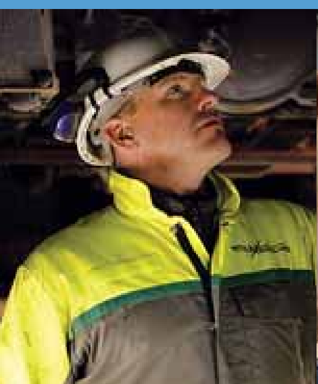
Annual Report & Accounts 2006






We operate in 27 countries and provide insurance products and services in over 130 countries.

Our portfolio of businesses is diverse and provides exposure to markets at different stages of development and at different points in the insurance cycle.

We are committed to delivering sustainable returns, targeted profitable growth and continuous operational excellence.

2006 has been another strong year.

The combined operating ratio improved by 0.8 points to 93.3% and the underlying return on equity was 20.7%.

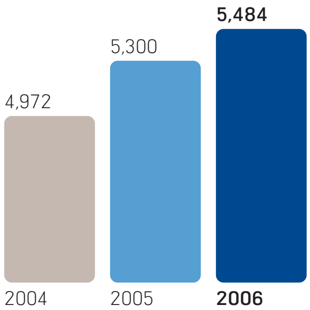
The total dividend is up 24%.

Visit **www.royalsunalliance.com** for more information. This Annual Report & Accounts contains forward looking statements as defined in the US Private Securities Reform Act. For a discussion of factors that could affect future results, reference should be made to the 'Important disclaimer' on the inside back cover. The following sections, pages 1 to 25 constitute the Business Review of Royal & SunAlliance and are incorporated by reference into the directors' report set out on pages 29 to 30. The directors' report has been drawn up and presented in accordance with, and in reliance upon applicable English Company Law and the liabilities of the directors in connection with that Report shall be subject to the limitations and restrictions provided by such law.

Financial highlights

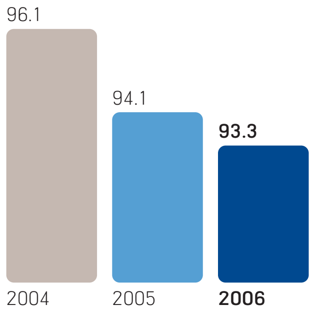
Net written premiums

£5,484m



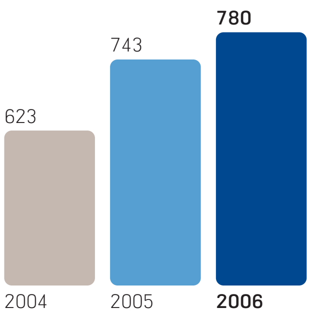
Combined operating ratio

93.3%



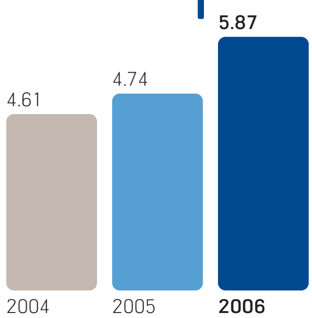
Operating result

£780m



Dividend

5.87p



	2006	2005
Results		
Operating result	**£780m**	£743m
Profit before disposals and pension scheme change	**£650m**	£588m
Profit after tax from continuing operations	**£479m**	£635m
(Loss)/profit after tax	**£(20m)**	£605m
Balance sheet at 31 December		
Total capital	**£4,084m**	£4,229m
Shareholders' funds	**£2,561m**	£2,686m
Net asset value per share	**82p**	88p
Dividend		
Total dividend for the year per ordinary share	**5.87p**	4.74p
Underlying return on equity	**20.7%**	21.6%

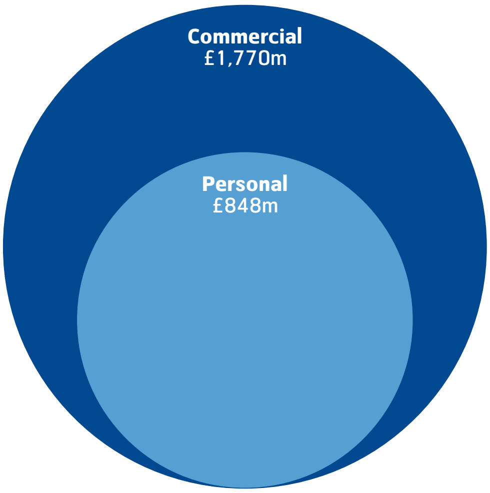
Combined operating ratio (COR): The ratio of claim costs and expenses (including commission) to premiums.

R&SA at a glance

A strong portfolio of businesses, balanced between mature markets and emerging markets with higher growth potential

UK

Net written premiums £2,618m



Key business areas

We are the largest Commercial insurer in the UK, with 13% market share, writing property, motor, liability and marine insurance. Property is the largest segment, accounting for over 35% of Commercial net written premiums. The business has a strong reputation for technical excellence, it insures 70% of FTSE 100 retailers and is one of the leading carriers of Professional & Financial and Marine risks outside of Lloyd's of London.

Our Personal business is ranked third largest in the UK with around four million covers in place. UK Personal primarily provides household, motor and travel insurance through MORE TH>N® our direct business. In Affinity, we provide the retail customers of our corporate partners with a range of insurance products.

Key strategies

We are aiming to become number one in the broker market for reputation, capabilities and profitability. In Commercial we are leveraging our reputation for technical excellence in our target markets to deliver profitable growth and manage retention.

In Personal, we are aiming to strengthen our number three retail position by enhancing our customer focus. By 2010, we plan to grow our Affinity business by more than 50% from 2005 levels.

We will grow organically and will consider acquisitions that strengthen our portfolio.

We are targeting £70m of annualised cost savings by mid 2008 and an expense ratio of below 15%.

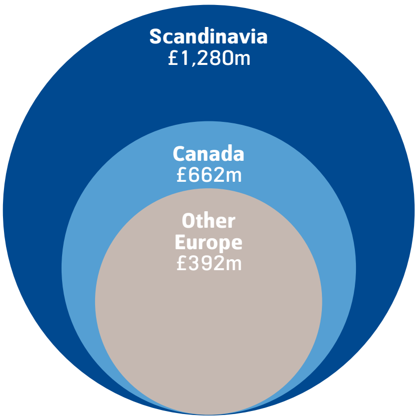
2006 highlights

In 2006, the UK delivered a COR of 92.3%, almost one point better than last year and a 4% increase in the underwriting result. Commercial delivered a COR of 92.6% and the Personal COR improved 4 points to 91.6%.

In Commercial, our most competitive market, retention remains strong at 84% and we increased new business by 31% to £298m. In November, we acquired Martello Underwriting Limited, a specialist provider of professional indemnity insurance which is expected to generate premiums of around £40m in 2007.

In Personal, MORE TH>N® delivered a 28% increase in new business and is making good progress in achieving a sub 20% expense ratio by the end of 2007. In Intermediated, we signed 11 distribution agreements, including Paymentshield, the largest independent provider of mortgage related products in the UK, which is expected to contribute over £200m in premiums in 2008.

International
Net written premiums £2,334m



International comprises our businesses in the mature insurance markets of Scandinavia (Sweden, Denmark and Norway), Canada, Ireland and Italy.

Scandinavia accounts for 55% of International premiums. In Denmark and Sweden, our businesses are ranked third largest, operating under the Codan brand in Denmark and Trygg-Hansa in Sweden.

Canada comprises our direct business, Johnson Corporation, as well as Personal Intermediated and Commercial.

In Ireland, we are the leading provider of household insurance.

Our Italian business distributes the majority of its products through non tied agents, with a network focused on Northern Italy.

In International, our objective is to drive the business harder. We are targeting sustainable profitable growth ahead of the market and building market share in our target segments.

We are also successfully driving growth by exploiting alternative distribution channels and taking a segmented approach to our target customer base to develop new customer propositions. We will consider supplementing organic growth with acquisitions in existing territories.

Our cost reduction and operational improvement programmes are further enhancing profitability across the region.

In 2006, International delivered above market premium growth and a COR of 93.1%.

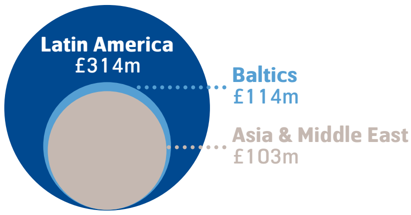
In Scandinavia, we continued to develop our motor proposition, signing additional agreements with car dealers in Denmark and Sweden. We acquired White Label Holding and Duborgh Skadeforsikring in Norway.

Canada increased net written premiums by 15%, reflecting strong organic growth in Johnson and the successful integration of the Morgex and Shillington acquisitions.

Ireland produced another good result in a competitive market. The acquisition of EGI Holdings Limited extends our expertise and product offerings in selected liability and motor lines.

Italy outperformed the market in terms of top line growth, and delivered a strong increase in underwriting profits.

Emerging Markets
Net written premiums £531m



Emerging Markets is our fastest growing business, covering 20 markets which offer high growth potential.

Latin America is the largest operation accounting for 59% of Emerging Markets' net written premiums. Our largest operations are based in Chile, where we are the market leader, Brazil and Mexico.

Our businesses in Latvia and Lithuania are ranked number one in each of their markets and we are launching a new operation in Estonia in 2007.

We are located in 10 countries across Asia and the Middle East, including India and China. The Asia and the Middle East portfolio accounts for 19% of Emerging Markets' net written premiums and consistently delivers strong underwriting results.

We are targeting double digit growth per annum in these exciting markets by expanding distribution, disciplined underwriting and improving operational performance. We will complement organic growth with acquisitions that accelerate the delivery of our strategic objectives.

We are targeting 15% growth per annum in Latin America, Asia and the Middle East and the Baltics, in order to double premiums by 2010 from 2005 levels. Over the same period, we intend increasing gross written premiums in India to £200m. All targets are on a local currency basis.

Emerging Markets delivered an excellent 21% increase in net written premiums in 2006 and a combined operating ratio of 97.3%.

Premium growth was strong across the region, with a 26% increase in Latin America, 38% in India and 32% in the Baltics. In Latin America, the increase reflects double digit organic growth as well as the integration of our 2005 acquisition, Cruz del Sur. Asia and the Middle East also delivered double digit premium growth, after adjusting for the disposal of the Japanese business in 2005.

Emerging Markets increased the underwriting result by 83% to £11m, driven primarily by Asia and the Middle East which delivered another excellent result improving its COR by 6.4 points to 83.1%.

Chairman's statement

A year of significant achievement, which positions us to accelerate further our plans to improve and grow profitably our portfolio of businesses

I am pleased to report for the fourth successive year further significant achievements in your Company's operational performance and progress in its realisation of its stated strategic goals. In short we have completed all the goals we set for our restructuring plan and can now accelerate further our plans to both improve and grow profitably our portfolio of businesses. Although much has been achieved over the last four years there is still work to do as we progress our plans to transform all aspects of the Company's activities and enhance our leadership position in the markets we choose to operate in.

The detailed achievements of 2006 are covered in the Chief Executive's and Chief Financial Officer's reports. On the operating and financial front I would like to note:

- A continued strong financial performance,
- Growth in net written premiums and operating result,
- Our operational improvement programme and other cost initiatives are ahead of target,
- Further strengthening of our capital and balance sheet position,
- The delisting from the New York Stock Exchange (NYSE) and deregistration from the Securities and Exchange Commission (SEC).

We announced in October a revised organisation structure and management changes to strengthen growth and development plans in our chosen markets. Bridget McIntyre, following her appointment in 2005, has continued to strengthen our UK market position. Simon Lee has been appointed to head an International division comprising our large overseas units. The smaller companies in Emerging Markets have been focused under Paul Whittaker with a key task of accelerating further profitable growth. There were further senior management changes to our top hundred managers involving both the promotion of internal candidates and external appointments. A new Chief Executive of Scandinavia, Rickard Gustafson, has been appointed following the retirement of Jens Erik Christensen.

Although a more significant impact of these changes is expected in 2007, there have been continuing business development successes in the year including:

- Further expansion of our distribution in the UK and acquisition of new capability set to deliver profitable growth,
- Successful acquisitions in Norway, Canada and Ireland,
- Above market growth in Scandinavia with new distribution initiatives,
- Double digit growth in Canada, the Baltics and Latin America.

The key strategic priority set for 2006 was, however, achieving an acceptable exit from the USA, an objective discussed in some detail in last year's annual report. I repeat a comment made then that "this outcome requires us to resolve a number of highly complex issues on which we are making good headway in an area which will remain difficult to predict". If anything, this was an understatement of the challenge. Although we signed the MBO agreement with Arrowpoint Capital (the new company set up by our former US management team to acquire our US operations) in the calendar year 2006, the necessary regulatory approval for the transaction was finally agreed just prior to the disposal being completed and announced on 4 March 2007.

The US exit was a significant management achievement. It required very substantial effort and attention from the senior management and the Board.

The range and scale of issues related to delivering an acceptable basis of exit from the US, required the Board in making any final judgement to balance a series of issues, not least including:

- Our responsibility to policyholders,
- Our fiduciary duties to shareholders,
- Our obligations to our regulators.

This has been a long and complex project and has required the fullest involvement of the Board. The Board have been resolute in their approach and are confident that the deal represents the appropriate deal for both policyholders and shareholders. Whilst it is normal to thank my Board colleagues generally at the end of my report, I would like to specifically thank them on this occasion for their diligence, input and overall contribution into what has proved to be an acceptable exit from our US operation.

Finally, despite the demands of our US exit, other essential and important objectives were also achieved in 2006. This was a significant test of management and a very considerable achievement.

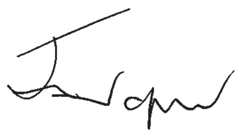
With respect to issues related to continuing operational improvement, and strengthened management control, of particular note has been the launch of a Technical Academy for underwriting and claims. There has also been the continuation of our plans to improve operational effectiveness, reduce costs, improve competitiveness and customer service. Although these involve some further loss of headcount, with an announced reduction of over 1,500 to be effective by June 2008, we continue to positively engage with staff and management at all levels on those key objectives. Our staff understand and support our goal to be the best-in-class. We thank them and appreciate their support, upon which our continued progress depends.

Having noted our success in achieving our strategic aims and core performance objectives, and with confidence in our plans to further improve the business, the Board considered our dividend policy. As a reflection of your Board's confidence in the future sustainability of the earnings of the Company, we announced at our preliminary results on 8 March a 35% increase in the final dividend for 2006. We plan to increase the 2007 interim dividend level by at least inflation plus 35% and thereafter plan to grow dividends at least in line with inflation.

On Board composition matters two changes have occurred. We welcomed Simon Lee, CEO of our International business, to the Board on 1 January 2007. At the same time, David Paige, Group Risk Director, retired from full-time employment to take up a portfolio career. David made a significant contribution to our risk and regulatory areas and we would like to wish him further success on his new career path. The number of directors who

retire by rotation and stand for re-election this year is significant and include Edward Lea, John Maxwell, Noel Harwerth, Malcolm Le May and George Culmer. They form part of a key Board team that I have already warmly commended.

The outlook as seen by the Board is positive. We have firm plans to both improve existing performance and grow and develop our business further. The priorities for the Company are clear and, despite competitive market conditions, particularly in the UK, we aim to make full use of our strategic portfolio. We see ourselves as a Company with a quality set of businesses and strong and effective management, well able, in relative terms, to face with confidence world market uncertainties. At the time of writing, the 2007 pattern in international financial markets has been of some limited instability with market willingness to self-correct and seek reasonable stability. With that comment in mind, I would like to repeat what I said at the beginning; namely as a Company we can now put our restructuring plans behind us and accelerate further our plans to improve and grow profitably our portfolio of businesses.



John Napier Chairman

Group CEO's business review

It has been an important year for the Group during which we have continued to deliver on our strategic and financial objectives

£m	2006	2005
Net written premiums	5,484	5,300
Underwriting result	310	263
Operating result	780	743
Combined operating ratio (COR)	93.3%	94.1%
Underlying return on equity	20.7%	21.6%

Over the last four years, we have built a portfolio with a good geographic spread and strong market positions. We have also been focused on operational excellence in our underwriting, claims and expense management. The benefits of this work are clearly evident in our financial performance, and in 2006 we've delivered another strong result.

Last year I also set out our plans to come off risk in the US and bring finality and certainty to our exposure. In line with this strategy, in September, we announced the disposal of our US business to the US management team through a company called Arrowpoint Capital. We've now completed the transaction, resolving the last of the Group's legacy issues and completing the Group restructuring we started in 2003.

The disposal allows us to focus solely on the development of our ongoing businesses and to continue to deliver on our objective of building one of the leading Property and Casualty insurers.

Strong financial performance

During 2006, we have increased net written premiums by 3% to £5.5bn. In each of our regions there are opportunities to profitably grow the franchise and new business was up 26% on last year.

In Denmark, Sweden and Italy we are growing ahead of the market, while in Canada, the Baltics and Latin America we have continued to achieve double digit growth. The UK remains our toughest market with premiums broadly in line with last year, reflecting our disciplined approach.

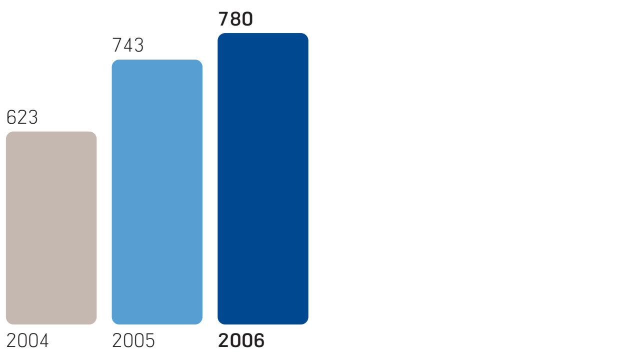
Across the Group, retention rates remained strong at 83%.

We have continued to supplement our organic growth with selective acquisitions in Ireland, the UK, Norway and Canada. The acquisitions along with the distribution deals that we announced in 2006 are expected to contribute premiums of over £400m when at a full run rate.

While we look to profitably grow the business, our commitment is to sustainable profitable performance. In 2006 we've continued to deliver against this. We have increased the underwriting profit by 18% to £310m and we've improved the operating result by 5% to a profit of £780m. The combined operating ratio of just over 93%, marks the twelfth consecutive quarter of combined ratios in the nineties.

The after tax loss of £20m reflects the expected £499m writedown of the US operation and US trading loss for the year. On a like-for-like basis, profit after tax from continuing operations increased by 14% reflecting the strength of the ongoing Group.

Operating result – £m



Across the Group, each of the regions has delivered a strong result. The UK combined of 92.3% is in line with last year and the underwriting result is up 4% to £160m. The Commercial combined of 92.6% remains strong, while in Personal we have achieved an excellent result, improving the combined ratio by 4 points to 91.6%.

In International we have improved the combined ratio by nearly a point to 94.0%. The underwriting result is up by 35% to £85m, driven by continued strong performances in Canada, Europe, Asia and the Middle East. Canada has achieved another outstanding result with an 85% increase in the underwriting result to £48m.

The Latin American combined of 103.7% reflects acquisition integration costs, higher reinsurance costs and the impact of some adverse weather and large losses. We have taken the opportunity to strengthen the leadership team with the appointments of a new regional CEO, CFO and a new Risk Director and with the actions we have taken, we expect to see the result improve during 2007.

Scandinavia delivered another good performance with a combined of 93.9% and a 15% improvement in the underwriting result to £75m. This was driven by a positive rating environment and improvements we have made to our claims management.

These results have been achieved against the backdrop of a competitive market and highlight the benefits of our balanced portfolio.

The rating environment has remained mixed by business class and region. In Personal lines, we've seen rate increases in the low single digits across our core markets. In Commercial, while the environment has remained stable through the year, rates are off around 4%.

Operational excellence

Against this market backdrop, our strong financial performance has been driven by our focus on operational excellence and strong management controls. It covers the work we are doing on underwriting, pricing, claims and expense management as well as the discipline with which we run the business.

Our underwriting and claims skills are market leading and provide a real source of competitive advantage. In 2006 we launched our Technical Academy to ensure we remain best in class in these key areas. The purpose of the Academy is to develop the next generation of talent, utilise our technical skills to support our growth plans and ensure we are driving best practices across the Group.

In terms of expenses, we have now achieved our original goal of £270m of savings ahead of schedule. In June, we announced a new target to reduce headcount by over 1,500 and to deliver a further £130m of expense savings by the middle of 2008. We are making good progress. We have reduced headcount by over 1,000 and are on track to deliver the new savings targets ahead of schedule.

Our focus on technical and operational excellence is supported by tight management controls. In underwriting, we have a clearly defined risk appetite and a system of global licensing to ensure that it is enforced. We implement a Group wide technical pricing strategy, backed up by active portfolio management. We hold detailed quarterly reviews with each business and carry out regular audits of business won and business lost.

It is why we are confident that we're taking on the right business – putting rate through where it is required and walking away when we can't get the right price, terms or conditions.

Group CEO's business review

continued

Delivering strong financial performance also means having the best people on the team. Last year I talked about how we were embedding a performance culture throughout the business. It is about giving people clear accountability and responsibility as well as opportunities to develop their careers.

Part of achieving this culture means having differentiated reward based on performance at all levels. In 2003, only 15% of employees had pay linked to their performance. We set ourselves a target of increasing this to 90% of employees by the end of 2006, and I am pleased to report that we have now met this target.

Just as we reward superior performance, we take action on underperformance. Of our top 100 management group, we've changed out around 10% during the year. We have appointed 12 people from outside the Group into senior roles and we have continued to promote talent from within the business, with 15 of our top managers moving into roles of greater responsibility.

During the year, we have had a real focus on employee development. In addition to the Technical Academy, we have launched a number of new initiatives such as 'FastTrack', an accelerated scheme for high potential graduates. Our Executive Development Programme entered its third year and has been highly successful, with 70% of participants in the first two programmes now in more senior roles.

Part of our culture is about listening to our people and taking action on their feedback. We have again completed our annual global employee survey and on the back of actions taken last year the overall satisfaction response improved 3%.

We use the results to build clear action plans to address issues raised and make improvements in each of our businesses. One of the areas we continue to focus on is driving further improvement in the level of employee engagement across the business in order to support the Group's strategic and financial objectives.

Group reorganisation

Over the last couple of years, we have built a balanced portfolio of high performing businesses with strong market positions. Our objective is to target profitable growth across the Group and in 2006 we reorganised to give us the right structure to deliver on this objective.

Under the new structure, the Group is organised into three regions – International, Emerging Markets and the UK.

International continues to be headed by Simon Lee. It now includes Scandinavia where we've appointed Rickard Gustafson as the new CEO, as well as Canada, Ireland and Italy. Our objective is to drive the businesses harder and deliver growth ahead of the market.

Emerging Markets comprises the Group's operations in Latin America, Asia and the Middle East and the Baltics. It is headed up by Paul Whittaker who has substantial experience in Eastern Europe and Asia. At R&SA, he's been a key part of the Executive Team throughout the restructuring.

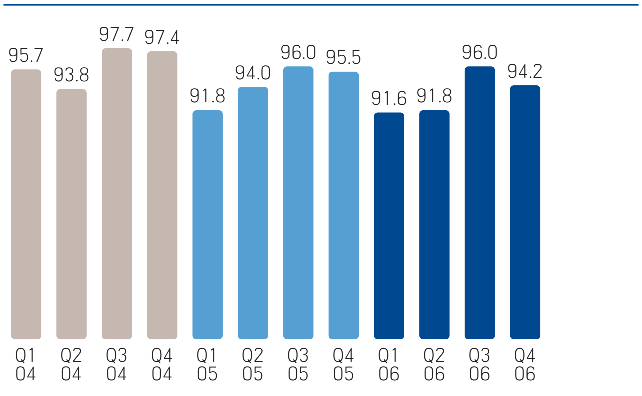
Emerging Markets is our fastest growing region and has enormous potential. We've established good positions in Latin America, Asia and the Middle East and the Baltics and our plan is to continue to drive growth of around 15% per annum in order to double premiums by 2010.

Bridget McIntyre continues to lead the UK and is driving the business forward. In Broker, we're expanding in our target trades and segments such as Marine and Profin. In Retail, we're growing MORE TH>N® – new business was up nearly 30% in 2006 and we have taken this good momentum into 2007. In Affinity, we entered a major deal with Paymentshield during the year and we are confident we'll meet our target of over 50% growth by 2010.

In each of our businesses, we're driving a real customer focus, whether it's in new product development or customer service. In Commercial, we're leveraging our global expertise to develop new customer propositions such as our 'One Stop Cargo' offering for the international marine market. In Personal lines, we're leading the market on new product innovation to meet changing customer demands. During the year we became the first insurer in the UK to offer discounts for drivers of hybrid cars and following the successful launch of the product, we have now rolled it out in Ireland. It's a good example of where we are able to take successful initiatives from one market to another.

We are committed to providing high levels of customer service and are always looking for ways to improve our offering. In Canada, our Personal lines business, Johnson has been a market leader in terms of its customer service. This year, we took their model of personal account managers for every customer and piloted it in the UK with 60,000 MORE TH>N® customers. Feedback was so positive, that we have now made the service available to all MORE TH>N® customers.

Combined operating ratio – %



Driving sustainable profitable performance

Our overriding commitment is to sustainable profitable performance. We will continue to deliver this through the discipline and focus with which we run the businesses combined with the balance and strength of our portfolio.

In 2007 we're confident that each region will again deliver a strong result.

The strength of the portfolio will be evident as we shift capacity to where we see the best opportunities. We expect International to deliver a greater proportion of the Group's underwriting result, largely driven by an improved Scandinavian performance.

Across the Group, our current expectation is that we will deliver a combined ratio of better than 95% for the full year.

Over the past four years, we've built a track record of delivering on our commitments. And we take this same level of energy, drive and ambition into the next phase of the Company's development.

We have a clear strategy, a strong portfolio of businesses, market leading underwriting and claims skills, and a team with a real focus on execution. It is a powerful combination and it's why we're confident about the long term sustainability of our performance.

Andy Haste

Andy Haste Group CEO

Market leading capabilities

Driving profitable performance through technical expertise, operational improvement and performance management

- **Delivered a 0.8 point improvement in the COR to 93.3%**
- **Targeting £130m of annualised savings by mid 2008**
- **Industry recognition**
- **Technical Academy promoting and developing expertise**
- **Energised teams driving the business forward**

We are focused on driving sustainable profitable performance through technical excellence, continuous operational improvement and performance management. Our technical expertise has driven the delivery of 12 consecutive quarters of sub 100 CORs, and the 0.8 point improvement in the 2006 COR to 93.3%.

Our strong results are driven by a culture of delivery, discipline, technical expertise and continuous operational improvement. Over the last three years we have implemented new claims and policy systems, enhanced the control environment and delivered £270m of cost savings ahead of plan. We have committed to deliver an additional £130m of annualised savings by mid 2008 and in the UK and Scandinavia we are progressing well towards our target sub 15% expense ratio.

In the UK, our technical excellence continues to be recognised by the industry. In 2006, we were awarded the title of 'British Insurer of the Year' at the British Insurance Awards, and our marine business received a British Insurance Award for its Aquaculture insurance solution. We were awarded 'Claims Initiative of the Year' with Marishal Thompson for our work on subsidence risks.

Since 2004, we have transformed our claims capabilities and processes and built a market leading supply chain, which has significantly reduced claim costs. Our supply chain is now used by Lloyds TSB and Co-operative Insurance Services.

We have established a Technical Academy to promote and develop underwriting, claims and actuarial expertise across the Group. The Academy shares best practice and provides a career development framework for those working in technical disciplines. We are also implementing a Groupwide sales effectiveness programme to strengthen the sales tools, infrastructure and reward processes to drive disciplined profitable growth.

We have embedded a performance management culture with clear accountabilities and reward aligned to performance. During the year, we continued to strengthen the top management team. The business is committed to investing in talent to develop its people, including through Executive Development and 'FastTrack' programmes. We have a strong, highly motivated, energised team driving the business forward.

Through the combination of our technical expertise, performance management culture and focus on operational excellence, we will continue delivering sustainable profitable performance.

Leading technical expertise

We have a strong reputation for our technical expertise and work closely with our clients to provide tailored risk management and insurance solutions. We continuously focus on enhancing our capabilities to drive sustainable profitable performance.

Our reputation for strong technical expertise is an integral part of our customer proposition. In the UK for example, we insure 70% of FTSE 100 retailers and have customer relationships dating back over 200 years. This, together with our leading claims management processes, helps drive our strong retention levels and profitable growth.

Profitable growth

Delivering profitable growth in target markets through a disciplined approach

- Clear growth targets for each business
- Focus on target trades and segments
- Building momentum – new business up 26% in 2006
- Strong retention across the Group at 83%
- Tailored customer propositions and risk solutions

Our overriding objective is to deliver sustainable earnings – we will only grow where we can do so profitably. We are building strong positions in our target markets using our technical expertise and customer focus to expand distribution and enhance our customer propositions.

Each of our businesses has clear growth targets. In the UK, we are aiming to grow our Affinity business by more than 50%, strengthen our number three retail position and move to number one in Broker by 2010. In Scandinavia, we are aiming to strengthen our number three market position, while in Canada, Ireland and Italy we are targeting 10% annual premium growth. We are targeting 15% growth per annum in Latin America, Asia and the Middle East and the Baltics, in order to double premiums in 2010 from 2005 levels. Over the same period, we intend increasing gross written premiums in India to £200m. All targets are on a local currency basis.

We focus on target trades and segments that provide opportunities for profitable growth. Within these segments, we are using our technical expertise to develop tailored customer propositions and risk solutions. Renewable energy, for example, is a rapidly growing sector and we have quickly built a strong wind turbine proposition in Canada, Scandinavia and Ireland.

By expanding distribution, we are finding more ways to profitably access new customers. Our agreement with Paymentshield, the UK's largest independent supplier of mortgage related insurance, is expected to deliver over £200m of premiums in 2008. In Scandinavia, our motor dealership proposition now provides us with access to around 30% of the new car market in Denmark and 27% in Sweden. In Canada, Johnson signed a number of affinity deals during 2006 giving it access to a potential 400,000 new customers.

Our increasing customer focus is reflected in our strong new business and retention levels. In the UK, we have customer relationships that go back more than 200 years. In our mature markets, we are using customer segmentation to develop innovative products to attract new customers and widen our target customer base. In the UK, MORE TH>N® has recently launched a number of propositions aimed at increasing customer acquisition and retention, to increase profitability and opportunities for cross selling.

Our focus on profitable market and customer segments, combined with our technical expertise, means that the Group is well positioned to continue to deliver profitable growth.

Expanding our motor proposition

In 2006 in Scandinavia we signed a number of distribution agreements with motor manufacturers and distributors. These agreements include Peugeot and Volkswagen in Sweden and Toyota in Denmark. Through these agreements we have access to 27% of the Swedish new car market and around 30% of the Danish new car market.

In the UK we have strong relationships with major manufacturers including Toyota, Land Rover and Volvo. We continue to develop our motor proposition and this year we have signed a new agreement with Kia.

UK business review

Building momentum in target markets and delivering sustainable profitable performance

2006 General Insurer of the Year

£m	2006	2005
Net written premiums	**2,618**	2,632
Underwriting result	**160**	154
Combined operating ratio (COR)	**92.3%**	93.1%

It has been another year of significant achievement for our UK business. We have delivered another strong result, demonstrating our commitment to disciplined technical underwriting and continuous operational improvement. In 2006 we continued to build momentum and our capabilities, creating an excellent platform from which to drive future profitable performance. We were named 'General Insurer of the Year' at the 2006 British Insurance Awards.

Overview of major strategies

We are aiming to become number one in the broker market for reputation, capabilities and profitability. In Commercial, we are leveraging our reputation for technical excellence and innovative risk solutions to deliver profitable growth and manage retention in our target markets.

In Personal, we are aiming to strengthen our number three retail position by enhancing our customer focus. Using increased customer segmentation and pricing sophistication, we are launching increasingly tailored customer propositions and innovative products to attract new customers and build retention. We plan to grow our Affinity business by over 50% by 2010 from 2005 levels.

The UK market remains very competitive, and we will only write business that is profitable. We are supporting our profit led stance on rating by continuing to build our underwriting and claims management capabilities and successfully driving further operational improvements and cost efficiencies. To improve our competitiveness, we are targeting £70m of annualised cost savings by mid 2008 and a sub 15% expense ratio.

Business progress against strategies

In 2006, the UK delivered another strong result, with an 0.8 point improvement in the COR to 92.3% and a 4% increase in the underwriting result to £160m. New business increased by 31% to £559m, while net written premiums were in line with last year, demonstrating our commitment to disciplined underwriting and risk selection.

The business continued to make excellent progress towards delivering on our expense targets, reducing the expense ratio by 1.3% to 18.1%. This year we have reduced headcount by over 550 against our target of 1,000 by mid 2008.

Commercial

UK Commercial performed well, delivering a COR of 92.6%. This is our most competitive market; net written premiums were down 2% to £1,770m, reflecting our commitment to disciplined underwriting. Retention remains strong at 84%, reflecting the quality of our underwriting and our customer focus.

In our target segments, we continued to build momentum, increasing new business by 31% to £298m with strong growth in Marine, Profin and Risk Solutions. In November, we acquired Martello Underwriting Limited, a specialist provider of professional indemnity insurance and expect this business to deliver premiums of around £40m in 2007.

Personal

UK Personal improved the COR by 4 points to 91.6% and the underwriting result by 67% to £65m. Household performed particularly strongly, delivering a COR of 80.9%, while motor

MORE TH>N® 'DriveTime'

We are increasing the use of sophisticated underwriting tools to tailor our products to our customers and price our risks.

In 2006, MORE TH>N® launched 'DriveTime', a telematics product aimed at reducing young driver accidents. An in-car telematics system monitors when a car is driven, rewarding drivers aged between 18-25 with reduced insurance premiums if they don't drive their cars between 11.00pm and 6.00am, the time when 40% of young driver accidents result in death or serious injury.

improved its COR by 0.4 points to 102.5%. Net written premiums increased 2% to £848m and new business was up 31%.

MORE TH>N® recorded another impressive performance, improving its COR by 3.7 points to 88.7%. New business sales were up 28% and net written premiums increased 2% to £441m. The expense ratio was 22%, down from 24.1% at the end of 2005 and we are on track to achieve our sub 20% target expense ratio by the end of 2007.

In Personal Intermediated we signed 11 new distribution agreements, including Paymentshield, the UK's largest independent supplier of mortgage related insurance. We expect this deal to generate premiums of over £200m in 2008.

Technical excellence

We continue to build our reputation through our technical excellence and risk solutions. By segmenting our customer base and enhancing our pricing sophistication, we are able to tailor pricing to different customer groups and develop innovative products. In 2006, MORE TH>N® launched 'DriveTime', a product aimed at 18-25 year olds which uses GPS technology to reward drivers with reduced premiums if they do not drive at peak times when accidents occur. MORE TH>N® has also used sophisticated risk analysis to broaden its motor customer base, increasing average motor premiums by 10% over 2006.

Our underwriting risk assessment is market leading and our complex flood mapping, arson and crime risk models enable us to accurately price risks. Our technical excellence continues to receive industry recognition. In 2006, our marine business received a British Insurance Award for its Aquaculture insurance solution, and we were awarded 'Claims Initiative of the Year' with Marishal Thompson for our work on subsidence risks.

Since 2004, we have transformed our claims capabilities and processes and built a market leading supply chain, which has significantly reduced claim costs. Our supply chain is now used by Lloyds TSB and Co-operative Insurance Services.

Market conditions

The UK is the Group's most competitive market and we anticipate similar conditions in 2007. It has been a challenging year but we have continued to deliver profitable growth.

In Commercial, the distribution market is evolving with the emergence of new channels creating new opportunities for insurers with strong customer propositions. Partnership agreements offer growth opportunities in the regional broker market and provide access to high volumes of business within our risk criteria.

The Personal market remains competitive. In Motor, we have consistently put rate through ahead of the market over the last three years, and we are now seeing some evidence of an improvement in rates.

Outlook

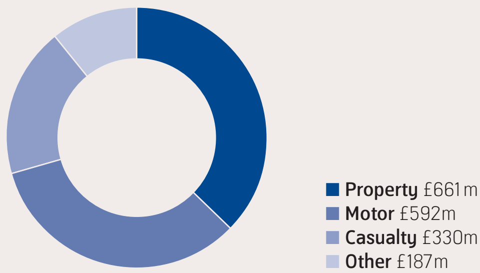
We are committed to maintaining underwriting discipline and rigorous risk selection to deliver sustainable profitable performance. In Commercial, we will continue to focus on our target trades and segments and use our industry recognised technical skills to maintain strong retention. We will continue to innovate our product offerings and pricing to realise the growth potential of MORE TH>N® and achieve a sub 20% expense ratio. In Affinity, we will continue to target new opportunities and deliver profitable growth from the deals we completed in 2006.

By continuing to build our capabilities and new business momentum, our UK business will continue to deliver sustainable profitable performance.

New business premiums
+31%

Combined operating ratio
92.3%

Commercial net written premiums – £1,770m



International business review

A strong portfolio of businesses focused on maximising opportunities for profitable growth in mature markets

£m	2006	2005
Net written premiums	**2,334**	2,221
Underwriting result	**149**	122
Combined operating ratio (COR)	**93.1%**	93.9%

International brings together our businesses in Scandinavia (Sweden, Denmark and Norway), Canada, Ireland and Italy enabling us to drive strategies for growth in mature markets on a regional basis. International delivered excellent results in 2006, with a 5% increase in net written premiums and a COR of 93.1%.

Overview of major strategies

We continue to focus on driving sustainable profitable growth ahead of the market and building market share in our target segments. We are delivering this through a combination of organic growth and acquisitions in existing territories.

We are successfully driving growth by exploiting alternative distribution channels, taking a segmented approach to our target customer base and developing new customer propositions. We are sharing best practice and looking for cost synergies across the region. Long term expense management is a key priority and all businesses are delivering on this important element of our strategy.

The geographic spread of our International businesses allows us to access markets at different points in the rating cycle. This diversification is a key component in the sustainability of our results.

Business progress against strategies

Our business in Scandinavia is the largest in the portfolio accounting for 55% of International premiums. We are the third largest insurer in the region and are driving the business as a pan-Nordic organisation with a portfolio of very strong local brands, principally Codan in Denmark and Trygg-Hansa in Sweden. These brands each have a prompted brand awareness of almost 100%.

The Scandinavian business performed strongly again in 2006, with 4% growth in net written premiums on a local basis and an 18% increase in the underwriting result.

In Commercial, we have focused our sales teams on specific customer segments and developed tailored customer value propositions. As a result, growth rates have increased significantly, particularly in the Marine and Health Insurance portfolios.

We continue to strengthen our market positions in Personal lines in Scandinavia and have increased net written premiums by 6%. We have expanded our distribution capacity, signing additional agreements with car dealers in both Denmark and Sweden. We now have access to 27% of the Swedish new car market and around 30% of the Danish market and continue to grow our market share. In Denmark, our bancassurance partnerships give us access to over two-thirds of banks in the Local Bank Association.

We continue to build our platform in the Norwegian market. We acquired White Label Holding AS Group and Duborgh Skadeforsikring AS, who are leading specialist providers of Personal and Commercial affinity products in Norway. These

Global marine proposition

We are a top three marine insurer in Canada and Scandinavia. Building on the marine expertise within International and UK businesses, we have launched 'One Stop Cargo' a comprehensive global offering. This product has been developed to provide small and medium sized businesses and general merchandise cargo owners with access to leading expertise, global capabilities and competitive pricing. It has flexible cover options and can be purchased online or through R&SA's global network. 'One Stop Cargo' was initially launched in Ireland, Asia and the Middle East and will be rolled out more widely across the Group during 2007.

businesses also have a growing presence in Sweden and are expanding into Denmark. In 2007, we expect these businesses to generate premiums of around £50m.

Canada has again delivered excellent results, with a 15% increase in net written premiums reflecting a strong performance by Johnson, our direct Personal business and Commercial. The Canadian business delivered a 2.8 point improvement in the COR to 92% and increased the underwriting result by 85% to £48m. This reflects the benefits of our disciplined risk selection, claims management and the continued delivery of cost savings.

The Commercial business delivered a 27% increase in net written premiums. Strong new business growth across all regions was supported by the launch of innovative products and quoting tools, including the continued roll out of 'RapideQuote' which is now used by over 425 brokers.

Johnson increased net written premiums by 25%, reflecting both strong organic growth and the successful integration of the Morgex and Shillington acquisitions. New affinity deals were signed during the year and Johnson now has access to sponsorship groups and credit unions representing 2.9 million members. Johnson continues to develop a strong pipeline of bolt-on acquisitions.

In the Personal Intermediated business, we signed 82 new contracts with brokers, taking the number of new broker contracts to 330 since 2004.

Ireland produced another good result in a competitive market. We continue to hold the number one market position in household. 'Enterprise', a local telephone-based service offering for brokers, underpinned a positive commercial lines performance.

In line with our strategy of targeting specific segments, we acquired EGI Holdings Ltd in Ireland during the year. This established business, with strong positions in selected liability and motor lines, extends our range of expertise and product offerings.

Italy outperformed the market in terms of top line growth, and delivered a strong increase in underwriting profit. We continue to invest in our broker extranet, which is increasing the efficiency of our broker business. Electronic broker transactions increased by 126% during the year. Our non-tied agent recruitment is on track with a further 35 appointments during the year.

Outlook

We are experiencing strong competition in all our markets but, for the most part, pricing discipline is holding. We continue to maintain a rigorous approach to improving our sales effectiveness and are starting to see the benefits of this in a robust pipeline of new business. We also remain open to further strengthening our portfolio by acquisition.

We have undertaken a range of initiatives to improve operational efficiency and are exploiting the many sales and operational advantages that the web provides. In addition, we are on track to deliver £40m of cost savings, which represents International's share of the Group target. As a result of these initiatives and our developing pipeline, we anticipate steady improvements in the expense ratio.

In 2007, we expect International to represent an increased proportion of the Group's underwriting result and our Scandinavian business to deliver an improved combined operating ratio of 91-93% (2006: 93.9%).

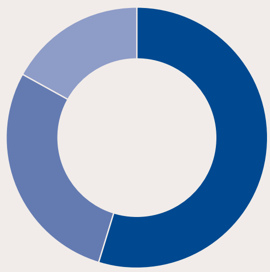
Underwriting result

+22%

Combined operating ratio

93.1%

Net written premiums – £2,334m



- **Scandinavia** £1,280m
- **Canada** £662m
- **Other Europe** £392m

Emerging Markets business review

Exposure to faster growing, high potential markets

£m	2006	2005
Net written premiums	531	440
Underwriting result	11	6
Combined operating ratio (COR)	97.3%	96.4%

During 2006 we brought together our businesses across Latin America, the Baltics and Asia and the Middle East, to strengthen our strategic focus on these fast growing markets and fully realise the operations' profitable growth potential. Emerging Markets delivered an excellent 21% increase in net written premiums and a combined operating ratio of 97.3%.

Overview of major strategies

Emerging Markets is our fastest growing business. We see significant growth potential in both Commercial and Personal lines. In Commercial, strong Gross Domestic Product (GDP) growth is driving a greater requirement for risk transfer and in Personal, a more affluent population, with more assets at risk is leading to a greater propensity to insure. We are focused on delivering profitable growth through expanding distribution, disciplined underwriting and improving operational performance, and will complement organic growth with acquisitions that accelerate the delivery of our strategic objectives.

By 2010 we expect to double net written premiums from 2005 levels in the Baltics, Latin America and Asia and the Middle East, and to increase gross written premiums in India to £200m.

Business progress against strategies

In 2006 there were floods in Chile, storms in Mexico and increased reinsurance costs in Latin America following hurricanes Emily, Katrina and Wilma. Despite the impact of these events, we improved the overall underwriting result by 83% to £11m, demonstrating the strength of the Emerging Markets portfolio.

Latin America delivered a 26% increase in premiums, reflecting strong underlying growth and the successful integration of our 2005 acquisition of Cruz del Sur in Chile. We are focused on driving growth in market segments where we have strong positions and a competitive advantage. In Brazil, our marine franchise continued to perform strongly, growing premiums by 50% in 2006 and we are building on this regional expertise with the launch of Carga Royal in Colombia. Expanding distribution was a key driver of growth in Venezuela where we added 420 new agents during the year.

The additional reinsurance and one-off integration costs noted above, impacted the Latin America result, increasing the COR to 103.7% for the year.

Asia and the Middle East delivered another excellent result with a COR of 83.1%. The business delivered underlying double digit premium growth after adjusting for the disposal of the Japanese business in 2005. Motor was a key driver of growth in the region, particularly in the Middle East, where we have increased volumes after web-enabling our brokers, allowing them to transact more efficiently with us.

Our joint venture in India increased premiums by 38% over the year. We are focused on accelerating the development of this business, and would look to increase our shareholding should the Indian government lift the 26% cap on foreign direct investment.

The Baltics continue to deliver strong net written premium growth with premiums up 31% to £114m, driven by strong performances in both Personal and Commercial lines. The COR was 92.2%

Santiago, Chile
Chile is one of the most vibrant and stable economies in Latin America benefiting from a mineral rich environment, low inflation and high levels of foreign trade. In 2007 GDP growth is forecast to exceed 5% and Chileans spend more per head on insurance than any other Latin American country. We are the clear market leader following our acquisition of Cruz del Sur in 2005, with 17% market share. Our business is headquartered in Santiago which is home to around 40% of the Chilean population.

compared with 90.1% in 2005. In Latvia, new car sales increased by 53% in 2006 and we now have agreements in place with over 50% of major car dealerships in the country.

Market and economic conditions

Our Emerging Markets business covers 20 countries with economies at differing stages of development and growth. Premium volumes are growing strongly in the Middle East and Baltics, and in Latin America there are some signs of increasing rates following the hurricanes in 2005. In Asia, increased capacity is creating downward pressure on rates.

Other initiatives

We are building a senior team at the centre with specialist technical knowledge to drive product development and growth across the business. This team is supported by key appointments at a regional level including a new CEO for Latin America.

In the Baltics, we have implemented a number of operational efficiency initiatives including automatic renewals on our motor, accident and property portfolios. These actions increase customer retention and free our agent network from administrative tasks allowing them to focus on new business sales.

Net Promoter Score surveys, which measure customer advocacy, have been successfully piloted in the UAE, Hong Kong and Latin America and will be rolled out more widely across Emerging Markets in 2007. We are committed to ensuring that our customers have positive experiences when dealing with us, and implementing improvements advocated by them should lead to stronger retention and increased cross selling opportunities.

Outlook

Our Baltic operations are leading the modernisation of the industry in the region, through the introduction of call centres, centralised claims handling and more sophisticated pricing techniques. We are focused on writing business profitably in all of our markets and in 2007, have increased prices and introduced deductibles in Latvia to combat strong claims inflation.

In the second half of 2007 we will launch our Estonian operation. Leveraging the expertise of our existing Baltic operations, we are confident of building a strong franchise to realise the growth potential we see in this exciting market.

We have taken a number of actions designed to improve the performance of our Latin American operations, including the appointment of a new CEO, CFO and Risk Director at the regional level, and a new CEO in Mexico. Following these actions, we expect an improvement in the Latin American underwriting performance in 2007.

We will continue to leverage the technical expertise and operational efficiency initiatives of the R&SA Group to build competitive advantage and strengthen profitability. In preparation for the Indian detariffication which was implemented on 1 January 2007, we significantly enhanced our pricing capability. Although tariffs were not fully liberalised, our enhanced segmentation and risk selection capability provides us with a real competitive advantage.

The Emerging Markets region is exciting, with high growth potential. With the strength of the R&SA Group, our businesses are well positioned to deliver on the profitable growth opportunities that this region presents. We are committed to underwriting discipline and continuous operational improvement to continue to drive sustainable profitable performance.

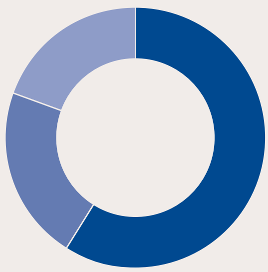
Underwriting result

+83%

Net written premiums

+21%

Net written premiums – £531m



- **Latin America** £314m
- **Baltics** £114m
- **Asia & Middle East** £103m

Financial review

Strong, sustainable earnings and increasing capital strength

Analysis of result

	2006 £m	2005 £m	Movement %
Net written premiums	**5,484**	5,300	3
Underwriting result	**310**	263	18
Investment result[1]	**556**	580	(4)
Insurance result	**866**	843	3
Other activities[2]	**(86)**	(100)	(14)
Operating result	**780**	743	5
Other movements[3]	**(130)**	(155)	(16)
Profit on change in pension scheme design	**–**	180	–
(Loss)/profit on disposals	**(1)**	126	–
Profit before tax[4]	**649**	894	(27)
Tax	**(170)**	(259)	34
Profit after tax from continuing operations	**479**	635	(25)
Discontinued activities			
Loss after tax from discontinued operations	**(499)**	(30)	–
(Loss)/profit after tax	**(20)**	605	–
Combined operating ratio	**93.3**	94.1	0.8pts
Shareholders' funds	**2,561**	2,686	(5)

Guide to terms

1. Investment result
Comprises investment income, certain realised gains and unrealised gains/(losses), impairments, foreign exchange and the unwind of discount.

2. Other activities
The result for other activities comprises:
- the operating result from non insurance activities,
- the movement in non insurance derivatives,
- income from associates,
- central Group expenses,
- investment expenses and charges.

3. Other movements
Other movements include interest charges on debt, amortisation and reorganisation costs.

4. Profit before tax
Profit before tax is shown on a management basis. Profit before tax on a statutory basis is shown on page 46.

Results overview
2006 was another strong year for the Group, with 3% growth in net written premiums and a 5% increase in the operating result.

In March 2007, we completed the sale of our US business to Arrowpoint Capital. In the 2006 results, we have reclassified the business as 'held for sale' and it is shown as a discontinued item in the income statement. The writedown of the US operation and the trading loss for the year totals £499m after tax.

Net written premiums
Net written premiums increased by 3% to £5.5bn, demonstrating the strength of our portfolio, with a disciplined approach in the UK, above market growth in Scandinavia and double digit growth in International.

Operating result
The operating result increased 5% to £780m, comprising an improved underwriting result and lower central expenses, offset by a lower investment result.

The 18% increase in the underwriting result to £310m reflects stronger underwriting performances across all of our regions, and our disciplined approach to underwriting and claims and expense management.

The underwriting result includes a £39m strengthening of our UK asbestos reserves following an increase in the frequency of claims notifications during the year.

In Scandinavia, we have strengthened our 2001 and prior Swedish personal accident and motor third party reserves. This strengthening has been offset by positive experience for these lines in more recent years following management actions, and the release of surplus in our Danish Personal and Commercial motor business. Going forward, we do not anticipate any further material strengthening of our Swedish personal reserves.

The Group's overall reserve position remains strong and our reserves are stronger at the end of the year than at the start of the year.

The investment result of £556m is marginally lower than 2005 and comprises a 4% increase in investment income, offset by lower realised and unrealised gains. The increase in investment income reflects a £0.2bn increase in the average size of the portfolio, while the average yield remained in line with last year at 4%. I currently expect that the 2007 total investment result will be broadly in line with 2006.

Other activities predominantly comprise central Group expenses and investment expenses. In 2006, central Group expenses were £74m, 10% lower than 2005, reflecting a small increase in project costs and a 16% reduction in head office expenses.

Other activities also include a £12m gain on the expiration of two derivatives contracts.

Loss after tax

In 2006, we incurred a loss after tax of £20m, compared with a profit of £605m in 2005. This movement reflects the writedown of the US operations in 2006, and the one off benefits of a number of disposals and the impact of the change in the UK pension scheme design in 2005.

The table below sets out a reconciliation of the operating result to the loss after tax:

	2006 £m	2005 £m	Movement %
Operating result	**780**	743	5
Total interest costs	**(92)**	(107)	14
Amortisation	**(15)**	(11)	(36)
Reorganisation costs	**(23)**	(37)	38
Change in pension scheme design	**–**	180	–
(Loss)/profit on disposals	**(1)**	126	–
Profit before tax	**649**	894	(27)
Taxation	**(170)**	(259)	34
Profit after tax	**479**	635	(25)
Loss after tax from discontinued operations	**(499)**	(30)	–
(Loss)/profit after tax	**(20)**	605	–

Interest costs on the Group's senior and subordinated debt decreased by £15m to £92m, reflecting the repayment of senior debt during the year.

Amortisation of £15m was charged in respect of software assets and goodwill on acquired claims provisions, compared with £11m in 2005.

Reorganisation costs of £23m relate to the costs of implementing the Group's operational improvement programme. This restructuring programme announced at the time of the Rights Issue is now complete and no further restructuring costs will be charged to the income statement in 2007.

Profit before disposals and the pension scheme change is up 11% to £650m, while the tax charge of £170m reflects an effective tax rate of 26%.

Profit after tax on continuing operations is £479m, which represents an underlying return on equity of 20.7%. Profit after tax in 2005 of £635m included £216m from the disposal of our Japanese operation and our investment in Rothschilds, as well as the change to the UK pension schemes. On a like-for-like basis, profit after tax is up 14%.

The after tax impact of our US disposal is £499m. This comprises the writedown of the net assets and the loss for the year, and the impact of the capital movements and associated transaction costs.

Financial review

continued

With the completion of the disposal, in accordance with IFRS, we will recycle the cumulative US foreign exchange losses of £19m from reserves through the income statement in the 2007 results. This will be shown outside the operating result and will have no impact on net assets.

Dividend policy

The directors will recommend at the Annual General Meeting, to be held on 21 May 2007, a final dividend of 4.12p (2005: 3.05p) per share. This, together with the interim dividend of 1.75p paid on 30 November 2006, will make a total distribution for the year of 5.87p (2005: 4.74p).

Financial strength

The overall financial strength of the Group continues to improve, with further actions taken during 2006 on the balance sheet, capital position, pension fund deficit and the Group's credit rating.

Balance sheet

The Group's balance sheet, cashflows and capital position have continued to strengthen during 2006.

During 2006, we implemented a number of initiatives to improve the quality of our balance sheet. The Yankee Bond Exchange and Tender Offer replaced US$426m of sub Tier 2 capital with an innovative Tier 1 perpetual security, significantly improving our regulatory solvency position.

In addition, we further strengthened the quality of our balance sheet by repaying our senior debt facility early and replacing this with a £500m revolving facility on substantially better terms.

The Group's shareholders' funds were £2.6bn at 31 December 2006 down from £2.7bn at 31 December 2005. This movement reflects the profits of the continuing operations offset by the writedown of the US operation.

Cashflow

The Group's cashflows remain strong, with operating cashflows increasing 7% over the year to £817m. After interest and dividend costs, net cashflow is up 23% to £639m.

We have used these funds to meet our financing and pension funding commitments, and repay a net £169m of senior debt. We also financed £355m of corporate activity, which included funding for acquisitions and new distribution deals, and Codan's share buy back and buy out of minority interests in the Baltics. After these uses, our cash surplus for the year was £29m.

	12 Months 2006 £m	12 Months 2005 £m
Operating cashflow	**817**	766
Interest paid	**(82)**	(107)
Dividends	**(96)**	(138)
Net cashflow	**639**	521
Pension deficit funding	**(86)**	(86)
Net repayment of debt	**(169)**	(86)
Corporate activity	**(355)**	97
Cash surplus	**29**	446
Funding by:		
Increase/(decrease) in cash and cash equivalents	**443**	(127)
(Sale)/purchase of other investments	**(414)**	573
Cash surplus	**29**	446

Investment policy

The Group continues to operate a low risk investment policy. The structure of the investment portfolio remains dominated by high quality fixed income and cash assets which are held to provide a broad match to the duration of our insurance liabilities. The Group also invests in equities and property to provide return whilst ensuring an appropriate diversification of risk.

Group investments now total £12.8bn. In line with our investment policy, £8.6bn or 67% of this is invested in high quality short dated bonds. The average duration of the portfolio is approximately 2.6 years, reflecting the short tail nature of the Group's insurance liabilities. The percentage of the bond portfolio rated AA or better is 83% and less than 1% is held in non investment grade. The average yield of the Group's portfolio is 4.0%.

The Group's holding in equities has remained stable for a number of years with approximately £1.6bn or 12.5% of the investment portfolio invested in equities. We do not envisage any significant change to the Group's investment strategy.

Solvency position

We remain fully compliant with both the FSA's risk based Internal Capital Assessment (ICA) methodology, and Solvency I which is used to calculate our Insurance Group's Directive (IGD) requirement.

For the Group's senior regulated insurance company, Royal & Sun Alliance Insurance plc, we continue to report the capital position under Solvency I.

As at 31 December 2006, the Group had an IGD surplus of approximately £1.3bn, an increase of £0.3bn from 2005. The improvement in IGD surplus is mainly attributable to the completion of the Yankee Bond Exchange and Tender Offer, the profits of the continuing operations, offset by the dividend and writedown of the US operation. The coverage ratio has improved from 1.6 at the end of 2005 to a very strong 1.9 times the IGD requirement at the end of 2006.

On completion of the disposal of our US operation, the 2006 IGD coverage ratio increases to 2.0 times the requirement, reflecting the injection of US$287.5m of capital into the US operation in accordance with the terms of the sale, and the release of the US IGD capital requirement.

The Group agreed its Individual Capital Guidance (based on its ICA submission) with the FSA in late 2005, which at the request of the FSA remains confidential. The ICA is a forward looking, economic assessment of the capital requirements of the Group based on our assessment of the risks that we are exposed to. The models used to determine the ICA have been integrated into the Group's business processes and are used to enhance the management of the Group.

We are also implementing a number of capital management initiatives, including optimising the Group's regulatory structure and looking at options to improve the capital efficiency of our discontinued lines of business.

Our balance sheet and capital position is strong, and the Group has sufficient capital to meet its strategic objectives and financing commitments.

Pension fund

The table below shows the main movements in the pension funds' position during 2006:

£m	UK	Other	Total
Pension deficit as at 1 January 2006	(211)	(28)	(239)
Market movement	170	(2)	168
Deficit funding	60	–	60
Other movements	53	(18)	35
As at 31 December 2006	**72**	**(48)**	**24**

Our pension funds now show a surplus of £24m, compared with a £239m deficit at the start of the year. This improvement is primarily due to positive market movements and the funding payment made during the year.

Rating agencies

Standard & Poor's (S&P), AM Best and Moody's Investor Service provide insurer financial strength ratings for the Group and its principal subsidiaries. These ratings are based on the detailed financial modelling of the Group and a regular assessment of the Group's strategic direction. Details of the Group's ratings can be found in the Investor Relations section under Bond Investor Information on the Group's website www.royalsunalliance.com.

During 2006, AM Best revised their rating upward, from 'A-' (negative) to 'A-' at the year end. Following a review by Moody's, the Group's financial strength rating was upgraded to 'Baa1' (positive outlook) from 'Baa2' (stable).

In 2007, AM Best and Moody's upgraded the Group's financial strength ratings to 'A-' (positive) and 'A3' (stable) respectively.

We are committed to returning the Group's rating with all of the major agencies to 'A'.

Summary

2006 has again been a very successful year for the Group with continued delivery of growth, solid underlying profitability and strong cashflows. The Group has sufficient balance sheet strength to support its strategic objectives of delivering sustainable earnings and targeted profitable growth.

George Culmer Chief Financial Officer

Risk framework

Overall risk framework

The Group operates under an enterprise risk management framework that is designed to identify, assess, measure and manage exposure to risk. This process is subject to continuous review and development and further work was undertaken in 2006 to enhance the framework.

Risk management

The Board is responsible for the Group's systems of risk management.

Executive management has the responsibility for establishing and implementing appropriate systems and controls in their own areas of remit. The Group Risk Management Framework provides the mechanism through which risk management and control is embedded throughout the Group. Each Group business is required to follow a consistent process to identify, assess, manage and monitor their key risks.

Group risk appetite

The Group has a process for setting risk appetite at both Group and regional level and for monitoring compliance with this. The Group risk appetite sets business volumes for certain higher risk insurance classes, stipulates loss retention limits, reinsurance protection, targets for credit rating and solvency margins, and other appropriate measures.

There is a formal escalation process for potential or emerging risks that are outside the risk appetite.

Risk framework

The Group has continued to adopt the '3 lines of defence' governance model. The framework for the oversight and management of risk is as follows:

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

Group risk policy statements

Group risk policy statements set out the minimum standards to be maintained by the Group's operations in order to manage their risks in a way that is consistent with the risk appetite. Business managers are responsible for complying with Group and local risk policies and for managing risk by taking mitigating actions where risks are outside the appetite. The Board Risk Committee's oversight and challenge role includes consideration of risk mitigation.

Compliance with policy statements is mandatory. Policies are subject to regular review in order to reflect changes in circumstances and the risk appetite.

Risk categories

Within the Group the risk elements are viewed under headings that broadly correspond to those used in the Financial Services Authority's Integrated Prudential Sourcebook (PRU). Additional information is provided in note 28 to the financial statements.

The following details some of the key current practices, tools and other arrangements for each risk category.

Insurance risk

The Group's general insurance activities are primarily concerned with the pricing, acceptance and management of risks arising from our contracts with customers. The management of the underwriting and claims risks uses a number of key tools, including the review of the performance and management of all the individual insurance portfolios throughout the Group, and the investigation of potential emerging insurance risks.

Further work has been undertaken in 2006 to refine and improve the Portfolio Classification process, designed to provide a more effective method of evaluating portfolio performance. We are continuing to improve oversight, and tools in support of it, in this area to ensure that we remain in control of our insurance business and the risks within it.

Claims development and reserving levels are closely monitored by Reserve Committees. Each region's Reserve Committee determines a recommended level of outstanding claims reserves, in accordance with the Group Reserving Policy. The Group Reserving Committee considers the reasonableness of these recommendations. It then determines the level of aggregate outstanding claims reserves to be carried by the Group.

Reinsurance risk

The Group's reinsurance strategy and appetite are set and agreed by the Board Risk Committee and published and disseminated via the Group reinsurance policy statement. The Group Reinsurance Credit Committee oversees the implementation of the counterparty credit aspects of this strategy.

The reinsurance team monitors and controls reinsurance activity throughout the Group, and has responsibility for the purchase of the Group's worldwide programme of treaties.

All major treaty purchases are analysed using various sophisticated modelling tools to ensure that the level of cover purchased is capital efficient and aligned with Group risk appetite and strategy.

Operational risk

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

The Group uses a suite of risk tools to help manage operational risk using a common categorisation of risk. These tools include Risk and Control Self Assessments, Key Risk Indicators, Scenario Analyses, Incident Management and Loss Data.

A series of forward looking key risk indicators are used to assess potential future trends in operational risks, whilst data collected on actual operational risk incidents and 'near misses' captures past experiences. In addition, the use of scenario analyses enables the Group to assess whether certain operational events that have occurred elsewhere could manifest themselves within the Group. When taken together, the tools provide a complementary set of indicators of the Group's operational risk profile.

Credit, market and liquidity risks

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

Market risk arises from the Group's investment portfolios. The Global Asset Management Committee is the management committee that oversees the Group's investment strategy under the oversight of the Investment Committee, and operating within risk limits set by the Board Risk Committee.

Liquidity risk is considered to be a low risk category. Group liquidity is managed by Group Treasury and each operation is required to maintain a minimum level of cash or cash equivalents or highly liquid assets that can be liquidated within a maximum stated period of time. Contingency funding plans are prepared and monitored to ensure that these minimum levels are met even in stress conditions.

Regulatory risk

The Group operates in a number of geographical locations with diverse regulatory requirements. Internationally, the regulatory environment has become more complex and demanding. The Group continues to respond to these developments through its arrangements for regulatory compliance and by ensuring that it maintains open and cooperative relationships with its regulators.

Corporate responsibility

Corporate responsibility at R&SA is about good business practice. For us, this is about listening to and engaging with all of our stakeholders – our customers, employees, shareholders and the community

Our Business Principles provide detailed, practical guidance on how we interact with our stakeholders, acting responsibly as both a Company and as individuals. These principles link to our Group policies and form part of our broader risk and governance framework and together with our latest corporate responsibility report can be found at: www.royalsunalliance.com.

Customers

We are committed to communicating openly with customers and providing strong levels of service, whether it is a new business enquiry, renewal, claim or complaint.

We use clear segmentation to develop products to meet our customer needs. In 2006 we launched a wide range of products with environmental or social benefits:

- We were the first UK and Irish insurer to offer discounts for drivers of hybrid cars,
- In Canada, we launched 'ClearSky', commercial wind energy insurance, and have already captured 20% of the market,
- In the UK, we launched 'DriveTime', a product using satellite technology aimed at reducing accident rates and providing more affordable insurance for young drivers.

We are focused on ensuring our communication with customers is clear and easy to understand. During 2006, we completed a full review of our UK policy documentation.

We are dedicated to providing high standards of customer service and continually look for ways to improve our claims and customer service. In Canada, Johnson has been using personal customer managers for a number of years. It has been highly successful and 92% of customers say that they would renew their policies based on the customer service. In the UK, following the successful pilot of this model, we have now extended the service to all our MORE TH>N® customers.

We are committed to resolving complaints promptly. We continue to participate in the annual benchmarking survey on complaints handling by the Association of British Insurers. In 2006, our performance was assessed as upper quartile across all categories.

Employees

Over the last few years we have been building a high performance culture across the business. It means attracting, developing and rewarding top talent, as well as giving people responsibility and accountability for their actions.

We focus on developing our people and have a number of programmes underway to provide ongoing career development:

- We launched our Technical Academy to ensure we remain at the forefront of technical mastery in underwriting and claims, and to provide clear career pathways for our technical people,
- Our Executive Development Programme, aimed at developing senior managers, is now into its third year. It has been highly successful and 70% of graduates from the first two programmes are now in roles of greater responsibility,
- We launched 'FastTrack', an accelerated scheme for high potential graduates. The programme involves a six month international assignment and development plan to fast track individuals to more senior roles. We had 2,000 applicants and 16 have been selected to participate.

In other areas, we have continued to increase the proportion of employees with performance related pay from 15% in 2003 to 90%.

Rapid response to emergencies

Extreme weather conditions require an urgent response for customers. When a tornado hit London in December our emergency response unit was ready. As soon as the emergency services declared the area sufficiently safe, the R&SA engineers and loss adjustors were on site making essential repairs and claims assessments.

We have also carried out our annual global employee survey. Overall satisfaction improved 3% in 2006 and the results of the survey are used to build clear action plans to address issues raised.

Environment

Environmental issues and climate change have received substantial public attention in 2006. We have been taking action on these issues for some time.

As a Group:

- We have set challenging targets for 2008 which will result in a positive effect on the environment as well as cost savings,
- We became the first UK insurer to go 'Carbon Neutral' offsetting our emissions against renewable energy projects,
- We are managing the environmental impact of our buildings, such as moving to our new premises in Canada, built to high standards of environmental construction and design.

As an insurer, we are driving through a number of initiatives:

- We continue to lobby in the UK for increased Government spending on flood defence,
- We are investing in award winning technology to predict and assess risk such as, Eurotempest, Tropical Storm Risk and our flood risk assessment tool,
- We make it more affordable for consumers to make environmental choices through our products, such as discounted insurance for hybrid cars,
- Through our partnership with the international charity 'Trees for Cities' we support sustainable replanting in response to tree removal as a result of subsidence claims.

Community

We operate an active community engagement programme throughout the Group. While regions focus on the issues that matter locally, there are some common issues such as safety and social exclusion.

As a leading motor insurer, we are committed to improving road safety awareness. In Chile, we launched a road safety education programme which has already reached 15,000 children with a further 48,000 to take part in 2007. In Sweden, we've donated nearly 300,000 high visibility waistcoats and reflectors for children.

Social exclusion is also an issue across many of the regions in which we operate:

- In the UK, we have provided social housing insurance for over 15 years. This year our UK CEO, Bridget McIntyre, took up a post on the Government's Social Exclusion Taskforce,
- In India, we continue to provide insurance in association with Non Government Organisations for women and tribal groups in rural locations who are living below the poverty line,
- In Canada, we continue to support the United Way, a charity which funds a variety of social services such as children's development and disadvantaged families.

Responsible investment

Our UK assets continue to be managed by F&C Asset Management who apply their responsible engagement overlay across our portfolios to encourage companies to manage social, ethical and environmental risks. We receive regular feedback on the companies that F&C Asset Management have invested in on our behalf.

Group impacts 2006	
Energy	124,976 Mwh
CO_2	56,313 Tonnes
Water	285,009 M^3
Waste	5,080 Tonnes
Paper	1,827 Tonnes

Energy	Target
UK	5%
Denmark	10%
Sweden	6%
Ireland	5%
Lithuania	5%
Denmark (Steam)	10%
Sweden (Steam)	5%

CO_2	Target
Canada	5%
Ireland	10%
UK (Travel)	10%

Water	Target
UK	10%
Lithuania	5%

Waste	Target
UK	10%
Denmark	10%

Recycling	Target
Canada	10%
Hong Kong	20%

All targets to be achieved by end of 2007 are based on the levels set out in the 2005 Corporate Responsibility Report.
All energy targets are electricity unless otherwise specified. All targets are reductions, except recycling which is an increase in the rates.

Board of Directors


John Napier

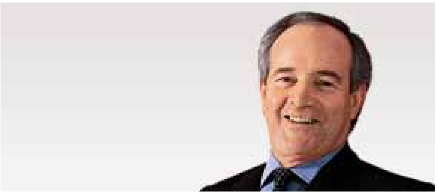

Andy Haste


George Culmer


Noel Harwerth


Edward Lea


Malcolm Le May


John Maxwell


Simon Lee


Bridget McIntyre

John Napier [N, I] Age 64. Director of the Group from January 2003 and Chairman of the Group from March 2003. Chairman of the Nomination Committee from March 2003. Non-executive Chairman of Kelda Group plc (water utility). Former Executive Chairman and Chief Executive of Kelda Group plc. Former Chairman of Booker plc (cash and carry). Former Managing Director of Hays plc (business services) from 1991 to 1998. Former Managing Director of AGB plc (international market research and information services).

Andy Haste [E, I] Age 45. Director and Group Chief Executive from April 2003. Former Chief Executive of AXA Sun Life plc and Director of AXA UK plc (life and pensions). Former President and Chief Executive Officer of Global Consumer Finance Europe at GE Capital UK, Western Europe and Eastern Europe (financial services). Former President of National Westminster Bank's US Consumer Credit Business (retail banking).

George Culmer [E, I] Age 44. Chief Financial Officer and director of the Group from May 2004. Previously Head of Capital Management Zurich Financial Services (insurance).

Noel Harwerth [A, I] Age 59. Director of the Group from March 2004. Director of Corus Group plc, Tube Lines Limited, Logica CMG, Corporate Services Group plc, Anglo Irish Bank and Partnership Director, London Underground. Deputy Chairman of Sumitomo Mitsui Banking Corporation Europe Limited (finance). Former Chief Operating Officer of Citibank International plc (finance).

Edward Lea [A, R, I] Age 65. Director of the Group from July 2003. Chairman of the Group Audit Committee from October 2003. Director Redbourn Group plc (property management and investment). Director of IDC Plugs Limited (electrical services). Director of MacIntyre Care (charity). Previously a director of The British United Provident Association (BUPA).

Malcolm Le May [R, I] Age 49. Director of the Group from March 2004 and Chairman of the Investment Committee from November 2005. President Europe JER Partners Limited (Europe) (property investment). Non-executive director of Pendragon plc. Former Deputy Chief Executive Morley Fund Management (Investment Fund Manager). Former Deputy CEO of ING-Barings (finance).

John Maxwell [A, N, R, I] Age 62. Director of the Group from July 2003. Chairman of the Remuneration Committee from October 2003. Director of Provident Financial plc (financial services). Director of Homeserve plc (support services). Governor of the Royal Ballet School. Chairman of the Institute of Advanced Motorists. Previously an Executive Director of Prudential Group plc. Former Chairman of DX Services plc (mail). Previously Director General (Chief Executive Officer) of The Automobile Association Limited.

Simon Lee [E] Age 46. Director of the Group from January 2007 having been Chief Executive of the International Businesses since April 2003. Former Chief Executive, Natwest Offshore and Head of US Retail Banking at National Westminster Group.

Bridget McIntyre [E] Age 45. UK Chief Executive and director of the Group from November 2005. Previously Executive Director of Norwich Union (insurance).

Executive Team

Andy Haste [E, I]
Group CEO

Mark Chambers
General Counsel and Group Company Secretary

George Culmer [E, I]
Chief Financial Officer

Orlagh Hunt
Group Human Resources Director

Tony Latham
Group Director, Global Relationships

Simon Lee [E]
Chief Executive, International Businesses

Neil Macmillan
Group Director, Audit, Risk and Compliance

Bridget McIntyre [E]
UK Chief Executive

Paul Whittaker
Chief Executive, Emerging Markets

E Executive director
A Member of Group Audit Committee
N Member of Nomination Committee
R Member of Remuneration Committee
I Member of Investment Committee

Directors' report

The directors of Royal & Sun Alliance Insurance Group plc present their report and the audited financial statements of the Company for the year ended 31 December 2006.

Principal activity

The Company is the holding company of the Royal & SunAlliance Group of companies (the Group) whose principal activity is the transaction of personal and commercial general insurance business. The Group operates in 27 countries.

Business review

An overview of the business performance during the year along with an analysis of its financial position is set out in the financial review on pages 18 to 21. The future developments of the business can be found in the Group CEO's business review on pages 6 to 9 and in the regional business reviews on pages 12 to 17. The principal risks and uncertainties facing the Group are set out in the estimation techniques, uncertainties and contingencies on pages 50 to 52, and in the risk framework on pages 22 to 23.

The Group uses Key Performance Indicators (KPIs) to provide a well balanced and comprehensive review of the Group's overall performance. KPIs are monitored in a number of areas including financial, employee, customer and the environment and community. Financial KPIs include combined operating ratio, expense ratio, operating result and net written premium growth. Employee KPIs include the percentage of staff that have performance related pay, the percentage of staff taking part in the employee survey and the increase in overall employee satisfaction as measured by the survey. Customer KPIs include the levels of customer retention and the Group's position in the annual benchmarking survey on complaints handling by the Association of British Insurers. Environment and community KPIs include the levels of CO_2 emissions and in addition the Group discloses the amount of the Group's charitable donations. Financial KPIs are detailed in the Group CEO review on pages 6 to 9 and the regional business reviews on pages 12 to 17. The employee, customer and the environment and community KPIs are detailed in the regional business reviews on pages 12 to 17, the corporate responsibility report on pages 24 to 25 and the directors' report on pages 29 to 30.

Post balance sheet events

On 4 March 2007 the Group announced the completion of the disposal of its US operation to Arrowpoint Capital Corp.

Dividends

The directors recommend a final dividend of 4.12p per share which, if approved by shareholders at the 2007 Annual General Meeting (AGM), will be due for payment on 1 June 2007 to holders of ordinary shares on the register at the close of business on 16 March 2007. This, together with the interim dividend of 1.75p per share, will make a total dividend for the year of 5.87p per share.

The preferential dividend at the rate of 3.6875% for the period from 1 October 2006 to 31 March 2007, will be paid on 3 April 2007 to holders of preference shares on the register at the close of business on 16 March 2007.

Employment policy

The Group's employment policy reflects our belief that motivated and skilled employees are critical to our success.

We encourage equal opportunities and diversity across the Group. This involves recruiting, engaging, retaining, rewarding and developing people solely on the grounds of ability to do the job, and establishing and promoting a working environment which is free from discrimination.

The Group is committed to the promotion of equal opportunities for all employees including those with a disability. In order to do this, we will ensure that any reasonable adjustment is made, where it is appropriate to do so, to provide equal opportunities to all in the provision of recruitment, terms and conditions, promotions, transfers, dismissals and vocational training. We are committed, wherever possible, to supporting the rehabilitation and return to work of employees who become disabled during their career with us.

The Group is committed to fostering a constructive dialogue with independent trade unions wherever they are recognised, ensuring a regular and constructive dialogue on business issues, and early consultation on changes affecting the workforce. In the UK, Amicus is formally recognised through a partnership agreement which covers collective consultation and bargaining on behalf of non management employees. The Management Association (TMA) represents managerial employees under a separate consultative agreement. The European Consultative Forum (ECF), is a cross European body created to enable information sharing and consultation on transnational issues with the European workforce. Since 2005, an amended constitution has been in place for the European workforce which enables streamlined consultation arrangements.

The Group continues to focus on the development of employees in order that they can deliver high levels of performance. We believe we can create real competitive advantage by building and maintaining a high performance culture across the Group. In 2006, the focus has been on developing talent and capability for today's business needs and those of the future. We have continued to accelerate the development of our in-house executive talent, through the Executive Development Programme which enters its third year in 2007. We have also introduced robust strategies to build capability and performance in the areas of sales, underwriting, claims and actuarial.

A Groupwide programme was introduced looking at sales effectiveness, with the aim of equipping our salesforce with the tools, skills, career pathways, training, reward and recognition that an effective salesforce would expect.

During 2006, we launched the Technical Academy, aimed at building on our technical mastery in underwriting, claims and actuarial to support the Group's growth objectives.

An accelerated career programme, FastTrack, was launched hiring 16 individuals who show potential to swiftly build capability to fulfil leadership positions in the Group. Typically, three or four years post graduate, these individuals follow a structured career acceleration programme involving a six month overseas assignment to help bring increased exposure to cultural and organisational differences.

The third annual web based Global Employee Survey was run in 2006. 91% of eligible employees took the opportunity to contribute. Our aim is to consistently seek feedback on the environment we are creating as an employer and to work constructively towards our objective of becoming an employer of choice. Our intention is to continue to repeat this survey annually, to ensure we have a current picture of employees' views and also to track year on year movement in particular areas of priority. In this way, by asking our employees, we measure how the culture of our business is changing. For example, in 2006 70% of staff felt that 'My job provides the opportunity to learn new skills and develop new talents', an increase of 3% on 2005. As in previous years, we have used the 2006 results to build a Groupwide action plan which requires every manager to identify and work on areas of particular importance to their team.

Directors' report

continued

Our policy is to encourage employee share ownership. Employees from the majority of our global businesses are encouraged to participate in the International Sharesave Plan which is an HM Revenue and Customs approved all employee sharesave scheme.

Employees are kept well informed of the overall performance and objectives of the Group.

The Group actively encourages employees to become involved in supporting their local communities. Further details are provided in the corporate responsibility section of this report on pages 24 to 25.

Environmental programme

Details of our environmental programme can be found on our website at www.royalsunalliance.com.

Supplier payment policy

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

The Company's outstanding indebtedness to trade creditors on 31 December 2006 amounted to £2,837,991corresponding to 13 days' payment when averaged over the year.

Share capital

During the year, 6,804,499 ordinary shares of 27.5p each were issued in satisfaction of the exercise of employee share options for a total consideration of £6m, and 45,604,849 ordinary shares of 27.5p each were issued under the Company's scrip dividend scheme for a total consideration of £62m. An authority from the shareholders for the Company to purchase up to 293,567,775 of its own ordinary shares (representing 10% of its issued share capital as at 16 March 2006) remained in force at 31 December 2006.

Substantial share interests

As at 7 March 2007, Deutsche Bank AG, Goldman Sachs Asset Management, Legal & General Group plc and Schroder Investment Management had declared an interest in ordinary shares of 27.5p each in the Company representing 3.20%, 8.72%, 3.53% and 4.97% respectively of the issued ordinary share capital, in accordance with Part 22 of the Companies Act 2006 and the Disclosure Rules and Transparency Rules of the UK Listing Authority.

Directors

Members of the Board of Directors are listed on page 26. David Paige resigned as a director on 31 December 2006 and Simon Lee was appointed to the Board effective from 1 January 2007.

At the 2007 AGM Simon Lee will be eligible for re-appointment under Article 110. Edward Lea, John Maxwell, Noel Harwerth, Malcolm Le May and George Culmer will retire by rotation under Article 106 and, being eligible, offer themselves for re-election.

Directors' interests are set out in the remuneration report on pages 42 to 44.

Directors' indemnity

Article 154 of the Company's Articles of Association provides, among other things, that, insofar as permitted by law, every director shall be indemnified by the Company against all costs, charges, expenses, losses or liabilities incurred in the execution and discharge of the directors' duties, power or office.

On 12 July 2006, the Company, pursuant to the power conferred by Article 154, executed deed polls for each of the then and all future executive and non-executive directors of the Company. The indemnities granted under these deed polls constitute qualifying third party indemnity provisions (as defined by Section 309B of the Companies Act 1985). The Board believes that it is in the best interests of the Group to provide this indemnity to its directors in order to ensure it attracts and retains high calibre directors through competitive terms of employment in line with the market.

In addition, the Company has arranged appropriate insurance cover in respect of legal action against its directors and officers.

Related party transactions

Related party transactions are set out in note 33 on page 102.

Charitable and political contributions

The Company and its subsidiaries worldwide made charitable donations of £2,033,711 during the year. The largest contribution of £317,866 was made towards purchasing reflectors and reflective waistcoats for children in Sweden to promote road safety. The Group did not make any donations to European Union (EU) political parties, nor to political parties outside the EU during 2006, and it is not the Group's policy to do so.

Annual General Meeting

The AGM will be held at the Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE on Monday, 21 May 2007 at 11.00am.

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

Auditors

So far as each director is aware, there is no relevant audit information (as defined in Section 234ZA(3) of the Companies Act 1985) of which the Company's auditors are unaware, and each director has taken all steps that he or she ought to have taken as a director in order to make himself or herself aware of, and to establish that the auditors are aware of, any relevant audit information.

Following an extensive review process earlier in the year, the directors will propose at the 2007 AGM that Deloitte & Touche LLP be appointed as auditors of the Company for the year ending 31 December 2007. PricewaterhouseCoopers LLP will stand down to enable Deloitte & Touche LLP to be appointed in their place. PricewaterhouseCoopers LLP have confirmed, as required by Section 394 of the Companies Act 1985, that there are no matters connected with their ceasing to hold office that they consider should be brought to the attention of Royal & SunAlliance's shareholders or creditors.

By order of the Board
Mark R Chambers
General Counsel and Group Company Secretary
7 March 2007

Corporate governance

Compliance with the provisions of the Combined Code

In respect of 2006, the Group is required to comply with the Principles and Provisions of Section 1 of the Combined Code published in 2003 and to provide an explanation where it has not done so. In June 2006, a revised version of the Combined Code was published. However, the Group was not required to comply with this during 2006. Additional disclosure in respect of how the Group already meets the requirements of the revised Code is provided below.

Throughout 2006, the Group has complied with the Principles and Provisions of the Combined Code except that the Group has not appointed a senior independent director nor is there a majority of independent directors on the Nomination Committee. The non-executive directors have a unanimous view that the appointment of a senior independent director is not appropriate at this time. All non-executive directors are encouraged to communicate directly with executive directors outside formal meetings and an active dialogue is maintained by the Board. Notwithstanding the composition of the Nomination Committee, all non-executive directors are involved in any process for the appointment of an additional director.

The Board

The Board meets regularly and is responsible for organising and directing the affairs of the Company and the Group in a manner that is in the best interests of the shareholders as a whole and is consistent with good corporate governance practices, and for ensuring that in carrying out its duties the Company and the Group meets legal and regulatory requirements. The Board is also responsible to the Financial Services Authority (FSA) for ensuring compliance with the Group's UK regulatory obligations.

The Board has a formal schedule of matters specifically reserved to it, which can only be amended by the Board itself and which is reviewed annually. Matters reserved to the Board include:

- Approval of the Group's long term objectives and commercial strategy,
- Approval of changes to the Group's senior management structure,
- Approval of the Group's overall risk appetite,
- Annual review of the effectiveness of internal control arrangements,
- Approval of the annual operating and capital budgets,
- Changes to the Group's capital structure,
- Approval of the Group's financial results and any significant changes to accounting practices or policies.

The separate roles of the Chairman, John Napier, and the Group CEO, Andy Haste, have been clearly defined in written role statements which have been approved by the Board.

The Chairman is responsible for leading the Board, liaising as necessary with the Group CEO on developments between Board meetings, ensuring that the Group CEO and his executive management team have appropriate objectives, and that their performance against those objectives are reviewed. The Group CEO is responsible to the Board for the executive management of the Group, and for liaising with the Chairman and keeping him informed on all material matters.

The Group operates a Delegated Authority Policy which specifies how executive authority is delegated from the Board to the Group CEO and on to other executives in the Group. Individual executive licences set out specific limits of authority in terms of entering into financial, underwriting and other business commitments. Each executive is responsible for ensuring a similar process of delegation is in place within their area of responsibility.

The Board met 11 times during 2006. Further details on the attendance of directors at Board and Committee meetings are provided on page 34.

The Directors

The Board comprises five non-executive directors and four executive directors. Details of the directors can be found on page 26. David Paige resigned as a director on 31 December 2006 and Simon Lee was appointed as a director with effect from 1 January 2007.

In accordance with the Company's Articles of Association and the Combined Code, the directors submit themselves for re-appointment at the first Annual General Meeting after their appointment and for re-election every three years thereafter. Simon Lee will therefore be proposed for re-appointment at the forthcoming Annual General Meeting and the directors retiring and proposed for re-election are George Culmer, Noel Harwerth, Edward Lea, Malcolm Le May and John Maxwell.

When appointing new directors, regard is given to the size of the Board and the balance of executive and non-executive directors as well as the skills and experience already represented by the existing Board members, and those which would be desirable on the Board going forward. The report of the Nomination Committee, including a description of its duties, is set out on page 33.

At all times during the year, at least half of the Board, excluding the Chairman, comprised non-executive directors. All non-executive directors have been determined by the Board to be independent. The Chairman meets regularly with the non-executive directors both individually and collectively without the executive directors being present. The Chairman met the independence criteria of the Combined Code on his appointment in 2003. There have been no changes to his external commitments since then which might affect his responsibilities to the Group. None of the executive directors serve on the board of another FTSE 100 company.

Directors have access to the services and advice of the General Counsel and Group Company Secretary and, in addition, may take independent professional advice at the expense of the Company in furtherance of their duties.

Directors' responsibilities

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

They must present financial statements for each financial year, in accordance with applicable law, accounting standards and regulations, which give a true and fair view of the state of affairs of the Company and Group and of the profit or loss and cashflows for that period. The directors are required to prepare financial statements for the Group in accordance with International Financial Reporting Standards (IFRS)

Corporate governance
continued

and have prepared financial statements for the Company in accordance with IFRS. Company law requires the directors to prepare such financial statements in accordance with IFRS, the Companies Act 1985 and Article 4 of the International Accounting Standards (IAS) Regulations.

In preparing such financial statements the directors are required to:

- Select suitable accounting policies and apply them on a consistent basis using reasonable and prudent judgement,
- State whether or not applicable accounting standards have been followed and explain any material departures,
- State whether the Group financial statements have been prepared in accordance with IFRS,
- Use the going concern basis unless it is inappropriate to do so.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

Professional development and training
On appointment, new directors are subject to a formal induction programme and receive training and guidance on their duties and responsibilities. Continuing professional development is offered to all directors which includes educational and business awareness presentations.

Board effectiveness
In 2006, the Board undertook an annual evaluation of its performance to assess how well the Board, its committees and the directors are performing. The review included the use of a comprehensive questionnaire.

Internal controls
The Board has overall responsibility for the Group's internal control systems and for monitoring effectiveness. Implementation and maintenance of the internal control systems are the responsibility of the executive directors and senior management. The performance of internal control systems is reviewed regularly by the Group Audit Committee and the boards of subsidiary companies.

The Board reviews annually the effectiveness of the Group's system of internal controls in order to safeguard the Group's assets and shareholders' investment. This system includes governance, financial controls, the risk management framework and operational, regulatory and compliance requirements. The systems are designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material financial misstatement or loss. Following the review of the system of internal control, the Board confirms that the actions it considers necessary to rectify any significant failings or weaknesses identified as a result of the review have been, or are being taken.

The Board, through the Group Audit Committee, receives reports from the Group Director, Audit, Risk and Compliance and his team on the integrity of the control environment and also receives reports from the external auditors based upon their audit work. The Group Audit Committee also receives reports on the Group's arrangements for ensuring regulatory compliance. The Board, through the Board Risk Committee, considers reports from risk specialists both internal and external to the Group, and reviews Group level risk management information.

Each quarter there is a self certification process completed by business managers across the Group to confirm the adequacy of controls and their compliance with Company policies, laws, rules and regulations.

The Board considers that collectively this reporting framework gives it sufficient information upon which to monitor the systems of internal control and to review their effectiveness as required by the Combined Code. The Board therefore considers that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group, that it has been in place for 2006 and up to the date of approval of the Annual Report & Accounts, that it is regularly reviewed by the Board and that it accords with the Turnbull Guidance on the Combined Code.

Further details on the overall risk framework is set out on pages 22 to 23.

Financial control framework
In 2006, the Company voluntarily delisted from the New York Stock Exchange and terminated its ADR programme. In January 2007, the Company terminated its US SEC registration and its reporting obligations to the SEC also ceased at that time. As a result of the SEC deregistration, the Company is no longer required to be compliant with the US Sarbanes Oxley Act 2002. However, the elements of Sarbanes Oxley compliance which have added value will be carried forward in the Group's financial control framework.

Corporate governance framework
The Group's corporate governance framework describes and prescribes how the Group is directed and managed by setting out the matters reserved for the Board, the terms of reference of the Board and management committees, role statements, policies, systems, procedures and controls.

Committees
Specific responsibilities of the Board have been delegated to the Group Audit, Remuneration, Nomination, Investment and Board Risk Committees. The role of the Investment, Board Risk, Group Audit and Nomination Committees are set out below and the role of the Remuneration Committee is set out in the remuneration report on pages 35 to 36. Details of the Chairmen and membership of the Group Audit, Nomination, Remuneration and Investment Committees are shown on page 34 together with details of attendance at meetings.

The Investment Committee is chaired by Malcolm Le May, meets twice a year and comprises all non-executive directors, Andy Haste and George Culmer. The Committee assists the Board in setting the Group's investment strategy and monitors the execution of that strategy and the Group's investment performance.

The Board Risk Committee, which meets quarterly, was chaired during the year by David Paige who resigned from the Board on 31 December 2006. George Culmer has since assumed the role of Committee Chairman. The Committee comprises the Group CEO and the Chief Financial Officer and other members of executive management. The Committee is authorised by the Board under its terms of reference to manage all risks faced by the Group. The Board-approved Group risk appetite is set by reference to policies, control limits and other mechanisms. The Committee's principal duties include:

- Defining the Group's risk appetite prior to approval by the Board,
- Approval of policy and minimum standards that are consistent with the risk appetite,
- Ensuring that risks that are outside the appetite are mitigated in an appropriate manner,
- Overseeing and challenging the Group's risk management processes.

The role of the Group Audit Committee and the Nomination Committee are set out below.

Report of the Group Audit Committee

Membership

The membership of the Committee and the attendance record of directors in 2006 are shown in the table on page 34. The Committee is comprised of independent non-executive directors who have recent and relevant financial experience.

In 2006, the Committee met six times. The Chairman, Group CEO, Chief Financial Officer, Director Regulatory Risk and Compliance and the Group Director, Audit, Risk and Compliance are regular attendees. Other members of executive management are also invited to attend from time to time. The outcome of meetings are reported to the Board and the Board receives the minutes of all Committee meetings.

Principal duties

The Committee's principal duties are as follows:

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

The Group Audit Committee has unrestricted access to Company documents and information, as well as to employees of the Company and the external auditors.

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

Internal audit

The Group has an internal audit function, whose activities and effectiveness are monitored and reviewed by the Committee. The Committee is responsible for ensuring that adequate access to information and resources is given to the Group Director, Audit, Risk and Compliance (who is responsible for Internal Audit within the Group) and for approving the appointment of and removal of the holder from that position.

External auditors

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

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

The Company has enjoyed a long standing and constructive relationship with its current auditor PricewaterhouseCoopers LLP. It is, however, our policy to periodically review major contracts. Following an extensive review earlier in the year, the Board has accepted the Committee's recommendation that PricewaterhouseCoopers LLP stand down as auditors of the Company and that a resolution be put to the 2007 AGM for the appointment of Deloitte & Touche LLP as external auditors in their place.

Whistleblowing

It is the Committee's responsibility to keep the procedures laid out in the Group whistleblowing policy under review. This policy deals with employees who wish to raise serious concerns in good faith, and either do not feel comfortable raising the matter with local management or are not satisfied with the local management response. They can raise their concerns with the Group Director, Audit, Risk and Compliance, who will either investigate or arrange for an investigation of the matter. Employees are offered such safeguards and support as may be necessary to protect their personal integrity and, where possible, identity.

Report of the Nomination Committee

Membership

The membership of the Committee and the attendance record of directors in 2006 are shown in the table on page 34. The Committee met twice during 2006.

Principal duties

The Committee's principal duties are to review the structure, size and composition of the Board and to evaluate the directors' skills, knowledge and experience. It has access to external recruitment consultants in order to help fill any vacancies. The Committee considers the leadership needs and succession planning of the Board when making decisions on new appointments. Resolutions to re-appoint directors at the AGM are not proposed automatically, but are subject to the approval of the Board, taking into account the recommendations of the Committee.

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

Corporate governance
continued

Board and board committee membership and attendance in 2006

Directors attending Board and board committee meetings during 2006 were:

	Notes	Board	Board Committee	Group Audit Committee	Investment Committee	Nomination Committee	Remuneration Committee
Total number of meetings in the year	1	**11**	**10**	**6**	**2**	**2**	**8**
George Culmer		11	10		1		
Noel Harwerth		11		6	2		
Andy Haste		11	10		1		
Edward Lea		11		6*	2		7
Malcolm Le May		10			2*		7
John Maxwell		11		6	2	2	7*
Bridget McIntyre		10					
John Napier	2	11*			2	2*	
David Paige		11					

*Chairman of the Board or board committee

Notes

1. In addition to attendance as above, Andy Haste and other executive directors regularly attend, by invitation, meetings of the Group Audit Committee and Remuneration Committee.

2. John Napier attended one meeting of the Remuneration Committee by invitation.

Annual General Meeting

The AGM Notice is despatched to shareholders at least 20 working days before the meeting and contains separate resolutions on each substantive issue, including a resolution to adopt the Annual Report & Accounts. All directors are requested to attend each AGM. The Chairman and the chairmen of the Group Audit, Nomination and Remuneration Committees make themselves available to take questions from shareholders.

The Company has arrangements in place with its Registrars to ensure that all proxy votes received are accurately counted. The results of proxies lodged on each resolution, including votes for, against and withheld, are published on the Group's website at www.royalsunalliance.com after each AGM. In accordance with best practice, these results are also announced to the London Stock Exchange.

Relations with shareholders

The Board attaches considerable importance to its relationships and communication with shareholders. Senior management meet principal institutional shareholders on a regular basis. In addition, investor relations events are held during the year to increase shareholders' understanding of the business.

Going concern

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

By order of the Board
Mark R Chambers
General Counsel and Group Company Secretary
7 March 2007

Remuneration report

The following report by the Remuneration Committee has been approved by the Board for submission to the shareholders at the 2007 AGM.

PricewaterhouseCoopers LLP have audited the following items stipulated in law for their review:

- The table of directors' remuneration and associated footnotes on page 41 and the disclosure of the items comprising benefits in kind,
- The tables of defined benefit and defined contribution pensions on page 41 and associated footnotes,
- The table of disclosure of directors' share options and share awards on pages 42 to 44 and associated footnotes.

In constitution and operation, the Committee complies fully with the Combined Code as appended to the Listing Rules of the UK Listing Authority and as described in the corporate governance section of this report, on page 31.

The role of the Remuneration Committee

The Committee is a formal committee of the Board and is accountable to shareholders through its annual remuneration report which is voted on at the AGM, and remains committed to reflecting the best interests of shareholders and to the pursuit of best practice in remuneration policy. The Committee welcomes ongoing dialogue with shareholders on remuneration policy.

The Committee's responsibilities are set out in its terms of reference which are available to shareholders on request and on our website at www.royalsunalliance.com. These include:

- Determining the terms and conditions and remuneration of the Chairman of the Board and the executive directors,
- Overseeing the operation of the Company's share based long term incentive schemes, including approving the value and timing of awards and overseeing the operation of performance conditions,
- Consideration of, and advice to the Board on, the Group's broader remuneration policy in relation to senior executives reporting to the Group CEO (the Executive Team).

The Committee presents a summary of its principal activities to shareholders through this report, and the Committee Chairman attends the AGM to answer questions from shareholders on the activities of the Committee and its remuneration policies.

Membership of the Remuneration Committee

During the year, the directors who served on the Committee were John Maxwell (Chairman), Edward Lea and Malcolm Le May. All of the non-executive directors on the Committee were determined by the Board to be independent. The attendance of members in 2006 is shown in the table on page 34.

Members of the Committee have no personal financial interest, other than as shareholders, in the Committee's decisions, and they have no conflict of interest arising from cross directorships. Fees for serving as a committee member and chairing committees of the Board are described in the non-executive directors section of this report on page 40.

Advisors to the Remuneration Committee

In developing remuneration strategy during the year, the Committee obtained its principal advice from New Bridge Street Consultants LLP, who were appointed by the Committee and provided no other services to it during 2006.

The terms of engagement for the remuneration consultants are available to shareholders on request and on our website at www.royalsunalliance.com.

The Group CEO is invited to attend all meetings of the Committee to provide context and advice to the Committee on company strategy and performance and senior executive pay strategy. The Group Human Resources Director normally attends meetings to provide information on wider remuneration strategy and practice within the Group. The Chairman of the Board is invited to attend meetings as appropriate. The General Counsel and Group Company Secretary acts as secretary to the Committee. None of the non Committee attendees are present as of right, and do not attend when their own remuneration is discussed.

Activities of the Remuneration Committee

The continuing focus of the Committee is the maintenance of a strong link between performance and reward. It is the Committee's view that the interests of shareholders are best served by ensuring a remuneration structure which has a significant element of performance related pay, and reinforces the culture of high performance and accountability that applies at all levels throughout the Group.

The Committee meets as often as necessary throughout the year to ensure that it is able to fully report to the Board and shareholders on all relevant matters. In 2006, the Committee met eight times and the principal business of those meetings included the following activities:

- The design and development of the 2006 Long Term Incentive Plan, the key features of which are described later in this report (the Long Term Incentive Plan). As well as discussions of the key features of the Long Term Incentive Plan, the Chairman of the Committee engaged in consultation with major shareholders in order to attain the support of shareholders at the 2006 AGM,
- The determination of performance conditions, and approval of the initial awards, under the Long Term Incentive Plan,
- Conducting the annual review of base salaries for executive directors and the Group CEO's recommendations for his Executive Team,

Remuneration report
continued

- The consideration and approval of annual bonus payments for 2005,
- The review of actual performance of the executive directors in 2005 against agreed goals and objectives,
- The review of proposed annual objectives and performance goals of executive directors for 2006,
- The ongoing review and monitoring of performance conditions and reports on performance for awards under the Share Matching Plan and various share option grants,
- The ongoing review of share incentives generally, including the approval of changes of an administrative or regulatory nature,
- The determination of termination arrangements for senior executives who left the Group in 2006, including those of David Paige,
- A review of the Committee's terms of reference,
- The drafting of the remuneration report for the 2006 Annual Report and Accounts.

Remuneration policy principles
The Committee's remuneration policy is consistent with the high performance culture across the Group. The key principles which underpin the remuneration policy are:

- Total remuneration is set at a level which enables the recruitment, retention and motivation of high quality executive talent,
- There is a strong and visible link between remuneration and performance,
- Executive remuneration and shareholder interests are strongly aligned. This is reflected in the design of the Long Term Incentive Plan, which provides a co-investment opportunity,
- The observation of existing share ownership guidelines to further enhance the alignment of shareholder interests with those of executive directors,
- Incentive arrangements are leveraged so that only exceptional performance attracts the highest levels of award,
- A balance of short and long term performance is used, incorporating measures of financial performance, delivery of shareholder value and a robust assessment of personal contribution,
- Remuneration policy and practice is transparent to shareholders.

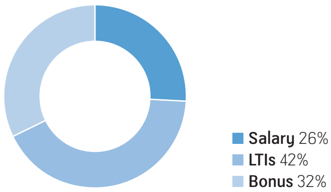
Elements of remuneration
Remuneration for executive directors in 2007 will consist of the four principal elements described below, of which only base salary is pensionable:

- Base salary,
- Annual performance bonus,
- Share based long term incentive awards,
- Pension provision and other benefits.

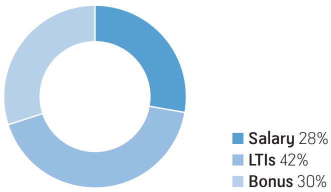
This structure will be replicated for other members of the Executive Team.

As an indication of the balance of remuneration, including long term incentives (LTIs), the following charts illustrate the remuneration attributable to the continuing executive directors over the year (excluding allowances and pension provision):

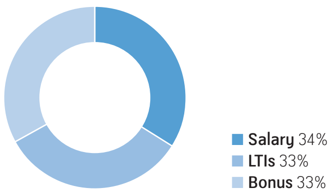
Andy Haste



George Culmer



Bridget McIntyre



For the purposes of the above charts, the bonus value is based on the cash bonus received plus the fair value of the compulsory Deferred Shares. The LTI value is based on the fair value of awards of Performance Shares and half of the maximum potential number of Matching Shares that may vest (subject to performance) relating to voluntary and compulsory Deferred Shares under the Long Term Incentive Plan. Details of how the fair values, referred to above, have been calculated are set out in note 27 on page 85.

Base salary

Policy: Base salary is set with reference to the median level for equivalent roles in similar companies.

Base salaries for executive directors and members of the Executive Team are set on appointment with reference to market data. The strong performance culture within the Group means that it is essential that executive directors are of the highest calibre. To enable the Group to compete for the most talented executives, the Committee relates base salary levels to the median level for equivalent roles in similar companies facing similar levels of complexity and challenge in the UK and internationally. In the UK, the comparator group most frequently used is a sample of financial service companies within the FTSE 100.

Base salaries are reviewed on the basis of market movements and an assessment of the performance of the executive. The 2006 salary review process resulted in the following increases, effective from 1 April 2006, for the continuing executive directors (as at 31 December 2006):

	Position	Increase	Base salary
Andy Haste	CEO	4.5%	£805,000
George Culmer	CFO	5%	£442,000
Bridget McIntyre	UK CEO	5%	£367,500

Recognising that base salaries are now generally competitive, as in 2006, increases in 2007 are expected to be broadly in line with movements in boardroom pay.

The following table sets out the base salaries of UK based executives below Board level on a banded basis as at 31 December 2006. No such executive received a base salary in excess of £350,000.

Base salary range	Number of employees
£250,001 and over	6
£200,001 – £250,000	3
£150,001 – £200,000	28

In relation to the increase in number of employees in the band £150,001 – £200,000, from 2005, there are 12 employees who received pay rises sufficient for them to be included in the above chart. There were also seven new employees throughout 2006 at this level bringing new capabilities to the Group.

Annual performance bonus

Policy: Bonus payments are related to stretching performance targets, and are capped at 133% of base salary. For maximum bonuses to be achieved, outstanding performance must be demonstrated.

The executive directors and the Executive Team participate in an annual bonus plan. If stretching targets are achieved, participants receive a cash bonus of up to 50% of base salary and Deferred Shares worth up to 16.5% of base salary. For outstanding performance, a cash bonus of up to 100% of base salary and Deferred Shares worth up to 33% of base salary are achievable. Deferred Shares are described in the section headed Share based long term incentive awards below.

Executives are also offered the opportunity to voluntarily invest up to 33% of the cash element of their bonus into Deferred Shares. In 2006 (under the Long Term Incentive Plan), an award of Matching Shares was made on a pro rata basis to the Deferred Shares. Matching Shares may vest subject to the performance conditions described on page 38 of this report.

The Committee reserves the right to reduce the permissible investment below this level. However, the Long Term Incentive Plan will continue to operate on the same terms in 2007.

The targets used for determining the amount of bonus payable are a combination of stretching business performance targets and the results of a structured assessment of each executive's performance against detailed and specific personal objectives.

Financial targets are measured against Combined Operating Ratio (COR) targets which are the preferred measures for Royal & SunAlliance businesses. COR is the single indicator which most fully captures the underlying strength and performance of an insurance business.

Personal targets are reviewed and approved by the Committee early in the financial year. The Group CEO's performance is assessed annually by the Chairman of the Board and members of the Committee. The Group CEO carries out a similar assessment for each of his direct reports, subject to review and sign off by the Committee in the case of executive directors. Assessments also take account of appropriate leadership style and each executive receives a performance rating against the standard scale used at all levels in the business.

Bonuses paid to executive directors in respect of the performance year 2006 are included in the table of directors' emoluments on page 41. The Remuneration Committee is satisfied that the bonus payments made in respect of 2006 reflect the consistently strong COR results across the Group throughout 2006, and the contribution made by each executive director.

UK based executives who are members of the global 'Top 100' group (the Top 100) participate in a bonus plan which is structured in the same way and measured using the same metrics as the plan described above. For outstanding performance, a cash bonus of up to 65% of base salary and Deferred Shares worth up to 33% of the cash bonus are achievable.

Share based long term incentive awards

Policy: To provide annual share awards to executives to ensure alignment with shareholder interests, solely through the Long Term Incentive Plan. Except in exceptional circumstances, no other discretionary share plan will be used to make awards.

Prior to the approval of the Long Term Incentive Plan, two share incentive plans were operated:

- The 2004 Share Matching Plan, which was designed to operate for two years. The final awards under this plan were made in 2005,
- The Executive Share Option Scheme (ESOS). Regular awards under the ESOS were discontinued from 2006, but the ESOS remains available for use in exceptional circumstances, such as executive recruitment.

Following shareholder approval at the 2006 AGM, the primary long term incentive is the Long Term Incentive Plan, the key features of which (and associated policies) are summarised in the sections below.

Awards under the Long Term Incentive Plan will be funded through a combination of new issues and shares purchased in the market.

Remuneration report
continued

Conditional awards of Performance Shares
Participants may receive a conditional award of shares with the grant level and performance condition determined by the Committee prior to each grant. Executive directors, members of the Executive Team and the Top 100 will be eligible for awards of Performance Shares.

It is intended that, in 2007, awards of Performance Shares to executive directors will be limited to a maximum face value of 100% of base salary, other than in exceptional circumstances. Awards of Performance Shares to members of the Executive Team in 2007 will be limited to a maximum face value of 80% of base salary, other than in exceptional circumstances. Account will be taken of personal performance in determining the scale of the award to each executive. For executives below this level, distribution policy will normally be based on a formula which relates the size of award to performance and potential, as measured through the annual performance appraisal process.

In any year, the face value of Performance Shares granted to any individual will be limited to 150% of base salary in normal circumstances, subject to an overriding cap of 250% of base salary in exceptional circumstances, such as an executive recruitment.

Performance Shares will vest after three years subject to the performance condition (see below) and provided the individual remains in employment with the Group (other than in exceptional circumstances such as death or retirement at normal retirement age).

Deferred Shares
As described in the annual performance bonus section on page 37, executive directors, members of the Executive Team and the Top 100 may be granted Deferred Shares as part of the annual bonus. These Deferred Shares may not be withdrawn and will normally vest three years from the date of grant subject to continued employment with the Group.

In addition, executives may invest an additional portion of bonus in Deferred Shares on a voluntary basis. Voluntary Deferred Shares are not at risk of forfeiture and may be withdrawn at any time (but the right to Matching Shares would lapse on those Deferred Shares withdrawn).

Conditional awards of Matching Shares
Executives may receive a conditional award of Matching Shares pro rata to the number of Deferred Shares held. The maximum matching ratio for Matching Shares:Deferred Shares will be 2.5:1, calculated on the gross value of the bonus invested in Deferred Shares. At threshold performance the matching ratio will be 0.625:1. Details of the performance condition used for the first grant are described below. Following a review, the Committee resolved to use the same performance conditions in relation to awards proposed in 2007.

Executive directors, members of the Executive Team and the Top 100 will be eligible for awards of Matching Shares.

Matching Shares will vest after three years subject to the performance condition (see below) and provided the individual remains in employment with the Group (other than in exceptional circumstances such as death or retirement at normal retirement age).

Performance conditions
The Committee will determine the performance condition for each grant of Performance Shares and Matching Shares, with performance measured over a single period of three years with no provision to retest. In 2007 (as in 2006), grants of Performance Shares and Matching Shares related to non voluntarily Deferred Shares will be subject to a performance condition consisting of a combination of Return on Equity (ROE) and Total Shareholder Return (TSR) targets. These are set out below:

- 50% of the shares comprising the award will vest according to ROE performance. If underlying average annual ROE over three years commencing with the financial year of grant is below 10%, no part of the award subject to the ROE performance condition will vest. If underlying average annual ROE over three years is 10%, 25% of the award will vest. If underlying average annual ROE over three years is 16%, 100% of the award will vest. Vesting will be on a straight line basis in between. Underlying ROE will exclude items of an exceptional nature which in the view of the Committee do not reflect the underlying performance of the business,
- 50% of the shares comprising the award will vest according to TSR performance against a comparator group of UK and International Financial Services companies. Below median performance, no part of the award subject to the TSR performance condition will vest. At median performance, 25% of the award will vest. At upper quintile (top 20%), 100% of the award will vest. Vesting will be on a straight line basis in between,
- Additionally, before any shares subject to the TSR condition vests, the Committee must be satisfied that the Company's TSR performance is reflective of underlying financial performance.

The comparator group will consist of the following companies:

Comparator companies

Aegon	AGF
Alleanza	Allianz
Aviva	Baloise
Fortis	Generali
Legal & General	Munich Re
QBE	Swiss Re
Zurich Financial Services	

The Company's TSR will be independently calculated and verified by the Committee for the purposes of awards made under the Long Term Incentive Plan.

The vesting of Matching Shares related to voluntarily Deferred Shares will be determined solely by the ROE performance condition.

ROE has been selected as the measure of financial performance as it is one of the key measures of overall business performance and is visible externally to shareholders.

The TSR performance condition has been designed to provide alignment between executive remuneration and shareholder interests and to ensure that an element of the package is linked directly to share price performance. The comparator group has been selected to ensure that performance is compared fairly against a group of similar companies operating in a similar competitive environment. The use of ROE and TSR in combination, provides a balanced approach to the measurement of Company performance over the longer term.

Dilution

Dilution levels for all schemes are held strictly within limits set by the Association of British Insurers (ABI) (10% over 10 years for all schemes and 5% for discretionary schemes). The dilution levels compared to ABI limits as at 31 December 2006 was:

ABI limit	Royal & SunAlliance dilution
10% over 10 years for all share schemes	5.83%
5% over 10 years for discretionary schemes	3.63%

Share ownership guidelines

Strengthened share ownership guidelines were introduced in 2004 for executive directors and members of the Executive Team.

The Group CEO is required to build and maintain a minimum shareholding in the Company equivalent to 150% of base salary. The other executive directors have a target of 100% of base salary and other members of the Executive Team have a target of 50% of base salary. In order to ensure that progress is made towards this target, executives are required to retain shares to a value of 50% of the net of tax gain under all executive schemes until the relevant guideline is attained. This requirement will apply to awards under the Long Term Incentive Plan, and will continue to apply to awards under all existing long term incentive plans.

The following table shows the number of shares (including voluntary Deferred Shares held under the Long Term Incentive Plan) held by each continuing executive director at 31 December 2006 and the increase in shareholding over the year.

	Shares held	Increase	% salary*
Andy Haste	804,705	21%	152%
George Culmer	160,565	59%	55%
Bridget McIntyre	31,337	n/a**	13%

*Assuming share price of 152.50p (the closing middle market price on the last dealing day of the year).

** All of Bridget McIntyre's shares were acquired during the year.

Pension provision and other benefits

Policy: Reasonable provision, in line with arrangements made in similar companies, will be made to allow executives to plan effectively for their retirement, but the Committee will not compensate executives affected by new tax limits effective 6 April 2006.

Andy Haste is a member of the SAL Pension Scheme (SAL), a contributory defined benefit occupational pension scheme. In common with all other members of the Royal & SunAlliance defined benefit occupational pension schemes, from 1 January 2006 Andy Haste's future benefits within SAL will accrue on a 'career average revalued earnings' basis rather than on a final salary basis. The Group has decided to retain a cap within its defined benefits after 'A Day' and, accordingly, Andy Haste's benefit accrual will continue to be calculated by reference to a 'capped' salary (which will be measured each year in line with past practice). In addition to his benefits within SAL, Andy Haste receives an age related taxable cash allowance to enable him to make his own provision for retirement above the cap. In 2007, he will be paid an allowance of 27% of base salary for this purpose.

Until 31 December 2005, George Culmer participated in a contributory defined contribution occupational pension scheme (the Royal & SunAlliance UK Pension Scheme 2002). From 1 January 2006, this scheme was replaced by the Royal & SunAlliance Stakeholder Pension Plan (the Stakeholder Plan), a contributory defined contribution stakeholder pension scheme. George Culmer became a member of the Stakeholder Plan from 1 January 2006. In 2007, he will receive employer contributions worth 15% of base salary, subject to an employee contribution of 5% of base salary up to the HM Revenue and Customs annual allowance as applicable. Additionally, following a review of the market competitiveness of his pension benefits, the Committee decided to provide George Culmer with a taxable cash allowance of 15% of base salary, in order to bring his overall pension provision closer to the market median.

Bridget McIntyre was enrolled in the Stakeholder Plan as from 1 January 2006. As in 2006, in 2007 she will receive employer contributions worth 15% of base salary, subject to an employee contribution of 5% of base salary up to the HM Revenue and Customs annual allowance as applicable. Due to Bridget McIntyre not being able to join the Royal & SunAlliance UK Pension Scheme 2002, further employer contributions of 15% of base salary, and employee contributions of 5% of base salary were paid during the year to cover the period from 1 November 2005 to 31 December 2005. Additionally, Bridget McIntyre receives a taxable cash allowance of 15% of base salary, in order to bring her overall pension provision closer to the market median.

David Paige elected not to join a Royal & SunAlliance pension plan on appointment and received a taxable cash allowance of 17.5% of base salary.

In addition, the executive directors participate in a number of benefits available to other senior managers, including life assurance at the rate of four times base salary together with a spouse/dependant annuity, sickness and ill health early retirement benefits and private medical insurance. They also have a choice between a company car and a monthly cash car allowance. In common with other employees, the executive directors are eligible to participate in the Royal & SunAlliance International Sharesave Plan (SAYE).

Service contracts

The Committee's policy on service contracts is that they should be subject to a maximum notice period of one year. Generally, in the event of termination, and in all cases of termination on performance grounds, the Committee's policy would be to seek and apply mitigation.

Andy Haste's service contract commenced on 2 April 2003 and he was appointed as a director of the Group on the same date. His contract expires under normal circumstances in January 2024 unless terminated earlier by the Company or by Andy Haste on 12 months' notice.

George Culmer's service contract commenced on 1 May 2004 and he was appointed as a director of the Group on the same date. Bridget McIntyre's service contract commenced on 1 November 2005 and she was appointed as a director of the Group on 2 November 2005. The service contracts for George Culmer and Bridget McIntyre terminate under normal circumstances in October 2024 and July 2023 respectively unless terminated earlier by the Company or by the individual on 12 months' notice.

Remuneration report
continued

David Paige's service contract commenced on 1 February 2005 and he was appointed as a director of the Group on 16 February 2005. His service contract was due to expire in July 2013, and was subject to a notice period of 12 months. Following the reorganisation of the Group Risk function, David Paige stood down from the Board and left the Group effective 31 December 2006. He received his usual remuneration (including participation in the 2006 annual performance bonus) up to 31 December 2006 and no compensation for loss of office. David Paige was not a member of any Group pension plan and there was no additional cost to the Group.

External directorships
Where appropriate, the Group encourages directors and other senior managers to accept, subject to the approval of the Chairman of the Board and the Group CEO, an invitation to join the Board of another company in a non-executive capacity, recognising the value of such wider experience. In these circumstances, they are permitted to retain the remuneration from the non-executive appointment. For executive directors and other members of the Executive Team, external appointments are limited to one although at present none of the executive directors hold non-executive positions in other companies.

Non-executive directors
All non-executive directors of the Company have letters of appointment which set out the terms and conditions of their appointment. Non-executive directors are not entitled to bonus payments or pension arrangements, nor do they participate in the Group's long term incentive plans.

Under the Company's Articles of Association, the remuneration paid to non-executive directors is determined by the Board, within limits set by shareholders. The basic fee for a non-executive director is £45,000pa. The additional fee for chairing the Group Audit Committee is £20,000pa and the additional fee for chairing the Remuneration Committee and the Investment Committee is £12,500pa for each committee. Additionally, a fee of £5,000pa is paid to any non-executive director sitting on more than one committee but not acting as chair of any committee. These fee rates will be unchanged for 2007.

The Remuneration Committee determines the remuneration of the Chairman of the Board. The fee payable to John Napier in respect of his appointment as Chairman of the Board (effective 17 March 2003) was increased effective 1 January 2006 from £250,000 to £325,000pa in order to reflect market movements and the complexity and challenge of the role. John Napier's letter of appointment was effective 9 January 2003 and the term of his appointment was initially three years; it has now been extended until 31 December 2008. No further review of John Napier's fees is anticipated during the current term of his appointment. The appointment may be terminated by John Napier giving three months' notice to the Company.

Edward Lea and John Maxwell have letters of appointment effective from 10 July 2003; Noel Harwerth and Malcolm Le May have letters of appointment effective from 30 March 2004. These letters of appointment all request one month's notice should the non-executive director wish to resign. All non-executive directors (including the Chairman) are subject to a three year rolling period of appointment in accordance with the Company's Articles of Association.

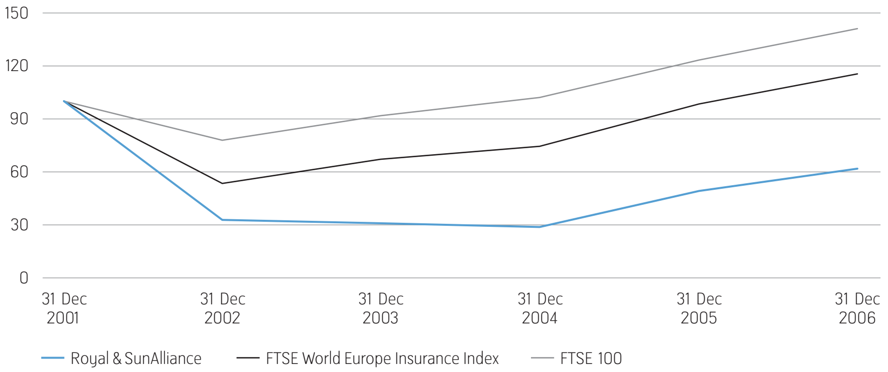
Historical TSR performance
The main graph below is included in the report of the Committee as a requirement of Schedule 7A to the Companies Act 1985.

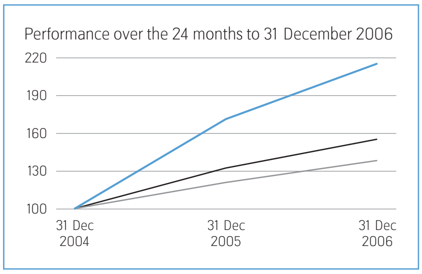
The graph shows the TSR of the Group with reference to the FTSE World Europe Insurance Index and the FTSE 100 Index. The FTSE World Europe Insurance Index comprises the range of European insurance businesses which most closely match our competitor group, and the TSR comparator group selected for 2006 awards under the Long Term Incentive Plan. The FTSE 100 Index comprises the 100 most highly capitalised companies, representing approximately 80% of the UK market. TSR performance relative to the indices is shown over the five years from 31 December 2001 to 31 December 2006.

The inset graph shows the TSR of the Group with reference to the same index over the 24 month period ending 31 December 2006.

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

Total shareholder return for Royal & SunAlliance, FTSE World Europe Insurance Index and FTSE 100 Index





Directors' emoluments

Directors' emoluments (audited part)

Remuneration for the year ended 31 December was as follows:

	Notes	Base salary and fees £000	Allowances and benefits £000	Bonuses £000	Total 2006 £000	Total 2005 £000
Executive directors	1					
George Culmer	2	437	97	381	915	849
Andy Haste	3	796	264	774	1,834	1,754
Bridget McIntyre	4	363	71	360	794	536
Non-executive directors						
Noel Harwerth		50	–	–	50	50
Edward Lea		65	–	–	65	65
Malcolm Le May		58	–	–	58	58
John Maxwell		58	–	–	58	58
John Napier		325	–	–	325	250
Directors who left during 2006						
David Paige (resigned 31 December 2006)	5	348	82	284	714	917

Notes:

1. 2006 bonuses were calculated as described in the remuneration report on page 37. In 2006 a maximum cash bonus of 100% of salary was achievable.
2. George Culmer received an annual performance bonus of £380,562 in respect of performance year 2006. His allowances include 15% of base salary as a retirement allowance, paid monthly. During 2006 the amount paid was £65,000. He also received car benefits worth £28,000 and medical and life assurance benefits worth £4,000.
3. Andy Haste received an annual performance bonus of £773,847 in respect of performance year 2006. His allowances include an age related percentage of base salary as a retirement allowance, paid monthly. During 2006 the allowance was 27% and the amount paid was £215,000. He also received car benefits worth £41,000 and medical and life assurance benefits worth £8,000.
4. Bridget McIntyre received an annual performance bonus of £360,150 in respect of performance year 2006. Her allowances include 15% of base salary as a retirement allowance, paid monthly. During 2006 the amount paid was £54,000. She also received car benefits worth £14,000 and medical and life assurance benefits worth £3,000.
5. David Paige resigned as director on 31 December 2006. He received an annual performance bonus of £284,012 in respect of performance year 2006. His allowances also included 17.5% of base salary as a retirement allowance, paid monthly. During 2006, the amount paid was £61,000. He also received car benefits worth £14,000 and medical and life assurance benefits worth £7,000. He received no compensation for loss of office.

Pension benefits (audited part)

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

	Change in accrued pension in year £	Total accrued pension at 31 December 2006 £	Transfer value of total accrued pension at 31 December 2006 £	Transfer value of total accrued pension at 31 December 2005 £	Difference in transfer values less members contribution (note 1) £
Andy Haste	1,928	6,768	68,403	48,225	14,786

Notes:

1. The difference in transfer values reflects the difference between the two transfer values calculated using relevant information on the respective dates and is not necessarily the actuarial increase of the underlying pension.
2. The figures set out in the table above provide information as required by the Directors' Remuneration Report Regulations 2002. The Listing Rules require the change in accrued pension to be shown excluding the effects of inflation and the transfer value of this increase. These figures are shown in the notes below.
3. The accrued pension figures shown are the annual amounts of the member's pension payable from normal retirement age. Increases to pensions when in payment are applied in accordance with the relevant scheme rules. On the death of the member leaving a surviving spouse and/or children, spouse's and/or childrens' pensions are payable in accordance with scheme rules.
4. The benefits shown above in respect of Andy Haste relate to his membership of a defined benefit pension scheme up to the earnings cap.
5. For Andy Haste the increase in his accrued pension during the year, excluding the effects of inflation, was £1,797 and the transfer value in respect of this less his contributions was £14,185 at 31 December 2006.
6. Andy Haste is required to contribute to the scheme and also has the option of paying Additional Voluntary Contributions (AVCs). Neither voluntary contributions nor the resulting benefits are included in the table.
7. Transfer values have been calculated in accordance with the guidance note GN11 published by the UK Institute of Actuaries and Faculty of Actuaries.
8. The transfer value of the accrued benefits represent the value of assets that the pension scheme would need to transfer to another pension provider on transferring the scheme's liability in respect of Andy Haste's pension benefits. The transfer values do not represent sums payable or due to Andy Haste.

The Company contributions paid in respect of executive directors who are members of Group defined contribution schemes, were as follows:

	Company contributions paid in 2006 £	Company contributions paid in 2005 £
George Culmer	65,504	61,500
Bridget McIntyre	63,219	n/a

Bridget McIntyre joined the Group in November 2005. Because of changes being made to the Group's pension arrangements, no contributions were paid into the Royal & SunAlliance UK Pension Scheme 2002 in respect of November and December 2005. These contributions were paid into the Royal & SunAlliance Stakeholder Pension Plan which was set up on 1 January 2006 and totalled £8,750.

David Paige was not a member of any Royal & SunAlliance pension scheme.

Directors' interests

Shareholdings (non audited part)

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

	Notes	**Shares held at 31 December 2006**	Shares held at 1 January 2006
Executive directors			
George Culmer	1, 3	**105,138**	100,819
Andy Haste	1, 3	**691,274**	666,076
Bridget McIntyre	1, 3	**14,937**	–
David Paige (resigned 31 December 2006)	1	**31,167**	31,167
Non-executive directors			
Noel Harwerth	2	**–**	34,000
Edward Lea		**302,003**	241,128
Malcolm Le May		**–**	–
John Maxwell		**261,011**	252,044
John Napier		**300,945**	290,605

Notes:

1. In addition to the interests shown above, the directors indicated, in common with other employees, had a beneficial interest as at 31 December 2006 in 4,938,894 (2005: 4,938,894) ordinary shares of 27.5p each held in the Royal & SunAlliance ESOP Trust No 2.
2. Noel Harwerth's shares were held in the form of 6,800 American Depositary Receipts (ADRs). One ADR represented five ordinary shares. The shares were disposed of as part of the compulsory sale process of ADRs. The ADR programme was terminated on 30 October 2006 .
3. The directors had a beneficial interest as at 31 December 2006 in the voluntary Deferred Shares of 27.5p each held under the Long Term Incentive Plan which are not included in the above table.
4. On 7 March 2006, the directors' interests remained unchanged.

Options (audited part)

Movements in option holdings during 2006 were as follows:

	Notes		Options held at 1 January 2006	Options granted during the year	Options exercised during the year	Options lapsed during the year	**Options held at 31 December 2006**
George Culmer		ESOS	1,994,318	–	–	–	**1,994,318**
		SAYE	12,466	–	–	–	**12,466**
Andy Haste		ESOS	7,573,433	–	–	–	**7,573,433**
		SAYE	23,858	–	–	–	**23,858**
Bridget McIntyre		ESOS	301,724	–	–	–	**301,724**
	1	SAYE	–	15,448	–	–	**15,448**
David Paige (resigned 31 December 2006)		ESOS	1,007,796	–	–	–	**1,007,796**
		SAYE	12,466	–	–	12,466	**–**

Options granted following the AGM in May 2003 are potentially exercisable if, at the end of the period of three business years starting with the business year in which the options were granted, the Group has achieved a Return on Capital (ROC) of at least 6% per annum (after inflation and excluding items of an exceptional nature which in the view of the Committee do not reflect the underlying performance of the business) when averaged over the period. One retest is allowed at the end of the fourth business year, but if the performance criterion has not been met over the full four year period, the options lapse. Options granted between September 1998 and May 2003 are also subject to a performance condition that the Group must achieve a ROC of at least 6% when averaged over a consecutive three year period, but if the measure is not satisfied at the end of the third business year following the date of grant, the test can be repeated on an annual basis over the 10 year life of the option. Options granted between April1997 and September 1998 were subject to a different performance condition linked to TSR. For options to be eligible for exercise, the Group's TSR has to be at or above the median of companies in the FTSE 100 Index over a consecutive period of three years, between the year of grant and the completion of the 10 year life of the option. The test is conducted twice per year, at the end of March and September, by independent external specialists. None of the terms or conditions of any of the existing options over shares of the Group were varied during the year. Full details of all directors' shareholdings and options to subscribe for shares are recorded in the Group's Register of Directors' Interests which is open to inspection in accordance with the provisions of the Companies Act 1985.

The official closing middle market price at its highest during the year was 154.75p per share and at its lowest was 118.25p per share; on the last dealing day of the year it was 152.50p per share.

Options held during 2006 in respect of the ordinary shares of the Company as a result of executive and SAYE share option schemes are as follows:

	Notes	Number of options at 1 January 2006	**Number of options at 31 December 2006**	Exercise price (pence)	Dates exercisable from	Dates exercisable to
George Culmer		481,012	**481,012**	79.0	14.06.07	13.06.14
		500,000	**500,000**	76.0	18.11.07	17.11.14
		787,500	**787,500**	80.0	08.04.08	07.04.15
		225,806	**225,806**	93.0	18.08.08	17.08.15
		12,466	**12,466**	75.0	01.12.08	31.05.09
Andy Haste		3,052,915	**3,052,915**	59.0	02.04.06	01.04.13
		1,298,701	**1,298,701**	92.4	16.10.06	15.10.13
		5,917	**5,917**	75.0	01.12.08	31.05.09
		443,037	**443,037**	79.0	14.06.07	13.06.14
		10,643	**10,643**	59.0	01.12.09	31.05.10
		921,052	**921,052**	76.0	18.11.07	17.11.14
		1,443,750	**1,443,750**	80.0	08.04.08	07.04.15
		413,978	**413,978**	93.0	18.08.08	17.08.15
		7,298	**7,298**	75.0	01.12.10	31.05.11
Bridget McIntyre		301,724	**301,724**	116.0	13.12.08	12.12.15
	1	–	**15,448**	106.0	01.12.11	31.05.12
David Paige (resigned 31 December 2006)		825,000	**825,000**	80.0	08.04.08	07.04.15
		182,796	**182,796**	93.0	18.08.08	17.08.15
		12,466	**–**	–	–	–

Notes:

1. On 13 September 2006, SAYE options were granted at an exercise price of 106.0p.

2. All of the above options were granted for nil consideration.

Long term incentive schemes (audited part)

Long term incentive scheme interests held during 2006 in respect of the ordinary shares of the Company are as follows:

Share Matching Plan

	Notes		Share awards held at 1 January 2006	Share awards granted during the year	Share awards vested during the year	Share awards lapsed during the year	**Share awards held at 31 December 2006**	Dates by which qualifying conditions must be fulfilled
George Culmer	1,3	Deferred Share awards	128,938	–	–	–	**128,938**	08.04.08
		Matching Share awards	386,814	–	–	–	**386,814**	08.04.08
Andy Haste	1,3	Deferred Share awards	462,182	–	197,046	–	**265,136**	14.06.07 – 08.04.08
	4	Matching Share awards	1,386,546	–	221,873	369,265	**795,408**	14.06.07 – 08.04.08
Bridget McIntyre	1,2	Deferred Share awards	–	150,000	–	–	**150,000**	01.11.08
		Matching Share awards	–	450,000	–	–	**450,000**	01.11.08
David Paige (resigned 31 December 2006)	1,3	Deferred Share awards	65,100	–	–	–	**65,100**	08.04.08
		Matching Share awards	195,300	–	–	–	**195,300**	08.04.08

Notes:

1. The market price of ordinary shares on 14 June 2004, 8 June 2005 and 1 November 2005, the dates on which the above long term incentive scheme interests were granted, was 79.25p, 77.62p and 100p respectively.

2. Bridget McIntyre's award of Deferred and Matching shares was approved prior to her appointment on 1 November 2005. Due to dealing restrictions in accordance with the Model Code, these awards could not be granted until 12 June 2006. The number of shares was calculated with reference to the share price on 1 November 2005. Subject to performance as described below, these awards may vest on the third anniversary of her appointment. In all other respects these awards are subject to the same rules as other awards granted in 2005.

3. Matching Share awards are capable of vesting in respect of a maximum of three times the number of Deferred Shares awarded, subject to the achievement of TSR targets over a single two year period. TSR performance is measured relative to other companies specified by the Remuneration Committee. For awards granted in 2004 and 2005, TSR will be measured partly relative to FTSE 100 companies and partly relative to the following financial services comparator group companies: Aegon, Legal & General Group, Allianz Group, Old Mutual, AXA, Prudential, Aviva, RAS, Generali and Zurich Financial Services Group. For 50% of the Matching Share awards, where TSR is measured against the FTSE 100, full vesting will only occur at upper decile performance, vesting will occur in the ratio of shares under Matching Share awards to shares under Deferred Share awards of 2:1 at upper quartile performance and vesting in the ratio 1:1 will occur at median performance. For the other 50% of the Matching Share awards, where TSR is measured against the financial services comparator group, full vesting will occur if TSR is highest in the comparator group, vesting in the ratio 2:1 will occur at upper quartile performance and vesting in the ratio 1:1 will occur at median performance. Matching Share awards will not vest at below median performance. For awards granted in 2004, the targets were measured over the period from 1 April 2004 to 31 March 2006. For awards granted in 2005, the targets will be measured over the period from 1 April 2005 to 31 March 2007. The relevant TSR figures will be averaged over the three months before the beginning and end of this performance period. Additionally, no Matching Shares will vest unless the Committee is satisfied that there has been a sustained improvement in the underlying performance of the Company over the performance period.

4. The performance condition attaching to the Matching Share awards granted in 2004 was met to the extent that 1.126 Matching Shares vested for each Deferred Share. The maximum number of Matching Shares has been adjusted accordingly. The number of Matching Shares shown in respect of Andy Haste have been adjusted from a maximum award of 591,138 to an actual award of 221,873 in relation to awards made in 2004.

Directors' interests

continued

Long term incentive plan

	Notes		Share awards held at 1 January 2006	Share awards granted during the year	**Share awards held at 31 December 2006**	Date by which qualifying conditions must be fulfilled
George Culmer	1, 2	Deferred Shares	–	149,098	**149,098**	12.06.09
	3	Matching Shares	–	469,036	**469,036**	12.06.09
	4	Performance Shares	–	347,347	**347,347**	12.06.09
Andy Haste	1, 2	Deferred Shares	–	305,129	**305,129**	12.06.09
	3	Matching Shares	–	959,884	**959,884**	12.06.09
	4	Performance Shares	–	632,612	**632,612**	12.06.09
Bridget Mcintyre	1, 2	Deferred Shares	–	44,116	**44,116**	12.06.09
	3	Matching Shares	–	138,781	**138,781**	12.06.09
	4	Performance Shares	–	288,801	**288,801**	12.06.09

Notes:

1. The market price of ordinary shares on 12 June 2006, the date on which the above long term incentive scheme interests were granted, was 123.35p.
2. Deferred Shares are inclusive of voluntary Deferred Shares and compulsory Deferred Shares. Voluntary Deferred Shares are purchased by Hill Samuel Trustees on behalf of each participant using part of the net annual bonus paid to them and are held in trust for three years. These Deferred Shares are not at risk of forfeiture and may be withdrawn from the trust at any time, but the related Matching Share awards would lapse if the voluntary Deferred Shares are withdrawn within three years of acquisition. Compulsory Deferred Shares are awarded as part of the annual bonus and are also held in trust and deferred for three years. These Deferred Shares may not be withdrawn and will normally vest in three years from the date of grant subject to continuous employment with the Group.
3. Matching Shares are capable of vesting in respect of a maximum of 2.5 times the number of Deferred Shares awarded, subject to the achievement of performance conditions over a three year period. One half of the Matching Shares relating to compulsory Deferred Shares (and all of the Matching Shares relating to voluntary Deferred Shares) are subject to TSR performance relative to other companies specified by the Remuneration Committee. For awards granted in 2006 TSR will be measured relative to the following comparator group companies: Aegon, AGF, Alleanza, Allianz, Aviva, Baloise, Fortis, Generali, Legal & General, Munich Re, QBE, Swiss Re, and Zurich Financial Services. Full vesting will only occur at upper quintile performance; at median performance 25% of the Matching Shares will vest. Vesting will be on a straight line basis in between. The remaining half of the Matching Shares relating to compulsory Deferred Shares are subject to a ROE performance condition. If underlying ROE over three years commencing on the year of grant is below 10%, no part of the award subject to ROE performance will vest. If underlying ROE over three years is 10%, 25% of the award will vest. If underlying average annual ROE over three years is 16% or higher, 100% of the award will vest. Vesting will be on a straight line basis in between. For the purpose of establishing the number of Matching Shares relating to voluntary Deferred Shares that may be awarded, the gross value of that part of the annual bonus payment that a participant elects to voluntarily defer is used.
4. Performance conditions relating to awards of Performance Shares are the same as those relating to compulsory Deferred Shares as described above. One half of an award of Performance Shares may vest subject to the TSR performance condition and one half may vest subject to the ROE performance condition.
5. No other directors of the Company held long term incentive scheme interests during 2006.

John Maxwell
Chairman of the Remuneration Committee, on behalf of the Board
7 March 2007

Independent auditors' report to the members of Royal & Sun Alliance Insurance Group plc

We have audited the consolidated financial statements of Royal & Sun Alliance Insurance Group plc for the year ended 31 December 2006 which comprise the consolidated income statement, the consolidated statement of recognised income and expense, the consolidated balance sheet, the consolidated cashflow statement, estimation techniques, uncertainties and contingencies, significant accounting policies and the related notes. These consolidated financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the Parent Company financial statements of Royal & Sun Alliance Insurance Group plc for the year ended 31 December 2006 and on the information in the remuneration report and the directors' interests that are described as having been audited.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the consolidated financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the directors' report.

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

We report to you our opinion as to whether the consolidated financial statements give a true and fair view and whether the consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the directors' report is consistent with the consolidated financial statements. The information given in the financial review, the directors' report includes that specific information presented in the Group CEO's business review, the regional business reviews and the estimations techniques, uncertainties and contingencies that are cross referred from the business review section of the directors' report.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding director's remuneration and other transactions is not disclosed.

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the Combined Code (2003) specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited consolidated financial statements. The other information comprises only the highlights, the R&SA at a glance section, the Chairman's statement, the Group CEO's business review, the market leading capability section, the profitable growth section, the UK business review, the International business review, the Emerging market business review, the financial review, the risk framework, the corporate responsibility section, the directors' report, the corporate governance statement, the remuneration report and the unaudited part of directors' interests. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the consolidated financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

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

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

Opinion

In our opinion:

- The consolidated financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2006 and of its loss and cash flows for the year then ended,
- The consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation,
- The information given in the directors' report is consistent with the consolidated financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
7 March 2007

Consolidated income statement

for the year ended 31 December 2006

	Notes	2006 £m	Restated 2005 £m
Continuing operations			
Income			
Gross written premiums		6,264	6,237
Less: reinsurance premiums		(780)	(937)
Net written premiums		5,484	5,300
Change in the gross provision for unearned premiums		(108)	(40)
Less: change in provision for unearned premiums, reinsurers' share		(84)	(21)
Change in provision for unearned premiums		(192)	(61)
Net earned premiums		5,292	5,239
Net investment return	2	600	668
Other operating income	4	121	99
Total income		6,013	6,006
Expenses			
Gross claims incurred		(3,758)	(4,103)
Less: claims recoveries from reinsurers		305	714
Net claims and benefits	3	(3,453)	(3,389)
Underwriting and policy acquisition costs		(1,626)	(1,649)
Benefit from change of pension scheme design		–	180
		(1,626)	(1,469)
Unwind of discount		(42)	(39)
Other operating expenses	4	(151)	(176)
Total expenses		(5,272)	(5,073)
Results of operating activities		741	933
Finance costs	4	(92)	(107)
(Loss)/profit on disposal of subsidiaries		(1)	65
Net share of profit after tax of associates	11	1	3
Profit before tax on continuing operations		649	894
Income tax expense	5	(170)	(259)
Profit for the year from continuing operations		479	635
Discontinued operations			
Loss for the year from discontinued operations	35	(499)	(30)
(Loss)/profit for the year		(20)	605
Attributable to:			
Equity holders of the Parent Company		(52)	555
Minority interests		32	50
		(20)	605
Earnings per share for profit from continuing operations attributable to the equity holders of the Parent Company			
Basic	6	15.0p	19.9p
Diluted	6	14.8p	19.7p
Earnings per share for (loss)/profit attributable to the equity holders of the Parent Company			
Basic	6	(2.1)p	18.9p
Diluted	6	(2.1)p	18.7p
Ordinary dividends paid and proposed for the year			
Interim dividend paid (per share)	7	1.75p	1.69p
Final dividend proposed (per share)	7	4.12p	3.05p

The attached notes form an integral part of these consolidated financial statements.

Consolidated statement of recognised income and expenses

for the year ended 31 December 2006

	2006 £m	Restated 2005 £m
Exchange (losses)/gains net of tax	(151)	62
Fair value gains/(losses) net of tax	32	(35)
Pension fund actuarial gains/(losses) net of tax	153	(53)
Tax on reclassification to loan capital	–	24
Net gains/(losses) recognised in equity	34	(2)
(Loss)/profit for the year	(20)	605
Total recognised income for the year	14	603
Attributable to:		
Equity holders of the Parent Company	(10)	564
Minority interests	24	39
	14	603

The attached notes form an integral part of these consolidated financial statements.

Consolidated balance sheet

as at 31 December 2006

	Notes	2006 £m	Restated 2005 £m
Assets			
Goodwill and other intangible assets	8	**552**	450
Property and equipment	9	**385**	410
Investment property	10	**454**	435
Investments in associates	11	**27**	29
Financial assets	12	**10,457**	13,533
Total investments		**10,938**	13,997
Reinsurers' share of insurance contract liabilities	13	**1,927**	4,406
Insurance and reinsurance debtors	14	**2,225**	2,547
Deferred acquisition costs	15	**453**	465
Current tax assets	23	**17**	40
Deferred tax assets	23	**29**	57
Other debtors and other assets	16	**806**	596
		852	693
Cash and cash equivalents	17	**1,831**	1,617
		19,163	24,585
Assets of discontinued operations	35	**3,485**	36
Total assets		**22,648**	24,621
Equity, reserves and liabilities			
Equity and reserves			
Shareholders' equity		**2,561**	2,686
Minority interests		**331**	391
Total equity and reserves	18	**2,892**	3,077
Liabilities			
Loan capital	19	**1,192**	1,152
Insurance contract liabilities	20	**12,790**	17,204
Insurance and reinsurance liabilities	21	**391**	475
Borrowings	22	**8**	251
Current tax liabilities	23	**56**	55
Deferred tax liabilities	23	**319**	236
Provisions	24	**380**	693
Other liabilities	25	**1,026**	1,478
Provisions and other liabilities		**1,781**	2,462
		16,162	21,544
Liabilities of discontinued operations	35	**3,594**	–
Total liabilities		**19,756**	21,544
Total equity, reserves and liabilities		**22,648**	24,621

The attached notes form an integral part of these consolidated financial statements.

The financial statements were approved on 7 March 2007 by the Board of Directors and are signed on its behalf by:

George Culmer
Chief Financial Officer

Consolidated cashflow statement

for the year ended 31 December 2006

	Notes	2006 £m	Restated 2005 £m
Cash generated from continuing operations	32	**320**	376
Income tax paid		**(118)**	(64)
Interest received		**527**	636
Interest paid		**(82)**	(107)
Dividends received		**1**	2
Cashflows from discontinued operations		**(531)**	(812)
Net cashflows from operating activities		**117**	31
Proceeds from sales or maturities of:			
Available for sale investments		**8,166**	8,788
Investment property		**55**	46
Property and equipment		**43**	13
Intangible assets		**1**	3
Investments in subsidiaries (net of cash disposed of)		**–**	113
Investments in associates		**–**	5
Purchase of:			
Available for sale investments		**(7,840)**	(9,373)
Investment property		**(17)**	(31)
Property and equipment		**(37)**	(59)
Intangible assets		**(127)**	(144)
Investments in subsidiaries (net of cash acquired)	31	**(69)**	(106)
Cashflows from discontinued operations		**606**	615
Net cashflows from investing activities		**781**	(130)
Proceeds from issue of share capital		**6**	2
Purchase of treasury shares		**–**	(3)
Purchase of shares from minorities		**(121)**	–
Dividends paid to ordinary shareholders		**(78)**	(116)
Dividends paid to preference shareholders		**(9)**	(9)
Dividends paid to minority interests		**(9)**	(13)
Proceeds from issuance of long term borrowings		**74**	–
Net movement in other borrowings		**(243)**	(86)
Cashflows from discontinued operations		**(9)**	–
Net cashflows from financing activities		**(389)**	(225)
Net increase/(decrease) in cash and cash equivalents and bank overdrafts		**509**	(324)
Cash and cash equivalents and bank overdrafts at beginning of the year		**1,612**	1,864
Effect of exchange rate changes on cash and cash equivalents		**(81)**	72
Cash and cash equivalents and bank overdrafts at end of the year	17	**2,040**	1,612

The attached notes form an integral part of these consolidated financial statements.

Estimation techniques, uncertainties and contingencies

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

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

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

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

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

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

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

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

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

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

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

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

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

The pension assets and pension and post retirement liabilities are calculated in accordance with International Accounting Standard 19 (IAS 19). The assets, liabilities and income statement charge, calculated in accordance with IAS 19, are sensitive to the assumptions made, including inflation, interest rate, investment return and mortality. IAS 19 compares, at a given date, the current market value of a pensions fund's assets with its long term liabilities, which are calculated using a discount rate in line with yields on 'AA' rated bonds of suitable duration and currency. As such, the financial position of a pension fund on this basis is highly sensitive to changes in bond rates and equity markets.

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

- Uncertainty as to whether an event has occurred which would give rise to a policyholder suffering an insured loss,
- Uncertainty as to the extent of policy coverage and limits applicable,

- Uncertainty as to the amount of insured loss suffered by a policyholder as a result of the event occurring,
- Uncertainty over the timing of a settlement to a policyholder for a loss suffered.

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

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

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

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

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

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

Asbestos and environmental claims

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

Factors contributing to this higher degree of uncertainty include:

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

Acquisitions and disposals

The Group makes acquisitions and disposals of businesses as part of its normal operations. All acquisitions are made after due diligence, which will include, amongst other matters, assessment of the adequacy of claims reserves, assessment of the recoverability of reinsurance balances, inquiries with regard to outstanding litigation and inquiries of local regulators and taxation authorities. Consideration is also given to potential costs, risks and issues in relation to the integration of any proposed acquisitions with existing R&SA operations. The Group will seek to receive the benefit of appropriate contractual representations and warranties in connection with any acquisition and, where necessary, additional indemnifications in relation to specific risks although there can be no guarantee that such protection will be adequate in all circumstances. The Group may also provide relevant representations, warranties and indemnities to counterparties on any disposal. While such representations, warranties and indemnities are essential components of many contractual relationships, they do not represent the underlying purpose for the transaction. These clauses are customary in such contracts and may from time to time lead to us receiving claims from counterparties.

Contracts with third parties

The Group enters into joint ventures, outsourcing contracts and distribution arrangements with third parties in the normal course of its business and is reliant upon those third parties performing their obligations in accordance with the terms and conditions of the contracts.

Litigation, mediation and arbitration

The Group, in common with the insurance industry in general, is subject to litigation, mediation and arbitration, and regulatory, governmental and other sectoral inquiries in the normal course of its business. In addition the Group is subject to litigation in connection with its former ownership

Estimation techniques, uncertainties and contingencies
continued

of the US operation. The directors do not believe that any current mediation, arbitration, regulatory, governmental or sectoral inquiries and pending or threatened litigation or dispute will have a material adverse effect on the Group's financial position, although there can be no assurance that losses resulting from any current mediation, arbitration, regulatory, governmental or sectoral inquiries and pending or threatened litigation or dispute will not materially affect the Group's financial position or cashflows for any period.

Reinsurance
The Group is exposed to disputes on, and defects in, contracts with its reinsurers and the possibility of default by its reinsurers. The Group is also exposed to the credit risk assumed in fronting arrangements. In selecting the reinsurers with whom we do business our strategy is to seek reinsurers with the best combination of credit rating, price and capacity. We publish internally a list of authorised reinsurers who pass our selection process and which our operations may use for new transactions.

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

Changes in foreign exchange rates may impact our results
We publish our consolidated financial statements in pounds sterling. Therefore, fluctuations in exchange rates used to translate other currencies, particularly other European currencies and the US dollar, into pounds sterling will impact our reported consolidated financial condition, results of operations and cashflows from period to period. These fluctuations in exchange rates will also impact the pound sterling value of our investments and the return on our investments.

Income and expenses for each income statement item are translated at average exchange rates. Balance sheet assets and liabilities are translated at the closing exchange rates at the balance sheet date.

Investment risk
The Group is exposed to credit risk on its invested assets. Credit risk includes the non performance of contractual payment obligations on invested assets and adverse changes in the credit worthiness of invested assets including exposures to issuers or counterparties for bonds, equities, deposits and derivatives. Our 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.

Rating agencies
The ability of the Group to write certain types of insurance business is dependent on the maintenance of the appropriate credit ratings from the rating agencies. The Group has the objective of maintaining single 'A' ratings. At the present time the ratings are 'A–' from S&P and 'A–' from AM Best. Any worsening in the ratings would have an adverse impact on the ability of the Group to write certain types of general insurance business.

Regulatory environment
The regulatory environment is subject to significant change in many of the jurisdictions in which we operate. We continue to monitor the developments and react accordingly. The directors are confident that the Group will continue to meet all future regulatory capital requirements.

In addition, the Group is continuing to monitor and respond to consultation on the latest Solvency II proposals, which are intended, in the medium term, to achieve greater harmonisation of approach across European member states to assessing capital resources and requirements.

Significant accounting policies

The principal accounting policies applied in the preparation of the consolidated financial statements are set out below.

Consolidated financial statements

The consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU). The consolidated financial statements are prepared under the historical cost convention as modified by the revaluation of available for sale financial assets, investment property, Group occupied property and financial assets and financial liabilities held for trading (which include all derivative contracts).

Except where otherwise stated, all figures included in the consolidated financial statements are presented in millions of British pounds sterling (£m), rounded to the nearest million.

Comparative information

The comparative information has been restated as follows:

- The Group has changed its accounting treatment and recognised the subordinated guaranteed perpetual notes at fair value at the date of conversion. Further information can be found in note 19,
- The US operation is classified as a disposal group at the end of 2006 and accordingly the results of the disposal group are presented as discontinued operations in the income statement. The comparative information in the 2005 results is represented as discontinued information. Further information can be found in note 35,
- The 2005 auditors' remuneration, disclosed in note 4, is presented on a comparable basis following changes in the legislation regarding auditors' remuneration disclosures.

Selection of accounting policies

The Group exercises judgement in selecting each Group accounting policy. The accounting policies of the Group are selected by the directors to present financial statements that they consider provides the most relevant information. For certain accounting policies there are different accounting treatments that could be adopted, each of which would be in compliance with IFRS and would have a significant influence upon the basis on which the financial statements are presented. The bases of selection of the accounting policies for the accounting for financial assets and for the recognition of actuarial gains and losses related to pension obligations are set out below:

- The Group accounting policy is to designate all financial assets that meet the necessary conditions as available for sale financial assets. This designation enables the Group to recognise the investment return earned on such assets in a consistent manner with the internal measures applied to measure the performance of the individual operations,
- The Group accounting policy is to recognise actuarial gains and losses arising from the recognition and funding of the Group's pension obligations in the period in which they arise. This policy has been adopted as it provides the most relevant basis of recognition of such gains and losses.

Consolidation

Subsidiaries

Subsidiaries are entities over which the Group has the power to govern the financial and operating policies so as to obtain benefits from its activities, generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group.

The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, including costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recognised as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries are changed where necessary to ensure consistency with the policies adopted by the Group.

Associates

Associates are entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost.

The Group's shares of its associates' post acquisition profits or losses are recognised in the income statement, and its share of post acquisition movements in reserves are recognised in reserves. The cumulative post acquisition movements are adjusted in the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Adjustments are made, where necessary, to conform the accounting policies of associates to ensure consistency with the policies adopted by the Group.

Translation of foreign currencies

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency).

Significant accounting policies
continued

The results and financial position of those Group entities whose functional currency is not British pounds sterling are translated into British pounds sterling as follows:

- Assets and liabilities for each balance sheet presented are translated at the closing exchange rate at the date of that balance sheet,
- Income and expenses for each income statement are translated at average exchange rates during each period,
- All resulting exchange differences are recognised as a component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to equity. When a foreign entity is sold, the cumulative exchange differences relating to that foreign entity are recognised in the income statement as part of the gain or loss on sale.

Goodwill arising on the acquisition of a foreign entity is treated as an asset of the foreign entity and the carrying value is translated at the closing exchange rate.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Translation differences on non monetary items, such as equities classified as available for sale financial assets, are included in the fair value reserve in equity.

Goodwill and other intangible assets
Goodwill, being the difference between the cost of a business acquisition and the Group's interest in the net fair value of the identifiable assets and liabilities acquired, is initially capitalised in the balance sheet at cost and is subsequently recognised at cost less accumulated impairment losses. The cost of the acquisition is the amount of cash paid and the fair value of other purchase consideration given together with associated expenses. Goodwill is allocated to cash generating units for the purpose of impairment testing. Each of those cash generating units represents the Group's investment in each country of operation. Goodwill is subject to an impairment review at least annually. An impairment review is also carried out whenever there is an indication that goodwill or other intangible assets are impaired. Where the carrying amount is more than the recoverable amount, an impairment is recognised.

When calculating the goodwill arising on an acquisition, claims provisions are discounted to present value. Immediately following the acquisition, the claims provisions are valued at full nominal value. This increase in liabilities is matched by the recognition of an intangible asset arising from acquired claims provisions, representing the present value of future investment income implicit in the claims discount. The intangible asset is amortised over the expected run off period and is tested in the context of the liability adequacy test of insurance liabilities where the balances of intangible assets associated with insurance contracts is deducted from the carrying amount of the insurance liabilities.

Expenditure that increases the future economic benefits arising from computer software in excess of its standard of performance assessed immediately before the expenditure was made, is recognised as an intangible asset and amortised using the straight line method to allocate the cost over their estimated useful lives which is normally estimated to be between three and five years.

Other intangible assets comprise renewal rights, customer lists, brands and other acquired identifiable non monetary assets without physical form. Other intangible assets are carried at cost less accumulated amortisation. Amortisation is calculated using the straight line method to allocate the cost over their estimated useful lives which is normally estimated to be between three and five years.

Property and equipment
Property and equipment comprise Group occupied land and buildings, fixtures, fittings and equipment (including computer hardware and motor vehicles). These assets are depreciated over their estimated useful life after taking into account residual values.

Group occupied property is stated at fair value, less subsequent depreciation for buildings. All other assets are stated at depreciated cost. Fair value movements are recorded in equity.

Fair value is based on current prices in an active market for similar property in the same location and condition and subject to similar contractual terms of ownership. Valuations are performed by external professionally qualified valuation surveyors on at least an annual basis, with reference to current market conditions.

All other classes are stated at cost less accumulated depreciation. Cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset only when it is probable that future economic benefits associated to the item will flow to the Group and the cost can be measured reliably.

Land is not depreciated. Depreciation on all other items is calculated on the straight line method to write down the cost of such assets to their residual value over their estimated useful lives as follows:

Group occupied buildings	normally 30 years
Fixtures and fittings	10 years
Motor vehicles	4 years
Equipment	3-5 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the balance sheet date.

An impairment review is carried out whenever there is an indication that the assets are impaired. An asset's carrying amount is written down to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Increases in the carrying amount arising on the revaluation of Group occupied property are credited to revaluation surplus in equity. Decreases that offset the previous increases of the same asset are charged against revaluation surplus directly in equity, other decreases are charged to the income statement. Each year, the difference between depreciation based on the fair value of the asset charged to the income statement and depreciation based on the assets original cost is transferred from revaluation surplus to retained earnings.

Investment property

Investment property, comprising freehold and leasehold land and buildings, is held for long term rental yields and is not occupied by the Group.

Investment property is recorded at fair value, measured by independent professionally qualified valuers, who hold a recognised and relevant professional qualification and have recent experience in the location and category of the investment property being valued, on an annual basis or more frequently and by internal valuers for interim periods, with reference to current market conditions. Related unrealised gains and unrealised losses or changes thereof are recognised in investment income.

Financial assets

A financial asset is initially recognised, on the date the Group commits to purchase the asset, at fair value plus, in the case of all financial assets not classified as at fair value through the income statement, transaction costs that are directly attributable to its acquisition. A financial asset is derecognised when the rights to receive cashflows from the investment have expired or have been transferred and the Group has also transferred substantially the risks and rewards of ownership of the asset.

On initial recognition, the financial assets may be categorised into the following categories: financial assets at fair value through the income statement, loans and receivables, held to maturity financial assets and available for sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition.

The Group designates, where possible, its financial assets as available for sale financial assets on initial recognition of a financial asset. On subsequent measurement, investments are measured at fair value with changes in fair value recognised in equity. Where the cumulative changes recognised in equity represent an unrealised loss the individual asset or group of assets is reviewed to test whether an indication of impairment exists.

For securities whose fair values are readily determined and where there is objective evidence that such an asset is impaired, including a significant or prolonged decline in the fair value below cost, the unrealised loss charged to equity is reclassified to the income statement.

If the fair value of a previously impaired debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, the impairment loss is reversed and the reversal recognised in the income statement. Impairment losses on equity investments are not reversed.

Investment income is recognised in the income statement. Dividends on equity investments are recognised on the date at which the investment is priced 'ex dividend'. Interest income is recognised using the effective interest method. Unrealised gains and losses on available for sale investments are recognised directly in equity, except for impairment losses and foreign exchange gains and losses on monetary items (which are recognised in the income statement). On derecognition of an investment, the cumulative gain or loss previously recognised in equity is recognised in the income statement.

Derivative financial instruments

Derivatives are recognised in the balance sheet on a trade date basis and are carried at fair value. Derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and the nature of the item being hedged. Where a derivative is not designated as a hedging instrument, changes in its fair value are recognised in the income statement.

Hedging

Transactions are classified as hedging transactions when the following conditions for hedge accounting are met:

- There is a formal designation and documentation of the hedging relationship and the Group's risk management objective and strategy for undertaking the hedge,
- The hedge is expected to be highly effective in achieving offsetting changes in fair value or cashflows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship,
- The effectiveness of the hedge can be reliably measured,
- For cashflow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cashflows that could ultimately affect profit or loss,
- The hedge is assessed on an ongoing basis and determined to have been highly effective.

Where loan capital is designated as the hedging instrument against the net investment in foreign entities, the effective portion of the hedge is recognised in equity; the gain or loss relating to the ineffective portion is recognised immediately in the income statement. Gains and losses accumulated in equity are included in the income statement when the underlying hedged item is derecognised.

Estimation of the fair value of financial assets and liabilities

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

- For fixed maturity securities, fair values are generally based upon quoted market prices. Where market prices are not readily available, fair values are estimated using either values obtained from quoted market prices of comparable securities or estimated by discounting expected future cashflows using a current market rate applicable to the yield, credit quality and maturity of the investment,
- For equity securities fair values are based upon quoted market prices,
- If the market for a financial asset is not active, the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cashflow analysis and option pricing models,
- For mortgage loans on real estate and collateral loans, fair values are estimated using discounted cashflow calculations based upon prevailing market rates,

Significant accounting policies
continued

- For cash, short term investments, commercial paper, other assets, liabilities and accruals, carrying amounts approximate to fair values,
- For notes, bonds, loans payable and loan capital, fair values are determined by reference to quoted market prices or estimated using discounted cashflow calculations based upon prevailing market rates. Loan capital is carried at amortised cost and when this is different from fair value this is shown in the relevant note. For borrowings that carry a variable rate of interest (other than loan capital), carrying values approximate to fair values,
- For derivatives, fair values are generally based upon quoted market prices.

Insurance contracts

Product classification
Insurance contracts are those contracts that transfer significant insurance risk at the inception of the contract. Insurance risk is transferred when the Group agrees to compensate a policyholder if a specified uncertain future event (other than a change in a financial variable) adversely affects the policyholder. Any contracts not meeting the definition of an insurance contract under IFRS are classified as investment contracts or derivative contracts, as appropriate.

Recognition of income
Premiums written are accounted for in the period 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 and directly related expenses, eg commissions. Premiums are earned as revenue over the period of the contract and are calculated principally on a daily pro rata basis.

Acquisition costs
Acquisition costs comprise the direct and indirect costs of obtaining and processing new insurance business. These costs are recognised as a deferred acquisition cost asset and amortised on the same basis as the related premiums are earned.

Insurance liabilities
The provision for unearned premium represents the portion of the premiums written relating to periods of insurance coverage subsequent to the balance sheet date.

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

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

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

Differences between the estimated cost and subsequent settlement of claims are recognised in the income statement in the year in which they are settled or in which the provisions for claims outstanding are re-estimated.

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

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

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

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

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

Cash and cash equivalents
Cash and cash equivalents are short term, highly liquid investments that are subject to insignificant changes in value and are readily convertible into known amounts of cash. Cash equivalents comprise financial assets with less than three months maturity from the date of acquisition.

Treasury shares
Treasury shares are deducted from equity. No gain or loss is recognised on the purchase, sale, issue or cancellation of the treasury shares. Any consideration paid or received is recognised directly in equity.

Loan capital
Loan capital comprises subordinated bonds which are stated at the consideration received less transaction costs. Subsequently, it is measured at amortised cost using the effective interest rate method.

An exchange with an existing lender of loan capital with substantially different terms is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. The terms are substantially different if the discounted present value of the cashflows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10% different from the discounted present value of the remaining cashflows of the original financial liability. An exchange where the terms are not substantially different is accounted for as an exchange.

If an exchange of loan capital or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If it is accounted for as an exchange, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability and no adjustment is made to the carrying value of the liability to reflect its fair value at the date of exchange.

Taxation

Taxation in the income statement 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 recognised as an expense in the year in which the profits arise, except where the remittance of earnings can be controlled and it is probable that remittance will not take place in the foreseeable future, in which case UK tax is based on dividends received.

Deferred tax is provided in full using the liability method on temporary differences arising between the tax bases of assets and liabilities and the carrying amounts in the financial statements. However, if the deferred tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. Deferred tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which these temporary differences can be utilised.

Employee benefits

Pension obligations

Group companies operate various pension schemes. The schemes are generally funded through payments to trustee administered funds, determined by periodic actuarial calculations. The Group has both defined contribution and defined benefit schemes. A defined contribution scheme is a pension scheme under which the Group pays fixed contributions into a separate entity. A defined benefit scheme is a pension scheme that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and salary.

Post retirement benefits (including pension schemes and post retirement health schemes)

Contributions to defined contribution pension schemes are charged in the period in which the employment services qualifying for the benefit are provided. The Group has no further payment obligations once the contributions have been paid.

The amounts charged (or credited where relevant) in the income statement relating to post retirement benefits in respect of defined benefit schemes are as follows:

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

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

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

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

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

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

The expected return on scheme assets is calculated using market expectations, at the beginning of the period, of the investment returns on assets over the entire life of the related obligations.

Actuarial gains and losses arise from changes to actuarial assumptions when revaluing future benefits and from actual experience in respect of scheme liabilities and investment performance of scheme assets being different from previous assumptions. Actuarial gains and losses are recognised as a component of equity.

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

- The present value of defined benefit obligation of the scheme at the balance sheet date,

Significant accounting policies

continued

- Minus any past service cost not yet recognised,
- Minus the fair value at the balance sheet date of the scheme assets out of which the obligations are to be settled directly.

Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the balance sheet date are discounted to present value.

Share based payment

The value of the employee share options and other equity settled share based payments is calculated at fair value at the grant date using appropriate and recognised option pricing models. The value of liabilities in respect of cash settled share based payment transactions are based upon the fair value of the awards at the balance sheet date.

Vesting conditions, other than those based upon market conditions, are not taken into account when estimating the fair value of such awards but are taken into account by adjusting the number of equity instruments included in the ultimate measurement of the transaction amount. The value of the awards are recognised as an expense on a systematic basis over the period during which the employment services are provided. The proceeds received net of any transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Dividends to equity holders

The final dividend is recognised as a liability when approved at the AGM. The interim dividend is recognised as a liability when announced.

Leases

Rental income from operating leases is recognised on a straight line basis over the term of the lease. Payments made under operating leases are charged on a straight line basis over the term of the lease.

Segment reporting

A geographical segment (primary segment) is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments. A business segment (secondary segment) is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments.

Non current assets and operations held for sale and discontinued operations

Non current assets and operations are classified as held for sale if their carrying amount is to be recovered principally through a sale transaction, that is highly probable to complete within one year from the date of classification, rather than through continuing use. Such assets are measured at the lower of carrying amount and fair value less costs to sell and are classified separately from other assets in the balance sheet. Assets and liabilities are not netted. In the period where an operation is presented for the first time as discontinued, the balance sheet for the comparative prior period presented is not restated.

Discontinued operations are presented on the face of the income statement as a single amount comprising the total of the net profit or loss of discontinued operations and the after tax gain or loss recognised on the sale or the measurement to fair value less costs to sell of the net assets constituting the discontinued operations. In the period where an operation is presented for the first time as discontinued, the income statement for the comparative prior period presented is restated to present that operation as discontinued.

Unless otherwise stated, in the period where an operation is presented for the first time as discontinued, the notes to the financial statements contain amounts attributable to continuing operations only. The comparatives for the notes to the income statement are restated.

Current and non current distinction

Assets are classified as current when expected to be realised within the Group's normal operating cycle of one year. Liabilities are classified as current when expected to be settled within the Group's normal operating cycle of one year. All other assets and liabilities are classified as non current.

The Group's consolidated balance sheet is not presented using a current/non current classification. However, the following balances are generally classified as current: cash and cash equivalents; deferred acquisition costs; and insurance and reinsurance debtors.

The following balances are generally classified as non current: goodwill and other intangible assets; property and equipment; investment property; investment in associates; financial assets; deferred tax assets; loan capital; and deferred tax liabilities.

The remaining balances are of a mixed nature. The current and non current portions of such balances are set out in the respective notes.

Recently issued accounting pronouncements not yet adopted by the Group

Below are listed the developments that are relevant in the future to the Group's future financial reporting. The Group does not anticipate that any of these developments will have a material impact on the Group's financial condition, results of its operations or disclosure in its financial statements.

(a) Published standards and amendments to published standards that are not yet effective and have not been early adopted by the Group

- On 18 August 2005, the International Accounting Standards Board (IASB) issued IFRS 7, Financial Instruments: Disclosures, and a complementary Amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures. IFRS 7 requires disclosures about the significance of financial instruments for an entity's financial position and performance. These disclosures incorporate many of the requirements previously in IAS 32. IFRS 7 also requires information about the extent to which the Group is exposed to risks arising from financial instruments, and a description of management's objectives, policies and processes for managing those risks. The Amendment to IAS 1 introduces requirements for disclosures about an entity's capital. IFRS 7 and the Amendment to IAS 1 have been adopted by the EU and are effective for periods beginning 1 January 2007,

- On 15 December 2005, the IASB issued a limited Amendment to IAS 21, The Effects of Changes in Foreign Exchange Rates. The Amendment clarifies the requirements of IAS 21 regarding an entity's investment in foreign operations. The limited Amendment to IAS 21 has been adopted by the EU. The Group will adopt limited Amendment to IAS 21 from 1 January 2007,

- On 30 November 2006, IASB issued IFRS 8, Operating Segments, which replaces IAS 14, Segment Reporting. In doing so, IFRS 8 requires:
  - Identification of operating segments based on internal reports that are regularly reviewed by the entity's chief operating decision maker in order to allocate resources to the segment and assess its performance. This is because the requirements of IFRS 8 are based on the information about the components of the entity that management uses to make decisions about operating matters,
  - Inclusion of a component of an entity that sells primarily or exclusively to other operating segments of the entity in the definition of an operating segment if the entity is managed that way,
  - The amount of each operating segment item reported to be the measure reported to the chief operating decision maker for the purposes of allocating resources to the segment and assessing its performance,
  - Reconciliations of total reportable segment revenues, total profit or loss, total assets, and other amounts disclosed for reportable segments to corresponding amounts in the entity's financial statements,
  - An explanation of how segment profit or loss and segment assets are measured for each reportable segment,
  - An entity to report information about the revenues derived from its products or services (or groups of similar products and services), about the countries in which it earns revenues and holds assets, and about major customers, regardless of whether that information is used by management in making operating decisions,
  - An entity to give descriptive information about the way that the operating segments were determined, the products and services provided by the segments, differences between the measurements used in reporting segment information and those used in the entity's financial statements, and changes in the measurement of segment amounts from period to period.

IFRS 8 is effective for annual periods beginning on or after 1 January 2009, with earlier application encouraged. IFRS 8 has not yet been adopted by the EU.

(b) Interpretations to published standards that are not yet effective and have not been early adopted by the Group

The following new interpretations to existing standards have been published that are mandatory for the Group's accounting periods beginning on or after 1 May 2006 or later periods, but that the Group has not early adopted:

- IFRIC 8, Scope of IFRS 2 (effective from annual periods beginning on or after 1 May 2006). IFRIC 8 requires consideration of transactions involving the issuance of equity instruments – where the identifiable consideration received is less than the fair value of the equity instruments issued – to establish whether or not they fall within the scope of IFRS 2. IFRIC 8 has been adopted by the EU. The Group will apply IFRIC 8 from 1 January 2007,

- IFRIC 10, Interim Financial Reporting and Impairment (effective for annual periods beginning on or after 1 November 2006). IFRIC 10 prohibits the impairment losses recognised in an interim period on goodwill and investments in equity instruments and in financial assets carried at cost to be reversed at a subsequent balance sheet date. IFRIC 10 has been adopted by the EU. The Group will apply IFRIC 10 from 1 January 2007.

(c) Interpretations to published standards that are not yet effective and not relevant for the Group's operations

- IFRIC 7, Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies (effective from 1 March 2006). IFRIC 7 provides guidance on how to apply requirements of IAS 29 in a reporting period in which an entity identifies the existence of hyperinflation in the economy of its functional currency, when the economy was not hyperinflationary in the prior period. As none of the Group entities has a currency of a hyperinflationary economy as its functional currency, IFRIC 7 is not relevant to the Group's operations. IFRIC 7 has been adopted by the EU,

- IFRIC 9, Reassessment of Embedded Derivatives (effective from annual periods beginning on or after 1 June 2006). IFRIC 9 requires an entity to assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cashflows that otherwise would be required under the contract, in which case reassessment is required. IFRIC 9 is not relevant to the Group's operations because none of the terms of the Group's contracts has been changed. IFRIC 9 has been adopted by the EU.

Notes to the financial statements

1. Segment reporting

The Group's internal reporting is organised into distinguishable components based on the major geographical regions in which it operates. These components represent the primary format for reporting segment information. The secondary segment reporting format is the Group's business segments: Personal and Commercial.

Items of segment revenue, segment expense, segment assets and segment liabilities include amounts of such items that are directly attributable to a segment and amounts of such items that can be allocated to a segment on a reasonable basis. Items are allocated consistently, such that an item of segment revenue is allocated to the segment that holds the income generating asset.

Transfers or transactions between segments are entered into under normal commercial terms and conditions that would also be available to unrelated third parties.

Primary segment – geographical

Year ended 31 December 2006

	UK £m	International £m	Scandinavia £m	Central functions and eliminations £m	Continuing operations £m
Gross written premiums	3,109	1,891	1,449	(185)	6,264
Less: reinsurance premiums	(491)	(420)	(55)	186	(780)
Net written premiums	2,618	1,471	1,394	1	5,484
Underwriting result	160	85	75	(10)	310
Investment income	282	117	117	–	516
Realised gains	25	11	10	–	46
Unrealised gains/(losses), impairments and foreign exchange	20	8	8	–	36
Unwind of discount	(21)	–	(21)	–	(42)
Investment result	306	136	114	–	556
Insurance result	466	221	189	(10)	866
Other activities	9	(13)	(5)	(77)	(86)
Operating result (management basis)	475	208	184	(87)	780
Amortisation	–	(9)	(6)	–	(15)
Reorganisation costs	(20)	(3)	–	–	(23)
Share of associates	–	–	(1)	–	(1)
Results of operating activities (per income statement)	455	196	177	(87)	741
Interest costs	(2)	–	(4)	(86)	(92)
Loss on disposal of subsidiaries	–	–	–	(1)	(1)
Share of associates net of tax	–	–	1	–	1
Profit/(loss) before tax	453	196	174	(174)	649
Income tax expense					(170)
Profit for the year					479
Other segment items included in the income statement:					
Depreciation and amortisation expenses	50	25	17	4	96

Other significant non cash expenses include unwind of discount.

On 1 January 2007, the Group restructured the segments of the continuing operations. While the UK remained the same, the Group's overseas business has been reorganised into International (Canada, Ireland, Italy and Scandinavia) and Emerging Markets (Latin America, Asia and the Middle East and the Baltics). Below is a memorandum of the key results for 2006 under the new structure.

	UK £m	International £m	Emerging Markets £m	Central functions and eliminations £m	Continuing operations £m
Net written premiums	2,618	2,334	531	1	5,484
Underwriting result	160	149	11	(10)	310

1. Segment reporting continued

The segment assets and liabilities at 31 December 2006 and capital expenditure for the year then ended are as follows:

	UK £m	International £m	Scandinavia £m	Central functions and eliminations £m	Continuing operations £m
Segment assets	9,027	4,517	4,480	1,066	19,090
Associates	–	–	1	26	27
Income tax assets	6	35	13	(8)	46
Total assets	9,033	4,552	4,494	1,084	19,163
Segment liabilities	7,563	3,423	3,409	1,392	15,787
Income tax liabilities	31	31	133	180	375
Total liabilities	7,594	3,454	3,542	1,572	16,162
Capital expenditure:					
Property and equipment	14	9	12	2	37
Goodwill	40	8	22	–	70
Intangible assets	93	20	14	–	127

Year ended 31 December 2005

	UK £m	International £m	Scandinavia £m	Central functions and eliminations £m	Continuing operations £m
Gross written premiums	3,359	1,680	1,368	(170)	6,237
Less: reinsurance premiums	(727)	(343)	(44)	177	(937)
Net written premiums	2,632	1,337	1,324	7	5,300
Underwriting result	154	63	65	(19)	263
Investment income	274	116	108	–	498
Realised gains	61	25	23	–	109
Unrealised gains/(losses), impairments and foreign exchange	7	3	2	–	12
Unwind of discount	(21)	–	(18)	–	(39)
Investment result	321	144	115	–	580
Insurance result	475	207	180	(19)	843
Other activities	(1)	2	(8)	(93)	(100)
Operating result (management basis)	474	209	172	(112)	743
Amortisation	–	(5)	(6)	–	(11)
Reorganisation costs	(37)	–	–	–	(37)
Benefit from change of pension scheme design	180	–	–	–	180
Profit on disposal of significant shareholding in Rothschilds	–	–	–	61	61
Share of associates	–	(3)	–	–	(3)
Results of operating activities (per income statement)	617	201	166	(51)	933
Interest costs	(2)	–	(5)	(100)	(107)
Profit on disposal of subsidiaries	–	–	–	65	65
Share of associates net of tax	–	3	–	–	3
Profit/(loss) before tax	615	204	161	(86)	894
Income tax expense					(259)
Profit for the year					635
Other segment items included in the income statement:					
Depreciation and amortisation expenses	38	23	18	4	83

Other significant non cash expenses include unwind of discount and the benefit from change of pension scheme design.

Notes to the financial statements
continued

1. Segment reporting continued
The restated segment assets and liabilities at 31 December 2005 and capital expenditure for the year then ended are as follows:

	UK £m	International £m	Scandinavia £m	Central functions and eliminations £m	Continuing operations £m	US £m	Total £m
Segment assets	9,098	4,991	4,182	1,331	19,602	4,893	24,495
Associates	–	–	3	26	29	–	29
Income tax assets	3	60	6	28	97	–	97
Total assets	9,101	5,051	4,191	1,385	19,728	4,893	24,621
Segment liabilities	7,939	3,901	3,054	1,835	16,729	4,524	21,253
Income tax liabilities	26	71	116	75	288	3	291
Total liabilities	7,965	3,972	3,170	1,910	17,017	4,527	21,544
Capital expenditure:							
Property and equipment	34	13	13	–	60	1	61
Goodwill	–	38	–	–	38	–	38
Intangible assets	102	34	8	–	144	–	144

Secondary segment – business
Year ended 31 December 2006

	Continuing operations			
	Personal £m	**Commercial £m**	**Central functions and eliminations £m**	**Continuing operations £m**
Gross written premiums from external customers	**2,952**	**3,497**	**(185)**	**6,264**
Total assets	**6,356**	**11,723**	**1,084**	**19,163**
Capital expenditure:				
Property and equipment	**18**	**17**	**2**	**37**
Goodwill	**25**	**45**	**–**	**70**
Intangible assets	**56**	**71**	**–**	**127**

Year ended 31 December 2005 restated

	Continuing operations				US		
	Personal £m	Commercial £m	Central functions and eliminations £m	Continuing operations £m	Personal £m	Commercial £m	Total £m
Gross written premiums from external customers	2,805	3,602	(170)	6,237			
Total assets	5,717	12,626	1,385	19,728	949	3,944	24,621
Capital expenditure:							
Property and equipment	18	42	–	60	–	1	61
Goodwill	14	24	–	38	–	–	38
Intangible assets	33	111	–	144	–	–	144

2. Net investment return

A summary of the gross investment income, net realised and net unrealised gains/(losses) included in the income statement is given below.

	Investment income		Net realised gains/(losses)		Net unrealised gains/(losses)		Impairments		Total investment return	
	2006 £m	Restated 2005 £m	**2006 £m**	Restated 2005 £m	**2006 £m**	Restated 2005 £m	**2006 £m**	Restated 2005 £m	**2006 £m**	Restated 2005 £m
Investment property	**13**	11	**12**	43	**42**	27	**–**	–	**67**	81
Equity securities	**56**	55	**52**	128	**–**	–	**(3)**	(5)	**105**	178
Debt securities	**372**	347	**(27)**	21	**–**	–	**–**	–	**345**	368
Other investments:										
Loans secured by mortgages	**1**	1	**–**	–	**–**	–	**–**	–	**1**	1
Other loans	**3**	4	**16**	–	**–**	–	**–**	–	**19**	4
Other	**8**	12	**7**	–	**–**	–	**–**	–	**15**	12
Deposits, cash and cash equivalents	**63**	55	**–**	–	**–**	–	**–**	–	**63**	55
Derivatives	**1**	–	**(14)**	(22)	**(2)**	(9)	**–**	–	**(15)**	(31)
Net investment return	**517**	485	**46**	170	**40**	18	**(3)**	(5)	**600**	668

Direct operating expenses (including repairs and maintenance) arising from investment properties were not material in 2006 and 2005.

Unrealised capital gains and losses recognised directly in equity for available for sale assets.

	Net unrealised gains/(losses)		Net realised gains/(losses) transferred to income statement		Impairments transferred to income statement		Net movement recognised in equity	
	2006 £m	2005 £m	**2006 £m**	2005 £m	**2006 £m**	2005 £m	**2006 £m**	2005 £m
Equity securities	**158**	186	**(39)**	(128)	**3**	5	**122**	63
Debt securities	**(132)**	(48)	**16**	(35)	**–**	–	**(116)**	(83)
Other	**2**	9	**(4)**	(5)	**–**	–	**(2)**	4
Total	**28**	147	**(27)**	(168)	**3**	5	**4**	(16)

3. Net claims and benefits

	2006 £m	Restated 2005 £m
Gross claims paid	**3,910**	3,828
Gross changes in insurance contract liabilities for claims	**(152)**	275
Reinsurance recoveries on loss and loss expenses paid	**(603)**	(702)
Reinsurers' share of change in insurance contract liabilities for claims	**298**	(12)
Net claims and benefits	**3,453**	3,389

4. Profit before tax

The following items have been included in arriving at the profit before tax on continuing operations:

Other operating income

	2006 £m	Restated 2005 £m
Other income	**109**	97
Net gains on derivatives	**12**	2
Other operating income	**121**	99

Notes to the financial statements
continued

4. Profit before tax continued
Other operating expenses

	2006 £m	Restated 2005 £m
Administration and other expenses	**87**	102
Reorganisation expenses	**23**	37
Investment expenses and charges	**25**	24
Amortisation and impairment of intangible assets	**15**	11
Foreign exchange losses	**1**	2
Other operating expenses	**151**	176

The operating lease payments recognised as an expense during the year were **£75m** (2005 restated: £59m).

Finance costs

	2006 £m	2005 £m
Interest expense on loan capital	**80**	79
Other loan interest	**12**	26
Other finance costs	**–**	2
Finance costs	**92**	107

Auditors' remuneration

	2006 £m	Restated 2005 £m
Fees payable to PricewaterhouseCoopers LLP for audit of the Company's annual accounts	**0.9**	0.8
Fees payable to PricewaterhouseCoopers LLP and its associates for other services:		
The audit of the Company's subsidiaries, pursuant to legislation	**5.3**	2.5
Other services pursuant to legislation	**0.5**	2.0
Tax services	**0.5**	0.5
Services relating to corporate finance activities	**0.2**	0.3
Other	**0.1**	1.4
Fees in respect to pension scheme:		
Audit	**0.1**	0.1
	7.6	7.6

Auditors' remuneration in 2006 included amounts relating to the requirements of Section 404 of the Sarbanes Oxley Act.

Directors' emoluments
The aggregate emoluments of the directors, including amounts received from subsidiaries, were as follows:

	2006 £000	2005 £000
Emoluments of executive directors	**4,257**	4,056
Fees and other payments to non-executive directors	**556**	481
	4,813	4,537

A pension payment of **£24,423** (2005: £22,953) was paid by a subsidiary to a former director in respect of services other than as a director.

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

Employee information
Staff costs for all employees comprise:

	2006 £m	Restated 2005 £m
Wages and salaries	**590**	592
Social security costs	**69**	46
Pension costs	**64**	(84)
Share based payments to directors and employees	**12**	8
	735	562

Pension costs in 2005 included a one-off benefit of £180m due to the change in pension scheme design.

4. Profit before tax continued

The average number of employees of the continuing operations during the year was as follows:

	2006 Number	Restated 2005 Number
UK	**10,377**	10,781
Scandinavia	**6,410**	6,709
International	**6,390**	6,036
	23,177	23,526

The statutory disclosure relating to discontinued operations is set out in note 35.

5. Income tax expense

The tax amounts charged in the income statement are as follows:

	2006 £m	Restated 2005 £m
Current tax	**156**	(18)
Deferred tax	**14**	277
Taxation attributable to the Group	**170**	259

UK corporation tax is calculated at **30%** (2005: 30%) of the estimated assessable profit for the year. Since the Group operates around the world, it is subject to income taxes in many different tax jurisdictions. Taxation for other jurisdictions is calculated at the rates prevailing in those jurisdictions. Of the above taxation attributable to the Group **£74m** (2005: £176m) relates to UK corporation tax and **£96m** (2005 restated: £83m) to overseas taxation.

	2006 £m	Restated 2005 £m
Profit before tax	**649**	894
Tax at the UK rate of **30%** (2005: 30%)	**195%**	268%
Tax effect of:		
Income/gains not taxable	**(35)**	(27)
Expenses not deductible for tax purposes	**14**	13
Tax losses not recognised	**4**	–
Adjustment for prior year provisions	**(5)**	18
Different tax rates of subsidiaries operating in other jurisdictions	**(3)**	(13)
Income tax expense	**170**	259

6. Earnings per share attributable to the equity holders of the Parent Company

The earnings per ordinary share is calculated by reference to the profit/(loss) attributable to the equity shareholders and the weighted average of shares in issue during the year.

Basic

Basic earnings per share is calculated by dividing the profit/(loss) attributable to equity holders of the Parent Company by the weighted average number of ordinary shares in issue during the period, excluding ordinary shares purchased by the ESOP Trusts and held as treasury shares.

	Continuing operations		Total Group	
	2006 £m	Restated 2005 £m	2006 £m	2005 £m
Profit/(loss) attributable to equity holders of the Parent Company	**447**	585	**(52)**	555
Less: Cumulative preference dividends	**(9)**	(9)	**(9)**	(9)
Profit/(loss) for the calculation of earnings per share	**438**	576	**(61)**	546
Weighted average number of ordinary shares in issue (thousands)	**2,929,453**	2,896,059	**2,929,453**	2,896,059
Basic earnings per share (p)	**15.0%**	19.9%	**(2.1)%**	18.9%

Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. The Parent Company has only one category, share options, of dilutive potential ordinary shares.

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6. Earnings per share attributable to the equity holders of the Parent Company continued

The calculation is performed for the share options to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Parent Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options.

	Continuing operations		Total Group	
	2006 £m	Restated 2005 £m	**2006 £m**	2005 £m
Profit/(loss) for the calculation of earnings per share	**438**	576	**(61)**	546
Weighted average number of ordinary shares in issue (thousands)	**2,929,453**	2,896,059	**2,929,453**	2,896,059
Adjustments for share options (thousands)	**29,835**	17,445	**29,835**	17,445
Weighted average number of ordinary shares for diluted earnings per share (thousands)	**2,959,288**	2,913,504	**2,959,288**	2,913,504
Diluted earnings per share (p)	**14.8**	19.7	**(2.1)**	18.7

7. Dividends

	2006 p	2005 p	**2006 £m**	2005 £m
Ordinary dividend:				
Final paid in respect of prior year	**3.05**	2.96	**89**	86
Interim paid in respect of current year	**1.75**	1.69	**51**	49
			140	135
Preference dividend			**9**	9
			149	144

At the Annual General Meeting (AGM) on 21 May 2007, a dividend in respect of 2006 of **4.12p** per share amounting to a total dividend of **£123m** is to be proposed. The proposed dividend will be paid and accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31 December 2007.

The trustees of the Royal & SunAlliance ESOP Trust and the Royal & SunAlliance ESOP Trust No 2 waived their entitlement to dividends which reduced the total dividend paid by **£1m** (2005: £1m).

8. Goodwill and other intangible assets

	Goodwill £m	Intangible asset arising from acquired claims provisions £m	Software development £m	Other £m	Total £m
Cost					
At 1 January 2006	769	218	325	88	1,400
Additions and transfers	70	–	94	33	197
Disposals and transfers	–	–	(3)	–	(3)
Exchange adjustment	(83)	(19)	(5)	(15)	(122)
Transfer to discontinued operations	(543)	(110)	(12)	–	(665)
At 31 December 2006	213	89	399	106	807
Accumulated amortisation					
At 1 January 2006	–	171	117	45	333
Amortisation charge	–	11	46	9	66
Amortisation on disposals	–	–	(1)	–	(1)
Exchange adjustment	–	(17)	(5)	(9)	(31)
Transfer to discontinued operations	–	(100)	(12)	–	(112)
At 31 December 2006	–	65	145	45	255
Accumulated impairment					
At 1 January 2006	617	–	–	–	617
Exchange adjustment	(74)	–	–	–	(74)
Transfer to discontinued operations	(543)	–	–	–	(543)
At 31 December 2006	–	–	–	–	–
Net book amount at 31 December 2006 – continuing operations	213	24	254	61	552

8. Goodwill and other intangible assets continued

	Goodwill £m	Intangible asset arising from acquired claims provisions £m	Software development £m	Other £m	Total £m
Cost					
At 1 January 2005	669	208	212	56	1,145
Additions and transfers	38	–	122	22	182
Disposals and transfers	(3)	–	(12)	–	(15)
Exchange adjustment	65	10	3	10	88
At 31 December 2005	769	218	325	88	1,400
Accumulated amortisation					
At 1 January 2005	–	150	85	34	269
Amortisation charge	–	12	39	5	56
Amortisation on disposals	–	–	(10)	–	(10)
Exchange adjustment	–	9	3	6	18
At 31 December 2005	–	171	117	45	333
Accumulated impairment					
At 1 January 2005	554	–	–	–	554
Exchange adjustment	63	–	–	–	63
At 31 December 2005	617	–	–	–	617
Net book amount at 31 December 2005	152	47	208	43	450

Amortisation expense of **£46m** (2005: £39m) has been charged to underwriting and policy acquisition costs.

Impairment tests for goodwill

Goodwill is allocated to the Group's cash generating units (CGUs) as follows:

	2006 £m	2005 £m
UK	**43**	3
International	**51**	51
Scandinavia	**119**	98

When testing for impairment, the recoverable amount of a CGU is determined based on value in use calculations. These calculations use cashflow projections based on financial budgets approved by management covering a five year period. Cashflows beyond the five year period are extrapolated using the estimated growth rates which do not exceed the long term average past growth rate for the insurance business in which the CGU operates.

A number of other assumptions and estimates are involved in the application of a cashflow model to forecast operating cashflows, premium volumes, expenses and working capital requirements. Forecasts of future cashflows are based on the best estimates of future premiums, operating expenses using historical trends, general geographical market conditions, industry trends and forecasts and other available information. These assumptions are subject to review by management and the Group Audit Committee of the Board of Directors. The cashflow forecasts are adjusted by an appropriate discount rate. The discount rates used are pre tax and reflect specific risks relating to the relevant segments at the date of evaluation. The weighted average growth rates used are consistent with the forecasts included in industry reports.

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9. Property and equipment

	Group occupied property – land and buildings £m	Equipment £m	Total £m
Cost/valuation			
At 1 January 2006	**301**	**329**	**630**
Additions	**7**	**30**	**37**
Acquisition of subsidiaries	**1**	**2**	**3**
Disposals	**(4)**	**(21)**	**(25)**
Revaluation adjustments	**16**	**–**	**16**
Exchange adjustment	**(7)**	**(13)**	**(20)**
Transfer to assets held for sale	**(16)**	**–**	**(16)**
Transfer to discontinued operations	**–**	**(7)**	**(7)**
At 31 December 2006	**298**	**320**	**618**
Accumulated depreciation			
At 1 January 2006	**–**	**220**	**220**
Depreciation charge	**4**	**32**	**36**
Depreciation on disposals	**–**	**(13)**	**(13)**
Revaluation adjustment	**(4)**	**–**	**(4)**
Exchange adjustment	**–**	**(7)**	**(7)**
Transfer to discontinued operations	**–**	**(5)**	**(5)**
At 31 December 2006	**–**	**227**	**227**
Accumulated impairment			
Impairment charge	**–**	**6**	**6**
At 31 December 2006	**–**	**6**	**6**
Net book amount at 31 December 2006	**298**	**87**	**385**

	Group occupied property – land and buildings £m	Equipment £m	Total £m
Cost/valuation			
At 1 January 2005	319	366	685
Additions	3	58	61
Acquisition/(disposal) of subsidiaries	1	(1)	–
Disposals	–	(85)	(85)
Revaluation adjustments	13	–	13
Exchange adjustment	(2)	8	6
Transfer to assets held for sale	(33)	(17)	(50)
At 31 December 2005	301	329	630
Accumulated depreciation			
At 1 January 2005	–	267	267
Depreciation charge	5	32	37
Depreciation on disposals	–	(69)	(69)
Disposal of subsidiaries	–	(1)	(1)
Revaluation adjustment	(5)	–	(5)
Exchange adjustment	–	3	3
Transfer to assets held for sale	–	(12)	(12)
At 31 December 2005	–	220	220
Net book amount at 31 December 2005	301	109	410

The Group occupied property was revalued on 31 December 2006 by independent valuers.

Depreciation and impairment expense of **£42m** (2005: £37m) has been charged to underwriting and policy acquisition costs.

The carrying amount of Group occupied property that would have been recognised had the assets been carried under the cost model at 31 December 2006 is **£218m** (2005: £260m).

10. Investment property

Investment property consists of the following:

	2006 £m	2005 £m
Land and buildings:		
Freehold and long leasehold	**451**	431
Short leasehold	**3**	4
Total land and buildings	**454**	435

Movement in the carrying value of investment property is detailed below:

	2006 £m	2005 £m
Investment property at 1 January	**435**	417
Additions from subsequent expenditure	**1**	10
Sales and purchases	**(21)**	(2)
Fair value gains	**40**	12
Exchange adjustment	**(1)**	(2)
Investment property at 31 December	**454**	435

11. Investments in associates

The Group has the following investments in associates:

	Country	Ordinary shareholding
Royal & Sun Alliance Insurance (Malaysia) Bhd	Malaysia	45.0%
Royal Sundaram Alliance Insurance Company Ltd	India	26.0%
Syn Mun Kong Public Company Ltd	Thailand	20.0%

Summarised below are the assets, liabilities, revenue and profit and loss of the companies above.

	2006 £m	2005 £m
Total assets	**207**	185
Total liabilities	**135**	121
Total revenue	**147**	128
Goodwill on acquisition	**5**	5
Profit for the year after tax	**8**	6

The Group's share of net assets and profit and loss are accounted for under the equity method.

Some associates have been omitted from this statement to avoid providing particulars of excessive length but none materially affects the results or assets of the Group.

12. Financial assets

	2006 £m	2005 £m
Equity securities	**1,620**	1,683
Debt securities	**8,568**	11,609
Other financial assets	**155**	146
Short term investments	**114**	95
Total financial assets – available for sale	**10,457**	13,533

At the period end, the Group had pledged **£651m** (2005: £2,503m) of financial assets as collateral for liabilities or contingent liabilities and had accepted **£1,025m** (2005: £1,802m) collateral that could be sold or pledged.

Notes to the financial statements

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13. Reinsurers' share of insurance contract liabilities

	2006 £m	2005 £m
Reinsurers' share of provision for unearned premiums	189	298
Reinsurers' share of provision for loss and loss adjustment expenses	1,738	4,108
Reinsurers' share of insurance contract liabilities	1,927	4,406

The following changes have occurred in the reinsurers' share of the provision for unearned premiums during the year:

	2006 £m	2005 £m
Reinsurers' share of provision for unearned premiums at 1 January	298	266
Premiums ceded to reinsurers	790	1,020
Reinsurers' share of premiums earned	(885)	(1,042)
Changes in reinsurance asset	(95)	(22)
Reinsurers' share of portfolio transfers and acquisitions	1	35
Exchange adjustment	(15)	19
Reinsurers' share of provision for unearned premiums at 31 December	189	298

The following changes have occurred in the reinsurers' share of the provision for loss and loss adjustment expenses during the year:

	2006 £m	2005 £m
Reinsurers' share of provisions for loss and loss adjustment expenses at 1 January	4,108	4,158
Reinsurers' share of total claims incurred	353	856
Total reinsurance recoveries received	(998)	(1,251)
Reinsurers' share of portfolio transfers and acquisitions	(13)	21
Exchange adjustment	(341)	318
Other movements	6	6
Transfer to discontinued operations	(1,377)	–
Reinsurers' share of provision for loss and loss adjustment expenses at 31 December	1,738	4,108
To be settled within 12 months	724	1,690
To be settled after 12 months	1,014	2,418

14. Insurance and reinsurance debtors

	2006 £m	2005 £m
Insurance debtors comprise:		
Due from policyholders	950	851
Due from intermediaries	1,046	1,127
Total insurance debtors	1,996	1,978
Reinsurance debtors	229	569
Total insurance and reinsurance debtors	2,225	2,547

All insurance and reinsurance debtors are recoverable within 12 months.

15. Deferred acquisition costs

	2006 £m	2005 £m
Deferred acquisition costs at 1 January	**465**	487
Exchange adjustment	**(18)**	13
Acquisition costs deferred during the year	**771**	738
Amortisation charged during the year	**(761)**	(769)
Charge to income statement in the year	**10**	(31)
Disposal of assets	**1**	(3)
Other	**–**	(1)
Transfer to discontinued operations	**(5)**	–
Deferred acquisition costs at 31 December	**453**	465

The Group records acquisition costs recovered from reinsurers as a deduction from deferred acquisition costs.

16. Other debtors and other assets

	2006 £m	2005 £m
Derivative assets	**17**	31
Other debtors	**339**	332
Pension scheme surplus	**188**	–
Accrued interest and rent	**128**	155
Prepayments	**134**	78
Total other debtors and other assets	**806**	596
To be settled within 12 months	**545**	461
To be settled after 12 months	**261**	135

17. Cash and cash equivalents

	2006 £m	2005 £m
Cash and cash equivalents and bank overdrafts (as reported within the cashflow statement)	**2,040**	1,612
Add: bank overdrafts	**4**	5
Less: transfer to discontinued operations	**(213)**	–
Total cash and cash equivalents	**1,831**	1,617

The interest bearing financial assets and financial liabilities included in cash and cash equivalents and bank overdrafts had an effective interest rate of **4.45%** (2005: 4.09%) and had an average maturity of **34 days** (2005: 30 days).

Notes to the financial statements

continued

18. Equity and reserves

Changes in equity

Changes in equity for the year ended 31 December 2006

	Ordinary share capital £m	Ordinary share premium £m	Treasury shares £m	Preference shares £m	Revaluation reserve £m	Capital redemption reserve £m	Translation reserve £m	Retained earnings £m	Share-holders' funds £m	Sub-ordinated guaranteed perpetual notes £m	Minority interest £m	Total equity £m
Balance at 1 January (as reported)	807	804	(57)	125	432	8	50	574	2,743	–	391	3,134
Prior year adjustment (note19)	–	–	–	–	–	–	–	(57)	(57)	–	–	(57)
Restated balance at 1 January	807	804	(57)	125	432	8	50	517	2,686	–	391	3,077
Total recognised income/ (expense) for the year	–	–	–	–	14	–	(131)	107	(10)	–	24	14
Dividends – paid (note 7)	–	–	–	–	–	–	–	(149)	(149)	–	(9)	(158)
Issued by scrip	12	49	–	–	–	–	–	–	61	–	–	61
Issued for cash	2	4	–	–	–	–	–	–	6	–	–	6
Changes in shareholders' interests in subsidiaries	–	–	–	–	–	–	–	(46)	(46)	–	(75)	(121)
Depreciation transfer	–	–	–	–	10	–	–	(10)	–	–	–	–
Share options	–	–	–	–	–	–	–	13	13	–	–	13
Balance at 31 December	821	857	(57)	125	456	8	(81)	432	2,561	–	331	2,892
Continuing operations	821	857	(57)	125	455	8	(69)	530	2,670	–	331	3,001
Discontinued operations	–	–	–	–	1	–	(12)	(98)	(109)	–	–	(109)
	821	857	(57)	125	456	8	(81)	432	2,561	–	331	2,892

The above amounts are presented net of deferred tax. The deferred tax charged or credited directly to equity is set out in note 23.

During the year, the Group purchased the minority interest of its subsidiaries in Latvia and Lithuania for DKK599m (£55m). Codan A/S purchased DKK736m (£66m) of its own shares on the market, this increased the Group's ownership of Codan A/S from 71.7% to 74.5%.

Changes in equity for the year ended 31 December 2005 (restated)

	Ordinary share capital £m	Ordinary share premium £m	Treasury shares £m	Preference shares £m	Revaluation reserve £m	Capital redemption reserve £m	Translation reserve £m	Retained earnings £m	Share-holders' funds £m	Sub-ordinated guaranteed perpetual notes £m	Minority interest £m	Total equity £m
Balance at 1 January	801	790	(54)	125	479	8	(19)	191	2,321	444	368	3,133
Total recognised income/ (expense) for the year	–	–	–	–	(31)	–	69	526	564	–	39	603
Dividends – paid (note 7)	–	–	–	–	–	–	–	(144)	(144)	–	(16)	(160)
Issued by scrip	5	13	–	–	–	–	–	–	18	–	–	18
Issued for cash	1	1	–	–	–	–	–	–	2	–	–	2
Treasury share purchase	–	–	(3)	–	–	–	–	–	(3)	–	–	(3)
Depreciation transfer	–	–	–	–	(16)	–	–	16	–	–	–	–
Share options	–	–	–	–	–	–	–	9	9	–	–	9
Reclassification to loan capital (note 19)	–	–	–	–	–	–	–	(81)	(81)	(444)	–	(525)
Balance at 31 December	807	804	(57)	125	432	8	50	517	2,686	–	391	3,077

The above amounts are presented net of deferred tax. The deferred tax charged or credited directly to equity is set out in note 23.

18. Equity and reserves continued

Ordinary and preference shares

During the year **6,804,499** (2005: 2,137,513) ordinary shares were issued on the exercise of employee share options for a cash consideration of **£6m** (2005: £2m). The Parent Company also issued **45,604,849** (2005: 20,661,210) ordinary shares during the year under the scrip dividend scheme. The total nominal value of ordinary shares issued during the year was **£14m** (2005: £6m).

	2006 £m	2005 £m
Authorised		
3,923,636,364 ordinary shares of 27.5p each (2005: 3,923,636,364 ordinary shares of 27.5p each)	**1,079**	1,079
300,000,000 preference shares of £1 each (2005: 300,000,000 preference shares of £1 each)	**300**	300
Issued and fully paid		
2,987,526,642 ordinary shares of 27.5p each (2005: 2,935,117,294 ordinary shares of 27.5p each)	**821**	807
125,000,000 preference shares of £1 each (2005: 125,000,000 preference shares of £1 each)	**125**	125
	946	932

The preference shares carry a right to a fixed cumulative preferential dividend of 7.375% per annum, payable in half yearly instalments, and are not redeemable. On a return of capital on a winding up (liquidation), the holders are entitled, in priority to holders of ordinary shares of the Parent Company, to receive out of the surplus assets of the Parent 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 Group only if at the date of the notice of the meeting the dividend payable on the share is in arrears or otherwise on a resolution to vary the rights attaching to the preference shares.

The Royal & SunAlliance ESOP Trust holds ordinary shares in the Parent Company, which may subsequently be transferred to employees (other than the executive directors). At 31 December 2006, the Trust held **17,751,097** ordinary shares (2005: 19,182,272) in the Parent Company with a nominal value of **£5m** (2005: £5m) and a mid market value, based on the market value of the Parent Company's shares at the close of business on 29 December 2006 as shown in the Official List of the London Stock Exchange, of **£27m** (2005: £24m).

The Royal & SunAlliance ESOP Trust No 2 holds ordinary shares in the Parent Company, which may subsequently be transferred to employees including executive directors. At 31 December 2006, the Trust held **4,938,894** ordinary shares (2005: 4,938,894) in the Parent Company with a nominal value of **£1m** (2005: £1m) and a mid market value, based on the market value of the Parent Company's shares at the close of business on 29 December 2006 as shown in the Official List of the London Stock Exchange, of **£8m** (2005: £6m).

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19. Loan capital

	2006 £m	Restated 2005 £m
Subordinated guaranteed US$ bonds	**37**	285
Subordinated guaranteed Euro bonds	**335**	341
Total dated loan capital	**372**	626
Subordinated Sterling perpetual guaranteed bonds	**301**	–
Subordinated guaranteed perpetual notes	**519**	526
Total loan capital	**1,192**	1,152

The subordinated guaranteed US$ bonds (Yankee Bonds) have a redemption date of 15 October 2029. The rate of interest payable on the US$ bonds is 8.95%.

On 20 April 2006, the Parent Company announced an offer to exchange any or all of the outstanding $500m Yankee Bonds for subordinated Sterling perpetual guaranteed bonds (New Bonds). Holders of $425,694,000 of the outstanding nominal amount of the Yankee Bonds participated in the offering, which was settled on 12 May 2006. The balance of the Yankee Bonds that remain outstanding following the closing of the transaction was $74,306,000.

On 20 April 2006, the Parent Company also announced a tender for any or all of the outstanding $500m Yankee Bonds. Yankee Bonds with a nominal value of $708,000 were tendered for settlement on 22 May 2006.

A further $419,000 were repurchased and cancelled on 13 November 2006. The outstanding Yankee Bonds at 31 December 2006 have a nominal value of $73,179,000.

On 22 February 2007, the Group repurchased Yankee Bonds with nominal value of $49,500,000 for a total consideration of $68m (including accrued interest of $1.5m). Yankee Bonds with nominal value of $23,679,000 remain.

The subordinated guaranteed Euro bonds (€500m) have a redemption date of 15 October 2019. €200m of the Euro bonds bear interest at a fixed rate of 6.875% until 15 October 2009 and a floating rate thereafter. €300m of the Euro bonds bear interest at a floating rate from the date of issue of EURIBOR +1.25%. The Parent Company has the option to repay the Euro bonds on specific dates from 15 October 2009.

New Bonds were issued under an offer to exchange any or all of the Yankee Bonds. This exchange improves the regulatory capital position of the Group by replacing the Yankee Bonds, which do not qualify as regulatory capital, with an innovative Tier 1 regulatory capital instrument under the FSA's General Prudential Sourcebook. This exchange is not accounted for as an extinguishment of the original financial liability (Yankee Bonds) and the recognition of a new financial liability (New Bonds) because the discounted present value of the cashflows under the terms of the New Bonds (including net fees paid) discounted using the effective interest rate of the Yankee Bonds, is less than 10% different from the discounted present value of the remaining cashflows of the Yankee Bonds. The carrying value of the Yankee Bonds exchanged at the date of the exchange became the carrying value of the New Bonds issued in the exchange. After charging expenses directly relating to the exchange of £3m, the carrying value of the New Bonds immediately after the exchange was £222m. The nominal value of the New Bonds issued in the exchange transaction is £297,279,000.

In addition to the New Bonds issued under the exchange, New Bonds with a nominal value of £77,721,000 were issued at par for cash consideration of £77m net of directly related expenses of £1m on the same terms as the New Bonds issued under the exchange. In total, New Bonds with a nominal value of £375,000,000 were issued on 12 May 2006.

The New Bonds are step up perpetual guaranteed subordinated capital securities and the rate of interest payable is 6.701% of the nominal value. The Group has the option to repay the bonds on specific dates starting 12 July 2017. If the bonds are not repaid, from that date, the rate of interest payable would be LIBOR + 2.51%.

The subordinated guaranteed perpetual notes have a nominal value of £450m and pay an annual coupon of 8.50% with an option to call the notes, or if not called for the coupon rate to be reset, on 8 December 2014 and every five years thereafter.

During 2005, the terms of the subordinated guaranteed perpetual notes were revised with the effect that their classification under IFRS changed from being equity instruments to debt instruments. In the 2005 financial statements, the reclassification was accounted for as an exchange transaction as the underlying terms of the notes were not substantially impacted by the variation in terms and there were no changes in the holders of the notes immediately before and immediately after the change. During 2006, the International Financial Reporting Interpretations Committee (IFRIC) provided guidance on its understanding of accounting for such a change in terms. The directors have considered the IFRIC's deliberations and concluded that the Company should change its accounting treatment. The accounting treatment now recognises the impact of the revision of the terms of the notes as if the revision had given rise to a redemption of the equity instrument in exchange for a debt instrument, which is measured at the fair value of the notes at the date of the revision. The carrying value of the notes included in the 2005 results has been increased by £81m and a corresponding deferred tax asset of £24m has been recognised in accordance with this revised accounting treatment. Opening shareholders' funds have been restated by the net amount of £57m, of which £24m was recognised through the statement of recognised income and expense and £81m was recognised directly in equity.

The bonds and the notes are contractually subordinated to all other creditors of the Parent Company such that in the event of a winding up or of bankruptcy, they are to be repaid only after the claims of all other creditors have been met.

The aggregate fair value of the dated loan capital, subordinated Sterling perpetual guaranteed bonds, and subordinated guaranteed perpetual notes at 31 December 2006 is **£1,291m** (2005: £1,271m).

20. Insurance contract liabilities

	2006 £m	2005 £m
Provision for unearned premiums	**2,969**	3,001
Provision for losses and loss adjustment expenses	**9,821**	14,203
Gross insurance contract liabilities	**12,790**	17,204

Provision for unearned premiums

The following changes have occurred in the provision for unearned premiums during the year:

	2006 £m	2005 £m
Provision for unearned premiums at 1 January	**3,001**	2,903
Premiums written	**6,270**	6,420
Less: premiums earned	**(6,191)**	(6,424)
Changes in provision for unearned premiums	**79**	(4)
Gross portfolio transfers and acquisitions	**10**	41
Exchange adjustment	**(96)**	61
Transfer to discontinued operations	**(25)**	–
Provision for unearned premiums at 31 December	**2,969**	3,001

Provisions for losses and loss adjustment expenses

	2006 £m	2005 £m
Provision for losses and loss adjustment expenses at 1 January	**14,203**	14,288
Claim losses and expenses incurred	**3,877**	4,451
Total claims payments made in the year, net of recoveries	**(4,748)**	(5,225)
Gross portfolio transfers and acquisitions	**4**	(15)
Exchange adjustment	**(773)**	637
Other movements	**67**	67
Transfer to discontinued operations	**(2,809)**	–
Provision for losses and loss adjustment expenses at 31 December	**9,821**	14,203
To be settled within 12 months	**2,268**	3,193
To be settled after 12 months	**7,553**	11,010

Assumptions

The total value of outstanding claims provisions less related reinsurance recoveries before discounting amounted to **£8,655m** (2005: £10,843m).

Claims on certain classes of business have been discounted as follows:

		Discount rate		Average number of years to settlement	
	Category	2006 %	2005 %	2006 Years	2005 Years
UK	Asbestos and environmental	**5.00**	5.00	**15**	13
Scandinavia	Disability	**3.58**	3.57	**12**	12
Canada	Asbestos and environmental	**5.00**	5.00	**6**	6

In determining the average number of years to ultimate claims settlement, estimates have been made based on the underlying claims settlement patterns.

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20. Insurance contract liabilities continued

Claims development tables

The tables below present changes in the historical general insurance provisions that were established in 2001 and the general insurance provisions arising in each subsequent accident year. The tables are presented at current year cumulative average exchange rates and have been adjusted for operations disposed of and discontinued operations.

The top triangle of the tables presents the estimated provision for ultimate incurred losses and loss adjustment expenses at the end of each accident year as at each balance sheet date.

The lower (paid) triangle of the tables presents the amounts paid against those provisions in each subsequent accounting period.

The estimated provision for ultimate incurred losses changes as more information becomes known about the actual losses for which the initial provisions were set up and as the rate of exchange changes. The 2006 redundancy/(deficiency) presents the claims development of earlier accident years incurred in the current accounting period. The redundancy/(deficiency) is equal to the current estimate of cumulative claims less the cumulative claims paid.

Consolidated claims development table gross of reinsurance

	2001 and prior £m	2002 £m	2003 £m	2004 £m	2005 £m	**2006 £m**	Total £m
Estimate of cumulative claims							
At end of accident year	9,182	3,053	2,981	2,504	2,622	**2,275**	
One year later	9,724	2,848	2,716	2,278	2,577		
Two years later	9,901	2,924	2,617	2,129			
Three years later	10,184	2,900	2,507				
Four years later	10,516	2,814					
Five years later	10,968						
Claims paid							
One year later	2,954	1,207	1,101	844	1,140		
Two years later	1,490	437	335	287			
Three years later	1,213	302	231				
Four years later	760	191					
Five years later	528						
Cumulative claims paid	6,945	2,137	1,667	1,131	1,140		
2006 (deficiency)/redundancy	(452)	86	110	149	45		(62)
Reconciliation to the balance sheet							
Current year provision before discounting	4,023	677	840	998	1,437	**2,275**	10,250
Exchange adjustment to closing rates							(154)
Discounting							(627)
Annuities							352
Present value recognised in the balance sheet							**9,821**

20. Insurance contract liabilities continued

Consolidated claims development table net of reinsurance

	2001 and prior £m	2002 £m	2003 £m	2004 £m	2005 £m	**2006 £m**	Total £m
Estimate of cumulative claims							
At end of accident year	7,178	2,380	2,171	2,043	2,164	**2,132**	
One year later	7,435	2,328	2,058	1,919	2,074		
Two years later	7,559	2,335	1,985	1,773			
Three years later	7,902	2,317	1,886				
Four years later	7,961	2,241					
Five years later	8,398						
Claims paid							
One year later	2,262	965	785	638	825		
Two years later	1,164	327	268	247			
Three years later	1,017	244	192				
Four years later	534	159					
Five years later	398						
Cumulative claims paid	5,375	1,695	1,245	885	825		
2006 (deficiency)/redundancy	(437)	76	99	146	90		(26)
Reconciliation to the balance sheet							
Current year provision before discounting	3,023	546	641	888	1,249	**2,132**	8,479
Exchange adjustment to closing rates							(132)
Discounting							(572)
Annuities							308
Present value recognised in the balance sheet							**8,083**

Prior year development in 2006 showed continued favourable experience in the 2002 to 2005 accident years, offset by reserve strengthening in the 2001 and prior accident years. The movement in the 2001 and prior years primarily reflects the strengthening of our UK asbestos reserves by £169m, and our long tail Scandinavian reserves by £260m. The positive run off in the years 2002 to 2005 comes from all main businesses and reflects the benefits of recent management actions as well as the release of surplus reserves within our Danish motor business. The total discounting of £572m compares with £462m in 2005, with the increase predominantly reflecting the impact of the increase in UK asbestos reserves.

21. Insurance and reinsurance liabilities

	2006 £m	2005 £m
Direct insurance creditors	**140**	196
Reinsurance creditors	**251**	279
Total insurance and reinsurance liabilities	**391**	475
To be settled within 12 months	**356**	458
To be settled after 12 months	**35**	17

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22. Borrowings

	2006 £m	2005 £m
Secured debenture loans	–	10
Amounts owed to credit institutions – unsecured:		
Under committed credit facilities	–	233
Other	8	8
Total borrowings	**8**	251

Borrowings at 31 December are repayable as follows:

	2006 £m	2005 £m
One year or less	6	242
After one year and within two years	1	1
After two years and within three years	1	1
After three years and within four years	–	1
After four years and within five years	–	2
After five years	–	4
Total borrowings	**8**	251

Loans from credit institutions of **£nil** at 31 December 2006 (2005: £233m) under committed credit facilities have been classified by reference to the earliest date on which repayment may be demanded by the lender. At 31 December 2006, total committed credit facilities available to the Group were **£500m** (2005: £233m), of which **£nil** (2005: £233m) expire within one year and **£500m** (2005: £nil) expire within two to five years.

At 31 December 2006 and 2005 the Group had in place a one billion US dollar Euro commercial paper program. There were no amounts outstanding at 31 December 2006 (2005: £nil).

The weighted average interest rate on short term borrowings at 31 December 2006 was **5.81%** (2005: 5.79%).

23. Current and deferred tax

Current tax

	Asset		Liability	
	2006 £m	2005 £m	2006 £m	2005 £m
To be settled within 12 months	–	–	34	33
To be settled after 12 months	17	40	22	22
	17	40	**56**	55

Deferred tax

	2006 £m	Restated 2005 £m
Deferred tax assets	29	57
Deferred tax liabilities	(319)	(236)
Net deferred tax position at 31 December	**(290)**	(179)

The movement for the year in the Group's net deferred tax position is as follows:

	2006 £m	Restated 2005 £m
Net deferred tax position at1 January	(179)	73
Charge to the income statement for the year	(29)	(277)
(Charge)/credit to equity for the year	(75)	15
Acquisition of subsidiaries	(5)	–
Exchange adjustment	(2)	10
Net deferred tax position at 31 December	**(290)**	(179)

23. Current and deferred tax continued

The following are the major deferred tax liabilities and assets recognised by the Group and their movements during the year:

Deferred tax assets

	Reclassification of debt £m	Retirement benefit obligations £m	Other temporary differences £m	Total £m
Deferred tax assets at 1 January 2005	–	170	4	174
Charge to the income statement for the year	–	(91)	(76)	(167)
Credit to equity for the year (restated)	24	24	–	48
Exchange adjustment	–	–	2	2
Restated deferred tax assets at 31 December 2005	24	103	(70)	57
(Charge)/credit to the income statement for the year	**–**	**(37)**	**80**	**43**
(Charge)/credit to equity for the year	**(2)**	**(74)**	**5**	**(71)**
Deferred tax assets at 31 December 2006	**22**	**(8)**	**15**	**29**

Deferred tax liabilities

	Claims equalisation reserves £m	Revaluation of investments £m	Other temporary differences £m	Total £m
Deferred tax liabilities at 1 January 2005	97	85	(81)	101
Charge to the income statement for the year	7	5	98	110
Charge to equity for the year	–	28	5	33
Exchange adjustment	–	–	(8)	(8)
Deferred tax liabilities at 31 December 2005	104	118	14	236
Charge/(credit) to the income statement for the year	**5**	**(11)**	**78**	**72**
Charge to equity for the year	**–**	**2**	**2**	**4**
Disposals	**–**	**–**	**5**	**5**
Exchange adjustment	**–**	**–**	**2**	**2**
Deferred tax liabilities at 31 December 2006	**109**	**109**	**101**	**319**

The deferred income tax (charged)/credited to equity is as follows:

	2006 £m	Restated 2005 £m
Fair value reserves in shareholders' equity		
Available for sale financial assets	**(2)**	(28)
Group occupied property	**(2)**	(5)
Retirement benefit obligations	**(74)**	24
Share options	**5**	–
Reclassification of debt	**(2)**	24
Total (charged)/credited to equity for the year	**(75)**	15

The aggregate current tax relating to items that were charged or credited to equity is **£8m** (2005: £21m).

At the balance sheet date, the Group had unused tax losses of **£653m** (2005: £1,812m) available for offset against future profits. A deferred tax asset has been recognised in respect of **£14m** (2005: £4m) of these losses. No deferred tax asset has been recognised in respect of the remaining **£639m** (2005: £1,808m) due to the unpredictability of future profit streams. Included in unrecognised tax losses are losses of **£39m** (2005: £1,086m) which will expire between 2007 and 2024. Other losses may be carried forward indefinitely.

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24. Provisions

Carrying amount

	2006 £m	2005 £m
Pensions and post retirement obligations	**156**	473
Reorganisation provisions	**27**	48
Other provisions	**197**	172
Total provisions at 31 December	**380**	693

Of the above, **£173m** is due to be settled outside of 12 months (2005: £468m).

Reorganisation provisions comprise costs relating to reorganisations mainly within the UK business. These provisions primarily comprise severance and property costs and are part of an ongoing programme to achieve business improvement and expense savings.

Other provisions includes **£51m** (2005: £nil) of provisions relating to the disposal of the discontinued US operation. In addition, there are provisions of **£52m** (2005: £54m) held relating to vacant property leases, dilapidations and refurbishments, the costs relating to which will be borne across the period over which the leases expire, which is up to 20 years. Other provisions also includes various litigation provisions of **£9m** (2005: £4m), the payment of which is dependent upon legal processes and Motor Insurance Bureau provision of **£33m** (2005: £24m).

See note 26 for further information regarding the pensions and post retirement benefit obligations.

Movements during the year on reorganisation and other provisions

	Reorganisation provisions £m	Other provisions £m
Provisions at 1 January 2006	**48**	**172**
Exchange adjustment	**(3)**	**(2)**
Credited	**43**	**160**
Utilised	**(53)**	**(111)**
Released	**(1)**	**(17)**
Transfer to discontinued operations	**(7)**	**(5)**
Provisions at 31 December 2006	**27**	**197**

25. Other liabilities

	2006 £m	2005 £m
Deposits received from reinsurers	**61**	347
Derivative trading liabilities	**28**	130
Other creditors	**560**	624
Accruals and deferred income	**377**	377
Total other liabilities	**1,026**	1,478
To be settled within 12 months	**935**	994
To be settled after 12 months	**91**	484

26. Retirement benefit obligations

The Group operates defined contribution pension schemes, funded and unfunded defined benefit pension schemes, and has other post retirement obligations. This note has been adjusted for discontinued operations.

Defined contribution pension schemes

Costs of **£30m** (2005: £28m) were recognised in respect of defined contribution schemes by the Group. The Group's Swedish subsidiaries are part of a multi employer defined benefit scheme along with other financial institutions in Sweden. As it is not possible to determine the assets and liabilities in respect of any one employer under this plan, it is included in these accounts as a defined contribution plan in accordance with Section 30 of IAS 19. Contributions of £9m were paid to this plan during 2006 and are included in the costs shown above. The latest information regarding the funding of this plan is taken from the interim report for the first half of 2006, when the scheme funding rate was 118%. The Group's Swedish subsidiaries' share of the total multi employer plan was less than 15%.

26. Retirement benefit obligations continued

Defined benefit pension schemes and other post retirement benefits

The major defined benefit pension schemes are located in the UK. The assets of these schemes are held mainly in separate trustee administered funds. The US defined benefit schemes are included in discontinued operations.

In April 2002, the primary UK defined benefit schemes were effectively closed to new entrants and in 2005, following discussions with the Trustees and consultation with the members, the UK defined benefit schemes were altered from providing benefits on a final salary basis to benefits on a revalued average salary basis with effect from 1 January 2006. Under the new benefit formula, the accrued benefits of current active members are based on salaries at the date of change and will increase in line with inflation each year (limited to 5% in any year) up to their retirement date. Benefits earned in each year from 1 January 2006 will be based on salaries in that year and similarly will be revalued up to retirement. As a result of the changes, the projected benefit obligations of the schemes are reduced from the date of change. The figures shown in the tables below reflect that reduction and the one-off benefit of £180m arising from the reduction was recorded in the income statement in 2005.

In addition to these changes, the 2002 Scheme (which was the scheme to which new UK employees have been admitted since the closure of the defined benefit schemes to new members) has been closed to further accrual from 1 January 2006. It has been replaced by a stakeholder arrangement and members of the 2002 Scheme and future new employees in the UK will accrue future benefits on a defined contribution basis under the stakeholder plan.

For the two main UK defined benefit schemes, the level of contributions in 2006 were **23%** and **21%** of pensionable salaries (2005: 23% and 21%). Additional contributions totalling **£86m** (2005: £86m) were made to the schemes, in accordance with the plan to reduce their deficits. Expected contributions to pension and post retirement benefit plans for the year ending 31 December 2007 are approximately £175m, including a further £86m of additional contributions.

The major defined benefit schemes are subject to regular valuation using the projected unit method which is the basis of the pension cost in the consolidated income statement. Independent, qualified actuaries carry out valuations of the major defined benefit schemes for the purposes of assessing pension costs.

The Group also provides post retirement healthcare 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. The estimated discounted present values of the unfunded accumulated obligations are calculated in accordance with the advice of independent, qualified actuaries.

Movement in the surplus/(deficit) during the year:

	2006 £m	2005 £m
Deficit at 1 January	**(472)**	(713)
Total pension (expense)/credit	**(34)**	121
Employer contribution	**203**	215
Actuarial gain/(loss)	**226**	(74)
Exchange adjustment	**18**	(21)
Transfer to discontinued operations	**91**	–
Surplus/(deficit) at 31 December	**32**	(472)
Unrecognised past service cost	**–**	(1)
Net pension and post retirement surplus/(liability) on balance sheet	**32**	(473)
Deferred tax in respect of net pension and post retirement asset/liability	**(8)**	103
Net pension asset/(liability) on balance sheet	**24**	(370)

Continuing operations – the amounts recognised are as follows:

	2006			2005
	UK £m	**Other £m**	**Total £m**	Restated Total £m
Current service cost	**44**	**13**	**57**	70
Interest cost	**220**	**13**	**233**	233
Expected return on scheme assets	**(255)**	**(13)**	**(268)**	(238)
Past service cost	**15**	**–**	**15**	5
(Gains)/losses on curtailment	**(4)**	**1**	**(3)**	(182)
Total (included in staff costs)	**20**	**14**	**34**	(112)

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26. Retirement benefit obligations continued

Discontinued operations – the amounts recognised are as follows:

	2006 £m	2005 £m
Current service cost	3	4
Interest cost	22	23
Expected return on scheme assets	(20)	(19)
Past service benefit	–	(11)
Gains on curtailment	(5)	(6)
Total (included in discontinued operations)	–	(9)

The actuarial gains/(losses) recognised in equity is as follows:

	2006					2005
	UK £m	Other £m	Continuing operations £m	Discontinued operation £m	Total £m	Total £m
Actual return on scheme assets	229	25	254	26	280	691
Less: expected return on scheme assets	(255)	(13)	(268)	(20)	(288)	(257)
Actual return on assets in (below)/in excess of expected	(26)	12	(14)	6	(8)	434
Experience gains/(losses) on liabilities	81	(39)	42	(1)	41	(50)
Changes in actuarial assumptions	208	(10)	198	(5)	193	(458)
Actuarial gains/(losses) on pension benefits	263	(37)	226	–	226	(74)

The accumulated actuarial gains since 1 January 2004 are **£82m** (2005: £144m loss).

	2006			2005
	UK £m	Other £m	Continuing operations £m	Total £m
Present value of funded obligations	4,560	207	4,767	5,334
Present value of unfunded obligations	6	65	71	105
Present value of obligations	4,566	272	4,838	5,439
Equities	2,086	105	2,191	2,406
Bonds	2,170	90	2,260	2,168
Cash	164	7	171	132
Property	248	–	248	261
Total assets in the schemes	4,668	202	4,870	4,967
Surplus/(deficit)	102	(70)	32	(472)
Unrecognised past service credit	–	–	–	(1)
Surplus/(liability) on continuing operations	102	(70)	32	(473)
Deficit on discontinued operations			(91)	–
Analysed:				
Defined benefit pension schemes	102	(46)	56	(426)
Other post retirement benefits	–	(24)	(24)	(47)
Schemes in surplus (note 16)	169	19	188	–
Schemes in deficit (note 24)	(67)	(89)	(156)	(473)
To be settled within 12 months	(86)	–	(86)	(86)
To be settled after 12 months	188	(70)	118	(387)

26. Retirement benefit obligations continued

The following is a reconciliation of the Group's retirement benefit obligation:

	2006 £m	2005 £m
Retirement benefit obligation at 1 January	**5,439**	4,939
Current service costs	**60**	74
Past service cost/(benefits)	**15**	(6)
Interest costs	**255**	256
Contributions by scheme participants	**3**	10
Actuarial (gain)/loss on obligations	**(234)**	508
Gain on curtailments	**(9)**	(188)
Benefits paid	**(248)**	(229)
Exchange rate adjustment	**(82)**	75
Transfer to discontinued operations	**(361)**	–
Retirement benefit obligation at 31 December	**4,838**	5,439

The following is a reconciliation of the Group's pension scheme assets:

	2006 £m	2005 £m
Pension scheme assets at 1 January	**4,967**	4,226
Return on scheme assets	**280**	691
Contributions by the employer	**203**	215
Contributions by scheme participants	**3**	10
Benefits paid	**(248)**	(229)
Loss on settlement	**(1)**	–
Exchange rate adjustment	**(64)**	54
Transfer to discontinued operations	**(270)**	–
Pension scheme assets at 31 December	**4,870**	4,967

Additional information for the current annual period and previous two annual periods:

	2006 £m	2005 £m	2004 £m
At 31 December			
Present value of defined benefit obligation	**4,838**	5,439	4,939
Fair value of plan assets	**4,870**	4,967	4,226
Surplus/(deficit)	**32**	(472)	(713)
Experience adjustments on plan liabilities	**42**	(50)	87
Experience adjustments on plan assets	**(14)**	434	145

Assumptions

The principal actuarial assumptions used were as follows:

	UK		Other	
	2006 %	2005 %	2006 %	2005 %
Assumptions used in calculation of retirement benefit obligation:				
Discount rate	**5.1**	4.7	**4.9**	5.0
Annual rate of general inflation	**2.7**	2.5	**2.5**	2.0
Annual rate of increase in salaries	**4.2**	4.0	**4.4**	4.1
Annual rate of increase in pensions	**2.7**	2.5	**2.5**	2.0
Assumptions used in calculation of income statement credit/charge in year:				
Discount rate	**4.7**	5.2	**5.0**	6.0
Expected return on:				
Equities	**7.5**	7.3	**8.3**	8.0
Bonds	**4.1**	4.5	**5.3**	5.5
Other	**6.0**	6.1	**3.5**	3.5

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26. Retirement benefit obligations continued

Expected return on plan assets

The weighted average expected return on assets across the Group for 2006 was **6.0%** (2005: 6.1%). The expected return on plan assets is determined by considering best estimates for the expected long term real rates of return from the main asset classes and from rates of return assumed elsewhere within the operation of the business.

Mortality rate

The mortality assumptions are set following investigations of the main schemes' recent experience by the scheme actuaries for their funding valuations. The mortality assumptions adopted for the main UK schemes used the PMA92 and PFA92 mortality tables for males and females respectively, with age ratings to reflect the schemes' recent experience compared with that expected under these tables.

Reductions in future mortality rates were allowed for using the 'medium cohort' projection and using the projected mortality rates applicable to calendar year 2012 for current pensioners and 2030 for future pensioners. The weighted average assumptions imply that a current pensioner aged 60 has an expected future lifetime of 24.7 years (males) and 26.8 years (females) and a future pensioner aged 60 has a future lifetime of 26.1 years (males) and 28.1 years (females).

Commutation

Each of the UK defined benefit pension schemes have changed their rules to allow for increased commutation following 'A day' in April 2006. The commutation factors are currently under review, but it is expected that the final factors will be cost neutral on the IAS 19 basis (ie when valued on the IAS 19 basis, the amount of cash taken is approximately equal to the value of the pension being given up). For this reason there is no change made to previous practice whereby the accounting valuation makes no allowance for commutation.

Post retirement medical benefits

The valuation of liabilities for post retirement liabilities in Canada assumes **9%** decreasing to **5%** in eight years for drugs (2005: 10% decreasing to 5% in 9 years) and **4%** (2005: 4%) for hospitals and **3%** (2005: 3%) for other.

Sensitivity analysis

The discount rate and the assumed inflation rate both have a significant effect on the IAS 19 accounting valuation. A 0.1% increase in the discount rate would reduce the defined benefit obligation in the UK by £78m. A 0.1% increase in the inflation rate assumption would increase the defined benefit obligation in the UK by £68m.

The effect of an increase of one percentage point and the effect of a decrease of one percentage point in the assumed medical cost trend rates on the following is set out below:

	1% increase		1% decrease	
	2006 £m	2005 £m	**2006 £m**	2005 £m
Aggregate of the current service cost and interest components of net periodic post employment medical costs	**0.4**	0.3	**0.3**	0.3
Accumulated post employment benefit obligation for medical costs	**2.8**	3.1	**2.3**	2.5

27. Share based compensation

The Group has five types of share based payment plans which are settled in the form of ordinary shares: the Executive Share Option; the Equity Incentive Scheme for US Employees; the International Sharesave Plan; the Share Matching Plan; and the 2006 Long Term Incentive Plan. Dilution levels for all schemes are held strictly within ABI limits.

In addition, in the US there are a number of cash settled share based payment plans.

The total employment cost recorded in the income statement for all plans was **£13m** in 2006 (2005: £9m). These costs include the costs associated with plans which are settled in the form of ordinary shares for awards that have been granted after 7 November 2002. The value of equity settled awards granted prior to this date have been excluded in accordance with the transitional provisions contained in IFRS 2.

Executive Share Option Scheme and Equity Incentive Scheme for US Employees

The Group operates an Executive Share Option Scheme and an Equity Incentive Scheme for US Employees, which provide options to purchase ordinary shares to officers and other key employees at prices not less than the fair value of the ordinary shares at the date of grant. The exercise of awards made under the Equity Incentive Scheme for US Employees can be accelerated dependent on the performance of the US subsidiary to between one and three years.

The performance conditions in respect of awards under the Executive Share Option Scheme are described in the footnote to the options table (audited part) on page 42. The exercise price of all options is the fair value of the ordinary shares on the date of grant. All options expire 10 years after the date of the grant.

27. Share based compensation continued

Additional information with respect to the plans at 31 December is as follows:

	2006 Shares	2006 Price*	2005 Shares	2005 Price*
Options outstanding at 1 January	80,629,852	148.58	72,044,516	214.35
Granted	–	–	28,126,364	84.79
Exercised	(2,576,629)	101.56	(16,190)	84.12
Forfeited	(3,985,252)	276.47	(18,814,826)	300.87
Expired	(228,009)	342.46	(710,012)	261.29
Options outstanding at 31 December	73,839,962	142.71	80,629,852	148.58
Options exercisable at year end	18,177,779	260.39	17,140,769	336.66

*Price refers to weighted average exercise price in sterling (pence).

The following share options under the Executive Share Option Scheme and Equity Incentive Scheme for US Employees are outstanding or exercisable at 31 December:

Options outstanding

	2006			2005		
Range of exercise prices	Number of shares	Weighted average remaining contractual life (years)	Weighted average exercise price*	Number of shares	Weighted average remaining contractual life (years)	Weighted average exercise price*
50.1 – 100.0	53,147,605	7.85	81.74	55,844,164	8.83	81.90
100.1 – 150.0	4,057,015	6.61	114.20	4,949,924	7.58	114.01
200.1 – 250.0	4,131,321	5.19	234.23	4,788,459	6.19	234.23
250.1 – 300.0	1,737,924	3.23	278.65	2,113,806	4.21	280.01
300.1 – 350.0	61,819	4.88	312.58	289,828	1.88	336.09
350.1 – 400.0	5,422,956	3.95	381.26	6,327,895	4.84	380.46
400.1 – 450.0	5,281,322	2.49	415.01	6,315,776	3.46	415.42
	73,839,962	6.85	142.71	80,629,852	7.72	148.58

*Price refers to weighted average exercise price in sterling (pence).

Options exercisable

	2006		2005	
Range of exercise prices	Number of shares	Weighted average exercise price*	Number of shares	Weighted average exercise price*
50.1 – 100.0	3,052,915	58.96	707,260	90.79
100.1 – 150.0	2,808,296	114.05	34,905	113.88
200.1 – 250.0	2,937,591	234.23	3,537,959	234.23
250.1 – 300.0	1,737,924	278.65	2,113,806	280.01
300.1 – 350.0	61,819	312.58	289,828	336.09
350.1 – 400.0	2,841,849	380.20	4,141,235	376.89
400.1 – 450.0	4,737,385	413.90	6,315,776	415.42
	18,177,779	260.39	17,140,769	336.66

*Price refers to weighted average exercise price in sterling (pence).

Under the schemes, there were no awards during 2006. The weighted average estimated fair value per option granted by the Company during 2005 was 27.42p. The fair value of the share options granted under the plans during 2005 was £8m. The value of the awards is charged in the income statement over the vesting period.

Fair values for the options granted under the schemes during 2005 were estimated as of the date of grant using the Black Scholes pricing model with the following weighted average assumptions: dividend yields of 5.0%; expected volatilities of 50%; risk free interest rates of 4.4%; expected terms of five years for Executive Share Option Scheme grants made prior to the 2003 AGM, four years for Executive Share Option Scheme grants made after the 2003 AGM and four years for grants made under the Equity Incentive Scheme for US Employees; and the assumption that all performance criteria are expected to be met. An estimate based on past experience is made of the number of forfeitures during the vesting period due to employees leaving the Group. The actual share price at 31 December 2006 was **152.50p** (2005: 125.75p).

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27. Share based compensation continued

International Sharesave Plan

Under the Group's International Sharesave Plan (savings related) eligible employees can receive options to purchase ordinary shares at a price equal to 80% of the fair value of the ordinary shares on the date of grant. All options vest either three or five years from the grant date and expire six months after vesting. 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 the individual's savings contract upon maturity. An individual's maximum monthly contribution to all current savings contracts is £250.

Additional information with respect to the Group's International Sharesave Plan at 31 December is as follows:

	2006		2005	
	Shares	Price*	Shares	Price*
Options outstanding at 1 January	**60,137,543**	**74.98**	52,761,469	81.29
Granted	**9,550,434**	**108.36**	16,628,956	76.95
Exercised	**(5,559,918)**	**71.65**	(2,169,748)	66.38
Forfeited	**(2,782,453)**	**77.90**	(5,596,314)	78.45
Expired	**(1,381,013)**	**218.64**	(1,486,820)	320.42
Options outstanding at 31 December	**59,964,593**	**77.16**	60,137,543	74.98
Options exercisable at year end	**1,918,062**	**136.78**	1,966,919	153.67

*Price refers to weighted average exercise price in sterling (pence).

The following share options under the International Sharesave Plan are outstanding or exercisable as of 31 December:

Options outstanding

	2006			2005		
Range of exercise prices	Number of shares	Weighted average remaining contractual life (years)	Weighted average exercise price*	Number of shares	Weighted average remaining contractual life (years)	Weighted average exercise price*
50.1 – 100.0	**49,934,125**	**1.98**	**68.55**	58,565,114	2.95	68.83
100.1 – 150.0	**9,421,988**	**3.67**	**108.39**	–	–	–
200.1 – 250.0	**104,201**	**0.09**	**250.00**	134,287	1.09	250.00
250.1 – 300.0	**–**	**–**	**–**	577,671	–	292.00
300.1 – 350.0	**504,279**	**–**	**310.00**	715,047	0.75	313.76
350.1 – 400.0	**–**	**–**	**–**	145,424	–	354.00
	59,964,593	**2.22**	**77.16**	60,137,543	2.89	74.98

*Price refers to weighted average exercise price in sterling (pence).

Options exercisable

	2006		2005	
Range of exercise prices	Number of shares	Weighted average exercise price*	Number of shares	Weighted average exercise price*
50.1 – 100.0	**1,413,783**	**75.00**	1,243,824	66.00
250.1 – 300.0	**–**	**–**	577,671	292.00
300.1 – 350.0	**504,279**	**310.00**	–	–
350.1 – 400.0	**–**	**–**	145,424	354.00
	1,918,062	**136.78**	1,966,919	153.67

*Price refers to weighted average exercise price in sterling (pence).

Under the International Sharesave Plan, the weighted average estimated fair value per option granted by the Company during 2006 was **46.66p** (2005: 36.62p). The fair value of share options granted under the International Sharesave Plan during 2006 was **£4m** (2005: £6m). The value of the awards is charged in the income statement over the vesting period.

Fair values for the options granted under the International Sharesave Plan were estimated as of the date of grant using the Black Scholes pricing model with the following weighted average assumptions: dividend yields of **3.5%** (2005: 5.0%); expected volatilities of **35%** (2005: 50%); risk free interest rates of **4.8%** (2005: 4.2%); and expected terms equal to the vesting terms of three or five years. An estimate based on past experience is made of the number of forfeitures during the vesting period due to employees leaving the Group. The actual share price at 31 December 2006 was **152.50p** (2005: 125.75p).

27. Share based compensation continued

Share Matching Plan

The Group's Share Matching Plan for executive directors and other selected executives was adopted following approval obtained at the 2004 AGM. Awards were made during 2004 and 2005 and the awards granted in 2005 were the final awards under the plan.

The performance conditions in respect of awards under the Share Matching Plan are described in the footnote to the options table (audited part) on page 43. Under the plan, Deferred Share awards granted are held in trust for three years and are normally forfeited upon an employee leaving the Group. No further performance conditions apply.

Participants may also receive Matching Share awards up to a maximum of three times the number of Deferred Shares awarded. Matching Share awards are subject to the achievement of total shareholder return targets over a single two year period, with performance measured by comparison against other UK listed companies. Matching Share awards vest with the Deferred Share awards on the third anniversary of the date of grant to the extent that the performance conditions have been met.

Further information on the Share Matching Plan may be found in the footnote to the long term incentive scheme table (audited part) on page 43.

Additional information with respect to Deferred and Matching Share awards at 31 December is as follows:

	2006 Shares	2005 Shares
Outstanding Deferred Share awards at 1 January	**4,075,168**	1,559,056
Granted*	**150,000**	2,704,444
Exercised	**(310,847)**	(25,374)
Forfeited	**(480,601)**	(162,958)
Outstanding Deferred Share awards at 31 December	**3,433,720**	4,075,168
Potential Matching Share awards	**8,230,850**	12,225,504
Total potential share awards outstanding at 31 December	**11,664,570**	16,300,672

There is no price for the Share Matching Plan.

* This award was approved in 2005, but could not be granted until 2006. It is subject to the same criteria as all the other grants made in 2005.

Under the Share Matching Plan, the fair values of each Deferred Share award granted by the Company during 2006 was **114.40p** (2005: 71.40p) and the fair value of each potential Matching Share award was **38.10p** (2005: 23.80p). The total fair value of the awards granted under the plan during 2006 was **£nil** (2005: £4m).

The fair value of the Deferred Share awards was calculated based upon the ordinary share price at grant date after deducting from it the estimated value of the dividends that will not be received during the vesting period. The fair value of the potential Matching Share awards was estimated by calculating the expected value arising from modelling the awards that would arise under different performance scenarios.

Long Term Incentive Plan

The 2006 Long Term Incentive Plan for executive directors and other selected executives was adopted following approval obtained at the 2006 AGM. Awards were made during 2006 following shareholder approval.

The structure of the plan allows for a number of different types of awards to be made. Voluntary Deferred Shares are purchased by participants from net bonus payable (limited to a maximum value of 33% of net bonus); in addition, for senior executives, the Remuneration Committee may defer a portion of an individual's bonus (limited to 33% of that bonus) into an award over shares referred to for the purpose of the plan as compulsory Deferred Shares. Deferred shares are held in trust for three years and compulsory Deferred Shares are normally forfeited on an employee leaving the Group. No further performance conditions apply. The Remuneration Committee may make a conditional award of shares on a 'matched' basis to voluntary and compulsory Deferred Shares (Matching Shares).

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

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

Further information on the 2006 Long Term Incentive Plan may be found in the remuneration report.

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27. Share based compensation continued

	2006				
	Restricted Shares	Voluntary Deferred Shares	Compulsory Deferred Shares	Performance Shares	Total Shares
Granted	4,277,904	667,002	1,622,178	4,829,205	11,396,289
Forfeited	(69,547)	–	–	–	(69,547)
Outstanding 31 December	4,208,357	667,002	1,622,178	4,829,205	11,326,742
Potential Matching Share awards	–	2,871,739	4,055,422	–	6,927,161
Total potential awards outstanding 31 December	4,208,357	3,538,741	5,677,600	4,829,205	18,253,903

There is no price for the Long Term Incentive Plan.

Under the 2006 Long Term Incentive Plan, the weighted average estimated fair value of each Restricted Share award granted by the Company in 2006 was **114.81p**. The fair value of each voluntary Deferred Share award was **£nil** and the fair value of each potential associated Matching Share was **126.00p**. The fair value of each compulsory Deferred Share award was **127.00p** and the fair value of each potential associated Matching Share was **87.85p**. The fair value of each Performance Share award granted was **88.71p**. The total fair value of the awards granted under the plan in 2006 was **£18m**.

Fair values of the awards granted under the 2006 Long Term Incentive Plan during 2006 are taken to be the share price on the day preceding the grant date, except for the Restricted Shares where the share price is reduced by an estimate of the value of dividends that will not be received. A dividend yield of **3.5%** was assumed. Market related performance criteria were based on an arithmetic mean estimate of performance against a specified group of 13 competitors; and it is assumed that all non market related performance criteria would be met such that all awards would vest. An estimate based on past experience is made of the number of forfeitures during the vesting period due to employees leaving the Group.

Other share based payments
In the US, there are plans under which awards have been granted to certain employees in the form of cash settled share based awards. Under these plans, if the vesting conditions are satisfied, cash awards are made based upon the underlying performance of the Company's ordinary shares. Awards were made in 1999 and 2001 under old schemes and during 2004 and 2005 on terms that provide the same potential benefits as the Share Matching Plan. The liability in respect of these plans at 31 December 2006 was **£2m** (2005: £1m). The intrinsic value of awards that had vested at 31 December 2006 was **£nil** (2005: £nil).

28. Management of risks
As an insurance company, the Group is fundamentally concerned with the management of risk. This note, which has been adjusted for the discontinued operations, summarises these risks and the way the Group manages them.

As set out in the corporate governance report, the Group's Board defines the risk appetite of the organisation.

The Group employs a comprehensive risk management framework to identify, assess, manage and monitor the risks arising as a result of operating the business. The framework includes a comprehensive suite of risk policies, procedures, measurement and monitoring techniques and a series of stress tests and scenario analyses to ensure that the Group's exposures do not exceed risk appetite.

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

The Group manages its financial assets within a framework that has been developed to seek to ensure the ability to meet its obligations under insurance and investment contracts. A key principle behind this process is to hold assets that provide a broad match against the liabilities arising from insurance and investment contracts.

Risks arise within the investment portfolio from the possibility of mismatching cash and fixed interest assets against liabilities by duration (eg inflation and reinvestment risk). However, the relatively short duration of a general insurance portfolio, together with the Group's strategy of broadly matching assets and liabilities by duration, provides mitigation against these risks. The Group reviews the duration of its liabilities and asset portfolios to ensure that they remain broadly matched. Regional investment directives limit permissible duration ranges within the individual portfolios. These directives also include objectives for liquidity, asset sector concentration and credit quality.

28. Management of risks continued

The components of risk: insurance, reinsurance, credit, market and liquidity risks are addressed below:

Insurance risk

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

The Group manages its exposure to insurance risk through the Board Risk Committee (BRC) which considers aggregation of risk and establishes how much risk the Group is willing to assume. The BRC also oversees an emerging risk identification process, including the identification of emerging issues and the setting of these into risk scenarios as part of an overall process of self appraisal.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the Group faces under its insurance contracts is that the actual claims and benefit payments exceed the expected amount of the insurance liabilities. This could occur because the frequency or severity of claims and benefits payable are greater than estimated. Insurance events are random and the actual number and amount of claims and benefits will vary from year to year from the estimate established using statistical techniques.

Experience shows that the larger the portfolio of similar insurance contracts, the smaller will be the relative variability about the expected outcome. In addition, a more diversified portfolio is less likely to be affected across the board by a change in any subset of the portfolio. The Group has developed its insurance underwriting strategy to diversify the type of insurance risks accepted and within each of these categories to achieve a sufficiently large population of risks to reduce the variability of the expected outcome.

Further discussion on underwriting risk and pricing, estimation of claims provisions, emerging and legal risks and aggregation of risks is set out below.

Underwriting risk and pricing

Disciplined underwriting, encompassing risk assessment, risk management, pricing and exposure control is critical to the Group's success.

The Group has an Underwriting and Claims Policy that clearly identifies the 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 the Group's underwriters to be in a position to:

- Understand and assess each risk,
- Make appropriate decisions within their area of competence and authority limits,
- Differentiate between risks,
- Price risks appropriately,
- Apply suitable terms and conditions in order to manage the portfolio,
- Control exposure,
- Improve the predictability of the loss experience and make appropriate use of the Group's underwriting capacity.

In establishing prices, each of the Group's businesses has access to extensive customer data from its own records and access to appropriate market data.

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

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

The BRC performs the following functions:

- Establishes how much risk the Group is willing to assume,
- Provides 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,

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continued

28. Management of risks continued

- Considers aggregation of risk across regions,
- Maintains and develops the Group risk management framework,
- Monitors and reports on the Group's approach to managing risks.

Specific considerations in relation to casualty insurance risks and property insurance risks are set out below:

Casualty insurance risks

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

Underwriting limits are in place to enforce appropriate risk selection criteria. For example, the Group has the right not to renew individual policies, it can impose deductibles and it has the right to reject the payment of a fraudulent claim. In certain territories, legislation requires that the maximum loss under each employers' liability contract is never lower than a prescribed amount. All the Group employers' liability contracts offer maximum cover in compliance with such minimums.

Reinsurance arrangements in place include excess, stop loss and catastrophe coverage. The effect of such reinsurance arrangements is that the Group should not suffer total net insurance losses of more than a specified amount in any one year. In addition to the overall Group reinsurance programme, individual business units are permitted to purchase additional reinsurance protection.

The Group has specialised claims units dealing with the mitigation of risks surrounding known asbestos claims. These units investigate and adjust all asbestos claims. The asbestos claims are reviewed individually at least semi annually and adjusted to reflect the latest information on the underlying facts, current law, jurisdiction, contractual terms and conditions and other factors. The Group actively manages and pursues early settlements of asbestos claims to reduce its exposure to unpredictable developments.

Property insurance

Property insurance covers a diverse collection of risks and therefore property insurance contracts are subdivided into four risk groups: fire, business interruption, weather damage and theft. The insurance risk arising from these contracts is not concentrated in any of the territories in which the Group operates, and there is a balance between commercial and personal properties in the overall portfolio of insured buildings. Large risks are reinsured via treaty reinsurance arrangements.

The Group has the right to reprice the risk on renewal. It also has the ability to impose deductibles and reject fraudulent claims. These contracts are underwritten by reference to the commercial replacement value of the properties and contents insured, and claims payment limits are always included to limit the amount payable on occurrence of the insured event. Cost of rebuilding properties, of replacement or indemnity for contents and time taken to restart operations for business interruption are the key factors that influence the level of claims under these policies. The greatest likelihood of significant losses on these contracts arises from storm, flood damage or other weather related incidents. The Group has reinsurance cover for such damage to limit losses.

Reserves – an overview

The Group establishes property and casualty loss reserves to account for the anticipated ultimate costs of all losses and related loss adjustment expenses (LAE) on losses that have already occurred. The Group establishes reserves for reported losses and LAE, as well as for incurred but not yet reported (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. The Group also considers the development of loss payment trends, levels of unpaid claims, judicial decisions and economic conditions.

The Group uses 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 sub classifications 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.

The Group has a Group Reserving Committee consisting of the Chief Executive Officer, Chief Financial Officer, Group Director Audit, Risk and Compliance and Group Chief Actuary. A similar committee has been established in each of the Group's major regions. The Group Reserving Committee monitors the decisions and judgments made by the business units as to the level of reserves recommended and makes the final decision on the reserves to be included within the financial statements. In making its judgment, the Group Reserving Committee's aim is that, over the longer term, reserves should be more likely to run off favourably than adversely. However, there can be no assurance that reserves will not develop adversely and exceed the Best Estimate. In making its judgment of the Best Estimate of Reserves to include in the financial statements the Group Reserving Committee adopts the following approach:

28. Management of risks continued

- The Group's actuaries provide an indication of ultimate losses together with an assessment of risks and possible favourable or adverse developments that may not have been fully considered in calculating these indications. At the end of 2006, these risks and developments included: the possibility of future legislative change having retrospective effect on open claims; changes in claims settlement procedures potentially leading to future claims payment patterns differing from historical experience; the possibility of new types of claim, such as disease claims, emerging from business written several years ago; general uncertainty in the claims environment; the emergence from latent exposures such as asbestos; the outcome of litigation on claims received; failure to recover reinsurance; and unanticipated changes in claims inflation,
- Consideration is also made of the views of internal peer reviewers of the reserves and of third parties including actuaries, legal counsel, risk directors, underwriters and claims managers,
- Consideration is made of how previous actuarial indications have developed.

In forming its collective judgment, the Committee will consider this information as a whole.

Estimation of claims provisions – non asbestos reserves

Reserves are analysed by line of business within the various regions. A single line of business may be written in one or more of the regions. Case reserves are established on each individual claim and are adjusted as new information becomes known during the course of handling the claim. Lines of business for which claims data (eg paid claims and case reserves) emerge over a long period of time are referred to as long tail lines of business. Lines of business for which claims data emerge more quickly are referred to as short tail lines of business. Within the Group's operations a typical short tail line of business is property. The longest tail lines of business include personal accident in Scandinavia, workers' compensation in the US, commercial liability and professional liability.

Our reserving managers regularly review reserves for both current and prior accident years using the most current claims data. These reserve reviews incorporate a variety of actuarial methods and judgements and involve extensive analysis. For most lines of business a variety of actuarial methods are reviewed and the reserving managers select methods and specific assumptions appropriate for each line of business based on the current circumstances affecting that line of business. These selections incorporate input from claims personnel, underwriters and operating management on reported claims trends and other factors that could affect the reserve estimates.

For short tail lines of business, development of paid claims and case reserves is reliable and indicative of ultimate losses. The method used is based on the amount of paid and case estimates for reported claims.

For long tail lines of business, initial development of paid claims and case reserves is less reliable and, accordingly, may not be fully indicative of ultimate losses. For this reason, within these lines, methods which incorporate a development pattern assumption are given less weight in calculating the reserves for the early stages of loss development. The estimation of reserves for these lines of business in the early stages of claims development is therefore largely influenced by prior accident years' loss ratios and changes to pricing, claims costs, mix of business, ceded reinsurance and other factors that are expected to affect the loss ratio. For later periods of loss emergence, methods which incorporate a development pattern assumption are given more weight in estimating ultimate losses.

Based on the results of the reserve reviews and after consideration of other factors such as the maturity of the accident year, trends observed over the recent past and the level of volatility within a particular line of business, we determine the appropriate level of reserves to book.

The Group is a multi line, multi national property and casualty insurer. It is therefore subject to reserve uncertainty stemming from a number of conditions, including but not limited to those noted above, any of which could be material at any point in time for any line of business. Certain issues may become more or less important over time as conditions change. As various market conditions develop, we must assess whether those conditions constitute a long term trend that should result in a reserving action (ie increasing or decreasing the reserve).

Estimation of claims provisions – asbestos reserves

The Group has exposure to liabilities for asbestos related 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.

In the UK, asbestos liabilities have emerged most frequently in the employers' liability line. This coverage indemnifies individuals injured in the workplace. The effect of reinsurance purchased against large individual losses is reduced by the often multi year nature of the liabilities which means a deductible for each year of exposure applies.

Reserving for asbestos 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 specialised techniques to determine reserves in a prudent manner using the extensive knowledge of both internal asbestos experts and external legal and professional advisors.

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28. Management of risks continued

UK risks written in the UK

The majority of business in this area is employers' liability (EL) written through our UK Commercial business with a small amount of public and products liability. The underlying method for the estimation of asbestos requirements for UK EL depends critically on establishing a model of all expected deaths from asbestos related disease, which is then adjusted to allow for the delay between claim and death of claimant. Calibration of the resultant model to Group experience of reported claims allows an estimate of future numbers of claims against the Group to be produced.

Average claim cost is monitored from claim notifications over time and, from this data, after adjustment for inflation, a view is taken of current average claims cost taking into account evidence of trends etc. The average costs observed will reflect the proportion of claims cost being borne by the Group as a result of current sharing agreements amongst insurers, which in turn reflects the Group's proportion of claimant exposure periods.

US risks written in the UK

US asbestos exposure arises from a variety of sources including: London market 'direct' business written through Marine operations many years ago, inward reinsurance exposures also written through the London market and from participation in UK aviation pools.

The position in the US is particularly problematic, as plaintiffs have expanded their focus to defendants beyond the 'traditional' asbestos manufacturers and distributors. This has arisen as a consequence of the increase in the number of insureds seeking bankruptcy protection because of asbestos related litigation and the exhaustion of their policy limits. Plaintiffs, supported by lawyers remunerated on a contingent fee basis, are now seeking to draw in a wide cross section of defendants who previously only had peripheral or secondary involvement in asbestos litigation. This may include companies which have distributed or incorporated asbestos containing parts in their products or operated premises where asbestos was present. There are also increasing signs of attempts to reopen and reclassify into other insurance coverages previously settled claims, and the filing of claims under the non aggregate premises or operation section of general liability policies. There are also indications that plaintiffs may seek damages by asserting that insurers had a duty to protect the public from the dangers of asbestos.

Emerging and legal risks

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

In addition, to the extent that legal decisions in any of the jurisdictions in which the Group operates worldwide may increase court awards, and that the impact may be applied prospectively or retrospectively, claims and benefits provisions may prove insufficient to cover actual losses, loss adjustment expenses or future policy benefits. In such an event, or where it has been previously estimated that no liability would apply, the Group would add to its loss provisions and incur a charge to earnings. Such insufficiencies could have a material adverse effect on the Group's future consolidated financial condition, results of operations and cashflows.

In the ordinary course of its insurance activities, the Group is routinely involved in legal or arbitration proceedings with respect to liabilities which are the subject of policy claims.

As insurance industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues can have a negative effect on the Group's business by either extending coverage beyond its underwriting intent or by increasing the number and size of claims.

Aggregation of risks

The Group is exposed to multiple insured losses arising out of a single occurrence, whether a natural peril event such as a hurricane, flood or an earthquake, or man made catastrophes such as an explosion or fire at a major industrial facility. Any such catastrophic event could generate insured losses under one or more of its policies.

The ability of the businesses in each territory to assess the aggregation risk of a single event impacting on thousands of policyholders is vital. The Group employs proprietary exposure measurement systems to assess these risks. In some markets, particularly in the UK, the Group has in addition, developed its own expertise in catastrophe modelling that is used in conjunction with outside consultants. The accurate estimation of the potential expected maximum loss for a catastrophe is critical and is the primary factor considered in designing the Group's catastrophe reinsurance programme.

The expertise within the Group on catastrophe modelling is shared through the Worldwide Reinsurance Practice Group, which also provides an overview of the company wide catastrophe exposures and reinsurance adequacy. A reinsurance programme is considered to be 'adequate' only if it covers at least 199 out of 200 possible events by loss size. This is referred to as the '1 in 200 year expected maximum loss'. Since 1999, the Group has set its total retention for a single catastrophic event based on geographic location.

The operations of the Group are responsible for buying reinsurance to protect their results against catastrophes and for determining their own retentions. The Group Corporate Centre reviews the operations' proposed catastrophe purchases to check that they at least meet the Group's '1 in 200 year' standard. Group Corporate Centre also checks to see that total Group exposures are within the limits set out above and also are consistent with the required risk based capital. As a result, the Group may decide to purchase further catastrophe coverage at the Group level.

28. Management of risks continued

Reinsurance risk

The Group reinsures a portion of the risks underwritten to control exposure to losses, to reduce volatility and protect capital. The Group's reinsurance strategy is to purchase reinsurance in the most effective manner from reinsurers who meet its security standards.

The Group uses financial analysis models to assess the risk and reward effects of different reinsurance structures and prices.

The Group remains primarily liable as the direct insurer on all risks reinsured, although the reinsurer is liable to the Group to the extent of the reinsurance ceded. To limit the risk that the reinsurer is unable to pay in full, under certain reinsurance agreements the Group holds collateral, including escrow funds and letters of credit. The Group monitors the financial condition of reinsurers on an ongoing basis, and reviews its reinsurance arrangements regularly to ensure that its total counterparty exposure to individual reinsurance groups is within the limits set by the BRC and the Financial Services Authority for insurers domiciled in the UK.

In selecting the reinsurers with whom the Group does business, the Group uses the following principles:

- Its strategy is to seek reinsurers with the best combination of credit rating, price and capacity. The Group publishes internally a list of authorised reinsurers who pass its security review process and which its operations may use for new transactions,
- The Group reviews the financial security of each of its reinsurers having regard to the work of rating agencies and specialist advice from other sources, such as the counterparty risk assessment units of its reinsurance brokers,
- As part of this review work, the Group assesses public ratings of its reinsurers. Reinsurers that have a Financial Strength Rating of less than 'A–' with Standard & Poor's, or a comparable rating with AM Best, are removed from the Group's authorised list unless the Group's own review discovers exceptional circumstances in favour of the reinsurer. Further, if a rating agency reduces a reinsurer's rating, the Group carries out its own review of that reinsurer to see whether it should remain on the list of authorised reinsurers,
- The BRC sets targets for the credit profile of reinsurers on the Group's treaty purchases,
- The Group limits the credit risk exposure to individual captive reinsurers, with whom it deals as part of the commercial lines business, by analysis of their finances and controlling the maximum exposure to each captive each time the reinsurance contract is renewed,
- The Group monitors changes in the financial security of all of its reinsurers to see whether their ability to pay recoverables in full is doubtful. Where a reinsurer's ability to pay in full is believed to be doubtful, the Group Corporate Centre sets guidelines for provisioning for uncollectible reinsurance. These guidelines apply to all operations. Group Corporate Centre analyses local provisions against the Group's guidelines.

Credit profile of Group reinsurance counterparties

The table below sets forth the rating assigned by Standard & Poor's to the Group's primary property and casualty treaty reinsurers and the amounts ceded to them under outward reinsurance contracts during 2006 and 2005. This type of reinsurance requires the reinsurer to assume insurance risk, on a predetermined basis, for all of the contracts underwritten by the Group and that are covered by the treaty. For each reinsurance group, the table shows the rating category of each reinsurance group as of 31 December 2006 together with the rating category of that reinsurance group as of 31 December 2005.

	2006		2005	
Reinsurance group	**Ceded treaty premiums £m**	**S&P rating at 31 December**	Ceded treaty premiums £m	S&P rating at 31 December
HDI Group	**66**	**AA-**	56	AA–
Lloyd's of London	**64**	**A**	44	A
Munich Re Group	**43**	**AA-**	280	A+
Renaissance Re Holdings	**25**	**A+**	37	A+
Swiss Re Group	**50**	**AA-**	37	AA

The premiums ceded to Munich Re have reduced by £237m in 2006 primarily due to the cessation of the 100% health quota share arrangements.

During 2006, over 99% of the Group's property and casualty treaty cessions by premium were to reinsurers that had a Standard & Poor's financial strength rating of at least 'A–' or better, or equivalent from AM Best, as at the start date of the contract.

The Group's property and casualty facultative placements, other than those with captive reinsurers of its major retail clients, are mainly with the same reinsurers used on treaty placements. Facultative placements, or risks under facultative treaties, reinsure all or part of a single policy determined on a contract by contract basis.

As of 31 December 2006, total impairment provisions for uncollectable reinsurance was **£61m** (2005: £141m).

Certain of the Group's subsidiaries are members of government mandated pools in various parts of the world. As of 31 December 2006, the largest pool (by premium volume) was Pool Re operated by the UK Government to provide terrorism cover.

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28. Management of risks continued

Credit risk

The BRC is responsible for ensuring that the Board approved Group credit risk appetite is not exceeded.

In defining its risk appetite, the Group draws a distinction between credit risks incurred as a result of offsetting insurance risks or operating in the insurance market (eg reinsurance credit risks and insurance operations credit risks) for which risk tolerances and target profiles are identified and credit risks incurred for the purposes of generating a return (eg invested assets credit risk) for which strict exposure limits are set.

The Group controls its credit exposures according to a series of Group credit risk policies that reflects the individual considerations of the risk categories. These policies are supported by a series of procedures (eg counterparty assessment processes) and limits (eg investment and bank counterparty limits), which are designed to ensure that the Group's risk appetite is not exceeded.

Reinsurance counterparties are subject to a rigorous internal assessment process on an ongoing basis to ensure that their creditworthiness continues to be satisfactory. Collateral is taken to mitigate exposures where appropriate to the size or credit quality of the exposure. Further discussion on credit risk arising from reinsurance ceded is discussed within the section on reinsurance risk.

Insurance operations credit risks are incurred on a devolved basis with regional operations undertaking the responsibility for assessing and monitoring the creditworthiness of their counterparties (eg brokers and policyholders). Local credit committees are responsible for ensuring these exposures are within the risk appetite of the local operations within the overall financial control framework. Exposure monitoring and reporting is embedded throughout the organisation with aggregate credit positions reported at Group level. Invested assets credit risk is discussed in more detail below.

The Group's maximum exposure to credit risk can be set out as follows:

	2006 Maximum credit risk (carrying value) £m	2005 Maximum credit risk (carrying value) £m
Cash and cash equivalents	**1,831**	1,617
Debt securities	**8,568**	11,609
Other financial assets	**155**	146
Short term investments	**114**	95
Derivative assets	**17**	31
Insurance debtors	**1,996**	1,978
Reinsurance debtors	**229**	569
Reinsurers' share of insurance contract liabilities	**1,927**	4,406

28. Management of risks continued

The Group's investments comprise a broad range of financial investments issued principally in the UK, US and Scandinavia. The mix of investments and their carrying values which include fixed maturities and equity securities is set out below.

Analysis of debt securities

The credit profile of the Group's fixed income portfolios reflects the Group's commitment to matching its liabilities with investment rated liquid instruments for the protection of the policyholder.

	2006		2005	
	£m	%	£m	%
By country/region				
UK	2,166	25	3,000	26
US	498	6	2,714	23
Scandinavia	3,151	37	2,906	25
International	2,753	32	2,989	26
Total	8,568	100	11,609	100
By industry				
Banks	963	11	1,959	17
Insurance	44	1	71	1
Manufacturing	1	–	222	2
Utilities	57	1	224	2
Retail	8	–	88	1
Government securities	4,377	51	5,527	47
Mortgage backed securities	1,734	20	2,100	18
Telecommunications	7	–	88	1
Services	199	2	179	1
Other	1,178	14	1,151	10
Total	8,568	100	11,609	100

Credit profile of Group fixed income portfolio (note 1):

	2006		2005	
	£m	%	£m	%
AAA (note 2)	5,794	68	6,786	58
AA	1,343	15	2,608	23
A	1,181	14	1,665	14
BBB	100	1	450	4
<BBB	150	2	100	1
Total	8,568	100	11,609	100

Notes:
1. The ratings set out above are assigned by independent rating agencies.
2. Includes UK Government guaranteed fixed income securities that are not rated.

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28. Management of risks continued

Analysis of equity securities

The Group's equity portfolio is diversified as follows across sectors:

	2006		2005	
	£m	%	£m	%
By country/region				
UK	1,174	73	1,077	64
US	16	1	82	5
Scandinavia	87	5	11	1
International	343	21	513	30
Total	1,620	100	1,683	100
By industry				
Banks	213	13	217	13
Pharmaceuticals	76	4	80	5
Insurance	75	4	82	5
Manufacturing	62	4	83	5
Utilities	57	4	101	6
Construction	62	4	22	1
Mining	62	4	183	11
Retail	128	8	52	3
Telecommunications	94	6	70	4
Services	112	7	155	9
Energy	146	9	142	8
Other	533	33	496	30
Total	1,620	100	1,683	100

Maturity periods or contractual repricing

The following table summarises the contractual repricing or maturity dates (whichever is earlier) for financial assets and financial liabilities, that are subject to fixed and variable interest rates. Equity instruments are not subject to interest rate risk.

	Less than one year £m	One to two years £m	Two to three years £m	Three to four years £m	Four to five years £m	Greater than five years £m	Total £m
2006							
Financial assets							
Cash and cash equivalents	1,831	–	–	–	–	–	1,831
Debt securities	2,416	1,610	1,285	947	535	1,775	8,568
Other financial assets	91	14	16	13	11	10	155
Short term investments	114	–	–	–	–	–	114
Derivative assets	12	–	–	–	–	5	17
Total	4,464	1,624	1,301	960	546	1,790	10,685
Financial liabilities							
Amounts owed to credit institutions – unsecured:							
Other	6	1	1	–	–	–	8
Subordinated guaranteed US$ bonds	–	–	–	–	–	37	37
Subordinated guaranteed Euro bonds	–	–	335	–	–	–	335
Subordinated guaranteed perpetual notes	–	–	–	–	–	519	519
Subordinated Sterling perpetual guaranteed bonds	–	–	–	–	–	301	301
Derivative trading liabilities	21	–	–	–	–	7	28
Total	27	1	336	–	–	864	1,228

28. Management of risks continued

	Less than One year £m	One to two years £m	Two to three years £m	Three to four years £m	Four to five years £m	Greater than five years £m	Total £m
2005							
Financial assets							
Cash and cash equivalents	1,617	–	–	–	–	–	1,617
Debt securities	2,615	2,147	1,734	1,520	999	2,594	11,609
Other financial assets	104	1	–	8	1	32	146
Short term investments	95	–	–	–	–	–	95
Derivative assets	13	5	5	2	2	4	31
Total	4,444	2,153	1,739	1,530	1,002	2,630	13,498
Financial liabilities							
Borrowings:							
Secured debenture loans	1	1	1	1	2	4	10
Amounts owed to credit institutions – unsecured:							
Under committed credit facilities	233	–	–	–	–	–	233
Other	8	–	–	–	–	–	8
Subordinated guaranteed US$ bonds	–	–	–	–	–	285	285
Subordinated guaranteed Euro bonds	–	–	–	341	–	–	341
Subordinated guaranteed perpetual notes (restated)	–	–	–	–	–	526	526
Derivative trading liabilities	20	–	–	–	11	99	130
Total	262	1	1	342	13	914	1,533

Market risk
The Group is exposed to the risk of potential losses from adverse movements in market rates and prices as follows:

- Interest rate risk,
- Equity price risk,
- Property price risk,
- Foreign currency exchange risk,
- Derivatives.

The investment risk policy governs the Group's exposure to market risks. Exposures are controlled by the setting of investment limits in line with the Group's risk appetite.

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

Interest rate risk
The fair value of the Group's portfolio of fixed income securities is inversely correlated to changes in the market interest rates. Thus if interest rates fall the fair value of the portfolio would tend to rise and vice versa as set out in the sensitivity analysis.

Equity price risk
The Group's portfolio of equity securities is subject to equity risk arising from changes in market price. Thus if the value of equities rise so will the fair value of its portfolio and vice versa as set out in the sensitivity analysis.

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28. Management of risks continued

The Group sets appropriate risk limits to ensure that no significant concentrations to individual companies or sectors arise. The Group takes a long term view in selecting stocks and looks to build value over a sustained period of time rather than churning the portfolio looking for short term gains from its equity holdings.

The Group makes use of derivative products as appropriate to protect the portfolio from losses outside of its risk appetite.

The Group does not have material holdings of unquoted equities.

Property price risk

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

A number of the Group's property holdings are Group occupied and therefore appear as property and equipment within the reported accounts. The Group's investment in investment property is recorded as such and is invested in as part of an efficient portfolio management strategy.

Foreign currency exchange risk

The Group operates in 27 countries. Accordingly, its net assets are subject to foreign currency exchange rate movements. The Group's primary foreign currency exposures are to the US$, Canadian$, Danish kroner, Swedish krona and Euro. If the value of the British Pound strengthens then the value of non British Pound net assets will decline when translated into British Pounds and consolidated.

The Group incurs exposure to foreign currency exchange risk in two ways:

- Operational foreign currency exchange risk – by underwriting liabilities in currencies other than the currency of the primary environment in which the business units operate (non functional currencies),
- Structural foreign currency exchange risk – by investing in overseas subsidiaries and operating an international insurance group.

Operational foreign currency exchange risk is managed within the Group's individual operations by broadly matching assets and liabilities by currency.

Structural foreign currency exchange risk is managed at a Group level. In managing structural foreign currency exchange risk net assets maintained by the Group's subsidiaries in local currencies are taken into account to satisfy local regulatory solvency and internal risk based capital assessment requirements. These assets should prove adequate to support local insurance activities irrespective of foreign currency exchange rate movements. Consequently, this may affect the value of the consolidated shareholders' equity expressed in pounds sterling.

Derivatives

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

While these derivative instruments are subject to fluctuations in value, such fluctuations are generally offset by the changes in value of the underlying exposures. Derivatives are generally held until their maturity date.

	Remaining life			Fair value		Notional principal amounts	
	Less than one year £m	One to five years £m	More than five years £m	2006 £m	2005 £m	2006 £m	2005 £m
Cross currency							
Asset	–	–	–	–	–	4	5
Liability	–	–	–	–	1	170	30
Credit							
Asset	–	–	4	4	23	37	38
Liability	–	–	7	7	112	46	226
Equity/index							
Asset	12	–	–	12	8	see below	see below
Liability	21	–	–	21	17	see below	see below

28. Management of risks continued

At 31 December 2006, there were derivative contracts in place to protect the value of the UK equity portfolios of the Group. These provided limited protection against declines in market levels whilst also capping participation in any appreciation of the market. In total, this strategy covered an underlying equity value of approximately £800m. The impact of these derivatives as of 31 December 2006 if world equity markets decreased by 15% would be to decrease the impact of the decline by **£41m** (2005: £18m).

Sensitivity analysis

Change in fair value of investments and borrowings (note 1 and note 5):

	(Decrease)/increase	
	2006 £m	2005 £m
Interest rate markets (note 2):		
Impact on fixed interest securities of increase in interest rates of 100bps	**(198)**	(295)
Impact on loan capital of increase in interest rates of 100bps	**85**	132
Equity markets (note 3):		
Decrease of equity markets of 15%	**(243)**	(252)
Impact arising from derivatives	**41**	18
Property markets (note 3):		
Decrease of property markets of 15%	**(68)**	(65)
Currency markets (note 4):		
Decrease of major currencies versus British pound of 15%	**(1,315)**	(1,154)

Notes:

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 sensitivity of the bond assets of the Group has been modelled by reference to a reasonable approximation of the average interest rate sensitivity of the investments held within each of the portfolios.
3. The effect of movements in equity and property markets is reflected as a one time decrease of worldwide equity and property markets on 1 January 2007 and 1 January 2006 which results in a 15% decline in the value of the Group's assets in these investment categories.
4. The effect of currency movements on investments is reflected as a one time decrease in the value of major currencies against the British pound on 1 January 2007 and 1 January 2006.
5. This analysis has not considered the impact of the above market changes on the valuation of the Group's insurance liabilities.

Liquidity risk

Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The Group has no appetite for incurring liquidity risk and is committed to meeting all liabilities as they fall due. The investment limits ensure the Group's portfolio is kept in highly liquid marketable securities sufficient to meet its liabilities as they come due based on actuarial assessment.

The limits are monitored at a Group level as part of the Group Risk exposure monitoring and BRC reporting process.

In addition, the Group has committed credit facilities available as set out in note 22.

29. Hedge accounting

At 1 January 2005, the Group designated the loan capital denominated in foreign currencies as hedging instruments against the net investment in designated subsidiaries to reduce the foreign currency exchange risk exposure. The book value of the hedging instruments at 31 December 2006 was **£335m** (2005: £626m). The fair value of the hedging instruments at 31 December 2006 was **£353m** (2005: £735m).

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30. Subsidiaries

Country of incorporation		Principal activity
United Kingdom	Royal Insurance Holdings plc (note 1)	Holding company
	Royal & Sun Alliance Insurance plc	General insurance
	British Aviation Insurance Company Limited (57.1%)	General insurance
	The Globe Insurance Company Limited	General insurance
	The Marine Insurance Company Limited	General insurance
	Martello Underwriting Limited	General Insurance
	Royal International Insurance Holdings Limited	General insurance
	Royal & Sun Alliance Reinsurance Limited	General insurance
	Sun Alliance and London Insurance plc	General insurance
	Sun Insurance Office Limited	General insurance
Argentina	Royal & Sun Alliance Seguros (Argentina) SA (note 2)	General insurance
Bahrain	Royal & Sun Alliance Insurance (Middle East) Limited E.C. (50.01%)	General insurance
Brazil	Royal & Sun Alliance Seguros (Brasil) SA	General insurance
Canada	Roins Financial Services Limited	Holding company
	Quebec Assurance Company	General insurance
	The Johnson Corporation	Holding company
	Royal & Sun Alliance Insurance Company of Canada	General insurance
	Western Assurance Company	General insurance
Chile	Royal & Sun Alliance Seguros (Chile) SA (99.4%) (note 3)	General insurance
Colombia	Royal & Sun Alliance Seguros (Colombia) SA (86.5%)	General insurance
Denmark	Codan A/S (71.7%) (note 4)	Holding company
	Codan Forsikring A/S (71.7%) (note 4)	General insurance
Guernsey	Insurance Corporation of the Channel Islands Limited	General insurance
Isle of Man	Tower Insurance Company Limited	General insurance
Mexico	Royal & Sun Alliance Seguros (Mexico) SA de C.V.	General insurance
Netherlands Antilles	Royal & Sun Alliance Insurance (Antilles) NV (51.0%)	General insurance
Norway	Duborgh Skadeforsikring AS (71.7%) (note 4)	Insurance brokerage
	White Label Holding AS Group (71.7%) (note 4)	Holding company
Republic of Ireland	EGI Holdings Limited	General Insurance
Singapore	Royal & Sun Alliance Insurance (Singapore) Limited	General insurance
Sweden	Trygg-Hansa Försäkrings AB, Publikt (71.7%) (note 4)	General insurance
United States of America	Royal & Sun Alliance USA, Inc	Holding company
	Royal Indemnity Company	General insurance
	Royal Surplus Lines Insurance Company	General insurance
	Security Insurance Company of Hartford (note 5)	General insurance
Uruguay	Royal & Sun Alliance Seguros (Uruguay) SA	General insurance
Venezuela	Royal & Sun Alliance Seguros (Venezuela) SA (99.8%)	General insurance

Notes:

1. 100% direct subsidiary of Royal & Sun Alliance Insurance Group plc.
2. Merged with La Republica Compania Argentina de Seguros Generales SA.
3. Merged with Compania de Seguros Generales Cruz del Sur SA.
4. During the year, Codan A/S purchased DKK736m (£66m) of its own shares on the market. This increased the Group's share of the results and shareholders' equity of Codan A/S and its subsidiaries from 71.7% to 74.5%. The Group legally owns 71.7% of Codan A/S until the shares are cancelled at their AGM.
5. Merged with Guaranty National Insurance Company.
6. Except where indicated all holdings are of equity shares and represent 100% of the nominal issued capital. In all cases the proportion of voting power held equals the proportion of ownership interest.
7. Some subsidiaries have been omitted from this statement to avoid providing particulars of excessive length but none materially affects the results or assets of the Group.

31. Business combinations

Acquisition of subsidiaries

On 1 August 2006, the Group acquired 100% of the share capital of EGI Holdings Limited in Ireland. On 12 September 2006, the Group acquired 100% of the share capital of White Label Holding AS Group and Duborgh Skadeforsikring AS in Norway. On 13 November 2006, the Group acquired 100% of the share capital of Martello Underwriting Limited in the UK. The total consideration was **£93m** and goodwill of **£70m** arose on the acquisitions.

	£m
Investments	**45**
Intangibles	**8**
Cash and cash equivalents	**11**
Other assets	**17**
Insurance contract liabilities	**(36)**
Other liabilities	**(22)**
Net assets	**23**
Cash consideration including acquisition costs	**80**
Deferred consideration	**13**
Goodwill on acquisition	**70**

If the acquisitions had occurred on 1 January 2006, Group revenue for the year would have increased by **£46m** and Group profit after tax for the year would have increased by **£4m**. The total profit after tax of the acquired entities since the acquisition date included in the Group's profit or loss for the period was **£1m**.

Goodwill is individually assessed on each acquisition. The goodwill shown above arose from the premium paid for strengthening our market position in targeted business segments and acquiring the skilled workforce to drive future profitability in those segments. Goodwill also represents the future cost saving from expected synergies and economies of scale.

The consideration in regard to EGI Holdings Limited is provisional consideration dependent on the net asset value in the finalised completion accounts.

Disposal of subsidiaries

There were no material disposals during the year.

32. Cash generated from continuing operations

	2006 £m	Restated 2005 £m
Net profit for the year before tax on continuing operations	**649**	894
Adjustments for:		
Depreciation	**35**	35
Amortisation	**61**	48
Fair value losses (including loss on disposal) on property and equipment	**1**	–
Fair value gains (including gain on disposal) on investments	**(38)**	(166)
Fair value gains (including gain on disposal) on investment property	**(53)**	(51)
Impairment charge on available for sale financial assets	**3**	5
Share of profit from associates	**(1)**	(3)
Loss/(profit) on disposal of subsidiaries	**1**	(65)
Foreign exchange (gain)/loss	**(34)**	25
Amortisation of available for sale investments	**78**	62
Other non cash movements	**193**	28
Changes in operating assets/liabilities:		
Movement in technical provisions		
Unearned premiums	**191**	61
Outstanding claims	**176**	303
Movement in working capital	**(505)**	(261)
Movement in deferred acquisition costs	**(14)**	19
Reclassification of interest received	**(423)**	(558)
Cash generated from continuing operations	**320**	376

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33. Related party transactions
The ultimate Parent Company of the Group is Royal & Sun Alliance Insurance Group plc which is incorporated in Great Britain and registered in England and Wales.

The following transactions were carried out with related parties:

Key management compensation

	2006 £m	2005 £m
Salaries and other short term employee benefits	**4**	5
Bonus awards	**4**	3
Pension benefits	**1**	1
Share based awards	**3**	1
Total	**12**	10

A number of the directors, other key managers, their close families and entities under their control have general 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.

Year end balances arising from insurance transactions

	2006 £m	2005 £m
Receivables from associates	**–**	1

34. Commitments
Capital commitments
The Group's significant capital commitments in respect of investment property, property and equipment, intangible assets and associates are detailed in the table below:

	2006 £m	2005 £m
Property and equipment	**2**	4

Financial instrument commitments
The Group has a number of guarantees and commitments.

Bank loan guarantees
In Canada, the Group guarantees outstanding loan repayments in the event of bank loan default by broker subsidiaries and special relationship brokers. The bank loan guarantees amount in total to **£7m** (2005: £9m) and have a term of up to 10 years. It is not anticipated that any of the brokers will default, and full recourse is available on any default. Scandinavia has financial and performance guarantees totalling **£2m** (2005: £2m). The fair value of the guarantees did not materially impact the consolidated financial position of the Group.

Operating lease commitments
The Group leases various outlets and offices under non cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

Operating lease commitments where the Group is the lessee
The future aggregate minimum lease payments under non cancellable operating leases are as follows:

	Land and buildings		Other	
	2006 £m	2005 £m	2006 £m	2005 £m
One year or less	**55**	58	**2**	5
Between one and five years	**184**	179	**2**	2
After five years	**158**	162	**–**	–
	397	399	**4**	7
Recoveries under sub tenancies	**(94)**	(104)	**–**	–
Total	**303**	295	**4**	7

34. Commitments continued

Operating lease commitments where the Group is the lessor

The future aggregate minimum lease payments under non cancellable operating leases are as follows:

	Land and buildings	
	2006 £m	2005 £m
One year or less	**23**	21
Between one and five years	**82**	77
After five years	**149**	159
Total	**254**	257

35. Discontinued operations, non current assets and assets and liabilities of operations held for sale

Discontinued operations

On 28 September, the Group announced the sale of its US operations to Arrowpoint Capital Corp. (Arrowpoint), a company set up by the US management team. The Group is selling its US operation to Arrowpoint for a deferred consideration of £158m ($300m), which will be funded from the future performance of the US operation. The Group will make a £151m ($287.5m) capital contribution into the US regulated entities. Two existing arrangements will remain in place: the Adverse Development Cover (ADC) and the Letter of Credit (LOC) supporting certain third party reinsurance recoverables and agreed pension contributions. The ADC is a reinsurance cover put in place in 2003. It is at its policy limit and only exposed to timing risk. The prudent assumptions supporting the projected payment patterns give additional cover against potential timing risks for payment of claims. For the LOC of £79m a methodology has been agreed to step it down commencing two years after the completion of the transaction conditional on the financial health of the US regulated entities. In the event that the regulated entities are required to draw down on the LOC, a mechanism has been agreed for reimbursement to the Group. Neither the ADC nor the LOC represent new exposures to the Group and the directors believe that they do not represent material risks to the Group given their nature, timing and likelihood. As part of the disposal the Group has given minimal representations and warranties and the transaction represents a clean exit from the US. It is intended that the present value of the deferred consideration will be held as part of the general investment portfolio of the Group. The loss recognised as a result of remeasurement to fair value less costs to sell is £399m.

On 4 March 2007, the Group announced the completion of the disposal of its US operations to Arrowpoint. The disposal will be recognised in the Group's financial statements for 2007.

An analysis of the result of discontinued operations, and the result recognised on the remeasurement of assets of the disposal group is as follows:

	2006 £m	2005 £m
Total income	**124**	293
Total expenses	**(209)**	(322)
Loss before tax and writedown	**(85)**	(29)
Writedown	**(399)**	–
Loss before tax of discontinued operations	**(484)**	(29)
Tax on writedown	**(15)**	(1)
Loss for the year from discontinued operations	**(499)**	(30)

Notes to the financial statements

continued

35. Discontinued operations, non current assets and assets and liabilities of operations held for sale continued

Non current assets held for sale and assets and liabilities of discontinued operations

IFRS requires that the total assets and total liabilities of discontinued operations are each shown separately and excluded from the individual line items of the balance sheet. The assets and liabilities of the US operation have been shown net of intercompany balances. No representation of prior period is required as the assets and liabilities are included in the individual line items:

	2006 £m
Assets	
Goodwill on acquired claims provisions	10
Property and equipment	2
Total investments	1,591
Reinsurers' share of insurance contract liabilities	1,377
Insurance and reinsurance debtors	250
Deferred acquisition costs	5
Other debtors and other assets	37
Cash and cash equivalents	213
Total assets	3,485
Liabilities	
Insurance contract liabilities	2,834
Insurance and reinsurance liabilities	41
Provisions and other liabilities	719
Total liabilities	3,594

Other statutory disclosures required in relation to discontinued operations

The statutory disclosures not included elsewhere in these financial statements are as follows:

Profit before tax

The following items have been included in arriving at the loss before tax:

	2006 £m	2005 £m
Reorganisation expenses	11	49
Investment expenses and charges	23	22
Amortisation and impairment of intangible assets	5	6

Auditors' remuneration

	2006 £m	2005 £m
Fees payable to PricewaterhouseCoopers for audit of the Company's annual accounts	–	–
Fees payable to PricewaterhouseCoopers and its associates for other services:		
The audit of the Company's subsidiaries, pursuant to legislation	1.1	0.5
Other services pursuant to legislation	–	0.1
Tax services	0.1	0.1
	1.2	0.7

35. Discontinued operations, non current assets and assets and liabilities of operations held for sale continued

Employee information

Staff costs for employees comprise:

	2006 £m	2005 £m
Wages and salaries	38	76
Social security costs	3	4
Pension costs	3	(9)
Share based payments to directors and employees	1	1
	45	72

The average number of employees of the US operation during the year was **543** (2005: 1,766).

Taxation

There was no deferred income tax charged to equity during the year.

Other disclosures not included elsewhere in these financial statements are as follows:

Related party transactions

As stated earlier, the Group is selling its US operation to Arrowpoint Capital, a company set up by the US management team. This transaction is undertaken on normal commercial terms and conditions.

John Tighe is the CEO of the US operation and his remuneration is included within the key management compensation set out in note 33.

Financial assets

At the period end, the US operation had pledged **£1,356m** of financial assets as collateral for liabilities or contingent liabilities and accepted **£948m** collateral that could be sold or pledged.

Earnings per share attributable to the equity shareholders

The earnings per ordinary share is calculated by reference to the profit/(loss) attributable to the equity shareholders and the weighted average of shares in issue during the year. Further details on calculation are set out in note 6, Earnings per share attributable to the equity holders of the Parent Company.

Basic

	Discontinued operations	
	2006 £m	Restated 2005 £m
Loss attributable to equity holders of the Parent Company	(499)	(30)
Less: Cumulative preference dividends	–	–
Loss for the calculation of earnings per share	(499)	(30)
Weighted average number of ordinary shares in issue (thousands)	2,929,453	2,896,059
Basic earnings per share (p)	(17.1)%	(1.0)%

Diluted

	Discontinued operations	
	2006 £m	Restated 2005 £m
Loss for the calculation of earnings per share	(499)	(30)
Weighted average number of ordinary shares in issue (thousands)	2,929,453	2,896,059
Adjustments for share options (thousands)	29,835	17,445
Weighted average number of ordinary shares for diluted earnings per share (thousands)	2,959,288	2,913,504
Diluted earnings per share (p)	(16.9)%	(1.0)%

Non current assets held for sale and assets and liabilities of discontinued operations

At 31 December 2005, a Group occupied property within the UK segment, valued at £36m, was presented as held for sale following the decision to dispose of it and the sale being considered highly probable.

Independent auditors' report to the members of Royal & Sun Alliance Insurance Group plc

We have audited the Parent Company financial statements of Royal & Sun Alliance Insurance Group plc for the year ended 31 December 2006 which comprise the Parent Company balance sheet, statement in changes in equity of the Parent Company, the Parent Company cashflow statement and the related notes. These Parent Company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the remuneration report and the directors' interests that are described as having been audited.

We have reported separately on the consolidated financial statements of Royal & Sun Alliance Insurance Group plc for the year ended 31 December 2006.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the remuneration report, the directors' interests and the Parent Company financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the directors' report.

Our responsibility is to audit the Parent Company financial statements and the parts of the remuneration report and the directors' interests to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the Parent Company financial statements give a true and fair view and whether the Parent Company financial statements and the parts of the remuneration report and the directors' interests to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the directors' report is consistent with the Parent Company financial statements. The information given in the directors' report includes that specific information presented in the financial review, the Group CEO's business review, in the regional business reviews and in the estimation techniques, uncertainties and contingencies that is cross referred from the business review section of the directors' report.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Parent Company financial statements. The other information comprises only the highlights, the R&SA at a glance section, the Chairman's statement, the Group CEO's business review, the market leading capability section, the profitable growth section, the UK business review, the International business review, the Emerging Market business review, the financial review, the risk framework, the corporate responsibility section, the directors' report, the corporate governance statement, the remuneration report and the unaudited part of the directors' interests. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Parent Company financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Parent Company financial statements and the parts of the remuneration report and the directors' interests to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the Parent Company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Parent Company financial statements and the parts of the remuneration report and the directors' interests to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Parent Company financial statements and the parts of the remuneration report and the directors' interests to be audited.

Opinion

In our opinion:

- The Parent Company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the Company's affairs as at 31 December 2006 and cashflows for the year then ended,
- The Parent Company financial statements and the part of the remuneration report and the directors' interests to be audited have been properly prepared in accordance with the Companies Act 1985,
- The information given in the directors' report is consistent with the Parent Company financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
7 March 2007

Parent Company balance sheet

As at 31 December 2006

	Notes	2006 £m	Restated 2005 £m
Assets			
Fixtures and fittings		2	–
Investments	2	5,811	4,870
Amounts owed by subsidiaries	9	1,212	1,149
Current income tax assets	6	57	27
Deferred tax assets	6	28	26
Other debtors and other assets	3	6	7
		1,303	1,209
Cash and cash equivalents		2	–
Total assets		7,118	6,079
Equity, reserves and liabilities			
Equity and reserves			
Share capital	4	946	932
Reserves		4,090	3,174
Retained earnings		288	281
Total equity and reserves		5,324	4,387
Liabilities			
Amounts owed to subsidiaries	9	540	474
Loan capital	5	1,192	1,152
Accruals and other liabilities		62	66
Total liabilities		1,794	1,692
Total equity, reserves and liabilities		7,118	6,079

The attached notes form an integral part of these separate financial statements.

The separate financial statements were approved on 7 March 2007 by the Board of Directors and are signed on its behalf by:

George Culmer
Chief Financial Officer

Statement of changes in equity of the Parent Company

for the year ended 31 December 2006

Changes in equity for the year ended 31 December 2006

	Ordinary share capital £m	Ordinary share premium £m	Preference shares £m	Revaluation reserves £m	Capital redemption reserve £m	Subordinated guaranteed perpetual debt £m	Retained earnings £m	Total equity £m
Balance at 1 January	807	804	125	2,362	8	–	338	4,444
Prior year adjustment (note 5)	–	–	–	–	–	–	(57)	(57)
Restated balance at 1 January	807	804	125	2,362	8	–	281	4,387
Profit for the year	–	–	–	–	–	–	143	143
Dividends – paid (note 7)	–	–	–	–	–	–	(149)	(149)
Issued by scrip	12	49	–	–	–	–	–	61
Issued for cash	2	4	–	–	–	–	–	6
Share options	–	–	–	–	–	–	13	13
Fair value gains/(losses) net of tax	–	–	–	863	–	–	–	863
Balance at 31 December	**821**	**857**	**125**	**3,225**	**8**	**–**	**288**	**5,324**

Changes in equity for the year ended 31 December 2005 (restated)

	Ordinary share capital £m	Ordinary share premium £m	Preference shares £m	Revaluation reserves £m	Capital redemption reserve £m	Subordinated guaranteed perpetual debt £m	Retained earnings £m	Total equity £m
Balance at 1 January	801	790	125	1,388	8	444	(3)	3,553
Profit for the year	–	–	–	–	–	–	476	476
Dividends – paid (note 7)	–	–	–	–	–	–	(144)	(144)
Issued by scrip	5	13	–	–	–	–	–	18
Issued for cash	1	1	–	–	–	–	–	2
Share options	–	–	–	–	–	–	9	9
Fair value gains/(losses) net of tax	–	–	–	974	–	–	–	974
Reclassification to loan capital (note 5)	–	–	–	–	–	(444)	(81)	(525)
Tax on reclassification to loan capital	–	–	–	–	–	–	24	24
Restated balance at 31 December	807	804	125	2,362	8	–	281	4,387

The attached notes form an integral part of these separate financial statements.

Parent Company cashflow statement

for the year ended 31 December 2006

	Note	2006 £m	2005 £m
Cash generated from operations	8	**63**	(112)
Income tax refunded/(paid)		**–**	–
Net cashflows from operating activities		**63**	(112)
Net movement in amounts owed to/by subsidiaries		**(52)**	235
Purchase of fixtures and fittings		**(2)**	–
Net cashflows from investing activities		**(54)**	235
Proceeds from issue of share capital		**6**	2
Dividends paid		**(87)**	(126)
Proceeds from issuance of long term borrowings		**74**	–
Net cashflows from financing activities		**(7)**	(124)
Net decrease in cash and cash equivalents		**2**	(1)
Cash and cash equivalents at beginning of the year		**–**	1
Cash and cash equivalents at end of the year		**2**	–

The attached notes form an integral part of these separate financial statements.

Notes to the separate financial statements

1. Significant accounting policies

Royal & Sun Alliance Insurance Group plc, domiciled in the United Kingdom is the ultimate Parent Company (the Company) for the Royal & Sun Alliance Insurance Group. The principal activity of the Company is to hold investments in its subsidiaries and the receipt and payment of dividends.

These separate financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

Except where otherwise stated, all figures included in the separate financial statements are presented in millions of pounds sterling (£m), rounded to the nearest million.

In accordance with Section 230 of Companies Act 1985, the Company's income statement and related notes have not been presented in these separate financial statements.

The accounting policies that are used in preparation of these separate financial statements are consistent with the accounting policies used in preparation of the consolidated financial statements of Royal & Sun Alliance Insurance Group as set out in those financial statements.

The additional accounting policies that are specific to the separate financial statements of the Company are set out below.

Investment in subsidiaries

The Company accounts for its investments in directly owned subsidiaries as available for sale financial assets, which are included in the accounts at fair value.

Changes in the fair value of the investments in subsidiaries are recognised directly in equity in the statement of changes in equity. Where there is a decline in the fair value of a directly owned subsidiary below cost, and there is objective evidence that the investment is impaired, the cumulative loss that has been recognised in equity is removed from equity and recognised in the income statement.

Dividend income

Dividend income from investments in subsidiaries is recognised when the right to receive payment is established.

2. Investments

	2006 £m	2005 £m
Investments at 1 January – at valuation	**4,870**	3,981
Additions/(disposals) during the year	**78**	(85)
Fair value adjustments	**863**	974
Investments at 31 December – at valuation	**5,811**	4,870

The balance at 31 December comprises:

	2006 £m	2005 £m
Investment in subsidiaries	**5,410**	4,547
Loans to subsidiaries	**401**	323
	5,811	4,870

The investments in subsidiaries are recognised in the balance sheet at fair value measured in accordance with the Company's accounting policies. Fair value of the Company's significant subsidiary is determined by reference to the market value (derived from relevant indices) of the Company's ordinary shares and loan capital instruments at the balance sheet date, being the most transparent independent available indicator. The market value is adjusted for the fair value of the Company's preference shares, assets and liabilities, excluding directly owned subsidiaries. The adjusting items have been fair valued by determining the present value of future cashflow projections, using an appropriate arms length discount rate. The remaining subsidiaries are held at fair value which has been determined to be net asset value.

The directors believe that the methodology used supports the inclusion of the investments in subsidiaries on the balance sheet, at the fair values ascribed to them. The market value of the Company's ordinary shares at 31 December 2006 was **152.5p**. A movement of 1% in the share price would have an impact of £46m on the fair value.

Full details of the principal subsidiaries of the Company are set out in note 30 to the consolidated financial statements.

3. Other debtors and other assets – to be settled within 12 months

	2006 £m	2005 £m
Other prepayments and accrued income	3	3
Other debtors	3	4
Total other debtors and other assets	**6**	7

4. Share capital

Full details of the share capital of the Company are set out in note 18 to the consolidated financial statements.

5. Loan capital

Full details of the loan capital of the Company are set out in note 19 to the consolidated financial statements.

6. Current and deferred tax

Current income tax

	2006 £m	2005 £m
To be settled within 12 months	57	27
To be settled after 12 months	–	–
	57	27

Deferred tax

	2006 £m	Restated 2005 £m
Deferred tax assets	28	26
Deferred tax liabilities	–	–
Net deferred tax position at 31 December	**28**	26

The movement for the year in the Company's net deferred tax position was as follows:

	2006 £m	Restated 2005 £m
Net deferred tax position at 1 January	26	(14)
Credited to income for the year	4	–
(Charged)/credited to equity	(2)	24
Net liability transferred to a subsidiary company	–	16
Net deferred tax position at 31 December	**28**	26

The following are the major deferred tax liabilities and assets recognised by the Company and their movements during the year:

Deferred tax liabilities

	Other temporary differences £m
Deferred tax liabilities at 1 January 2005	(14)
Transferred to a subsidiary company	14
Deferred tax liabilities at 31 December 2005	–
Charge to the income statement for the year	–
Deferred tax liabilities at 31 December 2006	**–**

Notes to the separate financial statements
continued

6. Current and deferred tax continued
Deferred tax assets

	Other temporary differences £m	Reclassification of bonds £m	Accelerated capital allowances £m	Total £m
Deferred tax assets at 1 January	–	–	–	–
Transfers	–	–	2	2
Credited to equity for the year	–	24	–	24
Deferred tax assets at 31 December 2005	–	24	2	26
Charge to equity for the year	**–**	**(2)**	**–**	**(2)**
Credited/(charged) to income for the year	**5**	**–**	**(1)**	**4**
Deferred tax assets at 31 December 2006	**5**	**22**	**1**	**28**

At the balance sheet date, the Company has unused tax losses of **£4m** (2005: £4m) available for offset against future profits. No deferred tax asset has been recognised in respect of the tax losses of **£4m** (2005: £4m) due to the unpredictability of future profit streams. The losses may be carried forward indefinitely.

The aggregate current tax relating to items that are credited to equity is **£2m** (2005: £2m).

7. Dividends
Full details of the dividends paid and proposed by the Company are set out in note 7 to the consolidated financial statements.

8. Cash generated from operations

	2006 £m	2005 £m
Net profit for the year before tax	**111**	450
Realised losses	**–**	2
Foreign exchange (profit)/loss	**(29)**	7
Dividends received	**–**	(590)
Changes in operating assets/liabilities	**(19)**	19
Cash generated from operations	**63**	(112)

9. Related party transactions

Royal & Sun Alliance Insurance Group plc (incorporated in Great Britain and registered in England and Wales) is the ultimate Parent Company of the Royal & Sun Alliance Insurance Group.

The following transactions were carried out with related parties:

Provision of services and benefits

Royal & Sun Alliance Insurance Group plc provides services and benefits to its subsidiary companies operating within the UK and overseas as follows:

- Provision of technical support in relation to risk management, information technology and reinsurance services. Services are charged for annually on a cost plus basis, allowing for a margin of **5%** (2005: 5%),
- Issue of share options and share awards to employees of subsidiaries. Costs are charged for annually based on the underlying value of the awards granted calculated in accordance with the guidance set out within IFRS 2.

Key management compensation

	2006 £m	2005 £m
Salaries and other short term employee benefits	**4**	5
Bonus awards	**4**	3
Pension benefits	**1**	1
Share based awards	**3**	1
Total	**12**	10

There are no employees with employment contracts with the Company. All employees are employed by subsidiary companies.

A number of the directors, other key managers, their close families and entities under their control have general 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.

Year end balances with related parties are set out below:

	2006 £m	2005 £m
Receivable from related parties:		
Receivable from subsidiaries, interest bearing loans	**1,009**	955
Receivable from subsidiaries, non interest bearing	**203**	194
Total receivable from related parties	**1,212**	1,149
Payable to related parties:		
Payable to subsidiaries, interest bearing loans	**427**	369
Payable to subsidiaries, non interest bearing	**113**	105
Total payable to related parties	**540**	474

Interest is charged on interest bearing loans, which are repayable on 24 hours written notice, at three month LIBOR + 0.6%.

Additional loans to subsidiaries of **£401m** (2005: £323m) as disclosed within note 2 have been made. Of this, **£294m** (2005: £294m) and **£78m** (2005: £nil) are subordinated loans on which interest is charged at 8.5% and 6.701% respectively with the remaining loan balance interest free with no specified repayment date.

10. Share based payments

Full details of share based payment plans are provided in note 27 to the consolidated financial statements.

Shareholder information

Registered Office and Group Corporate Centre

9th Floor, 1 Plantation Place, 30 Fenchurch Street, London EC3M 3BD. Telephone: +44 (0)20 7111 7000. Registered in England No. 2339826.

Company website

The Annual Report & Accounts, interim results and other useful information about the Company is available on our website www.royalsunalliance.com.

Investor Relations

For further information about Royal & SunAlliance, please contact the Investor Relations department at: Royal & Sun Alliance Insurance Group plc, 9th Floor, 1 Plantation Place, 30 Fenchurch Street, London EC3M 3BD. Telephone: +44 (0)20 7111 7136.

Annual General Meeting

Ordinary shareholders are invited to attend the Company's Annual General Meeting (AGM), which will be held in The Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE at 11.00am on Monday, 21 May 2007. Ordinary shareholders who are unable to attend the AGM to ask a question in person may write to the Company Secretary's department at the registered office at the address above.

Disabled shareholders

Royal & SunAlliance is committed to providing a quality service to all of its shareholders. An induction loop is installed at the AGM venue. Please contact the Company Secretary's department at the registered office at the address above.

Share price

The Company's share price is shown on Ceefax BBC1 page 230 and on Teletext Ch4 page 519. It is also available on the Company's website www.royalsunalliance.com.

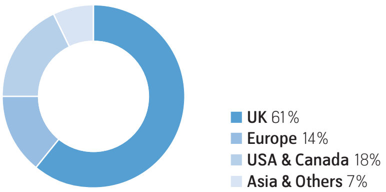
Share and shareholder analysis

Royal & SunAlliance is listed on the London Stock Exchange under the code RSA. The average total daily trading volume during 2006 was approximately 24m shares. The opening market price on 3 January 2006 was 128p and closing market price on 29 December 2006 was 152.5p. The highest daily closing price was 154.75p on 21 November 2006 and lowest daily closing price was 118.25p on 17 January 2006. Further details of the ordinary and preference shares are found in note 18 on page 73.

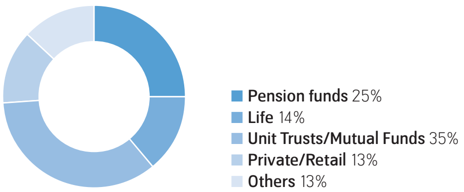
Shareholdings by size

No of shares	Shareholders	%	Shares	%
1 – 24,999	50,398	97.45	115.3m	3.86
25,000 – 99,999	699	1.35	32.1m	1.07
100,000 – 499,999	289	0.56	70.7m	2.37
500,000 – 999,999	96	0.19	68.6m	2.30
1,000,000 – 1,999,999	81	0.16	112.1m	3.75
more than 2,000,000	149	0.29	2,588.7m	86.65
Total	51,712	100	2,987.5m	100

Distribution of shares by geography



Analysis of investors



Share dealing

Shares can be bought or sold through a stockbroker, bank or building society. The rates of commission charged for share dealing services will vary depending on the kind of service required. The cheapest way to deal in shares is usually on an 'execution only' basis which means that a broker will act on their client's instructions to buy or sell, but will not give advice on the merits of the transaction.

The Company has established an execution only sharedealing service with Lloyds TSB Registrars for existing shareholders with a UK registered address. Shares can be bought or sold within minutes, between the hours of 8.30am and 4.30pm (UK time), Monday to Friday. To deal, log on to www.shareview.co.uk/dealing or telephone +44 (0)870 850 0852. Shareholders will need to have their share certificate(s) to hand when dealing.

Capital gains tax

The market value at 31 March 1982 of each post consolidation ordinary share of 27.5p in the Company, for capital gains tax purposes after relevant adjustments, was 146.41p (25p shares 133.1p) for former Royal Insurance shareholders and 57.97p (25p shares 52.7p) for former Sun Alliance shareholders. An adjustment to tax cost is required to take account of the 2003 rights issue, according to whether the rights were taken up or sold. Similarly, for former Royal Insurance shareholders an adjustment to tax cost is required to take account of the 1993 rights issue, according to whether the rights were taken up or sold.

ShareGift

The purpose of ShareGift is to make it easy for shareholders to donate any number of shares to charity. The service can be particularly useful for shareholders with a small number of shares, which would be uneconomic to sell. Shares donated through ShareGift are transferred into the name of The Orr Mackintosh Foundation, registered charity number 1052686. ShareGift's purpose is to realise as much value as possible by collecting shares, selling them and using the proceeds to make donations to a wide range of UK charities. Further details can be obtained from: The Orr Mackintosh Foundation, 46 Grosvenor Street, London W1K 3HN. Telephone: +44 (0)20 7828 1151. The website address is www.sharegift.org.

The Unclaimed Assets Register

Royal & SunAlliance supplies unclaimed dividend data to The Unclaimed Assets Register (UAR), which provides investors who have lost track of shareholdings with the opportunity to search the UAR's database of unclaimed financial assets on payment of a small, fixed fee. The UAR donates part of the search fee to charity. Further details can be obtained from: The Unclaimed Assets Register, Bain House, 16 Connaught Place, London W2 2ES. Telephone: +44 (0)870 241 1713. The website address is www.uar.co.uk.

Registrar

Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA. The shareholder helpline telephone number is +44 (0)870 600 3988. Overseas callers should use +44 (0)121 415 7064. Shareholders with a text phone facility should use +44 (0)870 600 3950.

Please quote the company reference number 0059 and your shareholder account number (on your share certificate or dividend tax vouchers) when contacting or corresponding with Lloyds TSB Registrars.

The Company has appointed Lloyds TSB Registrars as its registrar to manage the shareholder register, to ensure that all information held about the Company's shareholders is kept up to date and to pay dividends.

American Depositary Receipts

The Company terminated its listing, in the form of American Depositary Shares, on the New York Stock Exchange on 30 October 2006.

Should you have an enquiry relating to the above please contact the Investor Relations department at Royal & Sun Alliance Insurance Group plc, 9th Floor, 1 Plantation Place, 30 Fenchurch Street, London EC3M 3BD. Telephone: +44 (0)20 7111 7136.

Financial calendar

8 March 2007
Announcement of the full year results for 2006, the ordinary final dividend for 2006 and the first preference dividend for 2007

14 March 2007
Ex dividend date for the ordinary final dividend for 2006 and the first preference dividend for 2007

16 March 2007
Record date for the ordinary final dividend for 2006 and the first preference dividend for 2007

22 March 2007
Announcement of the scrip dividend price for the ordinary final dividend for 2006

3 April 2007
Payment date for the first preference dividend for 2007

9 May 2007
Deadline for sending scrip dividend mandates to Lloyds TSB Registrars (in relation to ordinary final dividend for 2006)

21 May 2007
Annual General Meeting

1 June 2007
Payment date for the ordinary final dividend for 2006 (subject to shareholder approval at the AGM)

9 August 2007
Announcement of the interim results for the six months ended 30 June 2007, the ordinary interim dividend for 2007 and the second preference dividend for 2007

15 August 2007*
Ex dividend date for the ordinary interim dividend for 2007

17 August 2007*
Record date for the ordinary interim dividend for 2007

23 August 2007*
Announcement of the scrip dividend price for the ordinary interim dividend for 2007

29 August 2007*
Ex dividend date for the second preference dividend for 2007

31 August 2007*
Record date for the second preference dividend for 2007

2 October 2007*
Payment date for the second preference dividend for 2007

2 November 2007*
Deadline for sending scrip dividend mandates to Lloyds TSB Registrars (in relation to ordinary interim dividend 2007)

30 November 2007*
Payment date for the ordinary interim dividend for 2007

*provisional date

Frequently asked questions

A range of shareholder information is available on line at www.shareview.co.uk, including practical help on transferring shares or updating details. Shareholders can also register for secure access to their portfolio, enabling them to check holdings and register their email address to receive shareholder information and the Annual Report & Accounts electronically. At present, the portfolio service is free.

Q I have recently moved house – who should I tell?

A Please notify Lloyds TSB Registrars in writing at the address given on page 115. Remember to state clearly your old address. If you hold shares in joint names, the letter must be signed by the first named person on the share certificate. If you have previously registered for the Shareview portfolio service, you can log onto www.shareview.co.uk and change your address electronically.

Q What should I do if I change my name?

A To ensure that your shareholding is registered in your new name, please write to Lloyds TSB Registrars. You will need to enclose evidence of the change, for example, a copy of your marriage certificate or change of name deed (please do not send originals), together with your share certificate(s) and any uncashed dividend cheques. New documents will then be issued in the right name.

Q My share certificate has been lost/stolen. How do I get a replacement?

A You should inform Lloyds TSB Registrars immediately. They will send you a form of indemnity to complete and request payment of an administration fee. The form of indemnity is required to protect the Company from the potential misuse of the missing share certificate, so must be returned before a new share certificate can be issued. Please remember that your share certificate is a valuable document which should be kept in a safe place.

Q I have lost my dividend tax voucher – how can I get another one?

A To get a replacement, you will need to contact Lloyds TSB Registrars. A small fee will be payable for this service.

Q I have found an out of date dividend cheque – how can I cash it?

A Please send the out of date cheque to Lloyds TSB Registrars, with a request that they issue a replacement cheque. There will be a small administration charge for issuing replacement dividend cheques for larger payments.

Q I would like to receive future communications electronically – how can I arrange this?

A Please register at www.shareview.co.uk and create your own portfolio. You will need your shareholder account number (on your share certificate(s) or dividend tax voucher) to access this service.

Q Why do I receive multiple sets of information whenever you send anything to me?

A If you have acquired shares on more than one occasion, your holdings may have been recorded on the register of shareholders with slightly different details. As a result, two or more accounts may have been set up for you. Sometimes multiple accounts are necessary, eg if you hold shares in your own name and also in joint names with a partner. However, sometimes multiple accounts can be amalgamated. Please contact Lloyds TSB Registrars to discuss whether your accounts can be amalgamated.

Q How can I get my dividends paid directly into my bank or building society account?

A You will need to supply your bank or building society account details to Lloyds TSB Registrars. You can obtain a dividend payment mandate form from Lloyds TSB Registrars. A copy of the form is also attached when dividend cheques are mailed out.

Q Can I receive shares in lieu of cash dividends?

A The Company offers a scrip dividend scheme, which allows ordinary shareholders to receive new ordinary shares of 27.5p each instead of cash dividends. The scrip dividend scheme applies to both interim and final dividends, and enables shareholders to increase their holdings in the Company without incurring dealing costs or stamp duty. Please telephone Lloyds TSB Registrars on +44 (0)870 600 3988 for further information.

Q I would like to transfer shares to somebody I know. How do I arrange this?

A Such transactions need not involve a stockbroker; you can use a stock transfer form. The form can be obtained from Lloyds TSB Registrars or printed from their website www.shareview.co.uk.

Q How do I register the death of a shareholder?

A The first step is to write to Lloyds TSB Registrars, to let them know what you are going to do. They will then place a temporary marker on the register to ensure that further dividend payments are not issued in the late shareholder's name. They will also send you the forms that you will need to complete.

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