><u>100.0%</u></u>	<u><u>111.2</u></u>	<u><u>1,396</u></u>	<u><u>100.0%</u></u>	<u><u>113.8</u></u>	<u><u>1,224</u></u>	<u><u>100.0%</u></u>	<u><u>113.3</u></u>

### Scandinavia

We operate in Scandinavia through our Danish subsidiary, Codan A/S, the holding company of an insurer writing both life and property and casualty business. We currently own approximately 72% of Codan. The balance is publicly traded on the Fondsborsen, the Danish stock exchange. Codan offers both personal and commercial business in Denmark, particularly personal and commercial automobile, household, property, personal accident, workers' compensation and marine insurance, through exclusive agents, brokers, an employee sales force and direct marketing. Based on 1999 net premiums earned, Codan is the third largest property and casualty insurer in Denmark with a 13% share of the market.

Household products accounted for 18% of our 1999 property and casualty gross premiums earned in Denmark, personal automobile products accounted for 17%, commercial automobile products accounted for 14%, property products accounted for 15%, personal accident products accounted for 11%, workers' compensation products accounted for 5% and marine products accounted for 13%. Codan's commercial clients include a number of the leading Danish companies, as well as medium and small businesses.

In 1999, employed agents accounted for 75% of our property and casualty sales in Denmark, brokers accounted for 9% and call centers and direct business accounted for 8%. We have approximately 400 employed agents who work out of 37 customer centers. Codan's industrial and large client department has an employee sales force that sells and provides service direct to our large commercial clients. Codan also markets property and casualty products direct through two teleservice centers to personal customers accounting for 13% of personal lines sales in 1999.

We operate in Sweden through Codan's subsidiary, Trygg-Hansa Försäkrings AB Publikt and its subsidiaries. Codan acquired Trygg-Hansa Försäkrings AB Publikt, a Swedish property and casualty insurer, in

August 1999. Trygg-Hansa, Sweden's fourth largest property and casualty insurer based on gross premiums written for the 12 months ended March 31, 2000, offers primarily personal and commercial automobile, household and general commercial products. The acquisition complements Codan's existing business in Sweden and increases Codan's share of the Swedish property and casualty market to approximately 16% based upon gross premiums written for the 12 months ended March 31, 2000. Call centers accounted for 80% of our Swedish personal lines sales in 1999.

### *Italy*

We operate in Italy through our branch, Royal & Sun Alliance Assicurazioni, with headquarters in Genoa and offices in Milan, Rome, Padua and Turin; our subsidiary, Lloyd Italico Assicurazioni SpA; and under the trade name Royal Insurance, our direct marketing operation in Italy. We offer principally personal automobile products in Italy although we also offer household, personal accident, property, casualty, engineering and marine products. In addition, we market personal automobile products direct to customers and via the Internet. Personal automobile products accounted for 74% of our 1999 property and casualty net premiums written in Italy, commercial products accounted for 16%, personal accident products accounted for 6%, household products accounted for 4% and marine products accounted for less than 1%. We have implemented a multichannel distribution strategy in Italy and in 1999, exclusive agents accounted for 62% of our property and casualty net premiums written in Italy, independent agents accounted for 17%, brokers accounted for 14%, direct sales accounted for 6% and corporate clients accounted for 1%.

### *Germany*

We operate in Germany primarily through our subsidiary, Securitas Bremer Allgemeine Versicherungs AG. We offer personal and commercial products in Germany, principally personal and commercial automobile, marine, property and personal accident. In 1999, personal automobile accounted for 20% of our property and casualty net premiums written in Germany, marine accounted for 15%, household products accounted for 14%, commercial accident accounted for 11%, commercial property accounted for 11%, personal accident accounted for 10%, commercial automobile accounted for 9% and personal legal expenses accounted for 8%. We have a network of eight regional offices in Germany. Five of the regional offices distribute our products in Germany through exclusive agents accounting for 37.2% of our property and casualty net premiums written and three of our regional offices distribute our products in Germany through brokers accounting for 62.8% of our 1999 property and casualty net premiums written.

### *Ireland*

We operate in Ireland through our branch office based in Dublin. We are the fourth largest property and casualty insurer in Ireland with a 13% share of the market, based on 1998 net premiums written. We offer all major classes of personal and commercial business in Ireland, principally household, personal automobile, property and casualty insurance, primarily through brokers and corporate partnerships. In 1999, commercial multi-peril accounted for 43% of our net premiums written in Ireland, personal automobile accounted for 29%, household accounted for 28%, and commercial special risks, such as professional indemnity and directors' and officers' policies, accounted for 6%. In 1999, brokers accounted for 81.9% of our property and casualty net premiums written in Ireland, corporate partnerships accounted for 12.7%, direct marketing accounted for 5.1% and agents accounted for 0.3%.

### *Spain*

We operate in Spain through our subsidiaries, Royal & Sun Alliance S.A., based in Madrid, and Regal Insurance Club, Compañía Española de Seguros, S.A., located in Barcelona. We offer principally personal automobile, household and personal accident insurance through agents, brokers and corporate partnerships. In addition, Regal offers personal automobile and household insurance on a direct basis. In 1999, agents

accounted for 59.6% of our net premiums written in Spain, direct sales accounted for 10.2%, corporate partnerships accounted for 20.9% and brokers accounted for 9.3%.

*Others*

We also write property and casualty business through subsidiaries, equity investments, branches and representative offices in Belgium, The Netherlands, Luxembourg, Lithuania, France, Malta, Portugal, Saudi Arabia, the United Arab Emirates and Oman. In addition, we have a 38% interest in Mutual & Federal Insurance Co Ltd. Mutual & Federal is based in Johannesburg and has 15 branches in South Africa, as well as subsidiaries operating in Botswana, Namibia and Zimbabwe. Mutual & Federal offers both personal and commercial products and has a 15% share of the property and casualty market in South Africa, based on 1998 net premiums written. We primarily distribute property and casualty products in these other countries through brokers and agents.

*Other Europe Life and Asset Accumulation Business*

Our Other Europe region conducts life and asset accumulation business in Luxembourg, The Netherlands, Denmark, Norway, Sweden, Lithuania, Germany, Italy, Poland and Spain as well as internationally through our Isle of Man-based business. We offer a range of products throughout Continental Europe, including products for individuals and group customers. In 1999:

- Life and asset accumulation business in Other Europe accounted for £961 million, or 29.3%, of our consolidated life and asset accumulation net premiums written; and
- Life and asset accumulation business in Other Europe accounted for £19 million, or 3.4%, of our Group operating result (based on longer term investment return).

The table below presents the distribution of our 1999, 1998 and 1997 life and asset accumulation net premiums written by product group in our Other Europe region.

	Year Ended December 31,					
	1999		1998		1997	
	£ in millions	% of Total	£ in millions	% of Total	£ in millions	% of Total
<b>Individual:</b>						
Periodic premium products . . . . .	292	30.4%	303	37.3%	277	39.3%
Single premium products . . . . .	<u>543</u>	<u>56.5</u>	<u>377</u>	<u>46.4</u>	<u>324</u>	<u>46.1</u>
Total Individual . . . . .	835	86.9	680	83.7	601	85.4
<b>Group:</b>						
General account products . . . . .	<u>126</u>	<u>13.1</u>	<u>132</u>	<u>16.3</u>	<u>103</u>	<u>14.6</u>
<b>Total</b> . . . . .	<u>961</u>	<u>100.0%</u>	<u>812</u>	<u>100.0%</u>	<u>704</u>	<u>100.0%</u>

*Scandinavia*

We began writing life and asset accumulation business in Scandinavia in 1943 and, based on 1998 net premiums earned of £221 million, are the fifth largest life insurer in Denmark with an 8% market share excluding group pensions business. In 1999, we wrote £43 million in new business periodic premiums and £12 million in new business single premiums in Denmark. Individual products accounted for approximately 50% of our new business premiums in Denmark in 1999 and group products accounted for approximately 50%. We offer group and individual life and savings products through our network of exclusive agents, who work from a network of 37 customer centers, and brokers.

### *Italy*

We write life and asset accumulation business in Italy through our subsidiaries, Royal & Sun Alliance Vita SpA, Sun Alliance Vita SpA and Lloyd Italico Vita SpA. Our main focus is single premium life products and medium and longer term savings products. In 1999, we wrote £150 million in new business single premiums and £14 million in new business periodic premiums in Italy.

### *Spain*

We write life and asset accumulation business in Spain through our subsidiary, Royal & Sun Alliance Vida y Pensiones S.A. Distribution is primarily through a direct sales force and independent agents. Our main focus in Spain is single premium life products and medium and longer term savings products. In 1999, we wrote £8 million in new business single premiums and £6 million in new business periodic premiums in Spain.

### *Isle of Man*

Our international financial services business, Royal & Sun Alliance International Financial Services Limited, operates primarily in the Far Eastern markets, particularly Hong Kong. We offer a variety of unit-linked savings, investment and trust products to customers in a wide range of international markets. Distribution is through intermediaries, including independent financial advisors, and banks. In 1999, we wrote £343 million in new business single premiums and £29 million in new business periodic premiums.

### *Others*

We also write life and asset accumulation business in The Netherlands, Sweden, Lithuania, Norway, Germany and Poland. We have established a mutual fund operation in Luxembourg to target asset accumulation business in selected markets and provide an underlying investment vehicle for the general and life insurance funds of our Continental European operations.

## **Americas**

### *Overview*

Our Americas region comprises our businesses in the United States, Canada, Latin America and the Caribbean. We offer property and casualty products throughout the Americas region, principally in the United States and Canada. We offer life insurance and asset accumulation products in Canada and Latin America.

We have been engaged in the insurance business in the United States for almost 150 years. Following the July 1999 sale of our U.S. life and asset accumulation businesses, Royal Maccabees Life Insurance Company (“Royal Maccabees”) and Royal Life Insurance Company of New York (“Royal New York”), we now focus on property and casualty business in the United States. That emphasis was furthered with the November 1999 acquisition of Orion Capital Corporation, a leading U.S. specialty property and casualty insurer. The premium and operating result information presented below includes the results of our U.S. life and asset accumulation business up until the date of disposal and includes the results of Orion from the date of acquisition. With the addition of Orion, we became one of the 25 largest U.S. property and casualty insurers, based on 1999 net premiums written, and operate in all 50 states.

We have operated in Canada since 1851 and are the country’s third largest property and casualty insurer with market share of 6.4% in 1999. We also are the 15th largest life insurer in Canada based on new life insurance sales in 1999 and the 12th largest based on new segregated funds (a Canadian form of mutual fund) sales in 1999. As of December 31, 1999, we had a 1.7% share of the Canadian life insurance market and a 2.4% share of the Canadian segregated funds market.

We began writing business in Latin America and the Caribbean more than 150 years ago. In Latin America and the Caribbean, we write property and casualty business in 15 countries and life and asset accumulation business in four countries through owned operations, representative offices and branches. At the end of 1999, we increased our interest in our Chilean associate, Compañía de Seguros de Vida La Construcción, to 51% from 40% for £17 million. Accordingly, we have consolidated the results of our Chilean operation with effect from December 31, 1999.

In 1999, our Americas region recorded segment operating result (based on longer term investment return) of £191 million, representing 33.7% of our Group operating result (based on longer term investment return). Property and casualty businesses accounted for £156 million, or 81.7%, of our total 1999 Americas segment operating result (based on longer term investment return) and life and asset accumulation business accounted for £35 million, or 18.3%, of our total 1999 Americas segment operating result (based on longer term investment return). At the end of December 1999, our Americas region employed approximately 8,500 people in 177 offices.

#### *Americas Property and Casualty Business*

Our Americas region conducts property and casualty business throughout the United States, Canada and 15 countries in Latin America and the Caribbean. In 1999:

- Property and casualty business in the Americas accounted for £1,817 million, or 25.4%, of our consolidated property and casualty net premiums written; and
- Property and casualty business in the Americas accounted for £156 million, or 27.6%, of our Group operating result (based on longer term investment return).

The table below presents the distribution of our 1999, 1998 and 1997 property and casualty net premiums written by principal market and line of business within our Americas region.

	Year Ended December 31,					
	1999		1998		1997	
	£ in millions	% of Total	£ in millions	% of Total	£ in millions	% of Total
<b>United States:</b>						
Personal .....	255	14.0%	224	14.4%	213	14.0%
Commercial .....	857	47.2	689	44.6	651	42.7
Total United States .....	1,112	61.2	913	59.0	864	56.7
<b>Canada:</b>						
Personal .....	308	17.0	254	16.5	259	17.0
Commercial .....	203	11.1	194	12.6	217	14.2
Total Canada .....	511	28.1	448	29.1	476	31.2
<b>Latin America/Caribbean:</b>						
Personal .....	83	4.6	71	4.6	73	4.8
Commercial .....	111	6.1	112	7.3	112	7.3
Total Latin America/Caribbean .....	194	10.7	183	11.9	185	12.1
<b>Total Americas</b> .....	<u>1,817</u>	<u>100.0%</u>	<u>1,544</u>	<u>100.0%</u>	<u>1,525</u>	<u>100.0%</u>
<b>Total Personal</b> .....	646	35.6%	549	35.5%	545	35.8%
<b>Total Commercial</b> .....	1,171	64.4	995	64.5	980	64.2
<b>Total Americas</b> .....	<u>1,817</u>	<u>100.0%</u>	<u>1,544</u>	<u>100.0%</u>	<u>1,525</u>	<u>100.0%</u>

The table below presents our 1999, 1998 and 1997 property and casualty loss, expense and combined ratios within our Americas region by principal market and line of business.

	Year Ended December 31,								
	1999			1998			1997		
	Loss Ratio %	Expense Ratio %	Combined Ratio %	Loss Ratio %	Expense Ratio %	Combined Ratio %	Loss Ratio %	Expense Ratio %	Combined Ratio %
<b>United States:</b>									
Personal	62.8	32.9	95.7	56.3	33.0	89.3	61.6	33.2	94.8
Commercial	76.8	33.1	109.9	76.3	35.7	112.0	71.4	37.2	108.6
Total United States	73.4	33.0	106.4	71.3	35.1	106.4	69.1	36.7	105.8
<b>Canada:</b>									
Personal	69.4	29.4	98.8	66.7	29.8	96.5	64.3	29.2	93.5
Commercial	79.1	36.0	115.1	73.8	35.5	109.3	70.0	35.0	105.0
Total Canada	73.4	32.0	105.4	69.8	32.3	102.1	67.2	32.0	99.2
<b>Latin America/Caribbean:</b>									
Personal	67.2	45.0	112.2	70.1	47.3	117.4	89.6	38.5	128.1
Commercial	78.3	42.1	120.4	74.0	45.4	119.4	56.6	37.6	94.2
Total Latin America/Caribbean	73.6	43.4	117.0	72.5	46.1	118.6	70.2	38.0	108.2
<b>Total Personal</b>	<b>66.5</b>	<b>32.8</b>	<b>99.3</b>	<b>62.8</b>	<b>33.2</b>	<b>96.0</b>	<b>66.7</b>	<b>32.0</b>	<b>98.7</b>
<b>Total Commercial</b>	<b>77.4</b>	<b>34.4</b>	<b>111.8</b>	<b>75.5</b>	<b>36.7</b>	<b>112.2</b>	<b>69.7</b>	<b>37.1</b>	<b>106.8</b>
<b>Total Americas</b>	<b>73.4</b>	<b>33.9</b>	<b>107.3</b>	<b>71.0</b>	<b>35.6</b>	<b>106.6</b>	<b>68.6</b>	<b>34.9</b>	<b>103.5</b>

#### *United States*

Our U.S. property and casualty business is headquartered in Charlotte, North Carolina. We offer a broad spectrum of standard and specialty property and casualty products, principally commercial multi-peril, workers' compensation, personal and commercial automobile and household insurance. We conduct business through a network of independent agents and brokers across the United States. Our commercial insurance operations work with over 2,000 agents. We offer standard personal insurance business through 1,000 agents, while we offer non-standard automobile insurance through approximately 14,000 agents. We support this network of independent agents and brokers with commercial and personal field offices located throughout the United States. Our overall organization structure provides for local authority, which we believe enhances our ability to provide a local touch and customer-responsive services. We write commercial and specialty business in all 50 states and personal insurance business in 42 states. In 1999, our U.S. property and casualty business accounted for 61.2% of the Americas region's property and casualty net premiums written.

In November 1999, we acquired Orion, a U.S. specialty insurance operation with strong market positions in workers' compensation, professional liability and non-standard automobile insurance. The acquisition doubled the size of our U.S. business, placing it among the 25 largest U.S. property and casualty operations. In addition to adding greater scale and presence to our U.S. operations, the acquisition of Orion also provided valuable business mix balance, along with complementary product lines and skills that enhance our capabilities.

There are approximately 2,400 property and casualty insurance companies in the United States. The top 200 companies and groups account for approximately 90% of the consolidated industry's total net premiums written. In the commercial market, an increasing number of client companies have been self-insuring through the use of large deductibles, risk-purchasing groups, risk-retention groups and captive insurance companies.

The U.S. personal automobile market is divided into two market segments: the standard and preferred market and the non-standard market. The standard and preferred market is dominated by a few large personal lines companies that either have significant scale and brand identity, provide customized products and services

to upscale customers, or are regionally focused with strong brand identity in their market. The non-standard market is controlled by a small number of niche companies with less brand identity which compete primarily on price. A few of the large personal lines companies also write non-standard business. The personal property and casualty market is highly competitive and regulated. We compete in both segments of the personal automobile marketplace and concentrate on those states that we believe have the highest profit potential and in the standard and preferred segments that are suited to our strategy of service differentiation.

In the United States, the commercial property and casualty market has been highly competitive and under extreme pressure due to the impact on pricing of excess capital in the marketplace. The assets of property and casualty insurance companies consist primarily of investments, such as stocks and bonds. As a result of the strength of the U.S. capital markets in recent years, the value of these investments has increased. At the same time, insurance liabilities have grown at a slower pace, in part a reflection of the slowdown in inflation. The difference in the growth of investment assets over the growth in liabilities has led to excess capital. Property and casualty insurance companies must maintain sufficient capital to absorb insurance losses and also to withstand unforeseen adverse loss development, such as large losses caused by catastrophes. Excess capital allows an insurance company to insure more risks by writing increased premium volumes. However, as the total demand for property and casualty insurance is finite, the principal way for companies to increase premium volume is to underprice competitors and to thus take market share away from them. This competition is largely in the commercial markets where premium rates are less rigorously regulated than the personal markets in the United States.

The highly competitive nature of the market and extreme pressure caused by excess capital can be demonstrated by the rise of the industry's solvency margin, the ratio of surplus to premiums, from approximately 80% at the end of 1994 to approximately 125% at the end of 1998. As surplus grew by more than 70% during this period, premiums rose by only 12%. Excess capital may translate into unfavorable pricing conditions because insurers have relatively more capital to support their insurance operations and thus can write more policies. Undifferentiated commercial product offerings, such as multi-peril package, general liability, and commercial automobile insurance, have been severely low-priced for several years. Specialty product offerings, those which offer non-standard coverage and services, typically carry higher margins and generally continued to be profitable during the prolonged period of low prices.

To compete in these market conditions, we have focused on underwriting performance and have sought to build our capabilities in higher margin specialty lines. In addition, we entered new markets and expanded our range of insurance products to offer a more complete array of products to our customers. We also targeted certain segments in order to improve our overall risk selection process. We also seek to distinguish ourselves in this competitive environment by emphasizing our global insurance capabilities. During 1999, industry surplus growth slowed and, during the latter half of 1999, prices in the commercial markets began to increase. In addition, in the fourth quarter of 1999, we began to raise prices across a wide range of commercial product lines.

Consistent with our focus on non-standard coverage and services, we developed Management Assurance<sup>®</sup>, comprehensive coverage for directors' and officers' liability, crime insurance and extortion coverage, as well as customized solutions for the unique exposures of high-tech companies. Orion enhanced our existing workers' compensation capabilities and added professional liability, non-standard automobile and other niche market areas to our growing list of specialty capabilities.

Overall, our U.S. strategy remains one of dedicating capital to specialty product markets and approaches where we can distinguish ourselves with differentiated features and skills. This proposition is one of our key strategies to differentiate us in the highly competitive commercial lines marketplace. Our acquisition of Orion has improved our business mix by adding a broad portfolio of highly differentiated specialty products.

Our commercial customers include a wide variety of insureds with not only domestic operations, but also with overseas locations, operations or assets. We have many customers that require tailored coverage to meet their needs. We meet many of those needs through our worldwide network that enables us to provide our customers with a broad product portfolio in over 130 countries. We organize our commercial products and service systems into three primary customer groups: middle-market commercial accounts; risk management and global accounts; and specialty products/programs.

Consistent with our strategy of providing global coverage to our commercial customers, we have developed a new product, called World Assurance®, which provides international coverages, including workers' compensation, general liability and property, for middle-market commercial customers. This product group is designed to provide innovative coverage and service for customers with international insurance needs and has achieved solid growth in 1998 and 1999. We continued to grow our warranty coverage unit, our excess and surplus lines unit and our residual value lease coverage unit in 1999.

We are currently realigning our middle-market operations, which focus on the segment of the commercial market between small businesses and Fortune 1000 companies. The realignment is designed to enhance our ability to use our underwriting, claims and accident prevention competencies to cover risks but also to improve the insurance risk profile of our customers. To do this, we have established multidisciplinary teams consisting of underwriters, accident prevention and claims personnel who work together with our clients to improve the safety of our clients' workplaces and thereby improve the insurance risk profile of our customer. As part of this realignment, we are reducing the number of physical middle-market locations from 75 to 32. The reduction in locations is intended to focus our presence near our customers, while eliminating redundant Royal & SunAlliance and Orion locations as well as locations where the market does not support the cost of a physical presence.

In addition to the middle-market realignment, we have created a distinct risk management and global unit to better serve this sophisticated and diverse market segment. The complexity of these accounts and the unique expectations of customers, demand a different approach than our "local touch" middle-market strategy.

The table below presents the distribution of our 1999, 1998, and 1997 property and casualty net premiums written and combined ratios by product group in the United States.

	Year Ended December 31,								
	1999			1998			1997		
	£ in millions	% of Total	Combined Ratio %	£ in millions	% of Total	Combined Ratio %	£ in millions	% of Total	Combined Ratio %
<b>Personal:</b>									
Household . . . . .	77	6.9%	109.9	71	7.8%	103.7	64	7.4%	94.7
Automobile . . . . .	161	14.5	91.2	138	15.1	85.1	136	15.7	97.6
Other . . . . .	17	1.5	74.3	15	1.6	61.1	13	1.5	71.6
Total Personal . . . . .	<u>255</u>	<u>22.9</u>	<u>95.7</u>	<u>224</u>	<u>24.5</u>	<u>89.3</u>	<u>213</u>	<u>24.6</u>	<u>94.8</u>
<b>Commercial:</b>									
Multi-peril . . . . .	204	18.3	114.5	187	20.5	107.4	191	22.2	114.7
Workers' compensation . . . . .	200	18.0	108.0	165	18.1	112.2	135	15.6	99.2
Property . . . . .	61	5.5	80.4	56	6.1	75.3	65	7.5	63.6
Casualty . . . . .	114	10.3	130.6	91	10.0	117.2	77	8.9	125.4
Automobile . . . . .	99	8.9	108.0	97	10.6	130.3	89	10.3	131.4
Other . . . . .	179	16.1	105.5	93	10.2	122.7	94	10.9	109.1
Total Commercial . . . . .	<u>857</u>	<u>77.1</u>	<u>109.9</u>	<u>689</u>	<u>75.5</u>	<u>112.0</u>	<u>651</u>	<u>75.4</u>	<u>108.6</u>
<b>Total United States . . . . .</b>	<u><u>1,112</u></u>	<u><u>100.0%</u></u>	<u><u>106.4</u></u>	<u><u>913</u></u>	<u><u>100.0%</u></u>	<u><u>106.4</u></u>	<u><u>864</u></u>	<u><u>100.0%</u></u>	<u><u>105.8</u></u>

## Canada

We are the third largest property and casualty insurer in Canada based on 1999 net premiums written. Our Canadian property and casualty business is headquartered in Toronto and writes the major lines of property and casualty business in Canada primarily through a network of approximately 1,600 brokerages across the country. In 1999, our Canadian property and casualty business accounted for 28.1% of the Americas region's property and casualty net premiums written.

In 1999, as a part of our strategy to capitalize on our multi-channel distribution capability, we established the Personal Financial Services Group, or PFS Group, as a separate platform to deliver a broad range of financial services to our personal customers. The PFS Group offers property and automobile insurance to our clients and credit card and warranty coverage to our corporate partners. The PFS Group is supported by a customer call center that also provides fee for service work for our non-PFS Group operations. The long term strategy for our PFS Group is to broker, distribute and service financial products, including life and wealth management products, in a flexible package that can be tailored to an organization's needs. To support this strategy, we have acquired a number of broker operations.

The property and casualty industry in Canada has undergone dramatic changes over the past five years. Already the most competitive of the country's financial services industries with over 240 market participants, the property and casualty sector is now facing aggressive new competition, primarily from the entrance of banks and direct writers. Both brokers and insurers have responded to these market conditions by consolidation through mergers, acquisitions and partnerships to strengthen their competitive position.

Our business has remained profitable despite the depressed prices in the Canadian property and casualty market because we have focused on innovation, technical expertise and customer service. We continue to invest in a brand-identity program designed to increase awareness of our products and services among consumers in Canada. We have made progress in our e-business capabilities as a result of the implementation of our new policy processing system that is designed to interface with the internet. We now have the capability to offer brokers real-time rating and updates, access customer information, and to transact sales through our internet presence.

We offer a broad range of property and casualty products in Canada, primarily personal and commercial automobile, household, property, casualty and marine insurance. The table below presents the distribution of our 1999, 1998 and 1997 property and casualty net premiums written and combined ratio by product group in Canada.

	Year Ended December 31,								
	1999			1998			1997		
	£ in millions	% of Total	Combined Ratio %	£ in millions	% of Total	Combined Ratio %	£ in millions	% of Total	Combined Ratio %
<b>Personal:</b>									
Household . . . . .	94	18.4%	103.7	79	17.6%	103.8	82	17.3%	95.4
Personal automobile . . . . .	214	41.9	96.7	175	39.1	93.1	177	37.2	93.1
Total Personal . . . . .	308	60.3	98.8	254	56.7	96.5	259	54.5	93.5
<b>Commercial:</b>									
Property . . . . .	57	11.1	112.1	56	12.5	117.5	63	13.2	104.3
Casualty . . . . .	45	8.8	141.7	46	10.3	120.7	54	11.3	127.0
Commercial automobile . . . . .	80	15.7	107.7	73	16.3	97.7	77	16.2	92.0
Other . . . . .	21	4.1	92.1	19	4.2	101.0	23	4.8	102.3
Total Commercial . . . . .	203	39.7	115.1	194	43.3	109.3	217	45.5	105.0
<b>Total Canada . . . . .</b>	<b>511</b>	<b>100.0%</b>	<b>105.4</b>	<b>448</b>	<b>100.0%</b>	<b>102.1</b>	<b>476</b>	<b>100.0%</b>	<b>99.2</b>

We provide commercial coverage to businesses of all sizes and focus our marketing efforts and products on three basic categories of customers:

- *Transactional*—small businesses;
- *Individual Risk*—mid-market companies; and
- *Risk Managed*—large domestic and multinational companies.

We have undertaken a number of customer service initiatives over the past few years, including the establishment of customer call centers, 24-hour emergency claims services, valet claims service for automobile repairs and the creation of a consolidated broker call center.

We distribute both commercial and personal property and casualty products in Canada through a network of brokers. To support our broker network, we have established 17 regional and district offices in key markets across Canada, each of which focuses on either personal or commercial business. Our network of offices provides regional expertise and access to our worldwide product and service capabilities. Our broker operations accounted for 90% of our 1999 net premiums written, our direct operations accounted for 9% and our corporate partnerships accounted for 1%.

Recently, the industry has gone through significant changes. Strong operating results have increased the capital of insurers and reinsurers and have helped fuel an increase in merger and acquisition activity, particularly large-scale consolidations. As a result, the larger revenue-generating insurers dominate the Canadian property and casualty market. The top ten property and casualty insurers, based on 1999 net premiums written, account for almost 60% of the market. Our principal competitors are the large Canadian and European-based insurers, and direct writing operations from the United States. In addition, the Canadian banks have entered the property and casualty market and are also strong competitors because of their broad customer base and access to capital.

#### *Latin America and the Caribbean*

We write property and casualty business in 15 countries in Latin America and the Caribbean, principally in Argentina, Chile and Puerto Rico. We also have operations in the Bahamas, Eastern Caribbean, Netherlands Antilles, Aruba, Jamaica, Colombia, Brazil, Venezuela, Peru and Uruguay, as well as agency representation in Bermuda and the Falkland Islands. We write the major lines of property and casualty business in Latin America and the Caribbean primarily through brokers and agents. In 1999, our Latin America and Caribbean property and casualty business accounted for 10.7% of the Americas region's property and casualty net premiums written.

In Latin America and the Caribbean, we are aiming to improve our results. A key aspect of this includes effectively managing our exposure to catastrophe risks. Following volcano and hurricane losses in recent years in the Caribbean, we reviewed our exposure in the region and determined to reduce future catastrophe exposure through a combination of strategic sales and increased reinsurance. In accordance with this strategy we sold our 20% shareholding in United Insurance Company Ltd of Barbados in 1999. Also during 1999, we increased external reinsurance covers for our Eastern Caribbean operations. We believe that the personal lines market in the region offers growth opportunities, particularly through corporate partnerships with banks and other financial institutions.

We write both personal and commercial lines in Latin America and the Caribbean, primarily property, automobile, marine, engineering and casualty insurance. In 1999, commercial lines accounted for £111 million, or 57.2%, of our net premiums written in Latin America and the Caribbean and personal lines accounted for £83 million, or 42.8%. We recently have seen a small but increasing demand for specialty covers such as directors' and officers' and professional indemnity insurance, particularly from our larger international clients.

Our target commercial customers are large and medium sized companies. We have invested significant time and money in Latin America and the Caribbean to ensure quality service to our customers. In Brazil, we are one of the first companies to offer brokers electronic quotation systems to help provide quicker and more efficient service to our customers. We also have created specialist customer call centers throughout most of Latin America to better meet the needs of our corporate partners and customers.

We distribute both commercial and personal property and casualty products in Latin America and the Caribbean through the major international brokers, local agents and brokers and through corporate partnerships, primarily with banks and other financial institutions. The vast majority of our commercial business in Latin America and the Caribbean is written through international brokers and large local intermediaries, although we are growing our personal lines business principally through corporate partnerships. In 1998, we began writing personal lines business on a direct basis in Argentina. This is one of the first direct operations in Latin America.

In Latin America and the Caribbean we compete with the large international insurers and large local insurers, some of which are state-owned. The Latin American markets are competitive, driven in part by the perceived potential for growth in the region by the global and regional players, and also the excess capacity in the world reinsurance markets. During 1999 in the Caribbean, markets remained competitive despite recent hurricanes due largely to excess reinsurance capacity.

#### *Americas Life and Asset Accumulation Business*

Our Americas region conducts life and asset accumulation business in Canada, Chile, Colombia, Peru, Argentina and Uruguay. We sold our U.S. life and asset accumulation operations, Royal Maccabees and Royal New York, in July 1999. In 1999, including Royal Maccabees and Royal New York which accounted for £76 million of net premiums written and £10 million of our Americas segment operating result (based on longer term investment return):

- Life and asset accumulation business in the Americas accounted for £126 million, or 3.8%, of our consolidated life and asset accumulation net premiums written; and
- Life and asset accumulation business in the Americas accounted for £35 million, or 6.2%, of our Group operating result (based on longer term investment return).

#### *Canada*

Through our subsidiary, Royal & SunAlliance Financial, we offer a broad portfolio of individual life insurance and asset accumulation products through a national network of independent brokers. We serve these brokers through eight regional offices and 36 managing general agencies across Canada. In 1999, life and asset accumulation net premiums written were £50 million.

Our life product line includes both participating and non-participating life insurance products. We offer traditional term and whole life as well as our universal life product. Flexible in design and price, our universal life product offers policyholders a variety of investment options including performance links to industry benchmarks or to our own segregated funds. Our investment and retirement product line includes 11 in-house segregated funds, four additional segregated funds offered through an alliance with a third party, annuities, daily interest accounts and guaranteed interest accounts with guaranteed interest rates for periods of one to 20 years. While our focus continues to be on life and asset accumulation products, we also offer lifestyle-protection plans such as critical illness insurance and long term-care insurance.

During 1999, we focused on strengthening our business partnerships by developing a web-based system designed to provide our distributors with real time access to customer information. In addition, we

launched an investment product software system and a comprehensive document processing system that should enhance our ability to develop and modify policy contracts and correspondence. We also improved customer service by restructuring our customer service division into regional teams, and establishing a customer service call center.

### *Latin America*

In Latin America, we offer life and asset accumulation products through our subsidiaries in Chile, Colombia, Peru, Argentina and Uruguay. La Construcción is the fourth largest life and asset accumulation company in Chile, based on 1999 gross premiums written. Our primary products are individual and group life insurance, annuities and pensions. We distribute our life and asset accumulation products in Latin America through a combination of direct and agency sales forces as well as intermediaries including banks offering insurance to their customers.

## **Asia Pacific**

### *Overview*

Our Asia Pacific region comprises our businesses in Australia, New Zealand, China, Hong Kong, Taiwan, Japan, Pakistan and Southeast Asia. We offer property and casualty products throughout the Asia Pacific region, principally in Australia and New Zealand, and we offer life insurance and asset accumulation products in Australia and New Zealand. In 1999, we established an office in Seoul, Korea, where we plan to start writing large, risk managed commercial business in 2000, following approval of our insurance license.

We have been engaged in the insurance business in the Asia Pacific region since 1825. We have operated in Australia since 1833 and are the country's fifth largest property and casualty insurer, based on 1998 gross premiums earned. Including Tyndall, which we acquired in May 1999, we are the fourth largest life risk insurer in Australia based on annual premiums in force as of December 31, 1999. We have operated in New Zealand since 1878 and are the country's third largest property and casualty insurer with a market share of approximately 13%, based on 1999 gross premiums written. We are the fourth largest life insurer in New Zealand based on 1999 annual premiums in force.

A significant opportunity for growth exists in Japan, which is the second largest property and casualty market in the world and the largest life and asset accumulation market in the world. Opportunities for foreign insurers have been created by recent legislation permitting the registration of insurance brokers and by the weakening of the keiretsu groupings. The keiretsu groupings are large conglomerates of affiliated companies from various industry sectors which dominated commerce in Japan. With the weakening of the keiretsu groupings, competition should increase, providing the Group opportunity for growth in the Japanese market. As of March 1999, we were the largest European insurer in Japan and are exploring growth opportunities in our property and casualty operations in Japan where limited deregulation is occurring. We are in the process of applying for a life insurance license in Japan.

In 1999, our Asia Pacific region recorded segment operating result (based on longer term investment return) of £3 million, representing 0.5% of our Group operating result (based on longer term investment return). Property and casualty businesses accounted for (£21) million of our total 1999 Asia Pacific segment operating result (based on longer term investment return) and life and asset accumulation business accounted for £24 million of our total 1999 Asia Pacific segment operating result (based on longer term investment return). Our Asia Pacific region employs approximately 5,200 people in 191 offices.

### Asia Pacific Property and Casualty Business

Our Asia Pacific region conducts property and casualty business in Australia, New Zealand and 11 other markets in the rest of the Asia Pacific region. In 1999:

- Property and casualty business in Asia Pacific accounted for £761 million, or 10.6%, of our consolidated property and casualty net premiums written; and
- Property and casualty business in Asia Pacific accounted for (£21) million, or (3.7%), of our Group operating result (based on longer term investment return).

The table below presents the distribution of our 1999, 1998 and 1997 property and casualty net premiums written by principal market and line of business within our Asia Pacific region.

	Year Ended December 31,					
	1999		1998		1997	
	£ in millions	% of Total	£ in millions	% of Total	£ in millions	% of Total
<b>Australia:</b>						
Personal . . . . .	353	46.4%	264	46.0%	251	44.1%
Commercial . . . . .	165	21.7	112	19.5	115	20.2
Total Australia . . . . .	<u>518</u>	<u>68.1</u>	<u>376</u>	<u>65.5</u>	<u>366</u>	<u>64.3</u>
<b>New Zealand:</b>						
Personal . . . . .	31	4.1	28	4.9	33	5.8
Commercial . . . . .	71	9.3	38	6.6	47	8.2
Total New Zealand . . . . .	<u>102</u>	<u>13.4</u>	<u>66</u>	<u>11.5</u>	<u>80</u>	<u>14.0</u>
<b>Other Asia Pacific:</b>						
Personal . . . . .	62	8.1	58	10.1	55	9.6
Commercial . . . . .	79	10.4	74	12.9	69	12.1
Total Other Asia Pacific . . . . .	<u>141</u>	<u>18.5</u>	<u>132</u>	<u>23.0</u>	<u>124</u>	<u>21.7</u>
<b>Total Asia Pacific . . . . .</b>	<u>761</u>	<u>100.0%</u>	<u>574</u>	<u>100.0%</u>	<u>570</u>	<u>100.0%</u>
<b>Total Personal . . . . .</b>	446	58.6%	350	61.0%	339	59.5%
<b>Total Commercial . . . . .</b>	315	41.4	224	39.0	231	40.5
<b>Total Asia Pacific . . . . .</b>	<u>761</u>	<u>100.0%</u>	<u>574</u>	<u>100.0%</u>	<u>570</u>	<u>100.0%</u>

The table below presents our 1999, 1998 and 1997 property and casualty loss, expense and combined ratios within our Asia Pacific region by principal market and line of business.

	Year Ended December 31,								
	1999			1998			1997		
	Loss	Expense	Combined	Loss	Expense	Combined	Loss	Expense	Combined
	Ratio	Ratio	Ratio	Ratio	Ratio	Ratio	Ratio	Ratio	Ratio
	%	%	%	%	%	%	%	%	%
<b>Australia:</b>									
Personal . . . . .	80.0	17.6	97.6	79.5	21.5	101.0	79.7	20.5	100.2
Commercial . . . . .	107.2	24.6	131.8	86.7	31.4	118.1	68.9	36.1	105.0
Total Australia . . . . .	88.5	19.9	108.4	81.7	24.5	106.2	76.1	25.4	101.5
<b>New Zealand:</b>									
Personal . . . . .	71.8	25.2	97.0	74.2	31.9	106.1	71.5	27.9	99.4
Commercial . . . . .	69.9	20.6	90.5	62.3	33.9	96.2	51.2	32.7	83.9
Total New Zealand . . . . .	70.6	22.0	92.6	67.0	33.1	100.1	58.5	30.8	89.3
<b>Other Asia Pacific:</b>									
Personal . . . . .	47.2	90.6	137.8	47.1	100.3	147.4	61.6	61.4	123.0
Commercial . . . . .	81.3	56.7	138.0	56.5	46.8	103.3	48.0	49.3	97.3
Total Other Asia Pacific . . . . .	66.4	71.7	138.1	52.1	70.4	122.5	54.0	54.7	108.7
<b>Total Personal</b> . . . . .	74.7	28.3	103.0	73.0	35.4	108.4	75.9	27.9	103.8
<b>Total Commercial</b> . . . . .	92.7	31.8	124.5	72.4	36.9	109.3	59.0	39.3	98.3
<b>Total Asia Pacific</b> . . . . .	82.0	29.7	111.7	72.7	36.0	108.7	68.5	32.5	101.0

*Australia*

Our Australian property and casualty business writes primarily personal automobile and household business. We also write commercial broker business, financial insurance consisting primarily of lenders' mortgage insurance, multinational risks, marine and workers' compensation products.

The Australian property and casualty market is extremely competitive in both commercial and personal lines. Commercial rates are beginning to increase after many years of lower rates. Rates for personal lines have held up well compared to commercial rates.

The table below presents the distribution of our 1999, 1998 and 1997 property and casualty net premiums written and combined ratios by product group in Australia.

	Year Ended December 31,								
	1999			1998			1997		
	£ in	% of	Combined	£ in	% of	Combined	£ in	% of	Combined
	millions	Total	Ratio %	millions	Total	Ratio %	millions	Total	Ratio %
<b>Personal:</b>									
Household . . . . .	69	13.3%	87.1	56	15.0%	98.1	56	15.4%	86.6
Personal automobile . . . . .	254	49.0	104.0	187	49.7	103.1	178	48.6	107.1
Other . . . . .	30	5.8	33.2	21	5.6	77.8	17	4.6	71.6
Total Personal . . . . .	353	68.1	97.6	264	70.3	101.0	251	68.6	100.2
<b>Commercial:</b>									
Property . . . . .	25	4.8	121.0	27	7.2	139.4	32	8.7	104.9
Casualty . . . . .	47	9.1	198.8	23	6.1	126.2	19	5.2	106.6
Commercial automobile . . . . .	31	6.0	114.0	37	9.8	108.4	35	9.6	108.8
Other . . . . .	62	12.0	104.9	25	6.6	100.5	29	7.9	99.7
Total Commercial . . . . .	165	31.9	131.8	112	29.7	118.1	115	31.4	105.0
<b>Total Australia</b> . . . . .	518	100.0%	108.4	376	100.0%	106.2	366	100.0%	101.5

We distribute both commercial and personal property and casualty products in Australia primarily through a network of independent agents and brokers, corporate partnerships and our two direct writing subsidiaries, Australian Associated Motor Insurers Limited, or AAMI, and Australian Alliance Insurance Company Limited, or AAI, which focus on personal lines business. These direct marketing operations in Australia, which contributed 77% of our total Australian personal net premiums written in 1999, have shown strong profitable growth over the last six years, with net premiums written growing to £273 million in 1999 from £108 million in 1994 at constant exchange rates. Of the increase, £26 million was due to assuming an additional 20% of the insurance risk in AAMI in 1999. AAMI focuses on personal automobile and household products. It has successfully maintained a low cost base and has been recognized for providing good customer service. AAMI's growth in gross premiums written has averaged 21% per annum for the last four years. Its total policy sales growth for the same period averaged 12% per annum. AAMI had 1.6 million policyholders at the end of 1999. AAI offers personal automobile and household products to a target group of retirement age individuals.

In 1999, our direct operations accounted for 53% of our property and casualty gross premiums written in Australia, brokers accounted for 32% and the corporate partnership channel accounted for 15%.

#### *New Zealand*

We write property and casualty business in New Zealand through our subsidiary Royal & Sun Alliance Insurance (New Zealand) Limited. We have acquired four property and casualty businesses in New Zealand over the past 12 years and our gross premiums written have grown from £13.8 million in 1987 to £123 million in 1999 on a constant exchange rate basis. The privatization of workers' compensation insurance during 1999 resulted in a significant opportunity, and during 1999 we wrote significant workers' compensation business in New Zealand. Unfortunately, the incoming government in 1999 has decided to re-nationalize workers' compensation during 2000 and therefore this market will be lost to private insurers. We do not expect to incur significant exit costs due to this event.

We offer both personal and commercial lines in New Zealand along with workers' compensation. Our principal commercial lines are property, accident, automobile, engineering and marine insurance. Commercial lines accounted for 74% of our 1999 property and casualty gross premiums written in New Zealand. Of this amount, workers' compensation accounted for 53% of our 1999 commercial lines gross premiums written, property products accounted for 21%, automobile products accounted for 8%, marine products accounted for 10%, accident products accounted for 6% and engineering products accounted for 2%.

Our principal personal lines are household, travel, automobile and pleasure hull insurance. We distribute our products primarily through international and local brokers. Personal lines accounted for approximately 26% of our 1999 property and casualty gross premiums written in New Zealand. Of this amount, household products accounted for 58% of our 1999 personal lines gross premiums written and automobile insurance accounted for 42%.

In 1999, brokers accounted for 89% of our property and casualty gross premiums written in New Zealand, direct sales accounted for 8% and the corporate partnership channel accounted for 3%.

#### *Other Asia Pacific*

We write property and casualty business in Japan, China, Hong Kong, Taiwan, Singapore, Pakistan, the Philippines, Malaysia, Indonesia, Thailand and Brunei through owned operations and equity investments. We have representative offices in India and Vietnam, and have recently established an office in Korea. Local regulations in some of these markets create significant barriers to entry for foreign firms, make majority foreign ownership difficult and ensure that local companies maintain substantial market share. However, limited deregulation and liberalization of the insurance market is occurring in Japan. We expect further steps to open

up the Chinese market following China's proposed entry into the World Trade Organization. In India, legislation has been passed which is expected to allow foreign insurers to establish a presence in the market in the next year or so, albeit as a minority shareholder in a local company.

Other than Japan, where approximately 65% of our 1999 gross premiums written were derived from personal lines, we are predominantly a commercial lines writer in these markets. In 1999, commercial lines accounted for approximately 56% of our property and casualty gross premiums written in Other Asia Pacific and personal lines accounted for approximately 44%. We primarily offer commercial property, casualty, engineering and marine insurance. Our personal lines consist principally of automobile insurance. Most of our Other Asia Pacific property and casualty premiums were derived from brokers and agents and the balance from corporate partnerships. In Japan, we also write personal accident insurance direct through corporate partnerships and with individual clients and in 1998 we launched a direct automobile insurance business in Japan under the brand name Royal Direct.

Competition is strong in the Asia Pacific region among numerous local and international insurers. Most of the Asia Pacific markets outside of Australia and New Zealand are dominated by local insurers as the availability of insurance licenses for foreign insurers is limited. In Japan, the property and casualty market is dominated by four local companies who control almost 50% of the market based on net premiums written for the year ended March 31, 1999.

#### *Asia Pacific Life and Asset Accumulation Business*

Our Asia Pacific region conducts life and asset accumulation business in Australia and New Zealand. We do not have a life insurance presence outside of Australia and New Zealand in Asia Pacific, but are investigating opportunities to expand in the region either through a start-up operation or by acquisition. In 1999:

- Life and asset accumulation business in Asia Pacific accounted for £247 million, or 7.5%, of our consolidated life and asset accumulation net premiums written; and
- Life and asset accumulation business in Asia Pacific accounted for £24 million, or 4.2%, of our Group operating result (based on longer term investment return).

The table below presents the distribution of our 1999, 1998, and 1997 life and asset accumulation net premiums written by product in our Asia Pacific region.

	Year Ended December 31,					
	1999		1998 (1)		1997 (1)	
	£ in millions	% of Total	£ in millions	% of Total	£ in millions	% of Total
<b>Individual:</b>						
Periodic premium products:						
With-profit (participating) contracts . . . . .	15	6.1%	12	9.3%	9	10.3%
Unit-linked (separate account) products . . . . .	30	12.1	26	20.2	19	21.8
Non-participating products . . . . .	74	30.0	31	23.9	28	32.2
Total periodic premium products . . . . .	<u>119</u>	<u>48.2</u>	<u>69</u>	<u>53.4</u>	<u>56</u>	<u>64.3</u>
Single premium products:						
Unit-linked (separate account) products . . . . .	54	21.9	22	17.1	20	23.0
Non-participating products . . . . .	12	4.8	22	17.1	0	0.0
Total single premium products . . . . .	<u>66</u>	<u>26.7</u>	<u>44</u>	<u>34.1</u>	<u>20</u>	<u>23.0</u>
Total Individual . . . . .	<u>185</u>	<u>74.9</u>	<u>113</u>	<u>87.5</u>	<u>76</u>	<u>87.3</u>
<b>Group:</b>						
General account products . . . . .	6	2.4	0	0.0	0	0.1
Unit-linked (separate account) products . . . . .	56	22.7	16	12.4	11	12.6
Total Group . . . . .	<u>62</u>	<u>25.1</u>	<u>16</u>	<u>12.4</u>	<u>11</u>	<u>12.7</u>
<b>Total</b> . . . . .	<u>247</u>	<u>100.0%</u>	<u>129</u>	<u>100.0%</u>	<u>87</u>	<u>100.0%</u>

(1) Our 1998 and 1997 net premiums written have been restated due to the reclassification of certain business between our individual and group lines.

#### *Australia*

We offer a broad portfolio of life insurance and asset accumulation products in Australia primarily through independent agents, brokers and financial advisers. We also distribute our products through corporate partnerships and direct marketing. In May 1999, we acquired Tyndall, a life insurer and funds management company for £302 million. In 1999, our operations in Australia accounted for 59.9% of the Asia Pacific region's life and asset accumulation net premiums written.

The Australian life insurance market is a mature market dominated by the four largest insurers, which control 52% of the market measured by annual premiums in force as of December 31, 1999. The Australian life insurance market is the 10th largest in the world measured on the basis of gross premiums in 1998. For the year ended December 31, 1999, individual retirement products accounted for approximately 57% of Australia's life insurance gross premiums in force, group retirement products accounted for 32% and individual life products accounted for 11%.

Our principal products in Australia include disability income insurance, term life insurance, retirement savings and retirement income products. We offer superannuation products and non-superannuation products. Superannuation products, similar to 401K savings plans in the United States, are for employer sponsored employee savings plans which have favorable tax treatment for the employee. Non-superannuation products are similar to superannuation products but do not have a favorable tax treatment. We also conduct wholesale business where we invest pooled funds on behalf of trustees or administrators but do not administer the policies.

In 1999, periodic premium products accounted for 48% of our total premium income in Australia and single premium products accounted for 52%. In 1999, total new business sales were split between periodic premiums of £10.2 million and single premiums of £77 million. Of our total periodic premium new business, term life accounted for 39%, disability income insurance accounted for 41%, critical illness insurance, which is referred to as trauma insurance in Australia, accounted for 13% and savings business accounted for 7%. Of the total single premium new business, complying lifetime pensions accounted for 7%, wholesale business accounted for 84%, superannuation products accounted for 7% and non-superannuation products accounted for 2%. The Tyndall acquisition has provided us with additional retirement and investment product revenues and has increased our non-insurance assets under management and administration in Asia Pacific by approximately £2.7 billion to approximately £3.2 billion as of December 31, 1999 compared to £380 million as of December 31, 1998.

#### *New Zealand*

We began writing life and asset accumulation business in New Zealand in 1878. The 1998 acquisitions of Norwich Union Life Insurance (NZ) Limited and Guardian Assurance Limited for an aggregate of £108 million added £420 million to total assets under management and contributed £44 million of net premiums written to our New Zealand operations in 1999. Tyndall Life (New Zealand) Limited, which we acquired in May 1999, added a further £16.5 million to assets under management and contributed £1.1 million of net premiums written for the eight months ended December 31, 1999. In 1999, our operations in New Zealand accounted for 40.1% of the Asia Pacific region's life and asset accumulation net premiums written.

The New Zealand life and asset accumulation market is relatively mature and subject to strong competitive pressures. The economy has benefited from low inflation although its relatively small size has made it vulnerable to interest rate and exchange rate fluctuations. The majority of the market share is accounted for by a small group of life insurance companies, unit trust companies and bank life companies. In 1999, based upon annual premium equivalent, asset accumulation products accounted for 63% of the new business written in New Zealand and traditional life insurance products accounted for 37%. The life insurance market has grown but, despite an aging population and government promotion of saving for retirement, the asset accumulation market has been fairly static. There is little employer subsidized superannuation business providing income or lump sum payments upon retirement.

We offer asset accumulation products that provide for lump sum payments at retirement or death prior to retirement, immediate annuities, term life insurance, disability insurance and health insurance predominantly on an individual basis through brokers, exclusive agents, corporate partnerships and direct marketing. In 1999, periodic premium life insurance and asset accumulation products accounted for 55% of our total gross premium income and single premium life insurance and asset accumulation products accounted for 45%. Asset accumulation products, consisting almost entirely of unit-linked (separate account) products, accounted for 76% of our 1999 total gross premium income and life insurance products accounted for 24%.

Brokers accounted for 65% of our 1999 new business periodic premiums, exclusive agents accounted for 25% and direct marketing accounted for 10%. Brokers accounted for 52% of our 1999 new business single premiums, exclusive agents accounted for 34% and other sources accounted for 14%.

## WORLDWIDE ASSET MANAGEMENT

### Overview

We manage our own insurance investments, as well as third party funds. Our insurance investment portfolios consist of our worldwide general insurance investment portfolios, which include the assets supporting our property and casualty liabilities as well as our shareholders' funds, and our worldwide life insurance investment portfolios. The table below presents the estimated fair value of our assets under management as of December 31, 1999, 1998 and 1997.

	As of December 31,		
	1999	1998	1997
	(£ in millions)		
Total Investments:			
Worldwide general insurance investment portfolios (1) . . . . .	15,851	15,786	15,748
Worldwide life insurance investment portfolios . . . . .	31,319	30,493	26,897
Unit-linked (separate account) assets . . . . .	8,304	6,675	5,645
Third party funds . . . . .	5,515	3,914	3,596
Total (2) . . . . .	60,989	56,868	51,886

(1) Includes shareholder fund investments attributable to our life and asset accumulation business of £233 million in 1999 and £391 million in 1998 and 1997.

(2) These amounts differ from the total investments shown in our consolidated balance sheet as they include assets held to cover separate accounts and third party funds that are not included in our consolidated balance sheet. These amounts exclude interests in associated undertakings, value of long term (life) business and deposits with ceding undertakings which are shown as investments in our consolidated balance sheet, but are not managed as part of our worldwide investment portfolios.

Our London-based principal investment subsidiaries Royal & Sun Alliance Investment Management Limited ("RSAIM") and Royal & Sun Alliance Property Investments Limited managed £41 billion, or 67%, of our worldwide assets under management as of December 31, 1999.

In addition to our U.K.-based investment operations, we have investment operations in Scandinavia, the United States, Canada, Australia, Germany, and New Zealand. As of December 31, 1999, we managed £6.2 billion in Scandinavia, £5.0 billion in the United States, £1.9 billion in Canada, £1.6 billion in Australia, £0.8 billion in Germany and £0.8 billion in New Zealand. In addition to the direct management of assets in the United Kingdom, RSAIM has contractual arrangements to manage portfolios on behalf of a number of our subsidiaries in continental Europe and it also provides investment advice to our smaller international investment operations. RSAIM sets guidelines for the activities of our other investment operations where a further £3.7 billion of funds are invested and monitors transactions on a regular basis to ensure compliance.

In Scandinavia, following the purchase of Trygg-Hansa in August 1999, we transferred the investment team and day-to-day management of our Scandinavian investment portfolios, excluding real estate, to Skandinaviska Enskilda Bank, or SEB, the former parent of Trygg-Hansa. Under the investment management agreement between Codan and SEB we set the investment policy for these assets.

### Third Party Asset Management

The development of third party asset management activities is part of our personal financial services strategy to capitalize on our existing investment management expertise and to expand our client base. We offer third party asset management services in the United Kingdom through RSAIM. We believe that our asset

management expertise should enable us to benefit from the expected growth in private savings products in the developed markets in which we operate.

In the United Kingdom, we manage assets for 110 U.K. institutional pension funds and have significantly enhanced the services we offer in this market. We launched two new pooled pension funds in the United Kingdom during 1999, one investing in European equities and the other in U.K. equities on a passive basis. We sell both pooled and segregated discretionary investment funds in the growing market for defined contribution pensions in the United Kingdom as well as the defined benefit market. We market these products to the plan sponsors of U.K.-based pension funds. RSAIM and other Group companies, primarily the U.K. life companies, distribute these products both directly to plan sponsors and also through investment consultants. Outside of the United Kingdom, we have the capability to offer third party asset management services in Australia, New Zealand and North America.

### Insurance Investments

Our results are in part dependent upon the quality and performance of our investment portfolios. As of December 31, 1999, the estimated fair value of our general insurance investment portfolios was £15,851 million, and the estimated fair value of our life insurance investment portfolios was £31,319 million. These amounts differ from the total investments shown in our consolidated balance sheet as they exclude interests in associated undertakings, value of long term (life) business and deposits with ceding undertakings which are shown as investments in our consolidated balance sheet, but are not managed as part of our worldwide investment portfolios.

The table below presents our net investment results on our worldwide general insurance investment portfolios for the years ended December 31, 1999, 1998 and 1997.

	<b>Year Ended December 31,</b>		
	<b>1999</b>	<b>1998</b>	<b>1997</b>
	(£ in millions)		
Income and realized gains and losses from:			
Fixed income securities . . . . .	579	561	578
Equity securities . . . . .	117	154	152
Other investments . . . . .	126	157	169
Net realized gains and losses . . . . .	752	816	218
Investment expenses (1) . . . . .	(79)	(213)	(61)
Net investment income . . . . .	<u>1,495</u>	<u>1,475</u>	<u>1,056</u>

(1) Investment expenses in 1999 include £14 million of premium paid on repurchase of long term subordinated liabilities of our U.S. operations and investment expenses in 1998 include £142 million representing premium paid on repurchase of our outstanding 7.25% subordinated convertible bonds due 2008.

The table below presents our net investment results on our worldwide life insurance investment portfolios for the years ended December 31, 1999, 1998 and 1997.

	<u>Year Ended December 31,</u>		
	<u>1999</u>	<u>1998</u>	<u>1997</u>
	(£ in millions)		
Income and realized gains and losses from:			
Fixed income securities . . . . .	954	954	861
Equity securities . . . . .	394	396	410
Other investments . . . . .	231	288	317
Net realized gains and losses . . . . .	2,266	2,127	1,067
Investment expenses . . . . .	<u>(60)</u>	<u>(52)</u>	<u>(47)</u>
Net investment income . . . . .	<u>3,785</u>	<u>3,713</u>	<u>2,608</u>

*Investment Strategy*

*General Insurance Investment Portfolios*

We invest our shareholders' funds together with our assets supporting our property and casualty insurance liabilities. Our investment policy focuses on maximizing our total expected returns while managing the inherent volatility of the various types of our investments. In determining our investment policy, we are primarily concerned with:

- ensuring that our investments can be liquidated into cash to meet our insurance liabilities as they arise; and
- matching the currency of our investments with our liabilities to avoid unnecessary exchange exposure.

With these considerations in mind, we believe that we can maximize our expected return on capital by investing all of our shareholders' funds and 5% of our insurance reserves in equities. We invest the balance of our insurance reserves in fixed income securities and cash deposits after funding working capital. We continually review our investment policy in light of changing market circumstances and shareholder requirements.

In connection with the introduction of our risk-based model, we established a Global Investment Strategy team in April 1999 under the direction of our Group Director, Investment & Financial Services. This team determines and manages the level of risk in our general insurance investment portfolios, with a particular focus on setting the level of our exposure to equity securities.

Our general insurance investment portfolios are concentrated in listed securities. We use derivative financial instruments to reduce our exposure to adverse fluctuations in interest rates, foreign exchange rates and equity markets. We have strict controls over the use of derivative instruments. A discussion of the risks associated with these derivatives and risk management techniques is included in "Item 9A—Qualitative and Quantitative Disclosures On Market Risk". Although RSAIM sets investment guidelines for our other investment operations, the distribution of fixed income securities by credit quality and asset type is determined on a country-by-country basis in accordance with locally determined guidelines that reflect local insurance regulations and fixed income markets.

### *Life Insurance Investment Portfolios*

We seek to provide a competitive return on our life insurance investment portfolios consistent with ensuring the financial stability of the portfolios. Our guidelines generally provide for the anticipated investment returns and the estimated duration of investments to match the estimated duration and currency of our liabilities, taking into account estimated levels of surrenders and withdrawals. In the United Kingdom, an appointed actuary advises on how much of our life insurance investment portfolios we should invest in fixed income securities based on our potential liabilities with respect to each life insurance fund. We may then invest the remainder of our life insurance investment portfolios in other investments. We base investments in equity securities and real estate on the outlook for the major investment markets and constantly review the level of such investments with the aim of ensuring that they remain appropriate in light of the reasonable expectations of our policyholders to earn a competitive return. We structure our life insurance investment portfolios in accordance with local regulatory requirements.

### *Investment Portfolios*

The table below presents the estimated fair value of our worldwide general insurance investment portfolios as of December 31, 1999, 1998 and 1997.

	As of December 31,					
	1999		1998		1997	
	£ in millions	% of Total	£ in millions	% of Total	£ in millions	% of Total
Fixed income securities . . . . .	9,712	61.3%	8,320	52.7%	7,817	49.6%
Equity securities . . . . .	4,856	30.6	5,663	35.9	6,267	39.8
Mortgage loans . . . . .	115	0.7	100	0.6	108	0.7
Real estate . . . . .	519	3.3	970	6.2	921	5.9
Other investments, including cash deposits . . . . .	649	4.1	733	4.6	635	4.0
Total . . . . .	<u>15,851</u>	<u>100.0%</u>	<u>15,786</u>	<u>100.0%</u>	<u>15,748</u>	<u>100.0%</u>

The table below presents the estimated fair value of our worldwide life insurance investment portfolios as of December 31, 1999, 1998 and 1997.

	As of December 31,					
	1999		1998		1997	
	£ in millions	% of Total	£ in millions	% of Total	£ in millions	% of Total
Fixed income securities . . . . .	14,934	47.7%	15,544	51.0%	11,677	43.5%
Equity securities . . . . .	13,887	44.3	12,444	40.8	12,357	45.9
Mortgage loans . . . . .	352	1.1	391	1.3	379	1.4
Real estate . . . . .	1,866	6.0	1,694	5.5	1,918	7.1
Other investments, including cash deposits . . . . .	280	0.9	420	1.4	566	2.1
Total . . . . .	<u>31,319</u>	<u>100.0%</u>	<u>30,493</u>	<u>100.0%</u>	<u>26,897</u>	<u>100.0%</u>

### *Fixed Income Securities*

We hold fixed income securities in both our general insurance and our life insurance investment portfolios with an emphasis on listed securities that are liquid. Fixed income securities covering our life insurance liabilities vary in duration depending on the underlying mix of business in a given market, but generally have a much longer average duration than those covering property and casualty liabilities.

The majority of our fixed income portfolio is rated by Standard & Poor's, Moody's or similar rating agencies. As of December 31, 1999, 92% of our fixed income portfolio was invested in investment-grade (BBB or better) securities and 57% of our fixed income portfolio was invested in AAA rated securities.

The table below presents the scheduled maturities for our investments in fixed income securities for our worldwide general insurance investment portfolios as of December 31, 1999 and 1998.

	As of December 31,			
	1999		1998	
	£ in millions	% of Total	£ in millions	% of Total
Due in one year or less . . . . .	1,342	13.8%	1,337	16.1%
Due after one year through five years . . . . .	5,077	52.3	3,886	46.7
Due after five years through 10 years . . . . .	1,910	19.7	1,838	22.1
Due after 10 years through 20 years . . . . .	817	8.4	827	9.9
Other . . . . .	566	5.8	432	5.2
Total . . . . .	<u>9,712</u>	<u>100.0%</u>	<u>8,320</u>	<u>100.0%</u>

The table below presents the scheduled maturities for our investments in fixed income securities for our worldwide life insurance investment portfolios as of December 31, 1999 and 1998.

	As of December 31,			
	1999		1998	
	£ in millions	% of Total	£ in millions	% of Total
Due in one year or less . . . . .	515	3.4%	227	1.8%
Due after one year through five years . . . . .	1,143	7.7	1,907	12.3
Due after five years through 10 years . . . . .	2,781	18.6	3,928	25.3
Due after 10 years through 20 years . . . . .	10,460	70.1	8,924	57.3
Other . . . . .	35	0.2	508	3.3
Total . . . . .	<u>14,934</u>	<u>100.0%</u>	<u>15,544</u>	<u>100.0%</u>

The table below presents the composition of our consolidated fixed income securities portfolio based on estimated fair value as of December 31, 1999, 1998 and 1997 by Standard & Poor's investment rating.

	As of December 31,					
	1999		1998		1997	
	£ in millions	% of Total	£ in millions	% of Total	£ in millions	% of Total
AAA (1) . . . . .	14,044	57.0%	13,940	58.4%	11,015	56.5%
AA . . . . .	5,944	24.1	5,445	22.8	4,626	23.7
A . . . . .	2,231	9.0	2,224	9.3	1,936	9.9
BBB . . . . .	506	2.1	560	2.4	405	2.2
Less than BBB . . . . .	112	0.5	101	0.4	220	1.1
Non-rated (2) . . . . .	1,809	7.3	1,594	6.7	1,292	6.6
Total . . . . .	<u>24,646</u>	<u>100.0%</u>	<u>23,864</u>	<u>100.0%</u>	<u>19,494</u>	<u>100.0%</u>

(1) Includes U.K. government guaranteed fixed income securities that are not rated.

(2) Primarily represent U.K. listed but unrated corporate debt.

### *Equity Securities*

Our equity security investments are concentrated in our investment portfolios in the United Kingdom, the United States, Canada, Denmark, Germany, Australia and New Zealand. For our general insurance investment portfolios, we invest in equity securities to support shareholders' funds and with the aim of achieving capital appreciation. For our life insurance investment portfolios, we invest in equity securities with the aim of achieving capital appreciation, and in order to help to achieve our aim of meeting our policyholders' reasonable expectations of returns earned on individual life products.

Our equity investments are actively managed and performance is measured against local benchmarks. Approximately 97% of our equity investments by estimated fair value as of December 31, 1999 were listed on approved securities markets. Our portfolios are diversified so as to provide a broad exposure across all sectors of individual stock markets with restrictions on the maximum investment in any one equity security or equity sector set by reference to local benchmarks and insurance regulations. Within our actively managed portfolios, no single issuer accounted for more than 10% of the fair value of our individual equity portfolios as of December 31, 1999. In addition to these portfolios, we also hold a number of strategic equity investments in our general insurance investment portfolios, the two largest of which as of December 31, 1999 were our investments in The Chubb Corporation and Rothschilds Continuation Holdings.

### *Mortgage Loans*

Our commercial mortgage portfolio is principally located in Germany, North America and Chile. In Germany, mortgage loans are held within our life insurance investment portfolio and secured almost entirely by residential buildings. In the United States and Canada, we hold mortgage loans secured by commercial buildings and land in our general insurance and our Canadian life insurance investment portfolios. We also hold mortgage loans in Chile, as part of our life insurance investment portfolio, which are secured by residential buildings. We invest in mortgage loans primarily for the purpose of matching our insurance liabilities. We set limits on the amount, as well as the distribution by property type and location, of mortgage loans within our funds.

### *Real Estate*

Real estate accounted for £2,386 million of the estimated fair value of our investment portfolios as of December 31, 1999, which includes £359 million of property used by our various operations. The majority of our real estate portfolio is located in the United Kingdom. As of December 31, 1999, the estimated fair value of our real estate portfolio in the United Kingdom was £1,670 million, down from £1,986 million as of December 31, 1998. In 1999, we sold £392 million of our U.K. real estate. We sold real estate held in our general insurance investment portfolios to reduce our exposure to the U.K. real estate market. We intend to maintain a balanced real estate portfolio within our U.K. life insurance investment portfolios with a view to maximizing investment returns on an ongoing basis. Outside of the United Kingdom, our primary real estate investments are in Denmark. As of December 31, 1999, the estimated fair value of our real estate portfolio in Denmark was £479 million.

### *Other Investments, including Cash Deposits*

The principal component of our other investments is cash held within our portfolios. We had £619 million in cash in our worldwide general insurance investment portfolios and £214 million in cash in our worldwide life insurance investment portfolios as of December 31, 1999. We hold cash either to meet known short-term commitments or as an asset allocation decision in the relevant investment portfolios.

## ***PROPERTY AND CASUALTY RESERVES***

### **General**

We establish property and casualty loss reserves to account for the anticipated ultimate costs of all losses and related loss adjustment expenses, or LAE, on losses that have already occurred. We establish reserves for reported losses and LAE, as well as for incurred but not yet reported, or IBNR, losses and LAE. Loss reserve estimates are based on known facts and on interpretation of circumstances including our experience with similar cases and historical claims payment trends. We also consider the development of loss payment trends, levels of unpaid claims, judicial decisions and economic conditions.

We use a variety of statistical techniques and a number of different bases to set reserves, depending on the business unit and line of business in question. Our reserving managers consider claims developments separately for each line of business and subdivide certain lines of business by major claim types or subclassifications of business. Large claims impacting each relevant account are also generally assessed separately, either being reserved at the face value of the loss adjusters' estimates or projected separately in order to allow for the future development of large claims.

Reserves are calculated gross of any reinsurance recovery, with a separate asset recorded for the reinsurer's share having due regard to collectability.

As permitted under local statutory guidelines, claims provisions relating to workers' compensation and other non-life disability case reserves in the United States, Canada and Scandinavia paid on an annuity basis are included after reflecting interest expected to be earned. The total discount applied to these reserves was £127 million in 1999 and £118 million in 1998. The income statement impact of this discounting was a £9 million credit in 1999 and a £2 million charge in 1998. Other than with respect to the above reserves, we do not record reserves on a discounted basis.

We analyze claims progressions according to calendar year accident periods, underwriting years and notification years, with allowances for pure IBNR claims effected in the last instance by way of analyses of claims notification delay tables.

The process of estimating loss reserves is subject to a number of internal and external variables such as changes in claims handling procedures, inflation, judicial trends and legislative changes. Many of these items involve considerable uncertainty. Additionally, there may be significant reporting lags between the occurrence of the insured event and the time it is actually reported to us. We continually refine reserve estimates in a regular ongoing process as experience develops and further losses are reported and settled. We reflect adjustments to reserves in the results of the periods in which we make such adjustments. In establishing reserves, we take into account estimated recoveries for salvage and subrogation.

We derive reserves for reported losses and LAE from estimates of future payments that will be made in respect of reported losses, including settlement costs, having regard to our particular experience with the type of risk involved.

Local regulation in some countries also requires the establishment of catastrophe equalization reserves. Such reserves defer a portion of income with respect to a line of business to future periods in which catastrophe losses might occur (as a result of such factors as hail, nuclear incidents, storms, floods and pollution) in that line of business. Catastrophe equalization reserves are required under U.K. statutory requirements to be presented under the heading "Technical Provisions" in our consolidated balance sheet. Catastrophe equalization reserves are not included in the loss development tables and the reconciliation of reserves for losses and LAE presented below.

From time to time we supplement our claims and underwriting processes by utilizing third party adjusters, appraisers, engineers, inspectors, other professionals and information sources to assess and settle catastrophe and non-catastrophe related claims.

Because the establishment of loss reserves is an inherently uncertain process, there can be no assurance that ultimate losses and LAE will not exceed existing loss reserves. Actual losses and LAE may deviate, perhaps substantially, from estimates of reserves reflected in our consolidated financial statements.

We believe based on the information currently available to us that, overall, our loss reserves as of December 31, 1999 were adequate.

### **Loss Reserve Development**

The tables below present changes in the historical property and casualty reserves that we established in 1993 and subsequent accounting years. The top line of the tables shows the estimated reserves for unpaid losses and LAE set up as of each balance sheet date. Each amount in the top line represents the estimated amount of future payments to be made for losses and LAE for losses occurring in that year and in prior years. The upper (paid) portion of the table presents the cumulative amounts paid through each subsequent year on those losses for which reserves were carried as of each balance sheet date. The lower (reserve re-estimated) portion of the table shows the re-estimate of the initially recorded reserves as of each succeeding year-end ignoring claims paid but adjusted for the effects of foreign exchange. The estimate changes as more information becomes known about the actual losses for which the initial reserves were set up. The cumulative redundancy/(deficiency) line reflects the cumulative changes in estimate since the initial reserve was established. The cumulative redundancy/(deficiency) is equal to the initial reserve less the liability re-estimated as of December 31, 1999.

Reserves for losses and LAE are an accumulation of the estimated amounts necessary to settle outstanding claims as of the date for which the reserve is stated. The following data is cumulative and therefore ending balances should not be added since the amount at the end of each calendar year includes activity for both the current and prior years.

**CONSOLIDATED LOSS DEVELOPMENT—GROSS OF REINSURANCE  
(U.K. GAAP BASIS)**

	As of December 31,						
	1993	1994	1995	1996	1997	1998	1999
	(£ in millions)						
Initial net reserves for unpaid losses and LAE . . . . .	9,473	9,533	9,805	9,305	9,388	9,391	10,834
Initial retroceded reserves . . . . .	2,513	2,451	2,224	2,241	2,240	2,152	3,183
Initial gross reserves . . . . .	11,986	11,984	12,029	11,546	11,628	11,543	14,017
Paid (cumulative) as of:							
One year later . . . . .	3,262	3,591	3,327	3,320	3,469	3,564	
Two years later . . . . .	5,530	5,337	5,156	5,125	5,303		
Three years later . . . . .	6,786	6,662	6,325	6,313			
Four years later . . . . .	7,754	7,476	7,146				
Five years later . . . . .	8,327	8,070					
Six years later . . . . .	8,770						
Reserve re-estimated as of:							
One year later . . . . .	11,863	12,006	11,192	11,147	11,397	11,387	
Two years later . . . . .	12,055	11,510	11,069	10,871	11,080		
Three years later . . . . .	11,718	11,421	10,879	10,639			
Four years later . . . . .	11,632	11,236	10,626				
Five years later . . . . .	11,458	11,050					
Six years later . . . . .	11,349						
Cumulative redundancy/(deficiency) . . . . .	637	935	1,402	906	548	156	

**CONSOLIDATED LOSS DEVELOPMENT—NET OF REINSURANCE  
(U.K. GAAP BASIS)**

	As of December 31,						
	1993	1994	1995	1996	1997	1998	1999
	(£ in millions)						
Initial net reserves for unpaid losses and LAE . . . . .	9,473	9,533	9,805	9,305	9,388	9,391	10,834
Paid (cumulative) as of:							
One year later . . . . .	2,580	2,833	2,613	2,499	2,706	2,863	
Two years later . . . . .	4,308	4,181	3,852	3,905	4,133		
Three years later . . . . .	5,278	5,093	4,826	4,942			
Four years later . . . . .	5,895	5,767	5,744				
Five years later . . . . .	6,365	6,364					
Six years later . . . . .	6,822						
Reserve re-estimated as of:							
One year later . . . . .	9,309	9,437	8,901	8,897	9,085	9,112	
Two years later . . . . .	9,344	8,901	8,692	8,709	8,780		
Three years later . . . . .	9,114	8,868	8,595	8,501			
Four years later . . . . .	8,984	8,774	8,379				
Five years later . . . . .	8,917	8,628					
Six years later . . . . .	8,803						
Cumulative redundancy/(deficiency) . . . . .	670	905	1,425	804	607	279	

We have experienced favorable loss reserve development in the more recent years as a result of improvements in our claims settlement processes and the effect of declining inflation rates. As of December 31, 1999, our gross reserve for property and casualty losses and LAE of £11,543 million established at the end of 1998 has developed favorably by £156 million. We also experienced favorable development in each of the preceding three years.

Future reserve development may not necessarily benefit to the same extent given the continuing pressure on the cost of medical and personal injury claims worldwide. In addition, conditions and trends that have affected development of the liability for unpaid claims and LAE in the past will not necessarily recur in the future. Accordingly, it is not appropriate to extrapolate future redundancies or deficiencies based on the data in the above table.

A substantial proportion of our property and casualty business, principally personal automobile and household, is short tail and therefore losses are reported and settled relatively quickly. It can be seen from the loss development table, net of reinsurance, that by three years later over 50% of the claims initially reserved are generally paid. Generally, by five years later the historical cumulative payment percentage is approximately 66% and by six years later it is approximately 72%.

Other than for the reinsurance arrangements with The Chubb Corporation described below, there have been no portfolio transfers significant enough to distort the reserve development tables. The tables presented include the run-off of acquired operations only for those periods subsequent to acquisition. A number of non-material acquisitions have been made in the periods covered by the development tables, none of which has significantly affected run-off. Run-off on the claims reserves of Trygg-Hansa and Orion, both acquired in 1999, will be reflected in the loss development tables for 2000 for the first time.

The merger of Royal and Sun Alliance in 1996 did not bring about any material change in reserving methodology or require additional reserving other than as described below. Some refinement to process took place in the respective actuarial units but on the whole the methodologies used by the two companies produced reserve levels of a consistent strength. It was general practice in both Royal and Sun Alliance to run a variety of statistical techniques on each reserving population and to select the technique that best approximated the ultimate costs of settling the claim. The selection of method was driven by the nature of the product and the claims experience data available. Methods used included chain ladder, Bornhuetter-Ferguson and average cost per claim. We continue to run a variety of statistical methods on reserving populations. The selection of the actuarial technique adopted has been affected by the nature of the products selected by the Group post-merger, the availability of data following changes to reserving systems and the introduction of consistent case handling and reserving philosophies. We continue to refine both reserving population and method selection with the aim of improving reserving quality. The most significant methodology change after the merger was the use of consulting actuaries in 1999 to model pollution and asbestos risks on our inbound reinsurance book of business covering old U.S. risks. The impact of this review is discussed below.

A reinsurance arrangement between Sun Alliance in the United Kingdom and The Chubb Corporation in the United States was terminated with effect from January 1, 1997. The effect of the change to the reinsurance arrangement was to transfer a portfolio of £175 million of existing net assumed reserves to Chubb. This transfer had no effect on the reserve development redundancies/deficiencies.

In the years 1992 and 1993, both of our pre-merger predecessors experienced a period of particularly adverse operating results that, coupled with a downturn in the U.K. economy, required them to strengthen significantly their IBNR loss reserves. In 1993 in the United Kingdom, this amounted to approximately £275 million, with approximately £200 million added to IBNR for the domestic mortgage indemnity business and £75 million to the marine and inbound reinsurance IBNR. Subsequent changes to policy wordings and the discontinuance of particularly unprofitable lines of business has helped to return these lines of business to profitability.

During this period the only exceptional reserve strengthening, other than in 1993, took place in 1996 in respect of asbestos and environmental IBNR in the United States where we increased reserves by £117 million.

Other than for the issues discussed above, we have had no material reserve strengthening or releases, nor have we noted any exceptional trends in our claims development in the six years preceding 1999. We have had favorable loss reserve development in the more recent years as a result of selective underwriting, improvements in our claims settlement processes and the effects of declining inflation rates.

The loss development tables presented are on a U.K. GAAP basis. The trends reflected would be materially unchanged if these tables were presented on a U.S. GAAP basis.

The table below reconciles, as of the dates indicated, the gross loss reserve information presented above to the reserves presented in our consolidated financial statements.

**CONSOLIDATED RECONCILIATION OF RESERVES FOR LOSSES AND LAE  
(U.K. GAAP BASIS)**

	As of December 31,		
	1999	1998	1997
	(£ in millions)		
Net reserves for unpaid losses and LAE at beginning of year . . . . .	9,391	9,388	9,305
Reinsurance recoveries/receivables for unpaid losses and LAE at beginning of year . . . . .	2,152	2,240	2,241
Gross reserves for losses and LAE at beginning of year . . . . .	11,543	11,628	11,546
Effect of changes in foreign exchange rates . . . . .	234	(147)	130
Effect of claims portfolio transfer and acquisitions . . . . .	2,215	—	59
Incurred related to:			
Current year . . . . .	6,799	6,309	5,928
Prior years . . . . .	(137)	(217)	(327)
Total incurred losses and LAE . . . . .	6,662	6,092	5,602
Paid related to:			
Current year . . . . .	3,073	2,561	2,330
Prior years . . . . .	3,564	3,469	3,320
Total paid losses and LAE . . . . .	6,637	6,030	5,650
Gross reserves for losses and LAE at end of year . . . . .	14,017	11,543	11,628
Reinsurance recoverable . . . . .	3,183	2,152	2,240
Net reserves for losses and LAE at end of year . . . . .	10,834	9,391	9,388
Total incurred as a percentage of gross reserves . . . . .	57.7 %	52.4 %	48.5 %
Current year incurred as a percentage of total incurred . . . . .	102.1 %	103.6 %	105.8 %
Prior years incurred as a percentage of total incurred . . . . .	(2.1)%	(3.6)%	(5.8)%
Total paid as a percentage of net reserves . . . . .	70.7 %	64.2 %	60.7 %
Current year paid as a percentage of total paid . . . . .	46.3 %	42.5 %	41.2 %
Prior years paid as a percentage of total paid . . . . .	53.7 %	57.5 %	58.8 %

The acquisitions of Trygg-Hansa and Orion in 1999 have led to the significant increase in reserves. The increase in reserves for these operations has been reflected in the claims portfolio transfer and acquisitions line item on the table.

Changes in foreign exchange rates have led to a £234 million increase in gross reserves at the end of 1999 mainly as a result of the strengthening of the Australian, Canadian and US dollar exchange rates. This compares to a £147 million decrease at the end of 1998.

### Reserves for Asbestos and Environmental Losses

The tables below present the changes in the historical asbestos and environmental reserves established by us for 1997 and subsequent accounting years.

#### ASBESTOS LOSS DEVELOPMENT TABLE—GROSS OF REINSURANCE (U.K. GAAP BASIS)

	As of December 31,		
	1997	1998	1999
	(£ in millions)		
Initial net reserves for unpaid losses and LAE . . . . .	309.2	301.6	293.2
Initial retroceded reserves . . . . .	82.1	75.7	44.9
Initial gross reserves . . . . .	391.3	377.3	338.1
Paid (cumulative) as of:			
One year later . . . . .	18.4	25.5	
Two years later . . . . .	43.2		
Reserve re-estimated as of:			
One year later . . . . .	394.5	341.7	
Two years later . . . . .	357.4		
Cumulative redundancy/(deficiency) . . . . .	33.9	35.6	

#### ASBESTOS LOSS DEVELOPMENT TABLE—NET OF REINSURANCE (U.K. GAAP BASIS)

	As of December 31,		
	1997	1998	1999
	(£ in millions)		
Initial net reserves for unpaid losses and LAE . . . . .	309.2	301.6	293.2
Paid (cumulative) as of:			
One year later . . . . .	9.7	23.1	
Two years later . . . . .	32.4		
Reserve re-estimated as of:			
One year later . . . . .	310.1	298.9	
Two years later . . . . .	306.7		
Cumulative redundancy/(deficiency) . . . . .	2.5	2.7	

**ENVIRONMENTAL LOSS DEVELOPMENT TABLE—GROSS OF REINSURANCE  
(U.K. GAAP BASIS)**

	As of December 31,		
	1997	1998	1999
	(£ in millions)		
Initial net reserves for unpaid losses and LAE . . . . .	328.8	301.3	317.1
Initial retroceded reserves . . . . .	76.8	70.6	71.9
Initial gross reserves . . . . .	405.6	371.9	389.0
Paid (cumulative) as of:			
One year later . . . . .	40.2	36.9	
Two years later . . . . .	76.3		
Reserve re-estimated as of:			
One year later . . . . .	408.7	397.0	
Two years later . . . . .	431.4		
Cumulative redundancy/(deficiency) . . . . .	(25.8)	(25.1)	

**ENVIRONMENTAL LOSS DEVELOPMENT TABLE—NET OF REINSURANCE  
(U.K. GAAP BASIS)**

	As of December 31,		
	1997	1998	1999
	(£ in millions)		
Initial net reserves for unpaid losses and LAE . . . . .	328.8	301.3	317.1
Paid (cumulative) as of:			
One year later . . . . .	31.5	27.9	
Two years later . . . . .	59.1		
Reserve re-estimated as of:			
One year later . . . . .	330.1	318.9	
Two years later . . . . .	346.7		
Cumulative redundancy/(deficiency) . . . . .	(17.9)	(17.6)	

We have exposure to liabilities for asbestos related and environmental pollution (“A&E”) losses arising from the sale of commercial liability and multi-peril policies prior to 1987. After 1987, policy wordings contained more prescriptive, and in many cases absolute, exclusions for these types of exposure thereby considerably reducing the potential for loss.

Coverages provided under which these liabilities have emerged were in most cases with smaller commercial customers and involved small policy aggregate limits and limits to coverage. We wrote a limited amount of excess coverage in the United States, most of which were excess policies on top of our own primary covers as opposed to primary policies written by other insurers. As a result, to a large extent, we were able to maintain underwriting and policy wording discipline. Excess policies are insurance policies which provide coverage in excess of the policy limits of another insurance policy, sometimes referred to as the primary policy. In other words, primary policies provide insurance coverage only to a defined limit of liability. Excess policies provide additional coverage beyond this liability limit.

Reserving for A&E claims is subject to a range of uncertainties that are generally greater than those presented by other types of claims. These include long reporting delays, unresolved legal issues on policy coverage and the identity of the insureds. As a consequence, traditional loss reserving techniques cannot wholly be relied on and we have employed specialized techniques to determine reserves in a prudent manner using the

extensive knowledge of both internal A&E experts and external legal and professional advisors. Despite the uncertainties, management believes that reserves are adequate to cover both notified claims and losses yet to be reported. However, changes to existing legal interpretation or new legislation could adversely impact reserves and thus results in further periods.

Total net outstanding A&E claims reserves at the end of 1999 amounted to £610.3 million. Net A&E reserves have increased from £602.9 million at the end of 1998, primarily as a result of the acquisition of Orion. The Orion acquisition increased net A&E reserves by £39.7 million. The increase in net A&E reserves following this acquisition has been partly offset by the high levels of payments on asbestos reserves in 1999. The loss development tables presented limit the impact of run-off attributable to acquired businesses to those periods subsequent to the acquisition date. No material A&E run-off has emerged from the businesses acquired in 1999. The A&E reserves are mainly in the United Kingdom and the United States (approximately £572 million), and to a lesser extent in Canada and Australia (approximately £38 million). Amounts recoverable from reinsurers as of December 31, 1999 amounted to £117 million. Unrecoverable amounts, which are not included in the above figure, are not significant and have been fully provided for.

Reserves for environmental liabilities include provision for IBNR claims. The Group has provided for IBNR claims based on modeling performed by both internal experts and external consulting actuaries.

As with other claims reserves, A&E reserves are subject to regular internal review and updating. It is our practice to periodically subject reserves to independent actuarial review and in 1996 following a comprehensive review by an independent actuarial consulting firm, A&E reserves in the United States were strengthened by £117 million and in the United Kingdom by £25 million. Our A&E reserves in the United States were reviewed by independent actuaries in 1999 and our overall level of claims reserves remains in the range indicated by the actuaries. Asbestos reserves on inbound reinsurance business in the United Kingdom were reviewed by consulting actuaries in 1999. Resulting from this and other reviews, we released gross reserves of £40 million. The net impact of this release after reinsurance was £6 million.

Over the past few years, our U.S. operation has been aggressively pursuing A&E claims settlements. This process has involved, where possible, legally enforceable settlement agreements to limit our liabilities.

## *UNDERWRITING AND PRICING*

### **Underwriting and Pricing**

Disciplined underwriting, encompassing risk assessment, risk management, pricing and exposure control is critical to our success. The Group has issued property and casualty underwriting policies that identify the broad approach to be adopted in respect of risk selection and management, pricing adequacy, identification and management of aggregation to exposure and claims handling. These principles are adapted to local market, legal and regulatory environments and further embodied in detailed underwriting procedures. The goal is for our underwriters to be in a position to:

- understand and assess each risk;
- make appropriate decisions;
- differentiate between risks;
- apply suitable terms and conditions in order to manage the portfolio;
- control exposure; and
- improve the predictability of the loss experience and make appropriate use of our capacity.

In establishing prices, each of our businesses has access to extensive customer data from its own records and access to appropriate market data. We have an extensive range of underwriting practice teams and intranets which pool knowledge from across our operations on specific subjects and ensure that the full body of corporate knowledge is available to any one of our underwriters when they are presented with a risk which may be outside their immediate experience.

We have a world-wide Risk Review Committee. It is comprised of members from each of our disciplines and helps our businesses evaluate risk and risk exposure. Its task is to:

- provide an emerging risk identification process, including the identification of emerging issues and the setting of these into risk scenarios for consideration by the regions as part of an overall process of self appraisal;
- consider aggregation of risk across regions;
- assist Group Financial Control on issues identified through the process of self appraisal;
- maintain and develop the Group risk model; and
- monitor and report on the Group's approach to managing risks.

Pricing for property and casualty products is generally based upon historic claims frequencies and claims severity averages, adjusted for inflation and trended forward to recognize anticipated changes in claims patterns. While claims remain our principal cost, we also make allowance in the pricing procedures for acquisition expenses, administration expenses and reasonable profit. Pricing for our life insurance products is generally based upon the expected pay out of benefits calculated through the use of assumptions regarding mortality, morbidity, expense, persistency and investment returns as well as certain economic factors such as inflation. Pricing for our asset accumulation products varies depending upon the specific product but is generally based upon investment return, expenses and persistency.

## Catastrophe Risk and Exposure Controls

Like other property and casualty insurers, we are exposed to multiple insured losses arising out of a single occurrence, whether a natural event such as a hurricane, flood or an earthquake, or another catastrophe such as an explosion or fire at a major industrial facility. Any such catastrophic event could generate insured losses under one or more of our policies. Our largest single net catastrophe loss in recent years arose from Hurricane Georges in 1998, which produced pre-tax catastrophe losses, net of reinsurance, of £87 million. Catastrophic events in recent years have caused us, like other property and casualty insurers generally, to reevaluate the probability of certain types of catastrophic events and the potential losses resulting from geographic concentrations of risk, and to more frequently monitor our overall exposure.

The ability of our businesses in each territory to assess the aggregation risk of a single event impacting on thousands of policyholders is vital. We employ proprietary exposure measurement systems to assess these risks. In some markets, particularly in the United Kingdom, we have in addition developed our own expertise in catastrophe modeling that we use in conjunction with outside consultants. The accurate estimation of our potential expected maximum loss for a catastrophe is critical and is the primary factor we consider when we design our catastrophe reinsurance program.

We share expertise among the Group on catastrophe modeling through our Worldwide Reinsurance Practice Group that also provides us with an overview of our company-wide catastrophe exposures and reinsurance adequacy. In all cases we buy sufficient catastrophe reinsurance to provide for exposures beyond our expected maximum loss. This is facilitated through use of our worldwide intranet.

From 1999, we set our total retention for a single catastrophic event based on geographic location. Our total retentions for a single event for 2000 are:

- £200 million total retention for an event in Europe, including the United Kingdom;
- £75 million total retention for an event in the United States and/or Canada; and
- £50 million total retention for an event anywhere else in the world.

Our subsidiaries are responsible for buying reinsurance to protect their results against catastrophes and for determining their own retentions. However, the aggregate of the retentions set by all of our subsidiaries on their external catastrophe reinsurance programs for a single event falls within the Group totals set forth above.

The following table summarizes our gross catastrophe exposures (measured by the total cost of claims before reinsurance) by geographic area for the periods indicated. These are calculated on a probable maximum loss basis for a return period of at least 100 years.

	<b>Year Ended December 31,</b>		
	<b>1999</b>	<b>1998</b>	<b>1997</b>
	(£ millions)		
United Kingdom . . . . .	825	985	1,075
Canada . . . . .	195	250	238
United States . . . . .	165	165	170
Caribbean and Latin America . . . . .	180	175	160
Australia . . . . .	176	213	223
New Zealand . . . . .	225	198	206

Although the above represents the areas of our largest probable maximum loss exposures, we also regularly monitor our exposure in all markets in which we have property and casualty business, none of which currently represents a probable maximum loss exposure in excess of £125 million gross, before reinsurance.

## *REINSURANCE*

We reinsure a portion of the risks we underwrite to control our exposure to losses, stabilize earnings and protect surplus. Our reinsurance strategy is to purchase reinsurance in the most cost-effective manner from reinsurers who meet the security standards set by our Worldwide Group Office for all of our subsidiaries. Each of our insurance company subsidiaries is empowered to purchase the reinsurance that it deems appropriate for the insurance that it writes. However, we have established a captive reinsurance vehicle because our business is highly diversified both in terms of the types of risks we cover and the markets in which we cover them. This allows us to retain risks for which we have available capital at the Group level but which we otherwise have to reinsure due to capital and surplus requirements at the local level. To accomplish this our captive reinsurer, Globe Reinsurance (IOM) Limited, or Globe Re, participates in our reinsurance programs with third party reinsurers. Globe Re's underwriter uses a risk-based capital model to help assess the optimum amount of catastrophe risk that Globe Re should underwrite on programs ceded by our subsidiaries to the external reinsurance market. The underwriter works within risk-based capital guidelines approved by the Board of Directors of Globe Re. For non-catastrophe reinsurance, Globe Re's underwriter selects risks to reinsure based on information provided by our ceding subsidiaries to the external reinsurance market, again working within guidelines set by the Board of Globe Re.

We cede to reinsurers a portion of our risks and pay premiums based upon the risk and exposure of the policies subject to such reinsurance. Reinsurance recoveries are subject to collectability in all cases and to aggregate loss limits in certain cases. Although the reinsurer is liable to us to the extent of the reinsurance ceded, we remain primarily liable as the direct insurer on all risks reinsured. We hold collateral, including escrow funds and letters of credit, under certain reinsurance agreements. We monitor the financial condition of reinsurers on an ongoing basis, and review our reinsurance arrangements regularly.

In monitoring our reinsurance:

- We review the adequacy of our reinsurance arrangements with a view to ensuring that they reflect our maximum exposure in any of our insurance company subsidiaries. We use external modeling agencies to calculate our potential catastrophe exposures in addition to our own analyses.
- Our strategy is to seek reinsurers with the best combination of credit rating, price and capacity. We publish internally a list of authorized reinsurers who have passed our security review process. We carry out a review of the financial security of each of our reinsurers at least annually.
- As a part of this review work, we look at the public ratings of our reinsurers. Reinsurers whose public rating is less than BBB with Standard & Poor's or comparable with A M Best are removed automatically from our authorized list.

Each of our primary reinsurers is rated A or higher by Standard & Poor's. As of December 31, 1999 over 94% of our treaty cessions by premium were with reinsurers rated A or higher. The table below sets forth the ratings assigned by Standard & Poor's to our primary treaty reinsurers and the amounts ceded to them during the year ended December 31, 1999. Treaty cessions are the risks we pass to our reinsurers under treaty reinsurance agreements. This type of reinsurance is based on a predetermined portion or category of specified risks underwritten by the ceding company and automatically assumed by the reinsurer. For each reinsurance group to which we cede material total premiums, the table shows the ratings of all reinsurance companies in that reinsurance group with which we do business.

<u>Reinsurance Group</u>	<u>Ceded Premiums (£ in millions)</u>	<u>S&amp;P Rating</u>
General Reinsurance Group . . . . .	39.4	AAA
Lloyd's of London . . . . .	38.1	A+
Swiss Re Group . . . . .	34.1	AAA
Munich Re Group . . . . .	31.9	AAA
G E Capital . . . . .	19.0	AAA
The St Paul Companies Inc . . . . .	10.9	A or Better
Exel Ltd . . . . .	10.8	AA
ACE Ltd . . . . .	9.5	A+
Zurich Insurance Group . . . . .	8.3	AA
Haftpflichtverband der Deutschen Ind (HDI) . . . . .	7.7	AA

Our facultative placements, other than those with captive reinsurers of our major retail clients, are overwhelmingly with the same reinsurers as shown above. Facultative placements, or risks under facultative treaties, reinsure all or part of a single policy determined on a contract-by-contract basis.

We monitor the amounts due to and from each of our major reinsurers. As of December 31, 1999, we had a reinsurance recoverable from one of our reinsurers, with a Standard & Poor's rating of AAA, of approximately £280 million. As of May 31, 2000, this amount had increased to approximately £380 million.

We aim to limit the impact of credit risk on claims due from captive reinsurers, with whom we deal as part of our commercial lines business, by analysis of their finances and controlling the maximum exposures of the captives.

We monitor changes in the financial security of reinsurers to see whether their ability to pay recoverables in full is doubtful. Where we believe a reinsurer's ability to pay in full is doubtful, our Worldwide Group Office sets guidelines for provisioning for uncollectable reinsurance. These guidelines apply to all operations. An operation setting provisions other than at the guideline level is required to notify our Worldwide Group Office of the reasons for doing so. This is so that, in setting guidance for future years, Worldwide Group Office is aware of locally available information. Worldwide Group Office analyzes local provisions versus our guidelines. As of December 31, 1999 total provisions for uncollectable reinsurance were £17.1 million.

Certain of our subsidiaries are members of government-mandated pools in various parts of the world. As of December 31, 1999 the largest pool (by premium volume) was Pool Re operated by the U.K. government to provide terrorism cover. Total premiums paid by our U.K. operations to Pool Re in 1999 were approximately £15.8 million.

## **REGULATION**

### **General**

Our insurance business is subject to detailed regulation in all the jurisdictions in which we transact business. In addition, European Union, or EU, directives have had and will have a significant impact on the regulation of the insurance industry in the EU as such directives are implemented through legislation adopted within each member state.

The 1992 EU insurance directives on direct life insurance and direct insurance other than life insurance were implemented in the United Kingdom and certain other jurisdictions through legislation, which became effective in July 1994. These directives are based on the “home country control” principle according to which the ongoing regulation of insurance companies, including their non-home insurance operations (whether direct or through branches) is the responsibility of the home country insurance regulatory authority. The home country insurance regulatory authority monitors compliance with applicable regulations, the solvency of the insurer and its actuarial liabilities and the supporting assets. As a result of the implementation of these directives, most insurance companies that have been licensed to conduct insurance business in one jurisdiction of the EU may do business directly or through branches in all other jurisdictions of the EU without being subject to licensing requirements under the laws of the additional jurisdictions. Selling activities of non-home insurance operations, however, are regulated by the regulatory authorities in the country in which the sale of the insurance product takes place.

A recent EU directive covers the supplementary supervision of insurance undertakings in an insurance group. The Financial Services Authority (“FSA”), in the United Kingdom has issued a further consultation paper (“CP50”) for comments by the end of August 2000. However, it is perceived that much of the new legislation is already contained within U.K. law.

Set forth below is a description of the principal regulations to which we and our principal insurance subsidiaries are subject.

### **United Kingdom**

#### *General*

Insurance companies in the United Kingdom for both long term (life) and general (property and casualty) insurance are regulated principally by the Insurance Companies Act 1982 (the “1982 Act”) and various regulations promulgated thereunder and EU insurance directives. The principal objective of the U.K. insurance regulations is protection of the policyholder. Legislation has been enacted to ensure that there is much closer control over certain aspects of the operations of insurance companies than for non-financial services companies. Much of the legislation is based on EU directives, so that the legislative environment in the United Kingdom is similar to that in many other European Economic Area, or EEA, member states.

The current regulatory framework is complex with a number of different bodies potentially exerting regulatory influence over different aspects of an insurance company’s operations. There are basically two different types of regulation, which have an impact on insurance companies:

- *Prudential supervision.* The FSA (formerly called the Securities and Investments Board, or SIB) has general supervisory authority under the 1982 Act. The 1982 Act gives the FSA (under the auspices of Her Majesty’s Treasury (the “Treasury”)) wide-ranging powers for the authorization of insurance companies, on-going supervision, powers of intervention in the management of insurance companies and, ultimately the power to withdraw authorization or petition for the winding up of an insurance operation. Under powers granted under the 1982

Act, the Treasury is able to issue regulations from time to time, which deal primarily with the supervision of insurance companies.

- *Sales practices regulation.* Monitoring of retail selling practices and the business conduct of an insurance company carrying on investment business (which includes most long term (life) business) is the responsibility of the FSA under the power conferred by the Financial Services Act 1986. In practice, this is being carried out by the FSA, acting as agent for the relevant Self Regulatory Organizations, or SROs, namely the Personal Investment Authority, or PIA, and the Investment Management Regulatory Organization, or IMRO.

The FSA has assumed de facto responsibility for both the prudential and business conduct regulation of insurance companies effective January 1, 1999. There has been substantial consultation over various aspects of their intended approach.

The FSA will assume the regulatory and registration functions of the PIA, IMRO and the Treasury under the Financial Services and Markets Act 2000, passed in June. The Act is designed to replace all current U.K. regulatory legislation including the Financial Services Act 1986, the 1982 Act, the Policyholders Protection Act 1975 and secondary legislation governing the regulation of insurance companies. Currently, the FSA has issued a number of consultative papers to gauge public opinion on the rules that are likely to be implemented. There is no current intention for the sale of general (property and casualty) insurance products to be made subject to the kind of sales practices regulation which currently applies to investment business, although the FSA will have powers to intervene in the event of misleading promotions of these insurance products. However, consideration is being given to applying these sales practice regulations to mortgage related products. We anticipate that the Act will be brought into force in the first half of 2001.

### *Company Regulation*

All insurers (including non-U.K. concerns wishing to establish and operate an insurance subsidiary within the U.K.) must be authorized by the FSA which grants authorizations after consideration of the applicant's capital resources, proposed business plan, underwriting policies and reinsurance arrangements and the qualifications of its directors and management. Authorizations may include limitations, for example, on gross premiums written, investments and transactions with associated companies or as the FSA otherwise deems appropriate.

However, if the applicant is a direct insurer (or a branch of a direct insurer) that is already authorized to write insurance business in its home jurisdiction within the EU, then it need only comply with minimal notification formalities.

All U.K. authorized insurance companies must submit to the FSA annual returns and, in some cases, more frequent returns, together with audited annual financial statements. The FSA uses the annual return to monitor the solvency (ability to meet current and future claims payments to policyholders) of an insurance company, and, for general (property and casualty) business, to assess retrospectively the adequacy of the company's claim provisions. For a long term (life) insurance company, the FSA is also concerned that the company is able to meet policyholders' reasonable expectations. For long term (life) business, the appointed actuary must sign a certificate as to whether admissible assets are sufficient to cover the long term (life) business liabilities. In the event that a long term (life) insurance company is insolvent, the parent company cannot pay out dividends. The directors are also required to sign a certificate, which includes a statement as to whether the company has maintained the required minimum margin of solvency throughout the year, and whether there has been appropriate segregation of long term (life) business funds from other funds and operations of the business.

The FSA has the authority to direct that assets be put under the control of an approved trustee as well as to investigate a company's affairs at any time and to determine whether an individual is a fit and proper person to control or manage an insurance company.

### *Compensation Schemes*

A potential annual assessment for the protection of individuals is imposed on all insurance companies (whether a U.K. or non-U.K. insurer) underwriting long term (life) and general (property and casualty) business in the United Kingdom to fund the Policyholders Protection Board, established under the Policyholders Protection Act 1975. The assessment is based on relevant net premium income with a maximum levy of 1.0% in any year. The funds collected by imposition of the assessment are used to provide compensation for individual policyholders in the event of insolvency of the insurance company. In practice, the levies made on insurers in recent years have related to general (property and casualty) business. No levy has been imposed in the last three years. In 1996, a 0.25% levy was imposed.

The Investors' Compensation Scheme created under the Financial Services Act 1986 is a fund set up to provide compensation to customers of authorized firms, including long term (life) insurance companies in the event that the company goes into liquidation. A charge is made on all PIA members to finance this fund. A levy was announced in May 1997 in connection with the pension misselling review on long term (life) insurance companies which received personal pension business from independent financial advisers between July 1, 1988 and June 30, 1994. Since this date, further levies have arisen and are likely to continue until the pensions misselling review has been completed. This is scheduled for June 2002.

The FSA intends, under the Financial Services and Markets Act 2000, to integrate the above schemes under one compensatory scheme, together with other schemes applicable in the financial services area.

In addition, there is a Motor Insurers' Bureau, or MIB, scheme, which imposes a levy on all companies underwriting automobile business. The MIB is used to compensate victims of uninsured and untraced drivers. The levy is made annually and will in part depend upon the total amount that the MIB needs to raise to finance compensation during the year. The levy is calculated by reference to gross premiums written.

### *Consumer Complaints*

The FSA, in November 1999, issued its second Consultation Paper ("CP33") on arrangements that should apply for handling consumer complaints under the new system of financial services regulation. The paper sets out detailed proposals relating to key aspects of the Financial Services Ombudsman Scheme, which will replace the eight existing dispute resolution mechanisms in the financial services area.

The statutory framework, the Scheme and the respective responsibilities of the FSA and the Scheme Operator, the separate company that will operate the Scheme, are set out in the Financial Services and Markets Act 2000. A further consultation paper was published in May 2000, which includes the responses received on CP33 and sets out the draft rules the FSA proposes to make. The period for consultation responses closes at the end of August 2000.

The Scheme is expected to be the largest Ombudsman in the world with a budget of £20 million. At least 10,000 firms are expected to be subject to the Scheme's Compulsory Jurisdiction which will apply to FSA authorized firms only. The new Scheme will provide a free, simple, informed and accessible alternative to the courts. It will cover similar kinds of dispute to the existing schemes including, for example, complaints about misselling, unsuitable advice, unfair treatment, maladministration, misleading advertising, delay and poor service in relation to products or services provided by financial services firms.

The Scheme will comply with the criteria of Ombudsmen schemes set out by the British and Irish Ombudsman Association which are independent from the industry, accessibility for complainants, fairness in its decision making and public accountability. The main change from the current schemes' arrangements will be that small business customers of insurers will be eligible to bring a complaint to the Scheme for the first time. The CP proposes that small businesses will be those that have a turnover of less than £1 million and fewer than five employees.

#### *Investments and Reserves*

The FSA requires that adequate reserves be maintained for each class of business underwritten both in respect of reported claims and those incurred but not reported. While no specific regulations exist that dictate the types of investment that must support insurance liabilities, there are asset admissibility rules for purposes of measuring solvency. In addition, an insurance company must ensure that such funds are not depleted to a point where they are no longer sufficient to meet the required margin of solvency.

#### *Solvency*

U.K. minimum solvency requirements are in accordance with relevant EU legislation. The required solvency margin and the guarantee fund minimum are calculated using the ECU British pound exchange rate on October 31, each year. The October 31, 1999 ECU rate was £0.6393. For general (property and casualty) insurers, the margin required is generally the larger of (a) 18% of the first 10,000,000 ECU of gross premiums for the year plus 16% of the remainder reduced by the ratio of gross reinsurance recoveries to gross claims paid during the last year (maximum reduction 50%), (b) 26% of the first 7,000,000 ECU of average gross claims for the past three years plus 23% of the remainder reduced by a reinsurance factor as under the premium basis, and (c) a fixed amount, referred to as the minimum guarantee fund, ranging from 200,000 ECU to 1,400,000 ECU depending on the class of business and, in the case of credit insurance business, the amount of premiums and contributions due in respect of that business.

For long term (life) insurers, the minimum solvency margin is assessed by a mathematical formula. However, the minimum guarantee fund must generally be at least 800,000 ECU should the formula produce a lesser figure.

The EU is currently in the process of a wholesale review of solvency margins. A quick fix is currently being considered of enhancing percentages for certain classes of business.

#### *Auditing Requirements*

The process of auditing an insurer's financial statements and part of the annual return is required to be carried out by a qualified and independent auditor who reports on the truth and fairness of the financial statements as presented. Under certain circumstances, the auditor may issue a qualified report. Failure to produce audited financial statements and the annual return as required by Treasury regulations may lead to the imposition of sanctions on the insurer.

#### *Appointed Actuary*

Under U.K. insurance legislation, each insurer carrying on long term (life) business must appoint an actuary who will prepare an annual report for the company's directors in relation to the company's long term (life) business quantifying the liabilities and confirming the solvency of the long term (life) business fund. The FSA must receive full details of the appointed actuary's report including the methods and assumptions adopted. The appointed actuary has a professional duty to be satisfied at all times as to the solvency of the insurance company's long term (life) fund and to report, with recommendations, on bonus rates and premium rates.

### *Supervision of Management and Control*

No U.K. insurance company may appoint any person as managing director or chief executive without the FSA's prior approval, and no person may become a "controller" (as defined in the 1982 Act, but the term includes, broadly, all holding companies, and the managing directors, the chief executives of holding companies of those companies which are insurance companies and any other company or person holding more than 10% of the shares in an insurance company or one of its holding companies) of an insurance company without such approval. In addition, a person who is already a controller of an insurance company may generally not acquire a "notifiable holding" in the company unless the person has served on the FSA notice of its intention to acquire such a holding and the number of shares or details of the voting rights which it proposes to acquire. The term "notifiable holding" means voting rights or shares of the insurance company or of a corporation of which it is a subsidiary which, if acquired either alone or with any associates by any person that is already a controller of the insurance company, will result in its increasing its percentage holding to 10% or more, to 20% or more, to 33% or more or to 50% or will result in the insurance company becoming a subsidiary of that person.

### *Products*

Only products that fall within the classes of business in respect of which an authorization is granted by the FSA may be underwritten. Applications to underwrite an additional class or classes of business will be considered by the FSA provided all regulatory requirements are fulfilled. Failure to write business in a class over a certain period of time may lead to the withdrawal of the authorization.

### *Marketing*

There is minimal specific regulation of the marketing of general (property and casualty) insurance in the United Kingdom. The 1982 Act requires certain information to be disclosed to policyholders at the time or shortly after a policy is taken out and contains certain provisions regarding advertisements but these regulatory requirements are not onerous.

The marketing of most long term (life) insurance business (including pension business) falls within the definition of "investment business" for the purposes of the Financial Services Act 1986. Any authorized insurer which markets such products is obliged to ensure that its marketing activities comply with the provisions of that Act and, in particular, with rules made by the FSA or by any of the SROs to which the FSA has delegated its rule making authority. In the case of long term (life) insurance companies, the relevant SRO is currently the PIA. Becoming a member of PIA and thereby agreeing to comply with its rules gives long term (life) insurers the requisite authorization to market insurance products which also qualify as investment business.

So-called "polarization" rules mean that sellers of investment products must either act for a single insurance product provider or must be completely independent, such as an independent financial adviser. In either case, there is a duty to disclose the tied or independent status and to recommend to prospective policyholders only products that are suited to their needs. Regulations prohibit insurers from establishing a commission structure that may encourage the promotion of any particular product at the expense of customer requirements.

### *Training and Compliance*

U.K. self-regulatory authorities have imposed strict requirements with respect to training and selling methods in recent years. In particular PIA members must have a training program for their agents, who must demonstrate that they meet certain competence standards. This training program must meet PIA requirements. All sales people whether working for an independent financial adviser or for a direct product provider are now

required to pass examinations in order to sell long term (life) insurance and pension products. In addition, long term (life) insurance companies are required to appoint a compliance officer whose responsibility is to ensure compliance with training and selling regulations. The compliance officer must report to a director of the company, unless the PIA agrees on an alternative approach. The costs of such training and oversight have increased insurers' costs.

Regular inspections of members, known as periodic inspection visits, or PIVs, are carried out by the PIA. The PIA has the authority to discipline members. The PIA also has a complaints bureau, the Ombudsman, which is compulsory for all PIA members.

### *Disclosure Regulations*

Detailed information is required to be disclosed to the customer at the time of sale about any investment product being purchased, in particular the projection of surrender and maturity values based on the insurer's own charges and expenses, and commission to be paid or commission plus benefits and services to be provided to the sales person as a reward for the introduction. The customer is also entitled to documents explaining key features of the contracts in non-technical language and to the right to cancel the contract within 14 days. These regulations exceed the disclosure standards mandated by EU directives.

### *Underwriting*

At the end of 1996, regulations came into force restricting discrimination by insurers against applicants on the grounds of disability, unless the underwriting decision is based upon a reasonable application of information relevant to the assessment of the risk to be insured, and from a source upon which it is reasonable to rely.

The Association of British Insurers issued a Code of Practice for Genetic Testing ("Code of Practice") effective January 1, 1998. The Code of Practice endorses the present two year moratorium on use of previously conducted genetic tests for underwriting decisions on contracts not in excess of £100,000 and connected to a mortgage. There are also strict statutory rules covering the confidential storage of and access to personal medical details.

The Human Genetics Advisory Council, established to advise the U.K. government, issued its report in December 1997. The report did not recommend a permanent ban on the use of genetic test results. However, they recommend a two year moratorium for all types of life insurance regardless of the amount of the insurance contract. In addition, the report acknowledges that the insurance industry has satisfactory arrangements in place to safeguard confidentiality of genetic test results.

### *New Regulatory Developments*

A Labor government was elected in May 1997 with a manifesto including plans for significant changes to the regulatory structure governing financial services, income tax treatment of certain investment products, and pensions legislation. This resulted in the publication of the Financial Services and Markets Act 2000. The core of the new financial regulatory structure was created on October 28, 1997 when the SIB formally changed its name to the FSA.

Since then, the Bank of England has transferred its supervisory responsibilities to the FSA. The regulatory role currently discharged by the Treasury and the SROs will in due course be formally transferred to the FSA, when the Financial Services and Markets Act 2000 is brought into force (expected to be in the first half of 2001).

A review of current pensions legislation has resulted in government proposals for “stakeholder” pension legislation, which will come into effect in April 2001. Such pensions would be offered by existing product providers. These products will be subject to low charges and would allow individuals to make a very low level of contribution. These proposals are currently being implemented by the U.K. pensions industry.

Apart from the new stakeholder pensions and a new defined contribution tax regime being introduced in April 2001, the U.K. government is introducing a new Second State Pension which will replace the existing state funded earnings related schemes possibly in 2002. This is still at the consultation stage.

## **United States**

### *General State Supervision*

In the United States, our U.S. subsidiaries are authorized to transact the business of insurance in all 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands and Guam. As licensed insurance companies, our U.S. subsidiaries are subject to considerable regulation and supervision by state insurance administrators. Each state has a chief insurance official (generally the commissioner or superintendent of insurance) and a staff (generally the department of insurance) to fulfill this regulatory mandate. The extent of regulation varies but generally has its source in statutes that delegate regulatory, supervisory and administrative authority to a department of insurance in each state. Among other things, state insurance commissioners regulate insurer solvency standards, insurer and agent licensing, authorized investments, premium rates, restrictions on the size of risks that may be insured under a single policy, loss and expense reserves and provisions for unearned premiums, deposits of securities for the benefit of policyholders, policy form approval and market conduct regulation, including the use of credit information in underwriting and other underwriting and claims practices. In addition, many states have enacted variations of competitive ratemaking laws, which allow insurers to set premium rates for certain classes of insurance without obtaining the prior approval of the state insurance department. State insurance departments also conduct periodic examinations of the affairs of insurance companies and require the filing of annual and other reports relating to the financial condition of companies and other matters.

Many states have insurance holding company laws which require notice to, and approval by, the state insurance commissioner for the declaration or payment of any dividend, which together with other distributions made within the preceding twelve months, exceeds the lesser of (i) 10% of the insurer’s surplus or (ii) the insurer’s net income for the twelve-month period ending the preceding December 31, in each case determined in accordance with statutory accounting practices. Such declaration or payment is further limited by adjusted unassigned surplus, as determined in accordance with statutory accounting practices. These same holding company laws will in many instances require notice (at times on a prior approval basis) of certain intra-group transactions and agreements.

Virtually all states require licensed insurers to participate in various forms of guaranty associations in order to bear a portion of the loss suffered by certain insureds caused by the insolvency of other insurers. Depending upon state law, insurers can be assessed an amount that is generally equal to between 1% and 2% of the annual premiums written for the relevant lines of insurance in that state to pay the claims of an insolvent insurer. Most of these assessments are recoverable through premium rates, premium tax credits or policy surcharges. Significant increases in assessments could limit the ability of our insurance subsidiaries to recover such assessments through tax credits. In addition, there have been legislative efforts to limit or repeal the tax offset provisions, which efforts, to date, have been generally unsuccessful. These assessments may increase or decrease in the future depending upon the rate of insolvencies of insurance companies.

Our insurance subsidiaries are also required to participate in various involuntary assigned risk pools, principally involving workers’ compensation and automobile insurance, which provide various insurance coverages to individuals or other entities that otherwise are unable to purchase such coverage in the voluntary

market. Participation in these pools in most states is generally in proportion to voluntary writings of related lines of business in that state.

In November 1999, the Gramm-Leach-Bliley Act (Financial Services Modernization Act) was enacted. The law authorizes financial services companies to affiliate and generally eliminates legal barriers established to separate the banking, insurance and securities industries. Certain state laws and regulations affecting the financial services industry, including the provisions governing relationships among insurance companies and agents, investment banks and commercial banks are preempted by the Financial Services Modernization Act. The potential impact of such legislation on our businesses cannot be predicted at this time.

### *Risk-Based Capital*

In order to enhance the regulation of insurer solvency, a Risk Based Capital, or RBC, formula and model were adopted by the National Association of Insurance Commissioners, or NAIC. RBC is designed to assess minimum capital requirements and raise the level of protection that statutory surplus provides for policyholder obligations. The RBC formula for property and casualty insurance companies measures four major areas of risk: (i) underwriting, which encompasses the risk of adverse loss developments and inadequate pricing; (ii) declines in asset values arising from credit risk; (iii) declines in asset values arising from investment risks; and (iv) off-balance sheet risk arising from adverse experience from non-controlled assets, guarantees for affiliates or other contingent liabilities and reserve and premium growth. Pursuant to the law, insurers having less statutory surplus than that required by the RBC calculation will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy.

The RBC law provides for four levels of regulatory action. The extent of regulatory intervention and action increases as the level of surplus to RBC falls. The “Company Action Level” (as defined by the NAIC) requires an insurer to submit a plan of corrective actions to the regulator if surplus falls below 200% of the RBC amount. The “Regulatory Action Level” (as defined by the NAIC) requires an insurer to submit a plan containing corrective actions and permits the relevant insurance commissioner to perform an examination or other analysis and issue a corrective order if surplus falls below 150% of the RBC amount. The “Authorized Control Level” (as defined by the NAIC) allows the relevant insurance commissioner to rehabilitate or liquidate an insurer in addition to the aforementioned actions if surplus falls below 100% of the RBC amount. The “Mandatory Control Level” (as defined by the NAIC) requires the relevant insurance commissioner to rehabilitate or liquidate the insurer if surplus falls below 70% of the RBC amount.

The formulas have not been designed to differentiate among adequately capitalized companies that operate with higher levels of capital. Therefore, it is inappropriate and ineffective to use the formulas to rate or to rank such companies. Our U.S. subsidiaries have satisfied the RBC formula since it was created in the mid-1990s and have exceeded all recognized industry solvency standards. At December 31, 1999, all of our U.S. property and casualty insurance subsidiaries had adjusted capital in excess of amounts requiring company or regulatory action at any of the four levels.

### *NAIC Ratios*

The NAIC Insurance Regulatory Information System, or IRIS, was developed to help state regulators identify companies that may require special attention. The IRIS system consists of a statistical phase and an analytical phase whereby financial examiners review annual statutory basis statements and financial ratios. The statistical phase consists of eleven key financial ratios that are generated from the NAIC database annually; each ratio has an established “usual range” of results. These ratios assist state insurance departments in executing their statutory mandate to oversee the financial condition of insurance companies.

A ratio result falling outside the usual range of IRIS ratios is not considered a failing result; rather, unusual values are viewed as part of the regulatory early monitoring system. Furthermore, in some years, it

may not be unusual for financially sound companies to have several ratios with results outside the usual ranges. An insurance company may fall out of the usual range for one or more ratios because of specific transactions that are in themselves immaterial. Generally, an insurance company will become subject to regulatory scrutiny if it falls outside the usual ranges of four or more of the ratios. Guaranty National Insurance Company, one of the insurance companies acquired as a part of the acquisition of Orion Capital Corporation, has been subject to basic enquiries from the NAIC which we believe have been satisfactorily answered and resolved. In normal years, 15% of the companies included in IRIS are expected by the NAIC to be outside the usual range on four or more ratios.

### *Change of Control*

Many state insurance laws intended primarily for the protection of policyholders require advance approval by state insurance commissioners of any change in control of an insurance company that is domiciled (or, in some cases, having such substantial business that it is deemed to be commercially domiciled) in that state. "Control" is generally presumed to exist through the ownership of 10% or more of the voting securities of a domestic insurance company or of any company that controls a domestic insurance company. In addition, many state insurance laws contain provisions that require prenotification to the insurance commissioners of a change in control of a non-domestic admitted insurance company in that state. Generally the states in which the insurer maintains a non-domestic license give significant regulatory deference to the company's state of domicile regarding a change in control. While these states could, under their own regulatory authority, exert greater scrutiny over a change in control of a non-domestic admitted insurance company, in practice they rarely do. Any future transactions that would constitute a change in control of our U.S. subsidiaries would generally require prior approval by the insurance departments of the insurance subsidiaries' states of domicile or commercial domicile and may require pre-acquisition notification in applicable states that have adopted pre-acquisition notification provisions.

### *Federal Initiatives*

Although, with limited exceptions such as flood insurance, the U.S. federal government does not directly regulate the business of insurance, federal initiatives often have an impact on the insurance industry. Legislation has been introduced in Congress during the past several sessions that, if enacted, would result in substantially greater federal regulation of the insurance business. Current and proposed federal measures that may affect the property and casualty industry may include: possible changes to the tax laws governing property and casualty insurance companies; proposals regarding natural disaster protection and tort reform (including limits to product liability lawsuits). The Financial Services Modernization Act, enacted in November 1999, sets the stage for greater affiliation among banks, insurers, security brokers and other financial service providers. The full impact of this new federal law, which repeals many of the institutional "firewalls" between the financial services sectors, has yet to be realized. However, the act is likely to increase competition in the U.S. insurance industry.

President Clinton's 2001 budget proposal (the "Budget Proposal") contains a number of tax provisions that could adversely impact us, including a provision relating to tax-exempt interest obligations. This provision of the Budget Proposal has not yet been introduced as part of any legislation in Congress but has engendered considerable opposition from the public and members of Congress.

It is not possible to predict whether the Budget Proposal or any of the proposed legislation discussed above will be enacted, what form such legislation might take when enacted, or the potential effects of such legislation on our competitors and us. Prior efforts by the Clinton administration to include similar provisions in budget proposals over the last few years have been unsuccessful.

## **Other Markets**

Our insurance operations are also subject to regulation in the other markets in which we operate, including Canada, Australia, Denmark and Sweden.

### *Canada*

The insurance market in Canada is regulated federally by the Office of the Superintendent of Financial Institutions, or OSFI, which reviews an insurance company's financial soundness and the scope of its business operations. OSFI derives its powers from, and is responsible for, administering the Insurance Companies Act (Canada), which sets out the rules for the structure and operation of federally incorporated insurance companies. The insurance market is also regulated provincially by 10 separate provincial and three territorial governments as to the licensing of companies, agents and brokers, policy wordings and policyholder rights. In Canada, we are authorized to engage in insurance activities in all ten provinces and three territories.

Insurance companies in Canada provide information to OSFI on an ongoing basis. Such information includes both corporate and financial information such as copies of the annual report, signed and audited annual financial statements, annual financial returns, and various monthly, quarterly and annual financial information. OSFI's continuing supervision includes analysis of this information and regular examinations of insurance companies. Generally, OSFI's review focuses on capital, assets, management, earnings and liquidity, as well as reinsurance, actuarial liabilities and underwriting. OSFI assesses each of these areas and makes recommendations to the company with respect to any situations that may need improvement. Failure to maintain minimum capital levels may result in a directive to increase or take some other action to rectify any deficiency.

This year, the OSFI has implemented its new Supervisory Framework. This new methodology will evaluate the risks associated with a company's significant activities and the internal controls that are in place to deal with them. The Supervisory Framework will provide a pro-active assessment of emerging risks or problems and the supervisory focus will be on activities more likely to affect the soundness of an institution.

The Insurance Companies Act (Canada) imposes a number of requirements on a company's Appointed Actuary to report to the company's board of directors and to file regular reports with OSFI. In addition, OSFI has recently mandated that all insurers have Legislative Compliance Management Systems, or LCMS, regarding the Insurance Companies Act (Canada). It is expected that the LCMS requirements will be extensive. OSFI has also issued a lengthy directive on the management of third party outsourcing arrangements, with which insurers are expected to comply.

Draft standards of Business and Financial Practice for property and casualty companies have recently been developed and these will be revised and implemented in the next year. Whilst these were developed using the life standards as a precedent, the amendments will follow the amended bank standards.

The federal government is also in the process of passing legislation for the protection of personal information. Once passed, insurance companies will have a transition period of 3 years to comply.

Finally, OSFI has a number of policies and directives regarding the conduct of the life insurance business. Beginning in 1998, insurers are required to demonstrate compliance with the Standards of Sound Business and Financial Practices. This requires a company to identify all risks material to its business and any offsetting controls and to file statements of compliance. Wherever an insurer cannot demonstrate compliance, an action plan for moving into compliance has to be filed. OSFI assigns a ranking to the company that then requires OSFI to audit more extensively and perhaps more frequently. The Inspecteur Generale of Quebec adopted a similar policy and insurers are required to demonstrate compliance and file in Quebec as well.

## *Australia*

Australian life insurers are subject to the Life Insurance Act, 1995 while Australian property and casualty insurers are regulated primarily by the Insurance Act, 1973. Workers' compensation and compulsory third party automobile insurance and trustee companies are separately regulated at the state level. Superannuation funds and investment management in Australia are regulated under the Superannuation Industry (Supervision) Act 1993 and the Corporations Law respectively. The Australian Prudential Regulation Authority, or APRA, is responsible for prudential regulation of insurance companies, superannuation funds, banks and other financial institutions. Consumer protection in the financial services industry generally and regulation of investment management are among the responsibilities of the Australian Securities and Investments Commission.

An Australian life insurance company is required to prepare financial statements in accordance with APRA's rules and to meet a solvency test and a capital adequacy test. Australian property and casualty insurers are required to meet a solvency test and prepare financial statements in accordance with accounting standards. APRA is currently undertaking a review of the prudential guidelines for property and casualty insurers including discussion papers proposing the adoption of a risk based approach to capital adequacy. Superannuation fund and managed investment scheme trustees must file audited financial statements based on Australian accounting standards. The Group's Australian trustee company is required to prepare financial statements in accordance with state regulations.

Life insurance companies in Australia are required to establish and maintain in the records of the company at least one statutory fund that relates solely to the life insurance business of the company. Where a company writes policies providing investment-linked benefits to policyholders in Australia, that business must be maintained in a separate statutory fund that is exclusive to that business. Likewise, the business of overseas branches established after July 1, 1995, must be maintained in a separate statutory fund or funds. Pursuant to the Life Insurance Act, 1995, an insurance company must allocate at the end of each fiscal year the profits and losses of each of its statutory funds and credit such amounts to the fund's retained earnings accounts to be held for distribution to the fund's participating policyholders and the insurance company's shareholders. Distributions of a statutory fund's retained earnings must be made in accordance with the requirements of the Life Insurance Act. The auditor and the appointed actuary of a life insurance company in Australia each have reporting obligations to directors and APRA relating to compliance with the Life Insurance Act, 1995 and protection of policyholder interests.

Product disclosure, advice and sales are currently regulated by a number of different specific statutes, codes and guidelines as well as general consumer protection legislation and common law. The Australian Government has recently released detailed proposals for the introduction of a single product disclosure, advice and sales regime for all financial products and services.

Acquisitions of substantial stakes in Australian insurance companies and businesses must be approved by one or more Australian Government authority.

## *Scandinavia*

### *Denmark*

Insurance companies in Denmark are subject to regulation under the Insurance Business Act, or IBA. Pursuant to the IBA, the Insurance Supervisory Authority, or ISA, has authority to grant regulatory permission to provide insurance for one or more of the classes recognized by the EU directives on non-life (property and casualty) and life insurance. Insurance companies are entitled to engage in insurance and closely related businesses only. Non-life (property and casualty) and life insurance operations must be organized in independent legal entities.

Insurance operations report their annual accounts to the ISA. They also annually submit to the ISA a detailed financial report and key figures statement for their insurance operations. In addition, the external and internal auditors' long form audit reports relating to the annual accounts must be filed with the ISA. The detailed financial report and key figures statement allows the ISA to check the business on a class-by-class basis and review the continuity of the business and the adequacy of actuarially calculated reserves. The ISA is also entitled to ask for any additional information from the board, management, internal auditors and external auditors. Every four to five years, the ISA conducts a thorough on-site inspection of an insurance company and its business. The ISA may review other issues such as IT-security, Year 2000 problems, reinsurance adequacy and valuation of assets at any time between the general inspections.

The IBA and ISA also regulate how funds are to be invested to minimize risks to the company's policyholders. Assets corresponding to life insurance reserves are registered as available exclusively to cover those obligations.

Acquisitions of more than 10 percent of the shares of an insurance company, and the passing of additional 10 percent intervals, must be reported to, and are subject to the ISA's approval. This approval is based on the filing of a statutory information questionnaire to allow the ISA to determine that the shareholder is acceptable. Also, new directors and executive managers must present an information questionnaire and their criminal record certificate to allow the ISA to determine that they are fit and proper persons to be involved in running the business.

#### *Norway and Sweden*

The regulations and legislation in Norway and Sweden are similar to those described above for Denmark.

## ITEM 2. DESCRIPTION OF PROPERTY

Our global headquarters is located at 30 Berkeley Square, London, England. We also have the following regional headquarters:

- Our Europe region has its headquarters in London, England and Copenhagen, Denmark;
- Our Americas region has its headquarters in Charlotte, North Carolina; and
- Our Asia Pacific region has its headquarters in Singapore and Sydney, Australia.

In addition to our headquarter offices, we have major offices in Liverpool and Horsham, England; Toronto, Canada; Copenhagen, Denmark; and Sydney, Australia. We own or lease office space in over 50 countries around the world. We believe that these facilities are adequate for our present needs in all material respects. We also hold other properties for investment purposes.

## ITEM 3. LEGAL PROCEEDINGS

Litigation and arbitration may affect various companies in our group as insurers, employers and taxpayers in the normal course of their business. While the ultimate outcome of these proceedings cannot be predicted with certainty, we do not believe that any pending proceedings will have a material adverse effect on our results of operations or financial position.

## ITEM 4. CONTROL OF REGISTRANT

We are not directly or indirectly owned or controlled by any other corporation or any government. We do not know of any person who owns more than 10% of our voting securities.

The table below sets forth the total amount of ordinary shares owned by our directors and officers as a group as of September 15, 2000, including ordinary shares evidenced by American Depositary Shares.

<u>Title of Class</u>	<u>Identity of Person or Group</u>	<u>Number Owned</u>	<u>Percent of Class</u>
Ordinary shares	Directors and officers as a group (20 persons)	369,341	0.03%

We do not know of any arrangements which may at a subsequent date result in a change in control of Royal & Sun Alliance.

## ITEM 5. NATURE OF TRADING MARKET

### Trading on the London Stock Exchange

Our ordinary shares are traded on the London Stock Exchange. This is the sole non-United States trading market for the ordinary shares. The London Stock Exchange assigns a normal market size, or NMS, for each company based on customer turnover. Market makers quote firm prices at a minimum of the NMS level allocated to a particular company. For all companies with an NMS of more than 1,000 shares, information such as best bid and offer prices, latest price traded and accumulated volumes is available. Our ordinary shares have an NMS of 150,000.

The table below sets forth the highest and lowest middle-market quotations for our ordinary shares as derived from the Official List of the UK Listing Authority and the closing price of the London Stock Exchange for the periods indicated.

	Price per Ordinary Share pence	
	High	Low
1997		
First Quarter . . . . .	513	430
Second Quarter . . . . .	525	433
Third Quarter . . . . .	593	454
Fourth Quarter . . . . .	645	512
1998		
First Quarter . . . . .	808	610
Second Quarter . . . . .	800	613
Third Quarter . . . . .	684	451
Fourth Quarter . . . . .	565	457
1999		
First Quarter . . . . .	623	460
Second Quarter . . . . .	586	499
Third Quarter . . . . .	600	457
Fourth Quarter . . . . .	488	356
2000		
First Quarter . . . . .	486	300
Second Quarter . . . . .	429	331
Third Quarter (to September 15, 2000) . . . . .	505	399

### Trading on the Over-the-Counter Market in the United States

Our American Depositary Shares, or ADSs, each representing five ordinary shares, have traded in the over-the-counter, or OTC, market in the United States since the fourth quarter of 1998. The ADSs are evidenced by American Depositary Receipts, or ADRs, issued by Citibank N.A., as Depositary.

The table below sets forth the reported high and low closing prices of our ADSs on the OTC for the periods indicated.

	Price per ADS	
	High	Low
1998		
Fourth Quarter . . . . .	43.36	41.61
1999		
First Quarter . . . . .	51.10	41.61
Second Quarter . . . . .	45.06	40.92
Third Quarter . . . . .	46.85	29.30
Fourth Quarter . . . . .	40.49	29.30
2000		
First Quarter . . . . .	38.50	24.00
Second Quarter . . . . .	34.25	25.25
Third Quarter (to September 15, 2000) . . . . .	37.81	30.24

Concurrently with the filing of this registration statement, we are filing a listing application to list our ADSs on The New York Stock Exchange.

**United States Shareholders**

Based on information from registrars and custodians, we estimate that U.S. shareholders held approximately 262,167,503 ordinary shares representing approximately 18% of our issued and outstanding ordinary shares as of September 15, 2000. As of September 15, 2000, 1,198,495 ordinary shares were held through 239,699 ADRs.

The number of record holders in the United States of our ordinary shares was approximately 247 as of September 15, 2000. The number of record holders in the United States of our ADRs was two as of September 15, 2000.

**ITEM 6. EXCHANGE CONTROLS AND OTHER LIMITATIONS AFFECTING SECURITY HOLDERS**

We are not restricted by any current U.K. law, decree or regulation from distributing to or receiving capital from, or paying dividends or interest or otherwise making payments to, persons who are neither residents nor nationals of the United Kingdom.

Under U.K. law and our Memorandum and Articles of Association, persons who are neither residents nor nationals of the United Kingdom may freely hold, vote and transfer their ordinary shares in the same manner as U.K. residents or nationals.

## **ITEM 7. TAXATION**

The following is a summary of the principal U.S. federal income and U.K. tax consequences to a U.S. Holder of ADRs representing ordinary shares, or of ordinary shares not held in ADR form, who is eligible for benefits under the current double taxation convention on income and capital gains (the “Convention”) between the United States and the United Kingdom.

For purposes of this discussion, a “U.S. Holder” includes any beneficial owner of ordinary shares or ADRs that is:

- a citizen or resident of the United States;
- a corporation organized under the laws of the United States or any State; or
- otherwise subject to U.S. federal income taxation in respect of an ordinary share or ADR.

This summary is based in part on representations by the Depositary and assumes that the obligations under the Deposit Agreement and any related agreements will be performed in accordance with their terms. In addition, this summary is based on U.S. tax law (including the Internal Revenue Code of 1986, as amended (the “Internal Revenue Code”), its legislative history, existing and proposed regulations thereunder, published rulings and court decisions), U.K. tax law and practice, and the Convention, all as of the date hereof and all of which are subject to change (including changes in interpretation), possibly with retroactive effect.

This summary is intended only as a descriptive summary and does not purport to address all potential tax consequences of the ownership of ordinary shares or ADRs, and does not take into account the specific circumstances of any particular investor (such as tax-exempt entities, certain insurance companies, broker-dealers, investors subject to the alternative minimum tax, investors that actually or constructively own 10% or more of our voting securities, investors that hold ordinary shares or ADRs as part of a straddle or hedging or conversion transaction, or investors whose functional currency is not the U.S. dollar), some of which may be subject to special rules. Both U.S. Holders and non-U.S. Holders should consult their own advisors as to the tax consequences to them of ownership of the ordinary shares or ADRs.

### **Holder for U.S. Federal Income Tax Purposes**

For the purposes of the current Convention and the Internal Revenue Code, the U.S. Holder will be treated as the beneficial owner of the underlying ordinary shares represented by the ADRs that are evidenced by such ADRs.

### **Taxation of Dividends**

#### *U.K. Taxation*

The U.K. Advance Corporation Tax, or ACT, system has been abolished since April 6, 1999. A U.K. company now pays dividends without withholding tax at source or being required to account for ACT.

A U.K. resident individual shareholder is entitled to a tax credit on dividends received, currently equal to one-ninth of the cash dividend. The shareholder is then treated as having taxable income equal to the sum of the dividend and that tax credit. The rate of income tax on dividends is 10 per cent for lower and basic rate taxpayers. The tax credit effectively discharges the full liability to income tax except for an individual whose marginal rate of income tax is the higher rate. Higher rate taxpayers will be liable for tax on such dividends at the rate of 32.5 per cent, so that an individual shareholder who is a higher rate taxpayer will have a liability, after taking account of the tax credit, equal to 25 per cent of the net cash dividend. The tax credit is not repaid by the Inland Revenue except for in very limited circumstances.

In general, U.K. resident corporate shareholders, other than those dealing in securities, will have no further liability for tax on dividends paid by us.

A shareholder resident in the United States is entitled to a tax credit repayment under the terms of the Convention on the aggregate of the dividend and that tax credit entitlement less a withholding tax. The level of

tax credit is now such that for a portfolio investor the withholding tax is equal to the tax credit. As the level of tax credit is now one-ninth, a portfolio investor will not be entitled to a refund but will not be subject to any further U.K. tax charge on the dividend. Such an investor will thus receive simply the dividend from us. A shareholder holding 10% or more of our voting stock will be entitled to reclaim from the U.K. Inland Revenue half the tax credit, less a withholding tax of 5% on the sum of the dividend and that tax credit entitlement. This will result in a net additional amount of approximately 0.3% of the dividend.

#### *U.S. Federal Income Taxation*

The amount of any distribution paid to a U.S. Holder will generally be subject to U.S. federal income tax to the extent paid out of current or accumulated earnings and profits, as determined for U.S. federal income tax purposes. The amount of any distribution of property other than cash will be the property's fair market value on the date of the distribution. To the extent that an amount received by a U.S. Holder exceeds that U.S. Holder's allocable share of current and accumulated earnings and profits, such excess will be applied first to reduce that U.S. Holder's tax basis in the shares and then, to the extent the distribution exceeds the U.S. Holder's tax basis, will be treated as capital gain. We do not maintain calculations of our earnings and profits for U.S. federal income tax purposes.

A U.S. Holder must include in income the U.S. dollar value of the British pound payment made, determined at the spot rate in effect on the day the distribution is paid to the Depositary regardless of whether the payment is in fact converted to U.S. dollars. If the British pounds are converted into U.S. dollars on the date of the payment, the U.S. Holder should not be required to recognize any foreign currency gain or loss with respect to the receipt of the British pounds as distributions. If, instead, the British pounds are converted at a later date, any currency gains or losses resulting from such conversion will be treated as U.S. source ordinary income or loss.

U.S. Holders will be required to include in gross income the gross dividend, including the amount withheld, as ordinary income when the dividend is actually or constructively received. The dividend will not be eligible for the dividends-received deduction generally allowed to U.S. corporations in respect of dividends received from other U.S. corporations.

Subject to certain limitations and restrictions, U.K. tax withheld, or deemed withheld, from dividends paid will be available as a credit against the U.S. Holder's U.S. federal income tax. U.S. Holders should refer to Internal Revenue Service Revenue Procedure 2000-13 for the specific rules and procedures for obtaining the credit. A U.S. Holder claiming foreign tax credits on an accrual basis generally must translate foreign taxes, including withholding taxes, into U.S. dollars at the average exchange rate for the taxable year to which the taxes relate. U.S. Holders claiming foreign tax credits on the cash basis must translate foreign taxes into U.S. dollars at the spot rate on the payment date. U.S. tax law provides that foreign tax credits are not allowed for withholding taxes imposed in respect of short-term or hedged positions in securities or in respect of arrangements in which a U.S. Holder's expected economic benefit, after non-U.S. taxes, is insubstantial. U.S. Holders should consult their tax advisors concerning the application of these rules in light of their particular circumstances.

### **Taxation of Capital Gains**

#### *U.K. Taxation*

U.S. Holders who are not resident or ordinarily resident in the United Kingdom will not be liable for U.K. tax on capital gains realized on the disposal of their ADRs or ordinary shares unless such ADRs or ordinary shares are held in connection with a trade, profession or vocation carried on in the United Kingdom through a branch or agency and the ADRs or ordinary shares are used, held or acquired for the purposes of such trade, profession or vocation or branch or agency. Generally, gains realized in the course of dealing in securities will be regarded as arising in the course of carrying on a trade. In this case, a different U.K. treatment applies and such U.S. Holders should seek specific U.K. tax advice. U.S. Holders who are liable for both U.K. and U.S. tax in respect of a gain on a disposal of ADRs or ordinary shares may, subject to certain limitations, be entitled to credit the U.K. tax paid in respect of such gain against their U.S. federal income tax,

or for purposes of U.S. federal income tax, may be able to deduct an amount equal to the U.K. tax paid in respect of such gain.

### *U.S. Federal Income Taxation*

Upon the sale or exchange of ordinary shares or ADRs, a U.S. Holder will generally recognize gain or loss for U.S. federal income tax purposes in an amount equal to the difference between the amount realized and the U.S. Holder's tax basis in the ordinary shares or ADRs. Such a gain or loss will be a capital gain or loss if the ordinary shares or ADRs were capital assets in the hands of the U.S. Holder. There are different tax rates that may apply depending upon the date of sale, the holding period and the individual's marginal rate of tax. In general, the capital gain of a non-corporate U.S. Holder is subject to tax at ordinary rates for ordinary shares or ADRs held for one year or less and to a maximum tax rate of 20% for ordinary shares or ADRs held for more than one year.

The surrender of ADRs in exchange for ordinary shares, or vice versa, will not be a taxable event for U.S. federal income tax purposes and U.S. Holders will not recognize any gain or loss upon such an exchange.

### **U.S. Backup Withholding**

A U.S. Holder generally will be subject to information reporting with respect to dividends paid on, or proceeds from the sale or other disposition of, an ordinary share or ADR unless the U.S. Holder is a corporation or comes within another category of exempt recipients. If it is not exempt, a U.S. Holder may be subject to backup withholding at a rate of 31% with respect to dividends or proceeds from the sale or disposition of an ordinary share or ADR unless a taxpayer identification number is provided and the other applicable requirements of the backup withholding rules are complied with. Any amount withheld under these rules will be creditable against the U.S. Holder's U.S. federal income tax liability or refundable to the extent that it exceeds this liability, provided that the required information is furnished to the Internal Revenue Service.

### **Estate and Gift Taxes**

U.K. Inheritance tax is similar to U.S. federal estate tax and gift tax. A U.S. Holder need only be concerned about liability for U.K. Inheritance tax to the extent that he or she is regarded as a U.K. domiciliary, or was so regarded at the time he or she made any trust or settlement, or otherwise to the limited extent of his U.K. property. The ordinary shares will be, and ADRs may be, U.K. property.

Under the current convention relating to estate and gift taxes (the "Estate Convention") between the United States and the United Kingdom, an ADR or ordinary share beneficially owned by an individual who is domiciled in the United States for the purposes of the Estate Convention and is not a national of the United Kingdom will usually not be subject to U.K. Inheritance tax on the individual's death or on a lifetime transfer of the ADR or ordinary share. There is an exception where the ADR or ordinary share is held in a trust created by a settlor who was not domiciled in the United States or who was a national of the United Kingdom at the time when the trust was created. There is also an exception where the ADR or ordinary share is part of the business property of a U.K. permanent establishment of an enterprise or pertains to the fixed base in the United Kingdom of an individual providing independent personal services. If an ADR or ordinary share is subject to both U.K. Inheritance tax and U.S. federal estate or gift tax, the Estate Convention generally provides for a credit of the amount of any tax paid in the United Kingdom against the U.S. federal tax liability or for a credit of the amount of any tax paid in the United States against the U.K. tax liability, on the basis of priority rules set forth in the Estate Convention.

### **U.K. Stamp Duty and Stamp Duty Reserve Tax**

U.K. stamp duty is payable in respect of certain documents and U.K. stamp duty reserve tax, or SDRT, is imposed in respect of certain transactions in securities.

Transfers of our ordinary shares will generally be subject to U.K. stamp duty at the rate of 0.5%, rounded up to the nearest multiple of £5, of the full consideration given for the transfer irrespective of the identity of the parties to the transfer and the place of execution of any instrument of transfer. There is generally no ad valorem stamp duty on an instrument of transfer which is made neither on sale nor in contemplation of sale. In such cases, the instrument of transfer will either be exempt from stamp duty or a fixed stamp duty of £5 per instrument will be payable.

An agreement to transfer ordinary shares or an interest therein for money or money's worth will normally give rise to a charge for SDRT at the rate of 0.5% of the amount or value of the consideration given for the ordinary shares. The liability for SDRT will arise, in respect of unconditional contracts, on the date the contract is made and, in respect of conditional contracts, on the date the conditions are satisfied. If a transfer completing an agreement to transfer ordinary shares is duly stamped within six years of the date of agreement or the date on which conditions are satisfied, in the case of a conditional agreement, then the charge for SDRT will be cancelled or, where the SDRT charge has been paid the SDRT will, provided that a claim for repayment is also made within the six year limit, be repaid generally with interest. However, the stamping of a transfer will not relieve any penalties due for late payment of SDRT. Penalties may also be due for late stamping of the transfer.

From October 28, 1996, ordinary shares were tradable through the U.K. electronic transfer system known as CREST. Transfers of ordinary shares into CREST are exempt from stamp duty so long as the transferee is a member of CREST and the transfer is in a form which will ensure that the securities become held in uncertificated form within CREST. Such transfers, however, if made for a consideration in money or money's worth are liable for SDRT, usually at 0.5%. Paperless transfers of ordinary shares within CREST will be liable for SDRT rather than stamp duty. SDRT on relevant transactions settled within the system or reported through it for regulatory purposes will be collected by CREST, and this will apply whether or not the transfer is effected in the United Kingdom, and whether or not the parties to it are resident or situated in the United Kingdom.

A charge for SDRT at the rate of 1.5% of the amount or value of the consideration or, in some circumstances, the value of the ordinary shares concerned, may arise on a transfer or issue of ordinary shares to the Depository, or its custodian, or certain persons providing a clearance service, or their nominees or agents, and will be generally payable by the Depository or person providing the clearance service. A charge for stamp duty at the rate of 1.5%, rounded up to the nearest multiple of £5, of the amount or value of the consideration, or of the value of the ordinary shares, may also arise on the transfer of ordinary shares in such circumstances. However, such duty will reduce or cancel any SDRT liability.

In accordance with the terms of the Deposit Agreement, any tax or duty payable by the Depository or the custodian of the Depository on deposits of ordinary shares will be charged by the Depository to the party to whom ADRs are delivered against such deposits.

No liability for stamp duty will arise on any transfer or agreement to transfer, an ADR or beneficial ownership of an ADR, provided that the ADR and any instrument of transfer or written agreement to transfer is not executed in the United Kingdom and the transfer does not relate to any matter or thing done or to be done in the United Kingdom. In any other case, any transfer in writing may give rise to a charge for ad valorem stamp duty on a transfer of stock or marketable securities, including ADRs, which will be at the rate of 0.5%, rounded up to the nearest multiple of £5, of the amount or value of the consideration, a transfer in contemplation of sale being stampable by reference to the value of the property transferred.

SDRT will not be payable on any agreement to transfer ADRs or beneficial ownership of ADRs.

A transfer of the underlying ordinary shares from the Depository other than on cancellation of the ADR, whether to the U.S. Holder or directly to a purchaser from him, may give rise to a liability for ad valorem stamp duty. However, on a transfer from the custodian to a U.S. Holder or registered holder of an ADR on cancellation of the ADR, only a fixed U.K. stamp duty of £5 per instrument of transfer would be payable.

## **ITEM 8. SELECTED FINANCIAL DATA**

### **Selected Financial Information**

The U.K. GAAP consolidated financial statements as of and for the year ended December 31, 1995 for Sun Alliance Group plc and Royal Insurance Holdings plc and the U.K. GAAP consolidated financial statements as of and for the years ended December 31, 1996 and 1997 for Royal & SunAlliance were audited by Coopers & Lybrand, independent chartered accountants. Our auditors, Coopers & Lybrand merged with Price Waterhouse on July 1, 1998, following which time Coopers & Lybrand resigned and we appointed the new firm PricewaterhouseCoopers as auditors. Our U.K. GAAP consolidated financial statements included herein as of December 31, 1999, 1998 and 1997 and for the years ended December 31, 1999, 1998 and 1997 have been audited by PricewaterhouseCoopers, independent chartered accountants. The following selected consolidated financial data are derived from and should be read in conjunction with our audited U.K. GAAP consolidated financial statements, including the notes thereto contained elsewhere in this registration statement. As described below, the financial information presented herein for the years ended December 31, 1998, 1997, 1996 and 1995 has been restated from the original audited financial statements to conform to the accounting policies applied in 1999. U.S. GAAP differs significantly from U.K. GAAP. A description of the significant differences between U.K. GAAP and U.S. GAAP and reconciliations of our shareholders' equity to U.S. GAAP as of December 31, 1999 and 1998, and of net income for the three years ended December 31, 1999, is included in note 48 to our consolidated financial statements included herein. We have included a translation of the data for the year ended December 31, 1999 from British pounds into U.S. dollars solely for your convenience. The translation rate is at the rate of £1.00 per \$1.51, the Noon Buying Rate on June 30, 2000.

#### *Changes in Accounting Presentation*

Our consolidated financial information for the year ended December 31, 1995, including the dividends per ordinary share, has been restated following the merger of Royal Insurance Holdings plc and Sun Alliance Group plc in 1996 to arrive at aggregate financial information that is comparable with the financial information presented in respect of 1996, 1997, 1998 and 1999. The merger was accounted for as a merger under U.K. GAAP and as a pooling of interests under U.S. GAAP. Accordingly, our consolidated financial information has been restated as if the merger had occurred at the beginning of the earliest period presented.

In 1999, we adopted the requirements of Financial Reporting Standard 16 "Current Tax". Under this standard, dividends, interest and other income receivable includes any withholding tax but excludes any other taxes, such as attributable credits, not payable wholly on our behalf. Previously, attributable tax credits were included in our investment income and the tax on ordinary activities is reduced by an equal amount. All prior years have been restated accordingly.

Following the publication of the SORP by the Association of British Insurers in the United Kingdom in December 1998, unrealized gains and losses on investments not attributable to our life and asset accumulation business are reflected in the non-technical account of the consolidated profit and loss account. Additionally, investment return based on the longer term rate of return has been transferred from the non-technical account to the general business technical account. Previously, no such transfers were made and unrealized gains and losses were included in the revaluation reserve (a separate component of shareholders' equity). All prior years have been restated accordingly.

## Consolidated Profit and Loss Account Data

	Year Ended December 31,					
	1999	1999	1998	1997	1996	1995
	\$	£	£	£	£	£
(in millions, except per ordinary share amounts)						
<b>Amounts in accordance with U.K. GAAP</b>						
Net premiums written— general (property and casualty) business . . . . .	10,810	7,159	6,867	6,634	6,814	7,112
Net premiums written—long term (life) business (1) . . . . .	4,959	3,284	2,856	2,591	2,546	2,291
Net investment income—general (property and casualty/shareholder) business (2) . . . . .	2,374	1,572	1,500	1,084	1,125	1,072
Net unrealized (losses) gains on investments—general (property and casualty/shareholder) business (2) . . . . .	(974)	(645)	(139)	965	136	1,100
Net investment income—long term (life) business (3) . . . . .	5,715	3,785	3,713	2,608	2,348	1,996
Net unrealized gains (losses) on investments—long term (life) business . . . . .	630	417	850	1,942	438	2,100
Long term (life) business result gross of tax (4) . . . . .	355	235	230	231	223	195
General (property and casualty) business result (4) . . . . .	365	242	288	535	310	869
Profit (loss) on ordinary activities before tax . . . . .	571	378	864	1,810	747	2,102
Tax on profit on ordinary activities (6) . . . . .	(408)	(270)	(374)	(354)	(245)	(211)
(Profit) loss attributable to minority interest . . . . .	(32)	(21)	(33)	(40)	(44)	(50)
Profit (loss) attributable to shareholders . . . . .	131	87	457	1,416	458	1,841
Earnings (loss) per ordinary share, basic . . . . .	8.0c	5.3p	28.7p	91.0p	29.3p	121.3p
Dividends per ordinary share (5) . . . . .	109.8c	72.7p	23.0p	21.0p	19.0p	16.3p
<b>Amounts in accordance with U.S. GAAP</b>						
Net premiums written and policy fees (1) . . . . .	13,419	8,887	8,507	8,379		
Net investment income (3) . . . . .	7,251	4,802	4,775	3,429		
Net unrealized gains (losses) on investments . . . . .	(711)	(471)	543	1,219		
Net income . . . . .	1,409	933	660	688		
Net income per ordinary share, basic:						
Income before extraordinary item . . . . .	93.6c	62.0p	55.9p	48.3p		
Extraordinary item . . . . .	4.4c	2.9p	(10.0)p	—		
Net income . . . . .	98.0c	64.9p	45.9p	48.3p		
Net income per ordinary share, diluted:						
Income before extraordinary item . . . . .	92.6c	61.3p	55.1p	46.9p		
Extraordinary item . . . . .	4.4c	2.9p	(9.9)p	—		
Net income . . . . .	96.9c	64.2p	45.2p	46.9p		

- (1) Premiums from life investment products attributable to unit-linked (separate account) business are recorded as premium income under U.K. GAAP. Under U.S. GAAP these premiums are reported as life investment product deposits, and revenue on this business comprises only the related policy fees for cost of insurance, administration, investment management and surrenders during the period.
- (2) Under U.K. GAAP, the investment income less investment expenses and charges recognized in both the property and casualty and shareholder operations includes related realized gains (losses) on investments. The investment return reflected in the general (property and casualty) business technical account is based upon the expected longer term rate of return. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Longer Term Investment Return”.
- (3) Includes realized gains and losses.
- (4) Represents the result transferred from the general (property and casualty) business technical account and the long term (life) business technical account to the non-technical account. The general (property and casualty) business result transferred to the non-technical account includes the investment return based on

longer term investment return and not the actual net investment income and realized and unrealized gains and losses on related investments. The long term (life) business result transferred to the non-technical account represents the actuarially determined surplus released in the year after considering investment, mortality and morbidity margins in respect of non-participating companies and the shareholders' share of bonuses declared to with-profit (participating) policyholders.

- (5) The dividends per ordinary share, in accordance with U.K. GAAP, include a final dividend for each year proposed by our Board subsequent to year end which is not paid until approved by our shareholders at our annual general meeting held in May of the subsequent year. In 1999, we paid a special dividend of 48p per share. See “—Dividends”.
- (6) Investment income net of expenses and charges has been reduced and tax on profit on ordinary activities reduced by an equal amount to reflect the change in accounting policy arising from the adoption of Financial Reporting Standard 16 “Current Tax”.

Year Ended December 31,					
1999	1999	1998	1997	1996	1995
\$	£	£	£	£	£
(in millions)					

**Additional information—segmental results**

Group operating result (based on longer term investment return):					
General (property and casualty) operations . . . . .	471	312	352	683	582
Long term (life) business operations . . . . .	367	243	230	231	233
Other activities (1) . . . . .	<u>17</u>	<u>11</u>	<u>20</u>	<u>74</u>	<u>(22)</u>
Group operating result (based on longer term investment return) . . . . .	<u>855</u>	<u>566</u>	<u>602</u>	<u>988</u>	<u>793</u>
	<u>976</u>				<u>976</u>

- (1) Other activities includes the operating result from non-insurance businesses such as real estate agency, insurance broking operations and investment management business. In addition it includes the longer term investment return applied to surplus capital, central expenses, income from associated undertakings, expenses related to investment activities and short term loan interest expense.

Group operating result (based on longer term investment return) is a measure used for internal purposes in the management of our business segments. It includes the pre-tax profits of our life and asset accumulation business, our property and casualty business and other activities including the Group's share of the results of investments accounted for under the equity method. Both the property and casualty profit and the profit from other activities are determined using a longer term investment return to remove the effect of short term fluctuations in our investment portfolio. Group operating result (based on longer term investment return) is the same as group operating profit (based on long-term investment return) determined in accordance with the Association of British Insurers' SORP, but before charging the following unallocated corporate items: the change in equalization provisions, amortization of goodwill (including goodwill in acquired claims provisions), amortization of the value of long term (life) business, premium paid on the redemption of our convertible bonds, long term subordinated debt interest and reorganization costs and other movements in investments. It also excludes the profit on disposal of subsidiaries and branches. This is the result we use to measure the financial performance of our segments. It is not necessarily directly comparable to similar measurements used by other U.K. insurers. This measure differs from the profit on ordinary activities before tax, which includes each of the above items.

Group operating result (based on the longer term investment return) may not be comparable from one U.K. company to another as the method of calculation of the longer term investment return and the elements of the result that are included and excluded may differ between companies. For a discussion of longer term investment return, see “Management's Discussion and Analysis of Financial Condition and Results of Operations—Longer Term Investment Return”.

## Consolidated Balance Sheet Data

	Year Ended December 31,					
	1999	1999	1998	1997	1996	1995
	\$	£	£	£	£	£
	(in millions, except per ordinary share amounts)					
<b>Amounts in accordance with U.K. GAAP</b>						
Total investments . . . . .	74,429	49,291	48,113	44,655	41,893	41,336
Unit-linked (separate account) assets . . . . .	12,539	8,304	6,675	5,645	4,980	4,723
Total assets . . . . .	106,011	70,206	64,779	60,496	55,673	55,441
Total technical provisions (excluding linked liabilities) . . . . .	68,448	45,330	42,473	39,268	36,622	36,971
Technical provisions for linked liabilities (separate account liabilities) (1) . . . . .	12,560	8,318	6,687	5,656	4,980	4,733
Total technical provisions (gross of reinsurance) . . . . .	81,008	53,648	49,160	44,924	41,602	41,704
Fund for Future Appropriations (2) . . . . .	7,308	4,840	3,785	3,737	3,553	3,235
Long term subordinated liabilities . . . . .	921	610	—	—	—	—
Borrowings . . . . .	1,021	676	449	551	761	838
Shareholders' funds (excluding minority interest) . . . . .	9,791	6,484	7,269	7,333	6,341	6,160
Net assets per ordinary share (3) . . . . .	672c	445p	457p	464p	399p	397p
<b>Amounts in accordance with U.S. GAAP</b>						
Total investments . . . . .	67,293	44,565	43,642			
Total assets . . . . .	104,705	69,341	63,646			
Property and casualty liabilities . . . . .	28,512	18,882	15,918			
Life and asset accumulation liabilities . . . . .	43,695	28,937	28,237			
Separate account liabilities . . . . .	12,409	8,218	6,602			
Shareholders' equity . . . . .	8,941	5,921	6,515			
Net asset value per ordinary share (3) . . . . .	627c	415p	417p			

- (1) Technical provisions for linked liabilities (separate account liabilities) are stated gross of reinsurance.
- (2) Under U.K. GAAP, certain long term (life) funds include either policyholder participating, or both policyholder participating and non-participating life and asset accumulation 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 recorded in the fund for future appropriations.
- (3) Net assets per share is calculated on shareholders' funds (after excluding minority interest) and the number of ordinary shares issued at the end of the year.

## Recent Operating Results

On August 3, 2000, we announced our operating results for the six months ended June 30, 2000. The table below presents our U.K. GAAP results of operations for the six months ended June 30, 1999 and 2000. For a description of material variations in the accounting principles, practices and methods used in preparing our U.K. GAAP financial statements from U.S. GAAP, see note 48 to our consolidated financial statements and “Item 9—Management’s Discussion and Analysis of Financial Condition and Results of Operations—Summary of Significant Differences between U.K. GAAP and U.S. GAAP”. The nature of our reconciling items to U.S. GAAP has not changed significantly from our 1999 consolidated financial statements.

	<u>Six Months Ended June 30,</u>	
	<u>2000</u>	<u>1999</u>
	(£ in millions, except ratios and per ordinary share amounts)	
<b>Consolidated profit and loss account data—U.K. GAAP basis</b>		
Net premiums written:		
Property and casualty . . . . .	4,293	3,686
Life and asset accumulation . . . . .	1,750	1,561
Segmental results:		
United Kingdom . . . . .	163	168
Other Europe . . . . .	33	39
Americas . . . . .	108	94
Asia Pacific . . . . .	38	—
Total . . . . .	342	301
Other activities (1) . . . . .	(22)	14
Group operating result (based on longer term investment return) . . . . .	320	315
Interest on long term subordinated liabilities . . . . .	(27)	—
Changes in equalization provisions . . . . .	10	(5)
Amortization of goodwill . . . . .	(26)	(2)
Amortization of goodwill in acquired claims provisions . . . . .	(29)	—
Reorganization/additional integration costs . . . . .	(31)	—
Amortization of present value of acquired in force business . . . . .	(4)	(2)
Profit on disposal of subsidiaries . . . . .	2	—
Group operating profit (based on longer term investment return) . . . . .	215	306
Other movements in investments (2) . . . . .	(199)	123
Profit on ordinary activities before tax . . . . .	16	429
Tax on profit on ordinary activities . . . . .	(66)	(220)
Profit/(loss) on ordinary activities after tax . . . . .	(50)	209
Loss attributable to equity minority interests . . . . .	(7)	(21)
Profit/(loss) for the period attributable to shareholders . . . . .	(57)	188
Earnings per ordinary share . . . . .	(4.4)p	11.9p
Diluted earnings per ordinary share . . . . .	(4.4)p	11.7p

As of June 30, 2000

(£ in millions, except per ordinary  
share amounts)

**Consolidated balance sheet data—U.K. GAAP basis**

Shareholders' funds . . . . .	6,452
Net asset value per ordinary share . . . . .	460p
Interim dividend per ordinary share . . . . .	8.8p

- (1) Other activities includes the operating result from non-insurance businesses such as real estate agency and insurance broking operations and investment management business. In addition, it includes the longer term investment return applied to the surplus capital, central expenses, income from associated undertakings, expenses related to investment activities and short term loan interest expense.
- (2) Reflects the difference between the actual investment return and the longer term investment return. See “—Longer Term Investment Return”.

**Exchange Rate Information**

The following table sets forth, for the periods indicated, certain information concerning the Noon Buying Rate in New York City for cable transfers in British pounds as certified for customs purposes by the Federal Reserve Bank of New York, expressed in U.S. dollars per £1.00.

<u>Year Ended December 31,</u>	<u>High</u>	<u>Low</u>	<u>Average (1)</u>	<u>End of Period</u>
	(U.S. dollars per British pound)			
2000 (through September 15, 2000) . . . . .	1.65	1.40	1.54	1.40
1999 . . . . .	1.62	1.61	1.62	1.61
1998 . . . . .	1.72	1.61	1.66	1.66
1997 . . . . .	1.70	1.58	1.64	1.64
1996 . . . . .	1.71	1.49	1.57	1.71
1995 . . . . .	1.64	1.53	1.58	1.55

- (1) The average of the Noon Buying Rate on the last business day of each month during the relevant period.

We publish our financial statements in British pounds. Because a substantial portion of our revenues and expenses is denominated in U.S. dollars and other currencies, we have a financial reporting translation exposure attributable to fluctuations in the value of these currencies against the British pound. The rates used in the preparation of our consolidated financial statements differed from the Noon Buying Rates shown above. Refer to note 6 to our consolidated financial statements which presents the year end rates used in the preparation of our consolidated financial statements. See also “Management’s Discussion and Analysis of Financial Condition and Results of Operations” for information regarding the effects of currency fluctuation on our financial results.

**Dividends**

The payment of dividends on outstanding ordinary shares is subject to the recommendation of our Board and, with respect to the final dividend, the approval of our shareholders at a general meeting. The interim dividend is generally paid in December of each year. The declaration of the interim dividend is subject to the discretion of our Board. The final dividend is proposed by our Board after the end of the year and is reflected in our consolidated financial statements for that year in accordance with U.K. GAAP. The final dividend is generally approved at and paid after our annual general meeting held generally in May of the following year.

The table below presents dividends per ordinary share in each year indicated. The dividend information below has not been increased by the tax credit relating to the U.K. Advance Corporation Tax.

	Year Ended December 31,				
	1999	1998	1997	1996	1995
<b>Pence</b>					
Special dividend (paid) . . . . .	48.00p	—	—	—	—
Interim (paid) (1) . . . . .	8.40	7.80p	7.15p	6.50p	5.40p
Final (proposed) (2) . . . . .	16.30	15.20	13.85	12.50	10.90
Total . . . . .	<u>72.70p</u>	<u>23.00p</u>	<u>21.00p</u>	<u>19.00p</u>	<u>16.30p</u>
<b>Cents (3)</b>					
Special dividend (paid) . . . . .	77.28c	—	—	—	—
Interim (paid) . . . . .	13.52	12.90c	12.03c	10.95c	8.29c
Final (proposed) . . . . .	26.24	25.27	22.75	21.40	16.93
Total . . . . .	<u>117.04c</u>	<u>38.17c</u>	<u>34.78c</u>	<u>32.35c</u>	<u>25.22c</u>

- (1) For the 1997, 1996 and 1995 interim dividend, a scrip dividend alternative (a dividend reinvestment plan) was in place. The actual amount paid depended on acceptances of the scrip dividend offer. The amount over-provided in respect of acceptances received is subsequently added back to shareholders' funds. The scrip amount added back to shareholders' funds was £47 million in 1997, £15 million in 1996 and £10 million in 1995.
- (2) The dividends presented above are reported in accordance with U.K. GAAP. Under U.K. GAAP dividends are recorded when proposed by the Board but prior to the approval by the shareholders, at which time the dividends are declared and subsequently paid.
- (3) Solely for the convenience of U.S. investors, we have translated the historical interim dividend amounts per ordinary share into U.S. dollars at the Noon Buying Rates on the respective dividend payment dates, or on the following business day if such date was not a business day in the United Kingdom or the United States. Final (proposed) dividends have been translated at the Noon Buying Rates on December 31 of each year.

## **ITEM 9. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*You should read the following discussion and analysis in conjunction with our consolidated financial statements and the related notes to those financial statements. Our consolidated financial statements have been prepared in accordance with U.K. GAAP, which differs significantly from U.S. GAAP. A summary of significant differences between U.K. GAAP and U.S. GAAP is included in note 48 to our consolidated financial statements. You should read the information under "Forward-Looking Statements" for information about our presentation of forward-looking information.*

### **Overview**

We are one of the world's leading global insurers. We have operations in over 50 countries and cover risks in over 130 countries, thus possessing one of the few truly global networks in the industry. We offer a broad range of property and casualty insurance, life insurance, asset accumulation products and related services to both businesses and individuals.

We are the product of the 1996 merger of two of the then largest U.K. insurers writing both life and property and casualty business, Royal Insurance Holdings plc and Sun Alliance Group plc. Following the merger, we began the major task of integrating our operations and other fundamental business objectives such as growth strategy, approach to risk, investment policies, capital management, reserving policies and methods of accounting and reporting. The merger enabled us to significantly increase our operating and distribution capabilities in the U.K. market and provided a strong base for global expansion and participation in the consolidating global insurance market. Since the merger, we have built on our size, underwriting and investment management expertise, product strength and capital base to transform ourselves from a U.K. insurer with overseas operations into a global enterprise headquartered in the United Kingdom.

Expense reduction was one rationale for the merger in 1996, and having achieved our targeted cost savings we are now reviewing our businesses to obtain additional ongoing operational efficiencies. In particular, we believe that our ongoing review of our operations in the United Kingdom and the commercial business reorganization implemented in the United States in 2000 will produce further cost savings.

To assist us in evaluating our current businesses and strategic opportunities, we introduced a risk-based capital assessment model in 1998 as our core measure of financial performance. This approach allows us to measure better the relative profitability of our component businesses and to set clear performance targets across our operations, better identifying those operations that we should expand and those that we should review or contract. In addition to evaluating the overall direction of our business, our risk-based capital model also enables us to make specific underwriting and investment management decisions based on returns on capital.

One feature of this approach that gives particular benefit to the worldwide Group is the advantage that is gained through having a diversified risk portfolio. The diversification of risk that arises from having operations in over 50 countries and writing both personal and commercial lines is that less capital is required to support these risks than if they were all concentrated in a limited number of territories or classes of business. We believe that as a consequence of diversification, we can achieve better returns on risk-based capital.

### **Industry Conditions**

A variety of factors continue to affect the insurance industry's outlook and profitability, including:

- fluctuations in interest rates and other changes in the economic environment that affect market prices of investments and investment returns on those investments;

- competitive pricing pressures affecting the property and casualty operations;
- consolidation of the industry;
- the frequency, severity, and development of insured loss events, including natural and other disasters (such as hurricanes, windstorms, earthquakes, floods, fires and explosions and other catastrophic events), the frequency and severity of which are inherently unpredictable;
- changes in demographics, particularly the aging of the population;
- thinning of profit margins in life and asset accumulation business; and
- the regulatory and tax environment.

#### *Interest rate and equity market fluctuations*

Over the past several years, movements in both short and long term interest rates have affected the level of gains and losses on securities. Generally, a sustained period of lower interest rates will reduce the investment income yield of our investment portfolio over time as higher-yielding investments are called, mature or sold and proceeds are reinvested at lower rates. However, declining interest rates will generally increase unrealized gains, as well as realized gains to the extent securities are sold. Conversely, a sustained period of rising interest rates will increase the investment income yield on the portfolio over time but will generally lead to a reduction in unrealized gains.

The various equity markets around the world can produce highly volatile and significantly varied results. Over the last several years, stock market conditions have been buoyant, with most stock exchanges world-wide achieving record highs, due in part to the decline in interest rates in principal markets, lower inflation levels and the convergence of European economies in preparation for the introduction of the euro. Although equity markets in the United Kingdom and the United States have fluctuated significantly, particularly in 2000, they have produced strong results overall over the last several years. In certain emerging markets of the world, there have been substantial declines in the value of equity markets over the past several years. Equity securities make up a significant portion of our investment portfolios, although we have limited exposure to equity securities in emerging markets. The volatility of the investment markets impacts our investment performance. We seek to minimize interest rate and equity market fluctuations through the diversification of our investment portfolio, developed as a result of the geographic spread of our insurance businesses and the corresponding strategy of matching assets and liabilities to the extent possible by currency and maturity.

Fluctuations in interest rates and returns from equity markets also impact consumer behavior, especially in the life and asset accumulation businesses, where demand for fixed income products, such as fixed-return pension products, may decline when interest rates fall and equity markets are performing well.

#### *Property and casualty pricing conditions*

The property and casualty insurance industry historically has been cyclical, characterized by periods of price competition due to excessive underwriting capacity as well as periods where shortages of underwriting capacity have permitted favorable price levels. The property and casualty insurance industry is highly competitive in the areas of price, service, product offerings, agent relationships and, in the case of personal lines property and casualty business, method of distribution. In addition, an increasing level of commercial risk is now covered by large deductibles, risk purchasing groups, risk-retention groups and captive companies (in-house self-insurance programs). Partially offsetting the negative impact on pricing, the low inflation rates of recent years have had a favorable impact on claims costs and the development of loss reserves.

Our property and casualty business operations generate operating results that may vary significantly from year to year depending on the occurrence of natural and other disasters (such as hurricanes, windstorms,

earthquakes, floods, fires and explosions and other catastrophic events), the frequency and severity of which are inherently unpredictable. Therefore, we have established risk management procedures to manage and reduce our risk from potential significant fluctuations in operating results due to natural and other disasters.

Recently, the property and casualty insurance market has experienced depressed returns due to increased weather claims and other losses. Historically, such conditions have prompted a return to more adequate pricing levels. As an example, we have seen price firming in U.K. personal automobile lines in the second half of 1998, which has continued into 1999 and 2000. In the commercial lines market, we have seen a slowing rate of decline in those areas where prices are still in decline, and increases taking hold for selective classes of business in the United Kingdom and United States in 1999, such as commercial automobile.

### *Consolidation*

The consolidation trend observed in recent years among the world's insurers is expected to continue for the foreseeable future. Consolidation is occurring for many reasons, including:

- achieving market expansion;
- increasing revenues and achieving critical mass;
- diversifying lines of business;
- expanding distribution channels; and
- securing cost and other operational synergies.

The result of this consolidation trend is increasing pressures on companies to reduce costs and increase brand recognition. In addition to the consolidation trend, new competitors have entered the market, such as banks selling personal lines, primarily automobile and household insurance and investment and savings vehicles.

### *Changes in demographics*

Demographic studies suggest that over the next decade there will be growth in the number of individuals who enter the age group that we believe is most likely to purchase retirement-oriented life insurance products in many of our life insurance markets. Additionally, in a number of European and other markets retirement, medical and other social benefits previously provided by state governments have been, or are expected in the coming years to be, curtailed or limited. We believe these factors will increase opportunities for private sector providers of life insurance, health, pension and other social benefits-related insurance products. We believe that our insurance distribution networks, the quality and diversity of our products and our management expertise in many of these markets place our businesses in the position to benefit from these demographic developments.

### *Profit margins in life and asset accumulation business*

The life industry has seen a significant change in the mix of business and, more particularly, the profit margins it is able to achieve. This is attributable to a number of factors. In the United Kingdom, increased requirements to disclose the charges against premium and accumulated funds for commissions and other costs have highlighted the similarities between savings-related life products and unit trust/mutual funds. This in turn has applied pressure on the life industry to reduce its margins to bring them more into line with the unit trust/mutual funds market. Increased scrutiny by consumers and regulators of disclosure and advice given to customers has increased the costs of distribution. In the market for life insurance risk products such as term insurance, improving mortality experience has encouraged new entrants into the market which has also led to increased price competition.

The above factors are particularly relevant to the profitability of new business. The profit arising from the U.K. life operations that is included in the operating result for the current year is principally comprised of profits emerging on existing business from prior years together with the investment return earned on the shareholders' capital committed to the life business. The reduced level of new business profit margin will not have an immediate impact on our reported life profits, but will affect these profits over time. The reported life operating result will more immediately be affected by a decline in interest rates and the consequent reduction in investment returns.

A significant element of the emerging profit relates to with-profits policies. The profit represents the shareholders' share of the bonuses (or dividends) allocated to policyholders. The bonuses are determined by an actuarial valuation and generally accrue over the policy period.

#### *Regulatory and tax environment*

Our insurance business is subject to detailed regulation in all the jurisdictions in which we do business. Regulation includes compliance with applicable laws covering training competencies, selling practices, operating and reporting requirements, monitoring of solvency and reserves, and asset valuation.

Since 1994, the regulator of the U.K. financial services industry has required insurers to review certain past business sold through their representatives (exclusive agencies and direct sales forces) involving personal pension products offered by the insurer. An insurer must provide compensation when it is determined that an individual was inappropriately advised by a representative of the insurer, to transfer pension funds from an employer sponsored scheme to a personal pension plan, or when inappropriately advised to purchase a personal pension plan instead of joining an employer sponsored scheme. U.K. insurers, including our U.K. life insurance companies, have established provisions for future review and compensation costs; however, it is not yet possible to definitely assess the cost to the U.K. insurance industry or to our U.K. life companies of such review and compensation. This review, including a similar one related to additional voluntary contributions, has been scheduled for completion by the regulator by June 2002. Our U.K. Life operation is currently on schedule to meet this target.

The regulator of the U.K. financial services industry has asked all U.K. insurers to contact policyholders who effected mortgage endowment policies to cover the repayment of an interest-only mortgage. A significant proportion of these policies were sold in the late 1980s and early 1990s, when inflation and investment returns were higher than today's environment. In the course of this exercise, U.K. insurers will provide policyholders with projections of the range of likely maturity proceeds from their policies, assuming a continuation of the current level of inflation and investment returns. This exercise is due to be completed by June 2001, in line with the timetable set down by the regulator.

The Finance Act 2000 introduced the discounting of claims reserves for U.K. tax purposes, commencing with reserve balances as of December 31, 2000. Detailed regulations have yet to be published and it is not possible at this stage to quantify the effect of the new legislation although the legislation is likely to increase the amount of our current tax payable.

The Finance Act 2000 also introduced changes to the methodology of claiming relief for foreign tax against U.K. corporation tax. The impact of these changes is likely to be additional U.K. tax of £4 million annually.

The Australian federal government is introducing changes to the existing tax arrangements for life insurers. Under these changes, the first part of which is effective from July 1, 2000, the tax-advantaged treatment of life insurance and savings products has been removed on a transitional basis. Like many in the Australian life industry, we are still assessing the impact of these changes on our life insurance, superannuation and retail funds management businesses. These tax reforms will increase the tax burden of life insurers in

Australia and may have a consequential negative impact on our embedded values and future sales of life and asset accumulation products.

### **Exchange Rate Fluctuations**

We publish our consolidated financial statements in British pounds. A large portion of our consolidated revenues and expenses are denominated in currencies other than the British pound, primarily the U.S. dollar, Australian dollar, Canadian dollar, and Danish kroner. Fluctuations in the exchange rates used to translate these currencies into British pounds have had, and can be expected in the future to have, an impact on our reported results from year to year. We seek to mitigate this impact by investing in assets denominated in the same currencies and maturities as our corresponding insurance liabilities.

In preparing our consolidated financial statements, we use year-end exchange rates to translate balance sheet and profit and loss account items not denominated in British pounds. See note 6 to our consolidated financial statements for the rates of exchange into British pounds used in translating amounts in our consolidated financial statements.

### **Capital Management**

The capital requirements of an insurance company are determined by its exposure to risk and the solvency criteria established by management and statutory requirements. During 1998, we adopted a new risk-based capital model for:

- determining our capital requirements;
- setting return targets for our regional operations; and
- establishing incentive plans for management.

Our risk-based capital model is designed to produce different capital requirements depending on the policies applied to the business, particularly investment and reinsurance policy. In employing our risk-based capital model, we used our present reinsurance and investment policies. For property and casualty business our policy is to invest 100% of capital and 5% of insurance reserves in equity securities, with the remaining 95% of insurance reserves invested in fixed income securities after funding working capital. Modeling the various policy scenarios indicates that this investment mix, combined with our current reinsurance program, maximizes our expected Return on Capital Employed. However, this requires more capital than other possible investment policies. Accordingly, we may, over time reduce our exposure to equities and change the reinsurance program to eliminate volatility in the underwriting result and thus lower our capital requirements.

Our risk-based capital methodology has been applied to individual lines of business as well as territories and regions. It has also been applied retrospectively to 1998, 1997 and 1996 to determine notional capital allocations for internal comparisons.

The risk-based capital for each of our time-zone-based regions has been calculated using the same methodology as for the Group. However, the sum of the capital requirements for each region, calculated as if each was a separate entity, and based on the same solvency criteria (99% confidence of solvency not falling below 25% of net premiums written over a prospective five year period) is greater than that required for the Group as a whole. The difference between the two is the diversification benefit generated by the additional spread of risk in the Group.

The table below presents the capital allocated to our property and casualty businesses as of December 31, 1999.

### Allocation of Capital

	<b>Risk-Based Capital Requirement</b>
	<b>(£ in millions)</b>
United Kingdom . . . . .	1,301
Other Europe . . . . .	782
Americas . . . . .	886
Asia Pacific . . . . .	396

For the with-profit life and asset accumulation business in the United Kingdom, capital is in effect provided jointly by policyholders and shareholders. The combined surplus is, therefore, not available for other purposes and will only be released to policyholders and shareholders through the declaration of bonuses. Therefore, we treat actual capital employed by the operations as our capital requirement for this business. For those life businesses that do not have policyholder participation, notably our U.K. unit-linked insurance subsidiary as well as other non-insurance businesses, the capital employed in the business is generally based on the local statutory capital requirement and is therefore reasonable to use as a risk-based capital measure.

The aggregate risk-based capital requirement for the Group as of December 31, 1999 was estimated to be £6,141 million. The total actual capital, after deducting goodwill including goodwill in claims acquired, deferred tax and after adding back the equalization provisions, was £6,275 million. The actual capital includes £610 million of long term subordinated debt.

Our post-tax nominal return on equity for 1999 was 9%. Despite this reduced return the annual average post-tax nominal return over the past five years was 19%. The annual average post-tax nominal return is calculated after adding back all dividends and capital movements such as the issuance or redemption of our share capital and providing in full for deferred tax liabilities on unrealized gains. The return is expressed as a percentage of our shareholders' funds at the beginning of the period.

### Longer Term Investment Return

The Association of British Insurers (the U.K. insurance industry trade association) Statement of Recommended Practice on Accounting for Insurance Business ("SORP") published in December 1998 introduced major changes in insurance accounting particularly in respect of investments. The SORP requires all investment capital gains and losses on assets backing property and casualty business and shareholder funds to be reflected in the consolidated profit and loss account. To avoid the distortions of short term market value movements, the SORP also recommends that U.K. insurers present a calculation of operating result including an allocated investment return which we refer to as longer term investment return. We use this method as the basis on which we monitor the performance of our business segments.

We have adopted this measure of Group operating result (based on longer term investment return) to bring the reporting of our property and casualty business into line with our risk-based capital measure of financial performance. Accordingly, we measure the performance of our operations by adding:

- underwriting result, excluding the change in the equalization provision; plus
- longer term investment return on assets backing property and casualty insurance liabilities; plus

- longer term investment return on risk-based capital supporting the property and casualty business; less
- certain corporate operating expenses not allocated to our segments.

The difference between Group operating result (based on longer term investment return) and profit before tax is principally attributable to:

- the balance of the movement in investments between that generated by the longer term investment return and actual investment income and investment gains and losses, both realized and unrealized on a market value basis;
- the change in the claims equalization provisions;
- reorganization costs, amortization of goodwill (including goodwill in acquired claims provisions), amortization of the value of long term business and long term subordinated debt interest; and
- profit on disposal of subsidiaries and branches.

See “—Consolidated Results of Operations” for a detailed analysis of the items and amounts comprising the differences between Group operating result (based on longer term investment return) and profit before tax.

A consequence of this approach is that the property and casualty Group operating result (based on longer term investment return) will represent the pre-tax return on risk-based capital for this part of the business. We estimated the longer term investment return by reviewing investment market performance since 1918. Based on this analysis, we set the longer term investment return assuming a risk free rate of 3%, equity risk premium of 3% and inflation of 3% per year. We believe this rate reflects the aggregate actual return on our investments over the longer term and our expectations for investment returns.

The longer term rate of return is set taking into account the investment policy of the Group reflecting a combination of historical experience and current market expectations for each geographical area and category of investments along with other political and economic factors. The longer term rate is set with an anticipation that longer term returns credited to operating results will not consistently exceed or fall below actual returns being earned. Rates will be reviewed annually and any downturns in our expectations of the longer term returns will be recognized immediately by reducing the assumed rate of return.

The following measures our actual investment returns as compared to longer term investment returns for the years ended December 31, 1994 through December 31, 1999. Over the last six years the aggregate of the actual movements has exceeded those calculated using the longer term rate of return however the longer term return in 1994 and 1999 exceeded actual returns.

### Total Investment Return

	<u>Actual</u>	<u>Longer Term</u>
	(£ in billions)	
1994 .....	0	1.0
1995 .....	2.3	1.1
1996 .....	1.4	1.1
1997 .....	2.1	1.1
1998 .....	1.6	1.1
1999 .....	<u>1.0</u>	<u>1.1</u>
Total .....	<u>8.4</u>	<u>6.5</u>

Total actual investment return includes investment income less investment expenses and related charges, realized gains and losses and unrealized gains and losses. The excess of actual over longer term over the last six years reflects the favorable investment climate that has generally prevailed during that period.

A similar basis of calculation has been applied to both the shareholders' funds attributable to our life business and any capital that is not required to support our property and casualty and life operations on a risk-based approach. The income resulting from the longer term rate of investment return applied to the balance of capital is included in Other Activities. In calculating this return, the pre-tax long term investment returns above are applied to the adjusted average values of the various categories of investment. The investment values taken are market prices, adjusted in situations where unusual market conditions existed during the valuation period. Thus at the end of 1999, 1998 and 1997, the actual market values were reduced in the calculation of the long term return to reflect the disparity between the market yields at that time and the longer term yields. This normalization adjustment is based on longer term yield assumptions and produces an effective return as follows:

	<u>Stated long term return</u>	<u>Effective return</u>
Equities . . . . .	9%	6.8%
Fixed interest . . . . .	6%	6.0%

**Comparability of Results**

The following section contains financial information prepared using the longer term investment return measure of Group operating result. See “—Longer Term Investment Return”. In addition, certain financial information has been further segmented by region and between personal and commercial business lines reflecting how we currently present our financial performance. These bases of presentation were introduced in 1998. We have restated our 1997 and 1996 financial information on a similar basis in order to provide you with a basis for meaningful comparison. The product segment results and geographic segment results contained in the “Description of Business” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” sections, including the tables therein, contain certain information that is not extracted from or derived from audited financial statements and is derived from our books and records based upon our best estimates and overall knowledge of our business, and include adjustments that we believe are appropriate to reflect a true and fair view of the product segment results and geographic segment results for the periods indicated.

## Recent Operating Results

On August 3, 2000, we announced our operating results for the six months ended June 30, 2000. The table below presents our U.K. GAAP results of operations for the six months ended June 30, 1999 and 2000. For a description of material variations in the accounting principles, practices and methods used in preparing our U.K. GAAP financial statements from U.S. GAAP, see note 48 to our consolidated financial statements and “—Summary of Significant Differences between U.K. GAAP and U.S. GAAP”. The nature of our reconciling items to U.S. GAAP has not changed significantly from our 1999 consolidated financial statements.

	<u>Six Months Ended June 30,</u>	
	<u>2000</u>	<u>1999</u>
	(£ in millions, except ratios and per ordinary share amounts)	
<b>Consolidated profit and loss account data—U.K. GAAP basis</b>		
Net premiums written:		
Property and casualty . . . . .	4,293	3,686
Life and asset accumulation . . . . .	1,750	1,561
Segmental results:		
United Kingdom . . . . .	163	168
Other Europe . . . . .	33	39
Americas . . . . .	108	94
Asia Pacific . . . . .	38	—
Total . . . . .	342	301
Other activities (1) . . . . .	(22)	14
Group operating result (based on longer term investment return) . . . . .	320	315
Interest on long term subordinated liabilities . . . . .	(27)	—
Changes in equalization provisions . . . . .	10	(5)
Amortization of goodwill . . . . .	(26)	(2)
Amortization of goodwill in acquired claims provisions . . . . .	(29)	—
Reorganization/additional integration costs . . . . .	(31)	—
Amortization of present value of acquired in force business . . . . .	(4)	(2)
Profit on disposal of subsidiaries . . . . .	2	—
Group operating profit (based on longer term investment return) . . . . .	215	306
Other movements in investments (2) . . . . .	(199)	123
Profit on ordinary activities before tax . . . . .	16	429
Tax on profit on ordinary activities . . . . .	(66)	(220)
Profit / (loss) on ordinary activities after tax . . . . .	(50)	209
Loss attributable to equity minority interests . . . . .	(7)	(21)
Profit / (loss) for the period attributable to shareholders . . . . .	(57)	188
Earnings per ordinary share . . . . .	(4.4)p	11.9 p
Diluted earnings per ordinary share . . . . .	(4.4)p	11.7 p

- (1) Other activities includes the operating result from non-insurance businesses such as real estate agency and insurance broking operations and investment management business. In addition, it includes the longer term investment return applied to the surplus capital, central expenses, income from associated undertakings, expenses related to investment activities and short term loan interest expense.
- (2) Reflects the difference between the actual investment return and the longer term investment return. See “—Longer Term Investment Return”.

*Six months ended June 30, 2000 compared to six months ended June 30, 1999*

*United Kingdom*

Our United Kingdom region accounted for £163 million, or 50.9%, of our Group operating result (based on longer term investment return) in the first six months of 2000 as compared to £168 million, or 53.3%, in the first six months of 1999. The decrease in the United Kingdom segment operating result (based on longer term investment return) reflects the combined effect of a £5 million increase in property and casualty business operating result (based on longer term investment return) and a £10 million decrease in life and asset accumulation operating result.

The property and casualty business operating result (based on longer term investment return) was negatively impacted by £18 million due largely to the strengthening of the Group reinsurance protection program the results of which are included in our United Kingdom segment. This strengthening is designed to protect against catastrophe losses in 2000. Excluding the impact of the strengthening of the Group reinsurance protection program, property and casualty business operating result (based on longer term investment return) increased by £23 million. This was due to an improvement in the U.K. property and casualty business arising particularly from improved results in personal automobile and household business and from commercial property business.

Our life and asset accumulation operating result for the interim period is estimated based on the expected profit for the year, as bonuses are declared once a year. The profit at June 30, 1999 was £10 million more than half the annual 1999 profit and this accounts for the reduction in profit for the 2000 interim period compared to the 1999 interim period.

*Other Europe*

Our Other Europe region accounted for £33 million, or 10.3%, of our Group operating result (based on longer term investment return) in the first six months of 2000 as compared to £39 million, or 12.4%, in the first six months of 1999. The decrease in Other Europe segment operating result (based on longer term investment return) reflects the combined effect of a £8 million decrease in property and casualty business operating result (based on longer term investment return) and a £2 million increase in life and asset accumulation operating result.

Our Other Europe property and casualty business operating result (based on longer term investment return) decreased to £18 million from £26 million. Claims inflation in Scandinavia, as a result of December 1999 storms, adversely affected the result. In both Spain and Italy, our automobile business showed positive signs in response to increased prices and stricter underwriting controls. As a result, our underwriting losses in Italy declined £7 million to £15 million and our underwriting losses in Spain declined £4 million to £10 million in the first six months of 2000 as compared to the comparable period in 1999. However, further rate increases in Italy may be limited by recent legislation that freezes Italian automobile rates until May 31, 2001.

*Americas*

Our Americas region accounted for £108 million, or 33.8%, of our Group operating result (based on longer term investment return) in the first six months of 2000 as compared to £94 million, or 29.8%, in the first six months of 1999. The increase in Americas segment operating result (based on longer term investment return) reflects the combined effect of a £25 million increase in property and casualty business operating result (based on longer term investment return) and a £11 million decrease in life and asset accumulation operating result.

The improvement in the property and casualty business operating result (based on longer term investment return) was due primarily to the contribution of £31 million from Orion. The results from Orion were first included in December 1999. There was also an improvement in Latin America and the Caribbean of

£7 million due to reduced catastrophe losses compared with 1999. In the United States, excluding Orion, our property and casualty underwriting result reduced by £12 million primarily due to a deterioration in the result in workers' compensation and auto lines.

The decrease in life and asset accumulation operating result was due to the disposal of our U.S. life operations in 1999, which accounted for a £10 million reduction. In addition, the acquisition of La Construcción in Chile made a positive contribution of £7 million offsetting a reduction of £8 million in the result from Canada. The result for Canada for the first six months of 1999 included a £6 million nonrecurring benefit from the release of participating fund assets that was approved by the Canadian regulators.

#### *Asia Pacific*

Our Asia Pacific region accounted for £38 million, or 11.9%, of our Group operating result (based on longer term investment return) in the first six months of 2000 as compared to nil in the first six months of 1999. The increase in Asia Pacific segment operating result (based on longer term investment return) reflects the combined effect of a £28 million increase in property and casualty business operating result (based on longer term investment return) and a £10 million increase in life and asset accumulation operating result.

The improvement in the property and casualty business operating result (based on longer term investment return) is made up of £20 million improvement in the Australian result with a strong recovery in both personal and commercial business partly supported by the absence of catastrophe costs suffered in 1999 from the Sydney hailstorm.

The improvement in life and asset accumulation operating result was supported by the contribution of £5 million from Tyndall which we acquired in 1999.

#### *Net premiums written*

Property and casualty net premiums written increased by £607 million, or 16%, to £4,293 million in the first six months of 2000 from £3,686 million in the first six months of 1999. On a constant exchange rate basis, net premiums written increased by 17%. This increase is due primarily to our acquisitions of Orion and Trygg-Hansa in 1999. Premium rates have increased significantly across many lines, such as our commercial lines in the United States and Australia, but this has been offset by the loss of premiums resulting from remedial action that continues to be undertaken on our under-performing lines. Property and casualty net premiums written in the United Kingdom, for example, decreased £104 million, or 6%, due to double digit rate increases in our automobile and risk managed accounts that resulted in a loss of some business.

Life and asset accumulation net premiums written increased by £189 million, or 12%, to £1,750 million in the first six months of 2000 from £1,561 million in the first six months of 1999. On a constant exchange rate basis, net premiums written increased by 13%. The impact of our withdrawal from the exclusive agency and direct sales channels in the United Kingdom and the sale of our U.S. life business in 1999 have been offset by growth in U.K. sales through IFAs and the acquisitions of Tyndall in Australia and La Construcción in Chile.

On a constant exchange rate basis, new business annual premium equivalent increased 3% reflecting a 15% decrease in periodic premium and 25% increase in single premium business. The increase was primarily due to the inclusion of Canadian investment sales within single premium sales reflecting the insurance element within the contracts.

#### *Group operating result (based on longer term investment return)*

Group operating result (based on longer term investment return) increased by £5 million, or 2%, to £320 million in the first six months of 2000 from £315 million in the first six months of 1999. This increase

was due to a £50 million increase in our property and casualty operating result (based on longer term investment return) partly offset by a £9 million decrease in our life operating result (based on longer term investment return) and a £36 million worsening in the results of other activities. Our property and casualty operating result (based on longer term investment return) increased due to improved combined ratios in the United Kingdom, the Americas and Asia Pacific that were partly offset by deterioration in Other Europe and costs associated with the strengthening of our group reinsurance protection program described above.

Our life and asset accumulation operating result declined primarily due to the disposal of our U.S. life operations which contributed £10 million to profit in the first half of 1999 as well as a one-time release of profit in Canada in our life fund in 1999 and a decline in Canadian realized investment gains. These declines were partly offset by the acquisitions of Tyndall and La Construcción which contributed £9 million to our life operating result in the first six months of 2000. In 1999, the other activities result included investment returns of £39 million on surplus capital. Due to the acquisition of Orion and Trygg-Hansa, we now allocate this capital to our property and casualty operations. Accordingly, the investment return on this capital in the first six months of 2000 is reported in our property and casualty operating result (based on longer term investment return) rather than in other activities, thereby reducing our other activities result.

*Profit on ordinary activities before tax*

Profit on ordinary activities before tax decreased £413 million to £16 million in the first six months of 2000 from £429 million in the first six months of 1999. The Group operating result (based on longer term investment return) increased by £5 million as discussed above. The decrease in profit on ordinary activities before tax was due to other movements in investments, interest on long term subordinated liabilities, changes in equalization provisions, and other items described below. During 1999, we issued subordinated U.S. Dollar and Euro bonds to provide additional capital to assist in the financing of the acquisitions of Orion and Trygg-Hansa. We treat long term subordinated liabilities as part of our capital base. Accordingly, we treat interest on these subordinated liabilities of £27 million as a financing item and do not deduct it in arriving at Group operating result (based on longer term investment return). The change in equalization provisions was a reduction of £10 million in the first six months to 2000 compared to an increase of £5 million in the first six months of 1999 bringing the total equalization provision to £249 million. Claims equalization provisions are established in a number of countries in accordance with local regulatory requirements. They represent a provision over and above the liability for outstanding claims and accordingly are excluded from operating result (based on longer term investment return).

Other items affecting profit on ordinary activities before tax include amortization of goodwill of £26 million attributable mainly to our acquisition of Orion, Trygg-Hansa and Tyndall during 1999. In addition, under U.K. GAAP the fair value of general (property and casualty) business claims provision relating to businesses acquired is established after making allowance for future investment income and the resulting discount is amortized to the profit and loss account over the expected run-off period of the related claims. The charge of £29 million relates to Orion and Trygg-Hansa.

Reorganization costs were £31 million in the first six months of 2000. These costs principally arose in America and Scandinavia. The present value of in-force business existing at acquisition is amortized in the long term technical account over the anticipated periods of the related contracts in the portfolios in arriving at profit on ordinary activities before tax. Profit on disposal of subsidiaries, which we exclude from Group operating results (based on longer term investment return) was £2 million in the first six months of 2000 compared with nil in the first six months of 1999.

Other movements in investments represents the difference between the total actual investment return and longer term investment return. See “—Longer Term Investment Return” for a description of total actual investment return and longer term investment return. In the first six months of 2000 total actual investment return of £369 million was below the first six months 2000 longer term investment return of £568 million

resulting in a deficit in other movements of £199 million. The deficit in other movements in investments is due primarily to the fall in the value of equities during the first six months of 2000 which resulted in actual returns being less than those assumed on a longer term investment return basis.

*Profit attributable to shareholders*

Taxation on profit on ordinary activities decreased £154 million, or 70%, to £66 million in the first six months of 2000 from £220 million in the first six months of 1999. This represents an effective tax rate of 412% compared with the prevailing U.K. corporation tax rate for 2000 of 30%. Under U.K. GAAP full deferred tax provision is not made for unrealized gains. The difference in tax charge is due primarily to the high level of realized investment gains from sales of equities not covered by deferred tax provisions in prior years. Under U.K. accounting principles, the tax arising on an investment gain is only recognized either when the gain is realized or when realizations giving rise to a taxation liability are anticipated in the foreseeable future.

Loss attributable to shareholders in the first six months of 2000 was £57 million, a decrease of £245 million from the profit of £188 million in the first six months of 1999 due to the factors described above.

## Consolidated Results of Operations

The table below presents our U.K. GAAP consolidated results of operations for 1999, 1998 and 1997. U.K. GAAP differs significantly from U.S. GAAP. A reconciliation of the differences between U.K. GAAP and U.S. GAAP consolidated net income is included in note 48 of the consolidated financial statements.

	<u>Year Ended December 31,</u>		
	<u>1999</u>	<u>1998</u>	<u>1997</u>
	(£ in millions, except ratios)		
Net premiums written:			
Property and casualty . . . . .	7,159	6,867	6,634
Life and asset accumulation . . . . .	3,284	2,856	2,591
Segmental results:			
United Kingdom . . . . .	316	371	592
Other Europe . . . . .	45	(12)	4
Americas . . . . .	191	211	251
Asia Pacific . . . . .	3	12	67
Total . . . . .	555	582	914
Other activities (1) . . . . .	11	20	74
Group operating result (based on longer term investment return) . . . . .	566	602	988
Interest on long term subordinated liabilities . . . . .	(10)	—	—
Changes in equalization provisions . . . . .	(12)	(51)	(84)
Amortization of goodwill . . . . .	(14)	—	—
Amortization of goodwill in acquired claims provisions . . . . .	(12)	—	—
Premium on redemption of long term subordinated liabilities and convertible bonds . . . . .	(14)	(142)	—
Reorganization/additional integration costs . . . . .	(52)	(13)	(64)
Amortization of present value of acquired in force business . . . . .	(4)	—	—
Profit on disposal of subsidiaries . . . . .	10	5	3
Group operating profit (based on longer term investment return) . . . . .	458	401	843
Other movements in investments (2) . . . . .	(80)	463	967
Profit on ordinary activities before tax . . . . .	378	864	1,810
Tax on profit on ordinary activities . . . . .	(270)	(374)	(354)
Profit on ordinary activities after tax . . . . .	108	490	1,456
Profit attributable to equity minority interests . . . . .	(21)	(33)	(40)
Profit for the year attributable to shareholders . . . . .	87	457	1,416

(1) Other activities includes the operating result from non-insurance businesses such as real estate agency and insurance broking operations and investment management business. In addition it includes the longer term investment return applied to the surplus capital, central expenses, income from associated undertakings, expenses related to investment activities and short term loan interest expense.

(2) Reflects the difference between the actual investment return and the longer term investment return. See “—Longer Term Investment Return”.

*Year ended December 31, 1999 compared to year ended December 31, 1998*

*United Kingdom*

Our United Kingdom region accounted for £316 million, or 55.9%, of our Group operating result (based on longer term investment return) in 1999 as compared to £371 million, or 61.6%, in 1998. The decrease in the United Kingdom segment operating result (based on longer term investment return) reflects the combined effect of a £48 million, or 24.1%, decrease in property and casualty business operating result (based on longer term investment return) and a £7 million, or 4.1%, decrease in life and asset accumulation operating result.

*Other Europe*

Our Other Europe region accounted for £45 million, or 8.0%, of our Group operating result (based on longer term investment return) in 1999 as compared to a £12 million loss in 1998. The increase in Other Europe segment operating result (based on longer term investment return) reflects the combined effect of a £64 million, increase in property and casualty business operating result (based on longer term investment return) offset by a £7 million, or 26.9%, decrease in life and asset accumulation operating result.

*Americas*

Our Americas region accounted for £191 million, or 33.7%, of our Group operating result (based on longer term investment return) in 1999 as compared to £211 million, or 35.0%, in 1998. The decrease in Americas segment operating result (based on longer term investment return) reflects the combined effect of a £28 million, or 15.2%, decrease in property and casualty business operating result (based on longer term investment return) and a £8 million, or 29.6%, increase in life and asset accumulation operating result.

*Asia Pacific*

Our Asia Pacific region accounted for £3 million, or 0.5%, of our Group operating result (based on longer term investment return) in 1999 as compared to £12 million, or 2.0%, in 1998. The decrease in Asia Pacific segment operating result (based on longer term investment return) reflects the combined effect of a £28 million decrease in property and casualty business operating result (based on longer term investment return) and a £19 million increase in life and asset accumulation operating result.

*Net premiums written*

Property and casualty net premiums written increased by £292 million, or 4.3%, to £7,159 million in 1999 from £6,867 million in 1998. On a constant exchange rate basis, net premiums written increased £334 million, or 5.0%. This increase was primarily due to increases in net premiums written in Americas of £273 million, or 17.7%, to £1,817 million in 1999 from £1,544 million in 1998, Asia Pacific of £187 million, or 32.6%, to £761 million in 1999 from £574 million in 1998 and Other Europe of £44 million, or 3.2%, to £1,440 million in 1999 from £1,396 million in 1998. These increases in net premiums written were mainly due to the acquisitions of Trygg-Hansa and Orion during the year. However, they were partially offset by a decrease in net premiums written in the United Kingdom of £212 million, or 6.3%, to £3,141 million in 1999 from £3,353 million in 1998.

Life and asset accumulation net premiums written increased by £428 million, or 15.0%, to £3,284 million in 1999 from £2,856 million in 1998. This increase was primarily due to an increase in single premium business of £447 million.

On a constant exchange rate basis, new business annual premium equivalent increased 22.6% reflecting a 13.8% increase in periodic premium and 38.5% increase in single premium business. The increase

was primarily in the United Kingdom and Other Europe and was attributable to increased sales of single premium products, which increased by 34.4% in the United Kingdom and 50.4% in Other Europe over the period. Volume increases were concentrated in investment based products, which have lower margins than with-profits products.

*Group operating result (based on longer term investment return)*

Group operating result (based on longer term investment return) decreased £36 million, or 6%, to £566 million in 1999 from £602 million in 1998. This decline was principally due to increases in property and casualty underwriting losses in our U.K., Americas and Asia Pacific regions, as a result of significant worldwide weather and commercial claims in 1999. The majority of the increased underwriting losses occurred in the Americas, where our operating result (based on longer term investment return) decreased by £20 million, which was largely attributable to property and casualty business. The decrease in the Americas represented 55.6% of the decrease in our Group operating result (based on longer term investment return). In addition, our segment operating result in the United Kingdom decreased £55 million primarily due to a decline in our allocated investment return, which represents the longer term investment return on capital allocated to the U.K. property and casualty business. These decreases were partly offset by an improvement in our Other Europe underwriting result. Life and asset accumulation operating result increased by £13 million, or 5.7%, to £243 million in 1999 from £230 million in 1998 due to increases in our Asia Pacific and Americas regions that were partly offset by declines in the United Kingdom and Other Europe. See “—Results of Operations by Operating Segment”.

*Profit on ordinary activities before tax*

Profit on ordinary activities before tax decreased £486 million, or 56.3% to £378 million in 1999 from £864 million in 1998, due in part to the decrease in Group operating result (based on longer term investment return) discussed above. In addition, the profit on ordinary activities before tax is affected by other movements in investments, interest on long term subordinated liabilities, changes in equalization provisions, and other items described below.

During 1999, we issued subordinated U.S. dollar and Euro bonds to provide additional capital to assist in the financing of the acquisitions of Orion and Trygg-Hansa. We treat long term subordinated liabilities as part of our capital base. Accordingly, we treat interest on these subordinated liabilities of £10 million as a financing item and do not deduct it in arriving at Group operating result (based on longer term investment return).

The change in the equalization provisions was £12 million in 1999 as compared to £51 million in 1998 bringing the total equalization provision to £259 million. Claims equalization provisions are established in a number of countries in accordance with local regulatory requirements. They represent a provision over and above the liability for outstanding claims and accordingly are excluded from operating result (based on longer term investment return).

Other items affecting profit on ordinary activities before tax include amortization of goodwill of £14 million attributable to our acquisition of Orion, Trygg-Hansa and Tyndall during the year. In addition, under U.K. GAAP the fair value of general (property and casualty) business claims provisions relating to businesses acquired is established after making allowance for future investment income and the resulting discount is amortized to the profit and loss account over the expected run-off period of the related claims. The charge of £12 million relates to Orion and Trygg-Hansa. In 1999, the £14 million premium on redemption of long term subordinated liabilities and convertible bonds was attributable to the repayment of long term subordinated liabilities of Orion. Reorganization costs increased to £52 million from £13 million in 1998. The reorganization costs principally arose in the United Kingdom, America, Scandinavia and Japan. The present value of in-force

business existing at acquisition is amortized in the long term technical account over the anticipated periods of the related contracts in the portfolios in arriving at profit on ordinary activities before tax. Profit on disposal of subsidiaries, which we exclude from Group operating result (based on longer term investment return) was £10 million in 1999 as compared to £5 million in 1998.

Other movements in investments represents the difference between the total actual investment return and longer term investment return. See “—Longer Term Investment Return” for a description of total actual investment return and longer term investment return. In 1999, total actual investment return of £996 million was below 1999 longer term investment return of £1,076 million, resulting in deficit in other movements in investments of £80 million. The deficit in other movements in investments is due primarily to the high level of unrealized losses on the worldwide fixed interest investment portfolio during 1999 which resulted in actual returns being less than those assumed on a longer term investment return basis.

#### *Profit attributable to shareholders*

Taxation on profit on ordinary activities decreased £104 million, or 27.8%, to £270 million in 1999 from £374 million in 1998. This represents an effective tax rate of 71% which is higher than the prevailing U.K. corporation tax rate for 1999 of 30%. Under U.K. GAAP full deferred tax provision is not made for unrealized gains. The 40 percentage point difference is due primarily to the high level of realized investment gains from sales of equities not covered by deferred tax provisions in prior years. Under U.K. accounting principles, the tax arising on an investment gain is only recognized when the gain is realized.

Profit attributable to shareholders decreased by £370 million, or 81.0%, to £87 million in 1999 from £457 million in 1998 due to the factors described above.

#### *Year ended December 31, 1998 compared to year ended December 31, 1997*

##### *United Kingdom*

The United Kingdom region accounted for £371 million, or 61.6%, of our group operating result (based on longer term investment return) in 1998 as compared to £592 million in 1997. The decrease in the United Kingdom segment operating result (based on longer term investment return) reflects £222 million, or 52.7%, decrease in property and casualty business operating result (based on longer term investment return) and a £1 million, or 0.6%, increase in life and asset accumulation operating result.

##### *Other Europe*

Our Other Europe region accounted for a £12 million loss in our Group operating result (based on longer term investment return) in 1998 as compared to a £4 million gain in 1997. The decrease in Other Europe segment operating result (based on longer term investment return) was due to a £16 million, or 72.7%, decrease in property and casualty business operating result (based on longer term investment return). Life and asset accumulation operating result based on longer term investment return remained constant.

##### *Americas*

Our Americas region accounted for £211 million, or 35.0%, of our Group operating result (based on longer term investment return) in 1998 as compared to £251 million, or 25.4%, in 1997. The decrease in Americas segment operating result (based on longer term investment return) reflects the combined effect of a £44 million, or 19.3%, decrease in property and casualty business operating result (based on longer term investment return) and a £4 million, or 17.4%, increase in life and asset accumulation operating result.

### *Asia Pacific*

Our Asia Pacific region accounted for £12 million, or 2.0%, of our Group operating result (based on longer term investment return) in 1998 as compared to £67 million, or 6.8%, in 1997. The decrease in Asia Pacific segment operating result (based on longer term investment return) reflects the combined effect of a £49 million, or 87.5%, decrease in property and casualty business operating result (based on longer term investment return) and a £6 million, or 54.5%, decrease in life and asset accumulation operating result. The decrease in the property and casualty business was due to the competitive market in Australia and New Zealand and the increase in storm, flood and large property claims.

### *Net premiums written*

Property and casualty net premiums written increased by £233 million, or 3.5%, to £6,867 million in 1998 from £6,634 million in 1997. On a constant exchange rate basis, net premiums written increased £261 million, or 4.0%. This increase was primarily due to an increase in net premiums written in Other Europe of £172 million, or 14.1%, to £1,396 million in 1998 from £1,224 million in 1997. On a constant exchange rate basis, net premiums written in Other Europe increased by 9%, principally due to the acquisition of AMEV General Insurance Company Ltd., Ireland (“AMEV”) in September 1997 that was fully reflected in our 1998 results and strong growth in our Italian businesses.

Life and asset accumulation net premiums written increased by £265 million, or 10.2%, to £2,856 million in 1998 from £2,591 million in 1997. This increase was primarily due to an increase in single premium business of £118 million in the United Kingdom and increases in periodic and single premium business in Denmark and Italy. In addition, the acquisition of Norwich Union Life Insurance in New Zealand added £25 million of net premiums written in 1998.

On a constant exchange rate basis, new business annual premium equivalent increased 8% reflecting a 6% increase in periodic premium and 14% increase in single premium business. The increase was primarily in the United Kingdom and Other Europe and was attributable to increased sales of U.K. single premium products, which increased 19% over the period. Volume increases were concentrated in investment-based products, which have lower margins than with-profits products.

### *Group operating result (based on longer term investment return)*

Group operating result (based on longer term investment return) decreased £386 million, or 39%, to £602 million in 1998 from £988 million in 1997. This decline was principally due to increases in property and casualty underwriting losses in each of our Europe, Americas and Asia Pacific regions, as a result of significant worldwide weather and commercial claims in 1998. The majority of the increased underwriting losses occurred in the United Kingdom, where our operating result (based on longer term investment return) decreased by £221 million, all of which was attributable to property and casualty business. The decrease in the United Kingdom represented 57% of the decrease in our Group operating result (based on longer term investment return). Life and asset accumulation operating result in each of our Europe, Americas and Asia Pacific regions remained relatively stable at £230 million in 1998 compared to £231 million in 1997. See “—Results of Operations by Operating Segment”.

### *Profit on ordinary activities before tax*

Profit on ordinary activities before tax decreased £946 million, or 52%, to £864 million in 1998 from £1,810 million in 1997, due in part to the decreases in Group operating result (based on longer term investment return) discussed above. In addition, other movements in investments, changes in equalization provisions, and other items affect the profit on ordinary activities before tax.

Other movements in investments represents the difference between the total actual investment return and longer term investment return. See “—Longer Term Investment Return” for a description of total actual investment return and longer term investment return. In 1998, total actual investment return of £1,569 million exceeded 1998 longer term investment return of £1,106 million, resulting in other movements in investments surplus of £463 million. In 1997, total actual investment return of £2,107 million exceeded 1997 longer term investment return of £1,140 million, resulting in other movements in investments of £967 million. The decrease in other movements in investments is due primarily to the high level of unrealized gains reflected in total actual investment return in 1997. Since our portfolio is heavily weighted in equities, we benefited in 1997 from the strong performance of equity markets worldwide.

The change in the equalization provisions was £51 million in 1998 as compared to £84 million in 1997 bringing the total equalization provisions to £250 million. Claims equalization provisions are established in a number of countries in accordance with local regulatory requirements. They represent a provision over and above the liability for outstanding claims and accordingly are excluded from operating result (based on longer term investment return).

Other items include a charge of £142 million representing the premium paid on the repurchase of the remainder of our outstanding 7.25% subordinated convertible bonds due 2008 in 1998. The reorganization charge of £13 million in 1998 relates to the reorganization of our operations in Germany and Italy. The charge of £64 million in 1997 represents an addition to the integration provision made in 1996 relating to the merger.

#### *Profit attributable to shareholders*

Tax on profit on ordinary activities increased £20 million, or 5.6%, to £374 million in 1998 from £354 million in 1997. This represents an effective tax rate of 44% which is higher than the prevailing U.K. corporation tax rate for 1998 of 31%. Under U.K. GAAP full deferred tax provision is not made for unrealized gains. The 13 percentage point difference is due primarily to the high level of realized investment gains from sales of equities not covered by deferred tax provisions in prior years coupled with the nonrecognition of tax relief on the convertible bond repayment premium.

Profit attributable to shareholders decreased by £959 million, or 68%, to £457 million in 1998 from £1,416 million in 1997 due to the factors described above.

### **Results of Operations by Operating Segment**

Our operating segments have been defined based on our management structure which is organized into four time-zone-based regions. Our operating segments are:

- *United Kingdom.* This region is comprised of our businesses in the United Kingdom.
- *Other Europe.* This region is comprised of our businesses in Continental Europe, and Middle East and Africa.
- *Americas.* This region is comprised of our businesses in the United States, Canada, Latin America and the Caribbean.
- *Asia Pacific.* This region is comprised of our businesses in Asia, Australia and New Zealand.

Each region formulates its own strategic, commercial and financial policy in conformity with our overall strategy and performance targets. To measure segment profit, we allocate portions of our longer term

investment return to our segment underwriting results. See “—Capital Management” and “—Longer Term Investment Return”.

The table below presents summarized results of our operations by segment as well as a reconciliation of segment operating result (based on longer term investment return) to our consolidated profit on ordinary activities before tax.

	<b>Total</b>			<b>Property and casualty business</b>			<b>Life and asset accumulation business</b>		
	<b>1999</b>	<b>1998</b>	<b>1997</b>	<b>1999</b>	<b>1998</b>	<b>1997</b>	<b>1999</b>	<b>1998</b>	<b>1997</b>
	<b>(£ in millions)</b>			<b>(£ in millions)</b>			<b>(£ in millions)</b>		
<b>Net premiums written</b>									
United Kingdom(1)	5,091	5,063	4,872	3,141	3,353	3,315	1,950	1,710	1,557
Other Europe	2,401	2,208	1,928	1,440	1,396	1,224	961	812	704
Americas	1,943	1,749	1,768	1,817	1,544	1,525	126	205	243
Asia Pacific	1,008	703	657	761	574	570	247	129	87
Total	<u>10,443</u>	<u>9,723</u>	<u>9,225</u>	<u>7,159</u>	<u>6,867</u>	<u>6,634</u>	<u>3,284</u>	<u>2,856</u>	<u>2,591</u>
<b>Underwriting result/long term (life) business result(2)(3)</b>									
United Kingdom	(126)	(118)	110	(291)	(290)	(61)	165	172	171
Other Europe	(140)	(176)	(138)	(159)	(202)	(164)	19	26	26
Americas	(106)	(74)	(40)	(141)	(101)	(63)	35	27	23
Asia Pacific	(70)	(49)	(1)	(94)	(54)	(12)	24	5	11
Total	<u>(442)</u>	<u>(417)</u>	<u>(69)</u>	<u>(685)</u>	<u>(647)</u>	<u>(300)</u>	<u>243</u>	<u>230</u>	<u>231</u>
<b>Group operating result (based on longer term investment return)</b>									
United Kingdom	316	371	592	151	199	421	165	172	171
Other Europe	45	(12)	4	26	(38)	(22)	19	26	26
Americas	191	211	251	156	184	228	35	27	23
Asia Pacific	3	12	67	(21)	7	56	24	5	11
Total segmental results	<u>555</u>	<u>582</u>	<u>914</u>	<u>312</u>	<u>352</u>	<u>683</u>	<u>243</u>	<u>230</u>	<u>231</u>
Other activities	<u>11</u>	<u>20</u>	<u>74</u>						
Total	<u>566</u>	<u>602</u>	<u>988</u>						
<b>Amounts not allocated to operating segments:</b>									
Interest on long term subordinated liabilities	(10)	—	—						
Changes in equalization provisions	(12)	(51)	(84)						
Amortization of goodwill	(14)	—	—						
Amortization of goodwill in acquired claims provisions	(12)	—	—						
Premium on redemption of long term subordinated liabilities and convertible bonds	(14)	(142)	—						
Reorganization/additional integration costs	(52)	(13)	(64)						
Amortization of present value of acquired in force business	(4)	—	—						
Profit on disposal of subsidiaries	<u>10</u>	<u>5</u>	<u>3</u>						
Group operating profit (based on longer term investment return)	<u>458</u>	<u>401</u>	<u>843</u>						
Other movements in investments(4)	<u>(80)</u>	<u>463</u>	<u>967</u>						
Profit on ordinary activities before tax	<u>378</u>	<u>864</u>	<u>1,810</u>						

(1) Property and casualty net premiums written in 1997 are shown after giving effect to a premium portfolio transfer in connection with the termination of a reinsurance agreement with The Chubb Corporation which resulted in the transfer to Chubb of £49 million of premiums in 1997.

(2) Amounts are shown gross of tax.

- (3) The underwriting result/long term (life) business result presented above differs from that included in our consolidated financial statements because it excludes certain reorganization costs and integration costs, amortization of goodwill (including goodwill in acquired claims provisions) and amortization of acquired present value of long term business and merger-related expenditures not considered to be part of Group operating result (based on longer term investment return).
- (4) Reflects the difference between the actual investment return and the longer term investment return. See “—Longer Term Investment Return”.

## United Kingdom

The table below presents information regarding the United Kingdom segment’s results of operations for the years indicated.

	<u>Year Ended December 31,</u>		
	<u>1999</u>	<u>1998</u>	<u>1997</u>
	(£ in millions, except ratios)		
Net premiums written:			
Property and casualty . . . . .	3,141	3,353	3,315
Life and asset accumulation . . . . .	1,950	1,710	1,557
Property and casualty underwriting result . . . . .	(291)	(290)	(61)
Allocated investment return . . . . .	442	489	482
Property and casualty operating result (based on longer term investment return) . . .	151	199	421
Life and asset accumulation result . . . . .	165	172	171
Segment operating result (based on longer term investment return) . . . . .	316	371	592
Property and casualty loss ratio . . . . .	76.2%	77.3%	71.5%
Property and casualty expense ratio . . . . .	33.2%	30.7%	30.4%
Property and casualty combined ratio . . . . .	109.4%	108.0%	101.9%
Life new business annual premium equivalent . . . . .	215	188	168

*Year ended December 31, 1999 compared to year ended December 31, 1998*

### *United Kingdom net premiums written*

Property and casualty net premiums written decreased by £212 million, or 6.3%, to £3,141 million from £3,353 million in 1998. Of this decrease, £48 million was attributable to an internal business reorganization which resulted in the transfer of multinational commercial business to the region to which the coverage relates, plus the inclusion of the costs relating to the purchase of a stop loss reinsurance treaty covering our U.K. commercial business. In personal business, net premiums written increased £5 million, or 0.3%, to £1,734 million from £1,729 million in 1998. This moderate increase reflects a combination of growth in the health business during 1999, combined with the impact of rating increases in personal automobile policies sold through broker channels. These increases have however been largely offset by a decrease in the amount of property business sold through third party corporate clients, as a number of corporate partnerships were not renewed.

In commercial business, we experienced a £217 million, or 13.4%, decrease in net premiums written, to £1,407 million from £1,624 million in 1998. This reduction was largely due to the transfer of multinational business and the purchase of reinsurance discussed above. The remainder of the decrease is due to price competition, our more stringent underwriting stance and actions being taken to limit potential exposure to Year 2000 risks. As a result of these actions, we experienced volume declines in our risk managed business (large

U.K. multinational companies) and our commercial automobile portfolio after initiating a review of underwriting and pricing in these markets.

Life and asset accumulation net premiums written increased £240 million, or 14.0%, to £1,950 million in 1999 from £1,710 million in 1998. On an annual premium equivalent basis, sales increased by 14.4%, to £215 million in 1999 from £188 million in 1998, with particularly strong growth in business through independent financial advisers. New periodic premiums written increased by £2 million, or 1.7%, to £118 million in 1999 from £116 million in 1998 due to small increases in protection and group risk products. New single premiums increased by £249 million, or 34.4%, to £973 million in 1999 from £724 million in 1998, principally due to higher sales of with-profit bond investment products through independent financial advisors. During the year, a decision was taken to concentrate on sales from IFAs and to close distribution through tied agents and the direct sales force.

*United Kingdom segment operating result (based on longer term investment return)*

United Kingdom segment operating result (based on longer term investment return) decreased by £55 million, or 14.8%, to £316 million in 1999 from £371 million in 1998 due to a decrease in our property and casualty operating result. Our life and asset accumulation result remained relatively stable over the period.

The principal reduction in operating result was associated with the allocated investment return, which represents the longer term investment return on capital allocated to U.K. property and casualty business, which decreased £47 million, or 9.6%, to £442 million in 1999 from £489 million in 1998. See “—Longer Term Investment Return” for a discussion of how we allocate capital to our segments for purposes of measuring financial performance.

Our property and casualty operating result for 1999 of £151 million continued to be adversely affected by increased severity and frequency of claims, particularly in the automobile and risk managed books. The combined ratio deteriorated from 108.0% in 1998 to 109.4% in 1999, due to deterioration in our expense ratio which increased to 33.2% from 30.7%. The increase in our expense ratio was in part a result of expenditures on systems development to migrate from legacy systems, plus exceptional expenditures to ensure Year 2000 compliance. In addition, expenses in our commercial business have not fallen in proportion to our decline in net premiums written.

In commercial business, our operating result decreased by £3 million to £102 million in 1999. The commercial automobile combined ratio of 118.7% continued to reflect the high frequency and severity of underlying claims. The remedial action we introduced throughout 1999 on the fleet automobile account has resulted in improvements in the profitability of the book of business, while at the same time achieving a 13% increase in premium. Performance in the fourth quarter 1999 had already shown a substantial improvement in the third quarter, with our commercial automobile combined ratio improving from 126.3% in the third quarter of 1999 to 120.3% in the fourth quarter.

We also experienced an increase in underlying claims in the risk managed book during 1999. We took remedial actions throughout 1999 to improve our results in this business via ratings and strict underwriting review. The commercial result was also adversely affected by our group reinsurance result, which was impacted by the abnormally high level of natural disasters in 1999, as well as the costs associated with the purchase of worldwide catastrophe reinsurance. As a result our combined ratio for commercial business deteriorated to 112.2% from 111.2%. These adverse developments were partly offset by the lower frequency and severity of large property claims compared to 1998 and a net recovery of £50 million under the whole account reinsurance treaty described above.

In personal business, our underwriting result was adversely affected by underpricing and increased claims costs. In addition, personal automobile claims were adversely affected by the increase in average claims

cost. This is, in part, attributable to changes in legislation that have increased the bodily injury element of our claims cost. We have made adjustments to the pricing on automobile products in order to return profitability to acceptable levels. While claims have been the primary driver in increasing our personal automobile combined ratio to 115.2% in 1999 from 106.5% in 1998, the impact of the pricing changes is now beginning to improve our automobile combined ratios. Primarily as a result of losses on personal automobile business, the overall combined ratio for personal business declined from 104.4% in 1998 to 107.1% in 1999. However, the losses in personal automobile were offset by improved results in our household business where our combined ratio improved to 104.5% in 1999 from 105.7% in 1998 due to improved subsidence experience and relatively benign U.K. weather conditions.

Our life and asset accumulation result fell by £7 million to £165 million in 1999 from £172 million in 1998 as a result of reduced bond values. The relatively stable result reflects the fact that the profit under U.K. GAAP is strongly influenced by the declaration of bonuses to with-profits policyholders. The level of bonuses does not generally vary significantly from year to year, however, with-profits rates have been reduced significantly during 1999 compared to 1998 as a result of lower investment returns. The underlying driver of the life profit is primarily investment conditions. Strong equity performance is reflected in both of the key elements of the life profit, terminal bonuses and the return on shareholders' capital. The two main with-profits life operations maintained their levels of profitability over the three years as a consequence of both the investment conditions and the level of policy maturities. However, the number of policies maturing will begin to decline in the next few years which would lead to downward pressure on the profit.

In May 2000 new valuation regulations became effective for U.K. life insurance companies that effectively increased the level of reserves required to be held. To mitigate the effects of these new regulations we have taken out a financial reinsurance contract in one of our life companies, Sun Alliance Life Assurance Company Limited.

*Year ended December 31, 1998 compared to year ended December 31, 1997*

*United Kingdom net premiums written*

Property and casualty net premiums written increased by £38 million, or 1%, to £3,353 million in 1998 from £3,315 million in 1997. After allowing for the premium portfolio transfer in connection with the termination of a reinsurance agreement with The Chubb Corporation in 1997, which resulted in a transfer to Chubb of £49 million of premiums, there was an underlying decline in premiums of £11 million. Market conditions for property and casualty business remained very competitive.

In commercial business, we experienced a £151 million, or 9%, decrease in net premiums written due to price competition and our more stringent underwriting stance, particularly on potential exposures to Year 2000 risks. In addition, we experienced volume declines in our risk managed business (large U.K. multinational companies) after initiating a review of underwriting and pricing in that market.

In personal business, net premiums written increased £140 million, or 9%, reflecting a combination of new marketing initiatives and premium growth in our personal automobile business. Personal automobile accounted for £109 million of the increase in personal business. The increase in personal automobile resulted from the introduction of a new automobile liability and physical damage product.

Life and asset accumulation net premiums written increased £153 million, or 10%, to £1,710 million in 1998 from £1,557 million in 1997. On an annual premium equivalent basis, sales increased by 12%, with particularly strong growth in business through independent financial advisers. New periodic premiums written increased by £9 million, or 8%, to £116 million in 1998 from £107 million in 1997 with a strong performance in group risk products where new periodic premiums increased £10 million. New single premiums increased by

£118 million, or 19%, to £724 million in 1998 from £606 million in 1997, principally due to higher sales of with-profit bond savings products.

*United Kingdom segment operating result (based on longer term investment return)*

United Kingdom segment operating result (based on longer term investment return) decreased £221 million, or 37%, to £371 million in 1998 from £592 million in 1997 due to a decrease in our property and casualty operating result as our life and asset accumulation result remained relatively stable over the period.

Our property and casualty operating result for 1998 of £199 million was adversely impacted by an increase in large property losses for both U.K. commercial and risk managed business. Our property and casualty underwriting loss increased by £229 million to £290 million in 1998. Consequently, the loss ratio increased from 71.5% to 77.3%. The expense ratio increased to 30.7% from 30.4% due to a combination of low growth in net premiums written, expenditures related to our review of the costs of Year 2000 compliance, and new systems development. In addition, our expenses have not declined proportionally with declines in net premiums written in commercial business. The resulting combined ratio was 108.0% in 1998 compared to 101.9% in 1997.

In personal business, the combined ratio has deteriorated from 103.7% to 104.4%, mainly as a result of a £33 million increase in subsidence losses and higher incidence of weather events on household business, partly offset by a large improvement in the personal automobile business book. The personal automobile combined ratio improved from 112.7% in 1997 to 106.5% in 1998, mainly as a result of price increases of 12% and a reduction in claims frequency. The improvement in the ratio is also driven by an increase in net premiums written, discussed above.

In commercial business, underwriting losses increased by £119 million in our property line and £37 million in our casualty line, primarily due to the competitive commercial insurance market, where excess capacity from insurers and lower prices for reinsurance led to unfavorable pricing conditions. It also resulted from a series of major claims events, resulting in an increase in weather losses and an unprecedented rise in the number of large claims in property and casualty. A number of other U.K. companies experienced increased underwriting losses due to increases in claims frequency and cost and unfavorable pricing conditions. As a result, pricing levels in commercial business have shown a slower rate of decline in our property line and casualty line and modest increases in commercial automobile, where vehicle numbers have contracted during 1998 due to a reluctance to write at unprofitable rates. As a result of these factors and the factors contributing to the increase in our expense ratio, our combined ratio in commercial business deteriorated to 111.2% from 100.3% in 1997.

Allocated investment return, which represents the longer term investment return on capital allocated to U.K. property and casualty business, increased £7 million, or 1%, to £489 million in 1998 from £482 million in 1997. See “—Longer Term Investment Return” for a discussion of how we allocate capital to our segments for purposes of measuring financial performance.

Our life and asset accumulation result increased £1 million to £172 million in 1998 from £171 million in 1997. The relatively stable result reflects the fact that the profit under U.K. GAAP is strongly influenced by the declaration of bonuses to with-profits policyholders. The level of bonuses does not vary significantly from year to year. The underlying driver of the life profit is primarily investment conditions. Strong equity performance is reflected in both of the key elements of the life profit, terminal bonuses and the return on shareholders' capital. The two main with-profits life operations maintained their levels of profitability over the three years as a consequence of both the investment conditions and the level of policy maturities. However, the number of policies maturing will begin to decline in the next few years which would lead to downward pressure on the profit.

## Other Europe

Other Europe includes our operations in Continental Europe, the Middle East and Africa. The table below presents information regarding the Other Europe segment's results of operations for the years indicated.

	Year Ended December 31,		
	1999	1998	1997
	(£ in millions, except ratios)		
Net premiums written:			
Property and casualty . . . . .	1,440	1,396	1,224
Life and asset accumulation . . . . .	961	812	704
Property and casualty underwriting result . . . . .	(159)	(202)	(164)
Allocated investment return . . . . .	185	164	142
Property and casualty operating result (based on longer term investment return) . . . . .	26	(38)	(22)
Life and asset accumulation result . . . . .	19	26	26
Segment operating result (based on longer term investment return) . . . . .	45	(12)	4
Property and casualty loss ratio . . . . .	83.3%	81.9%	81.1%
Property and casualty expense ratio . . . . .	27.9%	31.9%	32.2%
Property and casualty combined ratio . . . . .	111.2%	113.8%	113.3%
Life new business annual premium equivalent . . . . .	156	122	111

*Year ended December 31, 1999 compared to year ended December 31, 1998*

### *Other Europe net premiums written*

Property and casualty net premiums written increased £44 million, or 3.2%, to £1,440 million in 1999 from £1,396 million in 1998. On a constant exchange rate basis, net premiums written increased £206 million, or 16.7%, primarily due to the acquisition of Trygg-Hansa in Sweden which took effect from August 31, 1999 and premium growth in Spain. Net premiums written increased in most of our principal markets in Other Europe as follows on a constant exchange rate basis:

- 42% in Scandinavia to £465 million, including £107 million of premiums of Trygg-Hansa from the date of acquisition;
- 7% in Italy to £285 million;
- 12% in Ireland to £163 million; and
- 23% in Spain to £179 million.

These increases were partly offset by a 3% decrease in Germany to £139 million of net premiums written, primarily due to the sale of our direct writing business in Germany at the beginning of 1999.

In Spain, the strong growth in net premiums written was largely attributable to growth in personal automobile business. In 1998 we instituted a recovery plan in Italy which had the objective of achieving our financial return targets. In connection with that plan, we have reduced volumes in automobile business in Italy, while increasing our rates. However, further rate increases in Italy may be limited by recent legislation that freezes Italian automobile rates until May 31, 2000.

Life and asset accumulation net premiums written increased £149 million, or 18.3%, to £961 million in 1999 from £812 million in 1998, primarily due to higher sales of unit-linked (separate account) products in the Isle of Man. On a constant exchange rate basis, net premiums written increased £212 million, or 28.3%. On an annual premium equivalent basis, sales increased by 39.3% in local currency terms consisting of a 32.9% increase in periodic premium business and a 49.9% increase in single premium business. This growth was largely attributable to premium volume increases in the Isle of Man and Denmark.

*Other Europe segment operating result (based on longer term investment return)*

Other Europe segment operating result (based on longer term investment return) increased £57 million to a profit of £45 million in 1999 from a loss of £12 million in 1998.

Our property and casualty operating result increased £64 million to a profit of £26 million due primarily to significantly improved performance in Germany, Italy and Ireland and the sale of our direct marketing operations in France and Germany during 1999. Our property and casualty underwriting loss decreased £43 million, or 21.3%, to a loss of £159 million in 1999 from a loss of £202 million in 1998. Our loss ratio increased to 83.3% in 1999 compared to 81.9% in 1998. Our expense ratio improved to 27.9% compared to 31.9% in 1998. Our combined ratio was 111.2% in 1999 compared to 113.8% in 1998.

In Scandinavia, on a constant exchange rate basis, our underwriting loss decreased £37 million to a loss of £39 million in 1999 which includes £19 million arising from the acquisitions of Trygg-Hansa in Sweden and Lietuvos Draudimas in Lithuania. In personal business our combined ratio worsened to 109.3% in 1999 from 102.8% in 1998 following a strengthening of reserves for bodily injury claims and an increased frequency of medium and large claims. There were also significant storm losses in December. In commercial business our combined ratio worsened to 106.5% in 1999 from 94.6% in 1998 due to an increasing incidence of significant commercial claims.

In Italy, on a constant exchange rate basis, our underwriting loss decreased £19 million to £43 million in 1999. The major factor behind the improvement in underwriting loss was the improved automobile claims experience in our Lloyd Italico operation. In personal business our combined ratio improved to 118.4% in 1999 from 123.4% in 1998. The improvement was also due to the continuing impact of our recovery plan initiated in 1998 which included the cancellation of certain of our agents and the application of premium rate increases above the market level. We believe that the Lloyd Italico recovery plan will be adversely impacted by the Italian government's decision to freeze automobile rates in 2000 as discussed above. In commercial business our combined ratio improved to 104.6% in 1999 from 115.9% in 1998.

In Spain, on a constant exchange rate basis, our underwriting loss increased £7 million to £32 million in 1999. In personal business our combined ratio increased to 120.4% in 1999 from 116.9% in 1998. During 1999 significant under-rating in the Spanish automobile insurance market continued. In response to this condition, we continued to raise prices in 1999, a program that we instituted at the end of 1998. We have begun to see improvements in this business in the first quarter of 2000.

In Ireland, on a constant exchange rate basis, our underwriting loss decreased £25 million to a loss of £3 million in 1999 due to absence of large losses and storm claims suffered in 1998 and our combined ratio for commercial business decreased to 115.5% in 1999 from 135.9% in 1998.

Allocated investment return, which represents the longer term investment return on capital allocated to Other Europe property and casualty business, increased £21 million, or 12.8%, to £185 million in 1999 from £164 million in 1998. See “—Longer Term Investment Return” for a discussion of how we allocate capital to our segments for purposes of measuring financial performance.

Our life and asset accumulation result in 1999 decreased by £7 million to £19 million from £26 million in 1998. This was primarily impacted by a change in the taxation legislation in Denmark. In addition, development costs of £3 million in Poland were offset by an increase in the result of our Isle of Man operations.

*Year ended December 31, 1998 compared to year ended December 31, 1997*

*Other Europe net premiums written*

Property and casualty net premiums written increased £172 million, or 14%, to £1,396 million in 1998 from £1,224 million in 1997. On a constant exchange rate basis, net premiums written increased £106 million, or 9%, due to the acquisition of AMEV in Ireland in September 1997 and premium growth in Italy. Net premiums written increased in all of our principal markets in Other Europe as follows:

- 3% in Denmark to £371 million;
- 19% in Italy to £302 million;
- 11% in Ireland to £165 million;
- 8% in Germany to £163 million; and
- 2% in Spain to £166 million.

In Italy, the strong growth in net premiums written was largely attributable to growth in personal automobile business. However, our personal lines business in Italy had poor underwriting results and as part of our recovery plan, we expect through pricing change and agency retrenchment to reduce volumes in automobile business.

Life and asset accumulation net premiums written increased £108 million, or 15%, to £812 million in 1998 from £704 million in 1997, primarily due to higher sales of unit-linked (separate account) products, with-profit bonds and single premium pensions products in Denmark, Italy and Spain. On a constant exchange rate basis, net premiums written increased £98 million, or 14%. On an annual premium equivalent basis, sales increased by 8% in local currency terms consisting of a 5% increase in periodic premium business and a 12% increase in single premium business. This growth was largely attributable to premium volume increases in Denmark, Italy and Spain.

*Other Europe segment operating result (based on longer term investment return)*

Other Europe segment operating result (based on longer term investment return) decreased £16 million to a loss of £12 million in 1998 from a profit of £4 million in 1997 due to a decrease in our property and casualty operating result as our life and asset accumulation result remained constant over the period.

Our property and casualty operating result decreased £16 million to a loss of £38 million due primarily to substantial losses in automobile business in Italy and Spain and property losses in Ireland. Our property and casualty underwriting loss increased £38 million, or 23%, to a loss of £202 million in 1998 from a loss of £164 million in 1997 as the losses in Italy and Spain in personal lines were offset by favorable results in Denmark. In addition, £38 million of our underwriting loss in 1998 was attributable to our direct marketing operations in France and Germany, which we agreed to sell in the first quarter of 1999. Our loss ratio increased to 81.9% in 1998 compared to 81.1% in 1997. Our expense ratio showed modest improvement at 31.9% compared to 32.2% in 1997. Our combined ratio was 113.8% in 1998 compared to 113.3% in 1997.

In Denmark, on a constant exchange rate basis, our underwriting loss decreased £16 million to a loss of £1 million in 1998. In personal business, our combined ratio improved to 102.8% in 1998 from 109.2% in

1997 as personal product lines benefited from the milder weather in 1998. In commercial business, our combined ratio improved to 94.6% in 1998 from 99.5% in 1997 as our commercial lines benefited from a lower level of property and marine cargo losses in 1998.

In Italy, on a constant exchange rate basis, our underwriting loss increased £2 million to £69 million in 1998. The major factor behind our underwriting loss was the adverse automobile claims experience in our Lloyd Italicco operation. In personal business, our combined ratio improved to 123.4% in 1998 from 125.0% in 1997. We have implemented a recovery plan which included the cancellation of 10% of our agents and the application of 14% premium rate increases, representing double the market level. In commercial business, our combined ratio improved to 115.9% in 1998 from 133.8% in 1997.

In Spain, on a constant exchange rate basis, our underwriting loss decreased £1 million to £28 million in 1998. In personal business, our combined ratio increased to 116.9% in 1998 from 115.8% in 1997. During 1998 there was a significant worsening in the auto claims experience throughout the insurance market in Spain. We applied rate increases in December 1998 with further increases in March 1999. Other lines of business showed improvement.

In Ireland, our underwriting result, particularly in commercial business, was affected by a substantial rise in the number of large fire claims of £18 million and a £10 million increase in weather losses. As a result, on a constant exchange rate basis, our underwriting loss increased £23 million to a loss of £32 million in 1998 and our combined ratio for commercial business increased to 135.9% in 1998 from 105.3% in 1997.

Allocated investment return, which represents the longer term investment return on capital allocated to Other Europe property and casualty business, increased £22 million, or 15%, to £164 million in 1998 from £142 million in 1997. See “—Longer Term Investment Return” for a discussion of how we allocate capital to our segments for purposes of measuring financial performance.

Our life and asset accumulation result in 1998 amounted to £26 million and was in line with the level achieved in 1997. The result for our offshore market operation based in the Isle of Man was adversely affected by a decrease in new business sales attributable to the Asian crises and worldwide stock market volatility.

## **Americas**

The table below presents information regarding our Americas segment’s results of operations for the years indicated. The information presented below includes the results of our U.S. life and asset accumulation business, until we sold it in July 1999 for £235 million. Our U.S. life and asset accumulation business accounted for:

- £76 million of our Americas life and asset accumulation net premiums written and £10 million of our life and asset accumulation result in 1999;
- £163 million of our Americas life and asset accumulation net premiums written and £22 million of our life and asset accumulation result in 1998; and
- £204 million of our Americas life and asset accumulation net premiums written and £20 million of our life and asset accumulation result in 1997.

	<u>Year Ended December 31,</u>		
	<u>1999</u>	<u>1998</u>	<u>1997</u>
	(£ in millions, except ratios)		
Net premiums written:			
Property and casualty . . . . .	1,817	1,544	1,525
Life and asset accumulation . . . . .	126	205	243
Property and casualty underwriting result . . . . .	(141)	(101)	(63)
Allocated investment return . . . . .	297	285	291
Property and casualty operating result (based on longer term investment return) . . . . .	156	184	228
Life and asset accumulation result . . . . .	35	27	23
Segment operating result (based on longer term investment return) . . . . .	191	211	251
Property and casualty loss ratio . . . . .	73.4%	71.0%	68.6%
Property and casualty expense ratio . . . . .	33.9%	35.6%	34.9%
Property and casualty combined ratio . . . . .	107.3%	106.6%	103.5%
Life new business annual premium equivalent . . . . .	11	17	23

*Year ended December 31, 1999 compared to year ended December 31, 1998*

*Americas net premiums written*

Property and casualty net premiums written increased £273 million, or 17.7%, to £1,817 million in 1999 from £1,544 million in 1998. On a constant exchange rate basis, net premiums written increased £206 million, or 12.8%.

In personal business, net premiums written increased £97 million to £646 million in 1999 from £549 million in 1998 attributable to a £31 million increase in premiums in the United States, a £54 million increase in Canada and a £12 million increase in Latin America and the Caribbean.

In the United States, on a constant exchange rate basis, personal lines net premiums written increased by 10% to £255 million including £22 million of non-standard automobile premiums from the Orion acquisition. Excluding Orion, premiums remained flat due to a 7% increase in voluntary automobile business, a 9% increase in household premiums and a 5% increase in automobile premiums offset by our decision to outsource involuntary automobile business and the impact of increased reinsurance. In Canada, on a constant exchange rate basis, personal lines net premiums written increased 11% despite a highly competitive market. Brokers sought our operation in Canada as a new market in response to recent merger activity among the leading Canadian insurance companies. A further contribution was made by our PFS Group, whose affinity group business more than doubled in volume. In Latin America and the Caribbean, on a constant exchange rate basis, personal lines net premiums written increased 20%, with strong growth in our Argentinean subsidiary.

In commercial business, net premiums written increased £176 million to £1,171 million in 1999 from £995 million in 1998 attributable to a £168 million increase in premiums in the United States, a £9 million increase in Canada and a £1 million decrease in Latin America and the Caribbean.

In the United States, on a constant exchange rate basis, commercial lines net premiums written increased £145 million, or 20.4%, due to several factors. Of this increase, £54 million was attributable to the inclusion of Orion net premiums written for the period November 16, 1999 to December 31, 1999. Growth in our targeted high margin products, such as technology, Management Assurance® and World Assurance®, and

targeted industry segments continued in 1999, as was also the case in our surplus lines operation. We also sustained our growth efforts in our residual value and warranty coverage specialty products. In our core commercial products, we continued to face competitive pressures throughout the majority of 1999; however, we increased prices beginning in the second half of the year across a wide range of business lines. These increases contributed to the growth in premiums written. Partially offsetting the above increases, we continued to contract our writings in certain historically unprofitable industry segments.

In Canada, on a constant exchange rate basis, commercial lines net premiums written decreased 4.0% primarily as a consequence of a firm underwriting position in select markets and an effort to rebalance our risk managed accounts. The transactional managed business produced significant growth with the increase a result of both additional business and rate increase.

In Latin America and the Caribbean, on a constant exchange rate basis, commercial lines net premiums written increased £2 million.

Life and asset accumulation net premiums written decreased £79 million, or 38.5%, to £126 million in 1999 from £205 million in 1998. On an annual premium equivalent basis, sales of life and asset accumulation business decreased by 35.3% to £11 million in 1999 from £17 million in 1998. The reductions were due mainly to the sale of our U.S. life and assets accumulation business in July 1999. Life and asset accumulation net premiums written in Canada increased 19.0% to £50 million from £42 million in 1998 and new business annual premium equivalent remained constant at £7 million in 1998. On a constant exchange rate basis, net premiums written increased £4 million.

*Americas segment operating result (based on longer term investment return)*

Americas segment operating result (based on longer term investment return) decreased £20 million, or 9.5%, to £191 million in 1999 from £211 million in 1998.

Our property and casualty operating result decreased £28 million to £156 million principally attributable to the unusually high level of weather-related losses including Hurricane Floyd and Hurricane Lenny and large property losses in commercial business. There were further large fire losses in Chile and the Netherlands Antilles. Our total property and casualty underwriting loss increased £40 million, or 39.6%, to £141 million from £101 million in 1998. The operating profit of the Americas in 1999 reflects a benefit of £32 million generated by recoveries on a stop loss reinsurance treaty. The high level of weather related claims and large property losses in the United States commercial account were also responsible for the rise in the loss ratio to 73.4% in 1999 from 71.0% in 1998. Our expense ratio decreased to 33.9% from 35.6% mainly arising in the United States. Our combined ratio was 107.3% in 1999 compared with 106.6% in 1998.

In the United States, our 1999 combined ratio remained constant with the 1998 result of 106.4%. The loss ratio, however, deteriorated by approximately two points to 73.4% in 1999 due to a high level of large non-catastrophe property losses and a significant deterioration in our general liability line of business. Our expense ratio in the United States continued its trend of improvement, decreasing to 33.0% in 1999 from 35.1% in 1998. This reduction was a result of strong premium growth and our ongoing efforts to contain costs.

In personal business, both our United States and Canadian operations recorded underwriting profits in 1999 with combined ratios of 95.7% in the United States and 98.8% in Canada. In the United States, our underwriting profit came from a 91.2% combined ratio performance in the automobile business. This offset a deterioration in household business where our combined ratio increased to 109.9% in 1999 from 103.7% in 1998 due to the heavy impact of Hurricane Floyd. In Canada, we recorded a combined ratio of 98.8% in 1999 on the strength of our personal automobile results. Pricing conditions for automobile remained difficult throughout the year however loss experience remained satisfactory producing a combined ratio of 96.7%. Property results of 103.7% remained at 1998 levels due to a continuation of poor weather related losses.

In commercial business, underwriting losses increased by £21 million to £143 million in 1999 from £122 million in 1998. In the United States, commercial business underwriting losses increased by £6 million due primarily to the factors discussed above and losses of approximately £18.6 million associated with Hurricane Floyd. The increase in the large property losses was primarily attributable to the multi-peril package line of business rather than our monoline property coverages. Our combined ratio for multi-peril package line of business increased to 114.5% in 1999 from 107.4% in 1998. The deterioration in underwriting result for the general liability line of business resulted from an increased frequency and an increase in large losses in 1999. In Canada, the commercial lines combined ratio deteriorated from 109.3% to 115.1% as a result of weakened earned premiums and poorer automobile and liability results. Poor performance in commercial automobile was attributable to long haul trucking accounts whose performance has been unsatisfactory. Beginning in March 1999, we instituted measures to reduce this exposure. Our commercial liability combined ratio was 141.7%. Poor results in this line were primarily a result of reserve strengthening for social and environmental liabilities.

In Latin America and the Caribbean, our property and casualty underwriting result declined £2 million to a loss of £34 million in 1999 from a loss of £32 million in 1998. The increased loss was primarily attributable to the large losses and weather related losses in 1999. Hurricane Lenny caused losses of £9 million and Hurricane Floyd caused losses of £7 million. In addition there was a single large loss of £5 million in the Netherlands Antilles and an unusually high incidence of large losses in Chile.

Allocated investment return, which represents the longer term investment return on capital allocated to Americas property and casualty business, increased £12 million, or 4.2%, to £297 million in 1999 from £285 million in 1998. See “—Longer Term Investment Return” for a discussion of how we allocate capital to our segments for purposes of measuring financial performance.

Our life and asset accumulation result increased £8 million to £35 million in 1999 compared to £27 million in 1998 despite the sale of our U.S. life and asset accumulation business on July 31, 1999. This increase was primarily due to increased profits contributed by Canada amounting to £23 million which arose from a one time release of profit in the participating fund and realization of investment gains.

*Year ended December 31, 1998 compared to year ended December 31, 1997*

*Americas net premiums written*

Property and casualty net premiums written increased £19 million, or 1%, to £1,544 million in 1998 from £1,525 million in 1997. On a constant exchange rate basis, net premiums written increased £76 million, or 5%.

In personal business, net premiums written increased £4 million to £549 million in 1998 from £545 million in 1997 attributable to an £11 million increase in premiums in the United States offset by a £5 million decrease in Canada and a £2 million decrease in Latin America/Caribbean.

In the United States, on a constant exchange rate basis, personal lines net premiums written increased 6% to £224 million due to an 8% increase in voluntary business which was offset to a small degree by a decline in involuntary business. Household net premiums written increased 11% and automobile net premiums written increased 3% due to increased volume. In Canada, on a constant exchange rate basis, personal lines net premiums written increased 6%, reflecting a growth in volumes following the introduction of a non-standard automobile product and improved renewal rates offset by deteriorating pricing considerations. We also experienced volume increases in household business.

In commercial business, net premiums written increased £15 million to £995 million in 1998 from £980 million in 1997 attributable to a £38 million increase in premiums in the United States offset by a £23 million decrease in Canada. In the United States, on a constant exchange rate basis, commercial lines net

premiums written increased 7% due to growth in our high margin products such as technology, Management Assurance® and World Assurance®, our surplus lines operation as well as in niche markets that we are aggressively developing. These areas have proven less susceptible to the continued severe competition in standard commercial markets which have been subject to price decreases. The growth in these areas in 1998 was partially offset by business consisting of the continued runoff of unprofitable affinity group programs and discontinued business, continued weakness in the marine market, and opportunistic reductions of exposures in certain wholesale markets. In Canada, on a constant exchange rate basis, net premiums written decreased 3% as the highly competitive commercial market continued to make it difficult to achieve real premium growth and our stringent underwriting stance led to volume decreases as we reduced our writing of some unprofitable specialty lines and risk managed business (large domestic and multinational companies). In Canadian casualty business, our stringent stance on excluding Year 2000 related covers caused premiums to decrease.

Life and asset accumulation net premiums written decreased £38 million, or 16%, to £205 million in 1998 from £243 million in 1997. On an annual premium equivalent basis, sales of life and asset accumulation business decreased by 26% to £17 million in 1998 from £23 million in 1997. Life and asset accumulation net premiums written in Canada increased 8% to £42 million and new business annual premium equivalent remained constant at £7 million in 1998. On a constant exchange rate basis, net premiums written increased £6 million due to premiums contributed by the portfolio of business we acquired from Gerling Global Life in Canada in August 1997.

*Americas segment operating result (based on longer term investment return)*

Americas segment operating result (based on longer term investment return) decreased £40 million, or 16%, to £211 million in 1998 from £251 million in 1997. Excluding our U.S. life operations, Americas segment operating result (based on longer term investment return) decreased by £42 million, or 18%, to £189 million in 1998 from £231 million in 1997 due to a decrease in our property and casualty operating result offset by a modest increase in our life and asset accumulation result.

Our property and casualty operating result decreased £44 million to £184 million principally attributable to the unusually high level of weather related losses including the Canadian ice storms, Peruvian floods and Hurricane Georges. These losses were partially offset by increased underwriting profit in U.S. and Canadian personal lines, specifically in personal automobile business where our combined ratio improved to 85.1% in 1998 from 97.6% in 1997 in the United States and held steady at 93.1% in Canada over the same period. However, pricing conditions have deteriorated significantly in the personal automobile market and we expect that margins will be thinner in 1999 as the pricing pressure is reflected in our underwriting results. Our property and casualty underwriting loss increased £38 million, or 60%, to £101 million from £63 million in 1997.

The higher level of weather related claims was also responsible for the rise in the loss ratio to 71.0% in 1998 from 68.6% in 1997. Our expense ratio increased to 35.6% from 34.9% due to higher information technology costs associated with Year 2000 projects, new system development costs to support our Canadian business, and an investment to launch our direct marketing company in Argentina. Our combined ratio was 106.6% in 1998 compared with 103.5% in 1997.

In the United States, our combined ratio increased to 106.4% in 1998 from 105.8% in 1997, with all the deterioration concentrated in the loss ratio which increased to 71.3% in 1998 from 69.1% in 1997. The increase in the loss ratio was the result of a return to more normal catastrophe losses after 1997's extraordinarily benign loss experience. Our expense ratio in the United States improved to 35.1% in 1998 from 36.7% in 1997 as a result of strong premium growth and our ongoing efforts to contain costs.

In personal business, both our U.S. and Canadian operations recorded underwriting profits in 1998 with combined ratios of 89.3% in the United States and 96.5% in Canada. In the United States, our improved underwriting result reflected an improvement in automobile business which more than offset the deterioration in

household business where our combined ratio increased to 103.7% in 1998 from 94.7% in 1997 due to higher weather related losses. In Canada, the 1998 personal lines underwriting result for the year was affected by losses of £16 million from the January ice storms, which was the largest insured loss in the history of the Canadian insurance industry. Each of the subsequent quarters saw the achievement of underwriting profit, with a particularly strong performance in automobile business.

In commercial business, underwriting losses in the United States increased by £25 million to £83 million in 1998, due primarily to the factors discussed above. In addition, our underwriting result was adversely affected by a return to more normal weather related losses and poor results in workers' compensation and marine business primarily due to price competition. Our combined ratio for workers' compensation deteriorated to 112.2% in 1998 from 99.2% in 1997 and our combined ratio for marine business deteriorated to 113.2% in 1998 from 102.9% in 1997. In Canada, commercial lines underwriting losses attributable to the January ice storm of £16 million were the major factor behind the deterioration in our Canadian underwriting result.

In Latin America and the Caribbean, our property and casualty underwriting result declined £17 million to a loss of £32 million in 1998 from a loss of £15 million in 1997. As a result, our combined ratio in Latin America and the Caribbean increased to 118.6% in 1998 from 108.2% in 1997. The increased loss was primarily attributable to the high level of weather related losses in 1998. El Nino flood losses of £5 million adversely affected the Latin America result while the Caribbean suffered losses of £26 million from Hurricane Georges.

Allocated investment return, which represents the longer term investment return on capital allocated to Americas property and casualty business, decreased £6 million, or 2%, to £285 million in 1998 from £291 million in 1997. See "—Longer Term Investment Return" for a discussion of how we allocate capital to our segments for purposes of measuring financial performance.

Our life and asset accumulation result increased £4 million to £27 million in 1998 compared to £23 million in 1997. Excluding our U.S. life operations, our life and asset accumulation result increased £2 million, or 67%, to £5 million in 1998 from £3 million in 1997. This increase was primarily due to profits contributed in 1998 by the business we acquired from Gerling Global Life in Canada offset by a shift in customer preferences away from single premium products in favor of lower margin segregated funds as interest rates declined.

## Asia Pacific

The table below presents information regarding our Asia Pacific segment's results of operations for the years indicated.

	<u>Year ended December 31,</u>		
	<u>1999</u>	<u>1998</u>	<u>1997</u>
	(£ in millions, except ratios)		
Net premiums written:			
Property and casualty . . . . .	761	574	570
Life and asset accumulation . . . . .	247	129	87
Property and casualty underwriting result . . . . .	(94)	(54)	(12)
Allocated investment return . . . . .	73	61	68
Property and casualty operating result . . . . .	(21)	7	56
Life and asset accumulation result . . . . .	24	5	11
Segment operating result (based on longer term investment return) . . . . .	3	12	67
Property and casualty loss ratio . . . . .	82.0%	72.7%	68.5%
Property and casualty expense ratio . . . . .	29.7%	36.0%	32.5%
Property and casualty combined ratio . . . . .	111.7%	108.7%	101.0%
Life new business annual premium equivalent . . . . .	31	18	15

*Year ended December 31, 1999 compared to year ended December 31, 1998*

*Asia Pacific net premiums written*

Property and casualty net premiums written increased by £187 million, or 32.6%, to £761 million in 1999 from £574 million in 1998. On a constant exchange rate basis, net premiums written increased £134 million, or 21%. In 1999, property and casualty net premiums written grew 38% in Australia to £518 million, 54.5% in New Zealand to £102 million, and 6.8% in Other Asia Pacific to £141 million. Personal written premiums increased £96 million to £446 million, and commercial written premiums increased £91 million to £315 million.

The growth in Australia was achieved in both personal and commercial business, with personal net premiums written increasing £89 million to £353 million in 1999 and commercial net premiums written increasing £53 million to £165 million. The increase in personal business was primarily due to the strong performance of our direct marketing company, AAMI, whose net premiums written increased £58 million, or 36%, to £220 million in 1999. We assumed the remaining 20% of the AAMI insurance risk effective in July 1999, which increased net premiums written by £26.4 million. On the commercial side, our broker operations net written premiums increased £32 million, or 34%, to £127 million on the back of a hardening commercial market where commercial rate increases averaged 10%. On a constant exchange rate basis, AAMI's net premiums written increased 23% and broker operations net written premiums increased 21%.

The increase in net written premiums in New Zealand was almost entirely as a result of entering the workers' compensation market which was privatized during 1999. Premiums in this portfolio totaled £34 million in 1999. The incoming government in 1999 has decided to renationalize workers' compensation in 2000 and therefore this market will be lost to private insurers. The re-nationalization of the workers' compensation business in 2000 will not require us to incur significant exit costs. The pricing conditions elsewhere in the commercial market in New Zealand continue to be difficult. We have implemented some rate increases, however, we have lost some business as a result.

Net premiums written in the rest of Asia Pacific increased £9 million, or 6.8%, to £141 million from £132 million in 1998. Growth of £14 million, or 59%, in our Japanese direct marketing operations was offset by a reduction in net premiums written of £5 million, or 5%, in the rest of Asia. In Hong Kong and in South East Asian operations net premiums written were down £3 million and £3 million respectively over 1998, as a result of the Asian economic downturn and difficult market conditions.

A review during 1999 of the business written through intermediaries in Japan resulted in a revised strategy for that market, including the decision to withdraw from writing personal lines through intermediaries, and the closure of several branch offices throughout Japan. The effects of this strategy are expected to reduce net premiums written in the full year 2000 through this channel by £14 million, mostly in the personal classes.

Life and asset accumulation net premiums written increased £118 million, or 91.5%, to £247 million in 1999 from £129 million in 1998. On a constant exchange rate basis, net premiums written increased £110 million, or 80.3%. The strong growth was almost entirely attributable to the acquisition of Tyndall in Australia effective in May 1999, and the acquisition of Guardian Assurance in New Zealand in November 1998. Revenues from Guardian were included in our results from January 1999. Tyndall added £89 million of net premiums written for the eight months ended December 1999 to the Australian operation, and Guardian business added £37 million of net premiums written for the full year 1999 to the New Zealand operation.

On an annual premium equivalent basis, premiums increased to £31 million in 1999 compared to £18 million in 1998, new periodic premiums written increased by £6 million, or 50.0%, to £18 million in 1999 from £12 million in 1998 and new single premiums written increased £69 million, or 127.8%, to £123 million in 1999 from £54 million in 1998. These increases were the result of the Guardian and Tyndall acquisitions.

*Asia Pacific segment operating result (based on longer term investment return)*

Asia Pacific segment operating result (based on longer term investment return) decreased £9 million to £3 million in 1999 from £12 million in 1998 as a result of the combined effect of a substantial decrease in our property and casualty operating result of £28 million and a significant increase in our life operating result of £19 million.

Our property and casualty operating result decreased £28 million to a loss of £21 million in 1999 from £7 million in 1998. Commercial business decreased £46 million to a loss of £44 million and personal business increased £18 million to a profit of £23 million. Our underwriting result for 1999 was a loss of £94 million, £76 million of which was attributable to commercial business and £18 million of which was attributable to personal business.

Commercial business operating result in Australia decreased £26 million to a loss of £31 million in 1999 from a loss of £5 million in 1998, with the combined ratio increasing from 118.1% in 1998 to 131.8% in 1999. This was due to a combination of large losses from the Sydney hailstorm of £4.4 million, the effect of the introduction of a goods and services tax, or GST, on claims payments of £6 million and a significant increase in reserves for the commercial liability portfolio. The GST applies to claims paid after the mid-2000 effective date of the GST. Going forward, the increased claims costs associated with the GST for claims paid after the effective date will be reflected in our premium prices. However, we may incur additional charges relating to claims made on policies issued prior to the premium adjustments we made to address the GST impact. Elsewhere in Asia Pacific, commercial operating results suffered from the effect of large loss and weather events.

The personal business operating result increase of £18 million was mainly attributable to an increased personal operating result in Australia of £11 million, despite claims for the hailstorm of £2.8 million and the effect of introduction of the GST of £10 million. Personal combined ratio for Australia improved from 101% in 1998 to 97.6% in 1999. The AAMI direct marketing business in Australia was particularly successful in achieving an increase of £2.9 million in underwriting result. In other Asia Pacific an increase in personal operating result of £7 million was achieved, primarily through reduced marketing expenses in the Japanese direct marketing operations in 1999 compared to 1998.

As a result of the large claims (Sydney hailstorm and other large claims in Asia) plus the GST effect on Australian claims, our loss ratio in Asia Pacific increased to 82.0% in 1999 compared to 72.7% in 1998. However our expense ratio fell to 29.7% in 1999 compared to 36.0% in 1998 reflecting a six point reduction in our expense ratio in Australia as a result of strong premium growth and expense rationalization initiatives. The expense ratio in Australia fell to 19.9% compared to 24.5% in 1998. The expense ratio in New Zealand also fell from 33.1% in 1998 to 22.0% in 1999, mostly as a result of the new workers' compensation business where management expenses are running at 11.8% of premiums and a favorable quota share reinsurance arrangement under which net commission is credited to the underwriting result. The re-nationalization of the workers' compensation business in 2000 will not result in significant exit costs for RSA New Zealand.

The level of large losses suffered in Asia in 1999 has prompted us to change our reinsurance strategy for the region in 2000. Under the new strategy, we will purchase additional excess of loss reinsurance to reduce our exposure to medium to large losses in Asia Pacific.

Allocated investment return, which represents the longer term investment return on capital allocated to Asia Pacific property and casualty business, increased £12 million, or 19.7%, to £73 million in 1999 from £61 million in 1998. See “—Longer Term Investment Return” for a discussion of how we allocate capital to our segments for purposes of measuring financial performance.

Our life and asset accumulation result increased £19 million to £24 million in 1999 compared to £5 million in 1998. Australia's life and asset accumulation result increased £14 million to £17 million in 1999 compared to £3 million in 1998. Of this amount, approximately £7 million was due to the acquisition of Tyndall and approximately £3 million was due to a one time tax credit related to the reorganization of our life business in Australia. The New Zealand life and asset accumulation result increased £5 million to £7 million in 1999, compared to £2 million in 1998. This was primarily due to strong life profit from our existing business, and an approximately £1 million contribution from New Zealand Guardian Trust's funds management and trustee business acquired as part of the Tyndall acquisition in Australia.

*Year ended December 31, 1998 compared to year ended December 31, 1997*

*Asia Pacific net premiums written*

Property and casualty net premiums written increased by £4 million, or 1%, to £574 million in 1998 from £570 million in 1997. On a constant exchange rate basis, net premiums written increased £41 million, or 10%. In 1998, property and casualty net premiums written grew 11% in Australia to £376 million and 10% in Other Asia Pacific to £132 million, offset by a decrease of 8% in New Zealand to £66 million.

The growth in Australia was largely attributable to growth in personal business, where net premiums written increased £13 million to £264 million in 1998 from £251 million in 1997. The increase was primarily due to the strong performance of our direct marketing company, AAMI, whose net premiums written increased £18 million, or 13%, to £162 million in 1998. On a constant exchange rate basis, AAMI's net premiums written increased 21%.

In Australia, the growth in personal lines net premiums written offset a decrease in commercial lines where net premiums written decreased to £112 million in 1998 from £115 million in 1997 due to strong competition and unfavorable pricing conditions in the market. Our operations in New Zealand were also adversely affected by unfavorable pricing conditions in the commercial market. As a result, net premiums written decreased £14 million, or 18%, to £66 million in 1998. In 1999, premium rate increases are being achieved. Net premiums written in the rest of Asia Pacific increased £8 million, or 6%, to £132 million from £124 million in 1997.

Life and asset accumulation net premiums written increased £42 million, or 48%, to £129 million in 1998 from £87 million in 1997. On a constant exchange rate basis, net premiums written increased £36 million, or 39%.

On an annual premium equivalent basis, premiums increased to £18 million in 1998 compared to £15 million in 1997. New periodic premiums written increased by £1 million, or 9%, to £12 million in 1998 from £11 million in 1997 and new single premiums written increased £23 million, or 74%, to £54 million in 1998 from £31 million in 1997. The strong growth was primarily attributable to our New Zealand operation, which acquired the life and asset accumulation businesses of Norwich Union and Guardian Assurance in 1998. Norwich Union added £25 million of net premiums written to our New Zealand operations in 1998. Guardian Assurance had premium income of £50 million in 1998, although we did not record Guardian Assurance's revenues or expenses in 1998 as the acquisition was not completed until December 1998.

*Asia Pacific segment operating result (based on longer term investment return)*

Asia Pacific segment operating result (based on longer term investment return) decreased £55 million, or 82%, to £12 million in 1998 from £67 million in 1997 primarily due to a substantial decrease in our property and casualty operating results.

Our property and casualty operating result decreased £49 million, or 88%, to £7 million in 1998 from £56 million in 1997 due to worsening underwriting results in our commercial business in Australia, where our combined ratio increased to 118.1% in 1998 from 105.0% in 1997, and New Zealand, where our combined ratio increased to 96.2% in 1998 from 83.9% in 1997. Our property and casualty underwriting loss increased £42 million to a £54 million loss in 1998 from a £12 million loss in 1997. The increase in the underwriting loss was primarily due to the competitive market in Australia, increase in the cost of storm and flood losses during the first six months of 1998, an increase in the number of large property claims, including a gas explosion in Victoria, Australia, large fire losses in Indonesia and Hong Kong, and costs associated with developing our direct marketing operations in Japan. In New Zealand, adverse pricing conditions in commercial business contributed to the deterioration in our combined ratio. This was partially offset by continuing underwriting profits in Malaysia, Pakistan, Philippines and Thailand.

As a result of these factors, our loss ratio in Asia Pacific increased to 72.7% in 1998 compared to 68.5% in 1997. Our expense ratio rose to 36.0% compared to 32.5% in 1997 reflecting our increased development expenditures in Japan. Our combined ratio was 108.7% in 1998 compared to 101.0% in 1997.

Allocated investment return, which represents the longer term investment return on capital allocated to Asia Pacific property and casualty business, decreased £7 million, or 10%, to £61 million in 1998 from £68 million in 1997. See “—Longer Term Investment Return” for a discussion of how we allocate capital to our segments for purposes of measuring financial performance.

Our life and asset accumulation result decreased £6 million, or 55%, to £5 million in 1998 compared to £11 million in 1997. This decrease was due primarily to charges in 1998 to strengthen our reserves for prior year disability business in Australia.

## **Insurance Investments**

Our insurance investment portfolios consist of our worldwide general insurance investment portfolios, which include the assets supporting our property and casualty liabilities as well as our shareholders’ funds, and our worldwide life insurance investment portfolios.

As with-profits and other participating policies represent a majority of our life and asset accumulation actuarial liabilities, net investment income on our worldwide life insurance investment portfolios primarily benefits our policyholders via the declaration of policyholder bonuses (or dividends).

The table below presents our actual investment returns, including investment income and net realized gains on investments, less investment expenses for the years indicated. The presentation of investment income is different from that in our consolidated financial statements due to the allocation of investment income attributable to shareholders’ funds supporting our life and asset accumulation business to the worldwide life insurance portfolios. The fair value of fixed income and equity securities is subject to volatility as interest rates and the equity markets fluctuate. The table below excludes income from deposits with ceding undertakings which are shown as investments in our consolidated balance sheet.

	Year ended December 31,		
	1999	1998	1997
	(£ in millions)		
<b>Worldwide general insurance investment portfolios:</b>			
Investment income . . . . .	822	872	899
Net realized gains on investments . . . . .	752	816	218
Income and realized gains from investments accounted for under the equity method of accounting . . . . .	77	25	28
Investment expenses and charges (1) . . . . .	<u>(79)</u>	<u>(213)</u>	<u>(61)</u>
Net investment income . . . . .	<u>1,572</u>	<u>1,500</u>	<u>1,084</u>
<b>Worldwide life insurance investment portfolios:</b>			
Investment income . . . . .	1,579	1,638	1,588
Net realized gains on investments . . . . .	2,266	2,127	1,067
Investment expenses and charges . . . . .	<u>(60)</u>	<u>(52)</u>	<u>(47)</u>
Net investment income . . . . .	<u>3,785</u>	<u>3,713</u>	<u>2,608</u>

(1) Investment expenses in 1999 include £14 million of premium paid on repurchases of long term subordinated liabilities in our U.S. operation and in 1998 include £142 million representing premium paid on repurchase of our outstanding 7.25% subordinated convertible bonds due 2008.

*Year ended December 31, 1999 compared to year ended December 31, 1998*

In our worldwide general insurance investment portfolios, net investment income increased £72 million to £1,572 million in 1999 from £1,500 million in 1998. Investment income of £822 million in 1999 was £50 million less than in 1998 largely reflecting the sales of equity securities in both 1999 and 1998. Income on the equity portfolio in 1999 was £117 million compared with £154 million in 1998, a fall of £37 million. Realized gains in 1999 were £752 million compared with £816 million in 1998 reflecting a lower level of profits on equity disposals. During 1999, we reduced our equity holdings from 36% to 31% of our worldwide general insurance investment portfolios. Investment expenses and charges in 1999 of £79 million were £134 million less than in 1998. The 1998 expenses included a one-time charge of £142 million relating to the premium paid on the redemption during 1998 of our outstanding 7.25% subordinated convertible bonds due 2008.

In our worldwide life insurance investment portfolios, net investment income increased by £72 million to £3,785 million in 1999 from £3,713 million in 1998. This was largely the result of an increase in realized gains on the sale of investments which in 1999 were £2,266 million compared to £2,127 million in 1998.

As a global business, approximately 33% of our assets as of December 31, 1999 were held outside the United Kingdom. Our investments are held in currencies to broadly match the currencies of our insurance liabilities. At the end of 1999 investments were held approximately 60% in British pounds, 15% in U.S. dollars, 10% in Danish kroner and 15% in other currencies.

*Year ended December 31, 1998 compared to year ended December 31, 1997*

In our worldwide general insurance investment portfolios, net investment income increased £416 million to £1,500 million in 1998 from £1,084 million in 1997. This increase was primarily the result of realized gains on the sale of investments (primarily equity securities) of £816 million, which increased significantly from £218 million in 1997. During 1998, we reduced our equity holdings from 40% to 36% of our worldwide general insurance investment portfolios. The increase in realized gains was partially offset by an increase in investment expenses and charges of £152 million to £213 million in 1998 from £61 million in 1997. This increase predominantly related to a premium of £142 million paid on the redemption of our outstanding

7.25% subordinated convertible bonds due 2008 during 1998. In addition, the investment income decreased £27 million to £872 million in 1998 from £899 million in 1997, due primarily to the fall in interest rates, as higher coupon bonds acquired in prior years were redeemed and the proceeds reinvested at lower yields.

In our worldwide life insurance investment portfolios, net investment income increased £1,105 million to £3,713 million in 1998 from £2,608 million in 1997. This increase was largely the result of realized gains on the sale of investments of £2,127 million, which increased significantly from £1,067 million in 1997. The increase in realized gains was due to sales of equities during the year. During 1998, we reduced our equity holdings from 46% to 41% of our life and asset accumulation portfolio.

### **Liquidity and Capital Resources**

The principal sources of funds for our operations are insurance premium collections and net investment income, while the major uses of these funds are the payment of insurance claims, policy benefits, operating expenses and dividends as well as servicing our debt obligations and the acquisition of, and investment in, our core businesses.

During 1999, we issued U.S. \$500 million subordinated bonds due October 15, 2029 and €500 million subordinated Eurobonds due October 15, 2019. The net proceeds were used to provide additional capital to assist in the financing of our acquisitions of Orion and Trygg-Hansa during the year. The rate of interest payable on the U.S. \$500 million subordinated bonds is 8.95%, although we have entered into derivative contracts which have the effect of converting the interest payable to a floating rate. €200 million of the Eurobonds bear interest at a fixed rate of 6.875% until October 15, 2009, and at a floating rate thereafter. €300 million of the Eurobonds bear interest at a floating rate from the date of issue. We have the option to repay the Eurobonds on specific dates starting October 15, 2009. After that date there is an increase in the interest rate of 120 basis points.

In February 2000, we raised £146 million in the form of a subordinated loan due 2030. The loan principal is denominated in Japanese yen and interest is payable in U.S. dollars. The loan has an effective British pound interest rate of 6.99% due to interest and currency swaps purchased pursuant to our hedging strategy.

In addition to the long term subordinated debt referred to above, our consolidated outstanding borrowings as of December 31, 1999 amounted to £676 million, of which £5 million was attributable to our long term (life) business and £188 million was denominated in foreign currencies, primarily the U.S. dollar. Of these consolidated outstanding borrowings as of December 31, 1999, £453 million were repayable within one year, £198 million were repayable within two to five years and £25 million had maturities in excess of 5 years. The principal purpose of this debt is to provide short-term liquidity funding.

We maintain standby committed revolving credit facilities in the amount of £1.5 billion, of which £103 million was outstanding as of December 31, 1999. As of December 31, 1999, these credit facilities had an average remaining expiration period of approximately 3.5 years. Of the £1.5 billion in committed credit facilities, £800 million is committed under a 5 year syndicated loan facility that we entered into in October 1998 and which is available to meet our short to medium term funding requirements. The amount of this facility was reduced from £1.6 billion in August 2000. We also maintain a U.S. \$1 billion euro commercial paper program.

As of December 31, 1999 our consolidated total investments included £833 million of deposits with credit institutions of which £214 million was attributable to long term (life) business. In addition, we had cash at bank and in hand of £822 million, £325 million of which was attributable to long term (life) business.

A large portion of our investment portfolio is held in highly liquid, listed securities which can be sold to raise funds if required. However having borrowing facilities to meet short term cash requirements avoids having to liquidate the investments at a disadvantageous time.

The table below is a summary of cash flow activities for the years ended December 31, 1999, 1998 and 1997, respectively. In accordance with U.K. GAAP, it does not include any amounts relating to the long term (life) business except cash transactions between the long term (life) operations and shareholders' funds.

Under U.S. GAAP, the long term (life) operations are included in the statement of cash flows. See note 49 to our consolidated financial statements.

	<u>Year Ended December 31,</u>		
	<u>1999</u>	<u>1998</u>	<u>1997</u>
	( <b>£ in millions</b> )		
Net cash inflow from operating activities . . . . .	320	82	509
Dividends from associates . . . . .	56	1	—
Servicing of finance . . . . .	(36)	(19)	(17)
Taxation paid . . . . .	(145)	(214)	(147)
Net acquisitions/disposals/capital expenditures/merger expenses . . . . .	(1,565)	(277)	(240)
Dividends paid on equity shares . . . . .	(1,109)	(337)	(258)
Issue of ordinary share capital . . . . .	15	14	31
Issue by subsidiary of ordinary share capital to minorities . . . . .	30	—	—
Net proceeds from issue of long term subordinated liabilities . . . . .	615	—	—
Purchase of own shares . . . . .	(29)	—	(153)
Cash available for investment . . . . .	<u>(1,848)</u>	<u>(750)</u>	<u>(275)</u>
Investment activities:			
Net (sales) purchases of property . . . . .	(489)	(2)	6
Net (sales) purchases of equities . . . . .	(1,459)	(1,210)	183
Net (increase) decrease in other investments . . . . .	107	400	(693)
Net (sales) purchases of investments . . . . .	<u>(1,841)</u>	<u>(812)</u>	<u>(504)</u>
Net increase (decrease) in cash . . . . .	215	28	(11)
(Increase) reduction in borrowings . . . . .	<u>(222)</u>	<u>34</u>	<u>240</u>
Total invested . . . . .	<u>(1,848)</u>	<u>(750)</u>	<u>(275)</u>

In 1999 net cash inflows from operating activities and net sales of investments amounted to £2,161 million. The proceeds from the sale of investments were used primarily to fund corporate cash flows relating to the acquisition of subsidiaries and the payment of a special dividend of £751 million which was approved in May 1999 and paid on June 1, 1999. In addition, during 1999 we paid interim and final dividends of £358 million, raised £615 million from the issue of subordinated debt and made acquisition and capital expenditures of £1,565 million. The net cash inflow from ordinary activities increased to £320 million from £82 million in 1998 due to improved general business flows in 1999 and the payment of a premium of £142 million on redemption of convertible bond borrowings in 1998.

In 1998 net cash inflows from operating activities and net sales of investments amounted to £894 million. During the year we paid equity dividends of £337 million, redeemed the remainder of our 7.25% subordinated convertible bonds due 2008 for £274 million and made acquisition and capital expenditures of £277 million.

In 1997 cash inflows from operating activities and net sales of investments amounted to £1,013 million. During the year we paid equity dividends of £258 million, made acquisition and capital expenditures of £240 million, repurchased 2.1% of our outstanding ordinary shares for £153 million and repaid borrowings of £240 million. We have obtained shareholder approval to repurchase up to 5% of our shares for the period May 2000 through May 2001, and we currently intend to continue to seek shareholder approval annually for the ability to repurchase up to 5% of our shares during the course of each year.

In May 1999, shareholders approved payment of a special dividend of £751 million in conjunction with a proportionate share consolidation. The special dividend was paid on June 1, 1999.

Our capital expenditures amounted to £83 million in 1999, £69 million in 1998 and £55 million in 1997. The principal expenditures relate to leasehold improvements, fixtures, equipment and fittings. We had outstanding commitments for capital expenditures of £4 million as of December 31, 1999.

During the three years ended December 31, 1999, we acquired interests in subsidiaries and associates (investments accounted for under the equity method of accounting) for aggregate consideration of £2,228 million and sold interests in subsidiaries and associates for aggregate consideration of £353 million. Specifically in 1999, we acquired interests in subsidiaries and associates for aggregate consideration of £1,806 million. In Asia Pacific, in May we acquired Tyndall for consideration of £302 million. In August, Codan acquired Trygg-Hansa Försäkring AB, Publikt, a Swedish property and casualty insurer, from Skandinaviska Enskilda Banken AB, or SEB, for total consideration of £287 million. As part of the transaction, Codan Bank A/S was sold to SEB for £57 million. In the Americas, in November 1999, we acquired Orion Capital Corporation, a U.S. property and casualty insurer, for total consideration, including the assumption of debt, of £1,168 million pursuant to a cash tender offer for all of the outstanding Orion shares. Of the £1,168 million, we used £300 million to redeem long term subordinated liabilities. In 1999, we sold interests in subsidiaries and associates, including our U.S. life and asset accumulation business, for consideration of £235 million.

Our businesses throughout the world are subject to regulatory and solvency requirements. On an aggregate basis, the Group exceeds its minimum solvency requirement by a substantial margin. The regulatory restrictions on parent and subsidiary dividends and minimum capital requirements are further described in note 44 to our consolidated financial statements. We are not aware of any recommendations by regulatory authorities that would have a material effect on our operations or liquidity.

Our core property and casualty insurance operations have financial strength ratings of AA- from Standard and Poor's and A+ from A.M. Best. Separately Moody's Investor Services rated our U.K. operations Aa3 and our U.S. operations as A3. Both Moody's and S&P have stated that the outlook on their ratings is negative.

We believe that our liquid assets, net cash provided by operations, and access to the capital markets will enable us to meet our foreseeable cash requirements.

## Summary of Significant Differences between U.K. GAAP and U.S. GAAP

The significant differences in accounting principles between U.K. GAAP and U.S. GAAP are described and summarized in note 48 to our consolidated financial statements. Our condensed consolidated financial statements, prepared in accordance with U.S. GAAP, as of and for the years ended December 31, 1999, 1998 and 1997 are presented in note 49 to our consolidated financial statements.

	Net Income Year Ended December 31,		
	1999	1998	1997
	(£ in millions)		
In accordance with U.K. GAAP . . . . .	87	457	1,416
In accordance with U.S. GAAP . . . . .	<u>933</u>	<u>660</u>	<u>688</u>
Difference . . . . .	<u>(846)</u>	<u>(203)</u>	<u>728</u>

Our consolidated net income under U.S. GAAP differs, and will continue to differ, significantly from that under U.K. GAAP as most of the fluctuations in our unrealized gains on investments in securities and properties will be excluded from our U.S. GAAP results, whereas they are included under U.K. GAAP. The fluctuations in unrealized gains on investments in securities backing our U.K. life operations' with-profits (participating) policies will continue to be included in our U.S. GAAP net income. However, their impact on our U.S. GAAP net income is substantially reduced as 90% of all profits within the long term (life) with-profits funds inure to the benefit of our policyholders.

### *Year ended December 31, 1999*

Consolidated net income under U.K. GAAP was £87 million compared to £933 million under U.S. GAAP for the year ended December 31, 1999. The principal reasons for the increase were the reversal of the decline in unrealized gains on investments in 1999, recognition of the prepaid pension cost, the reversal of equalization provisions not allowed under U.S. GAAP, the recognition of gains on sales of real estate now sold outside the Group that were recognized in the U.K. GAAP financial statements in 1998 but were eliminated from the U.S. GAAP financial statements as they were intercompany, and the increase in the difference between deferred policy acquisition costs, or DAC, on a U.K. GAAP basis and DAC on a U.S. GAAP basis as a result of improved expected gross margin, as well as the impact of policyholder participations. These increases were offset by depreciation on properties recognized for U.S. GAAP, the deferral of income on front end fees, the impact of the change in the long term (life) business provision, mainly as a result of the reversal of the change in the provision for guaranteed annuities that was included in U.K. GAAP net income, the full provisioning for deferred tax and the tax effects of these differences.

### *Year ended December 31, 1998*

Consolidated net income under U.K. GAAP was £457 million compared to £660 million under U.S. GAAP for the year ended December 31, 1998. The principal reasons for the increase were the reversal of the decline in unrealized gains on investments during 1998, recognition of the prepaid pension cost, the reversal of equalization provision not allowed under U.S. GAAP, the impact of the U.K. GAAP accounting policy change and the reduction in the long term (life) business provision mainly as a result of the reversal of the U.K. GAAP provision for guaranteed annuities. These increases were offset by depreciation on properties recognized for U.S. GAAP, amortization of goodwill required by U.S. GAAP, the elimination of gains on intercompany sales of investments, the full provisioning for deferred income taxes, the deferral of front end fees, the impact of expenses incurred in connection with the merger that were provided for in 1996 in the U.K. GAAP accounts

but did not meet the requirements for recognition under U.S. GAAP, and the policyholder participation and tax effects on these differences.

*Year ended December 31, 1997*

Consolidated net income under U.K. GAAP was £1,416 million compared to £688 million under U.S. GAAP for the year ended December 31, 1997. The principal reasons for the decrease were the reversal of the increase in unrealized gains on investments, depreciation on properties, amortization of goodwill, the deferral of income on front end fees and the impact of expenses incurred in connection with the 1996 merger that were provided for in 1996 in the U.K. GAAP accounts but that did not meet the requirements for recognition under U.S. GAAP. These items were offset by recognition of the prepaid pension cost, reversal of equalization provisions not allowed under U.S. GAAP, the full provisioning for deferred income taxes, the reduction of the long term (life) business provision, the impact of the U.K. GAAP accounting policy change, as well as the policyholder participation and tax effects of these differences.

**Year 2000 Position**

We recognized for some time that there were potentially significant problems associated with the inability of certain software and micro-chips to process Year 2000 dates. We ran major projects in all our businesses to identify, assess and rectify Year 2000 problems or risks. These projects extended to all areas of our operations which we identified as being susceptible to Year 2000 risks including our information technology systems, non-information technology equipment containing embedded micro-chips, suppliers, underwriting exposure, investment management and contingency planning. These projects were all successfully completed prior to the end of 1999.

We suffered no significant failures or problems in our systems or processes as a result of Year 2000 issues. We encountered a small number of minor problems, none of which had any impact on customer service or resulted in any material costs.

As an insurance company, we are exposed to potential claims filed as a result of an insured's negligence in addressing Year 2000 issues. This risk has been managed through the implementation of a stringent underwriting policy throughout the Group. We believe that our underwriting, risk assessment and claims management processes are sufficiently robust to keep potential losses within acceptable limits. Our strict underwriting stance on this issue caused a small loss of business during 1998 and 1999, but the impact of this has not been material to our financial results. As of the current date, only a very small number of claims have been received relating to the Year 2000 issue. However, there still exists the risk of latent claims and litigation risk in respect of claims and coverage issues.

The total cost of our Year 2000 programs was £97 million. During 1998 and 1997, the cost of preparing for Year 2000 was £48 million and £14 million respectively. We spent an additional £33 million during 1999, and the remaining £2 million during early 2000. This expenditure represents the cost of new hardware and software, the utilization of staff and the cost of outside contractors and consultants.

The majority of costs incurred are information technology related, over half of which relate to internal resources. These costs were included within our existing information technology, facilities management and business budgets. They were treated as normal business expenditures and charged against profits in the year in which they were incurred.

**Euro Conversion**

On January 1, 1999, the euro was introduced as the currency of the eleven European Union, or EU, countries who are participating in the third stage of European Economic and Monetary Union, or EMU. From

January 1, 1999 to December 31, 2001, the national currencies of the eleven participating countries (the “Member States”) and the euro will both be in use for non-cash transactions, although euro notes and coins will not be available until January 1, 2002. Whilst the Member States’ currencies remain in existence during this transitional period, most financial market operations, such as stock exchange and institutional banking transactions, are now transacted in euro. The final change to the euro will begin on January 1, 2002, when euro bank notes and coins will be substituted for Member States’ national currencies.

As a major European-based insurer, with more than 70% of our premium income emanating from the EU and business in all major EU countries, we are taking all necessary steps to meet the challenges presented by the change of currency to the euro and the subsequent economic impact, and to position ourselves to seize opportunities that may arise in the euro environment. As the opportunities and challenges vary by country and market segment, we are addressing them so as to meet the emerging needs of customers and business connections on a local and European level.

All areas of our business both in EU countries which are participating in the euro, and those which currently are not, are being affected to some degree; including information systems, treasury, risk management, accounting, financial reporting, customer service, communications and asset management.

System and product changes required during the transitional period to achieve euro capability have been successfully implemented in all relevant operations. We also have projects running in all affected businesses in order to complete the changeover to the euro by December 31, 2001. There is adequate contingency time available such that there are no current concerns that this timetable will not be met in any of the relevant businesses.

We expect that total external costs to be incurred on current euro projects, including future costs, will be less than £20 million, based on the United Kingdom, Denmark and Sweden remaining out of EMU in the immediate future. Our expectations about future costs associated with the euro are subject to uncertainties that could cause actual results to differ materially from what has been discussed above, such as an early decision by the United Kingdom, Denmark and Sweden to enter EMU. Assessments are currently underway to analyze the potential impact and cost to the Group of each of these countries joining EMU at a future date; this work is not yet complete.

### **Recently Issued Accounting Pronouncements Not Yet Adopted**

#### *U.K. GAAP*

On February 18, 1999, the U.K. Accounting Standards Board, or ASB, issued Financial Reporting Standard No. 15 “Tangible Fixed Assets” (“FRS 15”). FRS 15 is effective for periods ending on or after March 23, 2000. FRS 15 sets out the requirements for accounting for the initial measurement, valuation and depreciation of tangible fixed assets, with the exception of investment properties, and it codifies much of existing practice. Valuations remain optional, but if a policy of revaluation is adopted, then all assets of the same class should be revalued and revaluations should be kept up-to-date. Management does not believe that FRS 15 will have a material effect on our results of operations or financial position.

#### *U.S. GAAP*

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 “Accounting for Derivative Instruments and Hedging Activities” (“SFAS No. 133”), which establishes accounting and reporting standards for derivative financial instruments, including certain derivatives embedded in other contracts, and for hedging activities. SFAS 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as

part of a hedge transaction and, if it is, the type of hedge transaction. For fair value hedge transactions in which we are hedging changes in the fair value of an asset, liability or firm commitment, changes in the fair value will generally be offset in the income statement by changes in the hedged item fair value. For cash flow hedge transactions, in which we are hedging the variability of cash flows related to a variable rate asset, liability or a forecasted transaction, changes in the fair value of the derivative instrument will be reported in other comprehensive income. The gains and losses on the derivative instrument that are reported in other comprehensive income will be reclassified as earnings in the periods in which earnings are impacted by the variability of the cash flow of the hedged item. The ineffective portion of all hedges will be recognized in current-period earnings. SFAS No. 133 as amended requires adoption in fiscal years beginning after June 15, 2000. Retroactive application to financial statements of prior periods is prohibited. We expect to adopt SFAS No. 133 effective January 1, 2001. We have not yet determined the effects of adoption of SFAS No. 133 on its consolidated balance sheet or statements of income on a U.S. GAAP basis.

The American Institute of Certified Public Accountants has issued SOP 98-7 "Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk". The SOP is effective for financial statements for years beginning after June 15, 1999. The SOP provides guidance on how to account for insurance and reinsurance contracts that do not transfer insurance risk, and applies to all entities and all insurance and reinsurance contracts that do not transfer insurance risk as defined in SFAS 113, with the exception of long-duration life and health insurance contracts. The statement will require minor changes to our current financial statement disclosures and will not have a material impact on our results of operations or financial position.

## ITEM 9A. QUALITATIVE AND QUANTITATIVE DISCLOSURES ON MARKET RISK

*You should read the following information in conjunction with “Item 9—Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and the related notes to those financial statements, included herein as Item 18. You should read the information under “Forward-Looking Statements” for information about our presentation of forward-looking information.*

As an insurance company we are fundamentally concerned with the management of risk. We must ensure that we have the appropriate financial resources available to make claims, life benefits and expense payments as they arise while balancing this need with the requirement to produce satisfactory returns on capital employed. To manage capital requirements we have introduced a risk-based capital model which produces a model of our insurance and investment exposures to loss. Using both actual and market experience, a probability distribution for the expected payment pattern for our claims, life benefits and expenses is estimated. We have established criteria for the probability of loss that we should take and this determines our capital requirements. See “Item 9—Management’s Discussion and Analysis of Financial Condition and Results of Operations”.

This analysis of expected returns and capital requirements indicates how the overall expected return on capital employed is maximized for our property and casualty business over time. Our investment policy is to invest all assets backing shareholders’ funds and 5% of property and casualty reserves in equities with the balance in fixed income securities and cash.

Our assets and liabilities are subject to the market risk of potential losses from adverse movements in market rates and prices. The principal risks are the impact of interest rate risk on fixed income securities, equity price risk on equity securities, property market risk and foreign currency risk. We are not exposed to movements in commodity markets.

Our Investment Committee establishes strategy, policies, procedures, reporting, review mechanisms and prudent principles to manage exposures to market risks. Management sets out investment objectives, determines the benchmarks and stipulates the asset “quality” criteria. More detailed investment guidelines specify the agreed operational limits of deviation to be taken on individual securities and industry sectors. There is a regular review process to ensure compliance with agreements.

We view the risk of fluctuation in the investment portfolio in three parts:

- *Shareholder funds and property and casualty operations.* We bear the risk on these investment portfolios representing our shareholders’ funds and assets supporting our property and casualty reserves. Our primary consideration in determining the investment policy is to ensure that the investments can be liquidated into cash to meet our liabilities as they come due based on actuarial assessment. Investments should also match the currency of the liabilities so as to avoid unnecessary exchange exposure.
- *Long term (life) business (excluding unit-linked (separate account) business).* We and, in the case of with-profit (participating) business, the policyholders bear the risks attributable to the investment portfolios supporting the long term (life) business reserves. Risks attributable to policyholders are managed with a view to ensuring that risks are acceptable taking account of the potential rewards and that policyholders’ reasonable expectations will be met. Market changes affecting the underlying investments, in the case of with-profit (participating) business, will have a direct impact on the fund for future appropriations (“FFA”). The FFA is used to fund future bonuses allocated to policyholders (through an increase in the sum assured) on with-profit (participating) business and transfers to shareholders out of the long term funds (reported as a profit). The basis for allocating the payouts to policyholders and

shareholders is discussed in the notes to our consolidated financial statements. In addition, a sustained decline in interest rates could increase actuarially determined long term (life) business provisions for guaranteed benefits where the implied interest rates used to determine these liabilities are greater than yields on assets backing such liabilities. We believe our ultimate exposure for such liabilities is reduced as we have the ability to manage future bonus/profit payouts. We also manage the exposure through the matching of assets and liabilities by duration and through other hedging strategies.

- *Unit-linked (separate account) business.* The policyholders bear the investment risk associated with investment portfolios that support unit-linked (separate account) products. Consequently these products are not covered by the subsequent discussion.

We use common derivative financial instruments such as interest rate swaps, options, futures and forward foreign exchange contracts related to both investments and borrowings. We do not hold or issue derivative instruments for speculative trading purposes.

Market risks are reduced by the diversification of our portfolio of financial instruments both by industry and by country/region. The diversification is shown in note 50G to our consolidated financial statements.

### **Interest Rate Risk**

The fair value of our portfolio of fixed income securities is inversely correlated to changes in the market interest rates. Thus if interest rates fall the fair value of the portfolio would tend to rise and vice versa. Mortgage-backed securities representing 17.5% of our fixed income securities have a prepayment option that could subject us to reinvestment risk. In the event that interest rates decline and these securities are prepaid, we bear reinvestment risk as the funds would be reinvested in lower interest-bearing securities.

The fair value of our fixed income securities as of December 31, 1999 and 1998 was £24,646 million and £23,864 million, respectively. Using a sensitivity analysis, if interest rates were to rise by 100 basis points, the fair value of the fixed income securities would fall approximately £1,646 million, or 7%, in 1999, and £1,484 million, or 6%, in 1998.

As of December 31, 1999, 1998 and 1997 we had not entered into any material derivative contracts that mitigate this risk.

### **Equity Risk**

Our portfolio of equity securities is subject to equity price risk arising from market changes. Thus if the value of equities fall so will the fair value of our portfolio.

The fair value of our equity securities as of December 31, 1999 and 1998 was £18,742 million and £18,107 million, respectively. Using a sensitivity analysis, if world equity markets decreased by 15%, the fair value of the equity portfolio would fall approximately £2,811 million in 1999 (£2,716 million in 1998). As of December 31, 1999 we had entered into short-term forward contracts to mitigate the effects of a fall in U.K. FTSE 100 equity prices. These derivatives would reduce the impact of this decline by £5 million in 1999 and by £73 million in 1998.

We do not have material holdings of unquoted equities.

## **Property Market Risk**

Our portfolio of properties is subject to property price risk arising from market changes. Thus if the value of property falls so will the fair value of the portfolio. The value of properties depends upon many factors, such as the state of the local economy, location, state of repair and market competition.

The fair value of properties that we held was £2,386 million as of December 31, 1999 and £2,664 million as of December 31, 1998. Of these total amounts, 70% was held in the United Kingdom in 1999 and 74% was held in the United Kingdom in 1998. Using a sensitivity analysis, if world property markets decreased by 15%, the fair value of our property portfolio would fall approximately £358 million in 1999 and £400 million in 1998.

As of December 31, 1999 we had not entered into any material derivative contracts which affect this risk.

## **Foreign Exchange Risk**

We have operations in over 50 countries. Accordingly, our net assets may fluctuate as a result of foreign currency exchange rate movements. Our primary foreign currency exposures are to the U.S. dollar, Canadian dollar, Danish kroner and Australian dollar. If the value of the British pound strengthens then the value of non-British pound net assets will decline when consolidated. Details of the exchange rates used in connection with our consolidated financial statements as of December 31, 1999, 1998 and 1997 are presented in note 6 to our consolidated financial statements.

Based upon our risk-based capital assessment and local regulatory solvency requirements sufficient net assets are maintained by our subsidiaries in their local currencies. Therefore capital held in our subsidiaries should be able to support the local insurance activities irrespective of currency movements. Consequently, this may affect the value of our consolidated shareholders' equity expressed in British pounds.

Within our individual operations, currency risk is generally managed according to our Group currency policy, which is to match assets to the currency of the related liability. Where we have any exchange risk arising from fixed income securities not held in the currency of the related liability this will generally be hedged with the purchase of forward foreign exchange contracts. The exception, which forms part of our investment strategy of portfolio diversification, is foreign exchange risk on non-British pound equities which are typically not hedged by forward currency contracts so that we are exposed to currency risk.

Using a sensitivity analysis, if the British pound strengthens by 15% against our major currencies then the fair value of investments held in foreign currencies would fall by £3,323 million as of December 31, 1999 and by £2,787 million as of December 31, 1998.

As of December 31, 1999, we had entered into forward foreign exchange contracts to mitigate the effects of adverse exchange movements. These derivatives reduce the impact of the above fall in the fair value of investments by £185 million as of December 31, 1999 and £110 million as of December 31, 1998.

**Sensitivity Analysis**  
**Change in Fair Value of Investments (1)**  
**As of December 1999 and 1998**

<u>Movements of markets</u>	<u>Increase (decrease)</u>	
	<u>1999</u>	<u>1998</u>
	(£ in millions)	
Interest rate markets (2)		
Increase in interest rates of 100 bps . . . . .	(1,646)	(1,484)
Equity markets (3)		
Decrease of equity markets of 15% . . . . .	(2,811)	(2,716)
Effect arising from derivatives . . . . .	5	73
Property markets (3)		
Decrease of property markets of 15% . . . . .	(358)	(400)
Currency markets (4)		
Decrease of major currencies versus British pound of 15% . . . . .	(3,323)	(2,787)
Effect arising from derivatives . . . . .	185	110

- (1) This analysis assumes that there is no correlation between equity price, interest rate, property market and foreign currency exchange rate risks. It also assumes that all other assets and liabilities remain unchanged and that no management action is taken. This analysis does not represent management's view of future market change.
- (2) The effect of interest rate movements is reflected as the effect of a one-time parallel shift up of interest rates on January 1, 2000 and January 1, 1999.
- (3) The effect of movements in equity and property markets is reflected as a one-time decrease of worldwide equity and property markets on January 1, 2000 and January 1, 1999 which results in a 15% decline in the value of our assets in these investment categories.
- (4) The effect of currency movements is reflected as a one-time decrease in the value of major currencies against the British pound on January 1, 2000 and January 1, 1999.

This analysis has not considered the impact of the above market changes on the valuation of our insurance liabilities. In addition, this analysis has not addressed the impact to the profit attributable to the shareholders. Under U.K. GAAP, fair value adjustments are included in both the property and casualty and long term (life) business technical accounts. However, the amount transferred to the shareholders, and reported as profit, specifically relating to the long term (life) operations is limited by the basis for which profit is released from the long term (life) business as determined by the actuary. These operations include the with-profit (participating) business operations. Consequently, not all movements in investments are reflected in the current year profit attributable to the shareholders. This information limits the ability of the analysis to accurately predict the impact of future market movements on fair values and future earnings.

## ITEM 10. DIRECTORS AND OFFICERS OF REGISTRANT

Our Memorandum and Articles of Association provide for a Board of Directors consisting of not fewer than 12 and not more than 36 directors. There are presently 13 directors in office, including five executive directors.

Our current directors, each of whose business address is 30 Berkeley Square, London W1J 6EW, and their other significant directorships are as follows:

<u>Name</u>	<u>Position</u>	<u>Director Since</u>	<u>Other Significant Directorships</u>
Sir Patrick Gillam . . .	Chairman (1) (2)	1997	Standard Chartered PLC
Anthony Forbes . . . .	Deputy Chairman (1) (2) (3)	1996△	Carlton Communications, The Merchants Trust plc
Robert Ayling . . . . .	Director (1) (2)	1993*	None
John Baker . . . . .	Director (1) (3)	1996△	Celltech Group
Nicholas Barber . . . .	Director (2) (3)	1996△	None
Robert Gunn . . . . .	Group Director Americas (4)	1999†	None
Julian Hance . . . . .	Group Finance Director (4)	1998	None
Arthur Hayes . . . . .	Group Director Investment & Financial Services (4)	1992*	Thistle Hotels PLC
Stephen Hill . . . . .	Director	2000x	Data Broadcasting Corporation, Financial Times Group Limited, MarketWatch.com Inc.
Henry Keswick . . . . .	Director (2) (3)	1975*	Jardine Matheson Holdings Limited, Robert Fleming Holdings Limited, The Telegraph Group
Robert Mendelsohn . .	Group Chief Executive Officer (1) (4)	1997	None
Carole St. Mark . . . .	Director (1) (2)	1998	Polaroid Corp, SuperValu Inc. and Gerber Scientific Inc.
Paul Spencer . . . . .	Chief Executive U.K. (4)	1996△	None

(1) Member of Nomination Committee.

(2) Member of Remuneration Committee.

(3) Member of Audit & Compliance Committee.

(4) Executive Director.

\* Director of Sun Alliance Group plc prior to the merger.

△ Director of Royal Insurance Holdings plc prior to the merger.

† Appointed on June 2, 1999.

x Appointed on August 2, 2000.

On May 12, 1999, Sir John Kemp-Welch and The Duke of Westminster, both non-executive directors, resigned. John Rowson retired from the Board at the conclusion of our Annual General Meeting on May 17, 2000.

One-third or, if not divisible by three, the number nearest to but not exceeding one-third, of our directors, other than those subject to reappointment, shall retire from office by rotation each year. A retiring director shall be immediately eligible for re-election by our shareholders.

Our executive officers, other than the executive directors who are named above, as of September 15, 2000 were as follows:

<u>Additional Executive Officers</u>	<u>Position</u>	<u>Executive Officer Since</u>
Jens-Erik Christensen . . . . .	CEO Europe	1998
Ewoud Kulk . . . . .	CEO Asia Pacific	1998
Rick Hudson . . . . .	Group Director, Worldwide Commercial Practices	1998
Syd Pennington . . . . .	Group Director, Customers & People	1996
Rod Hoover . . . . .	Group Treasurer	1998
Ian Hutchinson . . . . .	Director, Group Finance	1999
Jan Miller . . . . .	Director, Financial Control and Group Company Secretary	1989†

† Group Finance Controller of Royal Insurance Holdings plc prior to the merger.

## **ITEM 11. COMPENSATION OF DIRECTORS AND OFFICERS**

### **Compensation Policy**

A Remuneration Committee made up of non-executive directors determines the salary and other benefits of our executive directors and certain senior executives. The Remuneration Committee's objectives are to:

- ensure the attraction, retention and motivation of high caliber individuals
- reward executive directors by reference to the overall performance of the Group, and where appropriate their individual business units
- align the interests of our executive directors as closely as possible with those of our shareholders

Over half of our revenues are earned outside the United Kingdom. The majority of our senior management team are not U.K. citizens. The Remuneration Committee therefore takes careful account of international, as well as U.K., trends in compensation. The Remuneration Committee's current policy is to compensate our executive directors and certain senior executives with an amount equivalent to the median pay levels of companies of comparable size and complexity, including both international financial services and other listed companies. We aim to encourage top quartile performance by means of short term and long term incentive plans. The Remuneration Committee reviews advice and data from compensation consultants where necessary. In framing its policy, the Remuneration Committee has taken account of the relevant provisions of the Combined Code annexed to the Listing Rules of the U.K. Listing Authority.

The Remuneration Committee annually reviews the individual salary, incentive and benefit levels of our executive directors and certain senior executives, giving regard to individual responsibilities and performance, and taking account of pay and conditions throughout the Group.

Compensation for executives consists of four principal elements:

- a base salary
- an annual bonus, based on the performance of the Group as a whole, the individual and, where appropriate, the applicable business unit
- participation in executive share option plans
- pension plans

## Compensation

The table below presents total compensation, excluding compensation for termination of contracts, for each of our directors, including those directors who resigned in 1999, and for our executive officers as a group, including our executive directors, for the year ended December 31, 1999.

<u>Name</u>	<u>Salary and Fees</u>	<u>Allowances and Benefits</u>	<u>Total</u>
	(£ in thousands)		
<b>Executive Directors:</b>			
Robert J. Gunn (1) .....	273	18	291
Julian C. Hance .....	275	10	285
T. Arthur Hayes .....	315	13	328
Robert V. Mendelsohn (2) .....	620	356	976
Paul Spencer .....	358	14	372
<b>Non-executive Directors:</b>			
Robert J. Ayling .....	31	—	31
John W. Baker .....	31	—	31
Nicholas C.F. Barber .....	39	—	39
Anthony D.A.W. Forbes .....	60	—	60
Sir Patrick Gillam .....	152	—	152
Henry Keswick .....	39	—	39
Carole F. St. Mark .....	31	—	31
<b>Former Directors:</b>			
Sir John Kemp-Welch (3) .....	9	—	9
John A. Rowson (4) .....	31	—	31
The Duke of Westminster (3) .....	9	—	9
<b>Executive Officers (as a group) .....</b>	<b>3,166</b>	<b>462</b>	<b>3,628</b>

- (1) Mr. Gunn was appointed to the Board on June 2, 1999. Of his compensation in 1999, £174,000 was receivable after appointment to the Board.
- (2) As an expatriate director, Mr. Mendelsohn receives compensation which is intended to put him in a position, after taking into account taxation and living cost differentials, where he is no worse off than were he to perform the same duties for us in his home country, the United States. We also pay him additional expatriate benefits, such as the provision of accommodation and relocation allowances. These benefits totalled £294,000 in 1999 and are included within allowances and benefits.
- (3) The Duke of Westminster and Sir John Kemp-Welch resigned on May 12, 1999.
- (4) Mr. Rowson retired from the Board on May 17, 2000.

On August 2, 2000, Stephen Hill was appointed to the Board. The aggregate compensation for our directors, including amounts received from subsidiaries, for the year ended December 31, 1999 was £2.7 million.

## Annual Bonus Plans

The annual bonus plans for 1999 and 2000 are based on our risk-based return on capital. The maximum payment in 2000 for our executive directors, except Mr. Gunn, and other senior executives will be 80% of their base salary. The individuals will be entitled to 30% of their base salary if certain targets are met. We will only pay the maximum amount in the event of exceptional individual and corporate performance. Mr. Gunn will be entitled to 50% of his base salary if certain targets are met and 100% in the event of exceptional individual and corporate performance.

Annual bonuses for executive directors with regional managerial responsibility are based 70% on the performance of their region and 30% on Group results.

We did not pay any bonuses to our executive directors for the business year ended December 31, 1999.

### **Performance Share Plan for Mr. Mendelsohn**

In order to recruit Mr. Mendelsohn as Group Chief Executive, his U.S. service contract was replaced with a U.K. contract that includes a new non-pensionable long-term incentive arrangement. We will grant Mr. Mendelsohn ordinary shares, at market prices, in an amount equal to his annual base salary multiplied by 1.6 effective January 1, 1998 and annually thereafter during the term of his U.K. employment contract. These grants are conditional upon satisfying challenging performance criteria over consecutive three-year periods, such that for 75% to 100% of the ordinary shares to vest all of the following conditions must be met over any given three-year period:

- growth in our total shareholder return, or TSR, must be in the top quartile of a defined group of twelve leading U.K., U.S. and continental European insurers;
- growth in our TSR must exceed the U.K. retail prices index, or RPI, plus 2% per annum compound; and
- our ordinary share price must grow by between 5% and 20%, with 20% growth required if 100% of the shares are to be vested.

If TSR growth is below the comparative group median, or RPI plus 2% per annum is not achieved, then no ordinary shares will vest. Between 30% and 60% of the ordinary shares will vest for TSR growth which falls outside the top quartile but which is at or above the comparative group median, subject to achieving the required 2% growth above RPI. TSR is based on ordinary share price and cumulative cash dividends. Each three-year performance period will be self-contained. Mr. Mendelsohn is required to accumulate and retain a minimum shareholding resulting from the operation of this plan that equals his annualized base salary.

### **Pension Benefits**

With the exception of Mr. Gunn, the base salary of executive directors is the only element of compensation that is pensionable. Mr. Gunn's pensionable compensation includes his base salary plus the average of bonuses that he receives in the 5 years before his retirement. With the exception of Mr. Mendelsohn and Mr. Gunn, all executive directors are participants in one of our two main U.K. pension plans, both of which are non-contributory and which are open to U.K. staff in general.

The U.K. plans provide participants with a pension of up to two-thirds of pensionable salary, which excludes any incentive payments, at age 62. Executives who joined either plan after May 1989 are subject to the statutory earnings cap of £91,800 for 2000/2001 on U.K. Inland Revenue approved pension plans. Benefits are secured for some executives in respect of that part of their salary exceeding the earnings cap under the Royal Insurance Supplementary Pension Scheme, which is an unapproved and unfunded plan.

Mr. Mendelsohn continues to accrue benefits under U.S. state and company non-contributory pension arrangements based on the U.S. dollar equivalent of his U.K. salary or, if higher, a deemed final salary of no less than \$1,300,000.

Mr. Gunn is a participant in the approved non-contributory Royal & SunAlliance Canada staff pension plan. This, together with a supplementary pension plan, provides a pension of approximately two-thirds of salary at age 62. The supplementary pension plan is an unapproved and unfunded plan.

Non-executive directors are not entitled to any pension benefits. The table below presents the pension benefits earned by each of our executive directors and our executive officers as a group, other than our executive directors, as participants in our defined benefit plans as of December 31, 1999.

<u>Name</u>	<u>Date of birth</u>	<u>Actual service to year end</u>	<u>Increase in accrued pension during the year (1)</u>	<u>Accumulated total accrued pension at December 31, 1999 (2)</u>
			£	£
Robert J. Gunn (3) . . . . .	April 23, 1945	26 yrs 7 m	101,965	229,209
Julian C. Hance (4) . . . . .	October 6, 1955	12 yrs 9 m	18,584	69,417
T. Arthur Hayes (4) . . . . .	March 31, 1943	37 yrs 11 m	15,610	202,224
Robert V. Mendelsohn (5) . . . . .	July 18, 1946	5 yrs 11 m	11,851	343,861
Paul Spencer (4) . . . . .	January 3, 1950	4 yrs 0 m	14,500	42,293
<b>Executive officers (as a group)</b> . . . . .	—	—	127,000	—

- (1) The increase in accrued pension during 1999 excludes any increase for inflation. No contribution by participants in the plans is required. All participants have the option of making additional voluntary payments. Neither the contribution nor the resulting benefits are included in the table.
- (2) The accumulated total accrued pension shown is the annual payment from normal retirement age based on service at December 31, 1999.
- (3) Mr. Gunn is a member of our Canadian defined benefit pension plans which provides level pensions from retirement during his lifetime and 60% of the pension to a surviving spouse. Increases to pensions when in payment are applied on a discretionary basis with the aim of providing increases of two-thirds of the increase in the Canadian Consumer Price Index. No allowance is made for these discretionary increases in transfer values.  
Of the amounts shown above, only £19,565 in respect of the accumulated total accrued pension at December 31, 1999 and £529 of the increase in accrued pension during the year had vested at December 31, 1999. The balance vested in April 2000 when Mr. Gunn turned 55.
- (4) Mr. Hance, Mr. Hayes and Mr. Spencer are participants in our U.K. plans, which provide a spouse's pension of two-thirds of the participant's pension. If not payable to a spouse it is payable to adult dependants, on a discretionary basis, or eligible children. In addition, children's pensions are one-third of the participant's pension except in the case of Mr. Spencer where any eligible children's pensions are £649 per year per child below age 10 and £973 per year per child aged 10 and above. On the death of a pensioner within 5 years of retirement, a lump sum is payable equal to the balance of 5 years' pension payments except for Mr. Spencer, where the sum is less any dependants' pensions payable during this period. Increases to pensions in payment are guaranteed at 5% per year or the increase in price inflation, if lower. However, an allowance for discretionary increases to pensions in payment is included in transfer value calculations, although not in the statutory minimum cash equivalent calculation. The allowance is in respect of the difference between increases in line with price inflation and the guaranteed level of increases. Early retirement rights at age 60 apply in respect of the component of pension for service from May 17, 1990, except for Mr. Spencer where the rights are for service from October 1, 1995.
- (5) Mr. Mendelsohn is a participant in our U.S. defined benefit pension plans which provide level pensions from normal retirement age during his lifetime. The benefits are to be paid in the form of a level pension during his lifetime and two-thirds of the pension to a surviving spouse, the value being actuarially equivalent to the single life pension to which he is entitled. The pension figures shown are in respect of the single life pension entitlement. The normal retirement age is 65.

Early retirement rights vested on January 15, 1999 and apply in respect of £335,073 of the total accrued pension at December 31, 1999 and in respect of £10,321 of the increase in the accrued pension in the year. If these rights had been exercised at December 31, 1999, the immediate annual pension entitlement would have been £248,791.

Mr. Mendelsohn is also a member of a defined contribution plan to which we contributed £2,748 during the year.

## **Directors' Service Contracts**

Directors holding executive office have service contracts, the terms of which are considered by the Remuneration Committee, to provide a proper balance of duties and security between the respective parties.

Mr. Hayes, Mr. Spencer and Mr. Mendelsohn have contracts that are terminable by us on two years' notice and Mr. Hance's contract is terminable on one year's notice. Mr. Gunn is employed under a Canadian employment agreement. There is no provision for termination in his agreement and thus termination would be a matter for mutual agreement in the context of Canadian employment law and practice.

In the case of all executive directors, dismissal by us, without notice and in the absence of specific grounds, may require payments by us. If not so terminated, each executive director's contract can continue until the director attains the age of 62, or 65 in the case of Mr. Mendelsohn and Mr. Gunn.

Non-executive directors do not have service contracts and are not entitled to bonus payments or pension arrangements. The Board sets the compensation levels for our non-executive directors.

## **ITEM 12. OPTIONS TO PURCHASE SECURITIES FROM REGISTRANT OR SUBSIDIARIES**

### **Options**

In 1999, our shareholders at the Annual General Meeting approved the introduction of a new executive share option scheme, or ESOS. This followed a detailed review by our Remuneration Committee into the effectiveness of our ESOS.

Awards of executive share options are targeted to reward and encourage high performance. Our executive directors and other senior executives are eligible to receive annual grants of options in an amount of ordinary shares equal in current market value to their base salary. When that level of options exceeds four times salary, these grants are funded by way of ordinary shares purchased in the market and retained in a trust. All participants in the plan are encouraged to retain their options for as long as possible. Shareholding guidelines apply to all participants. Our executive directors and certain other senior executives are required to build and retain a minimum shareholding of ordinary shares equivalent to at least one times their current salary. Normally, share options are exercisable between three and 10 years after grant.

Grants of executive share options made in 1999 were made subject to a performance condition that they could not be exercised unless we delivered a net return on capital which exceeded inflation by an annual average of at least 6% over a three year period. The performance condition is subject to annual review by the Remuneration Committee. Executive share options granted between 1996 and 1997 were subject to the performance condition that average total shareholder return must at least equal the median of the FTSE 100 companies for a period of three years prior to exercise.

With the exception of Mr. Mendelsohn, no directors received nor were entitled to receive any benefits under any other long-term incentive plans, apart from participation in our ESOS and the savings related share option plans. Our savings related share option plan is also open to all staff in the United Kingdom and an increasing number of other countries in which we operate.

As of September 15, 2000 our employees held options under the Savings Related Share Option Schemes, or SAYE, exercisable within 6 months after maturity, to subscribe for 30,713,995 ordinary shares at prices ranging between 206.2p and 483.0p per share.

As of September 15, 2000, our employees also held options under the ESOS, potentially exercisable between three and ten years after grant to subscribe for 33,409,170 ordinary shares at prices ranging between 141.6p and 550.8p per share.

The table below presents changes in option holdings of our executive officers, including our executive directors, during the year ended December 31, 1999.

Name	Plan	Options held	Options	Options	Weighted	Weighted	Gains on	Options held
		at January	granted	exercised	average	average		exercised
		1, 1999	during the	or lapsed	exercise	market		31, 1999
		or on	period	during the	price	price at date	exercise	
		appointment		period		of exercise		
					p	p	£	
<b>Executive directors:</b>								
Robert J. Gunn	ESOS	296,851	26,643	—	—	—	—	323,494
	SAYE	—	4,269	—	—	—	—	4,269
Julian C. Hance	ESOS	97,393	91,795	—	—	—	—	189,188
	SAYE	13,035	—	8,467	186	516	27,941	4,568
T. Arthur Hayes	ESOS	194,278	31,683	—	—	—	—	225,961
	SAYE	4,018	—	—	—	—	—	4,018
Robert V. Mendelsohn	ESOS	785,811	61,385	—	—	—	—	847,196
	SAYE	—	—	—	—	—	—	—
Paul Spencer	ESOS	296,526	72,053	—	—	—	—	368,579
	SAYE	5,407	—	—	—	—	—	5,407
<b>Executive officers:</b>								
Jens-Erik Christensen	ESOS	60,361	66,012	—	—	—	—	126,373
	SAYE	—	4,272	—	—	—	—	4,272
Rod Hoover	ESOS	22,132	26,721	—	—	—	—	48,853
	SAYE	—	—	—	—	—	—	—
Rick Hudson	ESOS	67,717	21,114	—	—	—	—	88,831
	SAYE	6,104	—	1,186	233	556	3,831	4,918
Ian Hutchinson	ESOS	52,574	13,861	—	—	—	—	66,435
	SAYE	12,841	598	6,290	186	515	20,663	7,149
Ewoud Kulk	ESOS	104,508	81,894	—	—	—	—	186,402
	SAYE	—	4,260	—	—	—	—	4,260
Jan Miller (1)	ESOS	91,169	14,059	—	—	—	—	105,228
	SAYE	28,482	—	20,830	122	464	59,650	7,652
Syd Pennington	ESOS	207,198	22,870	—	—	—	—	230,068
	SAYE	7,592	—	—	—	—	—	7,592

(1) Includes 3,368 options that lapsed during the period.

The table below presents options to acquire ordinary shares held by our executive officers, including our executive directors, as of September 15, 2000 as a result of executive and savings related share option plans.

Name	Number of ordinary shares underlying options	Weighted average exercise price		Dates exercisable (3)	
		(1)	(2)	From	To
		p			
<b>Executive Directors:</b>					
Robert J. Gunn	382,046	352.8		5/17/94	9/11/10
Julian C. Hance	282,689	453.4		4/14/97	9/11/10
T. Arthur Hayes	309,600	397.9		4/14/97	9/11/10
Robert V. Mendelsohn	1,006,548	339.6		6/1/99	9/11/10
Paul Spencer	466,697	420.7		10/17/99	9/11/10
<b>Executive Officers:</b>					
Jens-Erik Christensen	221,178	458.6		9/15/01	9/11/10
Rod Hoover	71,413	485.6		9/15/01	9/11/10
Rick Hudson	143,013	443.8		5/17/94	9/11/10
Ian Hutchinson	109,623	412.9		4/14/95	9/11/10
Ewoud Kulk	252,123	483.6		9/10/00	9/11/10
Jan Miller	120,872	377.5		6/2/99	9/11/10
Syd Pennington	301,672	424.1		10/17/99	9/11/10

- (1) Options granted during 1999 under the ESOS were granted at option prices of 505p and 550.8p, which were the market prices at the dates of the grants. Options granted during 2000 under the ESOS were granted at option prices of 345p and 458p, which were the market prices at the dates of the grants.
- (2) The official closing middle-market price at its highest during 1999 was 622.17p and at its lowest was 356.00p per share. On the last dealing day of the year, the official closing middle-market price was 471.50p per share. The official closing middle-market price on September 15, 2000 was 459.25p per share.
- (3) Options granted under the ESOS are potentially exercisable between three and 10 years after grant. Current practice is that the exercise of options under the Royal & Sun Alliance Insurance Group plc 1999 Executive Share Option Scheme is conditional upon our delivering a net real return on capital exceeding an average annual 6% over a period of three consecutive years prior to the exercise. The exercise of previously issued share options under the ESOS between 1996 and 1997 is conditional upon our achieving an average total shareholder return at least equal to the median of the FTSE 100 companies for a period of three years prior to exercise. No performance conditions apply to options granted prior to 1996 under other plans.

### Shareholdings

The table below presents the number of ordinary shares held by each of our directors and our executive officers.

<u>Name</u>	<u>Shares held at January 1, 1999 or on appointment (1)</u>	<u>Shares held at December 31, 1999 (2)</u>	<u>Shares held at September 15, 2000</u>
<b>Directors:</b>			
Robert J. Ayling . . . . .	600	545	545
John W. Baker . . . . .	1,890	1,718	4,218
Nicholas C.F. Barber . . . . .	7,334	6,667	6,667
Anthony D.A.W. Forbes . . . . .	5,335	4,850	4,850
Sir Patrick Gillam . . . . .	—	9,575	9,952
Robert J. Gunn (3) . . . . .	3,000	15,327	15,327
Julian C. Hance (3) . . . . .	—	8,467	8,467
T. Arthur Hayes (3) . . . . .	60,000	54,543	57,326
Stephen Hill (4) . . . . .	—	—	—
Henry Keswick . . . . .	30,844	29,536	30,699
Robert V. Mendelsohn (3) . . . . .	23,474	46,340	71,340
Paul Spencer (3) . . . . .	533	484	484
Carole F. St. Mark . . . . .	—	5,676	5,899
<b>Executive officers:</b>			
Jens-Erik Christensen . . . . .	—	—	—
Rod Hoover . . . . .	1,270	10,570	15,570
Rick Hudson . . . . .	—	29,329	31,554
Ian Hutchinson . . . . .	24	6,311	8,817
Ewoud Kulk . . . . .	—	—	—
Jan Miller . . . . .	74,723	85,233	85,637
Syd Pennington . . . . .	1,605	11,536	11,989

- (1) Or on appointment as a director or officer if appointed after January 1, 1999.
- (2) On May 14, 1999, every 11 ordinary shares of 25p each were consolidated into 10 new ordinary shares of 27.5p each.
- (3) In addition to the interests shown above, the directors indicated, in common with our employees, had a beneficial interest as at December 31, 1999 in 200,000 ordinary shares of 27.5p each held in the Royal &

Sun Alliance ESOP Trust No 2. On March 29, 2000 a further 275,000 ordinary shares of 27.5p each were purchased by the Royal & Sun Alliance ESOP Trust No. 2. On September 13, 2000 a further 222,200 ordinary shares of 27.5p each were purchased by the Royal & Sun Alliance ESOP Trust No. 2.

(4) Mr. Hill was appointed to the Board on August 2, 2000.

### **ITEM 13. INTEREST OF MANAGEMENT IN CERTAIN TRANSACTIONS**

A number of our directors, other key managers, their close families and entities under their control have property and casualty and/or life and asset accumulation policies or products with our subsidiary companies. Such policies and products are on normal commercial terms except that executive directors and key managers are entitled to special rates that are also available to other members of our staff. The Board has considered the financial effect of such insurance policies and other products and other transactions with our companies and has concluded that they are not material to us or to the individuals concerned and, if disclosed, would not influence decisions made by users of this registration statement.

At December 31, 1999, we had loans outstanding to Mr. Hance totaling £18,032 under the standard terms of our U.K. Car Ownership Scheme that is open to all U.K. managers within a qualifying salary band. The loans were entered into during 1998, prior to his appointment to the Board, and are repayable not later than 2001. Interest is charged at a variable rate, which was 8% per year throughout 1999, except on £5,000 that is interest free.

The Board has also concluded that there are no transactions with other directors or key managers that are material to their own financial affairs.

## **ITEM 14. DESCRIPTION OF SECURITIES**

### ***DESCRIPTION OF ORDINARY SHARES***

*The discussion below is a summary of the material provisions of our Memorandum and Articles of Association, the U.K. Companies Act 1985 and the U.K. Companies Act 1989. Because it is a summary, this discussion does not purport to be complete and is qualified in its entirety by reference to U.K. law and to the Memorandum and Articles of Association, a copy of which is filed with the SEC as an exhibit to this registration statement.*

#### **General**

We are authorized to issue 2,000,000,000 ordinary shares, nominal value 27.5p per share, and 300,000,000 preference shares, nominal value £1 per share. As of September 15, 2000, there were 1,432,554,960 ordinary shares and 125,000,000 preference shares issued and outstanding. All of our issued ordinary shares are fully paid and non-assessable. The ordinary shares are issued in registered form and in an uncertificated form under CREST.

#### **Dividends**

Subject to the provisions of the Companies Act 1985, the Companies Act 1989 and all other applicable U.K. statutes or legislation (the “Statutes”), our Board may pay such interim dividends as it determines are appropriate. Dividends may be paid only out of profits available for that purpose. The declaration of a final dividend on our ordinary shares requires shareholder approval by adoption of an ordinary resolution at a general meeting of our shareholders. Final dividends shall not exceed the amount recommended by our Board.

The holders of our preference shares are entitled to a preference over the holders of any other class of our shares for all payments of cumulative or non-cumulative dividends on such date or dates, and on such terms and conditions, as our Board may determine prior to issuance of such preference shares.

#### **Voting, Shareholder Meetings and Resolutions**

Voting at a general meeting of shareholders is by show of hands unless a poll (i.e., a written vote on a one vote for every ordinary share held basis) is demanded either before, or as a result of, the show of hands. A poll may be demanded by the chairman of the meeting, by at least three shareholders entitled to vote present in person or by proxy, or by any shareholder or shareholders present in person or by proxy representing not less than one-tenth of the total voting rights of all shareholders entitled to vote or holding not less than one-tenth of the total sum paid up on all shares entitled to vote. A poll may not be demanded for the election of the chairman of the meeting or on a question of adjournment.

An annual general meeting shall be held once every calendar year at the time (within a period of not more than 15 months after the last preceding annual general meeting) and at the place as may be determined by the Board. The quorum required for a general meeting of shareholders consists of three shareholders present in person or by proxy and entitled to vote.

An ordinary resolution (such as a resolution for the approval of the financial reports or the declaration of a final dividend) requires approval by the holders of a majority of the voting rights represented at a meeting, in person or by proxy, and voting thereon. A special or extraordinary resolution requires approval of the holders of 75% of the voting rights represented at the meeting, in person or by proxy, and voting thereon. A special or extraordinary resolution can only be considered if shareholders receive at least 21 days prior notice of the meeting at which such resolution will be considered.

Each shareholder of record is entitled to receive at least 14 days prior notice of a shareholders' meeting (other than an annual general meeting) and at least 21 days prior notice of an annual general meeting or any shareholders' meeting at which a special resolution is to be adopted.

Shareholders (excluding holders of our preference shares) have the right to receive notice of, to attend and to vote at all general meetings on all matters submitted to our shareholders for a vote. Except as otherwise provided in our Articles of Association (the "Articles"), each shareholder present in person and entitled to vote shall have one vote on all matters to be decided by a show of hands, and each shareholder who is present in person or by proxy and entitled to vote shall have one vote per share on all matters to be decided by a poll.

Holders of our preference shares have the right to receive notice of, attend, speak and vote at our general meetings only:

- if on the notice date we have not paid in full any preferential dividends currently due to the holders of the preference shares;
- if a resolution is proposed to modify any of the rights or privileges of the holders of the preference shares, to liquidate, dissolve or wind up our affairs or to reduce our share capital (other than by redemption or share repurchase), in which case they shall only be entitled to vote on such resolution; or
- in such other circumstances, and upon and subject to such terms, as our Board may determine prior to issuance of such preference shares.

In such events, holders of preference shares present at the meeting in person are each entitled to one vote on a show of hands and on a poll, each holder who is present in person or by proxy is entitled to one vote for each complete £1 nominal value of preference shares held conferring such entitlements or such other entitlement determined prior to issuance.

Unless our directors determine otherwise, no shareholder shall be entitled to be present or to vote at any general meeting if he or she currently owes us any amounts due to have been paid following a call in respect of our shares or if he or she has been served by our Board with a Restriction Notice (as defined below).

### **Restrictions on Holders of Ordinary Shares**

If any shareholder, or any other person our Board determines to be interested in any of our ordinary shares, has been duly served with a notice under Section 212 of the Companies Act 1985 (as amended) (the "Act") to provide certain information and such person is in default in supplying us the information thereby required within 14 days from the date of the service of such notice, we may (at our Board's discretion) serve such shareholder or person with a notice (a "Restriction Notice"). Such Restriction Notice shall direct that the shareholder, and any transferee except in prescribed circumstances, shall not be entitled to be present or to vote at any general meeting or class meeting, or be counted in a quorum with respect to the shares in relation to which the default occurred and/or any other shares held at the date of the Restriction Notice ("Restricted Shares"). Where the Restricted Shares represent at least 0.25 percent in nominal value of all issued shares of the same class, we may retain any dividends or other money otherwise payable on such shares without any liability to pay interest. We also may restrict any election in respect of Restricted Shares if we offer a scrip dividend and prohibit the transfer of any of the shares held by the shareholder unless the shareholder is not personally in default in supplying the information requested, the transfer is only part of the holder's shares and is accompanied by a certificate of the shareholder in a form satisfactory to our Board to the effect that after due and careful inquiry the shareholder is satisfied that none of the shares to be transferred are Restricted Shares.

## **Preemptive Rights/New Issues of Shares**

Holders of ordinary shares have no preemptive rights under our Articles. Under the Act, however, our Board generally may not issue any shares or rights to subscribe for or convert any security into shares unless so authorized by the Articles or by an ordinary resolution of our shareholders. The Act also restricts our Board from issuing ordinary shares for cash unless such securities are first offered to existing holders of ordinary shares in proportion to their shareholdings or the issuance is authorized by a special resolution of our shareholders.

By a special resolution dated May 17, 2000, our shareholders have waived the statutory preemptive rights available to holders of our ordinary shares until May 16, 2005 with respect to the issuance of ordinary shares up to an aggregate nominal value of £19,640,668, as well as for any rights issue or scrip dividend offer.

## **Distributions on Liquidation**

If we liquidate, dissolve or wind-up, the liquidator may, with the approval of an extraordinary resolution and any other approval required by the Statutes, divide among our shareholders all or part of our assets and may, for such purpose, value such property and determine how such division shall be carried out. Holders of our preference shares shall have priority over all other shares to receive, out of our surplus assets remaining after payment of our liabilities, an amount per preference share equal to the nominal amount of such preference share together with such premium (if any) as may be determined by our directors prior to issuance and any arrears and accruals of dividends payable (whether or not due and payable) calculated up to and including the day of commencement of the liquidation, dissolution or winding-up.

## **Registrar**

Our registrar is Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA, England.

## ***DESCRIPTION OF AMERICAN DEPOSITARY SHARES***

Citibank, N.A. will act as the depositary bank for the American Depositary Shares. Citibank's depositary offices are located at 111 Wall Street, New York, New York 10005. American Depositary Shares are frequently referred to as "ADSs" and represent ownership interests in securities that are on deposit with the depositary bank. ADSs are normally represented by certificates that are commonly known as "American Depositary Receipts" or "ADRs". The depositary bank typically appoints a custodian to safekeep the securities on deposit. In this case, the custodian is Citibank, N.A., London Branch located at Cotton Centre, Hays Lane, London SE1 2QT, England.

We have appointed Citibank as the depositary bank pursuant to a deposit agreement. A copy of the deposit agreement is on file with the SEC under cover of a Registration Statement on Form F-6. You may obtain a copy of the deposit agreement from the SEC's Public Reference Room at Judiciary Plaza, Room 1024, 450 Fifth Street, N.W., Washington, D.C. 20549. Please refer to Registration Number 333-9264 when retrieving such copy.

We are providing you with a summary description of the ADSs and your rights as an owner of ADSs. Please remember that summaries by their nature lack the precision of the information summarized and that a holder's rights and obligations as an owner of ADSs will be determined by the deposit agreement and not by this summary. We urge you to review the deposit agreement in its entirety as well as the form of ADR attached to the deposit agreement.

Each ADS represents five ordinary shares on deposit with the custodian bank. An ADS will also represent any other property received by the depositary bank or the custodian on behalf of the owner of the ADS but that has not been distributed to the owners of ADSs because of legal restrictions or practical considerations.

If you become an owner of ADSs, you will become a party to the deposit agreement and therefore will be bound to its terms and to the terms of the ADR that represents your ADSs. The deposit agreement and the ADR specify our rights and obligations as well as your rights and obligations as owner of ADSs and those of the depositary bank. As an ADS holder you appoint the depositary bank to act on your behalf in certain circumstances. The deposit agreement is governed by New York law. However, our obligations to the holders of ordinary shares will continue to be governed by the laws of England and Wales, which may be different from the laws in the United States.

As an owner of ADSs, you may hold your ADSs either by means of an ADR registered in your name or through a brokerage or safekeeping account. If you decide to hold your ADSs through your brokerage or safekeeping account, you must rely on the procedures of your broker or bank to assert your rights as ADS owner. Please consult with your broker or bank to determine what those procedures are. This summary description assumes you have opted to own the ADSs directly by means of an ADR registered in your name and, as such, we will refer to you as the “holder”.

## **Dividends and Distributions**

As a holder, you generally have the right to receive the distributions we make on the securities deposited with the custodian bank. Your receipt of these distributions may be limited, however, by practical considerations and legal limitations. Holders will receive such distributions under the terms of the deposit agreement in proportion to the number of ADSs held as of a specified record date.

### *Distributions of Cash*

Whenever we make a cash distribution for the securities on deposit with the custodian, we will notify the depositary bank. Upon receipt of such notice the depositary bank will arrange for the funds to be converted into U.S. dollars and for the distribution of the U.S. dollars to the holders.

The conversion into U.S. dollars will take place only if practicable and if the U.S. dollars are transferable to the United States. The amounts distributed to holders will be net of the fees, expenses, taxes and governmental charges payable by holders under the terms of the deposit agreement. The depositary will apply the same method for distributing the proceeds of the sale of any property (such as undistributed rights) held by the custodian in respect of securities on deposit.

### *Distributions of Shares*

Whenever we make a free distribution of ordinary shares for the securities on deposit with the custodian, we will notify the depositary bank. Upon receipt of such notice, the depositary bank will either distribute to holders new ADSs representing the ordinary shares deposited or modify the ADS-to-ordinary share ratio, in which case each ADS you hold will represent rights and interests in the additional ordinary shares so deposited. Only whole new ADSs will be distributed. Fractional entitlements will be sold and the proceeds of such sale will be distributed as in the case of a cash distribution.

The distribution of new ADSs or the modification of the ADS-to-ordinary share ratio upon a distribution of ordinary shares will be made net of the fees, expenses, taxes and governmental charges payable by holders under the terms of the deposit agreement. In order to pay such taxes or governmental charges, the depositary bank may sell all or a portion of the new ordinary shares so distributed.

No such distribution of new ADSs will be made if it would violate a law (e.g., the U.S. securities laws). If the depositary bank does not distribute new ADSs as described above, it may sell the ordinary shares received and distribute the proceeds of the sale as in the case of a distribution of cash. The depositary bank may hold and/or distribute any unsold ordinary shares in accordance with the deposit agreement.

#### *Distributions of Rights*

Whenever we intend to distribute rights to purchase additional ordinary shares, we will give prior notice to the depositary bank and we will assist the depositary bank in determining whether it is lawful and reasonably feasible to distribute rights to purchase additional ADSs to holders.

The depositary bank will establish procedures to distribute rights to purchase additional ADSs to holders and to enable such holders to exercise such rights if it is lawful and reasonably feasible to make the rights available to holders of ADSs, and if we provide all of the documentation contemplated in the deposit agreement (such as opinions to address the lawfulness of the transaction). You may have to pay fees, expenses, taxes and other governmental charges to subscribe for the new ADSs upon the exercise of your rights. The depositary bank is not obligated to establish procedures to facilitate the distribution and exercise by holders of rights to purchase new ordinary shares directly rather than new ADSs.

The depositary bank will *not* distribute the rights to you if:

- We do not request that the rights be distributed to you or we ask that the rights not be distributed to you; or
- We do not deliver satisfactory documents to the depositary bank; or
- It is not reasonably feasible to distribute the rights.

The depositary bank will sell the rights that are not exercised and appear to be about to lapse or not distributed if such sale is lawful and reasonably feasible. The proceeds of such sale will be distributed to holders as in the case of a cash distribution. If the depositary bank is unable to sell the rights, it will allow the rights to lapse.

#### *Elective Distributions*

Whenever we intend to distribute a dividend payable at the election of shareholders either in cash or in additional ordinary shares, we will give prior notice thereof to the depositary bank and will indicate whether we wish the elective distribution to be made available to you. In such case, we will assist the depositary bank in determining whether such distribution is lawful and reasonably feasible.

The depositary bank will make the election available to you only if it is reasonably feasible and if we have provided all of the documentation contemplated in the deposit agreement. In such case, the depositary bank will establish procedures to enable you to elect to receive either cash or additional ADSs, in each case as described in the deposit agreement.

If the election is not made available to you, you will receive either cash or additional ADSs, depending on what a shareholder in England and Wales would receive for failing to make an election, as more fully described in the deposit agreement.

#### *Other Distributions*

Whenever we intend to distribute property other than cash, ordinary shares or rights to purchase additional ordinary shares, we will notify the depositary bank in advance and will indicate whether we wish

such distribution to be made to you. If so, we will assist the depositary bank in determining whether such distribution to holders is lawful and reasonably practicable.

If it is reasonably practicable to distribute such property to you and if we provide all of the documentation contemplated in the deposit agreement, the depositary bank will distribute the property to the holders in a manner it deems practicable.

The distribution will be made net of fees, expenses, taxes and governmental charges payable by holders under the terms of the deposit agreement. In order to pay such fees, expenses, taxes and governmental charges, the depositary bank may sell all or a portion of the property received.

The depositary bank will *not* distribute the property to you and will sell the property if:

- We do not request that the property be distributed to you or if we ask that the property not be distributed to you; or
- We do not deliver satisfactory documents to the depositary bank; or
- The depositary bank determines that all or a portion of the distribution to you is not reasonably practicable or feasible.

The proceeds of such a sale will be distributed to holders as in the case of a cash distribution.

### **Redemption**

Whenever we decide to redeem any of the securities on deposit with the custodian, we will notify the depositary bank. If we provide all of the documentation contemplated in the deposit agreement, the depositary bank will mail notice of the redemption to the holders. Our Memorandum and Articles of Association currently prohibit the redemption of ordinary shares.

The custodian will be instructed to surrender the shares being redeemed against payment of the applicable redemption price. The depositary bank will convert the redemption funds received into U.S. dollars upon the terms of the deposit agreement and will establish procedures to enable holders to receive the net proceeds from the redemption upon surrender of their ADSs to the depositary bank. You may have to pay fees, expenses, taxes and other governmental charges upon the redemption of your ADSs. If less than all ADSs are being redeemed, the ADSs to be retired will be selected by lot or on a *pro rata* basis, as the depositary bank may determine.

### **Changes Affecting Ordinary Shares**

The ordinary shares held on deposit for your ADSs may change from time to time. For example, there may be a change in nominal value, a split-up, cancellation, consolidation or reclassification of such ordinary shares or a recapitalization, reorganization, merger, consolidation or sale of assets.

If any such change were to occur, your ADSs would, to the extent permitted by law, represent the right to receive the property received or exchanged in respect of the ordinary shares held on deposit. The depositary bank may in such circumstances deliver new ADSs to you or call for the exchange of your existing ADSs for new ADSs. If the depositary bank may not lawfully distribute such property to you, the depositary bank may sell such property and distribute the net proceeds to you as in the case of a cash distribution.

### **Issuance of ADSs upon Deposit of Ordinary Shares**

The depositary bank may create ADSs on your behalf if you or your broker deposit ordinary shares with the custodian. The depositary bank will deliver these ADSs to the person you indicate only after you pay

any applicable issuance fees and any charges and taxes payable for the transfer of the ordinary shares to the custodian.

The issuance of ADSs may be delayed until the depositary bank or the custodian receives confirmation that all required approvals have been given and that the ordinary shares have been duly transferred to the custodian. The depositary bank will only issue ADSs in whole numbers.

When you make a deposit of ordinary shares, you will be responsible for transferring good and valid title to the depositary bank. As such, you will be deemed to represent and warrant that:

- The ordinary shares are validly issued and outstanding, fully paid, non-assessable and legally obtained.
- The ordinary shares are free of any preemptive rights.
- You are duly authorized to deposit the ordinary shares.
- The ordinary shares presented for deposit are free and clear of any lien, encumbrance, charge, mortgage or adverse claim, and are not, and the ADSs issuable upon such deposit will not be, “restricted securities” (as defined in the deposit agreement).
- The ordinary shares are not liable to disenfranchisement or disposal by us and the deposit of ordinary shares is not prohibited by our Articles.

If any of the representations or warranties are incorrect in any way, we and the depositary bank may, at your cost and expense, take any and all actions necessary to correct the consequences of the misrepresentations.

### **Withdrawal of Ordinary Shares upon Cancellation of ADSs**

As a holder, you will be entitled to present your ADSs to the depositary bank for cancellation and then receive the underlying ordinary shares at the custodian’s offices. In order to withdraw the ordinary shares represented by your ADSs, you will be required to pay to the depositary the fees for cancellation of ADSs and any charges and taxes payable upon the transfer of the ordinary shares being withdrawn. You assume the risk for delivery of all funds and securities upon withdrawal. Once canceled, the ADSs will not have any rights under the deposit agreement.

If you hold an ADR registered in your name, the depositary bank may ask you to provide proof of identity and genuineness of any signature and certain other documents as the depositary bank may deem appropriate before it will cancel your ADSs. The withdrawal of the ordinary shares represented by your ADSs may be delayed until the depositary bank receives satisfactory evidence of compliance with all applicable laws and regulations. Please keep in mind that the depositary bank may refuse to accept ADSs for cancellation that represent a number other than a whole number of securities on deposit.

You will have the right to withdraw the securities represented by your ADSs at any time except:

- For temporary delays that may arise because (i) the transfer books for the ordinary shares or ADSs are closed, or (ii) ordinary shares are immobilized on account of a shareholders’ meeting.
- Until any outstanding obligations to pay fees, taxes and similar charges are discharged.
- If restrictions are imposed because of laws or regulations applicable to ADSs or the withdrawal of securities on deposit.

The deposit agreement may not be modified to impair your right to withdraw the securities represented by your ADSs except to comply with mandatory provisions of law.

### **Voting Rights**

As a holder, you generally have the right under the deposit agreement to instruct the depositary bank to exercise the voting rights for the ordinary shares represented by your ADSs. The voting rights of holders of ordinary shares are described above in “Description of Ordinary Shares—Voting Rights”.

At our request, the depositary bank will mail to you any notice of shareholders’ meeting received from us together with information explaining how to instruct the depositary bank to exercise the voting rights of the securities represented by ADSs.

If the depositary bank timely receives voting instructions from a holder of ADSs, it will endeavor to vote the securities represented by the holder’s ADSs in accordance with such voting instructions. On a vote by show of hands, the depositary will only have one vote and will vote in accordance with instructions received by a majority of the holders of ADSs. On a vote by a poll, the depositary will vote in accordance with instructions received from the holders giving instructions.

Please note that the ability of the depositary bank to carry out voting instructions may be limited by practical and legal limitations and the terms of the securities on deposit. We cannot assure you that you will receive voting materials in time to enable you to return voting instructions to the depositary bank in a timely manner. Securities for which no voting instructions have been received will not be voted.

### **Fees and Charges**

As an ADS holder, you will be required to pay the following service fees to the depositary bank:

<u>Service</u>	<u>Fees</u>
Issuance of ADSs	Up to 5¢ per ADS issued
Cancellation of ADSs	Up to 5¢ per ADS canceled
Distribution of ADSs pursuant to cash dividend or stock dividend or other free distribution of stock	No fee, as long as prohibited by the exchange upon which ADSs are listed
Distribution of cash upon sale of rights and other entitlements	Up to 2¢ per ADS held
Distribution of ADSs pursuant to exercise of rights	Up to 5¢ per ADS issued

As an ADS holder you will also be responsible to pay certain fees and expenses incurred by the depositary bank and certain taxes and governmental charges such as:

- Fees for the transfer and registration of ordinary shares (*i.e.*, upon deposit and withdrawal of ordinary shares).
- Expenses incurred for converting foreign currency into U.S. dollars.
- Fees and expenses incurred in connection with compliance with exchange control regulations and other regulatory requirements.
- Expenses for cable, telex and fax transmissions and for delivery of securities.

- Taxes and duties upon the transfer of securities (*i.e.*, when ordinary shares are deposited or withdrawn from deposit).

We have agreed to pay certain other charges and expenses of the depositary bank. Note that the fees and charges you may be required to pay may vary over time and may be changed by us and by the depositary bank. You will receive prior notice of such changes.

### **Amendments and Termination**

We may agree with the depositary bank to modify the deposit agreement at any time without your consent. We undertake to give holders 30 days prior notice of any modifications that would prejudice any of their substantial rights under the deposit agreement (except in very limited circumstances enumerated in the deposit agreement).

You will be bound by the modifications to the deposit agreement if you continue to hold your ADSs after the modifications to the deposit agreement become effective. The deposit agreement cannot be amended to prevent you from withdrawing the ordinary shares represented by your ADSs (except as permitted by law).

We have the right to direct the depositary bank to terminate the deposit agreement. Similarly, the depositary bank may in certain circumstances on its own initiative terminate the deposit agreement. In either case, the depositary bank must give notice to the holders at least 30 days before termination.

Upon termination, the following will occur under the deposit agreement:

- For a period of six months after termination, you will be able to request the cancellation of your ADSs and the withdrawal of the ordinary shares represented by your ADSs and the delivery of all other property held by the depositary bank in respect of those ordinary shares on the same terms as prior to the termination. During such six months' period the depositary bank will continue to collect all distributions received on the ordinary shares on deposit (*i.e.*, dividends) but will not distribute any such property to you until you request the cancellation of your ADSs.
- After the expiration of such six months' period, the depositary bank may sell the securities held on deposit. The depositary bank will hold the proceeds from such sale and any other funds then held for the holders of ADSs in an unsegregated non-interest bearing account. At that point, the depositary bank will have no further obligations to holders other than to account for the funds then held for the holders of ADSs still outstanding.

### **Books of Depositary**

The depositary bank will maintain ADS holder records at its depositary office. You may inspect such records at such office during regular business hours but solely for the purpose of communicating with other holders in the interest of business matters relating to us, the ADSs or the deposit agreement.

The depositary bank will maintain in New York facilities to record and process the issuance, cancellation, combination, split-up and transfer of ADRs. These facilities may be closed from time to time, to the extent not prohibited by law.

## **Limitations on Obligations and Liabilities**

The deposit agreement limits our obligations and the depositary bank's obligations to you. Please note the following:

- We and the depositary bank are obligated only to take the actions specifically stated in the deposit agreement without negligence or bad faith.
- The depositary bank disclaims any liability for any failure to carry out voting instructions, for any manner in which a vote is cast or for the effect of any vote, provided it acts in good faith and in accordance with the terms of the deposit agreement.
- The depositary bank disclaims any liability for any failure to determine the lawfulness or reasonable practicality of any action, for the content of any document forwarded to you on our behalf or for the accuracy of any translation of such a document, for the investment risks associated with investing in ordinary shares, for the validity or worth of the ordinary shares, for any tax consequences that result from the ownership of ADSs, for the credit worthiness of any third party, for allowing any rights to lapse under the terms of the deposit agreement, for the timeliness of any of our notices or for our failure to give notice.
- We and the depositary bank will not be obligated to perform any act that is inconsistent with the terms of the deposit agreement.
- We and the depositary bank disclaim any liability if we are prevented or forbidden from acting on account of any law or regulation of the United States, England or any other country, any provision of our Memorandum and Articles of Association, any provision of any securities on deposit or by reason of any act of God or war or other circumstances beyond our control.
- We and the depositary bank disclaim any liability by reason of any exercise of, or failure to exercise, any discretion provided for in the deposit agreement or in our Memorandum and Articles of Association, or in any provisions of any securities on deposit.
- We and the depositary bank further disclaim any liability for any action or inaction in reliance on the advice or information received from legal counsel, accountants, any person presenting ordinary shares for deposit, any holder or beneficial owner of ADSs or authorized representative thereof, or any other person believed by either of us in good faith to be competent to give such advice or information.
- We and the depositary bank also disclaim liability for the inability by a holder to benefit from any distribution, offering, right or other benefit which is made available to holders of ordinary shares but is not, under the terms of the deposit agreement, made available to you.
- We and the depositary bank may rely without any liability upon any written notice, request or other document believed to be genuine and to have been signed or presented by the proper parties.
- We and the depositary bank also disclaim any liability for any consequential or punitive damages for any breach of the terms of the deposit agreement.

## **Pre-Release Transactions**

The depositary bank may, in certain circumstances, issue ADSs before receiving a deposit of ordinary shares or release ordinary shares before receiving ADSs. These transactions are commonly referred to as "pre-release transactions". The deposit agreement limits the aggregate size of pre-release transactions and imposes a number of conditions on such transactions (*i.e.*, the need to receive collateral, the type of collateral required, the representations required from brokers, etc.). The depositary bank may retain the compensation received from the pre-release transactions.

## **Taxes**

You will be responsible for the taxes and other governmental charges payable on the ADSs and the securities represented by the ADSs. We, the depositary bank and the custodian may deduct from any distribution the taxes and governmental charges payable by holders and may sell any and all property on deposit to pay the taxes and governmental charges payable by holders. You will be liable for any deficiency if the sale proceeds do not cover the taxes that are due.

The depositary bank may refuse to issue ADSs, to deliver transfer, split and combine ADRs or to release securities on deposit until all taxes and charges are paid by the applicable holder. The depositary bank and the custodian may take reasonable administrative actions to obtain tax refunds and reduced tax withholding for any distributions on your behalf. However, you may be required to provide to the depositary bank and to the custodian proof of taxpayer status and residence and such other information as the depositary bank and the custodian may require to fulfill legal obligations. You are required to indemnify us, the depositary bank and the custodian for any claims with respect to taxes or based on any tax benefit obtained for you under the U.K.-U.S. double tax treaty.

## **Foreign Currency Conversion**

The depositary bank will arrange for the conversion of all foreign currency received into U.S. dollars if such conversion is practical, and it will distribute the U.S. dollars in accordance with the terms of the deposit agreement. You may have to pay fees and expenses incurred in converting foreign currency, such as fees and expenses incurred in complying with currency exchange controls and other governmental requirements.

If the conversion of foreign currency is not practical or lawful, or if any required approvals are denied or not obtainable at a reasonable cost or within a reasonable period, the depositary bank may take the following actions in its discretion:

- Convert the foreign currency to the extent practical and lawful and distribute the U.S. dollars to the holders for whom the conversion and distribution is lawful and practical.
- Distribute the foreign currency to holders for whom the distribution is lawful and practical.
- Hold the foreign currency (without liability for interest) for the applicable holders.

## **ITEM 15. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

## **ITEM 16. CHANGES IN SECURITIES AND CHANGES IN SECURITY FOR REGISTERED SECURITIES**

Not applicable.

## **ITEM 17. FINANCIAL STATEMENTS**

Not applicable.

## **ITEM 18. FINANCIAL STATEMENTS**

See the financial statements beginning on page F-1. Notes 48 and 49 include a discussion of net income and shareholders' equity based on U.S. GAAP, a reconciliation of these amounts to U.K. GAAP and condensed consolidated U.S. GAAP financial statements.

## ITEM 19. FINANCIAL STATEMENTS AND EXHIBITS

### (a) Consolidated Financial Statements and Financial Statement Schedules

The following financial statements and financial statement schedules are filed as part of this registration statement together with the report of the independent accountants:

<b>Financial Statements</b>	<b>Page</b>
<b>Royal &amp; Sun Alliance Insurance Group plc and Subsidiaries:</b>	
<i>Consolidated Financial Statements as of December 31, 1999 and 1998 and for the three years ended December 31, 1999, 1998 and 1997</i>	
Report of Independent Accountants . . . . .	F-2
Consolidated Profit and Loss Account (Statements of Income) for the years ended December 31, 1999, 1998 and 1997 . . . . .	F-3
Consolidated Statement of Total Recognized Gains and Losses for the years ended December 31, 1999, 1998 and 1997 . . . . .	F-11
Consolidated Movements in Shareholders' Funds for the years ended December 31, 1999, 1998 and 1997 . . . . .	F-12
Consolidated Balance Sheets as of December 31, 1999 and 1998 . . . . .	F-13
Consolidated Shareholders' Cash Flow Statement for the years ended December 31, 1999, 1998 and 1997 . . . . .	F-15
Notes to the Consolidated Financial Statements . . . . .	F-16
<i>Unaudited Interim Consolidated Financial Statements for the six months ended June 30, 2000 and 1999</i>	
Independent Review Report . . . . .	F-111
Consolidated Profit and Loss Account . . . . .	F-112
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Movement in Shareholders' Funds . . . . .	F-113
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Explanatory Notes to the Financial Information . . . . .	F-115
<b>Schedules</b>	
Report of Independent Accountants on Financial Statement Schedules . . . . .	S-1
Schedule I—Parent Company Condensed Financial Statements . . . . .	S-2
Schedule III—Supplementary Insurance Information . . . . .	S-10
Schedule V—Valuation and Qualifying Accounts . . . . .	S-12

### (b) Exhibits

The following exhibits are filed as part of this registration statement:

- 1.1 Memorandum and Articles of Association of the Royal & Sun Alliance Insurance Group plc.
- 2.1 Indenture relating to \$500,000,000 8.95% Subordinated Guaranteed Bonds due October 15, 2029, among Royal & Sun Alliance Insurance Group plc, as issuer, Royal & Sun Alliance Insurance plc, as guarantor and Citibank, N.A., as trustee, including the form of the 8.95% Subordinated Guaranteed Bonds.
- 2.2 Form of 8.95% Subordinated Guaranteed Bonds due October 15, 2029 (included in Exhibit 2.1).
- 2.3 Trust Deed relating to €200,000,000 6.875% Fixed/Floating Rate Subordinated Guaranteed Bonds due 2019 and €300,000,000 Floating Rate Subordinated Guaranteed Bonds due 2019, dated 15 October 1999, between Royal & Sun Alliance Insurance Group plc, as issuer, Royal & Sun Alliance Insurance plc, as guarantor and Citicorp Trustee Company Limited, as trustee.

- 2.4 Form of 6.875% Fixed/Floating Rate Subordinated Guaranteed Bonds due 2019 and Floating Rate Subordinated Guaranteed Bonds due 2019 (included in Exhibit 2.3).
- 3.1 The Royal & Sun Alliance Insurance Group plc 1999 Executive Share Option Scheme.
- 3.2 Rules of the Royal & Sun Alliance 1996 Executive Share Option Scheme, as amended up to August 5, 1998.
- 3.3 Rules of the Royal & Sun Alliance 1989 Executive Share Option Scheme, as amended up to August 7, 1996.
- 3.4 Rules of the Royal & Sun Alliance 1989 Savings Related Share Option Scheme.
- 3.5 Rules of the Royal Insurance Holdings 1988 Share Option Scheme.
- 3.6 £1,600,000,000 Multicurrency Credit Facility Agreement, dated 8 October 1998, by and among Royal & Sun Alliance Insurance Group plc, Royal & Sun Alliance Insurance plc and Royal Insurance Holdings plc, as original borrowers, Royal & Sun Alliance Insurance Group plc and Royal & Sun Alliance Insurance plc as original guarantors, Chase Manhattan plc as lead arranger, Chase Manhattan International Limited as facility agent, The Chase Manhattan Bank, New York, as swingline agent and Others listed therein.
- 5.1 Schedule of subsidiaries of Royal & Sun Alliance Insurance Group plc.

**ROYAL & SUN ALLIANCE INSURANCE GROUP PLC**

## ROYAL & SUN ALLIANCE INSURANCE GROUP PLC

### Consolidated Financial Statements

As at December 31, 1999 and 1998 and for the  
three years ended December 31, 1999, 1998 and 1997

### REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholders  
of Royal & Sun Alliance Insurance Group plc

We have audited the accompanying consolidated balance sheets of Royal & Sun Alliance Insurance Group plc and its subsidiaries (the "Group") as of December 31, 1999 and 1998 and the related consolidated profit and loss accounts, consolidated statements of total recognized gains and losses, reconciliation of movements in consolidated shareholders' funds, and consolidated statements of shareholders' cash flows for each of the three years in the period ended December 31, 1999. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

Our evaluation of the presentation of information in the financial statements has had regard to the statutory requirements for insurance companies to maintain equalization provisions. The nature of equalization provisions, the amounts set aside at December 31, 1999 and 1998 and the effect of the movement in those provisions during each of the three years in the period ended December 31, 1999 on the balance on the general (property and casualty) business technical account and profit on ordinary activities before tax, are disclosed in note 11.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Royal & Sun Alliance Insurance Group plc and its subsidiaries at December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United Kingdom.

Accounting principles generally accepted in the United Kingdom vary in certain significant respects from accounting principles generally accepted in the United States. The application of the latter would have affected the determination of consolidated net income for each of the three years in the period ended December 31, 1999 and the determination of consolidated shareholders' funds and consolidated financial position at December 31, 1999 and 1998; the extent of this effect for the three years in the period ended December 31, 1999 and as of December 31, 1999 and 1998 is summarized in note 48 to the consolidated financial statements.

PricewaterhouseCoopers  
London, England  
August 2, 2000

**SUMMARY CONSOLIDATED PROFIT AND LOSS ACCOUNTS (STATEMENTS OF INCOME)**  
**For the years ended December 31,**  
**(UK Basis of Accounting)**

	1999	Restated 1998	Restated 1997
	£m	£m	£m
<b>Gross premiums written</b> . . . . .	<b>11,664</b>	11,062	10,676
Outward reinsurance premiums . . . . .	<b>(1,221)</b>	(1,339)	(1,451)
Premiums written, net of reinsurance . . . . .	<b>10,443</b>	9,723	9,225
Change in the provision for unearned premiums, net . . . . .	<b>(142)</b>	(178)	16
<b>Earned premiums, net of reinsurance</b> . . . . .	<b>10,301</b>	9,545	9,241
Investment income (note 3, 12) . . . . .	<b>5,496</b>	5,478	3,800
Net unrealized gains/(losses) on investment . . . . .	<b>(228)</b>	711	2,907
<b>Total income</b> . . . . .	<b>15,569</b>	15,734	15,948
<b>Claims incurred, net of reinsurance</b> . . . . .	<b>(8,214)</b>	(8,051)	(7,460)
Change in long term (life) technical provisions, net of reinsurance . . . . .	<b>(2,525)</b>	(3,426)	(3,330)
Acquisition costs, net of amortization . . . . .	<b>(2,163)</b>	(2,068)	(1,964)
Administrative expenses (includes central expenses) (note 5) . . . . .	<b>(923)</b>	(852)	(835)
Amortization of goodwill (note 17) . . . . .	<b>(14)</b>	(1)	—
Amortization of goodwill in acquired property and casualty claims provisions (note 17) . . . . .	<b>(12)</b>	—	—
Other technical charges—amortization of acquired present value of long term (life) business (note 20) . . . . .	<b>(4)</b>	(1)	—
Reinsurance commissions and profit participation . . . . .	<b>166</b>	143	147
<b>Net operating expenses</b> (note 5) . . . . .	<b>(2,950)</b>	(2,779)	(2,652)
Investment expenses and charges (note 12) . . . . .	<b>(139)</b>	(265)	(108)
Tax attributable to the long term (life) business (note 14) . . . . .	<b>(240)</b>	(365)	(247)
Change in the equalization provisions (note 11) . . . . .	<b>(12)</b>	(51)	(84)
<b>Total charges</b> . . . . .	<b>(14,080)</b>	(14,937)	(13,881)
<b>Income less charges</b> . . . . .	<b>1,489</b>	797	2,067
Transfers to the fund for future appropriations . . . . .	<b>(1,191)</b>	(17)	(327)
	<b>298</b>	780	1,740
Tax credit attributable to balance on long term (life) business technical account (note 14) . . . . .	<b>59</b>	69	63
Income from other activities, net of charges (note 4, 5) . . . . .	<b>21</b>	15	7
<b>Profit on ordinary activities before tax</b> . . . . .	<b>378</b>	864	1,810
Tax on profit on ordinary activities (note 3, 14) . . . . .	<b>(270)</b>	(374)	(354)
<b>Profit on ordinary activities after tax</b> . . . . .	<b>108</b>	490	1,456
Attributable to equity minority interests . . . . .	<b>(21)</b>	(33)	(40)
<b>Profit for the financial year attributable to shareholders</b> . . . . .	<b>87</b>	457	1,416
Dividends (note 15) . . . . .	<b>(1,113)</b>	(369)	(334)
<b>Transfer to retained profits</b> . . . . .	<b>(1,026)</b>	88	1,082
<b>Earnings per ordinary share</b> (note 16) . . . . .	<b>5.3p</b>	28.7p	91.0p
<b>Diluted earnings per ordinary share</b> (note 16) . . . . .	<b>5.2p</b>	28.3p	88.2p
<b>Group operating earnings after tax per ordinary share (based on longer term investment return)</b> (note 16) . . . . .	<b>25.7p</b>	24.7p	42.4p
<b>Total Group operating profit before tax</b> . . . . .	<b>290</b>	909	1,770
Share of results of associated undertakings . . . . .	<b>88</b>	(45)	40
<b>Profit on ordinary activities before tax</b> . . . . .	<b>378</b>	864	1,810
<b>Analysis of profit on ordinary activities before tax</b>			
General (property and casualty) business result . . . . .	<b>312</b>	352	683
Long term (life) business result . . . . .	<b>243</b>	230	231
Other activities (including associated undertakings) . . . . .	<b>11</b>	20	74
<b>Group operating result (based on longer term investment return)</b> . . . . .	<b>566</b>	602	988
Change in the equalization provisions . . . . .	<b>(12)</b>	(51)	(84)
Other items (note 4) . . . . .	<b>(96)</b>	(150)	(61)
Group operating profit (based on longer term investment return) . . . . .	<b>458</b>	401	843
Other movements in investments . . . . .	<b>(80)</b>	463	967
<b>Profit on ordinary activities before tax</b> . . . . .	<b>378</b>	864	1,810

Discontinued and acquired operations do not form a material part of the figures above.

“Group operating result (based on longer term investment return)” is a measure used for internal purposes in the management of our business segments. It includes the profits of the long term (life) business, the general (property and casualty) business, and other activities with both the property and casualty profit and that of the profit from other activities determined using a longer term investment return to remove the effect of short term fluctuations. Group operating result (based on longer term investment return) is arrived at before the change in equalization provisions and certain other items (see note 4 to the consolidated financial statements). It also includes the Group’s share of the results of associates accounted for under the equity method. Group operating profit (based on longer term investment return) is stated after the above items but before other movements in investments. This measure differs from the profit on ordinary activities before taxation, which includes the effects of actual short-term fluctuations in investment return.

The accompanying notes are an integral part of the consolidated financial statements. During 2000 a presentational change was made to the Group’s consolidated profit and loss account (statement of income) from the published UK GAAP Report and Accounts for the year ended December 31, 1999. The line previously described in the 1999, 1998 and 1997 consolidated profit and loss accounts (statement of income) as Group operating profit (based on longer term investment return) was renamed Group operating result (based on longer term investment return).

**CONSOLIDATED PROFIT AND LOSS ACCOUNT (STATEMENT OF INCOME)**  
**For the year ended December 31, 1999**  
**(UK Basis of Accounting)**

	General Business Technical Account £m	Long Term Business Technical Account £m	Non-Technical Account £m	Summary Total £m
<b>Gross premiums written</b> . . . . .	8,260	3,404		11,664
Outward reinsurance premiums . . . . .	(1,101)	(120)		(1,221)
Premiums written, net of reinsurance . . . . .	7,159	3,284		10,443
Change in the gross provision for unearned premiums . . . . .	(147)	—		(147)
Change in the provision for unearned premiums, reinsurers' share . . . . .	5	—		5
<b>Earned premiums, net of reinsurance</b> . . . . .	7,017	3,284		10,301
Investment income (note 12) . . . . .	—	3,845	1,651	5,496
Net unrealized gains /(losses) on investments . . . . .	—	417	(645)	(228)
Allocated investment return transferred from the non-technical account (note 13) . . . . .	997	—	(997)	—
<b>Total income</b> . . . . .	<u>8,014</u>	<u>7,546</u>	<u>9</u>	<u>15,569</u>
<b>Claims paid</b>				
Gross amount . . . . .	(6,637)	(2,837)		(9,474)
Reinsurers' share . . . . .	1,043	87		1,130
	<u>(5,594)</u>	<u>(2,750)</u>		<u>(8,344)</u>
<b>Change in the provision for claims</b>				
Gross amount . . . . .	(25)	(24)		(49)
Reinsurers' share . . . . .	179	—		179
	<u>154</u>	<u>(24)</u>		<u>130</u>
<b>Claims incurred, net of reinsurance</b> . . . . .	<u>(5,440)</u>	<u>(2,774)</u>		<u>(8,214)</u>
<b>Change in long term (life) business provision</b>				
Gross amount . . . . .		(932)		(932)
Reinsurers' share . . . . .		47		47
		<u>(885)</u>		<u>(885)</u>
Change in technical provisions for linked liabilities, net of reinsurance . . . . .		<u>(1,640)</u>		<u>(1,640)</u>
<b>Change in other technical provisions, net of reinsurance</b> . . . . .		<u>(2,525)</u>		<u>(2,525)</u>
Acquisition costs . . . . .	(1,853)	(350)		(2,203)
Change in deferred acquisition costs . . . . .	24	16		40
Administrative expenses (includes central expenses) (note 5) . . . . .	(645)	(242)	(36)	(923)
Amortization of goodwill (note 17) . . . . .	—	—	(14)	(14)
Amortization of goodwill in acquired property and casualty claims provisions (note 17) . . . . .	(12)	—	—	(12)
Other technical charges—amortization of acquired present value of long term (life) business (note 20) . . . . .	—	(4)	—	(4)
Reinsurance commissions and profit participation . . . . .	166	—	—	166
<b>Net operating expenses (note 5)</b> . . . . .	<u>(2,320)</u>	<u>(580)</u>	<u>(50)</u>	<u>(2,950)</u>
Investment expenses and charges (note 12) . . . . .	—	(60)	(79)	(139)
Tax attributable to the long term (life) business (note 14) . . . . .	—	(240)	—	(240)
Change in the equalization provisions (note 11) . . . . .	(12)	—	—	(12)
<b>Total charges</b> . . . . .	<u>(7,772)</u>	<u>(6,179)</u>	<u>(129)</u>	<u>(14,080)</u>
Transfers to the fund for future appropriations . . . . .		(1,191)		(1,191)
<b>Balance on the general (property and casualty) business technical account</b> . . . . .	<u>242</u>		242	—
<b>Balance on the long term (life) business technical account</b> . . . . .		<u>176</u>	176	—

Discontinued and acquired operations do not form a material part of the above figures.

The accompanying notes are an integral part of the consolidated financial statements.

**CONSOLIDATED PROFIT AND LOSS ACCOUNT (STATEMENT OF INCOME), Continued**  
**For the year ended December 31, 1999**  
**(UK Basis of Accounting)**

	<b>General Business Technical Account £m</b>	<b>Long Term Business Technical Account £m</b>	<b>Non-Technical Account £m</b>	<b>Summary Total £m</b>
Tax credit attributable to balance on long term (life) business technical account (note 14) . . . . .			59	59
Income from other activities . . . . .			282	282
Charges from other activities (note 4, 5) . . . . .			(261)	(261)
<b>Profit on ordinary activities before tax</b> . . . . .			378	378
Tax on profit on ordinary activities (note 14) . . . . .			(270)	(270)
<b>Profit on ordinary activities after tax</b> . . . . .			108	108
Attributable to equity minority interests . . . . .			(21)	(21)
<b>Profit for the financial year attributable to shareholders</b> . . . . .			87	87
Dividends (note 15) . . . . .			(1,113)	(1,113)
<b>Transfer to retained profits</b> . . . . .			(1,026)	(1,026)
<b>Total Group operating profit</b> . . . . .			290	290
Share of results of associated undertakings . . . . .			88	88
<b>Profit on ordinary activities before tax</b> . . . . .			378	378

Discontinued and acquired operations do not form a material part of the above figures.

The accompanying notes are an integral part of the consolidated financial statements.

**CONSOLIDATED PROFIT AND LOSS ACCOUNT (STATEMENT OF INCOME), Continued**  
**For the year ended December 31, 1998**  
**(UK Basis of Accounting)**

	General Business Technical Account	Long Term Business Technical Account Restated	Non-Technical Account Restated	Summary Total Restated
	£m	£m	£m	£m
<b>Gross premiums written</b> . . . . .	8,088	2,974		11,062
Outward reinsurance premiums . . . . .	(1,221)	(118)		(1,339)
Premiums written, net of reinsurance . . . . .	6,867	2,856		9,723
Change in the gross provision for unearned premiums . . . . .	(117)	—		(117)
Change in the provision for unearned premiums, reinsurers' share . . . . .	(61)	—		(61)
<b>Earned premiums, net of reinsurance</b> . . . . .	6,689	2,856		9,545
Investment income (note 3, 12) . . . . .	—	3,765	1,713	5,478
Net unrealized gains/(losses) on investments . . . . .	—	850	(139)	711
Allocated investment return transferred from the non-technical account (note 13) . . . . .	999	—	(999)	—
<b>Total income</b> . . . . .	<u>7,688</u>	<u>7,471</u>	<u>575</u>	<u>15,734</u>
<b>Claims paid</b>				
Gross amount . . . . .	(6,030)	(3,015)		(9,045)
Reinsurers' share . . . . .	958	89		1,047
	<u>(5,072)</u>	<u>(2,926)</u>		<u>(7,998)</u>
<b>Change in the provision for claims</b>				
Gross amount . . . . .	(62)	(25)		(87)
Reinsurers' share . . . . .	25	9		34
	<u>(37)</u>	<u>(16)</u>		<u>(53)</u>
<b>Claims incurred, net of reinsurance</b> . . . . .	<u>(5,109)</u>	<u>(2,942)</u>		<u>(8,051)</u>
<b>Change in long term (life) business provision</b>				
Gross amount . . . . .		(2,650)		(2,650)
Reinsurers' share . . . . .		40		40
		<u>(2,610)</u>		<u>(2,610)</u>
Change in technical provisions for linked liabilities, net of reinsurance . . . . .		(816)		(816)
<b>Change in other technical provisions, net of reinsurance</b> . . . . .		<u>(3,426)</u>		<u>(3,426)</u>
Acquisition costs . . . . .	(1,764)	(308)		(2,072)
Change in deferred acquisition costs . . . . .	11	(7)		4
Administrative expenses (includes central expenses) (note 5) . . . . .	(630)	(192)	(30)	(852)
Amortization of goodwill (note 17) . . . . .			(1)	(1)
Other technical charges—Amortization of acquired present value of long term (life) business (note 20) . . . . .	—	(1)	—	(1)
Reinsurance commissions and profit participation . . . . .	143	—	—	143
<b>Net operating expenses</b> (note 5) . . . . .	<u>(2,240)</u>	<u>(508)</u>	<u>(31)</u>	<u>(2,779)</u>
Investment expenses and charges (note 12) . . . . .	—	(52)	(213)	(265)
Tax attributable to the long term (life) business (note 14) . . . . .	—	(365)	—	(365)
Change in the equalization provisions (note 11) . . . . .	(51)	—	—	(51)
<b>Total charges</b> . . . . .	<u>(7,400)</u>	<u>(7,293)</u>	<u>(244)</u>	<u>(14,937)</u>
Transfers to the fund for future appropriations . . . . .		(17)	—	(17)
<b>Balance on the general (property and casualty) business technical account</b> . . . . .	<u>288</u>		288	—
<b>Balance on the long term (life) business technical account</b> . . . . .		<u>161</u>	161	—

Discontinued and acquired operations do not form a material part of the above figures.

The accompanying notes are an integral part of the consolidated financial statements.

**CONSOLIDATED PROFIT AND LOSS ACCOUNT (STATEMENT OF INCOME), Continued**  
**For the year ended December 31, 1998**  
**(UK Basis of Accounting)**

	<b>General Business Technical Account</b>	<b>Long Term Business Technical Account</b>	<b>Non-Technical Account</b>	<b>Summary Total</b>
	<b>£m</b>	<b>Restated £m</b>	<b>Restated £m</b>	<b>Restated £m</b>
Tax credit attributable to balance on long term (life) business technical account (note 14) . . . . .			69	69
Income from other activities . . . . .			260	260
Charges from other activities (note 4, 5) . . . . .			(245)	(245)
<b>Profit on ordinary activities before tax</b> . . . . .			<u>864</u>	<u>864</u>
Tax on profit of ordinary activities (note 14) . . . . .			(374)	(374)
<b>Profit on ordinary activities after tax</b> . . . . .			<u>490</u>	<u>490</u>
Attributable to equity minority interests . . . . .			(33)	(33)
<b>Profit for the financial year attributable to shareholders</b> . . . . .			<u>457</u>	<u>457</u>
Dividends (note 15) . . . . .			(369)	(369)
<b>Transfer to retained profits</b> . . . . .			<u>88</u>	<u>88</u>
<b>Total Group operating profit</b> . . . . .			<u>909</u>	<u>909</u>
Share of results of associated undertakings . . . . .			(45)	(45)
<b>Profit on ordinary activities before tax</b> . . . . .			<u><u>864</u></u>	<u><u>864</u></u>

Discontinued and acquired operations do not form a material part of the above figures.

The accompanying notes are an integral part of the consolidated financial statements.

**CONSOLIDATED PROFIT AND LOSS ACCOUNT (STATEMENT OF INCOME), Continued**  
**For the year ended December 31, 1997**  
**(UK Basis of Accounting)**

	General Business Technical Account £m	Long Term Business Technical Account Restated £m	Non-Technical Account Restated £m	Summary Total Restated £m
<b>Gross premiums written</b> .....	8,002	2,674		10,676
Outward reinsurance premiums .....	(1,368)	(83)		(1,451)
Premiums written, net of reinsurance .....	6,634	2,591		9,225
Change in the gross provision for unearned premiums .....	69	—		69
Change in the provision for unearned premiums, reinsurers' share .....	(53)	—		(53)
<b>Earned premiums, net of reinsurance</b> .....	6,650	2,591		9,241
Investment income (note 3, 12) .....	—	2,655	1,145	3,800
Net unrealized gains on investments .....	—	1,942	965	2,907
Allocated investment return transferred from the non-technical account (note 13) .....	983	—	(983)	—
<b>Total income</b> .....	<u>7,633</u>	<u>7,188</u>	<u>1,127</u>	<u>15,948</u>
<b>Claims paid</b>				
Gross amount .....	(5,650)	(2,712)		(8,362)
Reinsurers' share .....	952	68		1,020
	<u>(4,698)</u>	<u>(2,644)</u>		<u>(7,342)</u>
<b>Change in the provision for claims</b>				
Gross amount .....	48	(9)		39
Reinsurers' share .....	(162)	5		(157)
	<u>(114)</u>	<u>(4)</u>		<u>(118)</u>
<b>Claims incurred, net of reinsurance</b> .....	<u>(4,812)</u>	<u>(2,648)</u>		<u>(7,460)</u>
<b>Change in long term (life) business provision</b>				
Gross amount .....		(2,691)		(2,691)
Reinsurers' share .....		38		38
		<u>(2,653)</u>		<u>(2,653)</u>
Change in technical provisions for linked liabilities, net of reinsurance .....		(677)		(677)
<b>Change in other technical provisions, net of reinsurance</b> .....		<u>(3,330)</u>		<u>(3,330)</u>
Acquisition costs .....	(1,748)	(301)		(2,049)
Change in deferred acquisition costs .....	17	68		85
Administrative expenses (includes central expenses) (note 5) .....	(618)	(188)	(29)	(835)
Reinsurance commissions and profit participation .....	147	—	—	147
<b>Net operating expenses</b> (note 5) .....	<u>(2,202)</u>	<u>(421)</u>	<u>(29)</u>	<u>(2,652)</u>
Investment expenses and charges (note 12) .....		(47)	(61)	(108)
Tax attributable to the long term (life) business (note 14) .....		(247)	—	(247)
Change in the equalization provisions (note 11) .....	(84)	—	—	(84)
<b>Total charges</b> .....	<u>(7,098)</u>	<u>(6,693)</u>	<u>(90)</u>	<u>(13,881)</u>
Transfers to the fund for future appropriations .....		(327)	—	(327)
<b>Balance on the general (property and casualty) business technical account</b> .....	<u>535</u>		535	—
<b>Balance on the long term (life) business technical account</b> .....		<u>168</u>	168	—

Discontinued and acquired operations do not form a material part of the above figures.

The accompanying notes are an integral part of the consolidated financial statements.

**CONSOLIDATED PROFIT AND LOSS ACCOUNT (STATEMENT OF INCOME), Continued**  
**For the year ended December 31, 1997**  
**(UK Basis of Accounting)**

	<b>General Business Technical Account £m</b>	<b>Long Term Business Technical Account Restated £m</b>	<b>Non-Technical Account Restated £m</b>	<b>Summary Total Restated £m</b>
Tax credit attributable to balance on long term (life) business technical account (note 14) . . . . .			63	63
Income from other activities . . . . .			194	194
Charges from other activities (note 4, 5) . . . . .			(187)	(187)
<b>Profit on ordinary activities before tax</b> . . . . .			<u>1,810</u>	<u>1,810</u>
Tax on profit on ordinary activities (note 14) . . . . .			(354)	(354)
<b>Profit on ordinary activities after tax</b> . . . . .			<u>1,456</u>	<u>1,456</u>
Attributable to equity minority interests . . . . .			(40)	(40)
<b>Profit for the financial year attributable to shareholders</b> . . . . .			<u>1,416</u>	<u>1,416</u>
Dividends (note 15) . . . . .			(334)	(334)
<b>Transfer to retained profits</b> . . . . .			<u>1,082</u>	<u>1,082</u>
<b>Total Group operating profit</b> . . . . .			<u>1,770</u>	<u>1,770</u>
Share of results of associated undertakings . . . . .			40	40
<b>Profit on ordinary activities before tax</b> . . . . .			<u>1,810</u>	<u>1,810</u>

Discontinued and acquired operations do not form a material part of the above figures.

The accompanying notes are an integral part of the consolidated financial statements.

**CONSOLIDATED STATEMENT OF TOTAL RECOGNIZED GAINS AND LOSSES**  
**For the years ended December 31,**  
**(UK Basis of Accounting)**

	<b>1999</b>		
	<b>Other reserves £m</b>	<b>Profit and loss account £m</b>	<b>Total £m</b>
Profit for the financial year . . . . .	—	87	87
Movement in value of long term (life) business (other than on acquisition) . . . . .	169	—	169
Exchange:			
Group . . . . .	(5)	39	34
Share of associates . . . . .	—	(3)	(3)
<b>Shareholders' consolidated recognized gains arising in the year . . . . .</b>	<b><u>164</u></b>	<b><u>123</u></b>	<b><u>287</u></b>
	<b>1998</b>		
	<b>Other reserves £m</b>	<b>Profit and loss account £m</b>	<b>Total £m</b>
Profit for the financial year . . . . .	—	457	457
Movement in value of long term (life) business (other than on acquisition) . . . . .	(115)	—	(115)
Exchange:			
Group . . . . .	(1)	(25)	(26)
Share of associates . . . . .	—	(43)	(43)
<b>Shareholders' consolidated recognized gains arising in the year . . . . .</b>	<b><u>(116)</u></b>	<b><u>389</u></b>	<b><u>273</u></b>
	<b>1997</b>		
	<b>Other reserves £m</b>	<b>Profit and loss account £m</b>	<b>Total £m</b>
Profit for the financial year . . . . .	—	1,416	1,416
Movement in value of long term (life) business (other than on acquisition) . . . . .	179	—	179
Exchange:			
Group . . . . .	—	(60)	(60)
Share of associates . . . . .	—	(8)	(8)
<b>Shareholders' consolidated recognized gains arising in the year . . . . .</b>	<b><u>179</u></b>	<b><u>1,348</u></b>	<b><u>1,527</u></b>

Exchange includes a loss of **£1m** (1998 and 1997 £0m) on exchange relating to foreign currency borrowings.

The accompanying notes are an integral part of the consolidated financial statements.

**CONSOLIDATED MOVEMENTS IN SHAREHOLDERS' FUNDS**  
**For the years ended December 31,**  
**(UK Basis of Accounting)**

	Share capital/ premium £m	Capital redemption reserve £m	Other reserves £m	Profit and loss account £m	Total £m
<b>Shareholders' funds at January 1, 1997</b> .....	<b>561</b>	<b>—</b>	<b>1,399</b>	<b>4,381</b>	<b>6,341</b>
Shareholders' consolidated recognized gains .....	—	—	179	1,348	1,527
Issue of share capital (note 27) .....	6	—	—	—	6
Increase in share premium (note 26, 27) .....	56	—	—	(26)	30
Purchase of own shares (note 27) .....	(8)	8	—	(153)	(153)
Goodwill written off (note 24, 26) .....	—	—	—	(131)	(131)
Dividends (note 15) .....	—	—	—	(334)	(334)
Scrip dividend adjustment (note 15) .....	—	—	—	47	47
<b>Shareholders' funds at December 31, 1997</b> .....	<b>615</b>	<b>8</b>	<b>1,578</b>	<b>5,132</b>	<b>7,333</b>
Shareholders' consolidated recognized gains .....	—	—	(116)	389	273
Issue of share capital (note 26, 27) .....	3	—	—	—	3
Increase in share premium (note 27) .....	40	—	—	(11)	29
Dividends (note 15) .....	—	—	—	(369)	(369)
<b>Shareholders' funds at December 31, 1998</b> .....	<b>658</b>	<b>8</b>	<b>1,462</b>	<b>5,141</b>	<b>7,269</b>
Shareholders' consolidated recognized gains .....	—	—	164	123	287
Issue of share capital (note 26, 27) .....	2	—	—	—	2
Increase in share premium (note 27) .....	28	—	—	(15)	13
Goodwill written back (note 25) .....	—	—	—	26	26
Dividends (note 15) .....	—	—	—	(1,113)	(1,113)
<b>Shareholders' funds at December 31, 1999</b> .....	<b>688</b>	<b>8</b>	<b>1,626</b>	<b>4,162</b>	<b>6,484</b>

The change in accounting policy explained in note 3 on page F-23 had no effect on recognized gains in 1998 or 1997 or on shareholders' funds at December 31, 1998 or 1997.

The accompanying notes are an integral part of the consolidated financial statements.

**CONSOLIDATED BALANCE SHEETS**  
**As of December 31, 1999 and 1998**  
**(UK Basis of Accounting)**

	<b>1999</b>	<b>1998</b>
	<b>£m</b>	<b>£m</b>
<b>ASSETS</b>		
<b>Intangible assets</b> (note 17) .....	<b>1,035</b>	13
<b>Investments</b>		
Land and buildings (note 18) .....	<b>2,386</b>	2,664
Interests in associated undertakings (note 23) .....	<b>222</b>	218
<b>Other financial investments</b> (note 18)		
Shares and other variable yield securities and units in unit trusts .....	<b>18,742</b>	18,107
Debt securities and other fixed income securities .....	<b>24,646</b>	23,864
Loans and deposits with credit institutions .....	<b>1,396</b>	1,644
	<b>44,784</b>	43,615
Value of long term (life) business (note 20, 43) .....	<b>1,784</b>	1,506
Deposits with ceding undertakings .....	<b>115</b>	110
<b>Total investments</b> .....	<b>49,291</b>	48,113
<b>Assets held to cover linked liabilities</b> (note 18) .....	<b>8,304</b>	6,675
<b>Reinsurers' share of technical provisions</b>		
Provision for unearned premiums .....	<b>507</b>	367
Long term (life) business provision .....	<b>394</b>	377
Claims outstanding .....	<b>3,189</b>	2,254
Technical provisions for linked liabilities .....	<b>14</b>	12
	<b>4,104</b>	3,010
<b>Debtors</b>		
Debtors arising out of direct insurance operations (note 21) .....	<b>2,710</b>	2,465
Debtors arising out of reinsurance operations .....	<b>886</b>	698
Other debtors (note 21) .....	<b>740</b>	1,066
	<b>4,336</b>	4,229
<b>Other assets</b>		
Tangible assets (note 22) .....	<b>268</b>	218
Cash at bank and in hand .....	<b>822</b>	626
Own shares (note 27) .....	<b>29</b>	—
	<b>1,119</b>	844
<b>Prepayments and accrued income</b>		
Accrued interest and rent .....	<b>443</b>	439
Deferred acquisition costs—long term (life) business .....	<b>628</b>	637
Deferred acquisition costs—general (property and casualty) business .....	<b>825</b>	712
Other prepayments and accrued income .....	<b>121</b>	107
	<b>2,017</b>	1,895
<b>Total assets</b> .....	<b>70,206</b>	64,779

The accompanying notes are an integral part of the consolidated financial statements.

**CONSOLIDATED BALANCE SHEETS, Continued**  
**As of December 31, 1999 and 1998**  
**(UK Basis of Accounting)**

	<b>1999</b>	<b>1998</b>
	<b>£m</b>	<b>£m</b>
<b>LIABILITIES</b>		
<b>Capital and reserves</b>		
Ordinary share capital (note 27) . . . . .	393	391
Preference share capital (note 27) . . . . .	125	125
Called up share capital . . . . .	518	516
Share premium account . . . . .	170	142
Other reserves . . . . .	1,626	1,462
Capital redemption reserve . . . . .	8	8
Profit and loss account . . . . .	4,162	5,141
Equity shareholders . . . . .	6,359	7,144
Non-equity shareholders . . . . .	125	125
<b>Shareholders' funds</b> (note 26) (see page F-12) . . . . .	<b>6,484</b>	<b>7,269</b>
Equity minority interests in subsidiary undertakings . . . . .	406	291
Long term subordinated liabilities (note 28) . . . . .	610	—
<b>Total capital, reserves and long term subordinated liabilities</b> . . . . .	<b>7,500</b>	<b>7,560</b>
<b>Fund for future appropriations</b> . . . . .	<b>4,840</b>	<b>3,785</b>
<b>Technical provisions</b>		
Provision for unearned premiums . . . . .	4,476	3,755
Long term (life) business provision (note 29) . . . . .	26,433	26,618
Claims outstanding . . . . .	14,162	11,850
Equalization provisions (note 11) . . . . .	259	250
	<b>45,330</b>	<b>42,473</b>
<b>Technical provisions for linked liabilities</b> . . . . .	<b>8,318</b>	<b>6,687</b>
<b>Provisions for other risks and charges</b> (note 30) . . . . .	<b>363</b>	<b>421</b>
<b>Deposits received from reinsurers</b> . . . . .	<b>203</b>	<b>198</b>
<b>Creditors</b>		
Creditors arising out of direct insurance operations . . . . .	504	471
Creditors arising out of reinsurance operations . . . . .	619	413
Debenture loans including convertible debt (note 31) . . . . .	540	279
Amounts owed to credit institutions (note 31) . . . . .	136	170
Other creditors including taxation and social security (note 32) . . . . .	1,238	1,719
Proposed dividend (note 15) . . . . .	233	238
	<b>3,270</b>	<b>3,290</b>
<b>Accruals and deferred income</b> . . . . .	<b>382</b>	<b>365</b>
<b>Total liabilities</b> . . . . .	<b>70,206</b>	<b>64,779</b>

Except for certain debenture loans and amounts owed to credit institutions shown in note 31, all creditors are payable within a period of five years.

The accompanying notes are an integral part of the consolidated financial statements. The financial statements on pages F-2 to F-109 were approved on August 2, 2000 on behalf of the Board of Directors and are signed on its behalf by:

JULIAN HANCE  
*Group Finance Director*

**CONSOLIDATED SHAREHOLDERS' CASH FLOW STATEMENT**  
**For the years ended December 31, 1999, 1998 and 1997**  
**(UK Basis of Accounting)**

	1999	Restated 1998	Restated 1997
	£m	£m	£m
<b>Operating activities</b>			
Net cash inflow from general (property and casualty) business	168	64	364
Shareholders' net cash inflow from long term (life) business	150	158	133
Other operating cash flows attributable to shareholders	2	2	12
Premium redemption of convertible bonds	—	(142)	—
<b>Net cash inflow from operating activities</b> (note 36)	<u>320</u>	<u>82</u>	<u>509</u>
<b>Dividends from associates</b>	56	1	—
<b>Servicing of finance</b>			
Premium on redemption of subordinated liabilities	(14)	—	—
Dividends paid on non-equity shares	(9)	(9)	(9)
Issue costs on long term subordinated liabilities	(5)	—	—
Dividends paid to minorities	(8)	(10)	(8)
	<u>(36)</u>	<u>(19)</u>	<u>(17)</u>
<b>Taxation paid</b>	<u>(145)</u>	<u>(214)</u>	<u>(147)</u>
<b>Capital expenditure</b>			
Purchases less sales of tangible assets	<u>(83)</u>	<u>(69)</u>	<u>(55)</u>
<b>Acquisitions and disposals</b>			
Acquisition of interests in associated undertakings	(49)	(74)	—
Acquisition of subsidiary undertakings and redemption of subordinated liabilities (note 24, 40)	(1,736)	(142)	(188)
Acquisition of minority interests in subsidiary undertakings	(21)	—	(18)
Disposal of interests in associated undertakings/branches	—	2	—
Disposal of subsidiary undertakings (note 25, 41)	319	6	21
Disposal of minority interests in subsidiary undertakings	5	—	—
	<u>(1,482)</u>	<u>(208)</u>	<u>(185)</u>
<b>Dividends paid on equity shares</b>	<u>(1,109)</u>	<u>(337)</u>	<u>(258)</u>
<b>Financing</b>			
Issue of ordinary share capital	15	14	31
Issue by subsidiary of ordinary share capital to minorities	30	—	—
Net proceeds from issue of long term subordinated liabilities (note 39)	615	—	—
Purchase of own shares	(29)	—	(153)
<b>Net cash inflow/(outflow) from financing</b>	<u>631</u>	<u>14</u>	<u>(122)</u>
<b>Cash available for investment</b>	<u>(1,848)</u>	<u>(750)</u>	<u>(275)</u>
Cash flows were invested as follows:			
<b>Movement in cash holdings</b> (note 39)	<u>215</u>	<u>28</u>	<u>(11)</u>
<b>Net portfolio investments</b> (note 37, 38, 39)			
Land and buildings	(489)	(2)	6
Shares and other variable yield securities	(1,459)	(1,210)	183
Loans, debt securities and other fixed income securities	153	290	(438)
Deposits with credit institutions	(46)	110	(255)
Borrowings	(222)	34	240
	<u>(2,063)</u>	<u>(778)</u>	<u>(264)</u>
<b>Net investment of cash flows</b>	<u>(1,848)</u>	<u>(750)</u>	<u>(275)</u>

As required by FRS 1 (Revised) the cash flow statement does not include any amounts relating to the long term (life) business except cash transactions between the long term (life) business and shareholders' funds.

The 1998 and 1997 amounts have been restated from our Subordinated Guaranteed Bonds offering memorandum dated September 28, 1999 to reflect the presentational change arising from the raising of long term subordinated liabilities and their designation as long term Group Financing. Borrowings are available to meet shorter term liquidity needs and, as such, are now shown as a component of investment movement. All cash flows arising from the servicing of borrowings have been restated as operational cash flows.

The accompanying notes are an integral part of the consolidated financial statements.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### 1. Summary of Significant Accounting Policies

#### A. Organization

On July 19, 1996, Sun Alliance Group plc (Sun Alliance) was renamed Royal & Sun Alliance Insurance Group plc and became the Parent Company of the new Group formed by the merger of Royal Insurance Holdings plc (Royal Insurance) and Sun Alliance. Merger accounting principles set out in Financial Reporting Standard 6 "Acquisitions and Mergers" have been used and the results have been presented as if the new Group had been established throughout all years. Royal & Sun Alliance Insurance Group plc and subsidiaries (the "Group") conducts both general (property and casualty) and long term (life) insurance business. The general (property and casualty) insurance subsidiaries are multiple line companies writing substantially all lines of general (property and casualty) insurance. The Group's life insurance subsidiaries offer a wide range of traditional insurance and financial and investment products. Traditional products consist of individual and group life, annuities, and accident and health policies. Financial and investment products consist of single premium annuity, variable annuities, guaranteed investment contracts and universal life products. The Group also offers principally in the UK, participating and unit-linked individual retirement products and life savings products. The Group writes business throughout the United Kingdom, Americas, Europe and Asia Pacific.

#### B. Presentation

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 (together "UK GAAP") which differs in certain significant respects from accounting principles generally accepted in the United States ("US GAAP"). A summary of the significant differences between UK GAAP and US GAAP is included in note 48 of the Notes to the Consolidated Financial Statements.

The figures in the consolidated financial statements are presented in millions of pounds sterling ("£m").

The consolidated profit and loss accounts and consolidated balance sheets are drawn up in accordance with the presentation recommended by the SORP. Certain presentational changes have been made to the consolidated profit and loss accounts previously published by the Group in its UK statutory financial statements in order to facilitate the understanding of the financial performance by readers of these financial statements in the United States. In particular, a summary consolidated profit and loss account has been prepared for each of the three years which presents the results in a format which is more familiar to US readers. This summary on page F-3 is a condensed aggregation of balances reported in the consolidated profit and loss accounts on pages F-5 to F-10 and should be read in conjunction with those statements.

These financial statements, including the consolidated balance sheets as of December 31, 1999 and 1998 and the consolidated profit and loss accounts for each of the three years in the period ended December 31, 1999 have been prepared under the accounting policies described below. These accounting policies reflect changes in UK accounting standards introduced during 1999, 1998 and 1997. The consolidated balance sheet as of December 31, 1998 and the consolidated profit and loss accounts and cash flow statements for the years ended December 31, 1998 and 1997 have been restated in certain respects from the Group's statutory financial statements, as published, for those years, which were prepared under accounting standards prevailing at that time and also to reflect the presentational changes highlighted in note 1C below.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### *C. Changes in Accounting Policy*

The Group has adopted the requirements of Financial Reporting Standard 16 "Current Tax" in 1999. Dividends, interest or other income receivable includes any withholding tax but excludes any other taxes, such as attributable credits, not payable wholly on behalf of the Group. Previously attributable tax credits were included in investment income. The tax on ordinary activities is reduced by an equal amount. The financial impact of this change is disclosed in note 3 on page F-23 and comparatives have been restated from those published in the Debt Offering Memorandum dated September 28, 1999.

### *D. Group Accounts*

The consolidated financial statements of the Group include the results of all subsidiaries for each of the three years in the period ended December 31, 1999. Intercompany transactions are eliminated in the consolidated financial statements except for certain transactions with the long term business fund as disclosed in note 49.

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

The consolidated shareholders' cash flow statement is prepared in accordance with Financial Reporting Standard 1 (Revised) which requires the cash flow statement to exclude the cash flows of the long term (life insurance) 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 note 50.

### *E. Translation of Foreign Currencies*

Assets and liabilities including long term subordinated liabilities 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 (a separate component of shareholders' equity) or in the case of long term (life) business are included within the long term (life) 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. Foreign currency assets and liabilities are translated into sterling at rates ruling at year end and the resulting exchange differences are included within the profit and loss account.

### *F. Derivatives*

The Group has entered into certain interest rate swaps in relation to its subordinated liabilities, which are treated as hedges. The underlying hedged liabilities are 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. Futures contracts and purchased options, and other derivatives are included within the category to which the contract relates and are valued at market value.

### *G. General (Property and Casualty) Business Technical Account (Property and Casualty Business)*

General (property and casualty) 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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

allocation of the investment return has been made to the general (property and casualty) 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 amortized 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 (property and casualty) business technical account is arrived at after taking account of changes in the equalization provisions. See note 11.

### *H. Long Term (Life) Business Technical Account (Life Business)*

Premiums and annuity considerations are accounted for when due except premiums in respect of linked (separate account) 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 and include premiums relating to certain group life and disability business which are considered recurring premiums. Claims arising on maturity are recognized 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 (life) business provision or the technical provisions for linked liabilities (separate account 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 amortized 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 (life) 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 (life) 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 recognized when the policy liability is established. New single premiums include recurrent single premium contracts including Department of Social Security 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 recognized when declared; terminal bonuses are recognized when payable.

Shareholders' accrued interest represents the excess of accumulated profit recognized under the modified statutory basis of reporting long term (life) business over the statutory transfers made from the long term funds to shareholders. The amount of profit recognized as shareholders' accrued interest is credited to the profit and loss account within capital and reserves.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### *I. Reinsurance*

Amounts recoverable from general (property and casualty) and long term (life) reinsurers are estimated in a manner consistent with the outstanding claim provision or settled claim associated with the reinsured policy. The cost of reinsurance related to long-duration contracts is accounted for over the life of the underlying reinsured policies using assumptions consistent with those used to account for the underlying policies.

In the ordinary course of business, the Group cedes reinsurance to other insurance companies for the purpose of limiting its net loss potential through diversification of its risks. Reinsurance arrangements do not relieve the Group from its direct obligations to its policyholders. Thus, a credit exposure exists with respect to general and life reinsurance ceded to the extent that any reinsurer is unable to meet the obligations assumed under the reinsurance agreements. A provision has been recorded for estimated unrecoverable reinsurance. The Group's business is not substantially dependent upon any reinsurance contract.

Reinsurance is effected under reinsurance treaties and by negotiation on individual risks. Certain of these reinsurance arrangements consist of excess of loss contracts which protect the Group against losses over stipulated amounts.

The Group, as a property insurer, is subject to losses that may arise from catastrophic events. The Group uses industry-developed software to estimate the probable maximum loss and to maintain a reinsurance program reflective of these estimates.

### *J. Investment Return*

Income from investments is included in the profit and loss account (statement of income) on an accruals basis. Dividend income on ordinary shares is recognized when the related investment goes "ex-dividend". Realized and unrealized gains and losses on investments attributable to long term (life) business are dealt with in the long term (life) business technical account. Realized and unrealized gains and losses on other investments, including the Group's share of realized and unrealized gains and losses of associated undertakings, are dealt with in the non-technical account. Realized gains and losses on investment disposals represent the difference between net sale proceeds and cost of acquisition. Unrealized 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 (based on longer term investment return) and Group operating 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 recognized in operating profit does not exceed or fall below the actual returns achieved. Other movements in investments represent the difference between the actual investment return in the year and that determined on the longer term rate of return basis.

### *K. Group Operating Result/Profit (Based on Longer Term Investment Return)*

Group operating result (based on longer term investment return) is the operating measure used by the Group to evaluate its segmental results and is analysed between general (property and casualty) business, long term (life) business and other activities as an additional disclosure. It excludes interest on long term subordinated liabilities, the change in the equalization provisions, amortization of goodwill and of goodwill in acquired claims provisions and other items including reorganisation costs and gains on the disposal of

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

subsidiaries. Group operating profit (based on longer term investment return) is stated after the above items but before other movements in investments.

### *L. Taxation*

Taxation in the non-technical account and long term (life) 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 (life) business technical account has been grossed up.

Deferred taxation is calculated on the liability method and consists of the estimated taxation, or relief from taxation, which is expected to arise in the foreseeable future from material timing differences using expected future rates of tax where applicable. Under this policy, no provision is made for taxation which might arise on the distribution of profits retained by overseas subsidiaries or associated undertakings. Credit is taken for relief for trading losses only to the extent that the directors anticipate that profits will absorb such losses in the foreseeable future.

Allowance is made in the long term (life) business provision reserve for future life and health policy benefits and within assets held for linked liabilities (separate account liabilities) for deferred taxation at appropriate discounted rates in respect of related unrealized gains. A provision for deferred taxation on other unrealized gains is made where realizations giving rise to a taxation liability are anticipated in the foreseeable future.

### *M. 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 capitalized in the balance sheet and amortized to the profit and loss account (statement of income) 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 amortization is determined by an assessment of the useful economic life of the goodwill, but not exceeding twenty years (as permitted by Financial Reporting Standard 10 "Goodwill and Intangible Assets"). Goodwill arising prior to December 31, 1997 has been eliminated against reserves (shareholders' equity) 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 credited to the reserves and then charged to the profit and loss account in the year of sale.

The shareholders' interest in the acquired value of long term (life) business is included as part of the fair value of the acquired net assets in the goodwill calculation and is dealt with as described in note O below.

The fair value of general (property and casualty) business claims provisions (loss reserves) 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 capitalized as goodwill in acquired claims provisions and amortized to the profit and loss account (statement of income) in relation to the expected run-off period of the related claims.

### *N. Investments*

Investments and assets held to cover linked liabilities (separate account assets), are shown at market value, for which purpose unlisted investments, mortgages and loans are included at directors' valuation and

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

properties at professional valuation. For listed securities the stock exchange values are used except that fixed income securities held for long term (life) business in certain overseas operations are included on an amortized cost basis. Properties are valued annually at open market value.

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.

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.

### *O. Value of Long Term (Life) Business*

This represents the directors’ assessment of the value of the shareholders’ investment in the long term (life) business funds, not already recognized under the modified statutory principles of profit recognition. It comprises the shareholders’ share of both the net of tax future cash flows arising from the in-force long term (life) business policies and the surplus held within the funds to meet solvency and future business development requirements. Movements in this asset, except those arising on acquisition, are recognized in the Statement of Total Recognized Gains and Losses.

The present value of in-force long term (life) business existing at acquisition which will be recognized as profit, is amortized in the long term technical account on a systematic basis over the anticipated periods of the related contracts in the portfolios.

### *P. Tangible Assets and Depreciation*

Tangible assets 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.

### *Q. Own Shares*

The shares held by the Royal & Sun Alliance ESOP Trusts are recognized as assets under the heading “Own Shares” at original cost 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 recognized at the exercise date.

### *R. Fund for Future Appropriations*

Certain long term funds (life insurance companies) comprise either participating, or both participating and non-participating, long term (life) 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.

### *S. Long Term Subordinated Liabilities*

Long term subordinated liabilities comprise long term subordinated bonds. Subordinated bonds are stated at the fair value of consideration received after deduction of unamortized issue costs and discount. Issue

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

costs together with discount allowed on issue of bonds are amortized to the profit and loss account on an annual basis over the term of the bonds.

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

### *T. Technical Provisions (Insurance Reserves)*

The provision for unearned premiums (unearned premium reserve) 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 (reserve for loss and loss adjustment expenses), 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 trends and after recognition of the potential time elapsed in the notification, development and settlement of claims. As permitted under local statutory guidelines, claims provisions relating to long term permanent disability claims in the United States, Canada and Scandinavia paid on an annuity basis are discounted after reflecting interest expected to be earned on the related investments.

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 (premium deficiency reserves) is assessed in aggregate for business classes which, in the opinion of the directors, are managed together.

The long term (life) business provision (reserve for future life and health policy benefits) 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). Implicit allowance is made for future reversionary bonuses through the use of a net premium valuation method employing a reduced valuation rate of interest. No provision is made for terminal bonuses.

Equalization 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 (separate account liabilities) are the repurchase value of units allocated to in-force policies 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.

### *U. Operating Leases*

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### V. Pension Costs

The cost of providing pensions for the Group's employees is accounted for over the employees' working lives on a systematic basis as advised by qualified actuaries.

### W. Use of Estimates

The preparation of the financial statements in conformity with accounting standards requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and revenue and expenses during the period reported. Actual results could differ from these estimates.

## 2. Merger of Royal Insurance and Sun Alliance

The merger of the businesses of Royal Insurance and Sun Alliance meets the definition of a merger as set out in Financial Reporting Standard 6 "Acquisitions and Mergers". The principles of merger accounting have been followed in presenting the combined Group's results.

The merger was effected on July 19, 1996 by means of a scheme of arrangement sanctioned by the High Court whereby all of Royal Insurance's issued share capital (other than one share held by Royal & Sun Alliance Insurance Group plc (the "Company")) was cancelled and new share capital was issued by Royal Insurance to the Company by capitalization of the reserve arising from the cancellation. Under the scheme, the Company issued new shares to the former Royal Insurance shareholders on the basis of 1,067 ordinary shares of 25p each in the Company for every 1,000 Royal Insurance shares of 25p each previously held. On July 18, 1996 the market price of the ordinary shares of the Company was 365p, and the market price of the ordinary shares of Royal Insurance was 389.5p.

In adopting merger accounting, the results of the former Royal Insurance and Sun Alliance groups were first brought together for the whole of 1996 with adjustments to achieve uniformity of accounting policies. Merger accounting requires that the share premium account of Royal Insurance together with the difference between the nominal value of the shares issued to former shareholders in Royal Insurance and the nominal value of the shares received in exchange is shown as a movement in the profit and loss account. By December 31, 1996, 736,710,336 ordinary shares of 25p each with a fair value of £2,699m had been issued by the Company in exchange for 690,450,172 ordinary shares of 25p in Royal Insurance.

## 3. Impact of Changes on Profit and Loss Account Arising from Accounting Policy Changes

The impact of the change in accounting policy arising from the adoption of Financial Reporting Standard 16 "Current Tax" in the non-technical account (see note 1C) is to reduce the investment income and the profit on ordinary activities before tax by **£7m** (1998 £14m, 1997 £21m). The tax on ordinary activities is reduced by an equivalent amount. In the long term (life) business technical account the impact is to reduce both investment income and tax attributable to long term (life) business by **£39m** (1998 £49m, 1997 £46m).

## 4. Other Items

- a. Other items within the consolidated profit and loss accounts comprise: **£46m** (1998 £13m, 1997 £0m) of reorganization costs in relation to general (property and casualty) insurance business in the UK, Scandinavia, USA and Asia Pacific, and in Asia Pacific **£4m** (1998 and 1997 £0m) of reorganization costs in relation to long term (life) businesses and **£2m** (1998 and 1997 £0m) of reorganization costs in relation to non-insurance activities. Additionally, there is **£4m** (1998 and 1997 £0m) amortization of the

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

present value of acquired in-force business, **£14m** (1998 £142m, 1997 £0m) premium on the redemption of subordinated liabilities and convertible bonds, interest on long term subordinated liabilities **£10m** (1998 and 1997 £0m), amortization of goodwill and goodwill in acquired claims provisions **£26m** (1998 and 1997 £0m) and **£10m** (1998 £5m, 1997 £3m) of profit on disposal of subsidiaries and branches.

- b. As a result of the integration of the businesses of the Royal Insurance and Sun Alliance groups following the merger on July 19, 1996, £64m of costs in 1997 have been charged to the consolidated profit and loss account (statement of income) within general (property and casualty) business administrative expenses.

### 5. Net Operating Expenses and Other Charges

	General (property & casualty) business			Long term (life) business		
	1999 £m	1998 £m	1997 £m	1999 £m	1998 £m	1997 £m
a. Net operating expenses in the technical accounts include:						
Depreciation . . . . .	56	53	70	15	12	15
Operating lease rentals—premises . . . . .	75	67	60	10	8	6
Operating lease rentals—other assets . . . . .	17	15	13	2	1	—

Operating expenses in 1998 include a fine of £225,000 levied by the Personal Investment Authority in respect of administration procedures, mainly arising before the end of 1996, which related to the review of pension transfer and opt-out business.

- b. Charges from other activities in the non-technical account include depreciation of **£5m** (1998 £7m, 1997 £8m), operating lease rentals—premises of **£13m** (1998 £12m, 1997 £11m) and operating lease rentals—other assets of **£1m** (1998 £1m, 1997 £0m).
- c. Administrative expenses in the non-technical account include depreciation of **£1m** (1998 and 1997 £0m) and operating lease rentals—premises of **£5m** (1998 £1m, 1997 £0m).
- d. Income and charges from other activities within the consolidated non-technical account include profit attributable to the shareholders' interest in Codan Bank A/S until its disposal on August 31, 1999 and the results arising from the Group's investment management, insurance broking and estate agency activities.

### 6. Exchange Rates

In respect of the major overseas currencies, the rates of exchange used in these financial statements are US Dollar **1.61** (1998 1.66, 1997 1.65), Canadian Dollar **2.34** (1998 2.56, 1997 2.35), Danish Kroner **11.96** (1998 10.59, 1997 11.27) and Australian Dollar **2.46** (1998 2.71, 1997 2.53).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### 7. Long Term (Life) Insurance Business

	1999 £m	1998 £m	1997 £m
New business written during the year, net of reinsurance was as follows:			
Annual premiums .....	247	223	211
Single premiums .....	<u>1,661</u>	<u>1,214</u>	<u>1,060</u>
	<u><u>1,908</u></u>	<u><u>1,437</u></u>	<u><u>1,271</u></u>

Gross new business premiums are not materially different to the above.

Total reversionary and terminal bonuses included within the long term (life) business technical account are **£690m** (1998 £855m, 1997 £791m).

Included in the long term (life) business premiums written, net of reinsurance, are **£1,354m** (1998 £1,216m, 1997 £1,131m) of premiums relating to participating business. For further discussion of participating business see note 48.

### 8. Employee Information

	1999 £m	1998 £m	1997 £m
Staff costs for all employees comprise:			
Wages and salaries .....	995	928	880
Social security costs .....	77	73	65
Pension costs .....	<u>49</u>	<u>48</u>	<u>46</u>
	<u><u>1,121</u></u>	<u><u>1,049</u></u>	<u><u>991</u></u>

#### Average for year

	1999 Number	1998 Number	1997 Number
The average number of employees of the Group during the year was as follows:			
UK .....	24,891	24,408	24,560
Other Europe .....	8,186	7,475	6,929
Americas .....	8,549	8,544	8,263
Asia Pacific .....	<u>4,868</u>	<u>4,067</u>	<u>3,733</u>
	<u><u>46,494</u></u>	<u><u>44,494</u></u>	<u><u>43,485</u></u>

### 9. Pension Costs

The Group mainly operates funded defined benefit pension plans for its employees. There is a funded defined contribution plan in Denmark and a number of unfunded overseas plans. Overseas plans are administered in accordance with local law and practice. The major pension plans in the UK, USA and Denmark together cover the majority of plan members throughout the Group, and the assets of these plans are mainly held in separate trustee administered funds. Each of the major defined benefit plans are subject to regular

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

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.

The total pension cost for the Group in 1999 was **£49m** (1998 £48m, 1997 £46m) of which **£16m** (1998 £21m, 1997 £23m) related to the two main UK plans, including **£0m** (1998 £0m, 1997 £1m) in respect of early retirements. Contributions of **£10m** (1998 £11m, 1997 £10m) were made to the defined contribution plan in Denmark.

Independent qualified actuaries carry out valuations of the major plans except for one of the UK plans, for which the actuary is an employee of the Group. At the most recent formal actuarial valuations of the major defined benefit plans for the purpose of assessing pension costs (the two UK plans June 30, 1999 and March 31, 1997, and USA January 1, 1999), the market value of the assets of these plans was **£3,882m** (1998 £3,441m, 1997 £3,402m). Of this amount, **£3,513m** (1998 and 1997 £3,103m) related to the UK plans, and their actuarial values were sufficient to cover **120%** and **127%** respectively (1998 and 1997 122% and 127%, respectively) of the benefits accrued to members of each of those plans, after allowing for projected increases in earnings and pensions. The valuations for the two major UK plans were based on assumptions that salaries increase by 5% and 6%, pensions increase by 3% and 4% and investment returns are 7.8% and 8.5%. The difference in these assumptions arises because of the different valuation dates of the two UK plans.

The level of contributions to the UK plans was 5.6% and 0%. The amounts respectively charged to the profit and loss account were 5.6% and 5% of relevant UK earnings. Actuarial surpluses arising from the valuations of both the UK plans and certain other plans are being applied to reduce pension costs over the estimated working lives of members of the respective schemes.

There are no significant contributions outstanding or prepaid as at December 31, 1999 except that included in creditors are amounts of **£60m** (1998 £49m) resulting from the difference between the amounts charged to revenue and the amounts contributed to the main plans in the UK and **£33m** (1998 £39m) in respect of provisions for unfunded overseas plans.

### 10. Post-Retirement Benefits

The Group provides post-retirement healthcare benefits to certain current and retired United States and Canadian employees. The estimated discounted present value of the unprovided accumulated obligations is calculated in accordance with the advice of independent qualified actuaries. At December 31, 1999, the unprovided accumulated obligation in the United States is estimated at **£7m** (1998 £8m, 1997 £10m) assuming a premium inflation initially of **7%** reducing over 5 years to **5.5%** (1998 7.5% reducing over 5 years to 5.5%, 1997 8% reducing over 6 years to 5.5%) and a discount rate of **8%**. The unprovided accumulated obligation in Canada is estimated at **£3m** (1998 £3m, 1997 £4m) assuming a premium inflation for medical care of **5.8%** (1998 9% reducing over 4 years to 6%, 1997 10% reducing over 5 years to 6%) and for dental care **4%** (1998 and 1997 6%) for all years and a discount rate of **6.8%**. The benefits are accounted for on a systematic basis over the remaining service lives of current employees, the cost in the year being **£5m** (1998 and 1997 £5m). The costs of meeting the liability for these benefits are expected to attract taxation relief when paid. The total provision (reserve) included in the consolidated balance sheet is **£35m** (1998 £27m).

### 11. Equalization Provisions (Reserves)

Equalization provisions (reserves) are established in the UK in accordance with the Insurance Companies (Reserves) Act 1995 and with similar legislation in certain overseas countries. These provisions, notwithstanding that they do not represent liabilities at the balance sheet date as they are over and above the

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

anticipated ultimate cost of outstanding claims, are required by Schedule 9A to the Companies Act 1985 to be included within the technical provisions in the balance sheet, and any change in the provisions during the year is required to be shown in the general (property and casualty) business technical account.

The effect of including the provisions is as follows:

	1999	1998	1997
	£m	£m	£m
Equalization provisions at January 1 . . . . .	250	194	112
Charged to the general (property and casualty) business technical account and in the profit on ordinary activities before tax . . . . .	12	51	84
Exchange movement on non-UK provisions . . . . .	(3)	5	(2)
<b>Equalization provisions at December 31 . . . . .</b>	<b><u>259</u></b>	<b><u>250</u></b>	<b><u>194</u></b>

The cumulative impact of equalization provisions on shareholders' funds at December 31, 1999 is **£253m** (1998 £242m, 1997 £187m).

### 12. Investment Income/Expenses and Charges

	Non-technical account		
		Restated	Restated
	1999	1998	1997
	£m	£m	£m
<b>Income from associated undertakings</b> (note 1) . . . . .			
Profit before gains on the realization of investments . . . . .	24	25	27
Gains on the realization of investments . . . . .	53	—	1
	<u>77</u>	25	28
<b>Other investment income</b>			
Income from land and buildings . . . . .	32	60	68
Income from other investments . . . . .	790	812	831
Gains on the realization of investments (note 2) . . . . .	752	816	218
	<u>1,574</u>	1,688	1,117
<b>Total investment income . . . . .</b>	<b><u>1,651</u></b>	<b><u>1,713</u></b>	<b><u>1,145</u></b>
<b>Investment expenses and charges</b>			
Interest on bank loans and overdrafts . . . . .	(20)	(36)	(17)
Interest on long term subordinated liabilities . . . . .	(10)	—	—
Interest on other loans . . . . .	(11)	(11)	(24)
Investment management expenses . . . . .	(24)	(24)	(20)
Premium on redemption of long term subordinated liabilities and convertible bonds . . . . .	(14)	(142)	—
	<u>(79)</u>	(213)	(61)
<b>Total investment expenses and charges . . . . .</b>	<b><u>(79)</u></b>	<b><u>(213)</u></b>	<b><u>(61)</u></b>
<b>Net investment income . . . . .</b>	<b><u>1,572</u></b>	<b><u>1,500</u></b>	<b><u>1,084</u></b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

	Technical account long term (life) business		
	1999	Restated 1998	Restated 1997
	£m	£m	£m
<b>Income from associated undertakings</b>			
Profit before gains on the realization of investments . . . . .	—	—	—
Gains on the realization of investments . . . . .	—	—	—
	—	—	—
<b>Other investment income</b>			
Income from land and buildings . . . . .	131	141	163
Income from other investments . . . . .	1,448	1,497	1,425
Gains on the realization of investments (note 2) . . . . .	2,266	2,127	1,067
	3,845	3,765	2,655
<b>Total investment income</b> . . . . .	3,845	3,765	2,655
<b>Investment expenses and charges</b>			
Interest on bank loans and overdrafts . . . . .	(1)	(1)	—
Interest on long term subordinated liabilities . . . . .	—	—	—
Interest on other loans . . . . .	(3)	(1)	(1)
Investment management expenses . . . . .	(56)	(50)	(46)
Premium on redemption of long term subordinated liabilities and convertible bonds . . . . .	—	—	—
	(60)	(52)	(47)
<b>Total investment expenses and charges</b> . . . . .	(60)	(52)	(47)
<b>Net investment income</b> . . . . .	3,785	3,713	2,608

**Notes:**

1. The 1998 figure includes results for an eighteen month period in respect of the Group's investment in Mutual & Federal Investments Limited following the change to a December 31 accounting reference date. The prior year's comparatives are for 12 months. The amounts involved are not material.
2. Gains on the realization of investments in 1999 include a gain of **£10m** (1998 £5m, 1997 £3m) relating to the Group's disposal of interests in subsidiaries and branches.

### 13. Methodology for Calculation 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:

	1999	1998	1997
	%	%	%
<b>Pre-tax returns assumed</b>			
Fixed interest returns (nominal) . . . . .	6.00	6.00	6.00
Equity returns (nominal) . . . . .	9.00	9.00	9.00
Inflation . . . . .	3.00	3.00	3.00

These returns are applied to the average, over the year, of the investments directly attributable to shareholders and the general (property and casualty) insurance technical provisions. In each case, the element

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

of shareholders' funds has been determined by reference to the risk based capital that the directors judge is necessary to support the business. The value of the investments are adjusted to reduce the effect of short-term fluctuations, while recognizing such changes over the longer term.

The aggregate amount of investment return recognized under the longer-term basis since January 1, 1994 through December 31, 1999 amounted to **£6.5bn**. The actual total investment return that arose in this period was **£8.4bn**.

### 14. Taxation

The taxation on profit on ordinary activities charged to the profit and loss account is as follows:

	Non-technical account		
	1999	Restated 1998	Restated 1997
	£m	£m	£m
<b>UK taxation</b>			
Corporation tax . . . . .	68	256	69
Trading losses utilized . . . . .	—	(10)	(9)
Deferred tax . . . . .	1	1	62
Prior year items—Corporation tax . . . . .	(14)	(6)	(12)
Prior year items—Deferred tax . . . . .	(19)	—	—
Double taxation relief . . . . .	(19)	(88)	(37)
	17	153	73
<b>Tax attributable to balance on the long term (life) business technical account</b> . . . . .	<b>59</b>	<b>69</b>	<b>63</b>
<b>Overseas taxation</b> . . . . .	<b>194</b>	<b>152</b>	<b>218</b>
	<b>270</b>	<b>374</b>	<b>354</b>
<b>Analyzed</b>			
Parent and subsidiaries . . . . .	261	369	345
Associated undertakings . . . . .	9	5	9
		Technical account long term (life) business	
	1999	Restated 1998	Restated 1997
	£m	£m	£m
<b>UK taxation</b>			
Corporation tax . . . . .	110	220	139
Trading losses utilized . . . . .	—	(2)	(2)
Deferred tax . . . . .	40	14	25
Prior year items—Corporation tax . . . . .	8	18	(10)
Prior year items—Deferred tax . . . . .	—	—	—
Double taxation relief . . . . .	(2)	(2)	(2)
	<b>156</b>	<b>248</b>	<b>150</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

	Technical account long term (life) business		
		Restated	Restated
	1999	1998	1997
	£m	£m	£m
<b>Tax attributable to balance on the long term (life) business technical account</b> . . . . .	—	—	—
<b>Overseas taxation</b> . . . . .	<b>84</b>	117	97
	<u><b>240</b></u>	<u>365</u>	<u>247</u>
<b>Analyzed</b>			
Parent and subsidiaries . . . . .	<b>240</b>	365	247
Associated undertakings . . . . .	—	—	—

UK corporation tax for the current year in the non-technical account is based on a rate of **30.25%** (1998 31%, 1997 31.5%). Further details of current and deferred tax are given in notes 30 and 33.

The tax charge for UK corporation tax in the long term (life) technical account is provided at rates between **20%** and **30.25%** (1998 between 20% and 31%, 1997 between 20% and 31.5%) depending upon the types of business written and computed in accordance with rules applicable to life insurance companies.

The effective tax rate in the non-technical account for 1999 was **71.4%** (1998 43.3%, 1997 19.6%). This wide variation in the effective rate is caused principally by the UK GAAP policy of partial deferred tax provisioning. In this regard the 1999 rate was high due to the level of investment realizations and unrealized depreciation in the value of investments for which no tax credit has been taken. Similarly in 1998 the rate was higher due to the high level of investment realizations and the non-recognition of tax relief on the convertible bond repayment premium of £142m which was taken in 1999. The low rate in 1997 was caused by the high level of unrealized investment appreciation.

### 15. Dividends

	1999	1998	1997
	£m	£m	£m
<b>Ordinary</b>			
Special dividend paid <b>48.00p</b> (1998 and 1997—0.00p) . . . . .	<b>751</b>	—	—
Interim paid <b>8.40p</b> (1998—7.80p, 1997—7.15p) . . . . .	<b>120</b>	122	110
Final proposed <b>16.30p</b> (1998—15.20p, 1997—13.85p) . . . . .	<b>233</b>	238	215
	<u><b>1,104</b></u>	<u>360</u>	<u>325</u>
<b>Preference</b> . . . . .	<b>9</b>	9	9
	<u><b>1,113</b></u>	<u>369</u>	<u>334</u>

The dividends in 1998 and the special dividend in 1999 were declared to holders of shares prior to the share consolidation (see note 27). The interim and final dividend in 1999 are in respect of holders of shares after the share consolidation. Full provision has been made for the proposed final dividend.

For the interim 1997 dividend, a scrip dividend (dividend reinvestment plan) alternative was in place. The actual amount paid depended on acceptances of the scrip dividend offer. The scrip amount added back to reserves (retained earnings) in 1997 was £47m.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### 16. Earnings Per Ordinary Share

The earnings per ordinary share shown in the consolidated profit and loss account is calculated by reference to the profit attributable to the equity shareholders of **£78m** (1998 £448m, 1997 £1,407m) and the weighted average of **1,482,855,246** (1998 1,559,949,394, 1997 1,546,297,803) shares in issue during the year.

	1999	1998	1997
	£m	£m	£m
Profit for the financial year attributable to shareholders . . . . .	87	457	1,416
Preference dividends . . . . .	(9)	(9)	(9)
<b>Profit for the financial year attributable to equity shareholders . . . . .</b>	<b>78</b>	<b>448</b>	<b>1,407</b>

The diluted earnings per share is calculated by reference to the profit attributable to equity shareholders adjusted for such items that on conversion to shares give rise to dilution. This is calculated using the adjusted profit of **£78m** (1998 £448m, 1997 £1,414m) and the adjusted weighted average of **1,497,260,487** (1998 1,581,139,645, 1997 1,603,830,606) shares in issue during the year.

Details of the items giving rise to dilution are shown below:

	Profit attributable to shareholders		
	1999	1998	1997
	£m	£m	£m
Earnings per share . . . . .	78	448	1,407
Options granted to employees . . . . .	—	—	—
Convertible debt issue . . . . .	—	—	7
Diluted earnings per share . . . . .	<b>78</b>	<b>448</b>	<b>1,414</b>

	Weighted average number of shares		
	1999	1998	1997
Earnings per share . . . . .	1,482,855,246	1,559,949,394	1,546,297,803
Options granted to employees . . . . .	14,405,241	21,190,251	19,078,700
Convertible debt issue . . . . .	—	—	38,454,103
Diluted earnings per share . . . . .	<b>1,497,260,487</b>	<b>1,581,139,645</b>	<b>1,603,830,606</b>

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 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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

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:

	<b>1999</b>	<b>1998</b>	<b>1997</b>
	<u><b>p</b></u>	<u><b>p</b></u>	<u><b>p</b></u>
<b>Group operating earnings (based on longer term investment return) after tax per ordinary share</b>			
Attributable to shareholders per ordinary share .....	<b>25.7</b>	24.7	42.4
Other movements in investments .....	<b>(5.4)</b>	29.1	62.9
Interest on long term subordinated liabilities .....	<b>(0.7)</b>	—	—
Change in the equalization provisions .....	<b>(0.8)</b>	(3.3)	(5.4)
Amortization of goodwill .....	<b>(0.9)</b>	—	—
Amortization of goodwill in acquired property and casualty claims provisions .....	<b>(0.8)</b>	—	—
Premium on redemption of convertible bonds .....	<b>(0.9)</b>	(9.1)	—
Reorganization and integration provisions .....	<b>(3.5)</b>	(0.8)	(4.1)
Gains on disposal of subsidiaries and branches .....	<b>0.7</b>	0.3	0.2
Other items .....	<b>(2.9)</b>	—	—
Tax .....	<b>(5.2)</b>	(12.2)	(5.0)
<b>Earnings per ordinary share</b> .....	<u><b>5.3</b></u>	<u>28.7</u>	<u>91.0</u>

### 17. Intangible Assets

	<b>Goodwill in acquired claims provisions £m</b>	<b>Goodwill arising on acquisition £m</b>	<b>Total 1999 £m</b>	<b>Total 1998 £m</b>
	<u><b>£m</b></u>	<u><b>£m</b></u>	<u><b>£m</b></u>	<u><b>£m</b></u>
<b>Cost</b>				
At January 1 .....	—	14	<b>14</b>	—
Additions .....	<u>204</u>	<u>844</u>	<u><b>1,048</b></u>	<u>14</u>
<b>At December 31</b> .....	<u>204</u>	<u>858</u>	<u><b>1,062</b></u>	<u>14</u>
<b>Amortization</b>				
At January 1 .....	—	(1)	<b>(1)</b>	—
Charge for the year .....	<u>(12)</u>	<u>(14)</u>	<u><b>(26)</b></u>	<u>(1)</u>
<b>At December 31</b> .....	<u>(12)</u>	<u>(15)</u>	<u><b>(27)</b></u>	<u>(1)</u>
<b>Net book value at December 31</b> .....	<u>192</u>	<u>843</u>	<u><b>1,035</b></u>	<u>13</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### 18. Investments

	1999 £m	1998 £m
<b>Land and buildings</b>		
Freehold . . . . .	2,067	2,420
Long leasehold . . . . .	304	225
Short leasehold . . . . .	15	19
<b>Total land and buildings</b> . . . . .	<b>2,386</b>	2,664
Of which Group occupied . . . . .	<b>359</b>	343
<b>Other financial investments</b>		
Shares and other variable yield securities and units in unit trusts . . . . .	18,742	18,107
Debt securities and other fixed income securities:		
British government securities . . . . .	6,494	7,501
Other government securities . . . . .	5,411	4,955
Local authority securities . . . . .	1,180	861
Corporate bonds . . . . .	11,131	10,345
Preference shares . . . . .	430	202
Loans secured by mortgages . . . . .	467	491
Other loans (see below) . . . . .	96	142
Deposits with credit institutions . . . . .	833	1,011
<b>Total other financial investments</b> . . . . .	<b>44,784</b>	43,615
<b>Listed investments</b>		
Included in total investments are the following:		
Interests in associated undertakings . . . . .	146	140
Shares and other variable yield securities and units in unit trusts . . . . .	18,248	17,532
Debt securities and other fixed income securities . . . . .	20,467	18,401
<b>Total listed investments</b> . . . . .	<b>38,861</b>	36,073

In addition, within the consolidated balance sheet, debt securities held in North America amounting to **£3,302m** (1998 £5,010m) at fair 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 consolidated balance sheet include securities valued on an amortized cost basis of **£3,141m** (1998 £4,805m) with a historical cost of **£3,135m** (1998 £4,798m), a fair value of **£3,127m** (1998 £5,041m) and a redemption value of **£3,178m** (1998 £5,070m).

Other loans shown above for the consolidated balance sheet include amounts of **£43m** (1998 £101m) relating to policyholder loans.

The historical cost of total investments (excluding value of long term business) included in the consolidated balance sheet is **£37,665m** (1998 £36,063m). The historical cost of assets held to cover linked liabilities (separate account liabilities) is **£6,297m** (1998 £5,390m).

The property valuations have been prepared on the basis of open fair value at the balance sheet date in accordance with The Royal Institute of Chartered Surveyors' Appraisal and Valuation Manual and have been certified by the Group's qualified valuation surveyor.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

As of December 31, 1999, securities of **£1,927m** (1998 £1,244m) had been loaned and collateral of **£1,987m** (1998 £1,287m) had been received from the securities lending participated in by the Group. The Group requires collateral equal to or greater than the fair value of the securities loaned. On average the collateral requirement is 102.5%.

Securities with a carrying value of **£419m** at December 31, 1999 (1998 £189m) were held in trust for the benefit of U.S. policyholders as required by the various states.

### 19. Derivatives

The Group uses derivative financial instruments for the purpose of reducing its exposure to adverse fluctuations in interest rates, foreign exchange rates and equity markets. While these hedging instruments are subject to fluctuations in value, such fluctuations are generally offset by the value of the underlying exposures being hedged. The Group is not a party to leveraged derivatives and does not hold or issue financial instruments for speculative purposes. Swaps (except those entered into in relation to the Group's subordinated liabilities—see note 1F), futures and forward contracts are accounted for as contractual commitments on a trade date basis and are carried at fair values. Any unrealized gains and losses arising on these contracts are reflected in the profit and loss account (statement of income). The fair values of futures contracts are based on closing exchange quotations. Forwards and futures are contracts that call for the delayed delivery of securities in which the seller agrees to deliver a specified instrument at a specified date at a specified price.

The Group utilizes foreign currency forward contracts to reduce exposure to exchange rate risks primarily associated with transactions in the regular course of the Group's international operations and to limit currency risk on assets matched to other currency denominated liabilities. The forward contracts establish the exchange rates at which the Group will purchase or sell the contracted amount of local currencies for specified foreign currencies at a future date. The Group utilizes forward contracts that are short-term in duration (generally less than six months) and pays the forward rate at the settlement date. The major currency exposures hedged by the Group include the US dollar and euro. The notional amount of foreign currency forwards at December 31, 1999 was **£1,235m** (1998 £737m).

The carrying amount and fair value of these contracts were not significant.

To reduce the risk of equity market fluctuations, the Group enters derivative futures contracts as an efficient portfolio management tool. The instruments used are readily marketable exchange traded futures contracts (Financial Times Stock Exchange "FTSE" futures). The change in fair value of such contracts has a high correlation to the price changes of the underlying investments. Gains or losses arising from open positions are included in the investment portfolio and the profit and loss account as an unrealized gain or loss. The contract amount of futures contracts at December 31, 1999 was **£52m** (1998 £650m). The carrying amount and fair value of these contracts were **(£4m)** (1998 (£25m)).

The Group has entered into a number of swaption contracts to mitigate certain interest guarantees offered on life products offered by the Group prior to 1996. The carrying amount and fair value of these contracts at December 31, 1999 was **£59m** (1998 £0m). Changes in the value of these contracts are charged to the profit and loss account (statement of income).

A subsidiary of the Group issues investment products that provide a guaranteed return plus a variable return based on a portion of the increase in certain stock market indices. The Group purchases investment contracts with similar return characteristics in order to match the requirements of the liabilities. The investments are stated at fair value. The Group held such investment contracts with a fair value of **£98m** at December 31, 1999 (1998 £93m).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

The derivative financial instruments have off-balance-sheet risk which includes to varying degrees, elements of credit and market risk in excess of the amount recognized in the consolidated balance sheet. The contract or notional amounts of these instruments reflect the extent of involvement the Group has in a particular class of financial instrument. However, the maximum loss of cash flow associated with these instruments can be less than these amounts. For forward contracts, credit risk is limited to the amount that it would cost the Group to replace the contracts. The Group monitors creditworthiness of counterparties to these financial instruments using criteria of acceptable risk that are consistent with on-balance-sheet financial instruments. The controls include credit approvals, limits and other monitoring procedures. Collateral is required, at the discretion of the Group, on certain transactions based on the creditworthiness of the counterparty.

### 20. Value of Long Term (Life) Business

This represents the directors' assessment of the value of the shareholders' investment in the long term (life) business funds not already recognized under the modified statutory principles of profit recognition under UK GAAP.

The principal assumptions used to calculate the value of the UK long term (life) business which constitutes 83% of the value of long term (life) business are:

	1999 %	1998 %
Investment return:		
Fixed interest . . . . .	5.15	4.46
UK equities . . . . .	7.65	6.96
Overseas equities . . . . .	7.65	6.96
Expense inflation . . . . .	3.60	3.00
Discount rate (including risk margins) . . . . .	7.50	7.00

The investment returns represent the underlying long term assumptions implicit in the calculation of the value of long term (life) business.

During the year, the Group acquired value of long term (life) business amounting to **£118m** (1998 £27m) which is being amortized over 20 years. Amortization charged to the long term (life) business technical account amounted to **£4m** (1998 £1m, 1997 £0m). The cumulative unamortized acquired value of long term (life) business at December 31, 1999 amounted to **£140m** (1998 £26m).

### 21. Debtors

Debtors arising out of direct insurance operations are analyzed as follows:

	1999 £m	1998 £m
Due from policyholders . . . . .	1,041	855
Due from intermediaries . . . . .	1,669	1,610
	2,710	2,465

Other debtors in the consolidated balance sheet includes **£798m** (1998 £579m) representing shareholders' accrued interest and shareholders' net assets of certain overseas long term (life) business operations. Other debtors at December 31, 1999 in the consolidated balance sheets includes advances of **£0m** (1998 £402m) to Codan Bank A/S customers.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### 22. Tangible Assets

The cost and related accumulated depreciation were as follows as of December 31:

	<b>1999</b>	<b>1998</b>
	<b>£m</b>	<b>£m</b>
<b>Cost</b>		
At January 1 . . . . .	<b>618</b>	632
Acquisitions . . . . .	<b>86</b>	—
Additions . . . . .	<b>134</b>	106
Exchange rate fluctuations . . . . .	<b>(11)</b>	6
Disposals . . . . .	<b>(125)</b>	(126)
<b>At December 31</b> . . . . .	<b><u>702</u></b>	<u>618</u>
<b>Accumulated Depreciation</b>		
At January 1 . . . . .	<b>400</b>	415
Depreciation charge for the year . . . . .	<b>77</b>	72
Exchange rate fluctuations . . . . .	<b>(4)</b>	4
Acquisitions . . . . .	<b>38</b>	—
Disposals . . . . .	<b>(77)</b>	(91)
<b>At December 31</b> . . . . .	<b><u>434</u></b>	<u>400</u>
<b>Net book value</b>		
<b>At December 31</b> . . . . .	<b><u><u>268</u></u></b>	<u><u>218</u></u>

Tangible assets principally comprise short leasehold improvements, fixtures, fittings and equipment.

### 23. Interests in Associated Undertakings

The equity method of accounting is used for the Group's investment in associated undertakings in accordance with Financial Reporting Standard 9 "Associated and Joint Ventures". The companies listed in note 51 are those, not being subsidiaries, in which Royal & Sun Alliance Insurance Group plc and its subsidiaries held at December 31, 1999 a participating interest and which are associated undertakings as defined in the Companies Act 1985. All holdings are of equity shares. Equity in income of associated undertakings is presented separately as a footnote to the consolidated profit and loss non-technical account.

Interests in associated undertakings comprise:

	<b>1999</b>	<b>1998</b>
	<b>£m</b>	<b>£m</b>
<b>Shares at cost</b>		
At January 1 . . . . .	<b>95</b>	100
Acquisitions . . . . .	<b>51</b>	—
Transfer to subsidiary undertakings/disposals . . . . .	<b>(72)</b>	(5)
<b>At December 31</b> . . . . .	<b>74</b>	95
<b>Adjustment to valuation</b> . . . . .	<b>148</b>	123
<b>Net book value</b> . . . . .	<b><u><u>222</u></u></b>	<u><u>218</u></u>

Balances due from associated undertakings at December 31, 1999 amounted to **£7m** (1998 £9m).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### 24. Acquisitions of Subsidiary Undertakings

During 1999, acquisitions of subsidiary undertakings were made for a total consideration of **£1,824m** including redemption of subordinated liabilities. Goodwill of **£818m** arising on those acquisitions has been capitalized and is being amortized. The Group has used the acquisition accounting method to account for all acquisitions and the amortization period for goodwill on all significant acquisitions is 20 years, this being the period over which the value of the businesses acquired are expected to exceed the value of their underlying assets.

During 1999 the Group acquired:

#### a. Orion Capital Corporation, USA, acquired on November 16, 1999.

	Book value on acquisition £m	Fair value adjustments £m	Fair value to Group £m
Investments .....	1,341	(5)	<b>1,336</b>
Other assets .....	1,161	19	<b>1,180</b>
Other liabilities .....	(205)	(10)	<b>(215)</b>
Technical provisions for general (property and casualty) business .....	<u>(1,795)</u>	<u>113</u>	<u><b>(1,682)</b></u>
<b>Net assets (excluding subordinated liabilities) .....</b>	<u><u>502</u></u>	<u><u>117</u></u>	<u><u><b>619</b></u></u>
<b>Consideration including acquisition costs and redemption of subordinated liabilities .....</b>			<u><u><b>1,168</b></u></u>
<b>Goodwill .....</b>			<u><u><b>549</b></u></u>

The consideration paid was cash. The principal fair value adjustment relates to the valuation of claims reserves on acquisition after making allowance for future investment income. The remaining fair value adjustments relate to valuation adjustments to assets and liabilities. All adjustments are provisional given the acquisition was completed shortly before the year end. The net assets at acquisition exclude **£300m** of long term subordinated liabilities as such debt was considered as capital to support the investment and insurance risks of the business. These liabilities were redeemed as part of the acquisition process and accordingly, consideration of **£1,168m** includes **£300m** paid to redeem the liabilities. The premium paid on redemption of the liabilities amounted to **£14m** which has been expensed in the non-technical account. The loss after tax reported under local GAAP for the period from January 1, 1999 until the date of acquisition was **£100m** and the profit after tax for the year ended December 31, 1998 was £62m.

#### b. Trygg-Hansa Försäkrings AB, Publikt, Sweden, acquired with effect from August 31, 1999.

	Book value on acquisition £m	Fair value adjustments £m	Fair value to Group £m
Investments .....	923	—	<b>923</b>
Other assets .....	207	—	<b>207</b>
Other liabilities .....	(227)	2	<b>(225)</b>
Technical provisions for general (property and casualty) business ..	<u>(743)</u>	<u>67</u>	<u><b>(676)</b></u>
<b>Net assets .....</b>	<u><u>160</u></u>	<u><u>69</u></u>	<u><u><b>229</b></u></u>
<b>Consideration including acquisition costs .....</b>			<u><u><b>287</b></u></u>
<b>Goodwill .....</b>			<u><u><b>58</b></u></u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

The consideration paid was cash except for **£36m** outstanding at the balance sheet date. As part of the same transaction the Group sold its interest in Codan Bank A/S, the details of which are disclosed in note 25. The principal fair value adjustments relate to the valuation of claims reserves on acquisition after making allowance for future investment income and alignment with Group policy of the methodology for determining technical provisions. All adjustments are provisional given the acquisition was completed shortly before the year end. The loss after tax reported under local GAAP for the period from January 1, 1999 until the date of acquisition was **£26m** and the profit after tax for the year ended December 31, 1998 was £135m.

### c. Tyndall Australia Limited, acquired on May 5, 1999.

	Book value on acquisition £m	Fair value adjustments £m	Fair value to Group £m
Investments . . . . .	426	(1)	<b>425</b>
Value of long term (life) business . . . . .	31	10	<b>41</b>
Other assets . . . . .	96	(3)	<b>93</b>
Other liabilities . . . . .	(41)	—	<b>(41)</b>
Technical provisions for long term (life) business . . . . .	(387)	—	<b>(387)</b>
Fund for future appropriations . . . . .	(4)	—	<b>(4)</b>
<b>Net assets</b> . . . . .	<b>121</b>	<b>6</b>	<b>127</b>
<b>Consideration including acquisition costs</b> . . . . .			<b>302</b>
<b>Goodwill</b> . . . . .			<b>175</b>

The consideration paid was cash. The principal fair value adjustment relates to the revision, in line with Group policy, of underlying assumptions relating to the valuation placed on the value of long term (life) business.

The profit after tax reported under local GAAP for the period from January 1, 1999 until the date of acquisition was **£5m** and for the year ended December 31, 1998 was £12m.

### d. Compañía de Seguros de Vida La Construcción, Chile, acquired on November 26, 1999.

	Book value on acquisition £m	Fair value adjustments £m	Fair value to Group £m
Investments . . . . .	580	—	<b>580</b>
Value of long term (life) business . . . . .	—	73	<b>73</b>
Other assets . . . . .	20	—	<b>20</b>
Other liabilities . . . . .	(4)	—	<b>(4)</b>
Technical provisions for long term (life) business . . . . .	(493)	—	<b>(493)</b>
<b>Net assets</b> . . . . .	<b>103</b>	<b>73</b>	<b>176</b>
<b>Fair value of net assets acquired (11%)</b> . . . . .			<b>19</b>
<b>Consideration including acquisition costs</b> . . . . .			<b>17</b>
<b>Goodwill</b> . . . . .			<b>(2)</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

A 40% interest in Compañía de Seguros de Vida La Construcción was acquired on November 12, 1997. The goodwill on this transaction, amounting to £16m, was written off to reserves in 1997. A further 11% interest was acquired in 1999 for **£17m** which was paid in cash. The principal fair value adjustment relates to the valuation placed on the value of long term (life) business at acquisition. The profit after tax reported under local GAAP for the period from January 1, 1999 until the date of acquisition was **£16m** and the loss after tax was £12m for the year ended December 31, 1998.

**e. Other Group acquisitions for the year included:**

1. Towarzystwo Ubezpieczeniowe PBK Zycie SA, Poland, acquired on April 14, 1999.
2. Lietuvos Draudimas, Lithuania, acquired on June 11, 1999.

The aggregate value of these and other immaterial transactions was:

	Book value on acquisition £m	Fair value adjustments £m	Fair value to Group £m
Investments . . . . .	42	—	<b>42</b>
Value of long term (life) business . . . . .	—	4	<b>4</b>
Other assets . . . . .	16	(4)	<b>12</b>
Other liabilities . . . . .	(9)	(1)	<b>(10)</b>
Technical provisions for general (property and casualty) business . . . . .	(12)	—	<b>(12)</b>
Technical provisions for long term (life) business . . . . .	(21)	—	<b>(21)</b>
<b>Net assets</b> . . . . .	<b>16</b>	<b>(1)</b>	<b>15</b>
<b>Fair value of net assets acquired</b> . . . . .			<b>12</b>
<b>Consideration including acquisition costs</b> . . . . .			<b>50</b>
<b>Goodwill</b> . . . . .			<b>38</b>

The consideration was paid in cash except for **£2m** outstanding at the balance sheet date.

In addition to the goodwill arising on the acquisition of subsidiary undertakings, the Group acquired for **£21m** the remaining 20% minority interest in Australia Associated Motor Insurers Limited which gave rise to additional goodwill of **£26m**. There were no significant fair value adjustments.

The goodwill amortization periods for other Group acquisitions and the minority purchase range from 10 to 20 years, being the periods over which the value of the businesses acquired are expected to exceed the value of their underlying assets.

The following unaudited proforma information presents the results of operations of the Group (consolidated profit and loss account (statement of income)) as if the acquisitions made in 1999 had taken place at January 1, 1998. These proforma results of operations have been prepared for comparative purposes only and do not purport to be indicative of the results of operations which actually would have resulted had the acquisitions occurred on the date indicated.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

	Unaudited	
	1999 £m	1998 £m
Net written premiums . . . . .	11,522	11,142
Profit on ordinary activities before tax . . . . .	164	1,066
Profit on ordinary activities after tax . . . . .	(67)	623
Earnings per share . . . . .	(6.5)p	37.2p

During 1998, acquisitions were made for a total consideration of £152m. Goodwill of £13m arising on acquisitions was capitalized. Group acquisitions during the year comprise:

1. On March 6, 1998 100% of the ordinary share capital of Norwich Union Life Insurance (NZ) Limited, New Zealand.
2. On May 5, 1998 the Group increased its interest to 64.9% of the ordinary share capital of La Fenix Peruana SA, Peru.
3. On November 18, 1998 100% of the ordinary share capital of Guardian Assurance Limited, New Zealand.
4. On December 24, 1998 100% of the ordinary share capital of Financial Structures Limited, Bermuda.

The aggregate assets and liabilities acquired were:

	Book value on acquisition £m	Fair value adjustments £m	Fair value to Group £m
Investments . . . . .	398	—	398
Value of long term (life) business . . . . .	—	27	27
Other assets . . . . .	39	(1)	38
Other liabilities . . . . .	(30)	—	(30)
Technical provisions for general (property and casualty) business . . . . .	(14)	—	(14)
Technical provisions for long term (life) business . . . . .	(334)	63	(271)
Minority interests . . . . .	(9)	—	(9)
<b>Net assets</b> . . . . .	50	89	139
<b>Consideration including acquisition costs</b> . . . . .			152
<b>Goodwill capitalized</b> . . . . .			13

The consideration of £152m comprises £148m of cash paid and an estimate of deferred contingent consideration of £4m, being the maximum amount payable on the achievement of specified post-acquisition performance criteria. The principal fair value adjustments relate to the valuation of the acquired value of in-force business and to adjustments to the valuation of long term (life) business provisions on appropriate bases and assumptions.

Goodwill arising on these acquisitions is being amortized in the non-technical account over its estimated economic life, which for the above acquisitions in the year is 10 years.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

During 1997, acquisitions were made for a total consideration of £183m. Goodwill of £110m arising on these acquisitions has been written off to reserves (retained earnings) in 1997. The acquisitions include the following:

1. On January 1, 1997 the Group acquired 100% of the ordinary share capital of The Johnson Corporation, Canada.
2. On May 23, 1997 the Group acquired the non-life and intermediary life businesses of Hercules Hispano SA, Spain.
3. On September 3, 1997 the Group acquired 100% of the ordinary share capital of AMEV General Insurance Company Ltd, Ireland.
4. On November 4, 1997 the Group acquired 100% of the ordinary share capital of Prudential Vita SpA, Italy.
5. On November 25, 1997 the Group acquired 100% of the ordinary share capital of Pet Healthcare Services Ltd.

The aggregate assets and liabilities acquired were:

	Book value on acquisition £m	Fair value adjustments £m	Fair value to Group £m
Investments . . . . .	504	12	<b>516</b>
Value of long term (life) business . . . . .	—	18	<b>18</b>
Other assets . . . . .	195	(7)	<b>188</b>
Other liabilities . . . . .	(137)	(3)	<b>(140)</b>
Technical provisions for general (property and casualty) business . . . . .	(214)	(1)	<b>(215)</b>
Technical provisions for long term (life) business . . . . .	(275)	—	<b>(275)</b>
Fund for future appropriations . . . . .	—	(7)	<b>(7)</b>
Minority interests . . . . .	<u>(12)</u>	<u>—</u>	<u><b>(12)</b></u>
<b>Net assets . . . . .</b>	<u>61</u>	<u>12</u>	<u><b>73</b></u>
<b>Consideration including acquisition costs . . . . .</b>			<u><b>183</b></u>
<b>Goodwill written off . . . . .</b>			<u><b>110</b></u>

The consideration of £183m comprises £146m of cash paid, amounts payable of £10m and an estimate of deferred contingent consideration of £27m, being the maximum amount payable on the achievement of specified post-acquisition performance criteria. The principal fair value adjustments relate to the alignment of book values on acquisition with the Group's accounting policies.

On December 31, 1997 the shareholders also acquired the ordinary share capital of Codan Bank A/S owned by the Danish long term funds. This increased the shareholders' stake in the bank from 35% to 100% of the ordinary share capital. The cash consideration was £70m and there was no goodwill arising.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### 25. Disposals of Subsidiary Undertakings

During 1999, disposals of subsidiary undertakings were made for a total consideration of **£302m**. Gains on disposals of subsidiaries and the branch gave rise to an exceptional pre-tax profit of **£10m** after write off of goodwill. Group disposals during the year comprise:

1. Royal Maccabees Life Insurance Company was sold on July 31, 1999. The transaction generated proceeds, net of costs, of **£235m** and generated an exceptional pre-tax profit of **£30m** before the write off of **£26m** of goodwill attributable to the business previously eliminated against reserves.
2. Codan Bank A/S was sold on August 31, 1999. The transaction generated proceeds, net of costs, of **£57m** and generated an exceptional pre-tax profit of **£0m**. There was no goodwill written off in relation to this disposal. As part of the same transaction the Group acquired Trygg-Hansa Försäkrings AB, Publikt, the details of which are disclosed in note 24.
3. Other disposals during the year comprised Tellit Assurances Sun Alliance SA, Sun Alliance Insurance (Hellas) SA and Phoenix Assurance Zimbabwe Limited which generated in aggregate an exceptional pre-tax loss of **£0m** after write off of goodwill. With the exception of **£2m** of goodwill written off in relation to the disposal of Tellit Assurances Sun Alliance SA, there was no goodwill written off in relation to any of these disposals.
4. The Group disposed of its branch Sun Direct, Germany, which gave rise to an exceptional pre-tax profit of **£6m**.

During 1998, the Group disposed of its interests in surveying businesses, for which there was no original purchased goodwill, for a consideration of **£6m** giving rise to a gain of **£5m**.

During 1997, the Group completed the disposal of a number of subsidiaries including the 100% interests in Sun Alliance International Life Assurance and National Vulcan Safety Products Ltd. Consideration received on disposals amounted to **£21m** and the aggregate resulting gain on disposal amounted to **£3m**. There was no goodwill written off in relation to these disposals.

Gains on disposal of subsidiaries and branches for all years have been included within the non-technical account as gains on the realization of investments.

### 26. Shareholders' Funds (Shareholders' Equity)

Included in goodwill written off in 1997 was **£5m** relating to acquisitions of certain minority interests in subsidiary and associated undertakings. Share premium of **£15m** (1998 **£11m**, 1997 **£26m**) arises from the capitalization of reserves consequent upon the exercise of employee share options.

The profit and loss account at December 31, 1999 includes cumulative amounts of goodwill written off directly to reserves prior to December 31, 1997 (adjusted for disposals) of **£778m** (1998 and 1997 **£806m**). It also includes the merger reserve of **£568m** arising during 1996 (1998 **£568m**) from the merger of Royal Insurance Holdings plc (Royal Insurance) and Sun Alliance Group plc. It represents the share premium of Royal Insurance together with the difference between the nominal value of the shares issued to former shareholders in Royal Insurance and the nominal value of the shares received in exchange.

Included in the balance on the consolidated profit and loss account is a reserve (appropriated retained earnings) of an overseas subsidiary attributable to the Group of **£198m** (1998 **£184m**, 1997 **£215m**) which was established on a discretionary basis as a contingency fund.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### 27. Share Capital

	<u>1999</u>	<u>1998</u>	<u>1997</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>Authorized</b> .....			
<b>2,000,000,000 ordinary shares of 27.5p each</b> (1998 and 1997 2,200,000,000 ordinary shares of 25p each) .....	<b>550</b>	550	550
<b>300,000,000 preference shares of £1 each</b> (1998 and 1997 300,000,000 preference shares of £1 each) .....	<b>300</b>	300	300
<b>Issued and fully paid</b> .....			
<b>1,428,412,281 ordinary shares of 27.5p each</b> (1998 1,564,012,681 and 1997 1,553,871,910 ordinary shares of 25p each) .....	<b>393</b>	391	388
<b>125,000,000</b> (1998 and 1997 125,000,000 preference shares of £1 each) .....	<b>125</b>	125	125
	<b><u>518</u></b>	<b><u>516</u></b>	<b><u>513</u></b>

Following the approval of the payment of a special dividend of 48p per ordinary share, at the close of business on May 14, 1999 each ordinary share of 25p was sub-divided into ten ordinary shares of 2.5p each, the "Intermediate Shares". Immediately after the subdivision every eleven of the Intermediate Shares were consolidated into one new ordinary share of 27.5p. Unconsolidated Intermediate Shares, were sold and the proceeds distributed to the relevant shareholders. This consolidation reduced the number of ordinary shares in issue from 1,565,474,931 to 1,423,127,534.

During 1999, **1,462,250** (1998 5,648,107, 1997 17,136,354) ordinary shares of 25p and, following the share consolidation, **5,284,747** ordinary shares of 27.5p were issued on the exercise of employee share options for a total cash consideration of **£15m** (1998 £14m, 1997 £31m). In 1998 4,492,664 (1997 1,289,486) ordinary shares were issued on conversion of the Group's Subordinated Convertible Bonds 2008 for a value of £18m (1997 £5m). The total nominal value of ordinary shares issued during the year was **£2m** (1998 £3m, 1997 £6m). In 1997, 9,193,232 ordinary shares were issued pursuant to scrip dividend (dividend reinvestment plan) offers.

Between May 20 and June 19, 1997, the Company purchased and subsequently cancelled 32,100,000 ordinary shares at an average price of 477p. The total cost of the purchase including expenses was £153m, which has been charged against the profit and loss account (retained earnings) in 1997. A capital redemption reserve (a separate component of shareholders' equity) was established in 1997 equal to the nominal value of the ordinary shares purchased.

The preference shares carry a right to a fixed cumulative preferential dividend of 7.375% per annum, payable in half-yearly installments, and are non-redeemable. On a return of capital on a winding up (liquidation), 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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

The Royal & SunAlliance ESOP Trust No 1 was created in 1999 and holds ordinary shares in the Company which may subsequently be transferred to employees (other than the executive directors). At December 31, 1999 the trust held **6,500,000** ordinary shares in the Company with a nominal value of **£1,787,500** and a market value, based on the mid market value of the Company's shares at the close of business on December 30, 1999 as shown in the Official List of the London Stock Exchange, of **£31m**.

The Royal & SunAlliance ESOP Trust No 2 was created in 1999 and holds ordinary shares in the Company which may subsequently be transferred to employees including executive directors. At 31 December 1999 the trust held **200,000** ordinary shares in the Company with a nominal value of **£55,000** and a market value, based on the mid market value of the Company's shares at the close of business on December 30, 1999 as shown in the Official List of the London Stock Exchange, of **£1m**.

The Trustee of each Trust has waived their rights to dividends in excess of 0.01p on shares held by the Trusts. When computing the earnings per share, the shares held by the Trusts have been ignored in the calculation as, under FRS 14 'Earnings per Share', they are treated as if they were cancelled.

At December 31, 1999, under employee savings related share option plans, employees held options over **28,477,333** (1998 26,926,727) ordinary shares at option prices ranging from **93.8p** to **483p** (1998 93.8p to 483p) per share. The options are normally exercisable within six months of the respective exercise dates which are between August 1, 1999 and November 1, 2005 as follows:

### At December 31, 1999

<u>Number of shares</u>	<u>Option price per share</u>	<u>Year of exercise</u>
489,321	93.80p—351.00p	1999
3,444,786	232.50p—473.00p	2000
4,648,925	206.20p—483.00p	2001
5,901,093	248.00p—435.00p	2002
5,016,621	294.00p—439.00p	2003
8,005,808	395.00p—430.00p	2004
<u>970,779</u>	356.00p—439.00p	2005
28,477,333		

### At December 31, 1998

<u>Number of shares</u>	<u>Option price per share</u>	<u>Year of exercise</u>
368,254	232.50p—307.00p	1998
5,709,647	93.80p—351.00p	1999
3,882,343	232.50p—473.00p	2000
5,353,102	206.20p—483.00p	2001
4,496,024	248.00p—430.00p	2002
5,724,389	294.00p—439.00p	2003
540,351	430.00p	2004
<u>852,617</u>	439.00p	2005
26,926,727		

At December 31, 1999 under executive share option schemes, options over **26,129,606** (1998 19,900,410) ordinary shares were held at option prices ranging from **141.6p** to **550.8p** (1998 141.6p to 525.7p).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

The options, which are potentially exercisable between 3 and 10 years after grant, were outstanding as follows:

### At December 31, 1999

<u>Number of shares</u>	<u>Option price per share</u>	<u>Year of exercise</u>
188,587	303.00p—438.30p	1993
612,761	384.00p—387.10p	1994
504,532	141.60p—232.00p	1995
737,476	262.90p—369.00p	1996
651,139	225.90p—344.00p	1997
854,838	311.60p—343.00p	1998
2,586,483	225.90p—424.00p	1999
6,260,525	258.20p—525.70p	2000
6,392,421	336.90p—497.00p	2001
<u>7,340,844</u>	<u>370.00p—550.80p</u>	<u>2002</u>
26,129,606		

### At December 31, 1998

<u>Number of shares</u>	<u>Option price per share</u>	<u>Year of exercise</u>
88,680	282.50p—365.50p	1992
275,626	303.00p—438.30p	1993
829,324	384.00p—387.10p	1994
624,601	141.60p—232.00p	1995
842,035	262.90p—369.00p	1996
728,716	225.90p—344.00p	1997
1,032,508	311.60p—343.00p	1998
2,711,094	225.90p—424.00p	1999
6,352,781	258.20p—525.70p	2000
<u>6,415,045</u>	<u>336.90p—497.00p</u>	<u>2001</u>
19,900,410		

### 28. Long Term Subordinated Liabilities

	<u>1999</u> <u>£m</u>	<u>1998</u> <u>£m</u>
Subordinated guaranteed US\$ bonds . . . . .	<b>302</b>	—
Subordinated guaranteed Euro bonds . . . . .	<b>308</b>	—
	<u><b>610</b></u>	<u>—</u>

During the financial year, the Company issued subordinated US\$ bonds and subordinated Euro bonds with dates of redemption of October 15, 2029 and October 15, 2019 respectively. The net proceeds (after issue costs) of **\$488m** and **€496m** respectively were used to provide additional capital to assist in the financing of the acquisition of subsidiary undertakings during the year. The amounts payable on redemption are **\$500m** and **€500m** respectively. The bonds are contractually subordinated to all other creditors of the Company such that in the event of winding up or of bankruptcy, they are to be repaid only after the claims of all other creditors have been met. The rate of interest payable on the US\$ bonds is 8.95%, although the Company has entered into

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

derivative contracts which have the effect of converting the interest payable to a floating rate which was 8.01% for the period ended December 31, 1999. These contracts have the same maturity dates as the US\$ bonds. €200m of the Euro bonds bear interest at a fixed rate of 6.875% until October 15, 2009 and a floating rate thereafter. €300m of the Euro bonds bear interest at a floating rate from the date of issue. As at December 31, 1999 the floating rate of interest on the Euro bonds was 4.57%. The Company has the option to repay the Euro bonds on specific dates from October 15, 2009.

### 29. Long Term (Life) Business Provision (Life Business Reserves)

The principal assumptions used to calculate the UK long term (life) business provision (reserve for future life and health policy benefits) for the main classes of business are:

	<u>1999</u>	<u>1998</u>	<u>1997</u>
<b>Interest rates</b>			
Life —with profit . . . . .	2.60% to 3.00%	2.60% to 2.75%	2.65% to 4.00%
Pensions —with profit . . . . .	3.00% to 4.50%	3.00% to 4.00%	3.20% to 3.75%
Annuities —in payment . . . . .	5.54%	4.35%	5.25% to 6.00%
<b>Mortality rates</b>			
Life —with profit . . . . .	AM80, AF80 with adjustments	AM80, AF80	AM80, AF80
Pensions —with profit . . . . .	AM80, AF80 with adjustments	AM80, AF80 with adjustments	AM80, AF80 with adjustments
Annuities —in payment . . . . .	PMA80/PFA80 (c=2010) with adjustments	PMA80 (c=2010) with adjustments	PMA80 (c=2010) with adjustments and PA90 minus 7 years

The valuation has been carried out principally using a net premium method.

Generally accepted actuarial tables are used as appropriate in overseas long term (life) business operations. Assumptions and bases will vary from one territory to another. No territory other than UK shown above is significant.

As of December 31, 1999, participating business represented **70%** (1998 68%) of the long term (life) business provision. For further discussion on participating business see note 48.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### 30. Provisions For Other Risks And Charges

Provisions for other risks and charges and their related movements during 1999, 1998 and 1997 were as follows:

	Integration provision £m	Deferred taxation £m	Pensions and post retirement benefits £m	Other provisions £m	Total £m
<b>At January 1, 1997</b> .....	204	47	81	23	355
Charged/transferred .....	64	109	27	37	237
Utilized .....	(161)	16	(6)	(9)	(160)
Advance corporation tax .....	—	(78)	—	—	(78)
Exchange adjustments .....	—	—	—	(1)	(1)
<b>At December 31, 1997</b> .....	<u>107</u>	<u>94</u>	<u>102</u>	<u>50</u>	<u>353</u>
Charged/transferred .....	—	27	21	9	57
Utilized .....	(77)	—	(10)	(12)	(99)
Advance corporation tax .....	—	108	—	—	108
Exchange adjustments .....	(1)	—	2	1	2
<b>At December 31, 1998</b> .....	<u>29</u>	<u>229</u>	<u>115</u>	<u>48</u>	<u>421</u>
Charged/transferred .....	—	(66)	29	77	40
Utilized .....	(17)	—	(21)	(21)	(59)
Acquisition of subsidiaries .....	—	(44)	5	3	(36)
Exchange adjustments .....	(1)	—	(1)	(1)	(3)
<b>At December 31, 1999</b> .....	<u><u>11</u></u>	<u><u>119</u></u>	<u><u>127</u></u>	<u><u>106</u></u>	<u><u>363</u></u>

The integration provision relates to the reorganization provisions established in 1996 and 1997 arising from the merger of Royal Insurance and Sun Alliance Groups on July 19, 1996. The remaining expenditure to be incurred mainly relates to commitments on property leases.

Other provisions as at December 31, 1999 comprise mainly the costs of reorganizations including those of the UK Life business **£34m** which is included in the long term technical account and USA (property and casualty) businesses **£14m** which is included in the general (property and casualty) business technical account. The bulk of these costs are expected to be incurred within one year. In addition, various litigation provisions are held amounting to **£27m**, the timing and amount of payment of which are dependent upon legal processes.

During 1999 **£30m** of deferred taxation relating to an overseas operation was transferred to the long term (life) business provision.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### 31. Borrowings

	<b>1999</b>	<b>1998</b>
	<u>£m</u>	<u>£m</u>
<b>Debenture loans</b>		
Secured		
10.47% mortgage loan, due Oct 1, 2012, semiannual payments of £1m principal and interest, collateralized June 30, 2000 by real estate . . . . .	15	15
9% mortgage loans, due through June, 30 2000, quarterly interest only payments, collateralized by various real estate . . . . .	5	6
Gilt repurchase agreements 5.10%—5.45% due 2000 . . . . .	278	—
Unsecured		
9.625% subordinated bonds due 2003, interest payable annually . . . . .	100	100
5.57%—6.13% commercial paper, due on demand . . . . .	141	157
Other . . . . .	1	1
<b>Total debenture loans</b> . . . . .	<b>540</b>	<b>279</b>
<b>Amounts owed to credit institutions—unsecured</b>		
Revolving credit facilities . . . . .	103	159
Other . . . . .	33	11
<b>Total borrowings</b> . . . . .	<b>676</b>	<b>449</b>
<b>Less borrowings repayable within one year</b> . . . . .	<b>(453)</b>	<b>(169)</b>
<b>Total borrowings repayable after more than one year</b> . . . . .	<b>223</b>	<b>280</b>

Borrowings at December 31 were repayable as follows:

	<b>1999</b>	<b>1998</b>
	<u>£m</u>	<u>£m</u>
2000 . . . . .	453	169
2001 . . . . .	—	—
2002 . . . . .	2	—
2003 . . . . .	196	255
After five years . . . . .	25	25
	<b>676</b>	<b>449</b>

At December 31, 1999 and 1998, the Group had in place a one billion US dollar Euro commercial paper program, with interest rates on the outstanding commercial paper as of December 31, 1999 ranging from 5.57% to 6.13%.

The Group had amounts outstanding under thirteen bilateral revolving credit facilities aggregating to £103m. Twelve of the facilities, with available amounts aggregating £654m, are in the UK and bear interest at 15 basis points above LIBOR. These facilities expire in January 2003. Amounts outstanding under these facilities were **£96m** at December 31, 1999 (1998 £150m). These facilities incur a 7.5 basis point commitment fee on unused funds. The remaining facility was entered into by a subsidiary of the Group for a maximum of £9.4m, of which **£7m** was outstanding at December 31, 1999 (1998 £9m). This facility bears interest quarterly at 75 basis points above the cost of refinancing in the Euro currency market, which was 4.35% at December 31, 1999. The interest rate charged includes a commitment fee of 25 basis points. The facility expires May 31, 2005.

Revolving credit facilities outstanding in the amount of £96m are subject to cross default conditions. The £7m due under a separate revolving credit facility will become payable if a subjective acceleration clause concerning financial performance is invoked.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

In October 1998, the Group entered into a syndicated revolving credit facility for a maximum of £1,600m to be used for general corporate purposes. The facility matures in October 2003 and bears interest at 22.5 basis points above LIBOR. There is a 10 basis point commitment fee on the unused portion of the facility. As of December 31, 1999 and 1998, there were no borrowings outstanding under this facility.

Loans from credit institutions of **£103m** at December 31, 1999 (1998 £159m) under revolving credit facilities have been classified by reference to the earliest date on which repayment may be demanded by the lender. At December 31, 1999 total revolving credit facilities available to the Group were **£2,262m** (1998 £2,251m), of which **£0m** (1998 £0m) expire within one year, **£2,254m** (1998 £2,242m) expire within two to five years and **£8m** (1998 £9m) expire after five years.

During 1998 the Company repurchased the remaining outstanding 7.25% subordinated convertible bonds, due 2008. The repurchase, which was carried out via a tender offer and open market purchases, resulted in a premium of £142m being charged to the consolidated profit and loss account (statement of income) in 1998. The premium included management, legal and other fees of £0.8m.

At December 31, 1999 interest payable on amounts repayable within five years was **£30m** (1998 £44m) and after five years **£1m** (1998 £3m).

### 32. Creditors (Other Liabilities)

Other creditors including taxation and social security in the consolidated balance sheet at December 31, 1999 includes a liability of **£201m** (1998 £309m) in respect of corporation tax payable.

At December 31, 1999 other creditors in the consolidated balance sheet includes customer deposits and other liabilities of **£0m** (1998 £570m) relating to Codan Bank A/S.

### 33. Deferred Taxation

	Provided		Unprovided	
	1999 £m	1998 £m	1999 £m	1998 £m
Unrealized gains/losses arising from investments other than long term . . . .	172	201	658	787
Other timing differences other than long term . . . . .	(53)	28	(209)	(121)
	<b>119</b>	<b>229</b>	<b>449</b>	<b>666</b>

Unprovided deferred taxation reflects amounts not expected to crystallize in the foreseeable future.

In addition to the amounts stated above, deferred taxation in respect of unrealized investment gains is allowed for:

1. In the long term (life) business provision amounting to **£482m** at December 31, 1999 (1998 £405m) on a discounted basis with movements during the year being included in that provision; the unprovided amount is **£208m** at December 31, 1999 (1998 £189m).
2. Within assets held for linked liabilities (separate account liabilities) amounting to **£202m** at December 31, 1999 (1998 £91m) with movements during the year being included in the tax attributable to long term (life) business; the unprovided amount is **£12m** at December 31, 1999 (1998 £23m).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### 34. Operating Leases

	Land and buildings		Other	
	1999 £m	1998 £m	1999 £m	1998 £m
Annual commitments under non-cancellable operating leases at December 31, 1999 which expire:				
One year or less . . . . .	10	6	6	15
Between two and five years . . . . .	32	23	20	18
After five years . . . . .	68	64	—	—
	<u>110</u>	<u>93</u>	<u>26</u>	<u>33</u>

All material leases of land and buildings are subject to rent review periods of between three and five years. The above table presents the annual expense in respect of operating leases analyzed by the period to maturity of the lease.

### 35. 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 consolidated balance sheet.

	1999 £m	1998 £m
Land and buildings . . . . .	31	40
Shares and other variable yield securities and units in unit trusts . . . . .	758	528
Debt securities and other fixed income securities . . . . .	237	233
Cash at bank and in hand . . . . .	38	18
	<u>1,064</u>	819
Debtors . . . . .	8	6
Creditors . . . . .	(42)	(1)
<b>Net assets</b> . . . . .	<u>1,030</u>	<u>824</u>

### 36. Reconciliation of Total Group Operating Profit Before Tax to Net Cash Inflow From Operating Activities

	1999 £m	1998 Restated £m	1997 Restated £m
Total Group operating profit before tax (*) . . . . .	290	909	1,770
Unrealized and realized gains . . . . .	(86)	(742)	(1,169)
Change in technical provisions . . . . .	—	188	(91)
Profits relating to long term (life) business . . . . .	(235)	(230)	(231)
Cash received from long term (life) business . . . . .	150	158	133
Depreciation . . . . .	62	60	78
Amortization of goodwill and goodwill in acquired claims provisions . . . . .	26	1	—
Interest on subordinated liabilities . . . . .	10	—	—
Change in debtors less creditors . . . . .	103	(262)	19
<b>Net cash inflow from operating activities</b> . . . . .	<u>320</u>	<u>82</u>	<u>509</u>

(\*) Excludes share of results of associated undertakings of **£88m** in 1999 (1998 £(45)m, 1997 £40m).

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**37. Movements in Opening and Closing Portfolio Investments Net of Financing**

	<b>1999</b>	<b>1998</b>	<b>1997</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Net cash inflow/(outflow) for the period . . . . .	<b>215</b>	28	(11)
Decrease in net portfolio investments . . . . .	<b>(1,841)</b>	(812)	(504)
Decrease/(increase) in borrowings . . . . .	<b>(222)</b>	34	240
Issue of long term subordinated liabilities . . . . .	<b>(615)</b>	—	—
Net (issue)/redemption of share capital . . . . .	<b>(15)</b>	(14)	122
Movement arising from cash flows . . . . .	<b>(2,478)</b>	(764)	(153)
Movement in long term (life) business . . . . .	<b>978</b>	3,297	2,148
Acquisitions and disposals of subsidiary undertakings . . . . .	<b>1,839</b>	41	315
Changes in fair values and exchange rates . . . . .	<b>(10)</b>	803	1,035
Other . . . . .	<b>(109)</b>	(3)	(171)
Total movement in portfolio investments net of financing . . . . .	<b>220</b>	3,374	3,174
<b>Portfolio investments net of financing</b>			
At January 1 . . . . .	<b>45,798</b>	42,424	39,250
<b>At December 31</b> . . . . .	<b>46,018</b>	45,798	42,424

**38. Portfolio Investments**

	<b>1999</b>	<b>1998</b>	<b>1997</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Purchase of portfolio investments</b>			
Land and buildings . . . . .	<b>14</b>	434	43
Shares and other variable yield securities . . . . .	<b>1,327</b>	1,484	2,532
Loans, debt securities and fixed income securities . . . . .	<b>21,569</b>	11,181	14,516
	<b>22,910</b>	13,099	17,091
<b>Sale of portfolio investments</b>			
Land and buildings . . . . .	<b>(503)</b>	(436)	(37)
Shares and other variable yield securities . . . . .	<b>(2,786)</b>	(2,694)	(2,349)
Loans, debt securities and fixed income securities . . . . .	<b>(21,416)</b>	(10,891)	(14,954)
	<b>(24,705)</b>	(14,021)	(17,340)
Net increase/(decrease) in deposits with credit institutions . . . . .	<b>(46)</b>	110	(255)
<b>Net portfolio investments</b> . . . . .	<b>(1,841)</b>	(812)	(504)

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued**

**39. Movements in Cash, Portfolio Investments and Financing**

	<b>At January 1 £m</b>	<b>Cash flow £m</b>	<b>Long term business £m</b>	<b>Acquisitions and disposals of subsidiary undertakings (excl cash) £m</b>	<b>Market value and currency £m</b>	<b>Other £m</b>	<b>At December 31 £m</b>
<b>1997</b>							
Land and buildings . . . . .	2,831	6	8	5	(11)	—	<b>2,839</b>
Shares and other variable yield securities . . . . .	15,250	183	2,069	50	1,072	—	<b>18,624</b>
Loans, debt securities and fixed income securities . . . . .	20,299	(438)	53	244	(26)	—	<b>20,132</b>
Deposits with credit institutions . . . . .	1,779	(255)	(507)	16	17	—	<b>1,050</b>
Net cash at bank and in hand (see below) . . . . .	398	(11)	530	—	(11)	—	<b>906</b>
Share capital/premium . . . . .	(561)	122	—	—	—	(176)	<b>(615)</b>
Borrowings (see below) . . . . .	(746)	240	(5)	—	(6)	5	<b>(512)</b>
	<u>39,250</u>	<u>(153)</u>	<u>2,148</u>	<u>315</u>	<u>1,035</u>	<u>(171)</u>	<u><b>42,424</b></u>
<b>1998</b>							
Land and buildings . . . . .	2,839	(2)	(224)	4	39	8	<b>2,664</b>
Shares and other variable yield securities . . . . .	18,624	(1,210)	88	22	583	—	<b>18,107</b>
Loans, debt securities and fixed income securities . . . . .	20,132	290	3,864	4	207	—	<b>24,497</b>
Deposits with credit institutions . . . . .	1,050	110	(132)	11	(28)	—	<b>1,011</b>
Net cash at bank and in hand (see below) . . . . .	906	28	(307)	—	(1)	—	<b>626</b>
Share capital/premium . . . . .	(615)	(14)	—	—	—	(29)	<b>(658)</b>
Borrowings (see below) . . . . .	(512)	34	8	—	3	18	<b>(449)</b>
	<u>42,424</u>	<u>(764)</u>	<u>3,297</u>	<u>41</u>	<u>803</u>	<u>(3)</u>	<u><b>45,798</b></u>
<b>1999</b>							
Land and buildings . . . . .	2,664	(489)	173	30	8	—	<b>2,386</b>
Shares and other variable yield securities . . . . .	18,107	(1,459)	1,433	(6)	604	63	<b>18,742</b>
Loans, debt securities and fixed income securities . . . . .	24,497	153	(593)	1,821	(615)	(54)	<b>25,209</b>
Deposits with credit institutions . . . . .	1,011	(46)	(29)	(4)	9	(108)	<b>833</b>
Net cash at bank and in hand (see below) . . . . .	626	215	(7)	—	(12)	—	<b>822</b>
Share capital/premium . . . . .	(658)	(15)	—	—	—	(15)	<b>(688)</b>
Borrowings (see below) . . . . .	(449)	(222)	1	(2)	(4)	—	<b>(676)</b>
Long term subordinated liabilities . . . . .	—	(615)	—	—	—	5	<b>(610)</b>
	<u>45,798</u>	<u>(2,478)</u>	<u>978</u>	<u>1,839</u>	<u>(10)</u>	<u>(109)</u>	<u><b>46,018</b></u>

At December 31, 1999 net cash at bank and in hand includes overdrafts payable on demand of **£0m** (1998 £0m, 1997 £39m) which are included within amounts owed to credit institutions in the consolidated balance sheet. The borrowings analysis above excludes these amounts.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### 40. Analysis of the Net Outflow of Cash in Respect of Acquisitions of Subsidiary Undertakings

	1999 £m	1998 £m	1997 £m
Cash consideration . . . . .	(1,786)	(148)	(216)
Cash at bank and in hand acquired . . . . .	50	6	28
<b>Net outflow of cash in respect of acquisitions of subsidiary undertakings . . . .</b>	<b>(1,736)</b>	<b>(142)</b>	<b>(188)</b>

### 41. Disposal of Subsidiaries

	Royal Maccabees Life Insurance Co £m	Codan Bank A/S £m	Other £m	1999 Total £m
Net assets disposed of:				
Investments . . . . .	1,567	239	25	1,831
Other assets . . . . .	112	113	15	240
Other liabilities . . . . .	(65)	(295)	(10)	(370)
Technical provisions for general (property and casualty) business . . . . .	—	—	(20)	(20)
Technical provisions for long term (life) business . . . . .	(1,409)	—	—	(1,409)
Profit on disposal before write off of goodwill . . . . .	30	—	—	30
	235	57	10	302
<b>Satisfied by cash consideration . . . . .</b>	<b>235</b>	<b>57</b>	<b>10</b>	<b>302</b>
<b>Net inflow of cash in respect of disposals of subsidiaries . .</b>	<b>235</b>	<b>57</b>	<b>10</b>	<b>302</b>

The consideration relating to the sale in 1999 of the Group's branch Sun Direct, Germany amounted to **£17m**.

Further information regarding the Group's disposal of subsidiaries and branches in 1998 and 1997 is disclosed in note 25.

### 42. 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 and, if disclosed, would not influence decisions made by users of these financial statements.

On December 10, 1999 Royal & Sun Alliance Linked Insurances Ltd (RSALI) and Phoenix Assurance plc, two wholly owned subsidiaries of the Group, entered into a financial reinsurance arrangement to improve the regulatory solvency of RSALI. Due to the legally segregated nature of the long term (life) business fund of Phoenix Assurance plc and profit recognition methods prescribed by the modified statutory basis of accounting for with profit life companies, the balance on the consolidated long term (life) business technical account of the Group, which is stated after tax, includes **£22m** of profit arising from this transaction.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

On December 31, 1997 all of the shares in Codan Bank A/S owned by the Danish long term funds were acquired for £70m, as described in note 24. In addition, during 1997, the Group purchased 13,615 shares in A/S Forsikringselskabet Codan for £1.1m from P Zobel, who was then Managing Director of the Group's Scandinavian operations, at the market price on the day.

The Board has also concluded that there are no transactions with other directors or key managers that are material to their own financial affairs.

### 43. Shareholders' Interest in Long Term (Life) Business

The total shareholders' interest in long term (life) business contained within the consolidated balance sheet comprises:

	Shareholders' accrued interest £m	Value of long term (life) business £m	Shareholders' funds and subordinated liabilities attributable £m	Total £m
<b>UK</b>				
<b>1999</b> .....	143	1,479	175	1,797
1998 .....	139	1,336	175	1,650
<b>Other Europe</b>				
<b>1999</b> .....	36	111	318	465
1998 .....	29	95	331	455
<b>Americas</b>				
<b>1999</b> .....	—	73	164	237
1998 .....	—	—	221	221
<b>Asia Pacific</b>				
<b>1999</b> .....	142	121	14	277
1998 .....	67	75	13	155
<b>Total</b>				
<b>1999</b> .....	321	1,784	671	2,776
1998 .....	235	1,506	740	2,481

Shareholders' accrued interest represents the excess of accumulated profit recognized for long term (life) business over the statutory transfers made from the long term funds to shareholders. The amount of profit recognized as shareholders' accrued interest is credited to the profit and loss account (retained earnings) within capital and reserves.

Value of long term (life) business is described in the accounting policies on page F-21 and in note 20. The movement in value of long term (life) business, other than the amortization of acquired value of in force business, is credited to other reserves within capital and reserves (shareholders equity).

Shareholders' funds attributable represent those assets held outside the long term funds but which are assessed by the directors to be the amount maintained in support of the long term (life) business. They comprise both profit and loss and other reserve items.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### 44. Restrictions, Commitments and Contingencies

The Group is required to give fourteen days advance notice of its intention to declare and pay a dividend. A dividend may only be paid out of the distributable profits reported by the parent, Royal & Sun Alliance Insurance Group plc. At December 31, 1999, Royal & Sun Alliance Insurance Group plc's distributable retained profits were **£507m** (1998 £498m).

Subsidiaries of the Group are subject to minimum capital or solvency requirements imposed by various regulatory authorities. While these restrictions impact on the dividends that can be passed on to the parent company, management does not believe such restrictions impact the parent company's ability to pay future dividends at current levels.

The Group may not pay any dividends to shareholders while any of its UK subsidiaries which underwrites long term (life) business has insufficient admissible assets within its life fund to meet its liabilities.

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

Since 1994 the regulator of the UK financial services industry has required insurers to review all past business sold through their representatives (exclusive agencies and direct sales forces) involving transfers and opt outs from employer-sponsored pension plans into personal pension products offered by the insurer. An insurer must provide compensation when it is determined that an individual was inappropriately advised to transfer pension funds by a representative of the insurer. Our UK life insurance company has established a provision for future review and compensation costs based on our best estimate of the likely outcome of these reviews, which is included within the long term business provision.

The Group is subject to assessments by various regulatory policyholder protection funds and various other assessments related to certain unaffiliated companies that have become insolvent during the years 1999 and prior, for which the insurance industry has estimated costs to cover the insolvent companies' policyholder liabilities. The Group's financial statements include accruals for all known assessments that have been levied against the Group. The Group is also contingently liable for any future assessments related to insolvencies of unaffiliated insurance companies, for which the insurance industry has been unable to estimate the cost to cover losses to policyholders. No specific amount can be reasonably estimated for such insolvencies as of December 31, 1999.

The most significant assessments required are in respect of Motor Insurers' Bureau levy and the Policy Protection Board levy in the UK and state guaranty funds and second injury and other workers' compensation security funds in the United States. The accrued amounts for these at December 31, 1999 were **£38m** (1998 £67m).

The estimated amounts of capital commitments contracted but not provided for in these financial statements is **£4m** (1998 £7m).

### 45. Operating Segments

Effective in 1998, the Group's operations were reorganized and are conducted through four time zone business segments: UK, Other Europe, Americas and Asia Pacific. The Other Europe segment comprises

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

businesses in Continental Europe and the Middle East and Africa. The Americas segment comprises businesses in the United States, Canada, Latin America and the Caribbean. The Asia Pacific segment comprises businesses in Asia, Australia and New Zealand. The creation of these four segments allows decentralized decision making, while at the same time retaining the global benefits of shared practices.

Both property and casualty and life and asset accumulation operations are conducted within each of the operating segments. For management purposes (including performance evaluation and assessment for resource allocation) the Group analyzes personal and commercial property and casualty business and life and asset accumulation financial performance results within each of the four segments. The financial results for each of the four segments are reported to the Board of Directors. Further information is provided to the segment managers, within each of the four time zones, sub-divided between the property and casualty and life and asset accumulation operations. Group operating result (based on the longer term investment return) from other activities for purposes of segmental reporting consists of profit from the non-insurance businesses including the Danish banking operations (disposed of on August 31, 1999), the estate agency, investment management and the insurance broking operations. In addition, it includes income from investments accounted for using the equity method, the longer term rate of investment return applied to the excess shareholders' excess capital, expenses related to borrowing activities, central expenses not allocated to operations, and interest expense.

The Group currently offers customers the following product lines within each of the time zone segments, unless otherwise noted below:

- Property and casualty products: personal product lines include primarily household, motor, creditor and travel insurance, personal accident and private medical insurance, and commercial product lines include primarily property, casualty, motor, workers' compensation and marine, transit and speciality lines (engineering insurance and reinsurance).
- Life and asset accumulation products: individual products include periodic premium life products, such as whole life, term assurance, mortgage protection, disability, critical illness and health insurance, life investment bonds, life savings products, immediate and deferred annuities, mortgage endowment products, and group risk products, include primarily disability, life and health, and group pension plans which are sold to corporate entities.

Net premiums written and the related insurance results are attributed directly to each operating segment and between the property and casualty and life and asset accumulation operations within each operating segment. Policy fee revenue earned from the sale of unit trusts and personal equity plans are included in the operating results of the segments and are not significant. For purposes of determining the operating result (based on longer term investment return), assets directly attributable to the long term (life) business operations in each operating segment are allocated solely to that business. All remaining assets are allocated between the property and casualty operations and shareholder activities within each segment based on the level of investments necessary to support the property and casualty liabilities including a solvency margin and sufficient risk-based capital to support ongoing organic growth requirements and acquisition initiatives within each segment. Central expenses incurred for the benefit of segment operations are allocated to the segments based on usage of those services, those not so allocated are included in the results of other activities.

The table below provides certain financial information with respect to the Group's operating segments utilizing the measure of "Group operating result" (based on longer term investment return) (refer to note 1K and the summary consolidated profit and loss account) and includes amounts not allocated to the operating segments. The most significant of these is other movements in investments, which includes the balance of total investment returns not allocated to segment operating result as longer term investment return. The accounting

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

policies of the segments are the same as those described under the heading “Accounting Policies” included herein.

	Total			Property and Casualty			Life and asset accumulation business		
	1999 £m	1998 £m*	1997 £m*	1999 £m	1998 £m	1997 £m	1999 £m	1998 £m	1997 £m
<b>Net premiums written</b> (note 1)									
United Kingdom . . . . .	<b>5,091</b>	5,063	4,872	<b>3,141</b>	3,353	3,315	<b>1,950</b>	1,710	1,557
Other Europe . . . . .	<b>2,401</b>	2,208	1,928	<b>1,440</b>	1,396	1,224	<b>961</b>	812	704
Americas (note 3) . . . . .	<b>1,943</b>	1,749	1,768	<b>1,817</b>	1,544	1,525	<b>126</b>	205	243
Asia Pacific (note 3) . . . . .	<b>1,008</b>	703	657	<b>761</b>	574	570	<b>247</b>	129	87
	<b>10,443</b>	9,723	9,225	<b>7,159</b>	6,867	6,634	<b>3,284</b>	2,856	2,591
<b>Underwriting result/Long term (life) technical income less charges</b> (note 2)									
United Kingdom . . . . .	<b>(143)</b>	(118)	46	<b>(308)</b>	(290)	(125)	<b>165</b>	172	171
Other Europe . . . . .	<b>(150)</b>	(189)	(138)	<b>(169)</b>	(215)	(164)	<b>19</b>	26	26
Americas (note 4) . . . . .	<b>(127)</b>	(74)	(40)	<b>(162)</b>	(101)	(63)	<b>35</b>	27	23
Asia Pacific (note 4) . . . . .	<b>(88)</b>	(49)	(1)	<b>(104)</b>	(54)	(12)	<b>16</b>	5	11
	<b>(508)</b>	(430)	(133)	<b>(743)</b>	(660)	(364)	<b>235</b>	230	231
<b>Group operating result (based on longer term investment return)</b>									
United Kingdom . . . . .	<b>316</b>	371	592	<b>151</b>	199	421	<b>165</b>	172	171
Other Europe . . . . .	<b>45</b>	(12)	4	<b>26</b>	(38)	(22)	<b>19</b>	26	26
Americas (note 5) . . . . .	<b>191</b>	211	251	<b>156</b>	184	228	<b>35</b>	27	23
Asia Pacific (note 5) . . . . .	<b>3</b>	12	67	<b>(21)</b>	7	56	<b>24</b>	5	11
	<b>555</b>	582	914	<b>312</b>	352	683	<b>243</b>	230	231
Other activities . . . . .	<b>11</b>	20	74						
<b>Group operating result (based on longer term investment return) Cfwd</b> . . . . .	<b>566</b>	602	988						

\* Restated

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued**

	Total		
	1999	1998	1997
	£m	£m*	£m*
<b>Group Operating result (based on longer term investment return) Bfwd . . . . .</b>	<b>566</b>	602	988
<b>Amounts not allocated to operating segments:</b>			
Interest on long term subordinated liabilities . . . . .	(10)	—	—
Changes in equalization provisions . . . . .	(12)	(51)	(84)
Amortization of goodwill . . . . .	(14)	—	—
Amortization of goodwill in acquired claims provisions . . . . .	(12)	—	—
Premium on redemption of long term subordinated liabilities and convertible bonds . . . . .	(14)	(142)	—
Reorganization/additional integration costs . . . . .	(52)	(13)	(64)
Amortization of present value of acquired in force business . . . . .	(4)	—	—
Profit on disposal of subsidiaries . . . . .	<u>10</u>	<u>5</u>	<u>3</u>
<b>Group operating profit (based on longer term investment return) . . . . .</b>	<b>458</b>	401	843
Other movements in investments . . . . .	(80)	463	967
<b>Profit on ordinary activities before tax . . . . .</b>	<b><u>378</u></b>	<u>864</u>	<u>1,810</u>

\* Restated

	Property and Casualty								
	Personal			Commercial			Total		
	1999	1998	1997	1999	1998	1997	1999	1998	1997
	£m	£m	£m	£m	£m	£m	£m	£m	£m
<b>Net premiums written (note 1)</b>									
United Kingdom . . . . .	<b>1,734</b>	1,729	1,589	<b>1,407</b>	1,624	1,726	<b>3,141</b>	3,353	3,315
Other Europe . . . . .	<b>908</b>	871	734	<b>532</b>	525	490	<b>1,440</b>	1,396	1,224
Americas . . . . .	<b>646</b>	549	545	<b>1,171</b>	995	980	<b>1,817</b>	1,544	1,525
Asia Pacific . . . . .	<b>446</b>	350	339	<b>315</b>	224	231	<b>761</b>	574	570
	<b><u>3,734</u></b>	<u>3,499</u>	<u>3,207</u>	<b><u>3,425</u></b>	<u>3,368</u>	<u>3,427</u>	<b><u>7,159</u></b>	<u>6,867</u>	<u>6,634</u>
<b>Underwriting result</b>									
United Kingdom . . . . .	(118)	(81)	(90)	(190)	(209)	(35)	(308)	(290)	(125)
Other Europe . . . . .	(106)	(134)	(114)	(63)	(81)	(50)	(169)	(215)	(164)
Americas . . . . .	—	20	6	(162)	(121)	(69)	(162)	(101)	(63)
Asia Pacific . . . . .	(24)	(31)	(18)	(80)	(23)	6	(104)	(54)	(12)
	<b><u>(248)</u></b>	<u>(226)</u>	<u>(216)</u>	<b><u>(495)</u></b>	<u>(434)</u>	<u>(148)</u>	<b><u>(743)</u></b>	<u>(660)</u>	<u>(364)</u>
<b>Group operating result (based on longer term investment return)</b>									
United Kingdom . . . . .	<b>49</b>	94	113	<b>102</b>	105	308	<b>151</b>	199	421
Other Europe . . . . .	<b>15</b>	(24)	(27)	<b>11</b>	(14)	5	<b>26</b>	(38)	(22)
Americas . . . . .	<b>65</b>	79	64	<b>91</b>	105	164	<b>156</b>	184	228
Asia Pacific . . . . .	<b>23</b>	5	23	<b>(44)</b>	2	33	<b>(21)</b>	7	56
	<b><u>152</u></b>	<u>154</u>	<u>173</u>	<b><u>160</u></b>	<u>198</u>	<u>510</u>	<b><u>312</u></b>	<u>352</u>	<u>683</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

The Group operating result (based on longer term investment return) reflected in the table above is after taking into account the following:

### Notes:

1. Net premiums written by source do not differ materially from net premiums written by destination.
2. The balance on the long term (life) business technical account is gross of tax.
3. Included in long term (life) business within Americas is **£76m** (1998 £163m, 1997 £204m) relating to the discontinued business Royal Maccabees Life Insurance Company and within Asia Pacific is **£89m** (1998 and 1997 £0m) relating to the acquired business Tyndall Australia Limited.
4. Included in long term (life) business within Americas is **£10m** (1998 £22m, 1997 £18m) relating to the discontinued business Royal Maccabees Life Insurance Company and within Asia Pacific is **£3m** (1998 and 1997 £0m) relating to the acquired business Tyndall Australia Limited.
5. Included in long term (life) business within Americas is **£10m** (1998 £22m, 1997 £18m) relating to the discontinued business Royal Maccabees Life Insurance Company and within Asia Pacific is **£7m** (1998 and 1997 £0m) relating to the acquired business Tyndall Australia Limited.
6. Group operating result (based on longer term investment return) of **£566m** (1998 £602m, 1997 £988m) comprises general (property and casualty) business result **£312m** (1998 £352m, 1997 £683m), long term (life) business result **£243m** (1998 £230m, 1997 £231m) and other activities **£11m** (1998 £20m, 1997 £74m). Other activities mainly arise in the United Kingdom.

	Depreciation expense				Total
	UK	Other Europe	Americas	Asia Pacific	
<b>Property and Casualty</b>					
<b>1999</b> .....	<b>28</b>	<b>14</b>	<b>11</b>	<b>9</b>	<b>62</b>
1998 .....	30	16	8	6	60
1997 .....	36	24	11	7	78
<b>Life and asset accumulation business</b>					
<b>1999</b> .....	<b>8</b>	<b>5</b>	<b>1</b>	<b>1</b>	<b>15</b>
1998 .....	5	3	3	1	12
1997 .....	7	7	1	—	15
<b>Total</b>					
<b>1999</b> .....	<b>36</b>	<b>19</b>	<b>12</b>	<b>10</b>	<b>77</b>
1998 .....	35	19	11	7	72
1997 .....	43	31	12	7	93

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued**

	Amortization of deferred acquisition costs				
	UK	Other Europe	Americas	Asia Pacific	Total
<b>Property and Casualty</b>					
<b>1999</b> .....	<b>888</b>	<b>274</b>	<b>524</b>	<b>143</b>	<b>1,829</b>
1998 .....	872	307	467	107	1,753
1997 .....	893	254	469	115	1,731
<b>Life and asset accumulation business</b>					
<b>1999</b> .....	<b>239</b>	<b>57</b>	<b>24</b>	<b>19</b>	<b>339</b>
1998 .....	215	61	18	21	315
1997 .....	155	40	20	18	233
<b>Total</b>					
<b>1999</b> .....	<b>1,122</b>	<b>331</b>	<b>548</b>	<b>162</b>	<b>2,163</b>
1998 .....	1,087	368	485	128	2,068
1997 .....	1,048	294	489	133	1,964

Property and casualty net premiums written in the UK are shown in the above table, and represent **44%** of the Group's total property and casualty net premiums written for the year ended December 31, 1999 (1998 49%, 1997 50%). Property and casualty net premiums written in the USA (Americas segment) were **16%** of the Group's total property and casualty net premiums written for the year ended December 31, 1999 (1998 and 1997 13%). Property and casualty net premiums written in other countries were individually less than 10% of the Group's total property and casualty net premiums written for each of the years ended December 31, 1999, 1998 and 1997.

Life and asset accumulation net premiums written in the UK are shown in the above table, and represent **59%** of the Group's total life and asset accumulation net premiums written for the year ended December 31, 1999 (1998 and 1997 60%). Life and asset accumulation net premiums written in the Isle of Man (Other Europe segment) were **13%** of the Group's total life and asset accumulation net premiums written for the year ended December 31, 1999 (1998 9%, 1997 12%). Life and asset accumulation net premiums written in other countries were individually less than 10% of the Group's total life and asset accumulation net premiums written for each of the years ended December 31, 1999, 1998 and 1997.

The Group does not accumulate revenues by product; therefore it would be impracticable to provide revenues from external customers for each product.

The Group does not have revenue from transactions with a single customer amounting to 10% or more of its revenues.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

	Property and Casualty					
	Personal		Commercial		Total	
	1999 £m	1998 £m	1999 £m	1998 £m	1999 £m	1998 £m
<b>Allocation of Risk Based Capital</b> (note 5)						
UK . . . . .	686	699	615	752	1,301	1,451
Other Europe . . . . .	482	390	300	246	782	636
Americas . . . . .	267	259	619	591	886	850
Asia Pacific . . . . .	222	169	174	121	396	290
	1,657	1,517	1,708	1,710	3,365	3,227

**Notes:**

1. The capital, reserves and long term subordinated liabilities attributed to other businesses include those of non insurance businesses and Group borrowings.
2. Included in long term (life) business within Americas is **£0m** (1998 £187m) relating to the discontinued business Royal Maccabees Life Insurance Company and **£175m** (1998 £0m) relating to the acquired business Compañía de Seguros de Vida La Construcción, within Asia Pacific is **£100m** (1998 £0m) relating to the acquired business Tyndall Australia Limited.
3. Included in general (property and casualty) business within Americas is **£477m** (1998 £0m) relating to the acquired business Orion Capital Corporation and within Other Europe is **£171m** (1998 £0m) relating to the acquired business Trygg-Hansa Försäkrings AB, Publikt.
4. There are differences between actual regional total capital and those considered to be required on a risk based capital basis due to regulatory requirements at the individual operation level. Included in general (property and casualty) business within Americas is **£302m** (1998 £0m) of long term subordinated liabilities and within Other Europe is **£308m** (1998 £0m) of long term subordinated liabilities.
5. The Group has adopted a risk based capital model as the basis of its active capital management. The model is used for determining our capital requirements, setting return targets for our regional operations and establishing incentive plans for management. For general (property and casualty) business the solvency required is expressed as a percentage of net written premiums at 47% and is allocated across our commercial and personal business within our operating segments. Our risk based capital model is designed to produce different capital requirements depending on the policies applied to the business, particularly investment and reinsurance policy. The solvency criteria adopted in the model is that of 99% confidence that solvency will not fall below 25% of net premiums written over a five year period. For property and casualty business our policy is to invest 100% of capital and 5% of insurance reserves after working capital in equity securities which maximises our expected Return on Capital. The risk based capital for each segment has been calculated using the same principles as the Group.

The life and asset accumulation business requirement is currently calculated as the shareholders' interest. The capital requirements for other activities are generally established at the actual level of shareholders' funds employed in the business.

Long lived assets include land and buildings of **£2,386m** (1998 £2,664m) of which **£1,670m** (1998 £1,986m) are located in the United Kingdom.

#### 46. New UK GAAP Accounting Pronouncements

On February 18, 1999, the UK Accounting Standards Board issued Financial Reporting Standard No 15 "Tangible Fixed Assets" ("FRS 15"). FRS 15 is effective for periods ending on or after March 23, 2000.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

FRS 15 sets out the requirements for accounting for the initial measurement, valuation and depreciation of tangible fixed assets, with the exception of investment properties and it codifies much of existing practice. Valuations remain optional, but if a policy of revaluation is adopted then all assets of the same class should be revalued and revaluations should be kept up-to-date. Management does not believe that FRS 15 will have a material effect on the financial results or the financial position of the Group.

### 47. Subsequent Events

Subsequent to December 31, 1999 a number of acquisitions and disposals of subsidiaries have taken place none of which are considered significant to operations. In addition, subsequent to December 31, 1999, the Group raised a further £146m of subordinated hybrid capital through a private placement.

In May 2000 new valuation regulations became effective for UK Life insurance companies that increased the level of statutory liabilities (reserves) required to be held. To mitigate the effects of these new regulations, a financial reinsurance contract has been put in place in one of our UK life companies, Sun Alliance and London Assurance Company Limited.

### 48. Summary of Differences Between UK and US Generally Accepted Accounting Principles (“GAAP”)

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United Kingdom (“UK GAAP”), which differ in certain significant respects from generally accepted accounting principles in the United States (“US GAAP”). Such differences involve methods for measuring the amounts shown in the financial statements, financial statement classification and presentational differences and additional disclosures required by US GAAP. The effect on consolidated net income and shareholders’ equity of applying the significant differences between UK GAAP and US GAAP described below is summarized as of December 31 and for the years then ended.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued**

	<b>1999</b>	<b>Restated</b>	<b>Restated</b>
	<b>£m</b>	<b>1998</b>	<b>1997</b>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>Profit for the financial year attributable to shareholders in accordance with UK GAAP</b> . . . . .	<b>87</b>	457	1,416
Value of long term (life) business (note B) . . . . .	<b>3</b>	(12)	(1)
Equalization provisions (note C) . . . . .	<b>12</b>	51	84
Goodwill (note D) . . . . .	<b>7</b>	(21)	(36)
Investments (note E) . . . . .	<b>305</b>	67	(1,318)
Real estate (note F) . . . . .	<b>(10)</b>	250	(102)
Intercompany sales of real estate (note G) . . . . .	<b>249</b>	(307)	—
Pensions (note H) . . . . .	<b>112</b>	55	45
Post retirement benefits (note I) . . . . .	<b>4</b>	3	6
Stock compensation (note J) . . . . .	—	(2)	(3)
Vacant leases (note K) . . . . .	<b>11</b>	6	(5)
Integration provision (note L) . . . . .	<b>(13)</b>	(17)	(26)
Discounting of claims provision (note M) . . . . .	<b>(4)</b>	(1)	(3)
Deferred income (note N) . . . . .	<b>(90)</b>	(37)	(35)
Deferred acquisition costs (note O) . . . . .	<b>122</b>	12	2
Long term business provision (note P) . . . . .	<b>(183)</b>	538	639
Gross up of investment income due to accounting policy change (note X) . . .	—	63	67
Foreign currency translation (note R) . . . . .	<b>9</b>	4	10
Policyholder allocations (note S) . . . . .	<b>458</b>	(305)	74
Structured settlements (note U) . . . . .	<b>1</b>	1	(2)
Other adjustments . . . . .	<b>(7)</b>	—	(6)
Tax effect of US GAAP adjustments . . . . .	<b>(137)</b>	(145)	(120)
Impact of US GAAP adjustments on profit attributable to minority interests (note V) . . . . .	<b>(3)</b>	—	2
<b>Consolidated net income in accordance with US GAAP</b> . . . . .	<b><u>933</u></b>	<b><u>660</u></b>	<b><u>688</u></b>

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued**

	1999		
	Gross	Policyholder	Shareholder
	Adjustment £m	share £m	share £m
<b>Consolidated Shareholders' Funds in Accordance with UK GAAP . . .</b>			6,484
Fund for future appropriations (note A) . . . . .	4,840	(3,800)	1,040
Value of long term (life) business (note B) . . . . .	(1,589)	—	(1,589)
Equalization provisions (reserves) (note C) . . . . .	259	—	259
Goodwill (note D) . . . . .	140	—	140
Investments (note E) . . . . .	(3)	2	(1)
Real estate (note F) . . . . .	(1,097)	755	(342)
Intercompany sales of real estate (note G) . . . . .	(112)	—	(112)
Pensions (note H) . . . . .	692	—	692
Post retirement benefits (note I) . . . . .	(11)	—	(11)
Discounting of claims provision (note M) . . . . .	(19)	—	(19)
Deferred income (note N) . . . . .	(494)	17	(477)
Deferred acquisition costs (note O) . . . . .	622	(279)	343
Long term business provision (note P) . . . . .	1,956	(1,748)	208
Deferred taxes (note Q) . . . . .	(1,087)	165	(922)
Dividends (note T) . . . . .	233	—	233
Structured settlements (note U) . . . . .	(5)	—	(5)
Employee share option plan (note W) . . . . .	(29)	—	(29)
Minority interests (note V) . . . . .	23	—	23
Other . . . . .	14	(8)	6
<b>Consolidated Shareholders' Funds in Accordance with US GAAP . . . .</b>		<u>(4,896)</u>	<u>5,921</u>

	1998 Restated		
	Gross	Policyholder	Shareholder
	Adjustment £m	share £m	share £m
<b>Consolidated Shareholders' Funds in Accordance with UK GAAP . . .</b>			7,269
Fund for future appropriations (note A) . . . . .	3,785	(2,927)	858
Value of long term (life) business (note B) . . . . .	(1,427)	—	(1,427)
Equalization provisions (reserves) (note C) . . . . .	250	—	250
Goodwill (note D) . . . . .	133	—	133
Investments (note E) . . . . .	158	(88)	70
Real estate (note F) . . . . .	(1,059)	640	(419)
Intercompany sales of real estate (note G) . . . . .	(361)	130	(231)
Pensions (note H) . . . . .	576	—	576
Post retirement benefits (note I) . . . . .	(13)	—	(13)
Vacant leases (note K) . . . . .	(15)	—	(15)
Integration provision (note L) . . . . .	13	—	13
Discounting of claims provision (note M) . . . . .	(17)	—	(17)
Deferred income (note N) . . . . .	(404)	17	(387)
Deferred acquisition costs (note O) . . . . .	486	(211)	275
Long term business provision (note P) . . . . .	2,142	(1,814)	328
Deferred taxes (note Q) . . . . .	(1,165)	153	(1,012)
Dividends (note T) . . . . .	238	—	238
Structured settlements (note U) . . . . .	(5)	—	(5)
Minority interests (note V) . . . . .	26	—	26
Other . . . . .	5	—	5
<b>Consolidated Shareholders' Funds in Accordance with US GAAP . . . .</b>		<u>(4,100)</u>	<u>6,515</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

Certain items in 1998 and 1997 as shown in our Subordinated Guaranteed Bonds offering memorandum dated September 28, 1999 have been restated to be consistent with presentation in 1999.

### Participating Contracts

A significant proportion of the life insurance issued by the Group is in the form of participating insurance. A participating contract provides the policyholders with a contingent interest in the excess assets over the liabilities (surplus) of the life company issuing the contract. Policyholder bonuses (dividends) are declared annually by the board of directors and credited to the individual policies from the surplus in the company.

Participating business is written by a number of the Group's life insurance operations and the participating rights of these contracts vary by contract, by company and by the market in which the contract is issued.

As of December 31, 1999, UK with-profits companies represented **65.7%** (1998 62.3%) of the future policy benefits and policy contract deposits of the Group. UK with-profits policies entitle the policyholder to participate in the total surplus within the life fund of the UK insurance company subsidiary which issued the policy. Regular bonuses are determined annually by the issuing company's actuary and the board of directors. The bonuses that may be declared are highly correlated to the overall performance of the underlying assets and liabilities of the fund in which the contracts participate and are the subject of normal variability and volatility. Terminal bonuses are paid on maturity of the contract and are designed to provide policyholders with a share of the total performance of the company during the period of the contract. The total performance includes investment income, realized and unrealized gains, together with the profits from expense margins, mortality experience and tax margins. Terminal and regular bonuses together ensure that policyholders' reasonable expectations are met.

For UK with-profits business written in our two main UK Life companies, approximately 90% of the surplus is allocated to policyholders as bonuses. This allocation is determined either by the legal form of the company or by the contract. The remainder of surplus is allocated to shareholders. Accordingly, broadly 90% of the US GAAP income for the UK with-profits business is recorded as undistributed policyholder allocations. The investments in securities backing the UK with-profits business have been classified as trading, which results in all related unrealized and realized gains/losses being recognized in income.

Certain of the other insurance businesses write fully participating contracts which provide bonuses (dividends) to policyholders based on actual experience of the insurer and annual policyholder dividends are paid in a manner that identifies divisible surplus and distributes the surplus in approximately the same proportion as the contracts contribute to the divisible surplus (the contribution principle). The liabilities related to these contracts are recorded in accordance with local statutory regulations. Premiums for these policies are reported as revenue when due from policyholders. Death, surrender and disability benefits are reported as expenses as incurred. Annual policyholder bonuses (dividends) are reported as a separate expense on an accrual basis. Under US GAAP, there is no impact on either net income or shareholders' equity for these changes.

The reconciliation of shareholders' equity from UK GAAP to US GAAP shows the effect on shareholders' equity, gross and net of the allocation to policyholders.

The reconciliation of net income from UK GAAP to US GAAP shows the total effect on net income of the differences in accounting treatment with the policyholders' share shown in the line entitled policyholder allocations.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### Merger of Royal Insurance and Sun Alliance

The merger of Royal Insurance and Sun Alliance has been accounted for as a pooling of interests under US GAAP. Pooling of interests accounting is equivalent to the merger accounting adopted under UK GAAP, as discussed in note 2.

#### A. Fund for Future Appropriations

Certain long term funds (life insurance companies) comprise either participating, or both participating and non-participating long term (life) business contracts, where policyholders have a contingent interest in the excess of assets over liabilities in the fund. Under UK GAAP, such excess is reflected in the fund for future appropriations until appropriated between policyholders and shareholders. The UK GAAP fund for future appropriations therefore comprises the full unappropriated excess of assets over liabilities. US GAAP requires such excesses to be appropriated between shareholders and policyholders in the proportion prescribed either by the legal form of the company or the terms of the contracts concerned, taking into account policyholders' reasonable expectations. The US GAAP undistributed policyholder allocations liability therefore comprises only the policyholders' share of excess assets over liabilities. The equity reconciliation adjustment therefore reflects the attribution of the shareholders' share of the UK GAAP fund for future appropriations to shareholders' equity. The policyholder share of the UK GAAP fund for future appropriations together with the policyholder share of other US GAAP adjustments forms the US GAAP liability for undistributed policyholder allocations. The net income impact of each difference flows through the policyholders' allocations line item of the net income reconciliation (refer note S).

Due to the profit recognition methods prescribed by the modified statutory basis of accounting under UK GAAP and the legally segregated nature of the long term (life) business of Phoenix Assurance plc, the UK GAAP financial statements include **£22m** in 1999 of profit arising from a financial reinsurance arrangement entered into between two wholly owned subsidiaries of the Group, as discussed in note 42. This gain is eliminated under US GAAP.

#### B. Value of Long Term (Life) Business

Under UK GAAP, the value of long term (life) business represents the value attributable to shareholders of the future cash flows (discounted for interest) arising from in-force long term (life) business policies (both acquired and internally generated) in excess of that already recognized in the profit and loss account. US GAAP provides for the recognition of the present value of only acquired life insurance business as of the date of acquisition which is amortized over the premium recognition period of the policies acquired. The adjustment to consolidated shareholders' equity is calculated as follows:

	<b>1999</b>	<b>1998</b>
	<b>£m</b>	<b>£m</b>
Value of long term (life) business as disclosed under UK GAAP . . . . .	<b>1,784</b>	1,506
Reclassified from other assets . . . . .	<b>3</b>	8
Total value of long term (life) business under UK GAAP . . . . .	<b>1,787</b>	1,514
Present value of profits of acquired long term business . . . . .	<b>(284)</b>	(136)
Deferred taxes on acquired present value of profits . . . . .	<b>86</b>	49
Consolidated shareholders' equity adjustment . . . . .	<b>1,589</b>	1,427

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

The consolidated net income adjustment is calculated as follows:

	<b>1999</b>	<b>1998</b>	<b>1997</b>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Amortization . . . . .	(11)	(20)	(10)
Interest accrued . . . . .	9	5	5
US GAAP income statement impact . . . . .	(2)	(15)	(5)
UK GAAP income statement impact . . . . .	(5)	(3)	(4)
Consolidated net income adjustment . . . . .	<u>3</u>	<u>(12)</u>	<u>(1)</u>

On a UK GAAP basis the value of long term (life) business arising from an acquisition was capitalized and included in the value of long term (life) business on the balance sheet. Prior to January 1, 1998 the amortization of the value of long term (life) business was included in the movement in the value of long term (life) business taken to other reserves.

### C. Equalization Provisions (Reserves)

Under UK GAAP, equalization provisions (reserves) are established under local statutory regulations, where relevant, for future catastrophe and other unusual losses. Under US GAAP, such losses are not provided for until incurred. The equity adjustment reflects the reversal of the year end equalization provisions as disclosed in note 11. The amounts charged to income under UK GAAP have been reversed in the net income reconciliation.

### D. Goodwill

Under US GAAP, goodwill arising from the purchase of a company for a price in excess of the fair value of its net assets is capitalized and amortized against income over its expected useful life. Prior to 1998, goodwill resulting from acquisitions was charged directly to reserves (a component of shareholders' equity) for UK GAAP reporting. In 1998, the Group adopted the requirements of Financial Reporting Standard 10, "Goodwill and Intangible Assets". This Standard required the capitalization of goodwill resulting from acquisitions occurring after January 1, 1998 for UK GAAP purposes. FRS 10 does not require reinstatement of goodwill written off to reserves in years prior to 1998 and accordingly the Group has made no such restatement for UK GAAP. Both UK and US GAAP require capitalized goodwill to be amortized against income over its expected useful life, primarily 20 years. The adjustments to net income and shareholders equity represent the capitalization and amortization of goodwill written off to reserves prior to 1998 under UK GAAP and the purchase accounting adjustments discussed below. The goodwill recognized under US GAAP is made up as follows:

	<b>1999</b>	<b>1998</b>	<b>1997</b>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
Goodwill charged to profit and loss reserves (retained earnings) under UK GAAP . . . .	—	—	675
Amounts charged to the income statement in the period prior to January 1, 1997 on a US GAAP basis due to:			
Amortization . . . . .	—	—	(457)
Impairment . . . . .	—	—	(81)
Disposal of operation . . . . .	—	—	(55)
Goodwill as at January 1 . . . . .	<b>153</b>	156	82
Additions . . . . .	<b>1,076</b>	19	110
Amortization . . . . .	<b>(47)</b>	(22)	(36)
<b>Goodwill as at December 31 . . . . .</b>	<u><b>1,182</b></u>	<u>153</u>	<u>156</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### *Purchase accounting adjustments*

Purchase accounting adjustments have been made under US GAAP, leading to a difference of **£28m** in the goodwill capitalized in 1999 when compared with UK GAAP. These adjustments relate to premium on debt redeemed as part of the acquisition of Orion Capital, and the treatment of restructuring charges. Under UK GAAP, premium on debt redeemed as part of the acquisition of Orion Capital has been expensed in the post-acquisition profit and loss. Under US GAAP, this premium is considered in assessing the fair value of the debt on acquisition, and was therefore included in the valuation of the liability, thereby reducing net assets and increasing goodwill. Under UK GAAP, restructuring charges are required to be recorded in the post acquisition income statement, while US GAAP requires that these amounts be recognized as a liability assumed in determining net asset value.

### *E. Investments*

Under UK GAAP, fixed interest securities (fixed maturities) and equity investments are recorded at fair value, except that fixed income securities held for long term business in certain overseas operations are included on an amortized cost basis. The cost basis is either historical cost or amortized cost. Unrealized investment gains and losses are included in the profit and loss account (statement of income). Under US GAAP, fixed maturities and equity securities are classified as held-to-maturity, trading or available for sale. Fixed maturities classified as held-to-maturity are those which the Group has the ability and positive intent to hold to maturity; these investments are carried at amortized cost. Fixed maturities and equity securities which the Group buys with the intention of reselling in the near term, together with fixed maturities and equity securities backing the UK life with-profits (participating) contracts, are classified as trading and are carried at fair value with the related unrealized gains or losses reflected in income. Other investments are classified as available for sale and are carried at fair value, with unrealized gains and losses reported as a separate component of shareholders' equity (net of tax effects). The cost basis of all fixed maturities is based on amortized cost, with amortization calculated and included in income to achieve a constant yield to maturity. Unrealized losses (net of deferred tax and policyholder allocations) reduced other comprehensive income in 1999 by **£445m** after tax (1998 £65m, 1997 £569m gain).

### *F. Real Estate*

Under UK GAAP, all properties are treated as investments including those that the Group occupies for its own use. Properties are reported at fair value with no depreciation charged against income. Under US GAAP, such assets are recorded at their historical cost less depreciation thereon and segregated between those held for investment purposes and those occupied. Real estate assets are depreciated over their expected useful lives primarily 30 years. The equity reconciliation reflects the impact of accounting for real estate on a depreciated cost basis (including real estate held within the participating funds). The net income adjustment reflects the depreciation charge and the change to realized gains as a result of this difference. It also reflects the reversal of the unrealised gains recorded on a UK GAAP basis. The policyholder allocations line item includes the portion of the adjustment attributable to with-profits policyholders.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

The adjustment to shareholders' equity was calculated as follows:

	<b>1999</b>	<b>1998</b>
	<b>£m</b>	<b>£m</b>
Fair value of investment real estate . . . . .	<b>1,936</b>	2,321
Fair value of occupied real estate . . . . .	<b>450</b>	343
Total fair value of real estate . . . . .	<b>2,386</b>	2,664
Net book value of investment real estate . . . . .	<b>(922)</b>	(1,011)
Net book value of occupied real estate . . . . .	<b>(255)</b>	(233)
Adjustment to restate real estate to depreciated cost . . . . .	<b>1,209</b>	1,420

Depreciation of **£38m** was charged in 1999 (1998 £65m, 1997 £51m) on the investment real estate.  
 Depreciation of **£9m** was charged in 1999 (1998 £6m, 1997 £12m) on occupied real estate.

### G. *Intercompany Sales of Real Estate*

Under UK GAAP intercompany sales of real estate investments between the general and life companies are not eliminated because the assets are held within the long term (life) business which is regarded as a separate legal fund for UK GAAP, whereas they are eliminated under US GAAP. The 1998 equity reconciliation adjustment restates the real estate sold within the Group to the original depreciated cost to the Group. The 1998 net income reconciliation reflects the reversal of the gain recognized under UK GAAP. In 1999 certain of the properties on which intercompany gains were recorded under UK GAAP in 1998 were sold outside the Group. The 1999 reconciliations therefore reflect the impact of realizing these gains on a US GAAP basis, as well as restating the remaining property which has not been sold outside the Group to its original depreciated cost.

### H. *Pensions*

For US GAAP, the projected benefit obligation is matched against the fair value of the underlying assets and other unrecognized actuarial gains and losses in determining the pension expense for the year. As a result, pension expense can be significantly different from that computed under UK GAAP which requires the cost of providing pension benefits to be expensed over the periods benefiting from the employees' service on the basis of constant percentage of current and estimated future earnings. In addition, US GAAP requires recording in the balance sheet the prepaid pension asset while UK GAAP does not permit recording such assets. The equity reconciliation adjustment reflects the recording of the prepaid pension asset under US GAAP after reversing any amounts recorded on a UK GAAP basis.

### I. *Post Retirement Benefits*

Under UK GAAP, there are unprovided accumulated obligations in respect of healthcare benefits to certain current and retired US and Canadian employees, with benefits being accounted for on a systematic basis over the remaining service lives of current employees. Under US GAAP, the accumulated obligations are recognized in full. The adjustment to the equity reconciliation reflects the recognition of the accumulated obligation in full under US GAAP after reversing any amounts recorded on a UK GAAP basis. The net income adjustment reflects the change in this obligation in the current year.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### *J. Stock Compensation*

For US GAAP purposes, the Group follows the provisions of Accounting Principles Board (“APB”) Opinion No. 25, “Accounting for Stock Issued to Employees” to account for its stock option activity. This method utilizes the intrinsic value-based method of accounting for stock option incentive plans whereby compensation expense is recorded for fixed plans only if the market price of the underlying stock at the date of the grant exceeds the exercise price, in which case the discount is amortized to income over the period to the exercise date. For variable plans, the compensation cost is recognized at a future date when both the number of shares that may be acquired or awarded to an employee and the price to be paid by the employee are known. Under UK GAAP, compensation cost is recognized for any discount between the exercise price and the market price at the date of grant and is amortized to income over the period of service of the employees in respect of which the options are granted. However no charge against income is required in respect of Save As You Earn share option plans. The net income reconciliation reflects the adjustment required to recognize the compensation cost calculated in accordance with APB 25. There is no adjustment to shareholders’ equity as under UK GAAP the difference between the market value exercise price is charged directly to reserves, while under US GAAP it is charged to net income.

### *K. Vacant Leases*

Under US GAAP, a provision is required in respect of the vacant leases as a loss under these leases was both probable and estimable. No adjustment is reflected in the shareholders’ equity reconciliation in 1999 as, following the introduction of FRS 12, the UK GAAP requirements are in line with the US GAAP requirements.

### *L. Integration Provision*

Part of the integration provision raised under UK GAAP and discussed in note 30 does not meet the requirements for recognition under US GAAP. The equity and net income reconciliations reflect the impact of reversing part of this provision. The integration provision that did meet the US GAAP requirements for recognition was as follows:

	Redundancy £m	Vacant Lease £m	IT Costs £m	FAS 88 Curtailement £m	Total £m
Balance at January 1, 1997 . . . . .	66	23	16	43	148
Less: Paid out in 1997 . . . . .	(40)	(3)	(5)	(23)	(71)
Balance as at December 31, 1997 . . . . .	26	20	11	20	77
Less: Paid out in 1998 . . . . .	(26)	(5)	(11)	(20)	(62)
Balance as at December 31, 1998 . . . . .	—	15	—	—	15
Less: Paid out in 1999 . . . . .	—	(4)	—	—	(4)
<b>Balance as at December 31, 1999 . . . . .</b>	<b>—</b>	<b>11</b>	<b>—</b>	<b>—</b>	<b>11</b>

### *M. Discounting of Claims Provisions*

Under UK GAAP, claims provisions relating to workers’ compensation and other non-life disability case reserves in the United States, Canada and Scandinavia paid on an annuity basis are included after reflecting interest expected to be earned. Under US GAAP, discounting is permitted only if the payment pattern and ultimate cost are fixed and determinable and the discount rate is reasonable. Discounting related to certain Scandinavian claims reserves has been reversed under US GAAP.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### *N. Deferred Income*

Under UK GAAP, initial policy fees on long duration life insurance contracts (primarily universal life and investments contracts) in the early years of the contract, which are in excess of the level of annual policy fees taken thereafter, are offset against the first available profit margins on these policies. Under US GAAP, such fees are deferred and recognized over the term of the policy in the same manner as deferred acquisition costs discussed in note O below. Fees on short duration life insurance contracts are not deferred under either UK GAAP or US GAAP. The equity and net income adjustments reflect the impact of the deferral of these fees and their recognition over the term of the policy.

### *O. Deferred Acquisition Costs*

Under both UK and US GAAP, the costs of acquiring both new and renewal general (property and casualty) insurance business are deferred and amortized over the period in which the related premiums are earned. Under US GAAP, however, only the acquisition costs which are directly related to and vary with the production of new and renewed contracts may be deferred, while under UK GAAP the amounts being deferred may include an allocation of overhead.

Under UK GAAP, unexpired risk reserves are set up where unearned premiums, net of deferred acquisition costs, are considered to be insufficient to meet expected future losses and loss adjustment expenses relating to unexpired risks after considering future investment income on unearned premium reserves. The unexpired risk provision is measured in aggregate for business classes which are managed together. Under US GAAP, premium deficiencies are recorded only once the related deferred acquisition costs are completely reduced. US GAAP requires the assessment of recoverability of deferred acquisition costs to be at least reviewed annually. In performing this review, insurance contracts are grouped only if this is consistent with the manner in which they are acquired and serviced and in which their profitability is measured.

Under UK GAAP, the costs of acquiring new and renewal life insurance business are capitalized and amortized against the emergence of profit on the contract. Under US GAAP, only acquisition costs which are directly related to and vary with acquisitions of new and renewal contracts are capitalized. These costs are amortized over the full period of the contract in proportion with the premiums earned for all contracts with the exception of investment, universal life, and separate account contracts which are amortized in proportion to the estimated gross profits arising from the contracts. The costs deferred and amortized on a US GAAP basis include commissions, underwriters' salaries and direct underwriting expenses (for example, costs of medical examinations). Unamortized acquisition costs associated with internally replaced contracts are written off in the income statement.

The equity reconciliation adjustment is made up as follows:

	1999 £m	1998 £m
Deferred acquisition costs in long term business provision . . . . .	628	637
Deferred acquisition costs in general business . . . . .	825	712
Total UK GAAP deferred acquisition costs . . . . .	<b>1,453</b>	1,349
Gross up for Insurance Premium Tax . . . . .	42	26
Adjustment as per consolidated shareholders' equity reconciliation . . . . .	622	486
US GAAP deferred acquisition costs . . . . .	<u><b>2,117</b></u>	<u>1,861</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

The increase in deferred acquisition costs under US GAAP is due to the longer amortization period for life business, which is partly offset by the impact of no overhead expenditure being capitalized under US GAAP. The gross up for Insurance Premium Tax has no equity impact since a similar adjustment is made to unearned premium reserves.

The net income reconciliation adjustment reflects the change in the consolidated shareholders' equity adjustment gross of policyholder allocations.

### *P. Long Term (Life) Business Provision (Reserve for Future Life and Health Policy Benefits)*

Under UK GAAP, the long term (life) business provision (reserve for future life and health policy benefits) for the Group is generally calculated in accordance with the actuarial principles and assumptions issued by insurance regulatory authorities. For UK life with-profits business, the calculation includes explicit allowance for vested bonuses (including those vesting following valuation at the balance sheet date). Implicit allowance is made for future reversionary bonuses through the use of a net premium valuation method employing a reduced valuation rate of interest. No provision is made for future terminal bonuses.

Under US GAAP, future policy benefits for traditional life policies are computed using a net level premium method on the basis of actuarial assumptions as to mortality, persistency and interest based on the insurance company's experience, with a margin for adverse deviations. Such actuarial assumptions are established as of the date of policy issue. When the liabilities for future policy benefits plus the present value of expected future gross premiums are insufficient to provide for expected future policy benefits and expenses, a premium deficiency reserve is established by a charge to earnings after the write-down of any related deferred acquisition costs, and future policy benefits are thereafter based on assumptions established as of that date.

Under UK GAAP, a liability is recorded for contingent losses related to UK with-profit annuity contract guarantees, as required by the UK statutory requirements. US GAAP does not permit current recognition of possible future losses upon potential conversion of guaranteed annuities. As the amount of any loss can only be reasonably determinable at the time of conversion, no liability can be recognized under US GAAP. The liability recorded under UK GAAP has therefore been reversed and a loss contingency disclosed under US GAAP.

### *Q. Deferred Taxes*

Under UK GAAP, a provision or benefit is recorded for deferred taxation under the liability method to the extent that it is considered probable that a liability or asset will crystallize in the foreseeable future. Discounted rates of tax are used in respect of unrealized gains on investments of the long term (life) business fund and the deferred tax provision is included within the long term business provision. Under US GAAP, deferred tax is provided for all differences between the book and tax bases of assets and liabilities at the statutory rate of each reporting date. US GAAP does not allow deferred tax to be discounted. A valuation allowance is established when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Group has changed its UK GAAP accounting policy following the adoption of FRS 16 discussed in note 3 and as a result the UK GAAP income tax charge and investment income have been restated. As the US GAAP accounting policies remain unchanged, the reconciliations include an adjustment to gross up both net income and tax for US GAAP purposes and consequently there is no overall impact on either net income or equity. The adjustments in the net income and equity reconciliations reflect the impact of recognizing deferred tax on a fully comprehensive, undiscounted basis, and the deferred tax impact of other US GAAP adjustments made that affect net income. For participating and separate account business, the Group is subject to the taxes on the income less expenses arising which is then charged to the policyholders. These taxes have been included within the income tax expense and policy fees receivable for the separate accounts and within

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

policyholder participations in profit in respect of the participating business. Under UK GAAP, deferred taxes in respect of the long term business are recorded within the long term business provision as explained in note 33. For US GAAP, these balances are reclassified to deferred tax liability.

The reconciliation of the UK GAAP tax charge to the US GAAP tax charge is as follows:

	<u>1999</u>	<u>1998</u>	<u>1997</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
UK GAAP tax attributable to the long term (life) business . . . . .	240	365	247
Tax on profit on ordinary activities (1) . . . . .	270	374	354
Tax credit attributable to the balance on the long term business technical account . . .	<u>(59)</u>	<u>(69)</u>	<u>(63)</u>
Total UK GAAP tax . . . . .	<u>451</u>	670	538
US GAAP net income adjustment . . . . .	<u>179</u>	<u>145</u>	<u>120</u>
Total US GAAP tax . . . . .	<u><u>630</u></u>	<u><u>815</u></u>	<u><u>658</u></u>

(1) This includes the tax credit attributable to the balance on the long term business technical account.

### R. Foreign Currency Translation

Under UK GAAP, assets and liabilities, including long term subordinated liabilities and results of both businesses and associates denominated in foreign currencies are translated into sterling at rates prevailing at year end and the resulting differences are taken to reserves (shareholders' equity) or in the case of long term (life) business are included within the long term technical account. Other exchange differences, including those relating to transactions denominated in foreign currency, are dealt with in the profit and loss account (statement of income). Under US GAAP, translation adjustments of assets and liabilities expressed in functional currencies, which are the currencies of the local operating environment, are calculated using year-end rates of exchange and the related translation adjustments are recorded as a separate component of shareholders' equity and other comprehensive income. Foreign currency translation adjustments increased other comprehensive income by **£50m** in 1999 (1998 (£66m), 1997 (£54m)). Income statement accounts expressed in functional currencies are translated using average exchange rates. The adjustment in the net income reconciliation reflects the impact of using average rates for income statement items under US GAAP.

### S. Policyholder Allocations

As noted above in note 48A, "fund for future appropriations", certain participating life insurance contracts require the sharing of the profits and losses of the long term (life) fund between the participating policyholders and the shareholders. The reconciling item in the net income reconciliation reflects the movement in the shareholders' share of the UK GAAP fund for future appropriations, as well as the effects of the aggregate UK to US GAAP adjustments attributable to policyholders.

### T. Dividends

Under UK GAAP, all dividends related to an accounting period that are declared or proposed up to the date of the approval of the financial statements by the Board of Directors are accrued in that accounting period. Under US GAAP, only those dividends declared during the year are accrued. The equity adjustment reflects the impact of reversing the year end proposed dividend as disclosed in note 15 to the financial statements.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### *U. Structured Settlements*

Under UK GAAP, claims are treated as fully settled at the date of purchase of the annuity. The claims provision is derecognized, as is the value of the annuity purchased, and a gain or loss is recognized for the difference between the claims liability and the cost of the annuity. Under US GAAP, the claims liability is not derecognized unless the insurer's liability to the policyholder has been legally extinguished. The equity and net income reconciliations reflect the impact of recognizing the claims liability where legal obligation has not been extinguished, and reversing the gain or loss recognized under UK GAAP.

### *V. Minority Interests*

The impact of the difference between US GAAP and UK GAAP upon minority interests and net income attributable to minorities has been reflected separately within the shareholders' equity and net income reconciliations.

### *W. Employee Share Option Plan*

Under UK GAAP, the Group is reflecting the shares held by the ESOP as "own shares" and has included this balance in other assets. Under US GAAP, the shares held by the ESOP have been reflected in shareholders' equity as unearned ESOP shares. There is no difference between the valuation of these shares on a US GAAP basis, and their valuation on a UK GAAP basis as reflected in note 27. No compensation costs have been recognized in the period as no shares have been committed to employees or executives. There is no repurchase obligation as at December 31, 1999.

### *X. Gross Up of Investment Income Due to Accounting Policy Change*

The Group has changed its UK GAAP accounting policy following the adoption of FRS 16 discussed in note 3, and as a result the UK GAAP income tax charge and investment income have been restated. As the US GAAP accounting policies remain unchanged, the net income reconciliation contains an adjustment to gross up investment income, with the tax adjustment included in the "Tax effect of US GAAP adjustments" item.

### *Classification Differences*

The following items, while not having a material impact upon net income or shareholders' equity, significantly affect the presentation of the consolidated financial statements and have been reflected in the condensed consolidated income statement and balance sheet presented on a US GAAP basis of accounting included in note 49.

### *Y. Net Written Premiums and Policy Fees*

Under US GAAP, revenues do not include premiums received for life insurance contracts that have insignificant mortality or morbidity risk. The premiums received which do not cover mortality, morbidity or policy fees are credited to policyholders' contract deposits. In a corresponding manner, benefit payments in excess of the related policy liability are directly charged to such liability, rather than being included in benefits, claims and other deductions. Revenues on such contracts consist of policy fees and charges. The investment return is reflected within the income statement, with interest credited to the policyholder. Initial fees received on these contracts are deferred and included with deferred income under US GAAP and as a reduction of deferred acquisition costs under UK GAAP.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### *Z. Assets Held to Cover Linked Liabilities (Separate Accounts)*

Separate account assets and liabilities represent funds maintained in segregated accounts to meet specific investment objectives of policyholders who bear the investment risk. Under both UK and US GAAP, investment income and investment gains and losses generally accrue directly to the policyholders. The assets and liabilities are carried at fair value. Under UK GAAP, the total premium and claims, net investment income and realized and unrealized gains and losses on unit linked (separate account) assets are reflected in the consolidated statement of income. Under US GAAP, only the cost of insurance, policy administration and surrender charges assessed against the policyholders' account balances are included in the income statement.

### *AA. Cash and Cash Equivalents*

Under UK GAAP, cash represents non-interest bearing cash. Under US GAAP, cash and cash equivalents, consist of amounts on deposit in banks and highly liquid investments, which are readily convertible into cash and purchased with maturities of three months or less, and exclude bank overdrafts.

### *AB. Treasury Shares*

Under UK GAAP, the par (nominal) value of treasury shares is deducted from common stock upon cancellation and transferred to a capital redemption reserve (note 27) while the amount paid for the cancelled shares is recorded in the profit and loss account (retained earnings). Under US GAAP, the cost of treasury shares is reported as a deduction from shareholders' equity. If shares are cancelled, the excess over par is recorded in retained earnings and par value deducted from common stock.

### *AC. Subordinated Debt*

Under UK GAAP, the Group has classified its long term subordinated debt as part of capital, reserves and long term subordinated liabilities. The costs of servicing this debt and the cash flows associated with the debt have been reflected as financing items. Under US GAAP, the interest payable on this debt has been included in interest expense, while debt issuance costs have been reflected as deferred charges which under the UK Group are netted against the value of the debt. There is no other difference between the US and UK GAAP valuation of the debt. Under both UK and US GAAP debt issuance costs are amortized over the term of the debt. The interest rate swap qualifies for accrual accounting under US GAAP, and there is therefore no difference between the US GAAP and UK GAAP treatments in respect of this transaction.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### 49. Condensed Consolidated US GAAP Financial Statements

The following condensed consolidated US GAAP financial statements reflect the effects of the material differences between UK GAAP and US GAAP on consolidated net income and shareholders' equity identified in note 48.

#### A. Condensed Consolidated Statements of Income

### CONDENSED CONSOLIDATED STATEMENTS OF INCOME (US Basis of Accounting)

	For the years ended December 31		
	1999 £m	Restated 1998 £m	Restated 1997 £m
<b>Revenues</b>			
Gross written premiums and policy fees . . . . .	10,109	9,829	9,855
Less premiums ceded to reinsurers . . . . .	(1,222)	(1,322)	(1,476)
Net written premiums and policy fees . . . . .	8,887	8,507	8,379
Net change in unearned premium reserve . . . . .	(137)	(180)	7
Net earned premiums and policy fees . . . . .	8,750	8,327	8,386
Net investment income . . . . .	1,974	2,042	2,170
Unrealized gains/(losses) on trading securities . . . . .	(471)	543	1,219
Realized gains, net . . . . .	2,828	2,733	1,259
Other income . . . . .	353	303	198
Total revenues . . . . .	<b>13,434</b>	13,948	13,232
<b>Benefits, losses and expenses</b>			
Property and casualty loss and loss adjustment expenses . . . . .	5,389	5,068	4,945
Life policyholder benefits . . . . .	1,980	3,313	3,044
Interest credited to policyholders . . . . .	466	458	468
Policyholder participations in profit . . . . .	797	394	388
Operating expenses . . . . .	2,919	2,727	2,705
Other expenses . . . . .	338	338	298
Total benefits, losses and expenses . . . . .	<b>11,889</b>	12,298	11,848
<b>Income before income tax expense, minority interests, and extraordinary item . . . . .</b>	<b>1,545</b>	1,650	1,384
Income tax expense . . . . .	630	815	658
Net income before minority interests and extraordinary item . . . . .	915	835	726
Net income applicable to minority interests of consolidated subsidiaries . . .	24	33	38
Net income before extraordinary item . . . . .	891	802	688
Extraordinary item (note 50 C) . . . . .	42	(142)	—
<b>Net income . . . . .</b>	<b>933</b>	660	688

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued**

	<u>For the years ended December 31</u>		
	<u>1999</u>	<u>Restated</u>	<u>Restated</u>
	<u>£m</u>	<u>1998</u>	<u>1997</u>
		<u>£m</u>	<u>£m</u>
<b>Primary earnings per share</b>			
Net income before extraordinary item . . . . .	<b>62.0p</b>	55.9p	48.3p
Extraordinary item . . . . .	<b>2.9p</b>	(10.0)p	—
Net income . . . . .	<b>64.9p</b>	45.9p	48.3p
<b>Fully diluted earnings per share</b>			
Net income before extraordinary item . . . . .	<b>61.3p</b>	55.1p	46.9p
Extraordinary item . . . . .	<b>2.9p</b>	(9.9)p	—
Net income . . . . .	<b>64.2p</b>	45.2p	46.9p

*B. Condensed Consolidated Balance Sheets*

**CONDENSED CONSOLIDATED BALANCE SHEETS  
(US Basis of Accounting)**

	<u>As of December 31</u>	
	<u>1999</u>	<u>Restated</u>
	<u>£m</u>	<u>1998</u>
		<u>£m</u>
<b>ASSETS</b>		
<b>Investments</b>		
Fixed maturities . . . . .	<b>23,758</b>	23,500
Equity securities . . . . .	<b>18,551</b>	17,949
Real estate . . . . .	<b>922</b>	1,011
Mortgage loans . . . . .	<b>464</b>	490
Policyholder, collateral and other loans . . . . .	<b>94</b>	135
Other investments . . . . .	<b>454</b>	382
Short-term investments . . . . .	<b>322</b>	175
<b>Total investments . . . . .</b>	<b>44,565</b>	43,642
<b>Other assets</b>		
Cash and cash equivalents . . . . .	<b>2,261</b>	1,939
Receivables from insurance operations . . . . .	<b>2,711</b>	2,447
Reinsurance recoverables . . . . .	<b>4,988</b>	3,790
Other receivables . . . . .	<b>923</b>	1,171
Accrued investment income . . . . .	<b>443</b>	450
Deferred policy acquisition costs . . . . .	<b>2,117</b>	1,861
Goodwill . . . . .	<b>1,182</b>	153
Present value of profits of acquired life (long term) business . . . . .	<b>284</b>	136
Other assets . . . . .	<b>1,649</b>	1,455
Separate account (unit-linked) assets . . . . .	<b>8,218</b>	6,602
<b>Total other assets . . . . .</b>	<b>24,776</b>	20,004
<b>Total assets . . . . .</b>	<b>69,341</b>	63,646

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

	As of December 31	
	1999 £m	Restated 1998 £m
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
Reserve for losses and loss adjustment expenses . . . . .	14,361	12,144
Reserve for unearned premiums . . . . .	4,521	3,774
Reserve for future life and health policyholders' benefits . . . . .	15,433	15,105
Policyholders' contract deposits and other funds . . . . .	8,608	9,032
Undistributed policyholder allocations . . . . .	4,896	4,100
Funds held under reinsurance contracts . . . . .	203	197
Notes, bonds and loans payable . . . . .	1,326	451
Deferred income taxes . . . . .	1,961	1,998
Deferred income . . . . .	493	403
Other insurance liabilities . . . . .	1,124	890
Other liabilities . . . . .	1,892	2,170
Separate account (unit-linked) liabilities . . . . .	8,218	6,602
<b>Total liabilities</b> . . . . .	<b>63,036</b>	<b>56,866</b>
<b>Minority interests</b> . . . . .	<b>384</b>	<b>265</b>
<b>Shareholders' equity</b>		
Common stock, par (nominal) value . . . . .	393	391
Preferred stock, par (nominal) value . . . . .	125	125
Additional paid-in capital (share premium) . . . . .	777	755
Retained earnings . . . . .	2,770	2,954
Accumulated other comprehensive income . . . . .		
Unearned compensation . . . . .	(24)	(14)
Unearned ESOP shares . . . . .	(29)	—
Unrealized gains on investments, net . . . . .	1,979	2,424
Cumulative translation adjustments . . . . .	(70)	(120)
<b>Total shareholders' equity</b> . . . . .	<b>5,921</b>	<b>6,515</b>
<b>Total liabilities and shareholders' equity</b> . . . . .	<b>69,341</b>	<b>63,646</b>

### C. Condensed Consolidated Statement of Shareholders' Equity and Comprehensive Income

	Common stock Number of Shares Issued	Preferred stock Number of Shares Issued	Common Stock £m	Preferred Stock £m	Additional Paid-in Capital £m	Unearned ESOP Shares £m	Cfwd below £m
<b>Balance at January 1, 1997</b> . . . . .	1,558,352,788	125,000,000	390	125	636	—	1,151
Net income . . . . .	—	—	—	—	—	—	—
Cumulative translation adjustments . . . . .	—	—	—	—	—	—	—
Issuance of common shares . . . . .	1,289,486	—	—	—	4	—	4
Dividends paid . . . . .	—	—	—	—	—	—	—
Unrealized gains, net . . . . .	—	—	—	—	—	—	—
Stock compensation . . . . .	17,136,354	—	4	—	38	—	42
Scrip dividend adjustment . . . . .	9,193,282	—	2	—	47	—	49
Purchase and cancellation of stock . . . . .	(32,100,000)	—	(8)	—	—	—	(8)
<b>Balance at December 31, 1997</b> . . . . .	1,553,871,910	125,000,000	388	125	725	—	1,238

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued**

	Accumulated Comprehensive Income					Total Shareholders' Equity £m
	Bfwd from above £m	Unearned Compensation £m	Unrealized Gains on Investments net £m*	Cumulative Translation Adjustments £m	Retained Earnings £m*	
<b>Balance at January 1, 1997</b> .....	1,151	(6)	1,920	—	2,414	5,479
Net income .....	—	—	—	—	688	688
Cumulative translation adjustments .....	—	—	—	(54)	—	(54)
Issuance of common shares .....	—	—	—	—	—	4
Dividends paid .....	4	—	—	—	(314)	(314)
Unrealized gains, net .....	—	—	569	—	—	569
Stock compensation .....	42	(9)	—	—	—	33
Scrip dividend adjustment .....	49	—	—	—	—	49
Purchase and cancellation of stock .....	—	—	—	—	(145)	(153)
<b>Balance at December 1, 1997</b> .....	<u>1,238</u>	<u>(15)</u>	<u>2,489</u>	<u>(54)</u>	<u>2,643</u>	<u>6,301</u>

	Common stock	Preferred stock	Common	Preferred	Additional	Unearned	Cfwd below £m
	Number of Shares Issued	Number of Shares Issued	Stock £m	Stock £m	Paid-in Capital £m	ESOP Shares £m	
<b>Balance at January 1, 1998</b> .....	1,553,871,910	125,000,000	388	125	725	—	1,238
Net income .....	—	—	—	—	—	—	—
Cumulative translation adjustments .....	—	—	—	—	—	—	—
Issuance of common shares .....	4,492,664	—	1	—	17	—	18
Dividends paid .....	—	—	—	—	—	—	—
Unrealized losses, net .....	—	—	—	—	—	—	—
Stock compensation .....	5,648,107	—	2	—	13	—	15
<b>Balance at December 31, 1998</b> .....	<u>1,564,012,681</u>	<u>125,000,000</u>	<u>391</u>	<u>125</u>	<u>755</u>	<u>—</u>	<u>1,271</u>

	Accumulated Comprehensive Income					Total Shareholders' Equity £m
	Bfwd from above £m	Unearned Compensation £m	Unrealized Gains on Investments net £m*	Cumulative Translation Adjustments £m	Retained Earnings £m*	
<b>Balance at January 1, 1998</b> .....	1,238	(15)	2,489	(54)	2,643	6,301
Net income .....	—	—	—	—	660	660
Cumulative translation adjustments .....	—	—	—	(66)	—	(66)
Issuance of common shares .....	18	—	—	—	—	18
Dividends paid .....	—	—	—	—	(349)	(349)
Unrealized losses, net .....	—	—	(65)	—	—	(65)
Stock compensation .....	15	1	—	—	—	16
<b>Balance at December 31, 1998</b> .....	<u>1,271</u>	<u>(14)</u>	<u>2,424</u>	<u>(120)</u>	<u>2,954</u>	<u>6,515</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

	Common stock Number of Shares Issued	Preferred stock Number of Shares Issued	Common Stock £m	Preferred Stock £m	Additional Paid-in Capital £m	Unearned ESOP Shares £m	Cfwd below £m
<b>Balance at January 1, 1999</b> . . . . .	1,564,012,681	125,000,000	391	125	755	—	1,271
Net income . . . . .	—	—	—	—	—	—	—
Cumulative translation adjustments . . . . .	—	—	—	—	—	—	—
Share consolidation (note 27) . . . . .	(142,347,397)	—	—	—	—	—	—
Dividends paid . . . . .	—	—	—	—	—	—	—
Unrealized losses, net . . . . .	—	—	—	—	—	—	—
Stock compensation . . . . .	6,746,997	—	2	—	22	—	24
Purchase of stock for ESOP . . . . .	—	—	—	—	—	(29)	(29)
<b>Balance at December 31, 1999</b> . . . . .	<u>1,428,412,281</u>	<u>125,000,000</u>	<u>393</u>	<u>125</u>	<u>777</u>	<u>(29)</u>	<u>1,266</u>

	Accumulated Comprehensive Income					Total Shareholders' Equity £m
	Bfwd from above £m	Unearned Compensation £m	Unrealized Gains on Investments net £m*	Cumulative Translation Adjustments £m	Retained Earnings £m*	
<b>Balance at January 1, 1999</b> . . . . .	1,271	(14)	2,424	(120)	2,954	6,515
Net income . . . . .	—	—	—	—	933	933
Cumulative translation adjustments . . . . .	—	—	—	50	—	50
Share consolidation (note 27) . . . . .	—	—	—	—	—	—
Dividends paid . . . . .	—	—	—	—	(1,118)	(1,118)
Unrealized losses, net . . . . .	—	—	(445)	—	—	(445)
Stock compensation . . . . .	24	(10)	—	—	1	15
Purchase of stock for ESOP . . . . .	(29)	—	—	—	—	(29)
<b>Balance at December 31, 1999</b> . . . . .	<u>1,266</u>	<u>(24)</u>	<u>1,979</u>	<u>(70)</u>	<u>2,770</u>	<u>5,921</u>

\* Restated

Total comprehensive income for the year ended December 31, 1999 was **£528m** (1998 £530m, 1997 £1,194 m).

Statement of Financial Accounting Standard 52, "Foreign Currency Translation" has been applied prospectively as of January 1, 1997. The effect of this is that the beginning cumulative foreign currency translation adjustment has not been separately stated within other comprehensive income but instead remains within retained earnings.

### D. Cash Flow Information

In accordance with UK GAAP, the Group's consolidated cash flow statements are presented in accordance with UK Financial Reporting Standard No.1, as revised ("FRS 1"). The statements and notes thereto present substantially the same information as that required under US GAAP as required by Statement of Financial Accounting Standards No. 95, "Statement of Cash Flows", with the exception that the UK GAAP cashflow excludes the cash flows of the Group's life insurance funds. Under US GAAP these cash flows are required to be presented except for separate accounts activity which is excluded.

Under UK GAAP, the Group's cash comprises cash in bank. Under US GAAP, cash and cash equivalents include cash and short-term investments with original maturities of three months or less. In addition, under UK GAAP, cash flows are presented for operating activities; returns on investments and servicing of finance; taxation; capital expenditure and financial investment; acquisitions and disposals; equity

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

dividends paid; management of liquid resources and financing. US GAAP requires the classification of cash flows as resulting from operating, investing and financing activities. Cash flows from capital expenditure and financial investment, acquisitions and disposals, shown separately under UK GAAP, would be included as part of the investing activities under US GAAP. The payment of dividends to shareholders is included as a financing activity under US GAAP.

### CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (US Basis of Accounting)

	For the years ended December 31		
	1999 £m	1998 £m	1997 £m
<b>Net cash provided by operating activities</b> . . . . .	<b>672</b>	167	467
<b>Net cash provided by/(used in) investing activities</b> . . . . .	<b>(334)</b>	135	(164)
<b>Net cash provided by/(used in) financing activities</b> . . . . .	<b>(25)</b>	(366)	(465)
Effect of exchange rate changes on cash and cash equivalents . . . . .	<b>9</b>	(4)	(7)
<b>Change in cash and cash equivalents</b> . . . . .	<b>322</b>	(68)	(169)
Cash and cash equivalents — as of January 1 . . . . .	<b>1,939</b>	2,007	2,176
Cash and cash equivalents — as of December 31 . . . . .	<b>2,261</b>	1,939	2,007

#### 50. Additional US GAAP Disclosures

Set forth below are the additional disclosures which are required to be included in the consolidated financial statements under US GAAP.

##### A. Exchange Rates

Weighted average rates of exchange for the periods are US Dollar **1.62** (1998 1.66, 1997 1.64), Canadian Dollar **2.40** (1998 2.49, 1997 2.26), Danish Kroner **11.32** (1998 11.05, 1997 10.83) and Australian Dollar **2.50** (1998 2.61, 1997 2.18).

##### B. Earnings Per Share (EPS)

The earnings per share calculation is calculated by reference to the US GAAP net income attributable to equity shareholders. The weighted average number of shares is based on the weighted average shares in issue during the year as disclosed in note 16, but adjusted for the impact of the ten for eleven share consolidation referred to in note 27.

The diluted earnings per share is calculated by reference to the US GAAP net income attributable to equity shareholders after adjustment for potentially dilutive securities. The weighted average number of shares has also been adjusted for the impact of the ten for eleven share consolidation referred to in note 27.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

The information used in determination of earnings per share for the years ended December 31, is as follows:

	1999		1998		1997	
	Ordinary Shares* m	Net Income £m	Ordinary Shares* m	Net Income £m	Ordinary Shares* m	Net Income £m
Net income .....	1,423.63	891	1,418.14	802	1,405.73	688
Preferred dividends .....		(9)		(9)		(9)
Income applicable to ordinary shares .....		882		793		679
Extraordinary item .....		42		(142)		—
<b>Income applicable to ordinary shares .....</b>		<b>924</b>		651		679
<b>Effect of dilutive securities:</b>						
Stock options .....	14.41	—	21.19	—	19.08	—
Convertible bonds .....	—	—	—	—	38.45	7
<b>Net income attributable to ordinary shares and potentially dilutive securities .....</b>	<b>1,438.04</b>	<b>924</b>	<b>1,439.33</b>	<b>651</b>	<b>1,463.26</b>	<b>686</b>
			<u>1999</u>	<u>1998</u>	<u>1997</u>	
<b>Basic earnings per share:</b>						
Income before extraordinary item .....			62.0p	55.9p	48.3p	
Extraordinary item .....			2.9p	(10.0)p	—	
Net income .....			<u>64.9p</u>	<u>45.9p</u>	<u>48.3p</u>	
<b>Diluted earnings per share:</b>						
Income before extraordinary item .....			61.3p	55.1p	46.9p	
Extraordinary item .....			2.9p	(9.9)p	—	
Net income .....			<u>64.2p</u>	<u>45.2p</u>	<u>46.9p</u>	

\* All shares in issue up to the date of consolidation were adjusted for the May 1999, ten for eleven share consolidation referred to in note 27. No adjustment has been made to reflect the impact of the £751m special dividend (48p per share) referred to in note 15.

### C. Extraordinary Item

During 1998, the Group recognized an extraordinary charge of £142m (or 10.0p basic earnings per share and 9.9p diluted earnings per share) as a result of the early extinguishment of the remaining outstanding 7.25% subordinated convertible bonds originally due 2008. The loss was a result of the Group paying market value for the bonds that at the time of repurchase exceeded the carrying value. The loss was not tax effected in 1998 as the UK Inland Revenue had indicated to the Group that they did not regard the amount as tax deductible. Late in 1999, the UK Inland Revenue changed its position to agree with the Group's tax position on the transaction. The tax relief on the extinguishment was recognized in 1999 as an extraordinary item, in the same manner as the original item.

### D. Revenue Recognition

Premiums on short duration property and casualty and life contracts are recognized as revenue over the period of the contract in proportion to the amount of insurance protection provided. Premiums on long duration

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

life contracts are recognized as revenue when due from policyholders. Revenues from universal life contracts include charges for costs of insurance, surrender charges and maintenance expenses and are recognized as they are assessed against the policyholder. Initial policy fees on long duration life insurance contracts (primarily universal life and investments contracts) that are in excess of the level of annual policy fees taken thereafter are deferred and recognized over the term of the policy.

### *E. Stock Option Plans*

At December 31, 1999, the Group had two types of stock-based compensation plans. One was an executive share options plan; the other, an employee savings related share options plan. The Group applies APB Opinion 25, "Accounting for Stock Issued to Employees", and related interpretations in accounting for its plans. Accordingly, compensation costs are recognized over the vesting periods only for variable plans and for those grants where the exercise price is below the fair value of the stock on the date of grant. Unearned compensation for future services relating to these plans has been recorded as a separate reduction of equity and is being amortized over the vesting periods. Compensation expense is not recorded for plans where the exercise price is equal to the market price on the date of the grant.

Statement of Financial Accounting Standards No. 123 "Accounting for Awards of Stock Based Compensation to Employees" encourages a fair value based method of accounting for employee stock option plans. Under the fair value method, compensation cost is measured at the grant date based on the fair value of the award and is recognized over the vesting period.

Had compensation costs for these plans been determined consistent with the fair value method, the Group's US GAAP net income and earnings per share for the years ended December 31 would have been reduced to the pro forma amounts as follows:

	<u>1999</u> £m	<u>1998</u> £m	<u>1997</u> £m
<b>Pro Forma:</b>			
Net income attributable to ordinary shares . . . . .	879	787	677
Extraordinary item . . . . .	42	(142)	—
Net income applicable to ordinary shares . . . . .	<u>921</u>	<u>645</u>	<u>677</u>
	<u>1999</u>	<u>1998</u>	<b>Restated</b> <u>1997</u>
<b>Earnings per share:</b>			
Income before extraordinary item . . . . .	61.7p	55.5p	48.2p
Extraordinary item . . . . .	2.9p	(10.0)p	—
Net income . . . . .	<u>64.6p</u>	<u>45.5p</u>	<u>48.2p</u>
<b>Diluted earnings per share:</b>			
Income before extraordinary item . . . . .	61.1p	54.7p	46.3p
Extraordinary item . . . . .	2.9p	(9.9)p	—
Net income . . . . .	<u>64.0p</u>	<u>44.8p</u>	<u>46.3p</u>

The fair value of stock grants included in the pro forma amounts is not necessarily indicative of future effects on net income and earnings per share.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

On May 1, 1996, the Group's Board of Directors adopted the 1996 executive share option plan, which provided that options to purchase shares of common stock could be granted to officers and other key employees at prices not less than fair value at the date of grant. Under the executive share option plan, awards made before February 23, 1996 vest from three to five years after the date of the grant and are not subject to any performance criteria. Awards made after February 23, 1996 (except for certain options granted in April 1997) vest only if the Group achieves certain shareholder return or return on capital targets. The exercise price of all options is equal to the grant date market value of the stock and all options expire ten years after the date of the grant. The executive share option plan has been accounted for as a variable plan under US GAAP.

Additional information with respect to the Group's executive share option plan at December 31, is as follows:

	1999		1998	
	Shares	Price (a)	Shares	Price (a)
Outstanding January 1 . . . . .	19,900,410	423.23p	16,229,289	380.28p
Granted . . . . .	7,340,834	501.37p	6,205,831	497.00p
Exercised . . . . .	(927,332)	321.16p	(2,106,242)	319.18p
Cancelled . . . . .	(184,306)	378.13p	(428,468)	378.30p
<b>Outstanding December 31 . . . . .</b>	<b>26,129,606</b>	<b>450.02p</b>	<b>19,900,410</b>	<b>423.23p</b>
Options exercisable at year end . . . . .	6,135,816	334.24p	4,425,372	321.38p

(a) Price refers to weighted average exercise price in sterling.

The following stock options under the executive share option plan were outstanding or exercisable as of December 31, 1999:

Range of Exercise Prices	Options Outstanding		
	Number of Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price
141.6-200	282,856	2.75	141.60p
201-250	1,258,835	4.10	226.97p
251-300	153,083	4.25	260.08p
301-350	3,011,811	4.74	329.00p
351-400	2,220,571	6.53	373.82p
401-450	3,729,529	6.97	431.90p
451-500	6,183,207	8.75	497.00p
501-525.7	9,289,714	8.92	526.34p
	<b>26,129,606</b>		

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

Range of Exercise Prices	Options Exercisable	
	Number of Shares	Weighted Average Exercise Price
141.6-200	282,856	141.60p
201-250	1,258,835	226.97p
251-300	87,244	262.90p
301-350	1,988,489	337.40p
351-400	857,604	381.58p
401-450	1,660,788	424.31p
451-500	—	—
501-525.7	—	—
	6,135,816	

Under the executive share option plan, the weighted average estimated fair value per option granted by the Company during 1999 was **116.93p** (1998 129.43p). The fair value of stock options granted under the executive share option plan during 1999 was **£8.6m** (1998 £8m). Fair values for the Company's executive share option plan were estimated as of the date of grant using the Black-Scholes pricing model with the following weighted average assumptions: dividend yields of **5.04%** (1998 and 1997 4.06%); expected volatilities of **34.02%** in 1999 (1998 30.92%, 1997 27.57%); risk-free interest rates of **5.29%** in 1999 (1998 6.65%, 1997 6.76%); and expected terms of five years.

The Group's savings related share option plan was adopted on May 17, 1989. Eligible employees can receive privileges to purchase shares of the Group's common stock at a price equal to 80% to 88% of the fair value on the date of grant of the purchase privilege for UK based participants, and 100% of the fair value on the date of grant of the purchase privilege for Republic of Ireland based participants. All options expire in three, five or seven years from the grant date. Purchase privileges were granted to all employees of the UK companies whose contract of employment is greater than two years, and to employees outside the UK on a UK Participating Company Contract of Employment who are participants of the Royal Insurance Group Pension Scheme or SAL Pension Scheme. The number of shares available for purchase from the plan by each participant is limited to the whole number of shares purchasable from the aggregate value of their savings contract upon maturity. An individual's maximum monthly contribution to all current savings contracts is £250.

The Group's International Sharesave Plan (savings related) was adopted on May 12, 1999. Eligible employees can receive privileges to purchase shares of the Group's common stock at a price equal to 80% to 88% of the fair value on the date of grant (fair value being the average of the middle market quotation, over the 5 business days immediately preceding the date of invitation, derived from the London Stock Exchange) of the purchase privilege for all eligible employees under the plan. All options expire in three or five years from the grant date. The number of shares available for purchase from the plan by each participant is limited to the whole number of shares purchasable from the aggregate value of their savings contract upon maturity. An individual's maximum monthly contribution to all current savings contracts is £250.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

Additional information with respect to the Group's savings related share option plan at December 31, was as follows:

	1999		1998	
	Shares	Price (a)	Shares	Price (a)
Outstanding January 1 . . . . .	26,926,727	328.18p	26,210,155	282.61p
Granted . . . . .	9,860,395	402.06p	6,653,662	446.20p
Exercised . . . . .	(5,819,665)	226.71p	(3,541,865)	215.35p
Cancelled . . . . .	(2,490,124)	390.19p	(2,395,225)	323.94p
<b>Outstanding December 31 . . . . .</b>	<b>28,477,333</b>	<b>374.68p</b>	<b>26,926,727</b>	<b>328.18p</b>
Options exercisable at year end . . . . .	<u>489,321</u>	<u>231.43p</u>	<u>368,254</u>	<u>260.96p</u>

(a) Price refers to weighted average exercise price in sterling.

The following stock options under the savings related share option plan were outstanding or exercisable as of December 31, 1999:

Options Outstanding			
Range of Exercise Prices	Number of Shares	Weighted Average Contractual Life (Years)	Weighted Average Exercise Price
93.8-150	118,638	0.25	93.80p
151-200	34,397	0.08	186.00p
201-250	2,881,718	0.81	238.99p
251-300	3,349,075	1.41	276.65p
301-350	2,544,823	2.19	319.03p
351-400	7,968,377	4.69	393.01p
401-450	10,350,136	3.45	436.61p
451-483	<u>1,230,169</u>	1.42	479.69p
	<u>28,477,333</u>		

Options Exercisable		
Range of Exercise Prices	Number of Shares	Weighted Average Exercise Price
93.8-150	118,638	93.80p
151-200	34,397	186.00p
201-250	117,261	206.20p
251-300	64,560	268.26p
301-350	—	—
351-400	154,465	351.00p
401-450	—	—
451-483	—	—
	<u>489,321</u>	

Under the savings related share option plan, the fair values of purchase privileges granted during 1999 was **£14.4m** (1998 £12.1m, 1997 £8.7m). The weighted average market value per share of those purchase rights

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

granted in 1999 was **147.61p** (1998 178.21p, 1997 168.02p). The market value of each purchase right is estimated on the date of the subscription using the Black-Scholes model.

The following weighted average assumptions were used for grants under the savings related share option plan in 1999, 1998 and 1997: dividend yields of **5.04%** (1998 and 1997 4.06%); risk-free interest rates of **5.83%** (1998 and 1997 6.65%); and expected terms of five years. Expected volatilities were **35.08%** in 1999 (1998 31.31%, 1997 27.81%).

The maximum number of shares to be granted are limited such that total shares issued under all employee stock option plans do not exceed ten percent of the ordinary share capital of the Group. Total compensation cost recorded in the US GAAP income statement for all plans was (**£0.5m**) in 1999 (1998 £2.2m, 1997 £2.8m). Unearned compensation recorded as a charge against US GAAP shareholders' equity was **£24.3m** as of December 31, 1999 (1998 £14.4m, 1997 £14.8m).

### *F. Investments*

For purposes of US GAAP, debt and equity securities are required to be classified into three categories: held-to-maturity, available-for-sale and trading. Debt securities include redeemable preferred shares and equity securities include non-redeemable preferred shares.

Impaired mortgage loans were **£28m** at December 31, 1999 (1998 £22m). As of December 31, 1999 a valuation allowance of **£17m** (1998 £18m) was established to reduce the carrying value of the mortgage loans to the present value of expected future cash flows for these loans. Interest foregone on these loans was **£1m** for the year ended December 31, 1999 (1998 £1m).

Investments in real estate are recorded at historical cost less accumulated depreciation.

Short-term investments comprise commercial paper, marketable certificates of deposits and other liquid investments maturing within one year. Short-term investments are carried at cost, which approximates to fair value.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

Total investments as of December 31 were as follows:

	1999		1998	
	Carrying Value £m	Fair Value £m	Carrying Value £m	Fair Value £m
Equity securities . . . . .	<u>18,551</u>	<u>18,551</u>	17,949	17,949
Fixed maturities:				
UK Government . . . . .	6,513	6,513	7,559	7,559
US Government . . . . .	962	963	839	839
Obligations of US state and local government authorities . . . . .	728	728	240	241
Other government . . . . .	4,701	4,701	4,415	4,416
Corporate securities . . . . .	6,754	6,754	5,030	5,030
Mortgage-backed securities . . . . .	3,030	3,030	4,125	4,125
Other bonds and private placements . . . . .	1,019	1,019	1,242	1,242
Other . . . . .	51	51	50	50
Total fixed maturities . . . . .	<u>23,758</u>	<u>23,759</u>	23,500	23,502
Mortgage loans on real estate . . . . .	464	464	490	493
Real estate . . . . .	922	1,936	1,011	2,321
Policyholder, collateral and other loans . . . . .	94	94	135	135
Short-term investments . . . . .	322	322	175	175
Other investments . . . . .	454	454	382	382
<b>Total investments . . . . .</b>	<u><u>44,565</u></u>	<u><u>45,580</u></u>	<u>43,642</u>	<u>44,957</u>

At December 31, 1999, investment real estate consisted of land with a cost of **£285m** (1998 £337m), buildings with a cost of **£1,154m** (1998 £1,404m) and accumulated depreciation of **£517m** (1998 £730m). Depreciation expense for 1999 was **£38m** (1998 £65m, 1997 £51m).

The amortized cost, gross unrealized gains and losses and estimated fair values of investments in fixed maturities held-to-maturity as of December 31 were as follows:

	Amortized Cost £m	Gross Unrealized Gains £m	Gross Unrealized Losses £m	Fair Value £m
	1999			
US Government and US state and local government authorities . . . . .	44	1	—	45
Other government . . . . .	10	—	—	10
Corporate securities . . . . .	10	—	—	10
Other bonds and private placements . . . . .	9	—	—	9
<b>Total . . . . .</b>	<u>73</u>	<u>1</u>	<u>—</u>	<u>74</u>
	1998			
US Government and US state and local government authorities . . . . .	39	1	—	40
Other government . . . . .	24	1	—	25
Corporate securities . . . . .	9	—	—	9
<b>Total . . . . .</b>	<u>72</u>	<u>2</u>	<u>—</u>	<u>74</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

The amortized cost and fair value of held-to-maturity fixed maturities by contractual maturity at December 31, 1999 were as follows:

	Amortized Cost £m	Fair Value £m
Due in one year or less . . . . .	—	—
Due after one year through five years . . . . .	50	50
Due after five years through ten years . . . . .	17	18
Due after ten years . . . . .	6	6
<b>Total</b> . . . . .	<b>73</b>	<b>74</b>

The amortized cost for fixed maturities and historical cost for equity securities, gross unrealized gains and losses and estimated fair values of investments in available-for-sale fixed maturities and equity securities as of December 31 were as follows:

	Cost £m	Gross Unrealized Gains £m	Gross Unrealized Losses £m	Fair Value £m
<b>1999</b>				
Equity securities . . . . .	<b>4,142</b>	<b>4,108</b>	<b>(157)</b>	<b>8,093</b>
Fixed maturities:				
UK Government . . . . .	1,922	47	(38)	1,931
US Government . . . . .	874	1	(14)	861
Obligations of US state and local government authorities . . . . .	740	1	(13)	728
Other Government . . . . .	3,437	71	(44)	3,464
Corporate securities . . . . .	3,898	36	(67)	3,867
Mortgage-backed securities . . . . .	3,034	28	(32)	3,030
Other bonds and private placements . . . . .	1,011	23	(24)	1,010
Other . . . . .	51	1	(1)	51
<b>Total</b> . . . . .	<b>19,109</b>	<b>4,316</b>	<b>(390)</b>	<b>23,035</b>
<b>1998</b>				
Equity securities . . . . .	4,462	4,076	(325)	8,213
Fixed maturities:				
UK Government . . . . .	2,163	75	—	2,238
US Government . . . . .	684	33	—	717
Obligations of US state and local government authorities . . . . .	198	3	—	201
Other Government . . . . .	3,083	186	(2)	3,267
Corporate securities . . . . .	3,313	172	(4)	3,481
Mortgage-backed securities . . . . .	4,023	103	(1)	4,125
Other bonds and private placements . . . . .	1,185	60	(3)	1,242
Other . . . . .	48	2	—	50
<b>Total</b> . . . . .	<b>19,159</b>	<b>4,710</b>	<b>(335)</b>	<b>23,534</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

The amortized cost and fair value of available-for-sale fixed maturities by contractual maturity at December 31, 1999 were as follows:

	Amortized Cost £m	Fair Value £m
Due in one year or less . . . . .	961	964
Due after one year through five years . . . . .	6,044	6,030
Due after five years through ten years . . . . .	2,914	2,884
Due after ten years . . . . .	4,453	4,475
Mortgage-backed securities and other securities—without a single maturity date* . . .	595	589
<b>Total</b> . . . . .	<b>14,967</b>	<b>14,942</b>

\* Actual maturities may differ from scheduled maturities because the borrowers have the right to call or prepay certain obligations, sometimes without penalties. Maturities of mortgage-backed and other asset-backed securities depend on the repayment characteristics and experience of the underlying obligations.

Realized gains and losses on available-for-sale fixed maturities and equity securities, as predominantly determined by the first-in-first-out method for fixed maturities and average cost for equity securities, and the proceeds thereon for the years ended December 31, were as follows:

	1999 £m	1998 £m	1997 £m
Proceeds from sales . . . . .	<b>17,672</b>	13,580	12,136
Gross realized gains on those sales . . . . .	<b>1,529</b>	1,339	631
Gross realized losses on those sales . . . . .	<b>(514)</b>	(249)	(174)

The amortized cost for fixed maturities and historical cost for equity securities, net unrealized gains and losses and estimated fair values of investments in trading fixed maturities and equity securities as of December 31, were as follows:

	Cost £m	Net Unrealized Gains £m	Fair Value £m
		1999	
Equity securities . . . . .	<b>5,169</b>	<b>5,289</b>	<b>10,458</b>
Fixed maturities:			
UK Government . . . . .	<b>4,430</b>	<b>152</b>	<b>4,582</b>
US Government . . . . .	<b>64</b>	<b>(7)</b>	<b>57</b>
Other Government . . . . .	<b>1,350</b>	<b>(123)</b>	<b>1,227</b>
Corporate securities . . . . .	<b>2,770</b>	<b>107</b>	<b>2,877</b>
<b>Total</b> . . . . .	<b>13,783</b>	<b>5,418</b>	<b>19,201</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

	Cost £m	Net Unrealized Gains £m	Fair Value £m
	1998		
Equity securities . . . . .	5,087	4,649	9,736
Fixed maturities:			
UK Government . . . . .	4,607	714	5,321
US Government . . . . .	118	4	122
Other Government . . . . .	1,053	71	1,124
Corporate securities . . . . .	1,242	298	1,540
<b>Total</b> . . . . .	<b>12,107</b>	<b>5,736</b>	<b>17,843</b>

Realized gains and losses on trading fixed maturities and equity securities, as predominantly determined by the first-in-first-out method for fixed maturities and average cost for equity securities, and the proceeds thereon for the years ended December 31, were as follows:

	1999 £m	1998 £m	1997 £m
Proceeds from sales . . . . .	<b>16,448</b>	12,090	6,651
Gross realized gains on those sales . . . . .	<b>2,187</b>	1,890	906
Gross realized losses on those sales . . . . .	<b>(699)</b>	(411)	(222)

Realized gains arising on the overall portfolio of available-for-sale and trading fixed maturities and equity investments are shown below:

	1999 £m	1998 £m	1997 £m
Equity securities . . . . .	<b>2,845</b>	2,408	979
Fixed maturities . . . . .	<b>(342)</b>	161	162
	<b>2,503</b>	2,569	1,141

Fixed maturities below investment grade or those not rated held by the Group as of December 31, 1999 were approximately **£1,921m** (1998 £1,669m).

At December 31, 1999 all collateralized mortgage obligations (CMOs) held were investment grade and approximately **33%** (1998 80%) were backed by various US government agencies. The remaining **67%** (1998 20%) were corporate issues. At December 31, 1999 the fair value of the CMO portfolio was **£226m** (1998 £626m). The Group's CMO portfolio is readily marketable. There were no derivative (high risk) CMO securities contained in the portfolio at December 31, 1999 and 1998.

Included within mortgage backed securities as of December 31, 1999 were **£2,796m** (1998 £3,270m) of Danish mortgage bonds. These bonds are issued by Danish mortgage credit institutions, which are monitored by the Danish Financial Supervisory Authority. Bonds are quoted and traded as securities on the Copenhagen Stock Exchange.

The UK operations of the Group enter into exchange traded futures contracts in order to switch from equities to gilts. These contracts are linked to the FTSE 100, an index that tracks the performance of the top

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

100 companies (by market capitalization) listed on the London Stock Exchange. The futures contracts are designated as hedges of the underlying equities and meet the US GAAP requirements for hedge accounting. Where the futures relate to equity securities that are classified as trading securities the futures are marked to market, with changes in their market value reflected in income as they occur. Where the futures relate to equity securities that are classified as available for sale securities, the futures have been marked to market, with changes in their market value recorded in other comprehensive income, to match the changes in market value of the securities that they hedge.

Income earned from investments was comprised of the following for the years ended December 31:

	<b>1999</b>	<b>Restated</b>	<b>Restated</b>
	<b>£m</b>	<b>1998</b>	<b>1997</b>
		<b>£m</b>	<b>£m</b>
Dividends .....	<b>397</b>	481	511
Interest income .....	<b>1,603</b>	1,542	1,570
Other .....	<b>131</b>	189	232
<b>Total</b> .....	<b><u>2,131</u></b>	<b><u>2,212</u></b>	<b><u>2,313</u></b>
Fixed maturities:			
UK Government .....	<b>406</b>	401	444
Foreign Government .....	<b>258</b>	243	213
US Government .....	<b>76</b>	62	53
Obligations of US state and local government authorities .....	<b>18</b>	8	15
Corporate securities .....	<b>358</b>	297	289
Mortgage-backed securities .....	<b>213</b>	245	290
Other bonds and private placements .....	<b>72</b>	84	67
Other .....	<b>183</b>	184	181
Equity securities .....	<b>397</b>	481	511
Investment in real estate .....	<b>131</b>	189	232
Short-term investments .....	<b>19</b>	18	18
<b>Total investment income</b> .....	<b><u>2,131</u></b>	<b><u>2,212</u></b>	<b><u>2,313</u></b>
Investment expenses .....	<b>(157)</b>	(170)	(143)
<b>Net investment income</b> .....	<b><u>1,974</u></b>	<b><u>2,042</u></b>	<b><u>2,170</u></b>

### G. Fair Value of Financial Instruments

Statement of Financial Accounting Standards No. 107, "Disclosure about Fair Value of Financial Instruments" (FAS 107), requires disclosure of fair value information about financial instruments, as defined therein, for which it is practicable to estimate such fair value. In the measurement of the fair value of certain of the financial instruments, if quoted market prices were not available, then other valuation techniques were utilized. These derived fair value estimates are significantly affected by the assumptions used. FAS 107 excludes certain financial instruments and insurance contracts.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

The methods and assumptions used by the Group in estimating fair value of the financial instruments are:

- Fixed maturity fair values are generally based upon quoted market prices. Where market prices are not readily available, fair values are estimated using either values obtained from quoted market prices of comparable securities or estimated by discounting expected future cash flows using a current market rate applicable to the yield, credit quality and maturity of the investment.
- Equity securities fair values are based upon quoted market prices.
- Mortgage loans on real estate, policyholder loans and collateral loans fair values are estimated using discounted cash flow calculations based upon prevailing market rates. Cash, short-term investments, commercial paper, other assets, liabilities and accruals carrying amounts approximate fair values.
- Notes, bonds and loans payable fair values are determined by reference to quoted market prices or estimated using discounted cash flow calculations based upon prevailing market rates. For borrowings that carry a variable rate of interest, carrying values approximate fair values.
- Fair values of annuity contracts included in policyholders' contract deposits and other funds are determined using discounted cash flow calculations based on interest rates currently offered for contracts with similar remaining maturities.
- Derivatives fair values are generally based upon quoted market prices.

The carrying amounts and fair values of the Group's financial instruments as of December 31 were as follows:

	1999		1998	
	Carrying Value £m	Fair Value £m	Restated Carrying Value £m	Restated Fair Value £m
Equity securities . . . . .	<b>18,551</b>	<b>18,551</b>	17,949	17,949
Fixed maturities (excluding mortgage-backed securities) . . . . .	<b>20,728</b>	<b>20,729</b>	19,375	19,377
Mortgage-backed securities . . . . .	<b>3,030</b>	<b>3,030</b>	4,125	4,125
Mortgage loans on real estate . . . . .	<b>464</b>	<b>464</b>	490	493
Policyholder, collateral and other loans . . . . .	<b>94</b>	<b>94</b>	135	135
Short-term investments . . . . .	<b>322</b>	<b>322</b>	175	175
Cash and cash equivalents . . . . .	<b>2,261</b>	<b>2,261</b>	1,939	1,939
Notes, long term subordinated debt, bonds and loans payable . . . . .	<b>1,326</b>	<b>1,342</b>	451	466
Policyholders' contract deposits and other funds . . . . .	<b>8,608</b>	<b>8,608</b>	9,032	9,032
Forward foreign currency contracts . . . . .	<b>23</b>	<b>23</b>	10	10
Options/futures . . . . .	<b>145</b>	<b>145</b>	70	70
Other . . . . .	<b>69</b>	<b>69</b>	6	6

### H. Concentrations of Credit Risk

The Group places cash and short-term deposits and undertakes foreign exchange contracts with a range of banks and financial institutions and controls its exposure to any one bank or financial institution. The Group's investments comprise a broad range of financial investments issued principally in the United Kingdom,

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

United States, Canada and Scandinavia. The mix of investments which include fixed maturities, equity securities and mortgage loans on real estate by geographic location were as follows at December 31:

	1999			
	Carrying Value £m	%	Fair Value £m	%
<b>By Country/Region:</b>				
United Kingdom . . . . .	21,352	50%	21,352	50%
United States . . . . .	5,971	14%	5,972	14%
Canada . . . . .	1,513	3%	1,513	3%
Australia . . . . .	1,113	3%	1,113	3%
Scandinavia . . . . .	5,029	12%	5,029	12%
Other Europe . . . . .	6,366	15%	6,366	15%
Asia . . . . .	554	1%	554	1%
Other . . . . .	875	2%	875	2%
<b>Total</b> . . . . .	<b>42,773</b>	<b>100%</b>	<b>42,774</b>	<b>100</b>
<b>By Industry:</b>				
Banks . . . . .	5,415	13%	5,415	13%
Pharmaceuticals . . . . .	1,450	3%	1,450	3%
Insurance . . . . .	1,300	3%	1,300	3%
Manufacturing . . . . .	1,393	3%	1,393	3%
Utilities . . . . .	1,704	4%	1,704	4%
Technology . . . . .	1,726	4%	1,726	4%
Chemical . . . . .	353	1%	353	1%
Construction . . . . .	507	1%	507	1%
Mining . . . . .	1,792	4%	1,792	4%
Retail . . . . .	971	2%	971	2%
Government securities . . . . .	13,229	31%	13,230	31%
Mortgage-backed securities . . . . .	3,030	7%	3,030	7%
Mortgage loans on real estate . . . . .	464	1%	464	1%
Telecommunications . . . . .	2,782	7%	2,782	7%
Services . . . . .	1,462	4%	1,462	4%
Other . . . . .	5,195	12%	5,195	12%
<b>Total</b> . . . . .	<b>42,773</b>	<b>100%</b>	<b>42,774</b>	<b>100%</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

	1998			
	Restated Carrying Value £m	%	Restated Fair Value £m	%
<b>By Country/Region:</b>				
United Kingdom . . . . .	21,814	52%	21,814	52%
United States . . . . .	6,366	15%	6,370	15%
Canada . . . . .	1,495	4%	1,495	4%
Australia . . . . .	1,052	3%	1,052	3%
Scandinavia . . . . .	4,930	12%	4,930	12%
Other Europe . . . . .	5,788	13%	5,789	13%
Asia . . . . .	445	1%	445	1%
Other . . . . .	49	0%	49	0%
<b>Total</b> . . . . .	<b>41,939</b>	<b>100%</b>	<b>41,944</b>	<b>100%</b>
<b>By Industry:</b>				
Banks . . . . .	4,793	11%	4,793	11%
Pharmaceuticals . . . . .	1,859	5%	1,859	5%
Insurance . . . . .	1,590	4%	1,590	4%
Manufacturing . . . . .	2,844	7%	2,844	7%
Utilities . . . . .	2,483	6%	2,483	6%
Technology . . . . .	1,295	3%	1,295	3%
Chemical . . . . .	403	1%	403	1%
Construction . . . . .	562	1%	562	1%
Mining . . . . .	1,354	3%	1,354	3%
Retail . . . . .	1,540	4%	1,540	4%
Government securities . . . . .	13,053	31%	13,055	31%
Mortgage-backed securities . . . . .	4,125	10%	4,125	10%
Mortgage loans on real estate . . . . .	490	1%	493	1%
Telecommunications . . . . .	1,618	4%	1,618	4%
Services . . . . .	1,272	3%	1,272	3%
Other . . . . .	2,658	6%	2,658	6%
<b>Total</b> . . . . .	<b>41,939</b>	<b>100%</b>	<b>41,944</b>	<b>100%</b>

Investments in equity securities include an investment in Chubb Corporation of **£315m** at December 31, 1999 (1998 £351m). Receivables include significant amounts due from policyholders, brokers and reinsurers. Due to the large number of policyholders, brokers and reinsurers across many geographic areas, the Group's credit exposure is minimized. At December 31, 1999 and 1998, the Group did not consider there to be any significant concentrations of credit risk.

At December 31, 1999 we have a reinsurance recoverable from a reinsurer, with a Standard & Poor's rating of AAA, of approximately **£280m**.

### *I. Reserves for Loss and Loss Adjustment Expenses*

The Group establishes its reserve for loss and loss adjustment expenses (LAE) by product, coverage and year. Loss and LAE liabilities consist of two components: case reserves and incurred but not reported (IBNR) reserves. Case reserves are estimates of future loss payments with respect to insured events that have

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

been reported to the Group. These reports may be made formally by the claimants or informally by other means, such as evaluation of claims by attorneys. The amount reserved is the amount expected to be ultimately paid. IBNR reserves are actuarially determined and reflect the estimated ultimate loss amount which will be paid by the Group and the expected change in the value of those claims which have already been reported to the insurer. Management considers many factors when establishing reserves, including (i) information from ceding companies, (ii) historical trends, such as historical claims development patterns, loss payments, pending levels of unpaid claims and product mix, (iii) internal methodologies which analyze the Group's experience with similar cases, (iv) current legal interpretations and (v) economic conditions. Based on these considerations, management believes that an adequate provision has been made for the Group's loss and LAE reserves, which on a gross basis totalled **£14,167m** (1998 £11,784m) for general (property and casualty) business and **£194m** (1998 £360m) for life and health business. Claims provisions relating to certain workers' compensation reserves in the United States, Canada and Scandinavia have been discounted as the payment pattern and ultimate costs are fixed. The amount of discount reflected in loss and LAE reserves as of December 31, 1999 was approximately **£108m** (1998 £101m).

The following analysis provides a reconciliation of the activity in the reserve for losses and loss adjustment expenses for the years ended December 31:

	<b>1999</b>	<b>Restated</b>
	<b>£m</b>	<b>1998</b>
	<b>£m</b>	<b>£m</b>
At January 1:		
Gross reserve for losses and loss adjustment expenses . . . . .	<b>12,144</b>	12,162
Less reinsurance recoverable . . . . .	<b>2,295</b>	2,310
Net reserve for losses and loss adjustment expenses . . . . .	<b>9,849</b>	9,852
Effect of foreign currency translations . . . . .	<b>15</b>	(22)
Effect of acquisitions, claim portfolio transfers and other reclassifications . . . . .	<b>1,533*</b>	1
Loss and loss adjustment expenses incurred:		
Current year . . . . .	<b>5,573</b>	5,367
Prior years . . . . .	<b>(184)</b>	(299)
Total incurred . . . . .	<b>5,389</b>	5,068
Loss and loss adjustment expenses paid:		
Current year . . . . .	<b>2,618</b>	2,371
Prior years . . . . .	<b>3,007</b>	2,679
Total paid . . . . .	<b>5,625</b>	5,050
At December 31:		
Net reserve for losses and loss adjustment expenses . . . . .	<b>11,161</b>	9,849
Plus reinsurance recoverable . . . . .	<b>3,200</b>	2,295
Gross reserve for losses and loss adjustment expenses . . . . .	<b>14,361</b>	12,144

\* Attributable mainly to the acquisitions discussed in note 24.

Estimation of asbestos and environmental loss reserves is subject to a significant level of uncertainty, as these claims cannot be estimated by conventional reserving techniques. The following factors are evaluated by the Group in projecting the ultimate claims cost for asbestos and environmental claims: available insurance coverage; limits and deductibles; an analysis of each policyholder's potential liability; jurisdictional involvement; past and projected future claim activity; past settlement values of similar claims; allocated claim

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

adjustment expense; potential role of other insurance; and applicable coverage defences, if any. Once the gross ultimate exposure for indemnity and allocated claim adjustment expense is determined for a policyholder by policy year, a ceded projection is calculated based on any applicable facultative and treaty reinsurance, and past ceded experience. In addition, a similar review is conducted for asbestos property damage claims.

The reserves carried for asbestos and environmental claims at December 31, 1999 are the Group's best estimate of ultimate loss and loss adjustment expenses based upon known facts and current law. However, the conditions surrounding the final resolution of these claims continue to change. Because of future unknowns, additional liabilities may arise for amounts in excess of the current reserves. These additional amounts, or a range of these additional amounts, cannot now be reasonably estimated, and could result in a liability exceeding reserves by an amount that would be material to the Group's operating results in a future period. However, the Group believes that it is not likely that these claims will have a material adverse effect on the Group's financial condition and liquidity.

Significant delays occur in the notification of claims and a substantial measure of experience and judgement is involved in assessing outstanding liabilities, the ultimate cost of which cannot be known with certainty at the balance sheet date. As the reserve for unpaid losses and LAE is determined on the basis of information currently available, it is inherent in the nature of the business written that the ultimate liabilities vary as a result of subsequent development. Management believes, based on the information currently available, that the Group's loss reserves are adequate. Loss reserve estimates are regularly reviewed and updated, using the most current information available to management. Any adjustments resulting from changes in reserve estimates are reflected in the consolidated statement of income.

### *J. Reserve for Future Life and Health Policy Benefits*

The analysis of future life and health policy benefits at December 31 was as follows:

	<b>1999</b>	<b>Restated</b>
	<b>£m</b>	<b>1998</b>
	<u>£m</u>	<u>£m</u>
Reserve for future life and health policy benefits:		
Long duration contracts . . . . .	<b>15,123</b>	14,828
Short duration contracts . . . . .	<b>310</b>	<u>277</u>
<b>Total</b> . . . . .	<b><u>15,433</u></b>	<u>15,105</u>

Long duration contract liabilities included in future policy benefits result from traditional life products. Short duration contract liabilities are primarily group life and health products.

Reserves for future life and health policy benefits and claims are established based upon the Group's best estimates of mortality, morbidity, lapses and investment income, with appropriate provision for adverse deviation. Actual experience in a particular period may be worse than assumed experience and, consequently, may adversely affect the Group's operating results for such period. The average rate of assumed investment yields varies between life insurance businesses around the Group. The liability for future life and health policy benefits has been established based on the following assumptions: (i) interest rates, which vary by business, year of issuance and products, range from **1.5%** to **11.1%** (1998 2.5% to 11.1%) for the Group's principal businesses in the UK and Denmark (ii) mortality, morbidity and surrender rates are based upon actual experience by geographical area modified to allow for variations in policy form.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### *K. Policyholders' Contract Deposits and Other Funds*

Policyholders' contract deposits and other funds comprise primarily investment contracts.

The assumptions for interest rates used to determine the liability for policyholders' contract deposits has been established using interest rates that vary by business, year of issuance and product type, and credited interest rate guarantees vary by product.

### *L. Undistributed Policyholder Allocations*

A portion of the life insurance issued by the Group is in the form of participating insurance. A participating contract gives the contract holder the right to a share of the profits earned on the group of contracts in which the contract is included. Participation rights of participating contracts issued by the Group vary by contract. The bonuses that may be declared are highly correlated to the overall performance of the underlying assets and liabilities of the fund (company) in which the contracts participate and are subject to normal variability and volatility. Bonuses are declared by the applicable company's directors taking account of actuarial valuations considering a long term view of the anticipated performance of the fund and the policyholders' reasonable expectations. Amounts not yet declared payable to the policyholders are segregated for future determination by the respective territories. Once declared as bonuses these amounts are added to the reserve for future life and health policyholders' benefits and policy contract deposits.

### *M. Reinsurance*

Letters of credit securing reinsurance recoverables amounted to **£259m** (1998 £225m).

The Group cedes reinsurance to Lloyd's syndicates. As of December 31, 1999 the aggregate exposure in respect of reinsurance ceded to Lloyd's syndicates including estimated reinsurance recoveries for losses incurred but not reported was approximately **£78m** (1998 £42m). No specific bad debt provision has been established for amounts due from Lloyd's syndicates as the amounts are considered to be recoverable.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

The general and life premiums written and earned, and loss and loss adjustment expenses incurred for the years ended December 31 are as follows:

	Premiums Written & Policy Fees		Premiums Earned & Policy Fees		Loss & LAE Incurred & Life Policyholder Benefits	
	1999	1998	1999	1998	1999	Restated 1998
	£m	£m	£m	£m	£m	£m
<b>General/Property &amp; Casualty:</b>						
Direct .....	<b>8,148</b>	7,701	<b>8,025</b>	7,605	<b>6,300</b>	5,650
Assumed .....	<b>311</b>	482	<b>292</b>	459	<b>315</b>	401
Ceded .....	<b>(1,102)</b>	(1,217)	<b>(1,097)</b>	(1,278)	<b>(1,226)</b>	(983)
<b>Total</b> .....	<b><u>7,357</u></b>	<u>6,966</u>	<b><u>7,220</u></b>	<u>6,786</u>	<b><u>5,389</u></b>	<u>5,068</u>
Ratio of assumed to net written/earned premium and policy fees .....	<b>4.2%</b>	6.9%	<b>4.0%</b>	6.8%		
<b>Life:</b>						
Direct .....	<b>1,650</b>	1,646	<b>1,650</b>	1,646	<b>2,056</b>	3,450
Ceded .....	<b>(120)</b>	(105)	<b>(120)</b>	(105)	<b>(76)</b>	(137)
<b>Total</b> .....	<b><u>1,530</u></b>	<u>1,541</u>	<b><u>1,530</u></b>	<u>1,541</u>	<b><u>1,980</u></b>	<u>3,313</u>
	<b><u>8,887</u></b>	<u>8,507</u>	<b><u>8,750</u></b>	<u>8,327</u>	<b><u>7,369</u></b>	<u>8,381</u>

There was no assumed life business for the year ended December 31, 1999 and 1998.

Reinsurance recoverables as of December 31 consist of the following:

	1999 £m	1998 £m
Unearned premium reserves .....	<b>507</b>	367
Reserve for loss and loss adjustment expenses .....	<b>3,214</b>	2,295
Reserve for future life and health policy benefits .....	<b>394</b>	394
Reinsurance recoverable on claims paid .....	<b>873</b>	734
	<b><u>4,988</u></b>	<u>3,790</u>

### *N. Value of Long Term (Life) Business (Present Value of Life Profits Business)*

The present value of profits (PVP) of acquired insurance in-force is amortized over the premium recognition period of the policies acquired. Discount rates of between 8% and 11.5% have been used in determining the present value of future profits. Amortization expense is estimated to total £127m for the years 2000 to 2004. The interest accrued was at an interest rate of **7.4%** in 1999 (1998 7.0%).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

The following is a summary of the changes in the present value of profits of acquired insurance contracts for the years ended December 31:

	<b>1999</b>	<b>Restated</b>
	<b>£m</b>	<b>1998</b>
		<b>£m</b>
Present value of profits of acquired life (long term) business as of January 1 . . . . .	<b>136</b>	112
Interest accrued . . . . .	<b>9</b>	5
Additions as a result of acquisitions . . . . .	<b>152</b>	39
Reduction as a result of disposal . . . . .	<b>(2)</b>	—
Amortization . . . . .	<b>(11)</b>	(20)
<b>Present value of profits of acquired life (long term) business as of</b>		
<b>December 31 . . . . .</b>	<b><u>284</u></b>	<b><u>136</u></b>

### O. Pension Plans

The Group sponsors a variety of pension benefit and retirement indemnity plans covering the majority of its employees. The specific features of these plans vary in accordance with the regulations of the country in which the employees are located, although generally plans covering salaried personnel provide retirement benefits based on career average or final pay compensation as defined within the provisions of the individual plans, while plans covering hourly employees provide benefits based on years of service. Eligibility for participation in the various plans is generally based on either completion of a specified period of continuous service or date of hire, subject to age limitation.

The range of weighted average assumptions associated with the projected benefit obligation and expected long term rate of return on plan assets at December 31, 1999 were as follows:

	<b>Range of Plans*</b>
Discount rate . . . . .	5.50-8.00%
Rates of increase in compensation levels . . . . .	3.50-6.50%
Expected long term rate of return on assets . . . . .	5.00-10.00%

\* The range reflects the local socio-economic environments in which the Group operates.

The following table sets forth the funded status of the various pension plans and the amounts recognized in the accompanying condensed consolidated balance sheets as of December 31:

	<b>1999</b>	<b>1998</b>
	<b>£m</b>	<b>£m</b>
Plan assets at fair value* . . . . .	<b>5,143</b>	4,408
Projected benefit obligation . . . . .	<b>(3,567)</b>	(3,772)
Plan assets in excess of benefit obligations . . . . .	<b>1,576</b>	636
Unrecognized transition asset . . . . .	<b>(224)</b>	(278)
Unrecognized prior service cost . . . . .	<b>2</b>	3
Unrecognized net (gain)/loss . . . . .	<b>(683)</b>	214
Prepaid pension asset . . . . .	<b><u>671</u></b>	<b><u>575</u></b>

\* Plan assets are invested primarily in fixed maturity securities and equity securities.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

Net pension cost for the years ended December 31 included the following components:

	1999 £m	1998 £m	1997 £m
Service cost . . . . .	112	94	84
Interest cost on benefit obligations . . . . .	192	206	215
Expected return on plan assets . . . . .	(348)	(321)	(288)
Amortization of the initial transition asset . . . . .	(56)	(56)	(56)
Recognition of net (gain)/loss . . . . .	2	—	—
<b>Net periodic pension credit</b> . . . . .	<b>(98)</b>	<b>(77)</b>	<b>(45)</b>

The following table sets forth the reconciliation of the above projected benefit obligations and fair value of plan assets as at December 31:

	1999 £m	1998 £m
<b>Change in benefit obligation:</b>		
Benefit obligation, at January 1 . . . . .	3,772	3,003
Service cost . . . . .	112	94
Interest cost . . . . .	192	206
Amendments . . . . .	—	2
Curtailment charge . . . . .	18	23
Acquisitions/sales . . . . .	3	—
Actuarial (gain)/loss . . . . .	(370)	645
Benefits paid . . . . .	(185)	(177)
Foreign currency exchange rate changes . . . . .	25	(24)
<b>Benefit obligation, at December 31</b> . . . . .	<b>3,567</b>	<b>3,772</b>
<b>Change in plan assets:</b>		
Plan assets at fair value, January 1 . . . . .	4,408	4,051
Actual return on plan assets . . . . .	875	536
Employer contributions . . . . .	9	19
Acquisitions/sales . . . . .	5	—
Benefits paid . . . . .	(185)	(177)
Foreign currency exchange rate changes . . . . .	31	(21)
<b>Plan assets at fair value, at December 31</b> . . . . .	<b>5,143</b>	<b>4,408</b>

Pension costs were increased in 1999 as a result of additional benefits granted following redundancy of certain employees in the UK, resulting in a curtailment charge of **£18m**. Pension costs were increased in 1998 as a result of a voluntary early retirement incentive program offered to certain employees in the US resulting in a curtailment charge of £23m.

Liabilities and assets were measured as of December 31, 1999 and 1998 for the US and UK plans, which comprise roughly 95% of both assets and liabilities. For the Australian, Canadian and New Zealand plans, varying methods and measurement dates were used. Measurement dates ranged from December 1, 1995 to December 31, 1997 for these plans. Estimation techniques were used to adjust liabilities and assets for the plans of these countries to conform with the appropriate US GAAP basis, as regards methodology, timing and discount rate selection.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

### P. Other Post-Retirement Benefits

The Group provides post-retirement healthcare and life insurance benefits to certain current and retired US and Canadian employees. The benefits are not pre-funded. Life insurance benefits, which provide varying levels of coverage, are provided at no cost to retirees. Healthcare benefits, which also provide varying levels of coverage, require retiree contributions in certain instances. Benefits are generally payable for life. During 1998, the Group adopted an amendment which shifted a large portion of pre-65 medical coverage costs to a qualified pension plan for certain US participants. In addition, the Group offered a voluntary early retirement incentive program to certain US employees during 1998. During 1999 the Group disposed of its US Life operations, resulting in a curtailment benefit of **£2m**.

The other post-retirement benefit expense was **£6m** for the year ended December 31, 1999 (1998 £5m, 1997 £4m). The components of these expenses are not shown separately, as they are insignificant.

The post-retirement benefit obligation was **£47m** at December 31, 1999 (1998 £43m). The weighted-average discount rates used in determining the post-retirement benefit obligation ranged from **7.0%** to **8.0%** in 1999 (6.75% to 8.5% in 1998). The weighted average rate of assumed increases in compensation levels ranged from 5% to 5.5%. The average health care cost trend rate assumed was 7.5% moving down to 5.5% over 6 years. The health care cost trend rate assumption has a significant effect on the amounts reported. Increasing the assumed medical care cost trend rates by one percentage point would increase the post-retirement benefit obligation as of December 31, 1999 by **£4m** (1998 £5m), and would not have a material impact on the service and interest cost components of post-retirement benefit expense. Decreasing the assumed health care cost trend rates by one percentage point would decrease the post retirement benefit obligation as of December 31, 1999 by **£3m**, and would not have a material impact on the service and interest cost components of post-retirement benefit expense.

### Q. Operating Leases

The Group leases its real estate held for investment to outside parties under non-cancellable operating leases as lessor. The Group has entered into various operating leases as lessee for office space and certain computer and other equipment. Future rental payments under non-cancellable leases with terms in excess of one year were as follows as of December 31:

	<b>1999</b>
	<b>£m</b>
2000 .....	119
2001 .....	104
2002 .....	90
2003 .....	75
2004 .....	68
Thereafter .....	398
<b>Total</b> .....	<b>854</b>

### R. Income Taxes

Under UK GAAP, deferred taxes are accounted for using the liability method to the extent that it is considered probable that a liability or asset will crystallize in the foreseeable future. Under US GAAP, deferred taxes are accounted for using the liability method on all temporary differences and the deferred tax assets are recognized where it is more likely than not that they will be realized.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

A summary of the US GAAP income tax expense within the income statement for the years ended December 31 is shown below:

	<b>1999</b>	<b>1998</b>	<b>1997</b>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>Current tax</b>			
United Kingdom . . . . .	<b>253</b>	457	230
Foreign . . . . .	<b>297</b>	223	277
<b>Deferred tax</b>			
United Kingdom . . . . .	<b>132</b>	86	204
Foreign . . . . .	<b>(52)</b>	49	(53)
	<u><b>630</b></u>	<u>815</u>	<u>658</u>

Deferred income taxes reflect the impact for financial statement reporting purposes of temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities. US GAAP components of the net deferred income tax asset and liability were as follows:

	<b>1999</b>	<b>1998</b>
	<u>£m</u>	<u>Restated £m</u>
<b>Deferred tax liability</b>		
Unrealized investment gains, net. . . . .	<b>1,862</b>	1,886
Post-retirement benefits . . . . .	<b>190</b>	156
Deferred acquisition costs . . . . .	<b>181</b>	173
Equalization reserves . . . . .	<b>163</b>	127
Other deferred tax liabilities . . . . .	<b>214</b>	172
<b>Total deferred tax liability . . . . .</b>	<u><b>2,610</b></u>	<u>2,514</u>
<b>Deferred tax asset</b>		
Depreciation on land and buildings . . . . .	<b>98</b>	167
Income accelerated for tax . . . . .	<b>158</b>	163
Expenditure deferred for tax . . . . .	<b>231</b>	107
Loss carryforwards (net of valuation allowance) . . . . .	<b>82</b>	49
Other deferred tax assets . . . . .	<b>80</b>	30
<b>Total deferred tax asset . . . . .</b>	<u><b>649</b></u>	<u>516</u>
<b>Net deferred tax liability . . . . .</b>	<u><b>1,961</b></u>	<u>1,998</u>

SFAS No. 109 requires the establishment of a valuation allowance for deferred income tax assets if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. Accordingly, the Group has established a valuation allowance of **£118m** as of December 31, 1999 (1998 £113m). This valuation allowance reflects the portion of deferred income tax benefits which may not be realized mainly due to the expiration of tax loss carryforwards on certain of the Group's subsidiaries and overseas branches.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

A reconciliation of income tax expense computed by applying the UK income tax rate of **30.25%** in 1999 (31% in 1998, 31.5% in 1997) to income from operations before income taxes for the years ended December 31 is as follows:

US GAAP Tax Reconciliation	1999		1998		1997	
	£m	%	£m	%	£m	%
Income before income taxes, minority interests and extraordinary item . . . . .	1,545		1,650		1,384	
Less tax recoveries from life policyholders included within total profits . . . . .	(260)		(340)		(428)	
Income taxable at corporate rates . . . . .	<u>1,285</u>	<u>100.0</u>	<u>1,310</u>	<u>100.0</u>	<u>956</u>	<u>100.0</u>
Income tax at corporate rates . . . . .	389	30.3	406	31.0	301	31.5
<b>Reconciling items:</b>						
Tax exempt revenues and expenses . . . . .	18	1.4	17	1.3	33	3.4
Changes in statutory rate applied to deferred tax balances brought forward . . . . .	—	—	(35)	(2.7)	(54)	(5.6)
UK dividends taxed at lower rates . . . . .	(24)	(1.9)	(22)	(1.6)	(18)	(1.8)
Losses arising in 1997 in overseas subsidiary, restricted in 1998 as a result of legislative change . . . . .	—	—	29	2.2	(62)	(6.5)
Change in valuation allowance . . . . .	5	0.4	34	2.6	38	4.0
Adjustment to prior year provision . . . . .	18	1.4	12	0.9	(17)	(1.8)
Other . . . . .	<u>(36)</u>	<u>(2.8)</u>	<u>34</u>	<u>2.5</u>	<u>9</u>	<u>0.9</u>
<b>Total</b> . . . . .	<u>370</u>	<u>28.8</u>	<u>475</u>	<u>36.2</u>	<u>230</u>	<u>24.1</u>
Add tax recoveries from life policyholders included within total profits* . . . . .	<u>260</u>	<u>20.2</u>	<u>340</u>	<u>26.0</u>	<u>428</u>	<u>44.7</u>
<b>Total income tax expense</b> . . . . .	<u><u>630</u></u>	<u><u>49.0</u></u>	<u><u>815</u></u>	<u><u>62.2</u></u>	<u><u>658</u></u>	<u><u>68.8</u></u>

\* The policyholder tax has been shown as a separate item because both income before tax and the income tax expense have been inflated by this tax. The tax is payable by the life companies within the Group, but is effectively recovered from the policyholders through charges through the contract terms.

The Group operates in a number of different territories and is subject to routine audits and examinations by the relevant local fiscal authorities. Provision has been made within these financial statements, on a realistic basis, for potential liabilities arising from such audits and examinations currently in progress.

### S. Equity Method Investments

Equity method investments have been accounted for on a US GAAP basis.

### T. New US GAAP Accounting Pronouncements

During 1999, the Group adopted American Institute of Certified Public Accountants (AICPA) Statement of Position 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" ("SOP 98-1") for its US GAAP reporting. Adoption of SOP 98-1 did not have a material impact on the condensed consolidated US GAAP financial statements.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", which establishes accounting and reporting standards for derivative financial instruments, including certain derivatives embedded in other contracts, and for hedging activities. SFAS No. 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. For fair-value hedge transactions in which the Group is hedging changes in the fair value of an asset, liability, or firm commitment, changes in the fair value will generally be offset in the income statement by changes in the hedged item fair value. For cash flow hedge transactions, in which the Group is hedging the variability of cash flows related to a variable rate asset, liability or a forecasted transaction, changes in the fair value of the derivative instrument will be reported in other comprehensive income. The gains and losses on the derivative instrument that are reported in other comprehensive income will be reclassified as earnings in the periods in which earnings are impacted by the variability of the cash flows of the hedged item. The ineffective portion of all hedges will be recognized in current-period earnings. SFAS No. 133 as amended requires adoption in fiscal years beginning after June 15, 2000. Retroactive application to financial statements of prior periods is prohibited. The Group expects to adopt SFAS No. 133 effective January 1, 2001. The Group has not yet determined the effects of adoption of SFAS No. 133 on its consolidated balance sheet or statement of income on a US GAAP basis.

The AICPA has issued SOP 98-7 "Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk". The SOP is effective for financial statements for years beginning after June 15, 1999. The SOP provides guidance on how to account for insurance and reinsurance contracts that do not transfer insurance risk, and applies to all entities and all insurance and reinsurance contracts that do not transfer insurance risk as defined in SFAS No. 113, with the exception of long-duration life and health insurance contracts. The statement will require minor changes to the Group's current financial statement disclosures and will not have a material impact on the results of operations or financial position of the Group.

### 51. Principal Associated Undertakings

	<u>Country</u>	<u>Holding</u>
<b>Principal associated undertakings</b> (see notes below)		
Federal Phoenix Assurance Co Inc (November 30, 1999) . . . . .	Philippines	40.0%
Intrepid Re Holdings Limited . . . . .	Bermuda	38.5%
Mutual & Federal Investments Ltd . . . . .	South Africa	49.0%
Nissan Insurance Company (Europe) Ltd . . . . .	Great Britain	24.8%
PT Royal & Sun Alliance Indrapura Insurance . . . . .	Indonesia	46.3%
Royal and Sun Alliance Insurance (Malaysia) Bhd . . . . .	Malaysia	45.0%
Syn Mun Kong Insurance Public Company Limited (September 30, 1999) . . . . .	Thailand	20.0%
<b>Other significant shareholdings</b> (see notes below)		
Rimac-Internacional Compania de Seguros y Reaseguros . . . . .	Peru	14.5%
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 December 31, 1999, the relevant accounting date is shown in brackets.
2. The countries shown are those of incorporation and principal operation. The Company shown as incorporated in Great Britain is registered in England.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

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 under US GAAP as we are unable to exercise significant influence. This mirrors the treatment under UK GAAP, where it is also accounted for as an investment because of the disposition of shareholdings.

### 52. Principal Subsidiaries

		Principal activity
<b>United Kingdom</b>	Royal Insurance Holdings plc*	Holding company
	Royal & Sun Alliance Insurance plc	General insurance
	British Aviation Insurance Company Ltd (57.1%)	General insurance
	FirstAssist Group Ltd	Insurance services
	The Globe Insurance Company Ltd	General insurance
	Legal Protection Group Holdings Ltd	Holding company
	The London Assurance	General insurance
	The Marine Insurance Company Ltd	General insurance
	RSA Engineering Ltd	General insurance
	Phoenix Assurance plc	Composite insurance
	Royal International Insurance Holdings Ltd	General insurance
	Royal & Sun Alliance Reinsurance Limited	General insurance
	Royal & Sun Alliance Property Services Ltd	Estate agencies
	Royal & Sun Alliance Life & Pensions Ltd	Life insurance
	Royal & Sun Alliance Linked Insurances Ltd	Life insurance
	Sun Alliance and London Insurance plc	General insurance
	Sun Alliance and London Assurance Company Ltd	Life insurance
	Royal & Sun Alliance Life Holdings Ltd	Holding company
	Royal & Sun Alliance Trust Company Ltd*	Trust company
	Sun Insurance Office Ltd	General insurance
Swinton (Holdings) Ltd	Holding company	
<b>Argentina</b>	Royal & Sun Alliance Seguros (Argentina) SA	General insurance
	RSA Marketing (Latin America) SA (86.5%)	General insurance
<b>Australia</b>	Royal & Sun Alliance Australia Holdings Ltd	Holding company
	Royal & Sun Alliance Insurance Australia Ltd	General insurance
	Royal & Sun Alliance Life Assurance Australia Ltd	Life insurance
	Tyndall Australia Limited	Life insurance
<b>Bahamas</b>	Royal & Sun Alliance Insurance (Bahamas) Ltd (65.0%)	General insurance
<b>Brazil</b>	Royal & Sun Alliance Seguros (Brazil) SA	General insurance
<b>Canada</b>	Roins Financial Services Ltd	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
	Royal & Sun Alliance Life Insurance Company of Canada	Life insurance
	Western Assurance Company	General insurance

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued**

		<u>Principal activity</u>
<b>Chile</b>	Compañía de Seguros La Republica SA (64.0%)	General insurance
	Compañía de Seguros de Vida La Construcción (51.0%)	Life insurance
<b>Colombia</b>	Royal & Sun Alliance Seguros (Colombia) SA (79.4%)	General insurance
<b>Denmark</b>	Codan Forsikring A/S (71.7%)	General insurance
	A/S Forsikringsselskabet Codan Liv (71.7%)	Life insurance
<b>France</b>	Royal & Sun Alliance SA	General insurance
<b>Germany</b>	Securitas Bremer Allgemeine Versicherungs AG (99.9%)	General insurance
	Securitas-Gilde Lebensversicherung AG (99.8%)	Life insurance
<b>Guernsey</b>	Insurance Corporation of Channel Islands Ltd	General insurance
<b>Hong Kong</b>	Royal & Sun Alliance Insurance (Hong Kong) Ltd	General insurance
<b>Ireland</b>	Royal & Sun Alliance Eurolife Ltd	Life insurance
<b>Isle of Man</b>	Royal & Sun Alliance International Financial Services Ltd	Life insurance
	Tower Insurance Company Ltd	General insurance
<b>Italy</b>	Lloyd Italico Assicurazioni SpA	General insurance
	Lloyd Italico Vita SpA	Life insurance
	Royal & Sun Alliance Vita SpA	Life insurance
	Sun Alliance Vita SpA	Life insurance
<b>Netherlands</b>	Royal & SunAlliance Schadeverzekering	General insurance
	Royal & SunAlliance Levensverzekering NV	Life insurance
<b>Netherlands Antilles</b>	Royal & Sun Alliance Insurance (Antilles) NV (51%)	General insurance
<b>New Zealand</b>	Royal & Sun Alliance Insurance (New Zealand) Ltd	General insurance
	Royal & Sun Alliance Life & Disability (New Zealand) Ltd	Life insurance
<b>Peru</b>	Compania de Seguros La Fenix Peruana (64.9%)	General insurance
<b>Puerto Rico</b>	Royal & Sun Alliance Insurance (Puerto Rico) Company Inc (94.3%)	General insurance
<b>Saudi Arabia</b>	Al-Alamiya Insurance Co Ltd (EC) (50.01%)	General insurance
<b>Singapore</b>	Royal & Sun Alliance Insurance (Singapore) Ltd	General insurance
<b>Spain</b>	Regal Insurance Club Compañía Española de Seguros SA	General insurance
	Royal & Sun Alliance SA (99.9%)	General insurance
	Royal & Sun Alliance Vida y Pensiones SA (99.9%)	Life insurance
<b>Sweden</b>	Holmia Försäkring AB (71.7%)	General insurance
	Trygg-Hansa Försäkrings AB, Publikt (71.7%)	General Insurance
<b>United States of America</b>	Royal & Sun Alliance USA Inc	Holding company
	Royal & Sun Alliance Personal Insurance Company	General insurance
	Royal Indemnity Company	General insurance
	Orion Capital Corporation	Holding company
	Security Insurance Company of Hartford	General insurance
	Guaranty National Insurance Company	General insurance

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, Continued

		<u>Principal activity</u>
<b>Uruguay</b>	Royal & Sun Alliance Seguros (Uruguay) SA	General insurance
<b>Venezuela</b>	Royal & Sun Alliance Seguros (Venezuela) SA (99.4%)	General insurance

### Notes:

1. All UK companies are incorporated in Great Britain and are registered in England.
2. \*100% direct subsidiaries 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 of these materially affects the results or assets of the Group.

**ROYAL & SUN ALLIANCE INSURANCE GROUP PLC**

**Unaudited Interim Consolidated Financial Statements**

**for the six months ended June 30, 2000**

# Independent Review Report

## Introduction

We have been instructed by the Company to review the financial information set out on pages F-112 to F-115 of the Statutory Financial Information and we have read the other information contained in the interim report for any apparent misstatements or material inconsistencies with the financial information.

## Directors' responsibilities

The interim report, including the financial information contained therein, is the responsibility of, and has been approved by the directors. The Listing Rules of the Financial Services Authority require that the accounting policies and presentation applied to the interim figures should be consistent with those applied in preparing the preceding annual accounts except where any changes, and the reasons for them, are disclosed.

## Review work performed

We conducted our review in accordance with guidance contained in Bulletin 1999/4 issued by the Auditing Practices Board. A review consists principally of making enquiries of management and applying analytical procedures to the financial information and underlying financial data, and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit performed in accordance with Auditing Standards and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the financial information.

## Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the six months ended 30 June 2000.

PricewaterhouseCoopers  
Chartered Accountants  
London  
2nd August 2000

## Consolidated Profit and Loss Account

	6 months to 30 June 2000 (unaudited) £m	6 months to 30 June 1999 (unaudited) £m	12 months to 31 Dec 1999 (audited) £m
General business net premiums written . . . . .	4,293	3,686	7,159
Life business net premiums written . . . . .	1,750	1,561	3,284
General business result . . . . .	218	168	312
Life business result . . . . .	124	133	243
Other activities result . . . . .	(22)	14	11
Group operating result (based on longer term investment return) . . . . .	320	315	566
Amortization of goodwill . . . . .	(26)	(2)	(14)
Amortization of goodwill in acquired claims provisions . . . . .	(29)	—	(12)
Amortization of present value in acquired in-force business . . . . .	(4)	(2)	(4)
Interest on long term subordinated liabilities . . . . .	(27)	—	(10)
Claims equalization provision . . . . .	10	(5)	(12)
Reorganization costs . . . . .	(31)	—	(52)
Other items . . . . .	2	—	(4)
Group operating profit (based on longer term investment return) . . . . .	215	306	458
Short term investment fluctuations . . . . .	(199)	123	(80)
Profit on ordinary activities before tax . . . . .	16	429	378
Tax on Group operating result (based on longer term investment return) . . . . .	(97)	(99)	(175)
Tax on other profits/(losses) . . . . .	31	(121)	(95)
Profit/(loss) on ordinary activities after tax . . . . .	(50)	209	108
Attributable to equity minority interests . . . . .	(7)	(21)	(21)
Profit/(loss) for the period attributable to shareholders . . . . .	(57)	188	87
Cost of preference dividend . . . . .	(5)	(5)	(9)
Cost of ordinary dividend . . . . .	(126)	(120)	(353)
Cost of special dividend . . . . .	—	(751)	(751)
Transfer from retained profits . . . . .	(188)	(688)	(1,026)
Group operating earnings after tax per ordinary share (based on longer term investment return) . . . . .	13.2p	13.8p	25.7p
Earnings per ordinary share . . . . .	(4.4)p	11.9p	5.3p
Diluted earnings per ordinary share . . . . .	(4.4)p	11.7p	5.2p

## Statement of Total Recognized Gains and Losses

	6 months to 30 June 2000 (unaudited) £m	6 months to 30 June 1999 (unaudited) £m	12 months to 31 Dec 1999 (audited) £m
Profit/(loss) for the period/year attributable to shareholders . . . . .	(57)	188	87
Movement in the value of long term business . . . . .	(16)	75	169
Exchange . . . . .	167	84	31
Total shareholders' consolidated recognized gains arising in the period . . . . .	94	347	287

## Movement in Shareholders' Funds

	6 months to 30 June 2000 (unaudited) £m	6 months to 30 June 1999 (unaudited) £m	12 months to 31 Dec 1999 (audited) £m
Shareholders' funds at January 1 . . . . .	6,484	7,269	7,269
Share capital issued and increase in share premium . . . . .	5	6	15
Total shareholders' recognized gains . . . . .	94	347	287
Goodwill written back . . . . .	—	—	26
Dividends . . . . .	(131)	(876)	(1,113)
Shareholders' funds at June 30/December 31 . . . . .	<u>6,452</u>	<u>6,746</u>	<u>6,484</u>

## Summary Consolidated Balance Sheet

	30 June 2000 (unaudited) £m	30 June 1999 (unaudited) £m	31 Dec 1999 (audited) £m
<b>ASSETS</b>			
Intangible assets . . . . .	1,051	219	1,035
Investments			
Land and buildings . . . . .	523	537	519
Interests in associated undertakings . . . . .	212	355	221
Other financial investments—equities . . . . .	4,603	5,033	4,866
—fixed interest . . . . .	10,111	8,892	9,912
—other . . . . .	856	917	883
Value of long term business . . . . .	<u>1,765</u>	<u>1,634</u>	<u>1,784</u>
	<b>18,070</b>	17,368	18,185
Reinsurers' share of technical provisions . . . . .	3,912	2,701	3,690
Debtors . . . . .	5,411	5,050	4,935
Other assets . . . . .	696	556	754
Prepayments and accrued income . . . . .	1,203	1,087	1,122
Long term business policyholders' assets . . . . .	<u>42,029</u>	<u>40,173</u>	<u>40,485</u>
Total assets . . . . .	<u>72,372</u>	<u>67,154</u>	<u>70,206</u>
<b>LIABILITIES</b>			
Shareholders' funds . . . . .	6,452	6,746	6,484
Equity minority interests in subsidiaries . . . . .	420	302	406
Long term subordinated liabilities . . . . .	782	—	610
Total capital and reserves and long term subordinated liabilities . . . . .	<u>7,654</u>	<u>7,048</u>	<u>7,500</u>
Technical provisions . . . . .	19,072	15,843	18,493
Claims equalization provisions . . . . .	249	256	259
Borrowings . . . . .	565	552	671
Other liabilities . . . . .	2,803	3,282	2,798
Long term business policyholders' liabilities . . . . .	<u>42,029</u>	<u>40,173</u>	<u>40,485</u>
Total liabilities . . . . .	<u>72,372</u>	<u>67,154</u>	<u>70,206</u>

## Note

The long term business policyholders' assets are presented before elimination of balances held between policyholders and shareholders.

## Summary Shareholders' Cash Flow Statement

	6 months to 30 June 2000 (unaudited) £m	6 months to 30 June 1999 (unaudited) £m	12 months to 31 Dec 1999 (audited) £m
Net cash (outflow)/inflow from operating activities . . . . .	(88)	286	320
Dividends from associates . . . . .	—	—	56
Servicing of finance . . . . .	(31)	(10)	(36)
Taxation paid . . . . .	(92)	(42)	(145)
Capital expenditure . . . . .	(39)	(31)	(83)
Acquisitions and disposals . . . . .	(7)	(372)	(1,482)
Dividends paid on equity shares . . . . .	<u>(232)</u>	<u>(989)</u>	<u>(1,109)</u>
	<b>(489)</b>	<b>(1,158)</b>	<b>(2,479)</b>
Issue of ordinary share capital . . . . .	5	5	15
Issue of subsidiary of ordinary share capital to minorities . . . . .	—	—	30
Issue of long term subordinated liabilities . . . . .	<b>146</b>	—	615
Purchase of own shares . . . . .	<u>(22)</u>	<u>—</u>	<u>(29)</u>
Cash flow (pre investment) . . . . .	<u><b>(360)</b></u>	<u><b>(1,153)</b></u>	<u><b>(1,848)</b></u>
Investment activities			
Sales of investments . . . . .	<b>(469)</b>	(1,074)	(1,626)
Reduction/(increase) in borrowings . . . . .	<u><b>109</b></u>	<u>(79)</u>	<u>(222)</u>
	<u><b>(360)</b></u>	<u><b>(1,153)</b></u>	<u><b>(1,848)</b></u>

### Note

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

## **Explanatory Notes to the Financial Information**

### **1. Accounting Policies**

There have been no significant changes in accounting policy in the period ended 30 June 2000. A minor accounting policy change has been made during the quarter in respect of the treatment of group risk business within UK life new business sales which is now treated as single premium rather than annual premium business, reflecting the fact that there is no contractual obligation on policyholders to renew. This change has no impact on this interim statement.

### **2. Longer Term Investment Return**

The Group operating result (based on LTIR) is the most appropriate measure used internally to recognize the performance of the operations. For General Insurance business, this result comprises the underwriting result (excluding changes in equalization provisions) together with the longer term investment return (see below) on the assets backing both the general business liabilities and the risk based capital required to support these businesses.

The main items excluded from the Group operating result (based on LTIR), but included in the profit on ordinary activities before tax are the balance of the investment return for the period (which includes realized and unrealized investment gains on a market to market value basis and investment income), the changes in equalization provisions, reorganization costs, amortization of purchased goodwill (including goodwill in acquired claims provisions) and purchased value of long term business, long term subordinated debt interest and profits and losses arising on the disposal of businesses.

The longer term investment return is calculated in accordance with the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers. The objective of calculating this return is to recognise the total investment return whilst avoiding the distortions of short term investment market fluctuations.

### **3. Year End Results 1999**

The results for the year ended 31 December 1999, which have been included as comparatives in the interim results, are not statutory accounts but have been abridged from the statutory accounts. A copy of the statutory accounts for that year, on which the auditors' report gave an unqualified opinion and did not contain a statement under Sections 237(2) or 237(3) of the Companies Act 1985, has been delivered to the Registrar of Companies.

## **REPORT OF INDEPENDENT ACCOUNTANTS ON FINANCIAL STATEMENT SCHEDULES**

To the Board of Directors and Members of Royal & Sun Alliance Insurance Group plc

Our audits of the consolidated financial statements referred to in our opinion dated August 2, 2000 appearing in this 20-F document on page F-2 also included an audit of the financial statement schedules within this 20-F. In our opinion, these financial statements schedules present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

PricewaterhouseCoopers

London, England  
August 2, 2000

**SCHEDULE I—PARENT COMPANY CONDENSED FINANCIAL STATEMENTS:**

**PARENT COMPANY BALANCE SHEET  
AS AT DECEMBER 31  
(UK BASIS OF ACCOUNTING)**

	<u>Notes</u>	<u>1999 £m</u>	<u>1998 £m</u>
<b>Fixed assets</b>			
Tangible assets . . . . .	1	39	16
Investments in subsidiary undertakings . . . . .	2	6,439	7,423
Other investments . . . . .		67	—
		<u>6,545</u>	<u>7,439</u>
<b>Current assets</b>			
Amounts owed by group undertakings . . . . .		1,099	471
Other debtors . . . . .		131	131
Cash at bank and in hand . . . . .		10	7
		<u>1,240</u>	<u>609</u>
<b>Creditors—amounts falling due within one year</b>			
Amounts owed to group undertakings . . . . .		(422)	(495)
Other creditors including taxation and social security . . . . .		(36)	(46)
Proposed dividend . . . . .	3	(233)	(238)
		<u>(691)</u>	<u>(779)</u>
<b>Net current (liabilities)/ assets</b> . . . . .		<u>549</u>	<u>(170)</u>
<b>Total assets less current liabilities</b> . . . . .		<u>7,094</u>	<u>7,269</u>
<b>Creditors—amounts falling due after more than one year</b>			
Long term subordinated liabilities . . . . .	4	610	—
<b>Net assets</b> . . . . .		<u>6,484</u>	<u>7,269</u>
<b>Capital and reserves</b>			
Ordinary share capital . . . . .		393	391
Preference share capital . . . . .		125	125
Called up share capital . . . . .	6	518	516
Share premium account . . . . .		170	142
Revaluation reserve . . . . .		5,281	6,105
Capital redemption reserve . . . . .		8	8
Profit and loss account . . . . .		507	498
<b>Shareholders' funds</b> . . . . .		<u>6,484</u>	<u>7,269</u>
<b>Analysed between</b>			
Equity shareholders . . . . .		6,359	7,144
Non-equity shareholders . . . . .		125	125

The accompanying notes are an integral part of the financial statements.

**ROYAL & SUN ALLIANCE INSURANCE GROUP PLC**  
**PARENT COMPANY PROFIT AND LOSS ACCOUNT FOR THE YEARS ENDED DECEMBER 31**  
**(UK BASIS OF ACCOUNTING)**

	<u>1999</u> £m	<u>1998</u> £m	<u>1997</u> £m
<b>Investment income</b>			
Income from group companies . . . . .	1,122	508	502
Gains on disposal of group companies . . . . .	—	—	2
Investment management charges including interest . . . . .	(10)	(2)	(15)
Expenses . . . . .	(37)	(30)	—
Other charges . . . . .	—	(142)	—
<b>Profit on ordinary activities before tax</b> . . . . .	<b>1,075</b>	<b>334</b>	<b>489</b>
Taxation on profit on ordinary activities . . . . .	<b>62</b>	<b>—</b>	<b>6</b>
<b>Profit on ordinary activities after tax</b> . . . . .	<b>1,137</b>	<b>334</b>	<b>495</b>
<b>Dividends</b>			
Special dividends paid . . . . .	(751)	—	—
Ordinary dividends paid . . . . .	(120)	(122)	(110)
Ordinary dividends proposed . . . . .	(233)	(238)	(215)
Preference dividends . . . . .	(9)	(9)	(9)
	<u>(1,113)</u>	<u>(369)</u>	<u>(334)</u>
<b>Transfer to retained profits</b> . . . . .	<b>24</b>	<b>(35)</b>	<b>161</b>

**STATEMENT OF RECOGNIZED GAINS AND LOSSES**  
**FOR THE YEARS ENDED DECEMBER 31**  
**(UK BASIS OF ACCOUNTING)**

	<u>Revaluation reserve £m</u>	<u>Profit and loss account £m</u>	<u>1999 £m</u>	<u>1998 £m</u>	<u>1997 £m</u>
Profit for the financial year . . . . .	—	1,137	1,137	334	495
Unrealized (losses)/gains on investment in subsidiary undertakings . . . . .	(824)	—	(824)	(61)	901
<b>Recognized gains arising in the year</b> . . . . .	<b>(824)</b>	<b>1,137</b>	<b>313</b>	<b>273</b>	<b>1,396</b>

**MOVEMENTS IN SHAREHOLDERS' FUNDS  
FOR THE YEARS ENDED DECEMBER 31  
(UK BASIS OF ACCOUNTING)**

	Share capital/ premium £m	Capital redemption reserve £m	Revaluation reserve £m	Profit and loss account £m	1999 £m	1998 £m	1997 £m
Shareholders' funds at January 1 . . . . .	<b>658</b>	<b>8</b>	<b>6,105</b>	<b>498</b>	<b>7,269</b>	7,333	6,341
Shareholders' recognized gains . . . . .	—	—	<b>(824)</b>	<b>1,137</b>	<b>313</b>	273	1,396
Issue of share capital . . . . .	<b>2</b>	—	—	—	<b>2</b>	3	6
Increase in share premium . . . . .	<b>28</b>	—	—	<b>(15)</b>	<b>13</b>	29	30
Purchase of own shares . . . . .	—	—	—	—	—	—	(153)
Dividends . . . . .	—	—	—	<b>(1,113)</b>	<b>(1,113)</b>	(369)	(334)
Scrip dividends adjustment . . . . .	—	—	—	—	—	—	47
Shareholders' funds at December 31 . .	<b><u>688</u></b>	<b><u>8</u></b>	<b><u>5,281</u></b>	<b><u>507</u></b>	<b><u>6,484</u></b>	<b><u>7,269</u></b>	<b><u>7,333</u></b>

The accompanying notes are an integral part of the financial statements

**PARENT COMPANY CASH FLOW STATEMENT  
FOR THE YEARS ENDED DECEMBER 31  
(UK BASIS OF ACCOUNTING)**

	<u>Notes</u>	<u>1999 £M</u>	<u>1998 £m</u>	<u>1997 £m</u>
<b>Operating activities</b>				
<b>Net cash inflow from operating activities</b> .....	6	378	608	1,165
<b>Servicing of finance</b>				
Interest paid .....		(12)	(2)	(14)
Dividends paid on non-equity shares .....		(9)	(9)	(9)
Premium on redemption of subordinated liabilities .....		—	(142)	—
		<u>(21)</u>	<u>(153)</u>	<u>(23)</u>
<b>Taxation received/(paid)</b> .....		62	—	(41)
<b>Capital expenditure</b>				
Purchases less sales of tangible assets .....		(25)	(16)	—
<b>Acquisitions and disposals</b>				
Acquisition of subsidiary undertakings .....		—	(107)	(6)
Disposal of subsidiary undertakings .....		82	—	—
		<u>82</u>	<u>(107)</u>	<u>(6)</u>
<b>Dividends paid on equity shares</b> .....		(1,109)	(337)	(258)
<b>Financing</b>				
Issue of ordinary share capital .....		15	14	31
Purchase of own shares .....		—	—	(153)
Increase in borrowings .....		610	(132)	(149)
<b>Net cash inflow from financing</b> .....		<u>625</u>	<u>(118)</u>	<u>(271)</u>
<b>Cash available for investment</b> .....		<u>(8)</u>	<u>(123)</u>	<u>566</u>
Cash flows were invested as follows:				
<b>Movement in cash holdings</b> .....		3	7	—
<b>Net portfolio investments</b>				
Shares and other variable yield securities .....		6	—	—
Fixed income securities .....		61	—	—
Loans .....		<u>(78)</u>	<u>(130)</u>	<u>566</u>
<b>Net investment of cash flows</b> .....		<u>(8)</u>	<u>(123)</u>	<u>566</u>

## NOTES TO THE PARENT COMPANY CONDENSED FINANCIAL STATEMENTS

### 1. TANGIBLE ASSETS

	<u>1999</u>	<u>1998</u>
	<u>£m</u>	<u>£m</u>
<b>Cost</b>		
At January 1 . . . . .	16	—
Additions . . . . .	25	16
Disposals . . . . .	<u>—</u>	<u>—</u>
<b>At December 31 . . . . .</b>	<b><u>41</u></b>	<b><u>16</u></b>
<b>Depreciation</b>		
At January 1 . . . . .	—	—
Charge for the year . . . . .	2	—
Disposals . . . . .	<u>—</u>	<u>—</u>
<b>At December 31 . . . . .</b>	<b><u>2</u></b>	<b><u>—</u></b>
<b>Net book value at December 31 . . . . .</b>	<b><u>39</u></b>	<b><u>16</u></b>

Tangible assets principally comprise short leasehold improvements, fixtures, fittings and equipment.

### 2. INVESTMENTS IN SUBSIDIARY UNDERTAKINGS

	<u>1999</u>	<u>1998</u>
	<u>£m</u>	<u>£m</u>
<b>Shares at cost</b>		
At January 1 . . . . .	790	683
Acquisitions/(disposals) . . . . .	<u>(82)</u>	<u>107</u>
<b>At December 31 . . . . .</b>	<b><u>708</u></b>	<b><u>790</u></b>
Loans . . . . .	450	528
Adjustment to net asset value . . . . .	<u>5,281</u>	<u>6,105</u>
	<b><u>6,439</u></b>	<b><u>7,423</u></b>

### 3. DIVIDENDS

	<u>1999</u>	<u>1998</u>	<u>1997</u>
	<u>£m</u>	<u>£m</u>	<u>£m</u>
<b>Ordinary</b>			
Special dividend paid <b>1999—48.0p</b> (1998—0.00p, 1997—0.00p) . . . . .	751	—	—
Interim paid <b>1999— 8.4p</b> (1998—7.80p, 1997—7.15p) . . . . .	120	122	110
Final proposed <b>1999—16.3p</b> (1998—15.20p, 1997—13.85p) . . . . .	<u>233</u>	<u>238</u>	<u>215</u>
	<b><u>1,104</u></b>	<b><u>360</u></b>	<b><u>325</u></b>
<b>Preference . . . . .</b>	<b><u>9</u></b>	<b><u>9</u></b>	<b><u>9</u></b>
	<b><u>1,113</u></b>	<b><u>369</u></b>	<b><u>334</u></b>

The dividends in 1998 and the special dividend in 1999 were declared to holders of shares prior to the share consolidation (see note 6). The interim and final dividend in 1999 are in respect of holders of shares after the share consolidation. Full provision has been made for the proposed final dividend.

## NOTES TO THE PARENT COMPANY CONDENSED FINANCIAL STATEMENTS

### 4. LONG TERM SUBORDINATED LIABILITIES

	<u>1999</u>	<u>1998</u>
	<u>£m</u>	<u>£m</u>
Subordinated US\$ bonds 2029 . . . . .	302	—
Subordinated Euro bonds 2019 . . . . .	308	—
<b>Total long term subordinated liabilities . . . . .</b>	<b><u>610</u></b>	<b><u>—</u></b>
Repayable as follows:		
1 year or less . . . . .	—	—
Between 1 and 2 years . . . . .	—	—
Between 2 and 5 years . . . . .	—	—
After 5 years . . . . .	<u>610</u>	<u>—</u>
	<b><u>610</u></b>	<b><u>—</u></b>

During the financial year, the Company issued subordinated US\$ bonds and subordinated Euro bonds with dates of redemption of October 15, 2029 and October 15, 2019 respectively. The net proceeds (after issue costs) of \$488m and €496m respectively were used to provide additional capital to assist in the financing of the acquisition of subsidiary undertakings during the year. The amounts payable on redemption are \$500m and €500m respectively. The bonds are contractually subordinated to all other creditors of the Company such that in the event of winding up or of bankruptcy, they are to be repaid only after the claims of all other creditors have been met. The rate of interest payable on the US\$ bonds is 8.95%, although the Company has entered into derivative contracts which have the effect of converting the interest payable to a floating rate which was 8.01% for the period ended December 31, 1999. These contracts have the same maturity dates as the US\$ bonds. €200m of the Euro bonds bear interest at a fixed rate of 6.875% until October 15, 2009 and a floating rate thereafter. €300m of the Euro bonds bear interest at a floating rate from the date of issue. As at December 31, 1999 the floating rate of interest on the Euro bonds was 4.75%. The Company has the option to repay the Euro bonds on specific dates from October 15, 2009.

### 5. CAPITAL COMMITMENTS

The Company has no unprovided capital commitments.

### 6. SHARE CAPITAL

	<u>1999</u>	<u>1998</u>
	<u>£m</u>	<u>£m</u>
<b>Authorised</b>		
<b>2,000,000,000</b> ordinary shares of 27.5p each		
(1998 2,200,000,000 ordinary shares of 25p each) . . . . .	550	550
<b>300,000,000</b>		
(1998 300,000,000) preference shares of £1 each . . . . .	<u>300</u>	<u>300</u>
<b>Issued and fully paid</b>		
<b>1,428,412,281</b> ordinary shares of 27.5p each		
(1998 1,564,012,681 ordinary shares of 25p each) . . . . .	393	391
<b>125,000,000</b>		
(1998 125,000,000) preference shares of £1 each . . . . .	<u>125</u>	<u>125</u>
	<b><u>518</u></b>	<b><u>516</u></b>

## NOTES TO THE PARENT COMPANY CONDENSED FINANCIAL STATEMENTS

Following the approval of the payment of a special dividend of 48p per ordinary share, at the close of business on May 14, 1999 each ordinary share of 25p was sub-divided into ten ordinary shares of 2.5p each, the “Intermediate Shares”. Immediately after the subdivision every eleven of the Intermediate Shares were consolidated into one new ordinary share of 27.5p. Unconsolidated Intermediate Shares were sold and the proceeds distributed to the relevant shareholders. This consolidation reduced the number of ordinary shares in issue from 1,565,474,931 to 1,423,127,534.

During the year 1,462,250 ordinary shares of 25p and, following the share consolidation, 5,284,747 ordinary shares of 27.5p were issued on the exercise of employee share options for a total cash consideration of **£15m**. The total nominal value of ordinary shares issued during the year was **£2m**.

The preference shares carry a right to a fixed cumulative preferential dividend of 7.375% per annum, 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 No 1 holds ordinary shares in the Company which may subsequently be transferred to employees (other than the executive directors). At December 31, 1999 the trust held **6,500,000** ordinary shares (1998 £nil) in the Company with a nominal value of **£1,787,500** (1998 £nil) and a market value, based on the mid market value of the Company’s shares at the close of business on December 30, 1999 as shown in the Official List of the London Stock Exchange, of **£31m** (1998 £nil).

The Royal & SunAlliance ESOP Trust No 2 holds ordinary shares in the Company which may subsequently be transferred to employees including executive directors. At December 31, 1999 the trust held **200,000 shares** (1998 £nil) in the Company with a nominal value of **£55,000** (1998 £nil) and a market value, based on the mid market value of the Company’s shares at the close of business on December 30, 1999 as shown in the Official List of the London Stock Exchange, of **£1m** (1998 £nil).

The Trustee of each Trust has waived their rights to dividends in excess of 0.01p on shares held by the Trusts. When computing the earnings per share, the shares held by the Trusts have been ignored in the calculation as, under FRS 14 ‘Earnings per Share’, they are treated as if they were cancelled.

At December 31, 1999, under employee savings related share option schemes, employees held options over 28,477,333 ordinary shares at option prices ranging from 93.80p to 483.00p per share. The options are normally exercisable within six months of the respective exercise dates which are between August 1, 1999 and November 1, 2005 as follows:

<u>Number of shares</u>	<u>Option price per share</u>	<u>Year of exercise</u>
489,321	93.80p—351.00p	1999
3,444,786	232.50p—473.00p	2000
4,648,925	206.20p—483.00p	2001
5,901,093	248.00p—435.00p	2002
5,016,621	294.00p—439.00p	2003
8,005,808	395.00p—430.00p	2004
<u>970,779</u>	356.00p—439.00p	2005
28,477,333		

## NOTES TO THE PARENT COMPANY CONDENSED FINANCIAL STATEMENTS

At December 31, 1999, under executive share option schemes, options over 26,129,606 ordinary shares were held at option prices ranging from 141.60p to 550.80p. The options, which are potentially exercisable between 3 and 10 years after grant, were outstanding as follows:

<u>Number of shares</u>	<u>Option price per share</u>	<u>Year of exercise</u>
188,587	303.00p—438.30p	1993
612,761	384.00p—387.10p	1994
504,532	141.60p—232.00p	1995
737,476	262.90p—369.00p	1996
651,139	225.90p—344.00p	1997
854,838	311.60p—343.00p	1998
2,586,483	225.90p—424.00p	1999
6,260,525	258.20p—525.70p	2000
6,392,421	336.90p—497.00p	2001
<u>7,340,844</u>	<u>370.00p—550.80p</u>	<u>2002</u>
26,129,606		

### 6. RECONCILIATION OF PROFIT BEFORE TAX TO NET CASH INFLOW FROM OPERATING ACTIVITIES

	<u>1999</u> <u>£m</u>	<u>1998</u> <u>£m</u>	<u>1997</u> <u>£m</u>
Profit on ordinary activities before tax . . . . .	<b>1,075</b>	334	489
Premium on redemption of convertible bonds . . . . .	—	142	—
Depreciation . . . . .	<b>2</b>	—	—
Interest on borrowings . . . . .	<b>12</b>	2	14
Changes in debtors less creditors . . . . .	<u>(711)</u>	<u>130</u>	<u>662</u>
Net cash inflow from operating activities . . . . .	<u><b>378</b></u>	<u>608</u>	<u>1,165</u>

**SCHEDULE III—SUPPLEMENTARY INSURANCE INFORMATION  
(UK BASIS OF ACCOUNTING—£m)**

	<u>Deferred acquisition cost</u>	<u>Future policy benefits, losses, claims and loss expenses(1)</u>	<u>Unearned premiums</u>
<b>1999:</b>			
United Kingdom .....	743	33,622	1,716
Other Europe .....	225	10,031	700
Americas .....	278	4,585	1,141
Asia Pacific .....	207	1,918	412
	<u>1,453</u>	<u>50,156</u>	<u>3,969</u>
<b>1998:</b>			
United Kingdom .....	758	31,310	1,741
Other Europe .....	232	8,974	591
Americas .....	236	4,788	753
Asia Pacific .....	123	1,225	303
	<u>1,349</u>	<u>46,297</u>	<u>3,388</u>

**SCHEDULE III—SUPPLEMENTARY INSURANCE INFORMATION  
(UK BASIS OF ACCOUNTING—£m)**

	Net premium revenue	Net investment income(2)	Benefits, claims, losses and settlement expenses(3)	Amortization of deferred acquisition costs(4)	Other operating expenses(5)	Net premiums written
<b>1999:</b>						
United Kingdom . . . . .	5,139	3,986	5,884	1,127	338	5,091
Other Europe . . . . .	2,367	718	2,639	331	198	2,401
Americas . . . . .	1,845	504	1,373	548	125	1,943
Asia Pacific . . . . .	950	149	843	162	126	1,008
	<u>10,301</u>	<u>5,357</u>	<u>10,739</u>	<u>2,168</u>	<u>787</u>	<u>10,443</u>
<b>1998:</b>						
United Kingdom . . . . .	4,990	3,817	7,241	1,087	312	5,063
Other Europe . . . . .	2,170	719	2,351	368	194	2,208
Americas . . . . .	1,709	536	1,345	485	105	1,749
Asia Pacific . . . . .	676	141	540	128	100	703
	<u>9,545</u>	<u>5,213</u>	<u>11,477</u>	<u>2,068</u>	<u>711</u>	<u>9,723</u>
<b>1997:</b>						
United Kingdom . . . . .	4,973	2,392	7,038	1,048	295	4,872
Other Europe . . . . .	1,878	655	1,915	294	214	1,928
Americas . . . . .	1,748	528	1,358	489	116	1,768
Asia Pacific . . . . .	642	117	479	133	63	657
	<u>9,241</u>	<u>3,692</u>	<u>10,790</u>	<u>1,964</u>	<u>688</u>	<u>9,225</u>

Notes:

- (1) Includes fund for future appropriations, long term (life) business provision, claims outstanding and technical provision for linked liabilities less the reinsurers' share of each item.
- (2) Net investment income comprises investment income less investment expenses and charges.
- (3) Includes claims incurred, net of reinsurance, change in long term (life) business, net of reinsurance, and change in technical provisions for linked liabilities, net of reinsurance.
- (4) Includes acquisition costs and change in deferred acquisition costs.
- (5) Other operating expenses comprises administrative expenses, amortization of goodwill, amortization of goodwill in acquired property and casualty claims provisions, amortization of acquired present value of long term (life) business and reinsurance commissions and profit participation.

**SCHEDULE V—VALUATION AND QUALIFYING ACCOUNTS  
(UK BASIS OF ACCOUNTING—£m)**

	<u>Balance to beginning of period</u>	<u>Exchange</u>	<u>Charged to costs and expenses</u>	<u>Charged to other accounts</u>	<u>Deductions</u>	<u>Balance at end of period</u>
<b>1999</b>						
Insurance . . . . .	92	—	24	5	(6)	115
Reinsurance . . . . .	40	—	9	2	—	51
Mortgage loans . . . . .	7	—	4	—	(1)	10
Other . . . . .	1	—	1	—	(1)	1
	<u>140</u>	<u>—</u>	<u>38</u>	<u>7</u>	<u>(8)</u>	<u>177</u>
<b>1998</b>						
Insurance . . . . .	54	(3)	49	—	(8)	92
Reinsurance . . . . .	27	—	17	—	(4)	40
Mortgage loans . . . . .	3	—	5	—	(1)	7
Other . . . . .	1	—	—	—	—	1
	<u>85</u>	<u>(3)</u>	<u>71</u>	<u>—</u>	<u>(13)</u>	<u>140</u>

## GLOSSARY

<i>Accident insurance</i> . . . . .	The provision of insured benefits in the event of accidental death or disability (the scope of cover will vary by product).
<i>Annuity</i> . . . . .	A contract that pays a periodic income benefit for the life of a person (the annuitant) or for a specified number of years, or a combination of the two, in return for a single premium payment. Immediate annuities provide income from the date the policy is taken out and deferred annuities provide income at a future specified date.
<i>Catastrophe equalization reserves</i> . . . . .	Premium revenue deferred to future periods to provide against future catastrophes.
<i>Cede; ceding insurer; cession</i> . . . . .	When an insurer reinsures its risk with another insurer (a “cession”), it “cedes” business and is referred to as the “ceding insurer”.
<i>Claims frequency</i> . . . . .	The number of claims occurring under a given coverage divided by the number of exposures for the given coverage.
<i>Combined ratio</i> . . . . .	The sum of the loss ratio and the expense ratio for a property and casualty insurance company or a reinsurance company. A combined ratio below 100 generally indicates profitable underwriting. A combined ratio over 100 generally indicates unprofitable underwriting. An insurance company with a combined ratio over 100 may be profitable to the extent net investment results exceed underwriting losses.
<i>Commercial specialty insurance</i> . . . . .	Customized liability and specialized risk insurance covers for particular classes or groups of clients.
<i>Composite insurer</i> . . . . .	A company which transacts both life and property and casualty insurance.
<i>Corporate pensions</i> . . . . .	Corporate pensions in the United Kingdom are provided as part of an employee’s compensation package. Both the employer and employee contribute towards the pension fund investment, and the plan is administered centrally by the employer and a fund manager.
<i>Creditor insurance</i> . . . . .	The provision of loan/mortgage/credit card repayments in the event of accidental death/disability, illness or unemployment (the scope of cover will vary by product).
<i>Critical illness policy</i> . . . . .	A policy where the insurer pays the sum insured to the policyholder in the event of diagnosis of a life threatening disease (e.g., cancer or heart disease).
<i>Deferred policy acquisition costs (“DAC”)</i> . . . . .	Commissions and certain other underwriting, policy issuance and selling expenses that are directly related to the production of

business. These expenses are deferred and later amortized to achieve matching of revenues and expenses.

<i>Direct marketing</i> . . . . .	Marketing of insurance products directly to customers by telephone and direct mail instead of through agents, brokers or other intermediaries.
<i>Direct sales force</i> . . . . .	A direct sales force is tied to one provider and, as such, their advice is not independent. They provide advice only on the product provider's products that they represent. Our direct sales force is self-employed and each sales person earns commissions on the products he or she sells.
<i>Disability income insurance</i> . . . . .	Health insurance that provides income payments to the insured wage earner when income is interrupted or terminated because of illness, sickness or accident.
<i>Endowment insurance</i> . . . . .	Life insurance under which an insured receives the face value of a policy if the individual survives the endowment period. If the insured does not survive, a beneficiary receives the face value of the policy.
<i>Exclusive agents</i> . . . . .	These are institutions or representatives thereof, who sell life and pensions products to their customers solely on behalf of their insurer clients or product providers.
<i>Expense ratio</i> . . . . .	The ratio of property and casualty insurance operating expenses (acquisition costs, plus administration expenses, less reinsurance commission and profit participation) to net premiums written.
<i>Facultative reinsurance</i> . . . . .	The reinsurance of part or all of the insurance provided by a single policy negotiated on a contract-by-contract basis.
<i>General account</i> . . . . .	The assets of an insurance company which support its insurance and other obligations (other than unit-linked (separate account) obligations).
<i>Gross premiums</i> . . . . .	Total premiums (whether or not earned) for insurance contracts written or assumed (including deposits for contracts with an insignificant amount of mortality or morbidity risk) during a specific period, without deduction for premiums ceded.
<i>Group permanent health insurance</i> . . . .	Policies arranged by employers for their employees, providing for the payment of income during a period of incapacity due to ill health or accident. The benefit is usually payable until retirement.
<i>Group personal pensions ("GPP")</i> . . . .	An arrangement in the United Kingdom made for employees of a particular employer to participate in a personal pension plan on a group basis. The employer administers the fund and may provide contributions towards it. A GPP is merely a collecting arrangement.

<i>Incurred but not yet reported (“IBNR”) reserves</i> . . . . .	Reserves for estimated losses and LAE which have been incurred but not yet reported to the insurer or reinsurer, including future development of claims which have been reported to the insurer or reinsurer but where the established reserves may ultimately prove to be inadequate.
<i>Independent Financial Adviser (“IFA”)</i> . . . . .	In the United Kingdom, IFAs advise and recommend life and asset accumulation products to individual clients but are not agents for any product provider. Many IFAs are part of a regional or national network.
<i>Individual permanent health insurance</i> . . . . .	Policies arranged by an individual providing for the payment of income during a period of incapacity due to ill health or accident. The benefit is paid to the policyholder until he/she is able to return to work, or until retirement.
<i>Individual savings account (“ISA”)</i> . . . . .	The ISA is a new tax-free savings plan in the United Kingdom that consists of three components: cash; equities; and life insurance.
<i>Lapse</i> . . . . .	Termination of a policy because of surrender, failure to pay a premium or lack of sufficient cash value to maintain in-force status.
<i>Life investment bonds</i> . . . . .	A single premium investment product in the United Kingdom. There are: (1) distribution bonds, where the funds are invested in equities and debt and income is paid each year to the policyholder dependent on performance of investment; and (2) guaranteed bonds, where the funds are linked to an equity index and the policyholder is guaranteed a minimum dividend at the end of the term.
<i>Life savings products</i> . . . . .	Policies in the United Kingdom that are used as a savings vehicle, including endowments not being used to repay a mortgage.
<i>Loss</i> . . . . .	An insured event that is the basis for submission and/or payment of a benefit under an insurance policy. Losses may be covered, limited or excluded from coverage, depending on the terms of the policy.
<i>Loss adjustment expenses (“LAE”)</i> . . . . .	The expenses of investigating and settling claims, including certain legal and other fees, and the expenses of administering the claims adjustment process.
<i>Loss ratio</i> . . . . .	The ratio of a property and casualty insurance or reinsurance company’s net incurred losses and LAE to net premiums earned.
<i>Loss reserves</i> . . . . .	Reserves established by an insurer or reinsurer and reflected on its balance sheet to reflect the estimated cost of payments for claims for which the insurer or reinsurer ultimately will be required to indemnify insureds or reinsureds in the future in respect of losses occurring on or prior to the balance sheet date on insurance or reinsurance it has written. Loss reserves are composed of individual case reserves for reported claims and IBNR reserves.

<i>Mortgage endowment</i> . . . . .	Policy in the United Kingdom used as a savings vehicle to repay a mortgage loan at maturity.
<i>Mortgage protection</i> . . . . .	Life insurance policy used to provide protection for a loan taken out to repay a mortgage.
<i>National Association of Insurance Commissioners</i> . . . . .	An association of the top insurance regulatory officials of all 50 states and the District of Columbia organized to promote consistency of regulatory practice and statutory accounting standards throughout the United States.
<i>Net Premiums</i> . . . . .	Gross premiums less premiums ceded for reinsurance.
<i>New business annual premium equivalent (“APE”)</i> . . . . .	Measure of sales of life and asset accumulation policies during the year calculated as periodic premiums plus 10% of single premiums. This is a widely recognized measure in the United Kingdom of total sales performance of a life insurer, which reflects the fact (all other things being equal), that a £1 single premium (a “one-off” payment) makes a lower value contribution to a company than £1 of new periodic premiums which will continue to be received in subsequent years, while the policy remains in force.
<i>Non-standard automobile insurance</i> . . . . .	Non-standard personal automobile insurance represents insurance (1) for drivers usually unacceptable to other insurers for, among other reasons, adverse driving or accident history, age or vehicle type, or (2) for customers who can only afford a low down payment or are transitioning from an uninsured to an insured status. Non-standard risks generally involve a potential for poor claims experience and requires specialized underwriting, claims management and other skills and experience. Loss exposure can be limited by the fact that insurers often purchase low liability limits, often at a State’s statutory minimum.
<i>Participating contracts</i> . . . . .	Insurance in which the policyholder is entitled to participate in the earnings or surplus of the insurance enterprise. The participation occurs through the distribution of dividends to policyholders.
<i>Periodic premiums</i> . . . . .	Life insurance products which provide for premiums to be paid periodically, typically either annually or monthly.
<i>Persistency</i> . . . . .	Measurement of insurance policies remaining in force from year-to-year.
<i>Personal equity plan (“Pep”)</i> . . . . .	The Pep is a tax free savings plan in the United Kingdom for equities only which was offered between 1987 and April 1999. Peps were recently replaced by the ISA.

<i>Personal pensions</i> . . . . .	Policies in the United Kingdom under which an individual makes payments during his working life. Payment can be made in a lump sum or regular installments, which are invested until retirement. Upon retirement the individual is able to use the pension and accumulated income to purchase an annuity, which will provide them with a regular source of income.
<i>Premiums earned</i> . . . . .	That portion of gross premiums written in current and past periods which applies to the expired portion of the policy period.
<i>Private medical insurance</i> . . . . .	A policy which covers the cost of private medical treatment.
<i>Regular bonuses</i> . . . . .	Bonuses for policyholder dividends periodically added to the with-profit (participating) policyholder's sum assured. Regular bonuses, once declared and added to the sum assured, are guaranteed on death or maturity. This term is used interchangeably with "reversionary bonuses".
<i>Reinsurance</i> . . . . .	The practice whereby one insurer, called the reinsurer, in consideration of premiums received, agrees to indemnify the ceding insurer for all or a portion of the risk under a policy or policies of insurance issued by the ceding insurer. However, the legal rights of the insured generally are not affected by the reinsurance transaction, and the insurance enterprise issuing the insurance contract remains liable to the insured for payment of policy benefits.
<i>Retail investments</i> . . . . .	Retail investments are personal investment products in the United Kingdom ( <i>e.g.</i> , those sold directly to the general public such as Peps and unit trusts), as opposed to institutional investments such as life and pension fund investments.
<i>Retention</i> . . . . .	The amount or portion of risk which a ceding insurer retains for its own account. Claims and claims expenses paid by the ceding insurer in excess of the retention level are then reimbursed to the insurer by the reinsurer. In proportional insurance, the retention may be a percentage of the original policy's limit. In non-proportional insurance, the retention is an amount of loss, a loss ratio or a percentage.
<i>Separate account</i> . . . . .	Investment account established and maintained by an insurer to which funds have been allocated for certain insurance policies or contracts of the insurer. The income, gains and losses realized from assets allocated to the account are, in accordance with the insurance policies or contracts, credited to or charged against the account without regard to other income, gains or losses of the company or the company's other separate accounts. Separate accounts cannot generally be charged with the liabilities of the general account. Products meeting this definition are often referred to as "investment linked" or "unit-linked" products. The policyholders bear all of the investment risk for these products.

<i>Single premium products</i> . . . . .	Life insurance products which provide for only one premium to be paid at the issuance of the contract.
<i>Specialty insurance</i> . . . . .	See “Commercial specialty insurance”.
<i>Tail</i> . . . . .	The period of time that elapses between the incurrence and settlement of losses under a policy. A “short-tail” insurance product is one where ultimate losses are known and settled comparatively quickly; ultimate losses under a “long-tail” insurance product are sometimes not known and settled for many years.
<i>Terminal bonuses</i> . . . . .	Bonuses (or policyholder dividends) paid at the termination of U.K. with-profits (participating) contracts. Terminal bonuses are not guaranteed in advance of contract termination.
<i>Term life insurance</i> . . . . .	Life insurance protection for a limited period that expires without maturity value if the insured survives the period specified in the policy.
<i>Travel insurance</i> . . . . .	The provision of insured benefits in the event of cancellation/curtailment, travel delays, loss of personal baggage/money, emergency medical and travel expenses, legal expenses and winter sports cover, if included (the scope of cover will vary by product).
<i>Treaty reinsurance</i> . . . . .	A type of reinsurance whereby the ceding company automatically will cede and the reinsurer automatically will assume a predetermined portion or category of specified risks underwritten by the ceding company.
<i>Underwriting results</i> . . . . .	The pre-tax profit or loss experienced by a property-casualty insurance company or reinsurance company after deducting incurred claims and claims expenses and operating expenses from premiums earned. This profit and loss calculation includes reinsurance assumed and ceded but excludes investment income.
<i>Unit trust</i> . . . . .	Unit trusts can be invested in stocks, shares, government securities and other investment instruments. The fund is divided into units, which fluctuate in value, depending on the value of the overall fund. The unit trust is an open-ended fund, which means it has a variable number of units in issue at any one time. Units are bought and sold from and to the fund manager.
<i>Universal life insurance</i> . . . . .	A life insurance product under which (1) premiums are generally flexible, (2) the level of death benefits may be adjusted and (3) expenses and other charges are specifically disclosed to the policyholder and deducted from his/her account balance.
<i>Whole life insurance</i> . . . . .	A permanent life insurance product offering guaranteed death benefits and guaranteed cash values.

*Withdrawal* . . . . . Surrender in part. Many life insurance products permit the insured to withdraw a portion of the cash surrender value of the contract. Future benefits are reduced accordingly.

*With-profits (participating) contracts* . . . Participating life insurance products offered in the United Kingdom.

## SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant certifies that it meets all of the requirements for filing on Form 20-F and has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized.

Royal & Sun Alliance Insurance Group plc

By: /s/ Joyce W. Wheeler

Name: Joyce W. Wheeler

Title: Authorized U.S. Representative

Dated: October 12, 2000