RSA

ANNUAL REPORT AND ACCOUNTS 2012



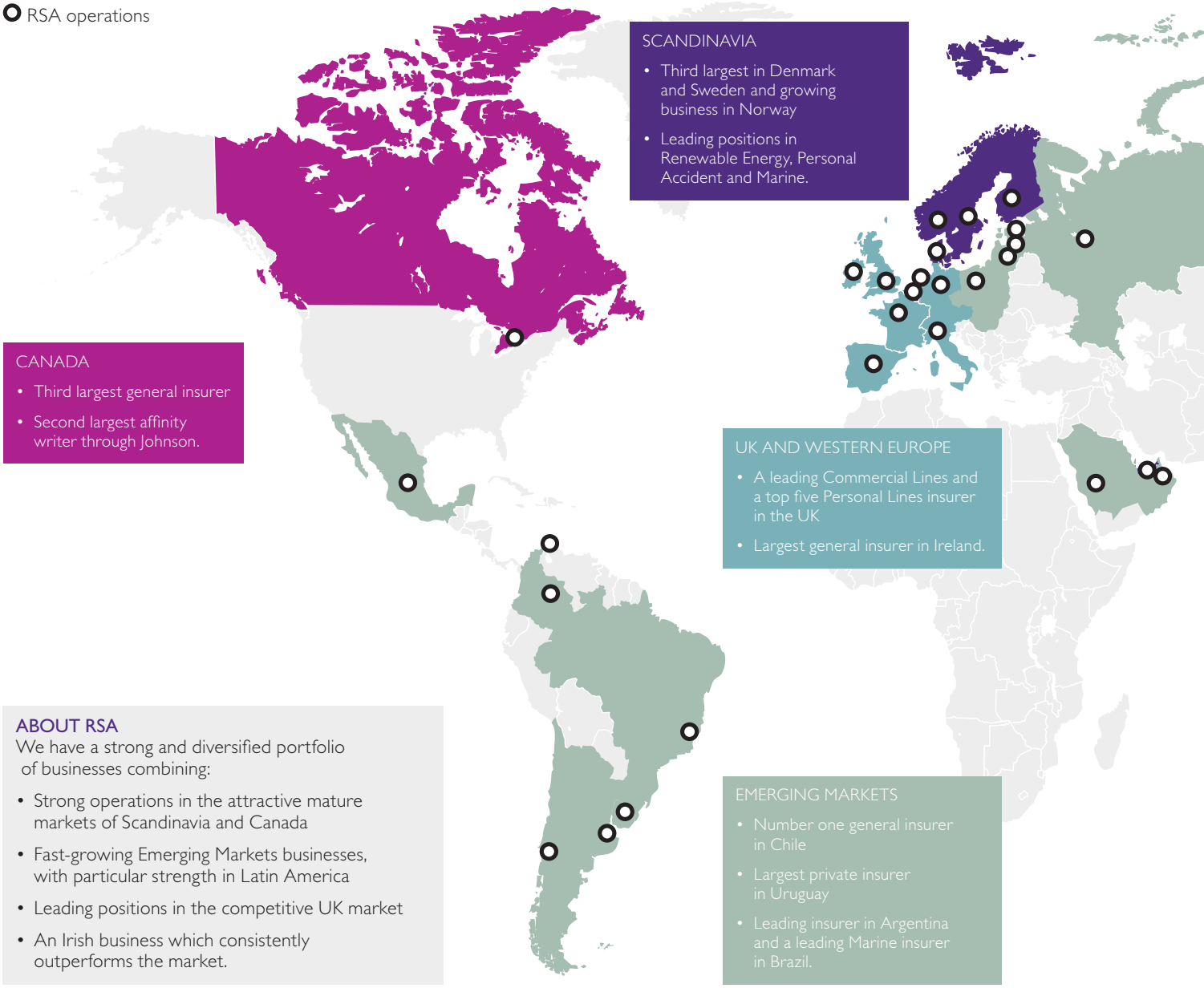
2012 HIGHLIGHTS

Welcome to our Annual Report and Accounts 2012



www.rsagroup.com

RSA operations



SCANDINAVIA

- Third largest in Denmark and Sweden and growing business in Norway
- Leading positions in Renewable Energy, Personal Accident and Marine.

CANADA

- Third largest general insurer
- Second largest affinity writer through Johnson.

UK AND WESTERN EUROPE

- A leading Commercial Lines and a top five Personal Lines insurer in the UK
- Largest general insurer in Ireland.

EMERGING MARKETS

- Number one general insurer in Chile
- Largest private insurer in Uruguay
- Leading insurer in Argentina and a leading Marine insurer in Brazil.

ABOUT RSA

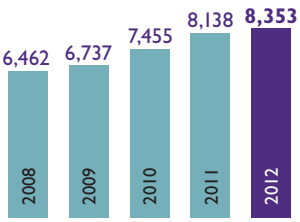
We have a strong and diversified portfolio of businesses combining:

- Strong operations in the attractive mature markets of Scandinavia and Canada
- Fast-growing Emerging Markets businesses, with particular strength in Latin America
- Leading positions in the competitive UK market
- An Irish business which consistently outperforms the market.

Net written premiums (£m)

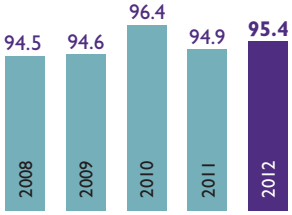
5% at constant exchange

Net written premium growth
(3% growth as reported)



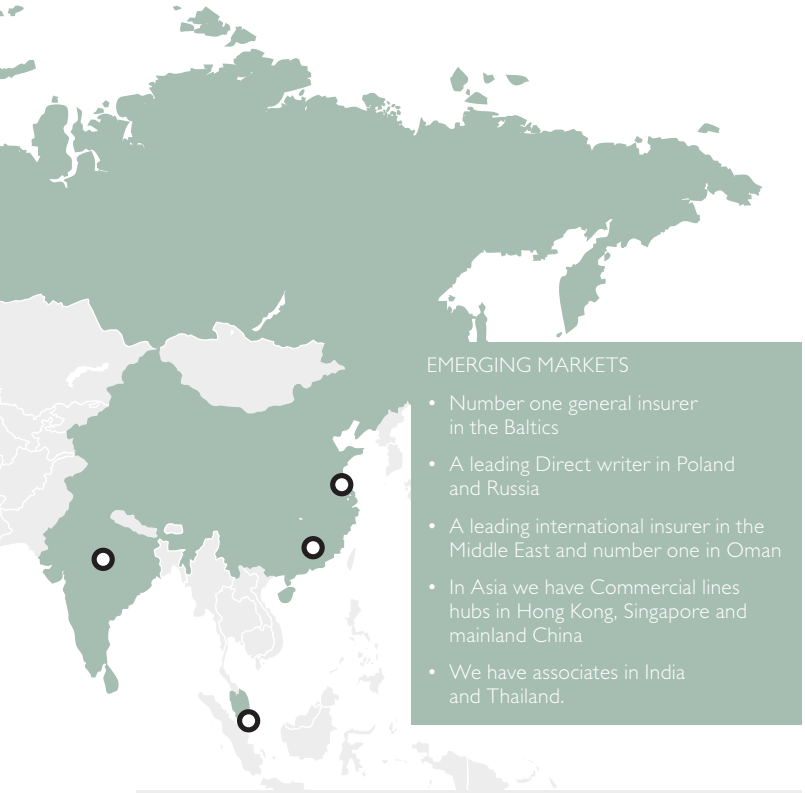
Combined operating ratio (%)

95.4%



This Annual Report and Accounts contains 'forward-looking statements' with respect to certain of the Group's plans and its current goals and expectations relating to its future financial condition, performance, results, strategic initiatives and objectives. For further details, reference should be made to the 'important disclaimer' on the inside back cover.

Pages 8 to 33 constitute the business review of RSA and are incorporated by reference into the Directors' and corporate governance report set out on pages 40 to 54. The Directors' and corporate governance 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.



EMERGING MARKETS

- Number one general insurer in the Baltics
- A leading Direct writer in Poland and Russia
- A leading international insurer in the Middle East and number one in Oman
- In Asia we have Commercial lines hubs in Hong Kong, Singapore and mainland China
- We have associates in India and Thailand.

OPERATING HIGHLIGHTS

- Net written premiums up 5% at constant exchange to £8.4bn
- Underwriting result flat at £375m after negative impact from UK adverse weather and Italian earthquakes in first half
- Investment income of £515m impacted by the continued low yield environment
- Emerging Markets now represents 10% of insurance result
- Capital position remains strong with an IGD surplus of £1.2bn
- In 2013 we expect to deliver strong premium growth, a COR of better than 95%, around £470m of investment income and return on equity of 10-12%.

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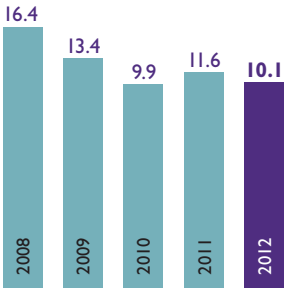
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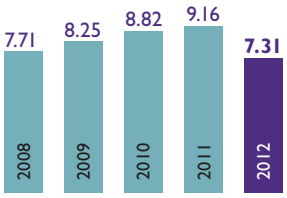
Underlying return on average equity (%)

10.1%



Dividend for the year (p)

7.31p



RSA AT A GLANCE

We are a leading general insurer operating in 32 countries and providing products and services in over 140 countries through our global network of local partners

THE INVESTMENT CASE

We provide insurance solutions to individuals and businesses across the globe.

We operate in a combination of stable economies with excellent profitability, high growth economies with opportunities to build scale and economies recovering from the effects of the global recession where we can improve performance.

We have an enviable track record of delivering steady growth in premiums and a consistently strong underwriting result with combined operating ratios of around 95% over the last seven years.

We manage the business conservatively ensuring prudent reserving and a low risk approach to our investment portfolio to minimise volatility in earnings and maximise shareholder returns.

We aim to achieve market-leading profitability in mature markets.

We will invest in attractive growth markets where the creation of operating leverage will drive significantly improved profitability.

We will continue to build our global Specialty capabilities where we have strong positions in Marine, Renewable Energy, Construction & Engineering and Risk Managed business.

We will be disciplined over capital allocation, embedding new measures into the Group to support robust portfolio management decisions.

We have an experienced and capable management team who are committed to and incentivised by the delivery of increasing shareholder value.

HERITAGE

1710
The Sun Fire Office is established.

1765
We insure the home of Captain James Cook, prior to the first of his legendary voyages.

1844
We cover Down House where Charles Darwin wrote On the Origin of Species.

1959
Sun Insurance Office merges with Alliance Assurance Company to form Sun Alliance Insurance Limited.

1996
Sun Alliance Group merges with Royal Insurance Holdings, to become Royal & SunAlliance Insurance Group plc.

2001
MORE TH>N launches in the UK.

2006
We became the first carbon-neutral UK Insurer.

2008
Royal & SunAlliance becomes RSA Insurance Group plc.

2009
We take part in the reconstruction of the Italian city of L'Aquila following it's earthquake.

2010
Major earthquake strikes Chile where we are the largest insurer.

2010
The RSA Group is 300 years old.

2011
Record year for natural catastrophes. RSA's exposures minimised through prudent use of reinsurance.

2012
Acquisitions of L'Union Canadienne in Quebec, and El Comercio and AC in Argentina.

CANADA

RSA

JOHNSON

WA

CNS

UK

RSA

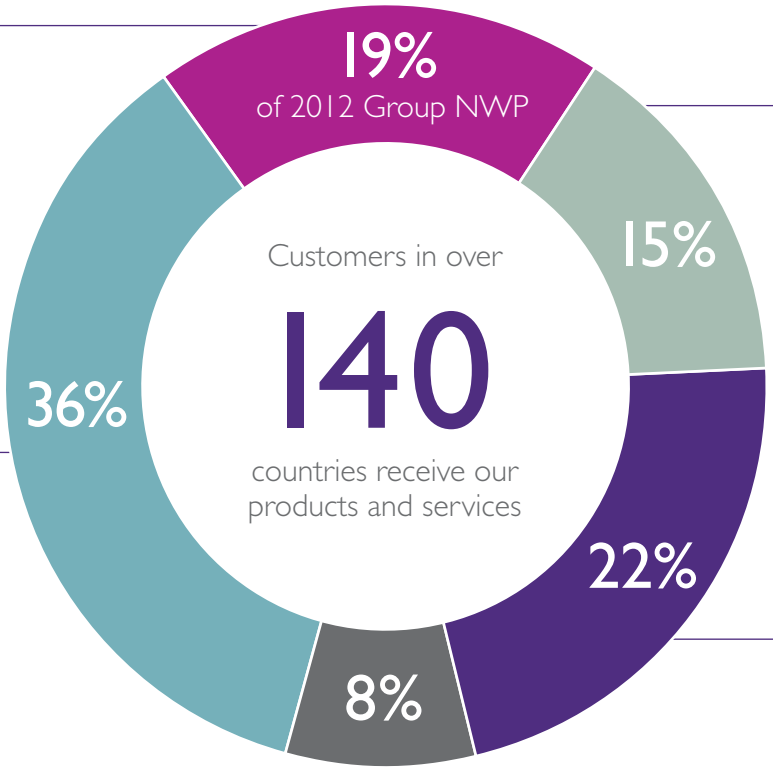
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MORE TH>N

WESTERN EUROPE

RSA

123.ie



EMERGING MARKETS

AL AHLIA

AL ALAMIYA

LINK4

ANSWER

LIETUVOS DRAUDIMAS

SCANDINAVIA

TRYGG HANSA

CODAN

CANADA

68% PERSONAL 32% COMMERCIAL (% OF NWP)

- We distribute products through intermediaries under the RSA brand. Our Direct offering is Johnson
- Through our affiliated broker network, Noraxis, we operate as one of the largest brokers in Canada
- In October 2012, we completed the acquisition of L'Union Canadienne, the third largest intermediated Motor and Property insurer in Quebec.

SCANDINAVIA

54% PERSONAL 46% COMMERCIAL

- We operate as Codan in Denmark and Norway and as Trygg-Hansa in Sweden
- We have a multi-channel distribution model, selling our products through call centres, intermediaries and affinity partners.

UK

44% PERSONAL 56% COMMERCIAL

- In the UK, we are a leading Commercial insurer and a top 5 Personal lines insurer
- In the Commercial market we operate as RSA through intermediaries and in Personal we operate through intermediaries, affinity partners as well as MORE TH>N and eChoice in the direct market.

WESTERN EUROPE

54% PERSONAL 46% COMMERCIAL

- In Ireland, we operate as RSA through intermediaries and as 123.ie in the Direct market
- Our Italian operation is purely intermediated, operating as RSA through brokers and non-tied agents
- We have RSA branded Specialty operations in Belgium, France, Germany, the Netherlands, Spain and Italy.

EMERGING MARKETS

43% PERSONAL 57% COMMERCIAL

- Our main focus is on Motor, Affinity, Large and Complex risks, Small and Medium Enterprises (SME), and Marine
- In Latin America, we operate as RSA in Argentina, Brazil, Chile, Columbia, Mexico, and Uruguay
- In Central and Eastern Europe, we operate as Lietuvos Draudimas in Lithuania, as Balta in Latvia, as RSA in Estonia, Link4 in Poland, and as InTouch in Russia
- In Asia and the Middle East we operate as RSA in China, Hong Kong, Singapore, UAE and Bahrain and we operate as Al Alamiya in Saudi Arabia and as Al Ahlia in Oman.

WHAT WE DO

We protect people and businesses against the risks they face in their daily lives. Our global network provides Property, Casualty, Motor and Household insurance in over 140 countries worldwide

RECRUIT AND RETAIN CUSTOMERS

Our business starts with our customers. Across the world we employ a wide range of distribution strategies tailored to meet the needs of local markets. Many of our markets are dominated by insurance brokers with whom we have built long term relationships based on trust and transparency. We have also developed direct distribution businesses where customers purchase policies over the phone, or increasingly online. We trade through distribution partnerships with retailers, employers and other affinity groups across the world.

Many of our customers have been with us for a long time. Whilst most of our products are short term by their nature, we want our relationship with our customers to develop over many years. We aim to delight our customers with our service to them and ensure that they have every reason to renew their policy each year. Our track record is excellent with customer retention a little under 80% every year for the last five years.

We have consistently retained close to

80%

of our business over the last five years

PRICE RISK AND SET PREMIUMS

We are experts in the pricing of risk. Across the world our underwriters develop a deep understanding of the risks that our customers want to insure with us.

These risks range from a pet insurance policy in the UK all the way to a wind farm in South America. With this understanding, we seek to offer an attractive price to the customer, competitive in the market but which ensures that we can deliver returns to our shareholders.

We reserve prudently, ensuring that we retain reserves which will comfortably cover the likely costs of claims from a policy. This means we are able to release reserves from time to time. This has delivered a consistent track record of positive prior year development into our profits. We expect this to be a consistent feature of our profits in years to come.

Current year/prior year results (£m)

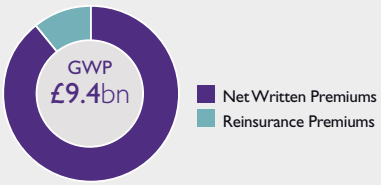


MANAGE RISK TO ALIGN WITH OUR RISK APPETITE

Our business is about understanding risk. Inherent within this understanding is the knowledge of those risks which are outside our appetite. When this is the case for insurance risk we seek to manage risk through our selective use of reinsurance. In 2012, we passed £1bn of premiums to reinsurers ensuring that our shareholders are not overly exposed to any single area of insurance risk. Over the years this prudent approach has had material benefits for shareholders and has meant that, despite natural disasters and extreme weather in the locations in which we operate, we have been able to maintain a consistent underwriting margin.

We take a similarly conservative approach to other risks within our business. We have completed various Group-wide assessments and rolled out activities to strengthen our operations and manage operational risk. On credit, market and liquidity risk, we continue to proactively manage our business to include factors such as the challenging economic climate. On regulatory risk, our active engagement with regulators and our close monitoring of regulatory requirements has helped safeguard our business.

2012 Reinsurance Premiums



PAY CLAIMS

Our customers rely on us to be there for them when they need to make a claim. Across all of our businesses we take customer service, especially in paying claims, very seriously.

Our response to the two earthquakes in the Emilia-Romagna region of Italy in May was focused on our customers and intermediaries. Within 24 hours, we had appointed loss adjusters to some of the largest and most important property claims, and set up a dedicated claims handling team. On the largest claim we faced, we made an interim payment of €1m within 45 days so that our customer could recommence production. We were the first insurer to pay a claim of this magnitude in the area.

The UK suffered serious flooding in June and July. During these floods we mobilised our Emergency Response Vehicle ensuring that local communities had access to claims handlers "on the ground" and that we could personally visit over 90% of flooded properties within a few days of the flood. This helped our customers return to a normal life as quickly as possible and also helped manage our claims spend.

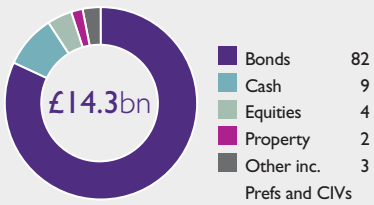


INVEST PRUDENTLY

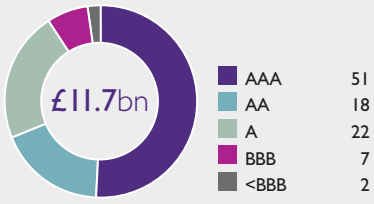
The delay between receiving premiums and paying claims means that we have a stock of assets which we can invest. We take a very prudent approach to our investment management, seeking to deliver a predictable level of investment income with minimal volatility. We do not seek to invest in high risk or illiquid assets which could restrict our ability to pay claims.

Our £14.3bn asset portfolio (including cash) is invested in a broad range of predominantly sovereign debt and high quality corporate bonds. We keep a portion of our portfolio in cash and have minimal exposure to equities and property. In 2012 this portfolio yielded investment returns of £515m.

Investment portfolio (%)



Bond portfolio – Credit quality (%)

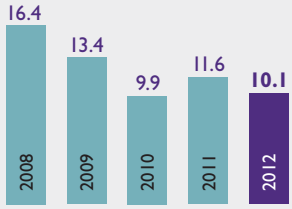


DELIVER SHAREHOLDER VALUE

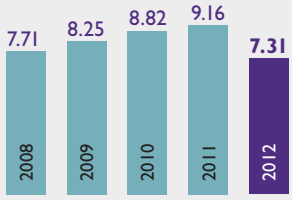
Our aim is to maintain a strong balance sheet, retaining sufficient capital to protect stakeholders from all but the most extreme shocks.

We aim to reward shareholders by delivering returns on equity consistently above our cost of equity and through the payment of a sustainable dividend.

Underlying return on average equity (%)



Dividend for the year (p)





Renewable Energy – Wind

We are one of the world's leading insurers of wind farms. We have more than 30 years' experience in finding insurance solutions for our customers in this sector. With an extensive track record of insuring wind energy projects at every stage of development, from construction through to operation, we are one of the few insurers to offer both onshore and offshore cover. Indeed, today we insure manufacturers of more than 25% of the world's wind turbines and are involved in the insurance of 80% of the world's off-shore wind farms.

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CHAIRMAN'S STATEMENT

Good performance in a continued challenging economic and market environment



"Our financial performance, our culture and the quality of our people means we are well positioned for success"

Martin Scicluna, Chairman

I am delighted to have been appointed as Chairman of RSA, a business which remains true to its purpose and committed to the principles its founders established three centuries ago.

Today, as a global business operating in 32 countries around the world, we continue to offer our customers the protection they need to grow their businesses and lead their lives.

We reported good growth and financial performance in both our mature markets and our higher-growth emerging markets.

Financial highlights for 2012 included:

- NWP growth of 5% at constant exchange;
- A combined operating ratio of 95.4%;
- An investment result of £431m;
- Underlying return on equity of 10.1%.

These results have been achieved in a tough trading environment.

Regulators remain very active but we continue to require greater recognition from them that the insurance sector in general, and non-life insurance in particular, continues to be well managed. Mature conversations about the best way to support the industry and the individuals and companies who rely on us are essential to our long-term success.

There are legitimate concerns over corporate behaviour but these need a measured response from regulators. Meanwhile the continuing delays in Europe in the implementation of Solvency II are a particular source of frustration to our business.

Appropriate regulation and controls are important, but they come at a cost, which ultimately falls on the consumer and we need it to be both appropriate and proportionate.

Western economies continue to struggle with slow economic growth and ongoing austerity measures. In these times, the need for effective risk management by individuals and companies is as great as ever, creating ongoing opportunities for insurers like RSA.

In the east and across many emerging markets there has been moderation of economic growth forecasts. Nonetheless, the attractiveness of these areas remains because of low insurance penetration levels, growing numbers of middle class families and continuing GDP growth.

Quantitative easing programmes across the globe continue to artificially depress bond yields creating downward pressure on insurers' investment income. We are planning for a period of prolonged low interest rates. We will nevertheless continue to pursue our high quality, low risk investment strategy.

Net written premium growth

5% (at constant exchange)

Finally, this year's poor weather in the UK has again thrown into sharp relief the unpredictable nature of the climate. The UK suffered its second-wettest year since records began, and there were also natural disasters such as the earthquakes in Italy.

I have been very impressed by the response of RSA employees on the front line whenever and wherever our customers have needed their support. A determination to help people recover from trauma and business interruptions runs through our operations. All insurers must prove their value by managing risk in good times but above all by the nature and speed of their response in difficult times. The effectiveness of our claims process demonstrates our commitment to the individuals, businesses and communities we protect.

This striving for excellence is one part of how we demonstrate our corporate and social responsibility. While passion for this is in everything we do, we also undertake specific work to underline our commitment, much of which is detailed later in this report

Notwithstanding the challenges that exist, we see significant opportunities for RSA. We are already a long way into the process of reshaping our portfolio in the UK and remediation in Italy which we expect to deliver tangible results in 2013. We have excellent market positions in Canada, Scandinavia and Ireland which will continue to perform in 2013. In addition, we are faced with a wealth of opportunities to deliver growth in premiums and earnings from our Emerging Markets businesses.

Looking ahead, our financial performance, our culture and the quality of our people means we are well positioned for further success.

As stewards of the Group's 300-year history we need the right strategy to continue building on our firm foundations. It is focused on achieving market-leading profitability in our mature markets, investing in those parts of the world which offer the best growth opportunities, leveraging our global specialty capabilities and showing sound judgement in capital allocation. I'm confident that by delivering this strategy we are assured of continued financial success and will be in a strong position when global growth returns.

The team responsible for delivering the Group strategy has seen some changes during the last year. My predecessor as chairman, John Napier, stepped down on 31 December 2012 after a decade in office. RSA was transformed during this time and I would like to pay particular tribute to John for all he did to help achieve this. The Company is significantly stronger because of his efforts.

Simon Lee has served an excellent first full year as Group Chief Executive, and in this has been supported by the welcome arrival of Richard Houghton as Group Chief Financial Officer. In addition, Hugh Mitchell has joined the Board as a Non-Executive Director.

Following the last Annual General Meeting, revisions were made to the Board committee structure: Alastair Barbour became Chairman of the Group Audit Committee; the Group Investment Committee was re-constituted to consist of Malcolm Le May, who continues as Chairman, Alastair Barbour, Simon Lee and Richard Houghton; and Hugh Mitchell became Chairman of the Group Remuneration Committee. Since my appointment I have joined the Board Risk Committee, the Group Investment Committee and the Group Nomination Committee, which I also chair.

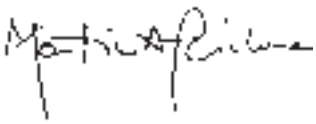


We continue to perform well in our Global Engagement Survey – which 93% of staff completed this year. We are now in the 93rd percentile for large companies which is considered world-class.

I have been struck by the focus of the senior leadership team, but also by the commitment of staff across the Group and their dedication in making a real difference to our customers. I believe we should draw confidence from our performance as well as from our plans, ambition and talent.

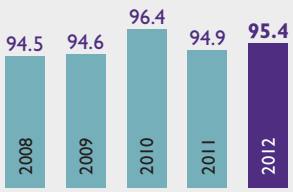
The decision to recommend rebasing our dividend means more of the capital we generate can be employed to pursue growth opportunities in the medium term while still rewarding our shareholders. It is in the best interests of both the Company and shareholders and will help us achieve the targets we have set. We expect to be recommending a similar change in the interim dividend.

RSA is well placed to continue its progress and we look forward to the year ahead with a sense of shared purpose.

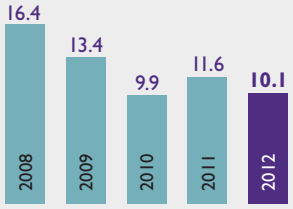


Martin Scicluna
Chairman

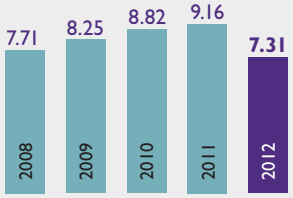
Combined operating ratio (%)



Underlying return on average equity (%)



Dividend for the year (p)



GROUP CHIEF EXECUTIVE'S REVIEW

Another strong performance in 2012 as we position the Group for the next stage of its journey



"I'm looking forward to the opportunities ahead of us. We will take the Company from strength to strength"

Simon Lee, Group Chief Executive

The 2012 results showed solid underlying organic growth, supplemented by well-executed acquisitions. We delivered healthy premium growth of 5% on a constant exchange rate basis and our profits reflect good contributions from Scandinavia and Canada, improving trends in the UK & Western Europe and strong profit from Emerging Markets as operational leverage emerges.

We continue to successfully execute our strategy to grow premiums, improve underwriting profitability and focus our capital on those parts of our business which offer the highest growth and returns. As we do so, I have been encouraged by the response of our people, and by the leadership shown by my executive team.

We have excellent market positions in many parts of the world. We are doing exactly what is necessary to position ourselves for the next stage of our journey, as we build on our growth ambitions overseas and our long-term success story in our mature markets.

The Board has taken the decision to recommend rebasing the dividend, reflecting the expectation of a prolonged low bond yield environment and greater opportunities to develop and grow the business outside the UK. The proposal is to reduce dividend payments by 33% in 2013, therefore we anticipate recommending a similar change to the interim dividend. This is the correct and prudent long-term decision for the business and will enable the Group to realise its medium-term growth opportunities.

2012 RESULTS

In 2012, net written premiums rose by 5% to £8.4bn, and the underwriting result was unchanged at £375m. The combined operating ratio was 95.4% (2011: 94.9%). The investment result was down 11%.

This gave us an overall insurance result of £806m (2011: £860m), including significant contributions from all our business regions but, in particular, our mature markets outside the UK as well as many of our emerging markets.

The operating result was down 6% to £684m and profit before tax was £479m (2011: £613m). The proposed dividend for the year is 7.31p.

Our financial position includes a regulatory capital surplus of £1.2bn, which represents coverage of 1.9 times. Net asset value per share was 101p.

SUCCESSES AND OPPORTUNITIES

We have seen sustained growth in both our Emerging Markets and Global Specialty Lines businesses. In addition to delivering strong organic growth, the year saw the successful acquisition of L'Union Canadienne in Quebec, as well as acquisitions in Argentina of El Comercio and Aseguradora de Créditos y Garantías.

We have also taken action to exit or rationalise those markets where our performance has fallen short of expectations. During the year we closed our business in the Czech Republic and announced the sale of our business in the Dutch Caribbean.

The reshaping of our UK business and the remediation of our Italian business are on track, but more remains to be done. The plans we have in place are the right ones and we will be pushing hard to deliver on these and ensure all parts of the business make the contribution they should to our overall performance.

All regions have worked hard to put the customer at the heart of everything we do. The Think!Customer programme in Scandinavia has had noted success and we are ensuring relevant lessons are learned across the organisation.

We continue to pay considerable attention to our corporate behaviour and our wider responsibilities to the individuals, businesses and communities we work with. Two examples are the projects we have undertaken to help draw attention to environmental degradation, asking RSA staff worldwide to propose plans to help us reduce our carbon footprint, and taking the creators of the best ideas to see for themselves the impact deforestation is having on the Brazilian rainforests. And in the UK, our 'Fit to Drive' campaign is pressing the government to do more to ensure drivers are safe on the road through more regular eye tests.

Looking ahead, I am confident about what we can achieve and how we can ensure the business continues to thrive.



OUR STRATEGY

I am confident in our ability to deliver sustained outperformance in our local markets and generate continued profitable growth. We have built a diversified general insurance business with strong technical capabilities, a track record of delivering operational efficiencies and a justified reputation for the quality of our people. We have a strong, experienced management team which provides continuity and determination to build on our track record of success.

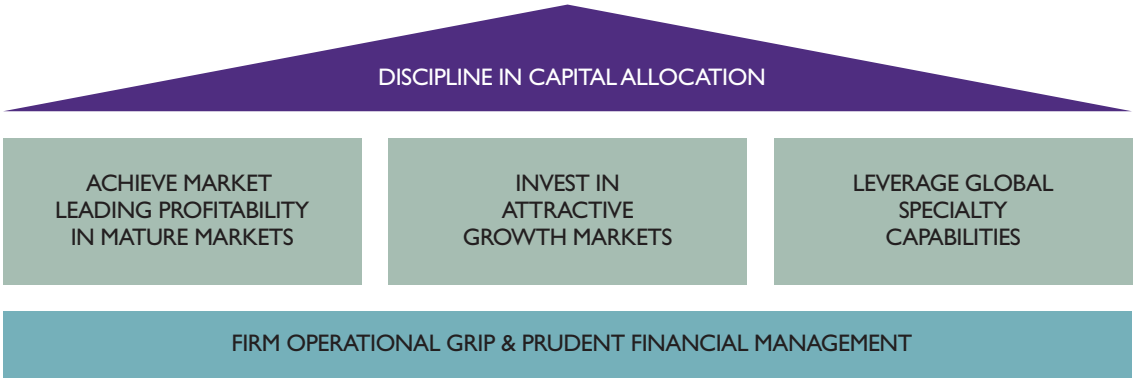
The strategy to deliver this is five-fold:

- Firm operational grip and prudent financial management;
- Achieve market leading profitability in mature markets;
- Invest in attractive growth markets;
- Leverage our global specialty capabilities;
- Be disciplined about capital allocation.

FIRM OPERATIONAL GRIP AND PRUDENT FINANCIAL MANAGEMENT

We will remain a pure-play general insurer with a well diversified portfolio of businesses. We will persist with our rigorous focus on underwriting discipline. We will keep our conservative approach to reinsurance and reserving. We will stick with our high quality, low risk investment strategy. We will continue to deliver a sustainable underwriting profit, the ultimate measure of an insurer's success in delivering on its core purpose.

Our strategy



GROUP CHIEF EXECUTIVE'S REVIEW CONTINUED

ACHIEVE MARKET LEADING PROFITABILITY IN MATURE MARKETS

RSA has leading positions in large, mature, sophisticated markets. We have strong positions in the attractive markets of Canada and Scandinavia. These businesses have driven the profitability of the Group and we will continue to defend the strong positions they currently enjoy. At the same time we will continue to search for further opportunities for profitable growth, as we have done in Quebec with the acquisition of L'Union Canadienne. In Ireland, we have a great business which has significantly outperformed its competition over a number of years and in 2012 became the country's leading insurer.

In the UK, we have leading positions in both Personal and Commercial lines. The UK is an extremely competitive trading environment which brings real advantages to the Group in terms of technical expertise, pricing sophistication and channel innovation. We continue to make good progress on refocusing this business and improving its operational efficiency to improve cash earnings and extract capital. Our Italian business has been underperforming and we have taken action to return it to break even during 2013.

INVEST IN ATTRACTIVE GROWTH MARKETS

We have an exciting franchise in our Emerging Markets business, with strong positions in a number of Latin American markets, and focused businesses in Central and Eastern Europe, the Middle East and Asia. Strong GDP growth and increasing insurance penetration mean these markets will continue to do well and profitability will continue to increase as the businesses grow and development costs become a smaller fraction of the overall earnings profile. We will carry on investing in these attractive markets to strengthen and broaden our position and deliver further profitable growth for the Group. As we reshape this portfolio, our investment decisions will be governed by strict criteria:

- Can we achieve meaningful scale, either through a leading position in a large market, or a leading region-wide position?



- Can we differentiate ourselves, either through a strong niche positioning or through leveraging capabilities from across RSA?
- Can we generate cash and earn in excess of our cost of capital?

LEVERAGE OUR GLOBAL SPECIALTY CAPABILITIES

One of the main sources of competitive advantage for RSA is our strong technical capability, particularly in specialty lines. Over the years we have recruited high quality technical specialists and have invested in 'best-in-class' training and development. We have a reputation for disciplined, high quality underwriting and claims management.

We already have strong positions in Marine, Renewable Energy, Construction & Engineering and Risk Managed business. We will continue to build on these strengths, deploying them across our global network to write profitable business, while acquiring and developing new technical capabilities.

BE DISCIPLINED ABOUT CAPITAL ALLOCATION

Finally, we will be disciplined about capital allocation. Acquisitions have been a key part of the way we have built the Group over the past few years, underpinned by strong financial disciplines as we evaluate deals, and strong post-transaction review discipline to ensure the operational targets for each deal are subsequently met and all lessons learned. This has been borne out by the success of deals such as 123.ie in Ireland and GCAN in Canada.

We have also used our internal Economic Capital model for a number of years as a key complement to traditional regulatory measures of solvency and financial strength and have also been using it to measure the return on capital allocated for each business. We will be increasingly using it in the future as a core element of our Group and business strategy process to test investment and portfolio management decisions and to evaluate business performance. As previously, where I see underperforming businesses or lines of business with no viable routes to outperformance we will take decisive action.

OUTLOOK AND FINANCIAL TARGETS

We are excited by the prospects for the business. We expect to continue to see good growth in net written premiums in many parts of the business. In Emerging Markets we see opportunities to grow our franchises in Latin America, Asia, the Middle East and Central and Eastern Europe both organically and inorganically. Through organic growth, we expect to increase the size of our Emerging Markets business, including our associates, by 2015 to £2.2bn of net written premiums, creating operational leverage which we expect to deliver an improving expense ratio with a consequent improvement in the combined ratio.

In Canada, we expect to see further market consolidation which will allow us to grow market share and strengthen our position within the top three insurers. We aim to grow the business both organically and through selective bolt on acquisitions. We expect our Scandinavian businesses to grow in line with local economic growth. We expect Canadian and Scandinavian combined ratios to continue around current levels over the medium term.

In the UK, we expect underlying premium growth in our chosen segments to be broadly offset by reductions in less profitable business lines. This will lead to improving combined ratios in the UK over the next three years. Italy is on track to be at break even during 2013 and Ireland will continue to grow premiums and underwriting profit.

We will continue to see the effect of falling investment yields on investment income and expect to deliver around £470m of investment income in 2013.

Overall we expect to achieve a combined ratio of better than 95% in 2013 and return on equity of 10%-12%.

RSA'S PEOPLE

One of our core strengths remains our people. Staff engagement and effective recruitment, retention and reward strategies will remain critical to our future success.

Effective leadership is crucial to driving operational efficiency and, in this, I am grateful for the support I receive from both the RSA Board of Directors and the Group Executive.

On 31 December 2012 John Napier stepped down as Group Chairman. During his decade-long tenure the business has successfully retrenched and then become stronger, more focused and more confident. Our performance during his time in office reflects the impact he has had. I would like to take this opportunity to offer my personal thanks and best wishes to John for the future.

In January 2013, we welcomed Martin Scicluna as our new chairman. Martin brings a wealth of experience and I am greatly looking forward to working with him, as we take the business forward.

During 2012 Richard Houghton took up his position as Group Chief Financial Officer while I further strengthened my executive team with the appointment of Caroline Ramsay as Group Chief Auditor.

When added together, our businesses create a compelling story for investors in RSA. I'm confident in our growth prospects. The actions we are taking will continue to grow premiums and drive improvements in the combined ratio which, together, will lead to good earnings growth. I'm looking forward to the opportunities ahead of us. We will take the Company from strength to strength.



Simon Lee
Group Chief Executive

FINANCIAL REVIEW

The Group delivered a solid financial result whilst maintaining its robust capital positions



"I am confident that we can deliver continued premium growth together with improving underwriting profitability"

Richard Houghton,
Group Chief Financial Officer

RESULTS OVERVIEW

In 2012, the Group delivered a solid performance in challenging conditions. Despite the continuation of historically low investment yields, adverse UK weather and the two earthquakes in Italy in May, we delivered premium growth of 5% at constant exchange, an underwriting result of £375m, a COR of 95.4% and underlying return on average equity of 10.1%.

NET WRITTEN PREMIUMS

Net written premiums were up by 5% at constant exchange to £8.4bn (3% as reported). Rate on renewals has added 4 points as we continued to take action across the Group. Volumes were flat, with planned reductions in UK Personal Motor and Italy offsetting growth in Emerging Markets and Canada. Our acquisitions in Argentina and Canada during 2012 added 1 point, accounting for £43m and £38m of NWP respectively. Foreign exchange accounted for 2 points of adverse variance driven by the strengthening of Sterling against a number of currencies.

OPERATING RESULT

The operating result of £684m (2011: £727m) was down 6% primarily due to reduced investment income driven by lower yields. The result was also impacted by adverse weather in the UK and Italian earthquakes in the first half.

Underwriting result

The underwriting result was £375m (2011: £375m). The current year underwriting result was a profit of £184m (2011: £146m) and the prior year result was a profit of £191m (2011: £229m). The combined operating ratio of 95.4% was 0.5 points higher than last year (2011: 94.9%).

The loss ratio (a measure of the value of claims as a proportion of premiums) is 0.4 points lower, driven by an improved underlying position. The commission ratio is 0.8 points higher than 2011 due to a change in business mix as affinity growth outpaces our direct channels in several regions. The expense ratio of 15.7% is marginally higher than the prior year.

The current year result again benefited from continued rate and management actions of around £200m, which is ahead of claims inflation, of around £150m. Large losses represented around 7 points of the loss ratio, in line with the prior year, and included the Italian earthquake losses in the first half. Weather accounted for around 2 points of the loss ratio, broadly in line with 2011 including the UK floods and severe winter weather in the first half.

In Scandinavia the underwriting profit was £237m (2011: 264m) driven by strong current year profits together with continued positive prior year development. The Canadian underwriting profit was £98m (2011: £116m) including a specific strengthening of prior year reserves in Personal Motor. In Emerging Markets, the underwriting result was £33m (2011: £3m) driven by a strong performance in our Latin America and Asia, Middle East businesses and an improved result in Central and Eastern Europe. In UK & Western Europe the underwriting result was £12m (2011: £1m) with a UK result of £39m, strongly supported by our Irish business. In Italy we continue to make progress and expect to be at break even by the end of 2013.

The prior year result of £191m reflected positive prior year development in all regions and across all years. In terms of accident year, 2011 has shown initial favourable development of £7m, which primarily comprises positive development in Scandinavian Personal Accident, Canada and UK Commercial Property. The earlier years continue to develop positively, with contributions from Scandinavian Personal and Commercial, Canada, UK Commercial Property and UK Liability.

The culture, methodologies and governance around the reserving process drive a prudent reserving policy and reserves remain significantly to the right side of best estimate. Historically, the prior year profit has been a consistent and high quality part of the result. Going forward, we expect positive prior year development to be a permanent and significant feature of the underwriting result.

FINANCIAL HIGHLIGHTS (MANAGEMENT BASIS)

£m	2012	2011	2010	2009	2008
Net written premiums	8,353	8,138	7,455	6,737	6,462
Underwriting result	375	375	238	386	384
Investment result	431	485	475	495	562
Insurance result	806	**860**	**713**	**881**	**946**
Other operating activities	(122)	(133)	(135)	(132)	(111)
Operating result*	684	**727**	**578**	**749**	**835**
Other items	(205)	(114)	(104)	(195)	(76)
Profit before tax	479	**613**	**474**	**554**	**759**
Tax	(128)	(186)	(119)	(135)	(173)
Profit after tax	351	**427**	**355**	**419**	**586**
Combined operating ratio (%)	95.4	94.9	96.4	94.6	94.5
Shareholders' funds (£m)	3,750	3,801	3,766	3,491	3,839

* In 2012 the consolidated management income statement was restated to exclude realised and unrealised gains from the operating result. These are now included in Other movements. All years shown above have been restated on this basis.

Investment result

The investment result, which now excludes realised and unrealised gains, was £431m and comprised investment income of £515m offset by the discount unwind of £84m.

Investment income of £515m was down by 11% as our fixed income investments continue to mature and are reinvested at lower yields. On a like-for-like basis, the reduction is about 7% after adjusting for last year's one-off property income of around £25m. The average underlying book yield on the fixed income portfolio was 3.6% compared to 3.9% during 2011. Reinvestment rates in the Group's main bond portfolios at 31 December 2012 were around 150bps lower than the underlying portfolio yield.

We continue to work hard to mitigate the impact of falling yields. In 2013, investment income is currently expected to be around £470m, which represents a decline of just under 9%, reflecting the ongoing variance between maturing and reinvestment yields.

Other operating activities

Other operating activities of £122m were 8% lower than last year and included central costs, investment expenses and the ongoing investment in our associate in India and our direct operations in Central and Eastern Europe.

Other items

Other items which included gains, interest, reorganisation costs, amortisation and Solvency II costs were £205m (2011: £114m) driven by lower gains, partly offset by lower amortisation costs.

Total gains in 2012 of £28m (2011: £157m) mainly comprise gains on equities as we continue to manage the portfolio towards higher yielding blue chip names. As anticipated in the 2011 results, we restated the consolidated management income statement in 2012 to exclude total gains from the operating result to provide greater transparency and predictability.

Interest costs of £115m were in line with the previous year (2011: £117m), while Solvency II costs were £32m (2011: £30m) and we would expect a lower charge in 2013 as we manage our activity in light of recent delays to the implementation date for Solvency II. Amortisation costs were £42m (2011: £114m) reflecting the non-repeat of goodwill write-downs in 2011 in UK Commercial and in Central and Eastern Europe. Reorganisation costs were £24m (2011: nil) and related mainly to the closure of our Czech Direct operation and the restructuring of our Group Corporate Centre where we reduced headcount by around one third.

Acquisition costs were £20m (2011: £10m) and include the integration costs for our 2012 acquisitions in Canada and Argentina.

Tax

The tax charge was £128m and represents an effective rate of 27%.

Profit after tax

Profit after tax was down by 18% to £351m and the underlying return on average equity was 10.1% (2011: 11.6%), with the movement on 2011 predominantly reflecting the lower investment result.

BALANCE SHEET

The total value of the investment portfolio (including cash) is £14.3bn and was broadly unchanged over the year. Of the total investment portfolio, 91% remains invested in high quality fixed income and cash assets.

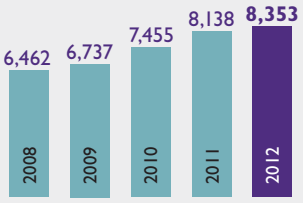
The fixed interest portfolio is concentrated on high quality short dated assets, with 98% of the bond portfolio investment grade, and 69% rated AA or above. The bond holdings are well diversified, with 75% invested in currencies other than Sterling, and 64% invested in non government bonds (31 December 2011: 60%).

During 2011 we reduced our exposure to equities and they comprised 5% of the portfolio at the start of 2012 (down from 9% at the start of 2011). At the end of 2012 our exposure to equities was 4%. We have increased the average duration of the bond portfolio across the Group from 3.4 years at the start of 2012 to 3.8 years to take advantage of opportunities on the yield curve and better match our liabilities.

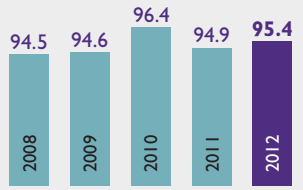
Finally, our exposure to peripheral Europe remains minimal. We hold peripheral government bonds of £121m, these represent less than 1% of the total portfolio, mainly backing the liabilities of our businesses in Ireland and Italy.

FINANCIAL REVIEW
CONTINUED

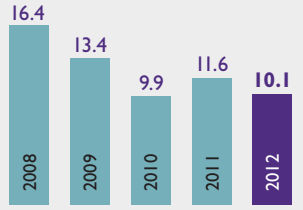
Net written premiums (£m)



Combined operating ratio (%)



Underlying return on average equity (%)



In 2013, we will continue to follow our high quality, low risk strategy. Given current portfolio disposition and market levels further increases in bond duration and non government bond holdings are likely to be modest. We will, however, continue to seek opportunities to enhance yield within our low risk framework and would anticipate income of around £470m in 2013. We expect the fall in investment income to be less severe in subsequent years.

CAPITAL POSITION

The Group has again maintained a strong and resilient capital position. Shareholders' funds are £3,750m, marginally down from the start of the year, with profits after tax offset by the increase in the pension deficit, dividends paid and foreign exchange movements. Net asset value per share was 101p (2011: 104p). If we were to add back the dividends which we have paid to shareholders in the year, then net asset value per share would have increased by 5%.

On regulatory capital, our IGD surplus remains very strong at £1.2bn and coverage of 1.9 times the requirement.

Our Economic Capital surplus remains strong. When calibrated to a probability of insolvency over one year consistent with the expected Solvency II calibration of 1 in 200 years, our ECA surplus was £1.2bn (31 December 2011: £1.2bn). When calibrated to Standard & Poor's long-term A rated bond default curve, equivalent to a probability of insolvency over one year of 1 in 1,250, our ECA surplus was £0.7bn at 31 December 2012 (31 December 2011: £0.8bn).

The movement in the year of the latter measure reflects the decline in risk free yields and the impact of goodwill from acquisitions which have been largely offset by capital generated, the impact of the proposed new dividend policy and improved modelling of our assets in run off.

SOLVENCY II

On Solvency II, we continue to make good progress and remain at the forefront of progress towards internal model approval. It now appears likely that Solvency II implementation will be further delayed until at least 2016. This is both frustrating and potentially costly to the industry as a whole. We have adjusted our work programme accordingly.

RATING AGENCIES

S&P and Moody's Investor Service provide insurance financial strength ratings for the Group and its principal subsidiaries. We remain at our target credit rating level and the Group is rated A2 stable outlook by Moody's and A+ negative outlook by S&P.

PENSION FUND

The pension deficit of £207m deteriorated by £67m over the year.

The UK pension fund position has deteriorated by £46m since 31 December 2011 to a deficit of £111m. This is driven by an increase in the pension inflation rate partially offset by an increase in the discount rate and greater than expected return on assets.

The overseas pension deficit has deteriorated by £21m over the same period to a deficit of £96m principally due to a fall in the discount rate on the Canadian pension scheme reflecting the AA corporate bond yield in Canada.

INVESTMENT RESULT

	2012	2011	Movement %
Bonds	403	446	(10)
Equities	57	63	(10)
Cash and cash equivalents	15	15	–
Land and buildings	28	37	(24)
Other	12	18	(33)
Investment income	515	**579**	(11)
Unwind of discount	(84)	(94)	11
Investment result	431	**485**	(11)

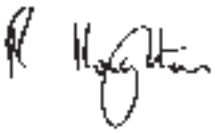
2012 DIVIDEND

The Board will recommend at the Annual General Meeting to be held on 15 May 2013, that a final ordinary dividend of 3.90p (2011: 5.82p) per share be paid representing a decrease of 33%. The Board anticipates recommending a similar change to the interim dividend in 2013.

The final dividend, together with the interim dividend of 3.41p (2011: 3.34p) paid on 23 November 2012, will make the total distribution for the year 7.31p (2010: 9.16p).

SUMMARY

Despite the challenging macro-economic environment and some natural losses from weather and earthquakes, 2012 was a good year for the Group. We are in a robust financial position and well placed to execute our strategy. Market conditions are expected to again be difficult in 2013, with investment yields remaining at historical lows and subdued economic growth in some of our markets. Despite this, the Group expects to deliver good premium growth, a COR of better than 95%, investment income of around £470m and return on equity of 10-12%.



Richard Houghton
Group Chief Financial Officer

Economic capital surplus (1/200 basis)

£1.2bn

Regulatory capital surplus

£1.2bn

1.9 x requirement

Credit ratings*

S&P	Moody's
A+	A2
(negative)	(stable)

*Group and principal subsidiaries

SCANDINAVIA

We are the third largest insurer in Denmark and Sweden, with a growing presence in Norway



"Scandinavia continues to contribute strongly to the Group's result. We have seen excellent underwriting profitability in 2012"

Mike Holliday-Williams,
Chief Executive, Scandinavia

STRATEGY

Our Scandinavian business has been a key driver of the Group's profitability in recent years. Going forward, we expect to continue to deliver a strong underwriting result. We will protect our leading positions in areas such as Motor, Personal Accident and Renewable Energy while improving profitability in Denmark and Norway. Scandinavia also plans to fully capitalise on the opportunities in Specialty and with global brokers that arise from being the only scale player in the region with a global presence.

Reflecting this, the strategic priorities set by the management team include:

- Increase growth in each of our businesses and strengthen profitability, with a particular focus on Care, Personal Accident and Specialty;
- Improve the customer experience. Driving improvements to our processes and communication will enable us to retain our existing customers and improve our customer proposition to target new ones;
- Improve operational efficiency. We are investing in new policy administration and claims systems and online capabilities that will make it easier for customers to deal with us. This will also allow us to simplify the business and further optimise our expense base;
- Invest in our people. We will measure and improve our overall people engagement. We will also invest in leadership and technical training for our people.

2012 OVERVIEW

In 2012 our Scandinavian businesses performed very strongly. Net written premium grew by 3% at constant exchange (down 2% as reported) despite a tough economic environment. Once again we delivered a strong underwriting result of £237m driven by a very strong current year performance in all countries, and an overall COR of 86.6%.

SWEDEN

Our Swedish business continues to deliver a strong result with 3% growth at constant exchange (flat as reported). At the same time we managed to improve our already strong current year underwriting result by 5%. These results are driven by our Personal lines products – Motor & Personal Accident, but we are also seeing a significant improvement within our Commercial lines products – particularly in Liability.

DENMARK

In Denmark our main focus has been on profitability, and we improved the underwriting result in both Personal and Commercial lines with the overall Danish business delivering an underwriting profit of £75m in 2012 compared to a loss of £11m in 2011. This was driven mainly by our Commercial Motor and Liability products, with our Personal Motor and Household products also delivering strongly. Premiums in Denmark were down 2% at constant exchange (8% decline as reported), driven mainly by our focus on profitability in Commercial lines.

NORWAY

In Norway, once again, we saw double digit growth with premiums up 23% at constant exchange (up 19% as reported). This was driven by 39% growth in our Commercial lines business, with Personal lines delivering double digit growth of 11%. Our underwriting result in Norway improved from a loss of £15m in 2011 to a profit of £5m in 2012.

MARKET CONDITIONS

Throughout 2012 trading conditions remained challenging in Scandinavia – especially in Denmark and Sweden. However, the Scandinavian insurance market remains stable and attractive.

We are focused on profitability and cost reduction, and are continuing to deliver strong profitability and with good top line momentum in our target growth areas.

CUSTOMER

We are committed to embedding our Think!Customer strategy and a customer mindset in all parts of the business.

A key focus of our strategy is to understand the customer's needs and requirements and adapt our service and propositions to meet their expectations. We have refreshed the content of customer letters, our online sales flow has been improved, and the phone systems in our call centres have been updated to improve our customers' experience. Another example of our customer focus is the alignment of the Corporate Responsibility agenda with claims prevention activities such as free SMS alerts about extreme weather and have formed strategic partnerships with the providers of security alarms and drainage contractors.

We are seeing positive results in our customer surveys as well as improved retention rates.

PEOPLE

Staff engagement is important to the success of our business. In 2012, we continued to invest in a wide range of technical, leadership and change management training for our staff and we have had great involvement in activities such as 'customer' and 'health' weeks.

Our staff engagement survey showed a significant improvement again this year, and the Scandinavian business now has a very strong engagement score.

Our Think!Customer strategy is also about focusing on people. We have implemented activities such as a company site on LinkedIn, recruitment videos and improved introduction programmes to ensure we recruit and retain people with a real customer mindset.

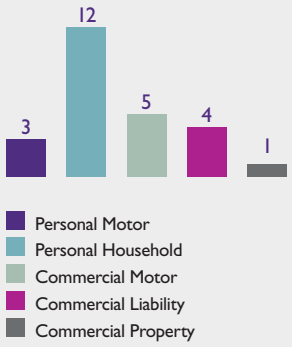
2013 OUTLOOK

The Scandinavian economies are heavily dependent on exports and are therefore suffering from weak international economic performance. However, relatively stable labour markets in Scandinavian countries are sustaining domestic demand.

In 2013, real GDP growth is expected to remain positive but at a low level in Denmark and Sweden while high oil prices and strong domestic demand in Norway will more than offset the international slowdown and the strong Norwegian Kroner.

Despite this environment, we are confident that we will deliver our strategy together with strong underwriting profitability in 2013.

Rate movement* (%)

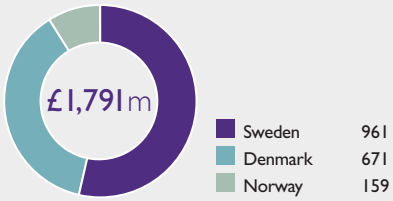


* Movement in renewal rate for December 2012 v December 2011

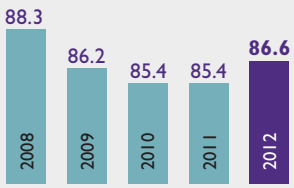
Net written premium growth

3% (at constant exchange)

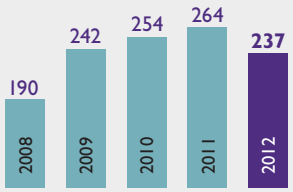
2012 net written premiums (£m)



Combined operating ratio (%)



Underwriting result (£m)



HIGHLIGHTS

- Total NWP growth of 3% at constant exchange (down 2% as reported) to £1,791m
- Personal lines growth of 3% at constant exchange (down 1% as reported), driven by Household, Personal Accident and Danish Motor
- Commercial Lines NWP growth of 2% at constant exchange (down 3% as reported) driven by Renewable Energy, Marine and Norway
- An excellent underwriting result of £237m and COR of 86.6%.

CANADA

We are Canada's third largest general insurer, and with our latest acquisition, L'Union Canadienne, the insurer with the broadest national Personal and Commercial proposition



"This was another solid year for Canada, strengthening our number three position in the market with topline growth of 8%"

Rowan Saunders,
Chief Executive, Canada

STRATEGY

In Canada, our strategy is to deliver sustainable, profitable growth:

- Maintaining leading positions in segments where we have strong technical knowledge and expertise;
- Extracting value from strategic acquisitions that provide us with scale in desirable geographic and specialty markets;
- Delivering differentiated propositions and targeted solutions to our broker partners and customers; and
- Fostering world-class broker relationships.

2012 OVERVIEW

In 2012, our Canadian business continued to perform strongly through a combination of acquisitions and organic growth despite challenging market conditions.

Net written premiums grew by 8% at constant exchange (9% as reported) to £1,614m, driven by strong organic growth, particularly within Commercial lines, and acquisitions, most notably L'Union Canadienne in the province of Quebec. The underwriting result was a robust £98m (2011: £116m) and the COR was 93.7% (2011: 91.6%) despite another year of above average severe weather, and the specific strengthening of prior year reserves in Personal Motor.

Through a series of acquisitions in recent years, our Canadian business is now positioned as the insurer with the broadest national Personal and Commercial proposition in Canada.

Commercial lines

Net written premiums grew by 11% (at both reported and constant exchange) to £524m as we continue to extract value from the GCAN acquisition, with significant new business growth within the Large Commercial & Specialty division, specifically property, despite continued soft market conditions.

New business growth in Ontario and Western regions also added to the year's result, as did solid retention across Motor and our Equipment Breakdown offering.

We continue to see positive results from our small-business e-trading platform launched in 2011, with robust new business growth and significantly improved response times for our broker partners.

In terms of underwriting result, Commercial lines delivered another strong performance with an underwriting profit of £55m (2011: £42m) and a COR of 88.2% (2011: 89.8%) driven primarily by Large Commercial & Specialty.

Personal lines

Net written premiums grew 7% at constant exchange (8% as reported) to £1,090m driven by strong growth across both Johnson and Personal Broker. Personal lines delivered a COR of 96.1% (2011: 92.3%) and an underwriting result of £43m (2011: £74m), including the identification and resolution of adverse development in bodily injury and accident benefits reserves in the pre-reform Johnson Ontario motor book.

Personal Broker

Premiums grew by 9% at constant exchange (10% as reported), largely driven by our expansion into Quebec and growth in the Ontario and Western regions of our property portfolio.

In June we announced the acquisition of L'Union Canadienne, a Quebec-based intermediated insurer mainly focused on Personal lines. This moved us from the eleventh to the fifth largest insurer in that province. Quebec is the second largest private insurance market in Canada, and the most profitable, with a stable regulatory environment and opportunities for future growth. The acquisition closed on 1 October, and integration is progressing according to plan.

Our Personal Specialty Insurance (PSI) offering had strong contributions from each of its Auto, Travel and Credit Card portfolios. We expect to launch a Pet offering to the Canadian marketplace in 2013, which positions us well for future growth.

Johnson

Growth of 5% at constant exchange (6% as reported) to £587m, was due largely to strong performances in the Atlantic and Western regions, the completion of two acquisitions, and the addition of 23 new affinity partners during the year.

MARKET CONDITIONS

Canada continues to weather the global economic downturn well relative to other parts of the world, with GDP growth, while low, remaining in positive territory. The Canadian dollar maintained its strong performance against major currencies, and employment rates are stable.

CUSTOMER

We saw excellent growth with global brokers in 2012, and the launch of our recognition programme for top national brokers has gained traction in securing volume. At Johnson, we continue to make strategic investments to influence our customer and eBusiness strategies, building on an already exceptional customer service platform.

PEOPLE

We maintained our status as a top quartile engagement employer in the Canadian marketplace, and Johnson was recognised as a Top 100 Employer in Canada for the fourth consecutive year.

TECHNICAL EXCELLENCE

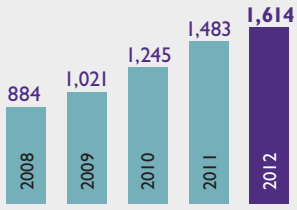
In 2012, we launched the Canadian Technical Academy to ensure we have consistent technical capabilities across the business to sustain profitable growth.

We continue to leverage our technical expertise across Large Commercial & Specialty to deliver targeted segment-specific solutions to our clients.

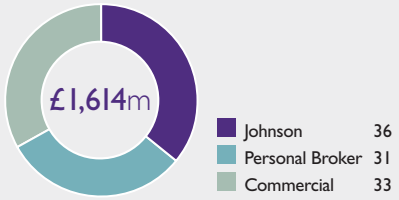
OUTLOOK

2012 was another strong year for us in Canada. With the completion of L'Union Canadienne we solidified our position as the third largest insurer in Canada and diversified our geographic footprint. Successfully integrating and driving value from this acquisition will be a priority in 2013, as is fully leveraging the competitive advantage of our multi-channel distribution strategy. We are confident of delivering another year of strong growth and sustained profitability in 2013.

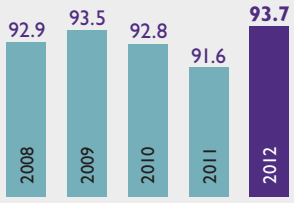
Net written premiums (£m)



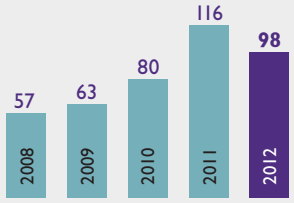
2012 net written premiums (%)



Combined operating ratio (%)



Underwriting result (£m)



HIGHLIGHTS

- Strengthened our position as third largest insurer in Canada
- NWP growth of 8% to £1.6bn at constant exchange (9% as reported)
- Commercial lines NWP growth of 11% (at both reported and constant exchange) as we continued to extract value from our GCAN acquisition in 2011
- Johnson growth of 5% at constant exchange (6% as reported) with 23 new affinity partners and two acquisitions
- Personal Broker NWP growth of 9% at constant exchange (10% as reported) driven by Household
- Underwriting result of £98m and COR of 93.7%
- Acquisition of L'Union Canadienne in Quebec.

UK AND WESTERN EUROPE

We are one of the UK's largest Commercial and Personal lines insurers, and the largest insurer in Ireland



"We have made good progress in 2012, growing strongly in areas where we can achieve sustained profitability. As we continue to take action to remediate key portfolios we expect to deliver improved profit"

Adrian Brown,
Chief Executive, UK and Western Europe

STRATEGY

UK

We have made good progress in 2012, targeting profitable growth and withdrawing from areas where we cannot achieve adequate returns.

The focus of the business is to maximise the contribution we make to the Group result, improving underwriting profitability by concentrating on those areas where we have strategic advantage, including Home, Pet, Marine and Risk Managed. UK Motor contributes less than 5% of Group premiums, and we have reduced the number of segments we operate in.

In Commercial lines, the strategy is to convert our leading market share into sustained underwriting profitability. We have a carefully selective approach to broker distribution, terminating 200 broker relationships during 2012 and focusing on our most valuable relationships, building long-term partnerships with key brokers through superior service.

Western Europe

In Ireland, our aim is to maintain and strengthen our market-leading position while outperforming our peers, and we continue to create excellent value from our leading direct insurer, 123.ie, which we purchased in 2010.

In Italy, remediation is ongoing, with the management team taking the right actions to achieve our strategic goals.

2012 OVERVIEW

UK & Western Europe net written premiums increased 1% at constant exchange to £3.7bn (flat as reported), driven by growth in UK Commercial and all UK Personal lines excluding Motor, where the decision was taken to reduce the top line to preserve profit.

The underwriting profit of £12m (2011: £1m) reflected effective management actions and the impact of adverse weather in the UK, Superstorm Sandy and the Italian earthquakes. Weather in the UK was £68m worse than 2011 with 2012 being the second wettest year on record in the UK.

UK Commercial

Net written premiums rose by 6% to £1.7bn, with strong growth of 9% in Marine offset by targeted reductions in areas where we could not achieve the right levels of profitability. Growth of 5% in Motor reflects the phasing of a large three year contract and excluding this contract, premiums reduced by 12% with exits underway in Risk Solutions Motor, Motor Trade and the sale of Fyfe, a specialist motor trade intermediary business, which will further reduce premiums in 2013.

The underwriting loss of £31m (2011: profit of £2m) marked a deterioration from 2011 reflecting factors such as the impact of Superstorm Sandy, weather and large marine losses, including Costa Concordia, with soft market conditions also continuing. The COR of 100.4% (2011: 98.7%) was affected by Commercial Motor and, particularly, losses from the old tranches of one large three year contract. These old tranches will continue to act as a drag on the business for the next few years.

UK Personal

The impact of delivering against our strategy is evident, with premiums shrinking by 3% to £1.3bn due to a deliberate reduction in our Motor top line partly offset by growth in Home and Pet.

Growth of 18% in Pet to £233m was driven by a strong performance with our affinity partners including the commencement of new contracts with Home Retail Group and John Lewis. Tesco annual growth continues at 3% with an agreement to extend the contract to 2019.

We achieved growth of 3% in Household, driven by the 2011 acquisition of Oak Underwriting and continued success with our affinity partners.

In Motor there is much uncertainty and we continue to take action to protect our underwriting result. Execution on our strategy for sustainable profit has delivered a 19% reduction in net written premiums, in specific segments we have reduced capacity where target returns cannot be secured, for example, Motorcycle. These actions led to an improved COR of 99.9% (2011: 100.7%).

Despite the impact of poor weather, UK Personal had an excellent underwriting result of £70m (2011: £60m) and a COR of 95.6% (2011: 95.7%), led by Household.

European Specialty Lines

In European Specialty Lines premiums were up by 11% at constant exchange (4% as reported) driven by strong growth in Spain.

Italy

We have had a challenging time in Italy with difficult market conditions. As we have focused on remediation we have reduced net written premiums by 18% to £200m at constant exchange (down 23% as reported), with targeted reductions in Motor and cancellation of contracts with underperforming agents. An underwriting loss of £51m was an improvement on 2011 (£63m), and was achieved despite the two earthquakes in May and severe weather. We expect to break even during 2013.

Ireland

We are now Ireland's largest general insurer, with net written premiums growing by 5% to £348m at constant exchange (down 1% as reported) driven by a strong performance from 123.ie and wins in Commercial. This compares to a 6% contraction in market premiums in 2012. With an underwriting result of £25m (2011: £24m) and a COR of 94.2% (2011: 92.6%), we outperformed the market in terms of growth and profitability.

MARKET CONDITIONS

The UK, Italy and Ireland are some of the Group's most competitive markets, with significant economic pressures on consumers and a tough business environment. Price comparison sites grew in Pet, Home and Motor in the UK, with new entrants during 2012. Commercial lines and Motor are challenging across the markets with the soft pricing environment continuing.

CUSTOMER

Our customers are at the heart of everything we do, and with one of the wettest years on record in the UK, they have relied on us more than ever. Over 36,000 weather claims were received in 2012. In the aftermath of a number of floods, we deployed our Emergency Response Vehicle providing support for our customers and the local community on occasions when they needed us most. Where the circumstances were appropriate, innovative drying techniques were deployed enabling our customers to move back into their homes only 20 days after the flood waters receded.

PEOPLE

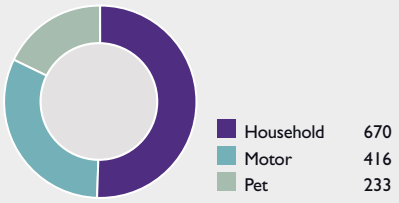
In 2012 we featured in the Sunday Times 'Best Big Companies to Work For' list, ranked at number six. We have continued to focus on employee engagement by prioritising investment in three main areas: recognition; learning and development; and contributing to the communities in which our people work.

OUTLOOK

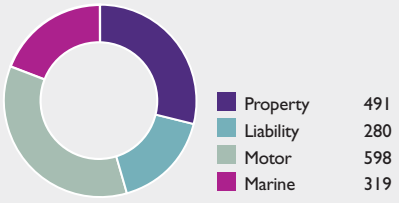
During 2012 we have taken strong management actions to remediate portfolios which are underperforming. We have focused on the areas we said we would, delivering an improvement to the underlying result. Growth has been achieved in those areas where we believe we can achieve sustained profitability.

The market will remain very competitive throughout 2013. We believe that building on the actions taken in 2012 and the improvement to our underlying result we will be well placed to deliver greater levels of profitability across the UK and Western Europe region in the future and we are confident about our prospects.

UK Personal NWP (£m)



UK Commercial NWP (£m)



UK combined operating ratio

98.2%

Ireland net premium growth

5% (at constant exchange)

Ireland combined operating ratio

94.2%

UK HIGHLIGHTS

- Net written premiums up 2%
- Underwriting profit of £39m (2011: £62m)
- Maintained expense ratio of around 14%
- Ranked six in 2012 Sunday Times 'Best Big Companies to Work For'.

Customer

- Motability team awarded winners of North West Contact Centre of the year
- MORE TH>N named as Pet insurance provider of the year for 3rd year running.

Commercial

- Net written premiums grew 6% to £1.7bn
- Underwriting loss of £31m, good performance in Marine, offset by Commercial Motor and Liability
- COR of 100.4% (2011: 98.7%).

Personal

- Net written premiums reduced by 3% due to actions to achieve profit over volume in Personal Motor
- Growth in strategic areas; 3% in Household and 18% in Pet
- Underwriting profit of £70m (2011: £60m)
- COR of 95.6% (2011: 95.7%) despite weather costs which were £49m worse than 2011.

IRELAND

- NWP growth of 5% at constant exchange due to 123.ie and Commercial lines
- Underwriting profit of £25m (2011: £24m)
- Excellent COR of 94.2% (2011: 92.6%) despite challenging economic conditions
- Number 1 position secured with market-leading position strengthened.

ITALY

- Taking the right action to remediate the business
- NWP decline of 18% at constant exchange as we reduce exposure in Personal Motor
- Underwriting loss of £51m
- Excluding the impact of two earthquakes in May, losses were significantly reduced in 2012 and we expect to breakeven during 2013.

EMERGING MARKETS

Emerging Markets operates across 20 countries in Latin America, Asia, the Middle East and Central and Eastern Europe



"Emerging Markets has delivered excellent top line growth and our underwriting result continues to improve as we achieve scale. We remain confident of achieving our net written premium target of £2.2bn by 2015"

Paul Whittaker,
Chief Executive, Emerging Markets

STRATEGY

We remain committed to delivering organic growth, an improved underwriting result and an increase in return on capital.

We have strong strategic positions (top five) in a number of markets and look to achieve scale in others through bolt on acquisitions. We also aim to achieve organic growth and improved underwriting results through the development of differentiated business models or scale in niche market segments.

We are committed to a significant reduction in the expense ratio driven by strong growth in written premiums and restricted growth in expenses. We will also pursue tactical expense reduction programmes particularly in high expense ratio businesses.

Our strategy continues to focus on Affinity, Specialty, Motor, Marine and Small and Medium Enterprises (SME). In each of these areas we develop solutions which can be replicated across our regions effectively and efficiently.

In 2012 we have taken further actions to implement our strategy.

Our growth ambitions in Asia and our focus on reducing management overheads have led us to reorganise our Asia Middle East region. As from January 2013 Asia will be a separate region and will include our associates in India and Thailand while the Middle East will be integrated into our Central and Eastern Europe region.

In July 2012 we completed the acquisition of El Comercio and ACG in Argentina, making RSA the sixth largest P&C insurer in the country. We have signed 31 new affinity deals in 2012 and we continue to invest in talent in our focus areas.

We are redeploying capital with the sale of our subsidiary in the Dutch Caribbean and our withdrawal from the Czech market.

2012 OVERVIEW

In 2011, we set our target for Emerging Markets premium to double to around £2.2bn by the end of 2015 and we remain on track to achieve this.

Net written premiums were up by 17% to £1,237m at constant exchange (12% as reported) and including our associates in India and Thailand total premiums were £1,540m.

Throughout the year we have continued to maintain underwriting discipline despite intense competition. Where necessary we have taken strong pricing action to achieve our target returns and we have maintained a tight grip on expenses. Our underwriting result of £33m (2011: £3m) reflects a strong performance in all three regions and an improvement in our expense ratio of 1.2%. The COR of 96.9% (2011: 98.7%) reflects the improved underwriting result.

Latin America

Premiums were up by 20% to £766m at constant exchange (14% as reported), with double digit growth in four countries. Argentina grew particularly strongly with premiums up by 79% aided by the acquisition of El Comercio and ACG in July 2012 as well as underlying growth of 36%.

Central and Eastern Europe

Premiums were up by 9% to £224m at constant exchange (2% as reported). Growth continued in the Baltics during 2012 and our Direct businesses in Poland and Russia once again delivered strong top line growth of 13% at constant exchange (5% as reported).

Asia and the Middle East

Premiums were up 14% to £247m at constant exchange (15% as reported) driven by strong performance in Oman and Specialty with growth of 23% and 15% respectively, at constant exchange.

Our Indian associate premiums were up 10% at constant exchange to £153m (down 3% as reported) and our Thailand associate grew 13% to £150m at constant exchange (12% as reported) driven by Motor.

MARKET CONDITIONS

In 2012, market conditions remained positive in most of the countries in which we operate, although the global economic downturn had greater impact as the year progressed. In Latin America, unemployment rates continue to improve on historic lows and consumer demand continued to increase in each of our markets although we saw a slow down in Brazil in the second half of the year. Across Asia and the Middle East economies enjoyed healthy growth. GDP grew across the Baltics and unemployment levels stabilised.

CUSTOMER

In 2012 we ran customer engagement surveys across Emerging Markets. We are using the results of these surveys to continue to enhance our differentiated service propositions based on being 'Easy to Deal With'. We are already seeing improvements in many of our businesses in customer retention and satisfaction.

PEOPLE

Talented and engaged people are the key to our success. We were recognised in Gallup's database of companies as achieving world class engagement in 2012. We also received a number of external awards including 'Great Place to Work' awards in Latin America (Chile (14th), Colombia (5th), Brazil (44th) and LATAM (14th)), our Lithuanian business received 7th place in 'Best Employer Award 2012' in Central and Eastern Europe and Mexico achieved a Top Companies award (14th place).

We continue to invest in people and to provide exciting opportunities for people to work and gain experience across a diverse region.

We remain committed to international mobility to give our developing talent the opportunity to gain experience in other markets and support the accelerated deployment of capability from developed markets. This can take the form of short-term secondments as well as longer-term transfers. We currently have 18 staff assignments outside of their home country across Emerging Markets.

This focus on talent development helps provide a strong pipeline of leadership talent and I'm pleased to say that 14 of our 20 business CEO's have been promoted from previous roles within the Group.

TECHNICAL EXCELLENCE

We have continued our focus on increasing sophistication in our underwriting and pricing processes. We have improved our underwriting tools for Personal and Commercial lines and also increased the number and capability of our pricing resources.

On claims, we have benefited from procurement initiatives, claims file reviews and salvage processes. Investment in technical training continued with senior underwriters participating in advanced technical training programmes and underwriting networks with their counterparts from across the RSA Group.

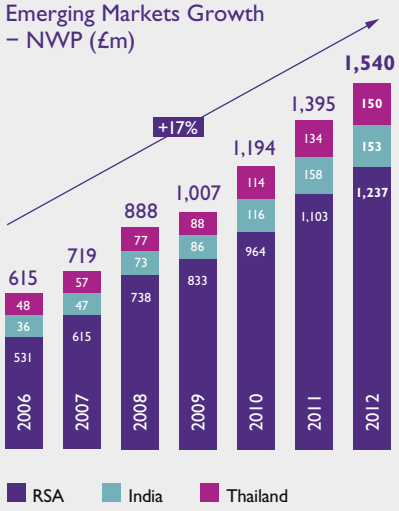
OUTLOOK

Emerging Markets offers huge growth potential for the Group. We are confident that we will achieve increased scale in the markets we operate in through in-market acquisitions, affinity distribution deals and improved customer experience.

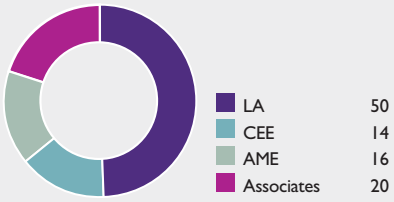
We will also grow profitably as we see the benefits of operating leverage and the results of our expense reduction programmes flow through to the operating result.

We will continue to invest in our chosen markets and remain committed to achieving our net written premium target of around £2.2bn by the end of 2015.

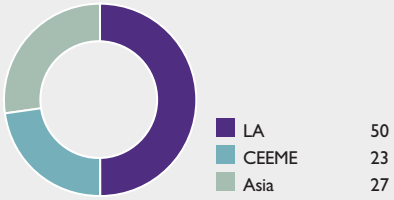
Emerging Markets Growth – NWP (£m)



Existing Reporting Structure NWP (%)



New Reporting Structure NWP (%)



HIGHLIGHTS

- NWP growth of 17% at constant exchange (12% as reported) in 2012
- On track for £2.2bn NWP by the end of 2015
- Won 31 new Affinity deals in 2012.

Latin America

- Latin America NWP growth of 20% at constant exchange
- Argentina, Brazil, Mexico and Uruguay all delivered double digit growth at constant exchange.

Asia and the Middle East

- Asia Middle East grew by 14% at constant exchange
- Oman grew 23% at constant exchange and is the number one P&C insurer in the market
- Delivered strong NWP growth in our Singapore Specialty hub
- India and Thailand grew at 10% and 13% respectively at constant exchange with continued growth in the Motor market.

Central and Eastern Europe

- Central and Eastern Europe grew by 9% at constant exchange as a result of double digit growth in Estonia, Poland and Russia
- We have maintained our market leading position in the Baltics.

RISK REVIEW

Our business success is underpinned by our strong risk management

RISK MANAGEMENT

We manage risk to minimise losses and take opportunities to invest appropriately in profitable growth.

We operate under a common framework through which risk management and control is embedded throughout the Group.

The Board is responsible for the Group's Risk Management System and for defining the Group's risk appetite.

Executive management is responsible for implementing systems and controls that manage our risk exposures in line with our risk appetite. Each Group business is required to follow a consistent process to identify, measure, manage, monitor and report its risks.

The Board Risk Committee ensures that material risks are identified and that appropriate arrangements are in place to manage and mitigate those risks effectively in line with risk appetite.

GROUP RISK APPETITE

The Group risk appetite is set and monitored at a Group, regional and business level, is reviewed annually, approved by the Board Risk Committee and signed off at the Group Board. It sets business volumes for certain higher risk insurance classes, stipulates loss retention limits, reinsurance protection, targets for credit rating and solvency margins.

RISK FRAMEWORK

The Group operates a 'three lines of defence' model for the oversight and management of risk as follows:

1st line – Management

- Delivering the business plan within risk appetite
- Accountable for implementing and using the Risk Management System
- Embedding an appropriate risk culture.

2nd line – Risk oversight

- Development and maintenance of a Risk Management System within which the Group policies and minimum standards are set
- Oversight and challenge across the Group.

3rd line – Independent assurance

- 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.

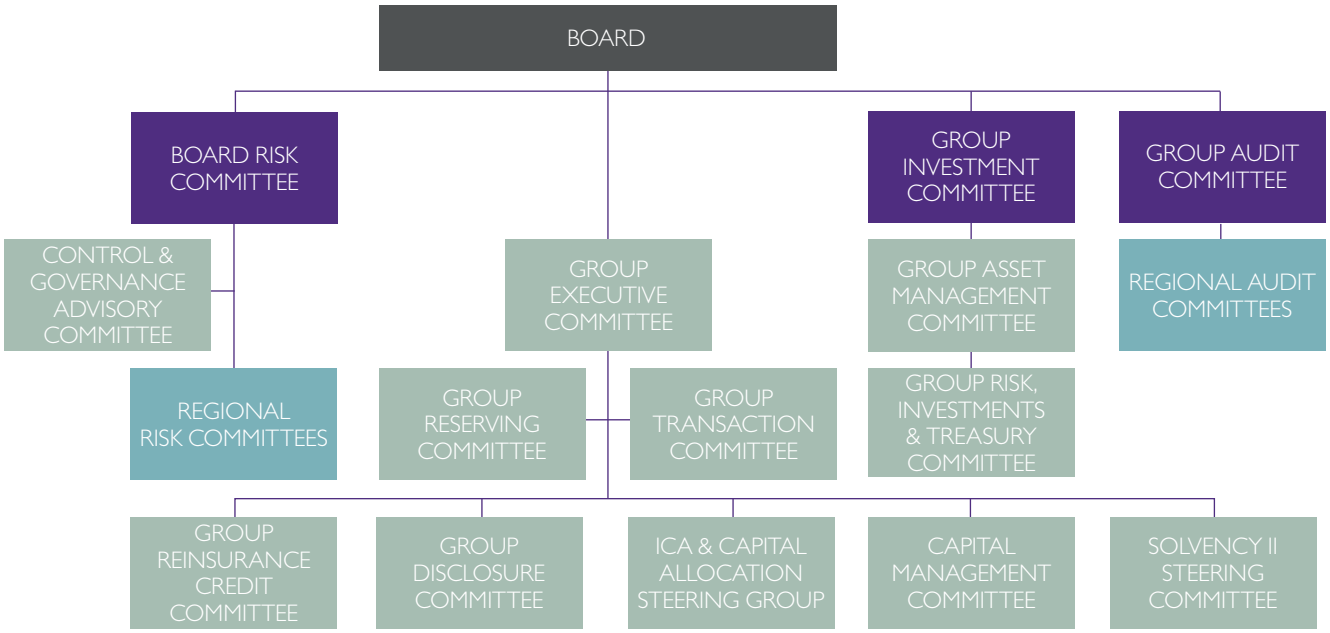
GROUP RISK POLICY STATEMENTS

Our policy statements set out the minimum standards to be maintained by the Group's operations to manage their risks in a way that is consistent with the risk appetite.

RISK CATEGORIES

Risks are viewed under categories that broadly correspond to those used in the Financial Services Authority's Prudential Sourcebook for Insurers (INSPRU) and Senior Management Arrangements, Systems and Controls (SYSC). Additional information is provided in the Risk Management section on page 92. Some of the key current practices and tools for each risk category are set out overleaf alongside our risks and uncertainties.

Governance structure – the principal committees are shown below



PRINCIPLES

Simple objectives	• Create value for all stakeholders • Focus on general insurance in our selected markets • Commitment to sustainable, profitable performance
Clear risk appetite	• Underwriting and operating excellence • Strong control environment • Tight financial management • Protecting and managing the Group's reputation
Robust governance, control and reporting	• Comprehensive policies, procedures and controls • Clear delegation of authorities • Robust lines of defence • Regular and relevant reporting and assurance processes
Strong culture	• Board set 'tone from the top' of open communication and engagement • Putting the customer at the centre of what we do • High quality and engaged staff

2012 UPDATE

During the year we have maintained our focus on risk management, strengthening and developing our processes, controls and capabilities across the Group through the following activities:

Organisation and Culture

- Establishment of sub Risk Committees, strengthening our 1st Line ownership of risk management principles and practices and further supporting our Regional Risk Committees and Board Risk Committee
- Risk management in the Group strengthened by the appointment of a Group Chief Risk Officer to the Executive Committee
- Continued to promote risk informed decision making, with more explicit consideration of risk and reward
- A continued evolution of our Risk Management System to ensure compliance with Solvency II regulatory environment.

Systems & Process

- Continued development of the validation process across the Group, to provide assurance of the results, design and workings of the Internal Model and the adequate reflection of the Group's risk profile
- Extended Stress and Scenario Testing programme across all EEA legal entities, enabling the Group to identify potential risks and their impact, calibrate risk appetite, help to validate the Internal Model
- Delivery of an Emerging Risk profile to the Board Risk Committee that included key themes such as:
  - Eurozone Crisis
  - Slow down of global growth engines
  - Changing attitudes of regulators to harmonisation of financial services regulation.

People

- We shared the strength of our risk experts around the business to develop excellence across the Group
- We continue to invest in our people, in particular continuing to strengthen our capabilities for insurance and financial risk management through training, recruitment and transfer of skilled staff.

RISK REVIEW CONTINUED

RISK CATEGORIES

Risks	Primary activities	Key tools for managing
INSURANCE RISK Our insurance risk strategy has enabled us to continue delivering strong insurance results through our diversified portfolio.	• **Pricing, acceptance and management of risks arising from our contracts with customers** • **Claims management and reserving** • **Exposure and accumulation management.**	• Portfolio classification that tracks trends and performance of individual insurance portfolios • Regional and Group Reserving Committees held to determine a recommended level of outstanding claims and aggregate outstanding claims reserves • Scenario modelling that is appropriate for the size and complexity of our portfolios • Investigation of potential emerging insurance risks.
REINSURANCE RISK Our reinsurance buying and management expertise has allowed us to manage our insurance exposure and losses such as those arising from natural catastrophes during 2011 and 2012.	• **Reinsurance strategy and appetite recommended to the Board by the Board Risk Committee** • **Purchase of the worldwide programme of global and local treaties** • **Reinsurance counterparty management.**	• Group Reinsurance policy aligned with strategy and appetite • Various modelling tools used to determine retention strategies and analyse the effectiveness of major treaty purchases • Monitoring and control of the Group's reinsurance activity • Monitoring of the reinsurance markets • Reinsurance counterparties approved by the Group Reinsurance Credit Committee.
OPERATIONAL RISK We have completed various Group-wide assessments to strengthen our operations.	• **Effective and reliable operation of processes** • **Business continuity and disaster recovery** • **Information security management** • **Monitoring and control to prevent fraud and human error.**	• Risk and control self assessments • Key risk indicators to assess and manage operational risk • Scenario analyses to assess operational events that have occurred elsewhere and potential exposure to the Group • Incident management, near misses and loss reporting.
CREDIT, MARKET & LIQUIDITY RISK We continue to proactively manage our financial risks during the challenging economic climate.	• **Investment strategy and portfolio management** • **Risk analysis using a range of techniques** • **Treasury activities such as Group liquidity and hedge effectiveness** • **Scenario and Stress Testing** • **Group Financial risk policies aligned with strategy and appetite** • **Counterparty credit assessments.**	• Controls to ensure that exposure is managed within risk appetite • Monitoring of exposure against limits set out in the investment limits framework • Portfolio analytics • Requirements to maintain a minimum level of cash or highly liquid assets • Committees overseeing the Group's investment strategy and risk limits.
REGULATORY RISK Responding to demanding and more intrusive regulatory environment across the Group to ensure compliance and safeguard our business.	• **Ensuring compliance in all geographical locations, with diverse regulatory requirements** • **Response to regulatory changes** • **Continued preparations for the implementation of Solvency II.**	• Active engagement with regulators • Close monitoring of regulatory requirements • Compliance framework with consistent monitoring methodology • Monthly reporting of significant regulatory developments and mitigation of emerging risks.

PRINCIPAL UNCERTAINTIES

Risks	Potential impact	Mitigation
PROLONGED ECONOMIC DOWNTURN	• Impact on investment portfolio and investment income due to lower interest rates and market volatility • Insufficient capital generation.	• Action taken to mitigate falling yields include increasing holdings in non government bonds, property exposures and bond duration • Retain focus on high quality, low risk investment strategy • Asset Liability Matching and cash flow management • Delivery of key operational plans • Internal and external dividend policy.
RATING ENVIRONMENT	• Inability to charge adequate rates places downward pressure on operating results.	• Diversified portfolio • Each portfolio has a rate plan which is regularly reviewed • Focus on underwriting and profitable growth • Actively shift capacity to where we see the best returns • Continue to invest in technical skills, sales and marketing capabilities.
ADVERSE LOSS EXPERIENCE	• Catastrophic losses arising from insurance events • Increasing frequency and severity of large losses • Deterioration in long tail reserves.	• Underwriting strategy set to ensure risks written are well diversified and within risk appetite • Regular portfolio reviews to monitor underwriting performance • Emerging trends in large losses, frequency and severity are investigated and corrective action taken • Reinsurance programmes limit net losses • Conservative reserving policy ensuring that claims reserves will be more likely than not to result in positive prior year development • Exposure and accumulation management tools to monitor and control exposures in higher risk areas.
INSURANCE RISKS OUTSIDE GROUP'S RISK APPETITE	• Adverse impact on operating results due to increased volatility.	• The Group operates under a clear risk appetite set by the Board which is monitored at Group and regional level • Underwriters are licensed only to write risks within specified limits based on their own experience • Reviews assess each portfolio against key performance and risk indicators. Portfolios that trigger key risk indicators are investigated. Corrective measures are implemented where required • Diversified portfolio providing exposure to markets at different levels of development and insurance cycle • Maintain focus on underwriting discipline and targeted profitable growth.

CORPORATE RESPONSIBILITY

We are committed to managing our business in a responsible and ethical manner

Our Corporate Responsibility (CR) strategy is increasingly important to our customers, our employees, investors and regulators. It is a core part of how we operate, with 'Doing the Right Thing' an intrinsic part of our values. We strive always to conduct our business with integrity and in a fair, transparent manner, adhering to ethical standards and responding appropriately to our stakeholders' needs.

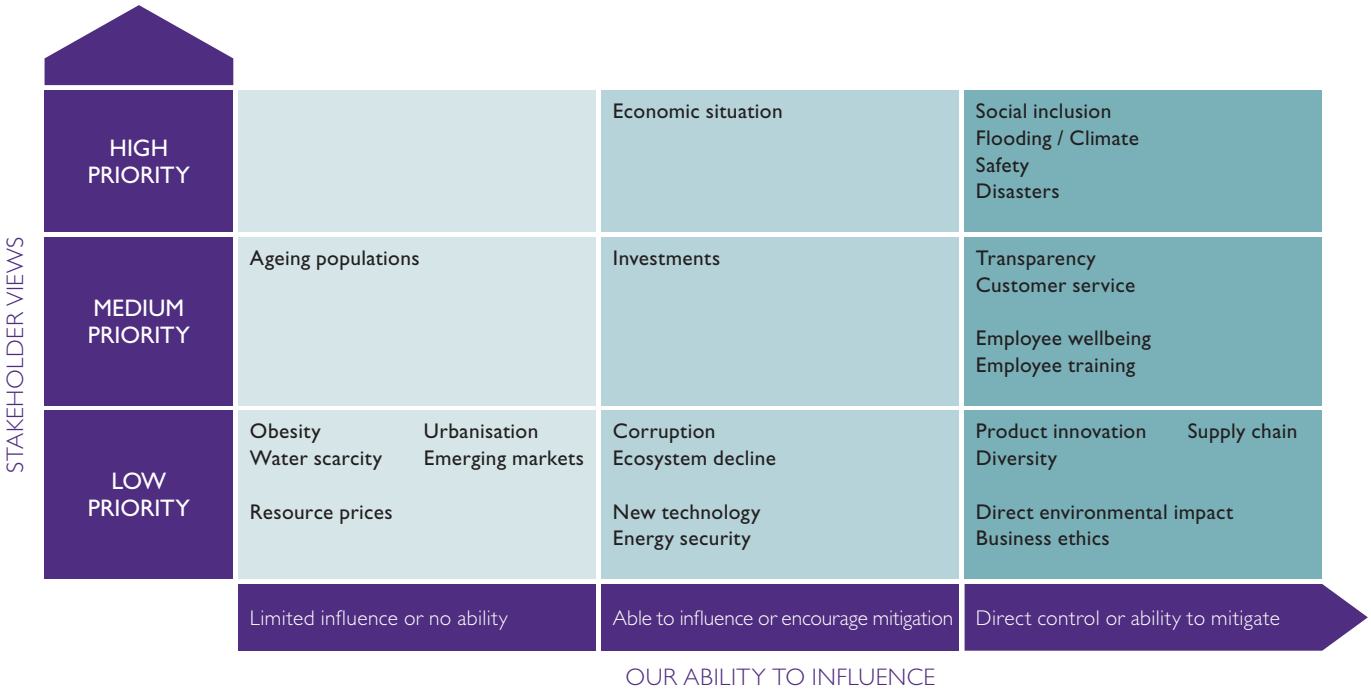
Our CR programme is designed to address the environmental, social and governance issues considered most relevant to our industry. During its first seven years it has supported the sustainable growth of our business, engaged our employees, minimised our environmental impacts and made a positive contribution to the communities in which we operate. The programme has been recognised by a number of external bodies: in 2012, we retained 'Platinum' status in Business in the Community's annual CR index, remained ranked as 'Prime' by Oekom and in the Carbon Disclosure Project (CDP), FTSE4Good and Dow Jones Sustainability Indices.

In 2012 we carried out a strategic review of the programme to ensure it remains appropriate to our stakeholders and responsive to our business needs. As part of this, we conducted a number of interviews with senior managers to understand both their aspirations and the aspects they see as critical to the success of the programme.

We also benchmarked our current progress to understand better our strengths and weaknesses, assessed socio-economic and environmental trends and how they could impact on our business and carried out an extensive stakeholder-engagement exercise.

Our review evaluated the 2012 materiality issues matrix, that sets out the issues of most importance to our stakeholders, that are core to our business operations and should be addressed by our CR programme. These issues include the increasing need for transparency within our sector, the need to identify and mitigate the potential impacts of climate change and disasters, and help adapt our economies to support financial inclusion. The matrix is developed through external stakeholder engagement, informed by

2012 Materiality Matrix



analysis by Forum for the Future and internal engagement, including our annual CR employee survey.

The existing strengths of our programme will be maintained and opportunities for improvement taken. In 2013 we will outline a new vision for our CR programme and the activities we will commit to.

Governance

Our CR programme is underpinned by a robust internal governance structure and policy framework. Ultimate responsibility rests with our Group Chief Executive, and in 2012, we introduced a Group CR Committee and Sub-Committee Working Groups to ensure accountability and delivery across business lines and regions, supported by our internal CR functions. Our CR policies also form part of our broader risk and governance framework. Every region is required to report any breaches on a quarterly basis, with compliance reviewed by the Group Executive Committee, Group Board and internal risk function.

Our materiality framework and non-financial 2012 data has been assured by external auditors PricewaterhouseCoopers against standards AA1000 and ISAE3000.

OUR 2012 CR PROGRAMME OF ACTIVITIES

Road Safety

In 2012 we extended our work on road safety around the world. As a significant motor insurer, we are committed to making roads safer for all users.

In the UK our activity focused on our 'Fit to Drive' campaign. This aims to raise awareness of the dangers of driving with poor vision as well as the importance of having regular eye tests and calls for changes to the way drivers' eyesight is tested.

We commissioned Deloitte to produce a cost-benefit analysis of our proposals and launched the findings at an event in the Houses of Parliament. Our research found that road crashes caused by poor driver vision cost an estimated £33 million a year and result in nearly 2,900 casualties. In comparison, our recommended approach is estimated to generate net savings to the UK economy after one year, increasing to £14.4 million by year ten. As part of the campaign we also held a series of free eye-health screening sessions for employees in offices throughout the country. We will continue to promote this important road-safety issue in 2013.

Our child road-safety education programme in the UK reached more than 40 primary schools (5,000+ children) nominated by our employees. In early 2012, we extended the programme to schools in Bahrain and Singapore.

We also continued to focus on night-time visibility for road users – a priority for many of our countries, particularly in the winter months – by continuing our long-running reflector programmes. Staff volunteers across multiple countries handed out more than 140,000 high-visibility vests and 135,000 reflectors.

Community Investment

Our community strategy remains focused on the issues that are important to our stakeholders. We seek to make a positive contribution to society and our local communities through our products and services as well as through our charitable activities. These include financial contributions, gifts in kind and the support of our people. RSA employees from all over the Group are actively involved in fundraising and volunteering to address issues relating to financial inclusion, unemployment, poverty, education, crime reduction and health.

A total of 1,651 (2011: 5,200) volunteers contributed 7,776 hours (2011: 17,000) of time to local charities. We donated £1.6m (2011: £2.6m) through corporate donations to our charitable partners and our employees raised £0.15m (2011: £0.25m) for their chosen charities. Volunteering and charitable donations were lower in 2012 than previous years as a result of a change in the way we define volunteering and fundraising hours. In addition, 2011 saw a spike in activity co-ordinated around an Arctic Challenge programme.

In Latin America, staff made donations of time, cash and gifts in kind to orphanages and schools as well as helping build accommodation for the homeless. Activity in Italy included fundraising and volunteering in the aftermath of the earthquake in Emilia to support the community affected.

In the UK we work with partners to address youth unemployment and employability. We have a long-standing relationship with Careers Academies UK, which works with schools, colleges and business to raise the aspirations of 16 to 19-year-olds. Since 2008, over 100 RSA employees have become 'Partners in Business', volunteering to mentor students. More UK employees will begin their work with students in early 2013.

We will continue to offer volunteering and charitable matched-funding resources to our employees. We are also developing ambitious plans to expand CR activities and measure the impact of our community investment programmes. We are focusing our efforts on creating opportunities for our people to contribute their skills in educational programmes and to support enterprise and entrepreneurship.

CORPORATE RESPONSIBILITY CONTINUED

ENVIRONMENT

Environment and climate change are critical factors affecting our business. We believe insurers have an important role to play in the development of an adequately adapted, low-carbon global economy. We understand the urgent need for our industry to identify and respond to environmental risk, including by developing appropriate products and services. At the same time, we will continue to reduce the impact of our own operations and those of our supply chains. We are committed to leading the debate on climate change and participating in forums including Climatewise and the United Nations Environment Programme Finance Initiative (UNEP FI) – Sustainable Insurance initiative.

Risks and Opportunities

Our long-term international partnership with WWF continues to help integrate environmental considerations into our business. In 2012, we undertook research with WWF into how changing sea ice distributions could affect shipping routes and present new risks to the sensitive environment within the Arctic Circle and commissioned research into global environmental systemic risks.

We published joint thought-leadership pieces looking at how Ireland's electricity sector could be de-carbonised and a briefing on sustainable aquaculture. We will continue to work with WWF in 2013 to provide insight to our business and the wider industry on environmental risks.

By better understanding emerging trends, we can identify opportunities for new products and services that promote sustainability, building on our work in 2012.

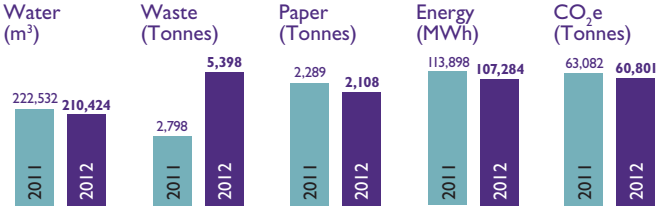
- In the UK, our Engineering division and the Carbon Trust committed to working together to raise our customers' awareness of energy efficiency;
- In Canada, our green home endorsement policy ensures any repairs are carried out with environmentally friendly, safe materials; and
- In Denmark, we work with existing suppliers to help our customers save energy and reduce CO_2 emissions, through an energy-efficient window replacement scheme.

Greenhouse gas emissions for RSA Insurance Group for 2012 (Tonnes of CO_2e*)

	2012	2011	2006 (baseline)
Scope 1	**13,262**	12,902	–
Scope 2	**27,263**	28,344	–
Scope 3	**20,276**	21,836	–
Total gross	**60,801**	**63,082**	**77,247**
Gross tonnes CO_2 per £m NWP	**7.3**	7.7	14.1
Carbon offsets (UK & Ireland)	**27,124**	27,470	–
Total net emissions	**33,677**	35,612	77,247
Net tonnes CO_2 per £m NWP	**4.0**	4.3	14.1

Geographical breakdown of greenhouse gas emissions for 2012 (Tonnes of CO_2e*)

	Scope 1	Scope 2	Scope 3
UK & Western Europe	7,196	13,788	7,086
Canada	978	2,775	3,617
Scandinavia	1,134	2,769	3,712
Emerging Markets	3,954	7,931	5,861



* Group carbon dioxide equivalent emissions (tonnes)
Scope 1: All direct GHG emissions
Scope 2: Indirect GHG emissions from consumption of purchased electricity, heat or steam
Scope 3: Other indirect emissions

Our Impacts

We understand the importance of reducing our own environmental impact, and this is supported by our policies. We are on track to achieve a 50% reduction in CO_2 emissions relative to the value of our net written premiums by 2020 (based on 2006 levels).

Our operations in the UK, Ireland and Group Corporate Centre are carbon neutral, offsetting their equivalent emissions in renewable-energy projects in China, India and South America which are certified to the Voluntary Carbon Standard.

We continue to monitor environmental data across the Group in order to meet reduction targets. In 2012, we focused on consolidating more local office data into the Group collection process. Combined with working with our third party suppliers to improve the accuracy of the data provided, we have noted an increase in our waste production. We remain committed to monitoring, targeting and reducing all our impacts across the Group.

We understand that engaging employees in our environmental programme is crucial to achieving its goals. In 2012, we launched an environmental champion online forum, the Green Network, and hosted a webinar with WWF on water efficiency.

For the second year running, we held our global environmental employee engagement campaign – 'Seeing is Believing' – with WWF. RSA's 'Rainforest Challenge' asked staff for novel, practicable ways we can reduce our environmental impact and save customers money. The winning idea was to link eco-friendly domestic improvements with cheaper home insurance, and its creators won an expedition to the Brazilian Atlantic Rainforest to see for themselves why ideas like theirs matter.

Our Supply Chain

We work closely with our business partners and intermediaries to grow a successful business while reducing our collective environmental and social impact. In the UK, we asked a number of our suppliers about their management of CR issues and engaged in active dialogue to improve standards. We also held our second supplier workshop to discuss our approach to CR and what we expect from them. Our UK business is actively working to minimise energy consumption in our claims supply chain through investigating new technologies and changing processes. In Scandinavia, we refreshed our supplier codes of conduct, ensuring strong action on environmental and social issues.

Responsible Investments

The majority of our UK equity assets continue to be managed by F&C Asset Management. F&C has one of the largest governance and sustainable-investment teams in Europe, enabling it to follow a policy of active engagement on environmental, social and governance issues. Last year, F&C engaged with 16 companies on a wide range of issues from climate change to labour standards across our portfolios.

In 2012, we worked with WWF and Mercer to understand how environmental, social and corporate governance issues are or can be integrated into fixed-income investment pricing and assessment. This research will be shared with our investment team and pension-fund trustees.

For further information on Corporate Responsibility, please email **corporate.responsibility@gcc.rsagroup.com** or to see the full Corporate Responsibility Report, visit **www.rsagroup.com**.



L'Union Canadienne acquisition

In October 2012 we completed the acquisition of L'Union Canadienne (UC), Quebec's third largest intermediated Personal lines insurer. The addition of UC builds on RSA's 160 year presence in the province of Quebec, positioning RSA as a top five insurer in that province in addition to solidifying its position as the third largest P&C insurer in Canada. As the second largest private insurance market in Canada, and the most profitable P&C market in the country, Quebec presents significant opportunities for us to grow our business. UC comprises around 70% Personal lines business with a strong focus on Motor.



CORPORATE GOVERNANCE

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BOARD OF DIRECTORS



MARTIN SCICLUNA I, N*, B

Chairman (age 62)

Skills and experience
Martin was appointed as Chairman and Director in January 2013. Previous roles include 34 years at Deloitte LLP including 26 years as Partner, Chairman of Deloitte LLP from 1995 to 2007 and a Director, Deloitte Touche Tohmatsu from 1999 to 2007.

External appointments
Chairman of Great Portland Estates plc and Non-Executive Director and Chairman of the Audit Committee, Lloyds Banking Group plc.



SIMON LEE B, I

Group Chief Executive (age 52)

Skills and experience
Simon Lee was appointed as Group Chief Executive in November 2011 having been Chief Executive of the Group's International region since April 2003 and an Executive Director since January 2007. Previous roles include 17 years with the National Westminster Group, in the UK and US, including time as Chief Executive, Natwest Offshore and Head of US Retail Banking.

External appointments
Member of the Board of the Association of British Insurers.



EDWARD LEA A, N, R

Senior Independent Non-Executive Director (age 71)

Skills and experience
Edward Lea was appointed as a Non-Executive Director in July 2003 and was appointed Senior Independent Director in January 2011. Previous roles include Finance Director of BUPA, ASDA and MFI and Chairman of Redbourn Group Limited.

External appointments
Director of Powertraveller Limited.



RICHARD HOUGHTON B, I

Group Chief Financial Officer (age 47)

Skills and experience
Richard was appointed Group Chief Financial Officer in June 2012. Previous roles include Group CFO of Aspen Insurance Holdings Limited, COO and CFO at RBS Insurance, Finance Director of Ulster Bank, Finance Director of Direct Line and Accountant at Deloitte & Touche. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

External appointments
None currently held.



ADRIAN BROWN

Chief Executive, UK and Western Europe (age 48)

Skills and experience
Adrian Brown was appointed as an Executive Director in July 2011 having been Chief Executive of the UK since September 2008. Adrian is a qualified management accountant and has been with the RSA Group since 1989. He was previously the UK Chief Operating Officer with responsibility for Claims, Sales and Service, IT and Change across Personal and Commercial lines, and prior to that he was UK Director of Personal lines, leading the launch of MORE TH>N.

External appointments
Adrian is a Director of Employers' Liability Tracing Office and DKH Legacy Trust.



ALASTAIR BARBOUR A*, I

Independent Non-Executive Director (age 60)

Skills and experience
Alastair Barbour was appointed as a Non-Executive Director in October 2011. Alastair retired from KPMG in March 2011. In the last 20 years of his 36 year career with the firm, in the UK and overseas, he led their financial services team in Scotland with a primary focus on insurance and investment management.

External appointments
Non-Executive Director of Standard Life European Private Equity Trust plc, CATCo Reinsurance Opportunities Fund Limited, CATCo Reinsurance Fund Limited, Liontrust Asset Management plc, Scottish Equitable Policyholders Trust Limited, The Bank of N.T. Butterfield & Son Limited and a Fellow of the Institute of Chartered Accountants in England and Wales.

Committee Member Key (as at 19 February 2013)
- **A** Group Audit Committee
- **B** Board Risk Committee
- **I** Group Investment Committee
- **N** Group Nomination Committee
- **R** Group Remuneration Committee
- * Denotes Chair of Committee



NOEL HARWERTH A, B*

Independent Non-Executive Director (age 65)

Skills and experience
Noel Harwerth was appointed as a Non-Executive Director in March 2004. Previous roles include Chief Operating Officer of Citibank International plc, Director of Logica plc and Impellam Group plc.

External appointments
Director of Harry Winston Diamond Corporation, GE Capital Bank Limited, LME Holdings Limited and Chairman of Sumitomo Mitsui Banking Corporation Europe Limited. Non-Executive Director of Standard Life plc, Avocet Mining plc and Alent plc.



JOHN MAXWELL N

Independent Non-Executive Director (age 68)

Skills and experience
John Maxwell was appointed as a Non-Executive Director in July 2003. Previous roles include Executive Director of Prudential Group plc, Chairman of DXServices plc, Director of Provident Financial plc and Homeserve plc and Director General of The Automobile Association Limited.

External appointments
Director of London Finance and Investment Group plc and a member of the Institute of Chartered Accountants of Scotland.



HUGH MITCHELL R*

Independent Non-Executive Director (age 56)

Skills and experience
Hugh Mitchell was appointed as a Non-Executive Director in September 2012. Hugh is the Chief Human Resources and Corporate Officer of Royal Dutch Shell plc and a member of the Shell Executive Committee.

External appointments
Director of Shell International Limited and Shell Aircraft Limited. Advisory roles held at The Centre for Advanced Human Resources at Cornell University Advisory Board, IMD Business School Advisory Board, Fellow of the National Academy of Human Resources (USA), Honorary Vice-President of the Chartered Institute of Personnel and Development and Advisory Board Member of the National College for School Leadership.



MALCOLM LE MAY B, I*, R

Independent Non-Executive Director (age 55)

Skills and experience
Malcolm Le May was appointed as a Non-Executive Director in March 2004. Previous roles include CEO Investment Banking (Europe) at UBS, Deputy CEO of ING-Barings and Morley Fund Management and President Europe at JER Partners.

External appointments
Non-Executive Director of Pendragon plc and Consultant to Ernst & Young LLP.



JOSEPH STREPPEL R

Independent Non-Executive Director (age 63)

Skills and experience
Jos Streppel was appointed as a Non-Executive Director in October 2011 and has a comprehensive understanding of the insurance market globally and good knowledge of international and emerging markets. He was Chief Financial Officer of Aegon until 2009 and has extensive financial services expertise.

External appointments
Chairman of KPN, Vice Chairman of Van Lanschot, a Dutch private banking and asset management firm, Chairman of the Monitoring Committee of the Dutch Corporate Governance Code, Arq Foundation and Chairman of Duisenberg School of Finance.



JOHANNA WATEROUS CBE A, N

Independent Non-Executive Director (age 55)

Skills and experience
Johanna Waterous was appointed as a Non-Executive Director in May 2008. Previous roles include Chairman of Tate Enterprises and over 20 years with McKinsey & Company, with roles including Co-leader of the Global Marketing and Sales Practice and Leader of their UK Consumer Practice and the European Retail Practice. Johanna was awarded a CBE in the 2013 New Year Honours List.

External appointments
Non-Executive Director of WM Morrison Supermarkets plc, Senior Independent Director of Rexam plc, Director of Shoppers Drug Mart Corporation, Director of RBG Kew Enterprises Limited, Operating Partner of Duke Street LLP and Chairman of Sandpiper CI.

EXECUTIVE TEAM

The Executive Team comprises the Executive Directors whose biographies are on pages 36 to 37 and the following senior executives:



PAUL DONALDSON

Group Broker Relationship and Sales Director

Paul was appointed Group Broker Relationship and Sales Director in July 2011. Paul has over 35 years' experience in the insurance industry, having joined RSA in 1976. He has held a number of leadership roles in RSA, including CEO for the Republic of Ireland and Managing Director, Commercial in RSA's UK business.



VANESSA EVANS

Group Human Resources Director

Vanessa was appointed Group Human Resources Director in March 2012. She joined RSA in 2005 as UK Human Resources Business Partner Director for Claims and Finance and has worked in a variety of roles across the Group. In 2006 she was appointed as Human Resources Director for the Emerging Markets Region. In 2008, she was promoted to UK Human Resources Director. Prior to working at RSA, Vanessa was HR Director – Global Retail at Lego and before that Head of HR for Gap, the international clothing retailer.



ROWAN SAUNDERS

President & CEO, RSA Canada

Rowan was appointed to the position of President & CEO of RSA Canada in September 2003 and is a member of the Canadian Board of Directors. He is also a member of the Group Executive Committee. Since joining RSA in 1987, Rowan has held progressive leadership positions in the areas of underwriting, marketing, sales and finance. He is a member of the Board of Directors of the Insurance Bureau of Canada (IBC) and was the IBC's past Chair.



DEREK WALSH

Group General Counsel and Group Company Secretary

Derek joined RSA as Group General Counsel and Group Company Secretary in July 2010 and has over 18 years' experience in the insurance industry. From 2002, he served as Group General Counsel at Benfield Group Limited, where he was responsible for the global legal, company secretarial and compliance teams. Prior to that, Derek held positions in law firms Pinsent Curtis (now Pinsent Masons), McKenna & Co (now CMS Cameron McKenna) and Norton Rose.



MIKE HOLLIDAY-WILLIAMS

Chief Executive, Scandinavia

Mike was appointed CEO of Scandinavia in February 2011. Mike is also CEO of Codan A/S and CEO of Trygg-Hansa. He joined RSA in 2006 and was previously Managing Director for RSA's UK Personal lines operation, which includes MORE TH>N and the Managing Director of RSA's UK retail business. Before joining RSA, Mike worked in the energy, telecoms and retail sectors, beginning his career at WH Smith Limited, before subsequently moving to various Centrica owned businesses, including British Gas and Onetel.



CAROLINE RAMSAY

Group Chief Auditor

Caroline has been with the Group since 2007. She was appointed Group Chief Auditor in September 2012 having been Group Financial Planning & Analysis Director and UK Finance Director. Prior to joining RSA, Caroline held a number of finance roles at Aviva and spent 12 years at KPMG.



TIMOTHY MITCHELL

Group Underwriting and Claims Director

Tim was appointed Group Underwriting and Claims Director in November 2007 when he joined the Group. Tim has nearly 40 years' experience in the insurance industry. He joined RSA from Zurich Financial Services where senior underwriting roles included three years as Global Chief Underwriting Officer for General Insurance. Tim has also held senior management roles at AIG and Continental Insurance. Tim is a member of the Cheltenham Ladies' College Council.



DAVID WEYMOUTH

Group Chief Risk Officer

Currently Group Chief Risk Officer, David joined the Group in June 2007 and was Group Operations and Risk Director until November 2012. Immediately prior to that David spent two years consulting to blue chip and government organisations. Previously David was CIO at Barclays and a member of the Group Executive Committee. He has extensive non-executive experience and is currently a NED at the Royal London Group and at the Financial Services Compensation Scheme.



PAUL WHITTAKER

Chief Executive, Emerging Markets

Paul was appointed Chief Executive of Emerging Markets in 2006 and the business has since more than doubled in size. He has over 20 years' senior management experience in the financial services sector including three years at AXA and ten years at GE Capital, including work in Asia and Eastern Europe on acquisition integration and business development.

DIRECTORS' AND CORPORATE GOVERNANCE REPORT

"The Board is committed to ensuring high standards of corporate governance and believes that a solid corporate governance framework enables efficient and effective decision-making with clear responsibilities, leading to the achievement of the Company's objectives and the delivery of long-term value to shareholders. Key areas of focus for the Board include developing the Group's strategy, monitoring financial performance and ensuring standards of conduct and accountability across the Group"

Martin Scicluna
Chairman

Compliance with the UK Corporate Governance Code

Throughout the year, the Company has complied with the Principles and Provisions of the UK Corporate Governance Code (the Code) with the exception that the former Chairman did not review and agree training and development needs with each Director. It is the intention that each Director will agree their training requirements with the Chairman in 2013.

Further explanation on how the Main Principles in the Code have been applied is set out below and in the Directors' Remuneration Report and Group Audit Committee Report as applicable.

The Code is available on the Financial Reporting Council's website **www.frc.org.uk.**

LEADERSHIP

The Role of the Board

The Board is responsible for organising and directing the affairs of the Company in a manner that is most likely to promote its success for the benefit of its members as a whole. Its role is to provide entrepreneurial leadership of the Company within a framework of prudent and effective controls.

There is a schedule of matters reserved for the Board which includes:

- Strategy and management of the Company, including formal approval of the Group's overall risk appetite
- Changes to the financial and legal structure and share capital of the Company
- Financial reporting and controls, including approval of financial statements, interim dividends and recommending final dividends to shareholders
- Reviewing the effectiveness of internal controls
- Approving significant expenditure and material transactions and contracts
- Shareholder communications including circulars and material stock exchange announcements
- Appointment and removal of Directors and the Group General Counsel and Group Company Secretary
- Determining the remuneration policy for the Executive Directors, the Chairman, Group General Counsel and Group Company Secretary and senior executives
- Review of the Company's overall corporate governance arrangements
- Delegation of authority to the Group Chief Executive.

2012 KEY ACTIVITIES

- Dedicated strategy sessions and updates throughout the year
- Approving the 2013 Operational Plan and risk appetite for the Group
- Approving the changes to the Board which took place during the year, including the selection of a new Chairman
- Considering matters relating to the Corporate Governance Framework and Solvency II implementation
- Considering corporate merger, acquisition and disposal activity material to the Group as a whole
- Monitoring material claims and reinsurance matters
- Monitoring the Company's policy in relation to bribery and corruption
- Monitoring Group financial performance
- Reviewing the Dividend Policy
- Ensuring ongoing compliance with regulatory requirements and maintaining a positive relationship with the Company's regulators
- Ensuring the UK business continues to treat customers fairly.

In addition to the schedule of matters reserved for the Board, each of its Committees, Group Audit, Group Remuneration, Group Nomination, Board Risk and Group Investment, has written terms of reference defining their role and the authority delegated to them.

The schedule of matters reserved for the Board and the terms of reference for each of the Board Committees were reviewed in the year and are available on the Company's website **www.rsagroup.com**. Further details on the principal duties of each of the Board Committees can be found under Accountability commencing on page 43, in the Group Audit Committee Report on pages 52 to 54 and the Directors' Remuneration Report on pages 55 to 71.

The Board sets annual objectives for the business in line with the current Group strategy and monitors achievement of the Company's objectives through regular reports which include updates from the Group Chief Executive and Group Chief Financial Officer (Group CFO) on all material business matters. The Board has a standing agenda of items that are regularly considered which is continually refreshed to include any topical matters that arise.

The Board held ten scheduled meetings during the year and two additional single purpose meetings. Where a Director was not available to attend a meeting, where possible their views were canvassed by the Chairman prior to the relevant meeting and the Board informed of their opinions and observations. When considering matters such as the approval of financial statements and large operational contracts, the Board may delegate authority to a Committee to finalise and approve as required.

Formal minutes recording the decisions of all Board and Committee meetings are prepared and circulated to each Director. If a Director objects to a particular decision this is recorded in the minutes of the relevant meeting.

The attendance of Directors at Board meetings during the year is set out below:

BOARD MEETINGS	Scheduled	Additional
Membership and attendance at 2012 meetings		
John Napier (Chairman)[1]	10/10	2/2
Alastair Barbour	10/10	1/2
Adrian Brown	9/10	2/2
George Culmer[2]	4/4	0/0
Noel Harwerth	9/10	2/2
Richard Houghton[3]	5/6	2/2
Edward Lea	10/10	2/2
Simon Lee	10/10	2/2
Malcolm Le May	9/10	2/2
John Maxwell	9/10	0/2
Hugh Mitchell[4]	3/3	2/2
Jos Streppel	10/10	1/2
Johanna Waterous	10/10	2/2

Notes:
1. John Napier retired from the Board with effect from 31 December 2012.
2. George Culmer resigned as a Director on 14 May 2012.
3. Richard Houghton was appointed to the Board on 12 June 2012.
4. Hugh Mitchell was appointed to the Board on 26 September 2012.

Delegated authorities

The Group operates a Delegated Authority Framework which specifies how Executive authority is delegated from the Board to the Group Chief Executive and onward delegation to other executives in the Group. Senior executives across the Group receive an executive licence setting out their specific limits of authority in terms of entering into financial, underwriting, claims and other business commitments. Each executive is responsible for ensuring a similar process of delegation is in place within his or her area of responsibility. Further detail on the overall risk framework is set out on pages 26 to 29.

Directors

The names of the Directors together with their biographical and Committee membership details are set out on pages 36 and 37 and are incorporated into this report by reference. Details of the Directors' service contracts and terms of appointment, together with their interests in the Company's shares, are shown in the Directors' Remuneration Report on pages 55 to 71 and are incorporated into this report by reference.

Non-Executive Directors

The Non-Executive Directors challenge and agree the Group's strategy with Executive management and assess their performance against it. Financial controls and systems are assessed through the Group Audit Committee, Board Risk Committee and the Board. The Group Remuneration Committee sets levels of remuneration for the Executive Directors and senior management. The Group Nomination Committee is responsible for reviewing the balance of skills, experience, independence and knowledge required by the Board and the senior leadership needs of the Group and makes recommendations to the Board on matters relating to the Board's membership.

During the year, the Chairman held meetings with the Non-Executive Directors without the Executive Directors being present. The Senior Independent Director held meetings with the Non-Executive Directors without the Chairman present which, in addition to other matters, reviewed the Chairman's performance.

Non-Executive Directors are initially appointed for a three year term with an expectation that they will continue for at least a further three year term.

Chairman and Group Chief Executive

The roles of the Chairman and the Group Chief Executive are separate and complementary, with responsibilities clearly divided and set out in role statements, which are available on the Company's website, **www.rsagroup.com**.

Their roles comprise the following principal responsibilities:

Chairman

- Ensuring the Board operates effectively including the receipt of accurate, timely and clear information
- Leading the Board in reviewing the recommended strategic operating plans and budgets
- Ensuring that appropriate and related objectives are established for the Group Chief Executive and Executive Team
- Maintaining effective communication between the Board and shareholders
- Ensuring the Board has the right balance of skills and experience to support the needs of the business
- Facilitating the effective contribution of the Non-Executive Directors
- Consulting with the Senior Independent Director on Board matters as required.

Group Chief Executive

- Recommending strategy and objectives to the Board, ensuring implementation in line with agreed business plans and budgets
- Reporting to the Board on the executive management of the Company
- Monitoring the performance of the Group and its main subsidiaries, ensuring that objectives agreed upon are achieved and reported to the Board
- Liaising with the Chairman on issues which relate to the Board and keeping the Chairman informed on all material matters relating to the performance of the Company and its strategic and market circumstances
- Assessing risk issues, making recommendations in relation to risk appetite and reporting on risk exposure on a regular basis to the Board
- Monitoring and reviewing progress on the strategic plan
- Reviewing the organisational framework to ensure that policies relating to management selection, performance review, development and change are appropriate, enabling the Company to operate in the upper quartile of management effectiveness, ensuring that management succession plans are in place
- Developing and maintaining an internal and external communications strategy

- Ensuring adequate standards of financial management and control are in place and that the Company complies with relevant legal and regulatory requirements
- Representing the Company as required in the industry and business community.

Senior Independent Director

Edward Lea is the Senior Independent Director. A role statement setting out the responsibilities of this position is available on the Company's website, **www.rsagroup.com**.

The principal responsibilities of the Senior Independent Director are:

- Providing support, as requested by the Chairman, in the delivery of his responsibilities
- Being available to shareholders if they have concerns which have not been resolved or are not appropriate to be dealt with through contact with the Chairman, Group Chief Executive or other Executive Directors
- Chairing the Group Nomination Committee when it is considering the matter of succession for the Chairman of the Board
- Assisting, if requested by the Chairman, in matters of Board evaluation
- Ensuring that the views of each of the Non-Executive Directors are given due consideration and facilitating communication between Non-Executive Directors and the Chairman.

EFFECTIVENESS

Composition of the Board

The Board believes that it has the appropriate balance of skills, experience, independence and knowledge to enable it and its Committees to discharge their duties and responsibilities effectively, as required by the Code. The Board is satisfied that it is of a size appropriate to the needs of the business and that no individual Director can dominate the Board's decision taking.

Board Appointments

When appointing new Directors, regard is given to the size of the Board, the balance of Executive and Non-Executive Directors and the benefits of diversity, including gender. The Board considers the skills, experience, independence and knowledge already represented when making decisions on new appointments and ensures that succession planning processes are in place.

The Board reviews the membership of its Committees on a regular basis to ensure they remain appropriate. Further details on changes to Board Committee membership are contained in the relevant Committee report. Only members of the Board Committees are entitled to attend Committee meetings; however, the Committee or its chairman may invite any Directors, other executives of the Group or any external professional advisers to attend all or part of any meetings as and when required.

Further details of appointments to the Board are contained in the report of the Group Nomination Committee below.

Independence

The Board considers all the Company's Non-Executive Directors to be independent in character and judgement. Collectively they contribute to an effective Board with a strong mix of skills and business experience, with each Director contributing significant weight to business decisions.

The independence of those Directors who have been on the Board for more than nine years has been subject to particular scrutiny. The Group Nomination Committee and the Board are satisfied that each of them continue to bring to the role all the skills and attributes required from them and that the term of their appointment has no bearing on their continued independence. The Board considers that no relationships or circumstances exist as specified in the Code which may be relevant to the determination of independence and no Executive Director will have served on the Board for the same nine year period. The Directors offering themselves for election or re-election at the 2013 AGM are shown in the Notice of Meeting.

Commitment

The Chairman's letter of appointment anticipates an expected time commitment involving attendance at all Board meetings, the AGM and Board Committee meetings which the Chairman chairs or of which he is a member, as well as being required from time to time to attend meetings with major shareholders, employees and professional advisers. It is anticipated that this will require a minimum time commitment of two days per week. In addition, the Chairman has agreed as part of his induction, to commit at least fifteen additional business days during which he will meet senior management and visit operations across the Group.

Martin Scicluna, who was appointed as a Director and Chairman with effect from 1 January 2013, is also Chairman of Great Portland Estates plc and is a Non-Executive Director and Chair of the Audit Committee of Lloyds Banking Group plc. The Board is satisfied that these commitments are not a constraint on the Chairman's ability to carry out his duties. During 2012, the former Chairman John Napier was also Chairman of Aegis Group plc and the Board was satisfied that his other commitments did not interfere with the performance of his role.

Service agreements and letters of appointment, for both the Executive and Non-Executive Directors, are available for inspection at the Company's registered office and at the AGM. The letters of appointment for each of the Non-Executive Directors state that in accepting the appointment, the Director confirms that he/she is able to allocate sufficient time to meet the expectations of the role, with an anticipated time commitment of 28-32 days per year.

The Executive Directors of the Company, Simon Lee, Richard Houghton and Adrian Brown, do not hold outside Directorships of FTSE 100 (or any other listed) companies but would be allowed to have one such appointment, subject to the approval of the Chairman.

Induction and Professional Development

On appointment to the Board and any Committees, Directors undertake an induction programme and receive a broad range of information about the Company which is appropriate to their existing knowledge and experience. This includes information on the

operational performance and business of the Group and details of Board procedures, governance matters and Directors' responsibilities, along with a series of meetings with members of the Board and Executive management on business and regulatory matters.

To keep them informed of matters which are material to the Group, Directors receive updates from the Group Executive on the financial and operational performance of the business. Development and training for the Directors is an ongoing process which includes briefings on legislative and regulatory changes and on corporate governance matters affecting the Group and other topics such as employee engagement and corporate responsibility. To date the Company has included questions regarding training requirements in the Board and Committee annual evaluations. Training requests have been recorded and actioned; however, individual training plans were not agreed. It is the intention that each Director will agree their training requirements with the Chairman in 2013. During the year, one Board meeting was held overseas, affording the Non-Executive Directors an opportunity to gain further insight into the business, the local management team and the culture. It is intended that a Board meeting will be held overseas in 2013, allowing a similar opportunity in a different business region.

The Chairman and Non-Executive Directors also visit different parts of the Group to meet with local management and deepen their understanding of the business. In 2012 these included John Napier visiting Canada to meet with the President & CEO of RSA Canada and the Canadian Senior Management team, Alastair Barbour attending a Codan Audit Committee meeting in Denmark and meetings with the UK Finance and Reinsurance teams, Johanna Waterous attending an Irish Audit Committee meeting and Noel Harwerth attending a Latin American Risk Committee meeting.

Information and Support

The Board considers that the information provided to the Board and its Committees is supplied in a timely manner and is of an appropriate quality to enable it to discharge its duties.

The Group General Counsel and Group Company Secretary is responsible for assisting the Chairman with arranging induction and professional development for the Directors and for bringing all governance matters to the attention of the Board. The Directors have access to the services and advice of the Group General Counsel and Group Company Secretary and in addition may take independent professional advice at the expense of the Company in the furtherance of their duties.

Performance evaluation

In late 2011 and early 2012, there was an internal review of Board performance, starting with an evaluation of the Committees and concluding with that of the Board. The Board review commenced in December 2011 and was concluded in January 2012. Further reviews of the Board Committees took place between November 2012 and January 2013. In light of the impending retirement of John Napier as Chairman on 31 December 2012, it was decided to defer the next annual evaluation of the Board until Martin Scicluna was in situ as the new Chairman in January 2013.

The Board evaluation for 2012, which concluded in February 2013, was conducted by way of a structured questionnaire. The questionnaire considered the balance of skills, experience, independence and knowledge of the Company represented on the Board, how the Board works together as a unit, its diversity and the effectiveness of the Board as a whole. The evaluation of individual Directors considered whether each Director contributed effectively and continued to demonstrate commitment to the role. Priorities identified by the evaluation for focus in 2013 included a commitment to increasing the diversity of the Board and ensuring appropriate use is made of the Non-Executive Directors' skills both inside and outside formal meetings, along with support for tailored training programmes. The evaluation confirmed each Director continues to be an effective member of the Board.

The Group Audit Committee, Board Risk Committee and Group Remuneration Committee also conducted evaluations of their performance during 2012. Further details of each of these reviews can be found in the relevant Committee reports.

In 2013, the Board intends to carry out an external evaluation of its performance as recommended by the Code.

Re-election

The Directors and shareholders by ordinary resolution may appoint a person who is willing to be a Director either to fill a casual vacancy or as an additional Director. In accordance with the Code, each Director will submit themselves for election or re-election, as appropriate, at each AGM. Resolutions to elect or re-elect Directors at the AGM are subject to the approval of the Board, taking into account the recommendations of the Group Nomination Committee. Shareholders may, by ordinary resolution of which special notice has been given, remove any Director before the expiration of his period of office.

ACCOUNTABILITY

Financial and Business Reporting

A balanced and understandable assessment of the Group's position and prospects, an explanation of its business model and the strategy for delivering the objectives of the Company are contained in the Business Review on pages 8 to 33. A statement of the Directors' responsibilities can be found on page 74 and reports from the external auditor can be found on page 75.

Going concern

In considering the appropriateness of the going concern basis, the Board has reviewed the Group's ongoing financial commitments for the next 12 months and beyond. The Board's review included consideration of the Group's underwriting plans, regulatory capital positions, diverse insurance risk profile, undrawn financing facilities and investment portfolio. As a result of this review, the Directors have satisfied themselves that it is appropriate to prepare these financial statements on a going concern basis.

BOARD COMMITTEES

The reports of the Group Audit Committee and the Group Remuneration Committee are set out on pages 52 to 54 and 55 to 71 respectively.

BOARD RISK COMMITTEE REPORT

"The Committee is authorised to advise on risk management issues and recommend the Group framework of risk limits and risk appetite to the Board. During 2012 the Committee has reviewed the Group's material risks in the context of the overall risk strategy and appetite of the Group. The scope of the Committee's remit includes existing and emerging risks facing the Group in relation to market, credit, liquidity, insurance and operational risk. The Committee is assisted in discharging its responsibilities by the risk function and regional risk committees"

Noel Harwerth
Chair, Board Risk Committee

BOARD RISK COMMITTEE

Membership and attendance at 2012 meetings	
Noel Harwerth (Chair)	4/4
George Culmer[1]	0/1
Richard Houghton[2]	3/3
Simon Lee	2/4
Malcolm Le May	3/4

Notes:
1. George Culmer resigned from the Committee with effect from 14 May 2012.
2. Richard Houghton was appointed to the Committee with effect from 12 June 2012.

PRINCIPAL DUTIES OF THE BOARD RISK COMMITTEE (BRC)

- To recommend the Group framework of risk limits and risk appetite to the Board
- To review the quantum of capital required for the Individual Capital Assessment (ICA) and Economic Capital Assessment (ECA)
- To ensure that material risks have been identified and mitigated appropriately
- To approve new and amended Group policies
- To approve the remit of the Group Risk team
- To review the Remuneration Policy for any implications for risk and risk management
- To review and monitor emerging risks.

2012 KEY ACTIVITIES

- Reviewing and challenging the Group's risk appetite and material risk profile
- Reviewing results of stress and scenario tests
- Considering emerging risks
- Reviewing and approving changes to Group policies
- Reviewing the quantum of the ICA and ECA capital models
- Reviewing risks facing the Group by type and region at each meeting
- Monitoring progress on preparation for compliance with the Solvency II regulatory framework
- Undertaking an effectiveness review of the Committee's performance in 2012
- Reviewing the Remuneration Policy and any implications for risk and risk management
- Reviewing and challenging the proposed reinsurance arrangements for 2013.

Membership

In 2012 the Committee comprised two Non-Executive Directors, the Group Chief Executive and Group CFO. In addition, the Group Chief Risk Officer, Group Risk Director, Group General Counsel and Group Company Secretary, Group Director of Corporate Finance, Group Underwriting & Claims Director and Regional Risk Directors are all regular attendees. The Committee Chairman may invite Directors, other executives of the Group or any external professional advisers to attend from time to time. The Chairman, Martin Scicluna, was appointed to the Committee with effect from 8 February 2013. With effect from 1 March 2013 Edward Lea and Alastair Barbour will become members of this Committee, with Edward Lea succeeding Noel Harwerth as Chairman of the Committee.

Terms of Reference

The terms of reference set out the authority of the Committee to carry out its duties. The Committee reviewed its terms of reference during the year and these are available on the Company's website, **www.rsagroup.com**.

The terms of reference are reviewed to ensure they reflect the requirements of the Group and meet current best practice and industry guidance. The BRC has a standing agenda to ensure that all items within its terms of reference are covered by the Committee. BRC agendas may include greater focus on specific risk disciplines or individual insurance portfolios as considered appropriate through pre-meeting discussions between the BRC Chairman and the Group Risk Director.

Meetings

The BRC oversees and challenges the results of stress and scenario tests carried out by the Group Risk team and the business. These tests are carried out each year with the involvement of senior executives to assess the Group's resilience in relation to extreme but plausible events that could have a material impact on the Group. The aim is to enable management and the BRC to better understand the dynamics of the Group's risk profile, identify potential mitigation strategies for such events and act as a validation tool for both the Group's capital modelling process and its risk appetite.

These tests involve exploring a range of scenarios which could adversely impact the Group's assets, liabilities and/or operational performance. The BRC has continued to evaluate the impact of scenarios such as a Euro sovereign debt default and the collapse of the Euro from a Group perspective. In 2012 the programme was extended across our 14

European Economic Area legal entities covering scenarios around the seven risk types: Catastrophe, Non-catastrophe, Reserve, Reinsurance, Credit, Market, Strategic and a single Reverse Stress Test. The results demonstrated the Group's resilience on both an absolute and relative basis to the scenarios considered. The results also allowed for the identification of potential additional management actions that could be taken to protect customers, shareholders and operations.

In addition to monitoring risks that are already recognised as material to the Group, the BRC monitors emerging risks that could threaten the Group's position of competitive advantage or successful delivery of strategy to ensure that plans are put in place where possible to mitigate such risks.

During the year, the BRC has received regular updates from the Solvency II Steering Committee on the Group's preparation for the implementation of Solvency II and its impact on the business. Solvency II is a fundamental overhaul of the regulatory capital adequacy regime for insurers and reinsurers within the EU. The deadline for compliance with Solvency II has been postponed and the FSA is working towards an implementation date of January 2016. Solvency II requires regulated insurers and reinsurers to have an effective system of governance in place which provides for sound and prudent management of the business. This includes ensuring that Board members possess sufficient relevant professional qualifications, knowledge and experience to ensure that, collectively, they provide sound and prudent corporate stewardship. There is an ongoing programme to document the governance policy and processes within each regulated Group company within the EU to ensure that a consistent and high standard of governance is maintained throughout the Group, which includes training Directors on Solvency II and the Company's Internal Capital Model.

The minutes of the regional risk committees are provided to the BRC and the regional risk Directors regularly present to the BRC.

Evaluation

The evaluation of the Board Risk Committee, which was conducted by way of a structured questionnaire, included a review of the annual planning cycle, the number and length of meetings and the quality of information provided. It also considered the responsiveness of management to the Committee's requests and the Committee's challenge of management. Priorities identified by the evaluation for focus in 2013 included training for new Committee members, continued focus on both key areas of risk by type and region and the ongoing challenge of management's risk assessments.

GROUP INVESTMENT COMMITTEE REPORT

"Global economic and market conditions remained challenging during 2012. Against this background the Committee has continued to ensure that the Group maintains its prudent approach to the management of investment assets whilst successfully taking advantage of selective opportunities to enhance portfolio income"

Malcolm Le May
Chairman, Group Investment Committee

GROUP INVESTMENT COMMITTEE

Membership and attendance at 2012 meetings[1, 2]

Malcolm Le May (Chairman)	2/2
Alastair Barbour	2/2
Richard Houghton[3]	2/2
Simon Lee	2/2

Notes:
1. George Culmer resigned from the Committee with effect from 14 May 2012, before the first meeting of the year.
2. Noel Harwerth, Edward Lea, John Maxwell, John Napier, Jos Streppel and Johanna Waterous resigned from the Committee prior to the first meeting of the year following a review of the Committee's constitution.
3. Richard Houghton was appointed to the Committee with effect from 12 June 2012.

PRINCIPAL DUTIES OF THE GROUP INVESTMENT COMMITTEE

- **To assist the Board in setting the Group's investment strategy**
- **To monitor the execution of that strategy and the Group's investment performance.**

2012 KEY ACTIVITIES

- **Reviewing activity in the Group's investment portfolio**
- **Approving and monitoring investment strategy implementation and portfolio results.**

Membership

During the year, the membership of the Committee was reviewed and revised to become the Group Chief Executive, Group CFO and two Non-Executive Directors. The Group Investments Director attends all meetings of the Committee to provide an update on the economic and market background and outlook affecting the Group, the investment activities taken since the Committee last met and any portfolio actions which require the Committee's approval. The Chairman, Martin Scicluna, was appointed to the Committee with effect from 8 February 2013 and with effect from 1 March 2013 Jos Streppel will become a member of the Committee.

Terms of Reference

The Committee is authorised by the Board to manage all aspects of investment policy and strategy for the Group and provide oversight of the operation of the Group's investment portfolios within established strategy and risk frameworks. The terms of reference set out the authority of the Committee to carry out its duties. The Committee reviewed its terms of reference during the year and these are available on the Company's website at **www.rsagroup.com**.

Meetings

Strategic themes relating to cash, bonds, equities and alternative yield assets were discussed during 2012, together with options for the Group to enhance its income in an environment of historically low interest rates and bond yields, whilst retaining the high quality and low risk nature of the portfolios. Details of the Group's investment activities are contained in the Financial Review on pages 14 to 17.

GROUP NOMINATION COMMITTEE REPORT

"During the year the Committee continued to focus on ensuring that the right balance of skills, experience, knowledge and independence is represented on the Board both currently and in the future. In doing so, the Committee identified potential new appointees and made recommendations to the Board regarding the appointment of a new Executive Director, a new Non-Executive Director and a new Chairman, all of whom bring complementary skills to maintain the quality of the Board"

Edward Lea
Senior Independent Director

GROUP NOMINATION COMMITTEE

Membership and attendance at 2012 meetings	
John Napier (Chairman)[1]	6/6
Edward Lea	6/6
John Maxwell	6/6
Johanna Waterous	6/6

Notes:
1. John Napier retired as a Director and member of the Committee with effect from 31 December 2012.

PRINCIPAL DUTIES OF THE GROUP NOMINATION COMMITTEE

- To keep under review the capabilities required by the Board and the leadership needs of the Group
- To review succession planning for the Board
- To manage the process of identifying potential Board appointees, seeking advice from external advisers as appropriate for recommending candidates for assessment by the Board as a whole
- To make recommendations to the Board in relation to the re-appointment of any Non-Executive Director at the conclusion of his/her specified term of office.

2012 KEY ACTIVITIES

- Managing the process of identifying Board appointees
- Recommending the appointment of a new Chairman
- Recommending the appointment of a new Executive Director
- Recommending the appointment of a new Non-Executive Director.

Membership
All members of the Committee are independent Non-Executive Directors, with the exception of both the former Chairman and the current Chairman who were independent on appointment. The Chairman chairs the Committee unless it is dealing with matters regarding his succession. The Chairman, Martin Scicluna, was appointed to the Committee with effect from 8 February 2013 and with effect from 1 March 2013, John Maxwell ceases to be a member of the Committee with Alastair Barbour and Hugh Mitchell joining the Committee on the same date.

Terms of Reference
The terms of reference set out the authority of the Committee to carry out its duties. The Committee reviewed its terms of reference during the year and these are available on the Company's website, **www.rsagroup.com**.

When appointing new Directors, regard is given to the size of the Board, the balance of Executive and Non-Executive Directors and the benefits of diversity, including gender. The Committee considers the skills, experience, independence and knowledge already represented when making recommendations to the Board on new appointments.

During the year, MWM Consulting Limited, an external search agency specialising in the recruitment of Directors, was engaged to assist the Company. A description of the role and the capabilities required for each appointment were provided to the agency. Reports on potential appointees were provided to the Committee members who, after careful consideration, made a recommendation to the Board. MWM Consulting Limited is independent and has no other relationship with the Company.

During 2012, the Committee considered and recommended to the Board the appointment of Richard Houghton as an Executive Director and Group CFO, Hugh Mitchell as a Non-Executive Director and Chairman of the Group Remuneration Committee and Martin Scicluna as a Non-Executive Director and Chairman of the Company. All candidates were considered to complement the existing skills, experience and knowledge on the Board, with sufficient time to dedicate to the role.

Group Remuneration Committee
Full details of the activities and duties of the Group Remuneration Committee can be found in the Directors' Remuneration Report on pages 55 to 71.

Group Audit Committee
Full details of the activities and duties of the Group Audit Committee can be found in the Group Audit Committee Report on pages 52 to 54.

RELATIONS WITH SHAREHOLDERS

Dialogue with institutional shareholders
The Board attaches considerable importance to its relationships and communication with shareholders. Senior management meet principal institutional shareholders on a regular basis and Non-Executive Directors are available to meet with institutional shareholders as required. Executive Directors attended 68 meetings with investors during 2012. The Board is made aware of significant issues raised by shareholders. The Board receives regular reports from the Investor Relations team on the views of institutional shareholders. Presentations and meetings are conducted in compliance with the Company's Inside Information Policy and the Disclosure and Transparency Rules to ensure that inside information is not disclosed prior to it being made available to shareholders generally.

Substantial Share Interests

	At 31 December 2012			At 19 February 2013		
	No. of ordinary shares	% of voting rights	Nature of holding	No. of ordinary shares	% of voting rights	Nature of holding
Blackrock, Inc	188,217,284	5.46	Indirect	188,217,284	5.46	Indirect
Legal & General Group plc	136,295,990	3.99	Direct and Indirect	136,295,990	3.99	Direct and Indirect
Newton Investment Management Ltd	168,455,475	4.88	Indirect as discretionary investment manager	168,455,475	4.88	Indirect as discretionary investment manager
Schroders plc	170,851,201	4.95	Direct and Indirect	170,851,201	4.95	Direct and Indirect
Standard Life Investments Ltd	152,266,879	4.42	Direct and Indirect	152,266,879	4.42	Direct and Indirect

Substantial share interests

The table above shows the holdings of major shareholders notified to the Company in accordance with the Disclosure and Transparency Rules as at 31 December 2012 and the date of this Report.

Annual General Meeting (AGM)

The AGM will be held at 200 Aldersgate, St Paul's, London EC1A 4HD on Wednesday, 15 May 2013 at 11.00am. A letter from the Chairman and the notice convening the AGM (Notice) is made available to all ordinary shareholders at least 20 working days before the meeting and can be found at **www.rsagroup.com**.

Presentations are given on the Company's performance and activities during the year and the financial results of the Company prior to the formal business of the meeting. All Directors are requested to attend the AGM. The Chairman and each Board Committee chairman make themselves available to take questions from ordinary shareholders at the AGM.

Separate resolutions are proposed on each substantive issue. In accordance with the provisions of the Articles of Association (Articles), any proxy form sent by the Company to shareholders in relation to any general meeting must be delivered to the Company, whether in written form or in electronic form, not less than 48 hours before the time for holding the meeting excluding non business days (or, in the case of a poll taken otherwise than at or on the same day as the meeting, not less than 24 hours before the time appointed for the taking of the poll).

At any general meeting, every ordinary shareholder present shall have one vote on a show of hands and on a poll, every ordinary shareholder present in person or by proxy shall have one vote for each share of which he is the holder. Each resolution will be put to a poll at the AGM in 2013. The results of the vote on each resolution will be announced to the London Stock Exchange and will be available on the Company's website, **www.rsagroup.com**.

Preference shareholders are only entitled to receive notice of, attend, speak and vote at general meetings if the dividend payable on the preference shares is in arrears at the date of the Notice, a resolution is proposed that affects the rights of the preference shareholders, a resolution is proposed to wind up the Company, a resolution is proposed to reduce the capital of the Company (other than a redemption or purchase of shares), or in such other circumstances as the Board shall determine. In any of these situations the preference shareholders may only vote on the relevant resolution and not on all the business of the general meeting.

OTHER STATUTORY INFORMATION

Principal activity

The Company is the holding company of the RSA group of companies (the Group) whose principal activity is the transaction of personal and commercial general insurance business. The Group operates in 32 countries and provides general insurance products and services in around 140 countries.

Business review and results

Throughout this Annual Report, the Business Review on pages 8 to 33 and the Directors' and Corporate Governance Report on pages 40 to 54, the Board seeks to present a balanced and clear assessment of the Group's activities, position and prospects. Each of those sections is incorporated by reference into the Directors' and Corporate Governance Report, which is comprised of those reports, the information set out below and the other information which is incorporated by reference. The Group's results for the financial year are shown in the consolidated income statement on page 76.

Employment policy

The Group's approach and employment policies reflect its belief that motivated, engaged and skilled employees are critical to its success.

The Group is committed to the promotion of equal opportunities for all employees and creating a working environment that fosters diversity and inclusion. The Group seeks to ensure that recruitment, talent selection and development, reward, performance management and internal promotion are all carried out solely on the grounds of ability and are entirely free from any form of discrimination. To do this, all reasonable adjustments are made, where it is appropriate to do so, to our policies, practices, processes and terms and conditions of employment. The Group is also committed, wherever possible, to employing people who are disabled or become disabled during their career with the Group. Diversity and inclusion are encouraged and supported and in 2012 a Global Forum was established, sponsored by Group and Regional CEOs, to ensure further focus and progress

in this area. Information on the diversity of the Group's workforce can be found in the Corporate Responsibility Report. The 2013 Corporate Responsibility Report will be published in May 2013 and will be available on the Company's website, **www.rsagroup.com**.

The Group is committed to fostering a constructive relationship with recognised independent trade unions, ensuring a regular and open dialogue on business issues and early consultation on changes affecting the workforce. In the UK, Unite 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. In Scandinavia, the Group has formal meeting forums with the national unions, where the Group informs and negotiates changes affecting the workforce. Within the Group's CNS operation in British Columbia, Canada, there is a collective bargaining agreement with the Canadian Office and Professional Employees Union. The European Works Council (EWC) is a cross European body that meets annually and was created to enable information sharing and consultation on transnational issues affecting our European workforce.

The Group continues to focus on the training and development of employees in order to ensure they can deliver high levels of leadership, performance and customer satisfaction. The Group believes it can create competitive advantage by building and maintaining a high performance culture.

The Executive Development Programme is a challenging, world class development programme for the Group's top leaders which aims to build strategic leadership capability. It is sponsored by the Executive Team who are actively involved in the programme and sponsor projects. Participants work in global teams on strategically important business challenges, researching the issues and recommending a solution.

The Leadership Development Programme, which won the Chartered Institute of Personnel Development (CIPD) award for the Organisational Learning category, aims to develop business, growth and people leadership skills in those with the potential to move into a country or regional senior management role. It is a nine month programme consisting of three modules, designed to build capability in core areas of leadership. This incorporates a strategic project based on current business challenges.

The Fast Track programme is aimed at growing emerging leadership talent (employees who are in their second or third role after graduating) who have already demonstrated high performance and leadership ability. The programme is structured to equip the Group's future leaders with the commercial understanding and leadership capabilities they will need to thrive; exposing them to global networking opportunities, in-depth self-analysis and performance coaching to encourage rapid career development.

In addition to significant investment in development programmes, the Group has robust talent and performance management processes in place to ensure that continual focus on the development of people and acquisition of talent in order to ensure the future proofing of the business. The Group Chief Executive and Executive Team actively manage senior group succession plans and prepare and develop leaders for future roles. In terms of performance management, every employee works with their line manager to create individual performance goals and a personal development plan for the year, which is supported by a journal to review and measure progress.

Alongside talent and development programmes, the Group has built Centres of Excellence and Academies that support specialist and technical expertise and the sharing of best practice globally. There are Centres of Excellence for Marketing and eBusiness, as well as a long established Technical Academy.

The Technical Academy continually aims to enhance the technical capabilities of the Group's underwriting, claims and actuarial staff by providing bespoke technical training, identifying talent, facilitating career development, analysing skills gaps, developing global best practice and supporting and recognising the attainment of technical skills and qualifications within the Group. The Academy also runs a two year Global Technical Graduate Programme which had 25 participants in the 2012 cohort.

Through the Marketing Centre of Excellence, the Group aims to build a world class marketing community. The award winning Marketing Academy provides both e-learning and face to face training throughout the year and to date over 350 people, from 12 countries, have attended the foundation course as well as further specialist master classes. In addition, the marketing community regularly takes part in monthly online meetings to share knowledge, experience and insights in order to leverage expertise and best practice.

In 2011, in response to customer and partner demand, the Group created a Global eBusiness Centre of Excellence. This team, having invested in additional capacity and capability, is now delivering market leading online capabilities across the Group. This approach has allowed the Group to start standardising and leveraging our eBusiness proposition globally; for example, a preferred website analytics tool is now deployed in 22 of our worldwide businesses and the skills to design and build market leading websites are now retained in-house. The team works across all 32 countries and in 2012 delivered over 70 eBusiness projects in conjunction with local businesses. To ensure continued capability build and the sharing of skills and expertise, there is a digital training academy to further develop our eBusiness community.

Underpinning all of these development opportunities is the Group's online 'Learning Zone' that was introduced in 2010 and offers a broad range of training and development options. 'Learning Zone' is available in 13 languages, across 28 countries and is now accessible to over 22,000 employees worldwide. There are over 2,000 learning resources available as well as thousands of e-books and audio books that can be downloaded to a computer, mobile device or Kindle. To further encourage global collaboration, learning and sharing of ideas, use is made of Webex, Webinar and 'Connect' forums.

The Group is committed to having an engaged and motivated workforce, believing that this has a direct impact on customers' experience and overall long-term success. Therefore every September the Group runs a global engagement survey of employees using the Gallup Q12 questions, which measure the key drivers of engagement. The survey is completed by circa three million people globally and is open to all employees. The Group has amongst the highest participation of any client Gallup works with and in 2012, saw its highest participation ever, with 94% of employees completing the survey.

Since 2008, significant progress has been made on improving employee engagement. In 2012, a Grand Mean score of 4.29 (out of a maximum score of 5) was achieved, which places the Group in Gallup's top decile for companies with over 1,000 employees. The Group has also won a range of awards in 2012 for our engagement programme including: the Gallup Global Workplace Award, presented to the world's most engaged and productive organisations; 6th in the Sunday Times Best Big Companies to Work For and Overall Winner and Employee Engagement category winner at the prestigious 2012 CIPD People Management Awards.

The Group has a long-standing philosophy of encouraging employee share ownership, operating two HMRC-recognised share schemes: Sharebuild and Sharesave. Details of the Executive Directors' interests in Sharesave and Sharebuild are noted on pages 69 and 71. Currently, a total of 6,543 employees from across the Group participate in Sharesave, contributing an average of £73.94 per month for the three year savings plan and an average of £61.17 for the five year savings plan. Sharebuild is offered to UK employees only and currently 34% of those eligible to join the plan participate in it, contributing an average of £73.97 per month.

The Group also encourages employees and their families to acquire products at a discounted rate. The Staff Saver Scheme in the UK currently has approximately 11,500 Staff Saver policies in force. Furthermore, the UK operates a flexible benefits scheme which provides employees with additional opportunities to tailor their benefits package to meet individual circumstances. Over 50% of employees elected to participate in the scheme in 2012.

Employees are kept well informed of the overall performance and objectives of the Group. Communications are regularly provided through face to face meetings and presentations, by email, intranet articles and staff publications. Key messages from the biannual Group Leaders Conferences are disseminated to teams by the Group Chief Executive via Webex and through local management.

The Group actively encourages employees to become involved in supporting their local communities. Further details are provided in the Corporate Responsibility Report on pages 30 to 33.

Business review and management report
Section 417 of the Companies Act 2006 requires the Directors to present a business review in this report. The information that fulfils this requirement can be found on pages 8 to 33, and is incorporated by reference into this report.

The Business Review has been prepared to the best of the Directors' knowledge in order to provide the Company's shareholders with a fair review of the development and performance of the Company and the Group as a whole, together with a description of the principal risks and uncertainties which may affect the Group. It may not be relied upon for any other purpose.

Information about the use of financial instruments by the Company and its subsidiaries and its risk management policies is disclosed in the Business Review on pages 8 to 33, in the Significant Accounting Policies on pages 80 to 87. Risk Management on pages 26 to 29 and note 12.

Disclosure and Transparency Rule 4.1.5(2) also requires the Annual Report to include a management report. The information that fulfils this requirement can be found in the Business Review on pages 8 to 33 and the Directors' and Corporate Governance Report on pages 40 to 54.

Events after the reporting period
No material events have occurred since 31 December 2012.

Dividends
The Directors recommend a final dividend of 3.90p per ordinary share to be paid on 24 May 2013 to holders of ordinary shares on the register at the close of business on 5 April 2013, subject to ordinary shareholder approval. This, together with the interim dividend of 3.41p per ordinary share, will make a total dividend for the year of 7.31p per ordinary share.

The preference dividend at the rate of 3.6875% for the period from 1 October 2012 to 31 March 2013 will be paid on 2 April 2013 to holders of preference shares on the register at the close of business on 1 March 2013.

Environmental programme
Details of our environmental programme can be found on pages 32 to 33 of the Business Review. The 2013 Corporate Responsibility Report will be published in May 2013 and will be available on the Group's website at **www.rsagroup.com**.

Share capital
Details of the Company's share capital, together with details of the movements in the Company's issued share capital during the year are shown in note 18. The Company has two classes of shares: ordinary shares of 27.5p each and preference shares of £1 each. Each ordinary share carries the right to one vote at general meetings of the Company and no right to fixed income. The rights attaching to the preference shares are detailed in note 18. As at 31 December 2012, the ordinary shares and the preference shares represented 96.6 % and 3.4 % respectively of the total issued share capital. Directors are still limited as to the number of shares they can allot (save in respect of employee share schemes). The current authority allows Directors to allot securities up to a nominal amount of £323,795,833 and renewal of the Directors' authority to allot shares will be sought at the 2013 AGM. During 2012, the Directors exercised their authority to allot in respect of employee share schemes and the scrip dividend scheme.

There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the general provisions of the Articles and legislation. The Directors are not aware of any agreements between the Company's shareholders that may result in restrictions on the transfer of securities or on voting rights. Further information on the rights attaching to the shares can be found in note 18 and is incorporated into this report by reference. The Company may purchase any of its own shares (including any redeemable shares). An authority from ordinary shareholders for the Company to purchase up to 353,231,818 of its own ordinary shares (representing 10% of its issued share capital as at 15 March 2012) remained in force at 31 December 2012.

The Company operates three employee benefit trusts to hold ordinary shares in the Company which are used to satisfy grants under the Group's share incentive schemes and Capita Trustees Limited is the current Trustee of each trust. In addition, a Share Incentive Plan (Sharebuild) Trust is operated of which Capita IRG Trustees is the Trustee. The Trustees may vote in respect of any shares held in the Trusts but has no obligation to do so and, in respect of the Royal & Sun Alliance ESOP Trust No. 3, the Trustee may have regard to the financial interests of the beneficiaries in exercising its voting rights over the Company's shares.

Supplier payment policy

It is the Group's policy to agree appropriate terms and conditions in advance with its suppliers and to make payment in accordance with those terms and conditions, provided 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 Strategic Sourcing, Leadenhall Court, 1 Leadenhall Street, London EC3V 1PP.

The Company's outstanding indebtedness to trade creditors on 31 December 2012 amounted to £2.45m, corresponding to 14 days' payment when averaged over the year.

Related party transactions

Related party transactions are set out in note 32.

Essential contracts and change of control

The Company does not consider that it, or any of its subsidiaries, has any contractual or other arrangements that are essential to the business of the Group that are required to be disclosed pursuant to section 417 of the Companies Act 2006.

In the event of a change of control, agreements may require consideration to determine the impact of any change of control clauses and the Company will take appropriate action to mitigate any risk arising from these events should they occur.

Under the Company's £500m five year senior committed debt facility, if a change of control occurs, if the majority of lenders require, the facility can be cancelled with immediate effect and all outstanding loans, together with accrued interest, become due and payable.

Charitable and political donations

The Company and its subsidiaries worldwide made charitable donations of £1.6m (2011: £2.6m) during the year, of which £0.5m (2011: £0.7m) related to donations made to UK based charities. The Group's Community and Charitable policy prohibits political donations.

Directors' conflicts of interest

Each Director is required to notify the Group General Counsel and Group Company Secretary when a conflict of interest arises and the Board reviews Directors' conflicts of interest annually. Under the Articles, the Board may authorise any conflict of interest. Any Director who has declared a conflict shall not count towards the quorum or vote on any resolution to authorise the conflict of interest and, at the Board's discretion, may be excluded from any meeting at which the conflict is under consideration. Where a conflict of interest is authorised, the Board may impose such restrictions on the conflicted Director as they deem appropriate, such as excluding the Director from receipt of information or discussions.

None of the Directors had any interest in any other contract with the Company or any of its subsidiaries during 2012, save as disclosed in the Related Party Transactions note 32.

The Board confirms that it has reviewed the schedule of Directors' conflicts of interest during the year and that the procedure in place operated effectively in 2012.

Articles of Association

The Company's Articles may be amended by special resolution of the Company's ordinary shareholders. The current Articles were adopted at the 2010 AGM and are available on the Company's website at **www.rsagroup.com**.

Borrowing powers

The Articles restrict the borrowings of the Company so that the aggregate amount, for the time being, remaining borrowed by the Group is not, without the previous sanction of an ordinary resolution of the Company, more than one and a half times the aggregate of:

- The amount paid up on the issued share capital of the Company
- The total of the capital and revenue reserves of the Group (subject to certain adjustments).

Directors' indemnity

Article 140 of the Articles provides that, among other things and insofar as permitted by law, the Company may indemnify its Directors against any liability and may purchase and maintain insurance against any liability.

The Company has granted an indemnity to each of the Directors pursuant to the power conferred by Article 140. The indemnities granted constitute qualifying third party indemnity provisions (as defined by section 234 of the Companies Act 2006). The Board believes that it promotes the success of the Company to provide this indemnity to its Directors in order to ensure that the Group attracts and retains high calibre Directors through competitive terms of employment in line with market standards.

The Directors and Officers of the Company and its subsidiaries also have the benefit of insurance which provides suitable cover in respect of legal actions brought against them.

In addition, the Company has indemnified the Directors of SAL Pension Fund Limited, a majority owned subsidiary of the Group, in relation to its role as Trustee of an occupational pension scheme. This indemnity constitutes a qualifying indemnity provision under section 235 of the Companies Act 2006.

Directors' responsibility statement
The Directors' responsibility statement appears on page 74 and is incorporated by reference into this Report.

By order of the Board

Derek Walsh
Group General Counsel and Group Company Secretary
19 February 2013

GROUP AUDIT COMMITTEE REPORT

"This report sets out the membership and responsibilities of the Group Audit Committee and its key activities in 2012. As in previous years, the Committee has reviewed the Group's financial reporting, internal control and risk management systems and the independence and effectiveness of the external auditor. In order to assist the Committee in discharging its responsibilities, regular reports are received from the Group CFO, the Disclosure Committee, the Group Chief Actuary, regional audit or management control committees, the external auditor, the Group Chief Auditor and Regulatory Risk & Compliance. The Committee, on behalf of the Board, also led the tender process for the appointment of a new external auditor for 2013, following the impending appointment of Deloitte LLP to undertake additional consultancy work in Scandinavia on our behalf. The Committee has recommended to the Board that KPMG LLP be appointed as the external auditor, which the Board has accepted for submission to shareholders"

Alastair Barbour, FCA
Chairman, Group Audit Committee

This report should be read in conjunction with and is incorporated by reference into the Directors' and Corporate Governance Report.

GROUP AUDIT COMMITTEE

Membership and attendance at 2012 meetings	
Alastair Barbour (Chairman)[1]	5/5
Noel Harwerth	4/5
Edward Lea[2]	5/5
Johanna Waterous	4/5

Notes:
1. Alastair Barbour became Chairman of the Committee on 1 June 2012.
2. Edward Lea resigned as Chairman of the Committee on 1 June 2012 and continues to serve as a Committee member.

PRINCIPAL DUTIES OF THE GROUP AUDIT COMMITTEE (GAC)

- To coordinate and oversee the integrity of the financial reporting process
- To monitor compliance with regulations, industry codes and legal requirements which affect the Group's operations
- To provide assurance on the effectiveness of the Group's financial and regulatory risk management systems
- To oversee the internal audit function
- To manage the effectiveness of the Group's systems of internal controls
- To review the Group's financial performance
- To review and monitor the independence and performance of the external auditor and develop policy in relation to the provision of non-audit services.

2012 KEY ACTIVITIES

- Reviewing all results announcements and the 2011 Annual Report and Accounts with particular emphasis on their fair presentation, the reasonableness of judgements made, valuation of assets and liability balances and the appropriateness of significant accounting policies used in their preparation together with the application of those policies
- Reviewing the Financial Control Framework on a quarterly basis
- Reviewing the effectiveness of internal controls and risk management process
- Reviewing regular reports from the Group CFO, Disclosure Committee, the Group Chief Actuary, regional audit or management control committees, the external auditor, the Group Chief Auditor and Regulatory Risk & Compliance
- Approving non-audit services provided by the external auditor
- Evaluating the external auditor's performance
- Approving the 2013 Group Internal Audit Plan
- Approving the 2013 Regulatory Risk & Compliance Plan
- Assessing the independence of the external auditor and overseeing the process for tendering the appointment of the Group's Auditor.

Membership

The GAC is comprised solely of independent Non-Executive Directors. As requested by the UK Corporate Governance Code, the Board is satisfied that all of the members have recent and relevant financial experience. The Group Chief Executive, Group CFO, Group General Counsel and Group Company Secretary, Group Chief Auditor, Group Head of Regulatory Risk & Compliance and representatives of the external auditor are regular attendees by invitation. The Chairman and other members of executive management are also invited to attend from time to time.

Terms of Reference

The terms of reference set out the authority of the Committee to carry out its duties. The Committee reviewed its terms of reference during the period and these are available on the Company's website at **www.rsagroup.com**.

Meetings

The outcomes of meetings are reported to the Board and the Board receives the minutes of all the GAC meetings. The GAC has unrestricted access to Company documents and information, as well as to employees of the Company and external professional advisers. Regular reports are received and reviewed by the GAC from the Disclosure Committee and regional audit or management control committees and in relation to the Financial Control Framework and Enterprise Risk Management. The GAC members meet privately at the start of each scheduled meeting to discuss issues to be raised with management in the meeting. The GAC holds regular meetings with the Group Chief Auditor, the Group Head of Regulatory Risk & Compliance and the external auditor without any other members of management being present to allow issues to be raised.

To assist the GAC with carrying out its duties, responsibility for identifying and considering disclosure matters in connection with the preparation of all market releases containing material financial information has been

delegated to a Disclosure Committee. The Disclosure Committee comprises members of senior management from Finance, Legal, Investor Relations, Company Secretarial and Risk and is chaired by the Group General Counsel and Group Company Secretary.

The GAC is satisfied that, during 2012, it has received sufficient, reliable and timely information from management to enable it to fulfil its responsibilities.

Evaluation

The evaluation of the GAC, which was conducted by way of a structured questionnaire, included consideration of the composition of the Committee, the number and length of meetings held, the time management of the Committee, the information received by the Committee and its timeliness and the effectiveness of the Committee's reviews of specific areas. The evaluation further considered the effectiveness of the Group Internal Audit function, the relationship with the external auditor and with the Board Risk Committee (BRC). Priorities for focus were identified as refining the relationship between the GAC and the BRC and a review of the training programme for 2013.

Whistle blowing

The Company's policy on whistle blowing provides a mechanism for employees to raise serious concerns in good faith, where they either do not feel comfortable raising the matter with local management or are not satisfied with the local management response. The GAC annually reviews the policy and is satisfied that it meets the criteria set out in the Code, and is well communicated with good processes in place.

Regulatory compliance

The Board is responsible to the Financial Services Authority (FSA) for ensuring compliance with the Group's UK insurance regulatory obligations. The Board attaches great importance to its regulatory responsibilities and is committed to dealing with the regulator in an open, cooperative and transparent manner.

During 2012 the GAC, on behalf of the Board, followed with interest, the progress of the Financial Services Bill through Parliament. Meetings were held with representatives of both the Prudential and Conduct Business Units established by the FSA in anticipation of their legal separation into two regulatory authorities in April 2013. The GAC also paid close attention to developing EU regulation, in particular Solvency II.

The FSA conducted private meetings with several members of the Board and executive management as a part of their 'close and continuous' programme.

In addition, the Group includes a number of regulated entities which rely on various licences to carry out their business. Accordingly, maintaining effective relationships with the Group's regulators across the world is integral to the success of the Group's strategy and its long-term value.

External auditor

Deloitte LLP was appointed as the Group's external auditor in 2007. The GAC evaluates the tenure of Deloitte LLP annually and is not restricted by any contractual obligations in its choice of auditor. The audit engagement partner responsible for the 2012 audit was assigned in 2012.

The GAC has developed and embedded a policy and procedures to govern the provision of audit and non-audit services provided by the auditor and its associates. A description of the policy and procedures is available on the Company's website at **www.rsagroup.com**. During the year Deloitte LLP was engaged as an adviser on a number of occasions. In order to maintain their independence, such appointments are only made in accordance with the policy. This provides that the external auditor should not carry out work where the output or recommendations are then subject to review and reliance upon by the firm as external auditor. Work may be given to the external auditor where it is closely allied with the audit function or it is advantageous to the Group to use its external auditor in view of its knowledge and experience of the Group. This could include accounting advice, regulatory returns, tax advice or due diligence work. All non-audit work over £100,000 must be approved in advance by the Group CFO and all non-audit work over £250,000 must be approved in advance by the GAC Chairman on recommendation from the Group CFO. With reference to the procedures, the GAC is satisfied that there are no matters that would compromise the independence of the external auditor or affect the performance of its statutory duties. Details of fees paid to Deloitte LLP during 2012 for audit and non-audit work are disclosed in the auditor remuneration table in note 4. There is no limitation of liability in the terms of appointment of Deloitte LLP as auditor to the Company.

During the year, the GAC performed a review of the effectiveness, objectivity and independence of the external auditor. The review included an assessment of the audit firm, the audit partner and audit teams, and was conducted by means of a questionnaire, completed by members of senior management and members of the Group's finance team and the GAC. The questionnaire sought opinions on the importance of certain criteria and the performance of the external auditor against those criteria. The GAC has concluded that during the year Deloitte LLP provided a service that was robust and fit for purpose. However, following the impending appointment of Deloitte LLP to undertake additional consultancy work in Scandinavia, the Board and Deloitte LLP felt it appropriate that they resign as the Company's external auditor. Rigorous safeguards have been put in place to ensure the continued independence of Deloitte LLP for the 2012 audit process. A tender process for the external audit contract has recently concluded and the GAC has recommended to the Board that a resolution be put to the 2013 AGM for the appointment of KPMG LLP as external auditor. The Board has accepted this recommendation.

So far as each Director of the Board is aware, there is no relevant audit information (as defined in section 418(3) of the Companies Act 2006) of which the Company's external auditor is unaware, and each Director has taken all steps necessary as a Director in order to make himself/herself aware of, and to establish that the external auditor is aware of, any relevant audit information.

Group Internal Audit (GIA)

The activities and effectiveness of the GIA are monitored and reviewed by the GAC. The GAC is responsible for ensuring that adequate access to information and resource is given to the Group Chief Auditor and for approving the appointment to and removal of the holder from, that position. In September 2012, Caroline Ramsay was appointed as Group Chief Auditor and a member of the Group Executive team. Her biography is on page 39. Her predecessor, Anne Jæger, became Chief Risk and Compliance Officer in Scandinavia at the same time.

The GIA reports to management on the effectiveness of the Company's systems of internal controls and the adequacy of these systems to manage business risk and to safeguard the Group's assets and resources. The GAC reviews and approves the annual Group Internal Audit Plan following presentations from the regional CEOs and regional auditors.

Financial Control Framework

The Financial Control Framework aims to deliver a consistent approach to finance related controls across the Group that is 'fit for purpose' for all regions, embedding a control culture that strengthens the Group's finance environment by ensuring that the Group's financial processes are managed effectively in order to mitigate the associated risks. This is done by documenting and testing the way that core elements of the business operate, providing a high degree of transparency around the Group's financial control environment. The Group has people, procedures and tools embedded in the business to maintain and streamline the control environment and to provide ongoing reporting and assurance. Quarterly reports were presented to the GAC on the assessment and testing of controls and which included notification of any control deficiencies or breaches in the period and action taken.

Internal Control

The Board has overall responsibility for the Group's internal control systems and for monitoring their 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 GAC and the Board annually reviews the effectiveness of the Group's systems of internal control in order to safeguard the Group's assets and shareholders' investment. This system includes governance, financial controls, the risk management framework and the process to deliver regulatory and compliance requirements. The systems are designed to identify and mitigate, rather than eliminate, the potential risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material financial misstatement or loss. In February 2013, the GAC and the Board reviewed the systems of internal control in operation during 2012. No significant failings or weaknesses were identified.

The Board, through the GAC, receives reports from the Group Chief Auditor and her team on the integrity of the control environment and also receives reports from the external auditor based upon its audit work. The GAC also receives reports on the adequacy of the Group's arrangements for ensuring regulatory compliance from the Group Head of Regulatory Risk & Compliance. The Board, through the BRC, considers reports from risk specialists across the Group and reviews Group-level risk management information.

A quarterly self certification process is completed by business managers across the Group to confirm the adequacy of controls and their compliance with Company policies, local laws, rules and regulations.

The current reporting framework delivers information to monitor the systems of internal control and to review their effectiveness as required by the Code. The Board therefore considers that an ongoing process for identifying, evaluating and managing the significant risks faced by the Group has been in place during 2012 and up to the date of approval of the Annual Report and Accounts. This process is regularly reviewed by the Board and accords with the revised Turnbull Guidance.

Key features of the current internal control systems of the Group include internal audit, the corporate governance framework, dialogue with institutional shareholders, constructive use of the AGM and the areas described in the Accountability section in this report.

Alastair Barbour, FCA
Chairman, Group Audit Committee, on behalf of the Board
19 February 2013

DIRECTORS' REMUNERATION REPORT

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Dear Shareholder,

As Chairman of the Group Remuneration Committee of the Board, I am delighted to present this report for your approval covering the year to 31 December 2012. However, before I begin, I would like to thank my predecessor, John Maxwell, for his long-standing and valued contribution to the Committee.

The operating and market environments remain challenging and, as Martin Scicluna has noted in his opening statement on page 8, RSA has reported good growth and financial performance across its businesses, despite the year's poor weather. The Group has delivered a Combined Operating Ratio of 95.4%, Net Written Premium of £8,353m and profit before tax of £479m for the year. Against this context, the Executive Directors' 2012 cash and compulsory deferred shares bonus awards have ranged from 69% to 80% of salary out of a maximum 160% of salary. This reflects RSA's performance against challenging targets and the strong individual performance of the Executive Directors; however, cash bonus awards have decreased by around one third in relative percentage of salary terms from 2011. In the year, the performance shares vested at 31% of the maximum, as did the matching shares derived from the compulsory deferral from the bonus awarded in 2009 earned for the 2008 financial year. The matching shares derived from the voluntary deferral from the 2008 bonus vested at 44% of the maximum. These outcomes reflect RSA's 11.5% average underlying Return On Equity (ROE) over the three-year period. Relative Total Shareholder Return (TSR) was below median. Further details of the remuneration outputs for the year are on pages 62 to 65.

The Committee reviewed Executive Directors' salaries and has agreed increases ranging from 2%-3% of salary, reflecting RSA's pay policy noted on page 60.

Shareholders were supportive of the Directors' Remuneration Report put to them at the 2012 AGM for the 2011 financial year. The Report received a positive vote of 93.6%.

We appointed Richard Houghton on 12 June 2012 as Group Chief Financial Officer from Aspen Holdings Limited to succeed George Culmer who left RSA on 14 May 2012 to join Lloyds Banking Group. Mr Houghton did not receive any sign-on payments or buyouts; however, his RSA bonus award was calculated according to the Group's performance in 2012 and was not pro-rated for time. The Committee made this decision to ensure that he was covered by a bonus arrangement for the full financial year. Shortly after his appointment, he received an award of performance shares in the LTIP equal to 150% of his salary; the inclusion of new senior hires in the LTIP is normal practice.

There were other changes to the Board in the year. The Group's Chairman, John Napier, retired from the Board on 31 December 2012 and he is succeeded by Martin Scicluna who commenced on 1 January 2013. Lastly, I was delighted to join RSA as a Non-Executive Director on 26 September 2012.

In the 2011 Remuneration Report, the Committee indicated its intention to conduct a wide-ranging review of RSA's remuneration arrangements during 2012. This review has concluded and a series of changes are now underway to further shape and improve the structure and detail of executive remuneration. Some of these changes have been implemented, while others will be determined over the next 12 months for adoption in 2014, pending any formal shareholder approval that may be required. This phased approach takes account of my recent appointment and gives our new Chairman an opportunity to input into the future remuneration framework. It also enables these further changes to fully take account of wider evolving legislation and best practice on executive remuneration ahead of the required shareholder vote on remuneration policy at the 2014 AGM.

We have consulted with RSA's 20 largest shareholders and the UK's principal corporate governance bodies on the following remuneration changes.

Remuneration benchmarking policy

In accordance with recommended practice, the Committee sets remuneration levels having regard to appropriate market data. The Committee has agreed that, from 2013 onwards, market data will be taken from two distinct peer groups which will be used to inform the judgement on appropriate pay positioning. These peer groups reflect the markets where RSA typically competes for talent and where remuneration structures and award levels are most similar to RSA; these are noted on page 60. Prior to 2012, RSA's policy was to benchmark executive remuneration against the FTSE 100 and the UK financial services sector, including banks.

Annual bonus plan

RSA's strategic focus is on generating sustainable earnings growth to increase shareholder value. In support of this, the annual bonus plan for 2013 will cease to incentivise growth in Net Written Premium. All executives will be targeted on profit performance, as measured by Group underlying Return on Equity (ROE). The calculation will exclude all net gains or losses to remove the impact of accounting volatility arising from trading RSA's investment portfolio. This metric will be the sole financial bonus element for executives who work at a Group level, including Simon Lee, Group Chief Executive and Richard Houghton, Group Chief Financial Officer. Divisional business leaders, including Adrian Brown, Chief Executive: UK and Western Europe and a director of the Company, will be incentivised against regional Combined Operating Ratio performance in addition to Group underlying ROE. In 2011, the Committee reduced the maximum bonus that could be earned by Executive Directors from 180% of salary to 160% of salary; this quantum level remains market aligned and will continue for 2013.

Long-term incentive plan (LTIP)

The current LTIP has been in place since 2006 when it was first approved by shareholders, and the Committee has refined it for the 2013 grant cycle following a robust modelling and testing process:

a) The Committee has removed those companies which are reinsurers or predominantly life insurers from the current relative TSR peer group to ensure that its constituents more closely align with RSA's insurance lines and geographies. The new peer group is noted on page 61;

b) Following careful consideration, the relative TSR outcome will be derived through using the peer group as an unweighted index, rather than a rank. The level of outperformance to be reached in the index approach will be equivalent in stretch to the current ranking methodology used by RSA, i.e. median rank for entry-level awards and upper quintile rank for maximum-level awards for this element. The reason for this decision is that, for RSA, an index produces a more stable and equitable outcome than a simple ranking method. In particular, although the basket of companies chosen provides, in its totality, a good comparator for RSA, individual constituents within the group in a number of cases reflect just a part of RSA's business. This means that comparing RSA's performance with the comparator group as an index is a more robust measure of performance. The Committee believes that the measure should be fair, so it can act as an effective incentive; and

c) The final LTIP change concerns the performance targets used to measure the underlying ROE performance condition. Since the economic downturn commenced, the decline in 'risk free' rates and subsequently bond investment yields have had a significant impact upon RSA, as they have upon other financial service sector companies. The current ROE target range of 10%-16% has been in place since the LTIP was launched in 2006, with the exception of one year, 2008, when it was raised to 12%-18%. The Committee has carefully considered the landscape in which RSA operates, together with its future plans. It has agreed that conditional awards granted in 2013 will be against a target scale of 9%-14%. This does not soften the degree of performance that needs to be achieved by executives, as inherent stretch is being maintained through the constraints being placed on RSA to grow its earnings in the context of its risk appetite and the current investment environment – consistent with the same challenge being faced by its competitors. The Committee will continue to monitor the external conditions in which RSA operates and will review the target range annually; it will revise them as is appropriate.

In 2011, the Committee reduced the maximum number of matching shares that could be earned through the LTIP from 2.5x to 2x, applying to both compulsory and voluntary deferred bonus shares. This level of award quantum will be maintained for the 2013 grant. The normal maximum number of performance shares that can be awarded also remains at 150% of salary.

It is the Committee's intention to develop a new long-term incentive plan in 2013, with a view to seeking shareholder approval for its launch at the AGM in 2014. The design will be simple and relevant, so that it is straightforward for both participants and shareholders to understand. As part of this review of the long-term incentive plan structure, the Committee will also consider retention and shareholding guidelines in the context of emerging best practice.

Clawback of awards

The Committee has considered the application of clawback terms within RSA's incentives and has agreed that these should form a part of both the bonus and LTIP. Deferred awards arising from the 2013 financial year and/or unvested awards granted in 2013 will be subject to forfeiture or reduction under certain circumstances. The policy is noted in more detail on page 65.

I am committed to building strong relationships with RSA's shareholders and communicating its remuneration policy, practices and decisions in a transparent way. I hope you find this report clear and informative, and the Board looks forward to your support at the AGM.

Hugh Mitchell
Chairman, Group Remuneration Committee

This report follows the UK requirements of the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, the Listing Rules and the UK Corporate Governance Code. It outlines the remuneration policies and individual remuneration details of the Executive Directors and Non-Executive Directors of RSA Insurance Group plc for the year ended 31 December 2012. The Board has approved this report and it will be presented to shareholders for approval at the 2013 AGM.

SECTION 1 – GROUP REMUNERATION COMMITTEE

Purpose of the Committee

The Group Remuneration Committee is a formal Committee of the Board, accountable to shareholders through its policies, actions and decisions which are contained in the annual Remuneration Report, upon which shareholders make an advisory vote at the AGM. Its accountabilities include:

- To determine the terms and conditions and remuneration of the Chairman of the Board, the Executive Directors and the Executive Team whose profiles are noted on pages 36 to 39
- To oversee the operation of the executives' incentive plans, including approving the value and timing of awards and setting and monitoring performance conditions
- To have regard to any concerns raised by the Board on the implications of the remuneration policy for risk and risk management
- To provide a draft of the Remuneration Report to be included in the Company's Annual Report and Accounts to members of the Board Risk Committee for review in respect of risk and risk management (to the extent not reviewed by the Board as a whole).

The Committee's terms of reference were significantly updated and strengthened in 2012; they are available on RSA's website at: **www.rsagroup.com** or upon written request from the Group General Counsel and Group Company Secretary.

Committee members

The Committee comprises a number of independent Non-Executive Directors and also, for 2012 the Group Chairman, who are called upon to exercise independent judgement on the setting and management of executive remuneration. The members of the Committee in 2012 are detailed in the table below, alongside the number of meetings they attended. The maximum number of meetings that each Director could attend during the year is noted in brackets.

Non-Executive Director	Meetings held in 2012	
	Scheduled (6)	Ad hoc (1)
Edward Lea	6 (6)	1 (1)
Malcolm Le May	6 (6)	1 (1)
John Maxwell[1]	5 (5)	0 (0)
Hugh Mitchell[2] (Chairman)	2 (2)	1 (1)
John Napier[3]	5 (6)	0 (0)
Jos Streppel	6 (6)	1 (1)

Notes:

1. Mr Maxwell was Chairman of the Group Remuneration Committee until 27 September 2012; his membership of the Committee ceased after this date.
2. Mr Mitchell was appointed as Chairman of the Group Remuneration Committee on 27 September 2012.
3. The ad hoc meeting covered Mr Scicluna's appointment.

Following John Napier's retirement from the Board on 31 December 2012, the Board agreed that his successor, Martin Scicluna, is not required to be a member of the Group Remuneration Committee. This decision was taken to reflect that the Committee's collective knowledge and expertise has been further strengthened following the appointment to it of Jos Streppel and Hugh Mitchell. However, Martin Scicluna may attend Committee meetings by invitation. With effect from 1 March 2013, Edward Lea ceases to be a member of the Committee and is replaced by Johanna Waterous.

Committee attendees

Several executives attend Committee meetings by invitation to advise on Group strategy, performance, HR and remuneration policies and practices. However, none of these attendees have a right to be present and they leave the meeting if their own remuneration is being discussed. The table below notes the Committee attendees during 2012.

Remuneration Committee attendee	Position
Derek Walsh	Group General Counsel & Group Company Secretary (Secretary to the Committee)
Simon Lee	Group Chief Executive
Vanessa Evans	Group Human Resources Director
Leigh Harrison	Group Reward Director

External advisors

During the year, the Committee obtained advice from Towers Watson and PricewaterhouseCoopers (PwC). Towers Watson acted as the Committee's principal independent adviser from January to June 2012 and it also supplied executive remuneration benchmarking data. In addition to providing advice to the Committee, Towers Watson advised RSA on general remuneration and pension-related matters in the year.

PwC was formally appointed as the Committee's independent adviser in September 2012 following a market tender exercise. It is a member of the Remuneration Consultants' Group and a signatory to its Code of Conduct. PwC provides wide-ranging advice and consultancy services across RSA globally on matters including reinsurance, IT, internal audit, corporate social responsibility, direct and indirect tax and governance.

The Committee received legal advice in the year from Linklaters and Allen & Overy.

Evaluation

During the year, the Committee reflected on feedback arising from the 2011 evaluation. Members' knowledge was kept up to date through a series of meetings convened with external advisers as part of the wider remuneration review, while the Committee's terms of reference were revised. An evaluation was conducted of the Committee in December 2012 and it considered matters such as its composition, advisers, meeting schedule and remuneration policy. Members identified future challenges arising from the macro economic environment, rapidly changing corporate governance and legislative landscapes, and the need to balance executives' and shareholders' interests.

Committee meetings held in 2012

Under its terms of reference, the Committee is required to meet at least twice each year, but it meets as often as is necessary to ensure that it can fully report to the Board and shareholders on all relevant matters. In the year, the Committee met on seven occasions – six regular meetings and one ad hoc meeting – and discussed, amongst other things, the subjects described in the next table. Over the course of several months, the Company reviewed its remuneration arrangements and members of the Committee were invited to give their input to it via six steering group meetings convened for this purpose. The letter to shareholders on pages 55 to 56 summarises the conclusions of the remuneration review.

Summary of the Group Remuneration Committee meetings held in 2012

Meeting	Regular items	Additional items
January	• Performance update and associated payout projections of the annual bonus plan 2011 and LTIP cycle 2009-2011 • Committee meeting schedule for 2012 • Outputs of the Remuneration Committee Effectiveness Survey 2011.	• Impact of the organisation restructure on the remuneration of the CEOs for Canada, Scandinavia and UK & Western Europe • Exceptional LTIP grant in 2012 for the CEO, UK & Western Europe • Approval of the rules relating to the Scandinavia Deferred Bonus Plan.
February	• Testing of the performance conditions underpinning the annual bonus plan 2011 and the LTIP cycle 2009-2011.	• LTIP forms of award and historic award levels • Appointment terms of the Group Chief Financial Officer • Head office restructuring programme.
March	• Review of the Directors' base salaries and approval of increases for 1st April 2012 • Approval of the Directors' bonus awards for 2011 • Approval of awards to vest under the LTIP cycle 2009-2011 • Approval of the 2012 annual bonus plan.	• Review of the LTIP rules.
April	• Approval of the terms of the LTIP cycle 2012-2014 and directors' associated conditional share awards • AGM briefing notes on Directors' remuneration.	• Terms of reference of the remuneration review • Corporate governance update.
September	• Approval for a supplementary grant of conditional LTIP awards in November 2012 for non-Board employees who had joined the Group after the main grant date • Approval to operate Sharesave in 2012.	• Revised Remuneration Committee terms of reference • Appointment of PwC as independent advisor • Appointment terms of the Group Chief Auditor • Handover of Committee Chair role from Mr Maxwell to Mr Mitchell.
November (ad hoc meeting)		• Appointment terms of Martin Scicluna as Chairman for submission to the Board for approval.
December	• Performance update on the annual bonus plan 2012 and LTIP cycles for 2010, 2011 and 2012 • Summary of the LTIP awards made during 2012 and an update on dilution levels • Market data for the 2013 salary review • Committee meeting schedule for 2013.	• Outputs of the remuneration review, which included the bonus design and performance targets for 2013, and revisions to the LTIP for the 2013 grant cycle • Revised pay benchmarking approach for approval • Change to Directors' private medical insurance benefit • Termination arrangements of Mr Napier.

SECTION 2 – REMUNERATION STRATEGY AND POLICY FRAMEWORK FOR 2013

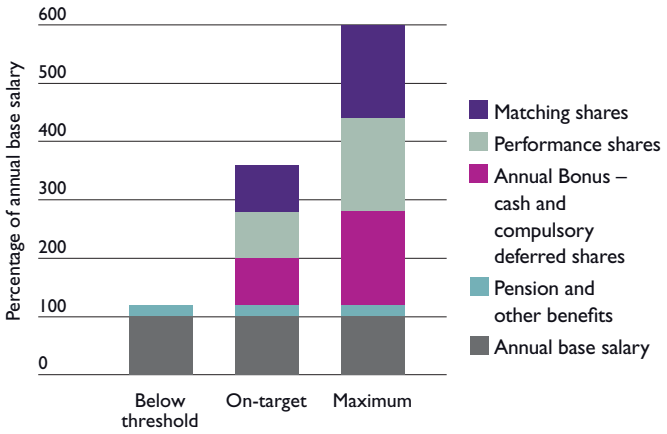
For over 300 years, RSA has consistently been respected by its customers and peers for its expertise in assessing and underwriting risk, and this still remains the backbone of the Group. Attracting, retaining and rewarding high calibre talent has never been more critical in today's competitive, global insurance market and RSA has developed an effective remuneration strategy in response to these pressures.

RSA believes that people are core to its business, whether they are customers, shareholders, employees or regulators. The remuneration strategy is aligned closely to the business strategy and draws on the interests of each of these stakeholder groups – how this is achieved is explained in the table on pages 60 to 61, alongside the remuneration policy for 2013. RSA operates a pay-for-performance culture across the Group and the reward principles and incentive framework applied to Executive Directors informs the remuneration policy and incentives for the Executive Team and other employees.

The Committee reviews the remuneration policy at least annually and any material changes to it are communicated to major shareholders and the corporate governance bodies in advance of implementation. As noted in the letter to shareholders on pages 55 to 56, several policy changes have been agreed for implementation in 2013 following a remuneration review and these are set out in the table on pages 60 to 61. The Committee will be further reviewing the LTIP, shareholding guidelines and holding policy during 2013 with a view to introducing a new LTIP in 2014, subject to shareholder approval.

A significant proportion of the Executive Directors' remuneration is variable, i.e. it is subject to performance conditions and is therefore 'at risk'. The chart below shows how the composition of their remuneration package changes using the face value award levels for 2013 and three different performance scenarios: below threshold (below expectations), on-target (in line with expectations) and maximum (outstanding). In the on-target scenario, around 65% of the Executive Directors' package consists of variable remuneration, rising to around 80% of the package for outstanding performance. The analysis assumes that the maximum voluntary bonus deferral is made into the LTIP in each case, and an average value of pension and other benefits is applied. No share price growth has been factored into the calculations, nor have accrued dividends or their equivalents.

Composition of Executive Directors' remuneration package at different levels of performance



Elements of remuneration

Purpose and strategic link	Policy for 2013
Base salary (fixed remuneration) Salaries are set at a level sufficient to attract and retain executives, taking account of their roles and individuals' expertise and experience.	• Reviewed annually with consideration of: market positioning, internal pay relativities, salary budgets, inflation and affordability • Benchmarked referencing the market median sourced from two peer groups of listed international insurers and FTSE listed companies of comparable market capitalisation to RSA, excluding banks and 'heavy' industries • Judgement is applied to ensure that pay decisions are not purely data-driven and recognise the impact of increases on other elements of remuneration.
Pension and other benefits (fixed remuneration) Pension and other employment benefits are provided at market competitive levels, reflecting the role, company size and sector.	• Benefits include non-contributory pension plan membership or cash allowance, company car or cash allowance, private medical cover, life assurance, discounts on certain insurance products, and participation in Sharesave and Sharebuild • Only annual base salary is pensionable • Executives are not compensated for any changes in taxation.
Annual bonus plan (variable remuneration) Supports RSA's short-term objectives. Targets are directly linked to RSA's operational plan and reflect RSA's priority to create shareholder value through sustained growth and profitability, based on its risk profiles. Deferral into shares creates shareholder alignment and acts as a retention mechanism.	• All permanent employees are eligible to receive a cash bonus award • Awards are calculated against annual targets and are made in cash and compulsory deferred shares • Overall bonus opportunity is set at a level to be market competitive. Awards subject to deferral arising from the 2013 annual bonus plan can also be forfeited or reduced prior to their release according to RSA's clawback policy summarised on page 65.
Long-term incentive plan (LTIP) (variable remuneration) Incentivises delivery against share price and profit growth targets. Share awards further the alignment of executives' and shareholders' interests, supported by RSA's Shareholding Guidelines. Under this policy (detailed on page 65) at least 50% of vested shares, net of statutory deductions, must be retained until the holding requirement has been achieved.	• Performance metrics chosen to give shareholder alignment and support business strategy • LTIP grants are made annually to a range of senior employees across the Group • Awards are made in the form of performance shares and matching shares which vest subject to performance conditions • Performance conditions are measured over three financial years and are not retested. Conditions are reviewed annually • Dividends do not start to accrue until after vesting • Unvested share awards granted from 2013 onwards can be subject to forfeiture under RSA's clawback policy as noted on page 65.
Leaver treatment Ensures fair treatment for departing executives while avoiding payment for failure.	• Executives who resign or are dismissed for cause are, by default, not eligible for an annual bonus if they have left or are under notice at date of payment, and forfeit all deferred bonus shares and LTIP shares, other than those shares that have been voluntarily deferred into the LTIP • At the Committee's discretion good leavers (normally including such circumstances as retirement, death, disability, and redundancy) may be eligible for an annual bonus for the proportion of the bonus year served • Deferred bonus shares will normally vest in line with the normal timetable, and LTIPs may vest subject to performance and time-prorating.

Opportunity and performance conditions	Key changes to policy from 2012
• Performance conditions do not apply to this element of remuneration • 2013 base salary for Executive Directors (with effect from 1 April 2013): – Simon Lee: £824,000 – Richard Houghton: £494,400 – Adrian Brown: £484,500.	• As a result of a review, RSA no longer benchmarks pay against the FTSE 100 and the UK financial services sector; it introduced two new peer groups in 2012.
• Provided at a level consistent with other senior employees • Employer pension contributions for Executive Directors are: – Simon Lee: 25% of salary – Richard Houghton: 13.18% of salary – Adrian Brown: 17.5% of salary • Performance conditions do not apply to this element of remuneration.	• No changes.
• On-target bonus opportunity is 80% of salary, rising to 160% of salary for maximum performance • Up to 50% of the Executive Directors' bonus is deferred into RSA shares • 70% of the bonus is based on financial targets. For 2013, measures for Executive Directors are: Group underlying Return on Equity (ROE) and, also for Adrian Brown, the Combined Operating Ratio for the UK & Western Europe division • 30% of the bonus is based on scorecard metrics including operational goals, customer satisfaction/retention, employee engagement and regulatory compliance/risk objectives.	• For 2013 Net Written Premium has been removed as a performance measure and Group underlying ROE introduced • A new clawback policy has also been introduced for 2013, noted on page 65.
• Normal maximum of 150% of salary annually (250% of salary in exceptional circumstances) • A maximum of two matching shares are granted for each share deferred from the 2012 bonus award • For conditional LTIP awards to be granted in 2013: – 70% Group underlying Return on Equity (ROE) – 30% relative Total Shareholder Return (TSR) • Any matching shares linked to voluntary deferral will vest solely according to ROE • 25% of the ROE part of the award will vest for three-year average ROE of 9% with full vesting for ROE of 14% • TSR performance will be compared to an unweighted index of comparators • 25% of the TSR part of the award will vest if RSA's TSR is equal to the index with full vesting if RSA outperforms the index by at least 7% per annum (22.5% compound over three years) or exceeds the TSR of the highest performing company in the index • A straight line calculation is applied for performance realised between the threshold and maximum targets • The TSR comparator group for 2013 comprises: ACE, Admiral, Allianz, Amlin, Aviva, Catlin, Direct Line, Gjensidige Forsikring, Intact, Hiscox, Mapfre, QBE, Topdanmark, Trygg and Zurich.	• The ROE target range for 2013 has been revised and further context for this revision is provided in the shareholder letter on pages 55 to 56 • The TSR comparator group has been refined to ensure alignment with RSA's insurance lines and geographies • The methodology for measuring TSR performance has also been changed from a ranked to an unweighted index basis to deliver a more robust measure of performance for this peer group • As noted above, a new clawback policy has also been introduced for 2013, noted on page 65.
• Where good leavers receive pro-rated bonus or LTIP awards, performance is tested in line with the normal performance timetable.	• No changes.

SECTION 3 – EXECUTIVE DIRECTORS' CONTRACTS AND EXTERNAL APPOINTMENTS

Service agreements

Each of the Executive Directors is employed under a service agreement, which contains a variety of contractual terms and conditions. Under normal circumstances, the service agreement in respect of each Executive Director continues until age 65; the agreements may, however, be terminated earlier by the Company or the individual, by the serving of 12 months' notice. Each of the Executive Directors' agreements contain restrictive covenants that protect RSA's interests should the individual leave the Company.

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 and payments may be made on a phased basis. None of the Executive Directors have terms in their service agreements which allow them additional rights or payment in the event of a reconstruction or amalgamation of the Group. The Company has the contractual right to place the Executive Directors on garden leave for part or all of their notice period.

The Executive Directors' service agreements became effective on the following dates:

Director	Effective date
Simon Lee	1 November 2011
Richard Houghton	12 June 2012
Adrian Brown	5 July 2011
George Culmer[1]	1 May 2004

Note:
1. George Culmer ceased to be employed by the Group on 14 May 2012.

External appointments

The Board recognises the value that can be gained from its executives obtaining wider experience outside of RSA. Where appropriate, and with the Chairman or Group Chief Executive's prior approval, Executive Directors and the Executive Team may hold one external Non-Executive appointment and may retain any remuneration arising from performing such a role. Simon Lee is a member of the Board of the Association of British Insurers for which he receives no remuneration.

SECTION 4 – REMUNERATION OUTCOMES AND OTHER MATERIAL MATTERS

1. Fixed remuneration

Base salary

The Committee reviewed the Executive Directors' salaries during 2012 and did so referencing a range of information including market data taken from the insurance sector and the FTSE 50-100, UK inflation figures and the average reviews applied elsewhere in the Group, including those for employees subject to collective bargaining agreements. The Committee made salary review decisions through the application of judgement, so as to avoid an automatic 'upward ratcheting' of remuneration.

On 1 November 2011, Simon Lee was appointed to succeed Andy Haste as Group Chief Executive on a salary of £800,000; his salary remained unchanged throughout 2012. Richard Houghton was appointed as Group Chief Financial Officer on 12 June 2012 on an annual salary of £480,000. Adrian Brown's role expanded significantly at the start of the year with the inclusion of Western Europe to his UK portfolio; to reflect this increase in responsibilities, his salary was adjusted from £430,000 to £475,000 on 1 January 2012. George Culmer did not receive a salary increase in 2012, as he had tendered his resignation before the salary review process had commenced.

The Executive Directors' earnings for 2012 are further noted on page 67. The salaries taking effect from 1 April 2013 are as follows:

Director	Annual base salary	Percentage change
Simon Lee	£824,000	3%
Richard Houghton	£494,400	3%
Adrian Brown	£484,500	2%

Pension provision

All UK employees are automatically enrolled in RSA's Stakeholder Pension Plan (a defined contribution plan) on a non-contributory basis when joining the Company. RSA closed its UK final salary pension scheme to new entrants on 1 April 2002 and current members of this scheme accrue benefits against pensionable earnings capped at £75,000, with Stakeholder Pension Plan membership being given for earnings above this cap. Pension plan membership is offered to employees across the Group according to local country practice. Executives are only permitted to receive a cash allowance fully in lieu of pension plan participation if they are at or approaching either HMRC's statutory Annual Allowance or the Lifetime Allowance.

The table below details the pension arrangements for the Executive Directors during 2012:

Director	Pension arrangement
Simon Lee	• a taxable cash supplement of 25% of base salary.
Richard Houghton	• a taxable cash supplement of 13.18% of base salary.

Director	Pension arrangement
Adrian Brown	• member of the Stakeholder Pension Plan until January 2012 and received an employer contribution of 11% of base salary and a taxable cash supplement of 6.5% of base salary; • a taxable cash supplement of 17.5% of base salary was paid from February 2012 onwards.
George Culmer	• member of Stakeholder Pension Plan and, until he left RSA on 14 May 2012, received an employer contribution of 8% of base salary and a taxable cash supplement of 22% of base salary.

Other employment benefits

The Executive Directors received a range of employment benefits during the year and the value of these is noted in the table on page 67. In addition, they can participate in RSA's all-employee share plans – Sharesave and Sharebuild – and details of their share interests in these plans to 31 December 2012 are noted in the tables on pages 69 and 71.

2. Variable remuneration

Annual bonus plan

During 2012, the Executive Directors' bonus plan consisted of stretching targets aligned to Combined Operating Ratio (COR), Net Written Premium (NWP) and operational objectives personal to their roles which were assessed against a performance scorecard. Seventy per cent of the bonus award is subject to COR and NWP targets.

The Executive Directors' award opportunity is set out in the table below.

	Cash bonus (% of salary)	Compulsory deferred shares (% of salary)
On-target performance	60%	20%
Outstanding performance	120%	40%

Executive Directors were also invited to defer a further 33% of their net cash bonus into shares on a voluntary basis. All three Executive Directors elected to make the maximum voluntary deferral. All deferred shares are held in trust for three years. Further matching shares may be awarded against these through the LTIP, which is described in more detail in this report.

To ensure that Richard Houghton was covered by a bonus arrangement for 2012, his bonus award has not been pro-rated for time based on his appointment date of 12 June 2012; it reflects the Group's performance across the full financial year. No other exceptional remuneration has been paid or awarded to him. The inclusion of Mr Houghton in the 2012 LTIP cycle is noted below.

George Culmer did not receive a bonus award for 2012 following his resignation from the Group.

The bonuses awarded to Simon Lee and Richard Houghton reflect the financial performance delivered across the Group, as well as their own leadership and operational goals. Adrian Brown's bonus award was weighted towards the performance of the UK & Western Europe division for which he is accountable, along with a proportion for the Group's financial performance and his operational goals. In summary, the Group reported good growth and financial performance despite a tough trading environment. It is successfully executing its strategy to grow premiums, improve underwriting profitability and focus its capital to generate shareholder value. The UK & Western Europe division made good progress in the year, targeting profitable growth and taking action to remediate key portfolios, but sustained significant losses higher than forecast reflecting weather and other exceptional events.

The cash bonuses awarded to Executive Directors for 2012 are noted below, out of a maximum of 120% of salary. For comparison, the value of the bonuses awarded to the Executive Directors in 2011 is noted in brackets as a percentage of salary; this highlights that bonuses have decreased year-on-year in relative percentage of salary terms by around one third. In accordance with RSA's LTIP, compulsory deferred shares will be granted in April 2013 valued at 33% of the executives' cash bonus awards. The cash awards are included in the emoluments table on page 67 and both the cash and compulsory deferred share awards are noted in the 'single figure' table on page 64.

	Cash bonus award 2012	
Director	Value	% of salary (2011 in brackets)
Simon Lee[1]	£481,440	60% (91%)
Richard Houghton[2]	£255,264	53% (–)
Adrian Brown[3]	£247,000	52% (88%)

Note:
The bonus awards were determined by the Committee relative to the following annual gross basic salaries, and in the case of Mr Lee for 2011, his actual earnings for the year.
1. 2012: £800,000; 2011: £538,000.
2. 2012: £480,000. Mr Houghton did not receive a bonus award for 2011.
3. 2012: £475,000; 2011: £430,000.

Long-term incentive plan (LTIP)

Under the 2009-2011 plan cycle, Executive Directors could be awarded performance shares up to 150% of salary and receive up to 2.5 matching shares for each share deferred through the 2008 annual bonus plan. The 2010 and 2011 cycles operate in the same way as described for the 2009 cycle.

The Group's performance against LTIP targets was tested by the Committee and independently verified. The results of this are set out in the table below.

	Target range	Group performance
Relative TSR	Median to upper quintile (5.9%-20.2%)	-4.8%
ROE (3-year average)	10%-16%	11.5%

The proportion of awards that vested as a consequence of this performance is given in the table below. The actual number of shares that vested and lapsed for Simon Lee and Adrian Brown is detailed in the table on page 70.

Form of award	Weighting of performance conditions		Proportion of awards that vested		
	ROE	Relative TSR	ROE	Relative TSR	Total
Performance Shares	70%	30%	43.75%	0%	30.63%
Compulsory Deferred Matching Shares	70%	30%	43.75%	0%	30.63%
Voluntarily Invested Deferred Matching Shares	100%	0%	43.75%	–	43.75%

During the year, conditional awards of performance shares and matching shares were made to Simon Lee and Adrian Brown. Simon Lee received performance shares equal to 150% of his salary and, as was disclosed in the 2011 Remuneration Report, the Committee agreed to award Adrian Brown performance shares worth 250% of his salary due to the critical nature of his role. Matching shares were awarded at 2x the number of shares that Mr Lee and Mr Brown had deferred from their 2011 bonus awards.

Richard Houghton received a conditional award of performance shares worth 150% of his salary shortly after his commencement date in line with RSA's standard practice for newly-hired senior executives. Mr Houghton was not granted any matching shares.

The performance and matching share awards granted in 2012 will vest in 2015, subject to the satisfaction of the plan's performance conditions as follows:

- Average Group underlying ROE of 10%-16% over the 2012-2014 financial years
- Relative TSR between median and upper quintile within a peer group of: Aegon, Allianz, Aviva, AXA, Baloise, Generali, Legal & General, Munich Re, QBE, Swiss Re and Zurich.

The proportion of the awards that are subject to these conditions is as noted in the table above. The policy for 2013 grants is set out on page 60. The Committee is not expecting to make any performance share awards to the Executive Directors or Executive Team in excess of 150% of salary in 2013, which is the normal policy level. As mentioned in the shareholder letter on page 55, the LTIP will be reviewed during 2013 with the expectation that a new plan will be put to shareholders for approval in 2014.

3. Total remuneration

The Committee welcomes greater transparency in the reporting of Directors' remuneration. As the revised reporting regulations have yet to come into force, the table below discloses the total remuneration of the Executive Directors serving as at 31 December 2012 as contained in the audited section of this report, in addition to the face value of the compulsory deferred shares to be granted for 2012 performance.

	Simon Lee	Richard Houghton[1]	Adrian Brown
Salary[2]	£800,000	£267,000	£475,000
Employer pension contribution[2,3]	£200,000	£35,191	£83,125
Employment benefits[2]	£34,000	£10,000	£70,150
Cash bonus[2]	£481,440	£255,264	£247,000
Compulsory deferred shares[4]	£158,875	£84,237	£81,510
Performance shares[5]	£128,839	–	£106,102
Matching shares[5]	£184,091	–	£70,965
All employee shares[6]	£2,505	–	£1,712
Total remuneration	**£1,989,750**	**£651,692**	**£1,135,564**
Total remuneration as a percentage of salary	**249%**	**244%**	**239%**

Notes:

1. Richard Houghton joined RSA on 12 June 2012.
2. These values are as set out in the emoluments table on page 67.
3. In respect of Adrian Brown, this figure includes the value that RSA contributed into RSA's Stakeholder Pension Plan during 2012 which is detailed in the table on page 68.
4. The face value of the compulsory deferred shares that were approved for awarding to the Executive Directors arising through the annual bonus plan for 2012.
5. The value of awards that vested on 6 April 2012 relating to the LTIP granted in 2009, against the market price of £1.043 as noted on page 70. Deferred shares vesting in the year are omitted from this calculation as they are derived from the 2008 bonus and are already earned.
6. The aggregate gain made in 2012 through the exercise of Sharesave options as noted on page 69, and the Sharebuild matching shares granted in 2012 valued at £1.257, as at 31 December 2012 as noted on page 71.

4. Other material matters

Clawback policy

The Committee has introduced a clawback policy which, at its discretion, reduces or forfeits bonus and LTIP awards that have yet to be paid or vest. Three circumstances have been defined where the principle of clawback (technically termed a 'malus' adjustment) could be applied: employee misconduct; error in the basis of the award calculation or other term; and material financial misstatement of the results underpinning the award. 'Material' will not be defined, but will be at a level the Committee considers is appropriate. As the adjustment of deferred bonus awards has not previously been communicated to employees, the clawback policy will apply to bonuses earned for 2013 performance and onwards thereafter. Similarly, the policy will apply to the 2013 LTIP and future grants and not retrospectively, i.e. awards granted in 2010, 2011 and 2012. The Committee will review the clawback policy annually and will report to shareholders in the event it is invoked.

Shareholding guidelines

RSA believes it is in shareholders' interests for its executives to hold shares in RSA. Its current share ownership guidelines have been in place since 2004 and they will be reviewed by the Committee in 2013. Under the guidelines, executives are expected to build up a minimum holding over a five year period and maintain it thereafter. Executives should not sell more than 50% of their net shares awarded through the Company's incentive plans until their guideline holding has been reached. The required shareholding levels are as follows:

Level of executive	Required shareholding (% of salary)
Group Chief Executive	200%
Other Executive Directors	150%
Executive Team	75%

The number of shares held by Simon Lee and Adrian Brown as at 31 December 2012 is shown in the table below; their holding exceeds the required shareholding level. Richard Houghton will start to acquire shares during 2013.

Director	Shareholding[1]	Valuation[2]	Percentage of salary[3]
Simon Lee	1,562,555	£1,964,132	246%
Adrian Brown	768,609	£966,142	203%

Notes:

1. The shareholding excludes all unvested share awards and those otherwise subject to forfeiture or a holding period. It includes Voluntarily Invested Deferred Shares and shares acquired through RSA's all-employee plan, Sharebuild.
2. The valuation is against the mid market closing price of an RSA ordinary share as at 31 December 2012 of £1.257.
3. The gross basic annual salary as at 31 December 2012.

Dilution

RSA monitors its dilution levels on a regular basis to ensure that they remain within the headroom limits set by the Association of British Insurers (ABI). As at 31 December 2012, the dilution levels were as follows:

ABI limit	RSA dilution %
10% over 10 years for all share schemes	7.08%
5% over 10 years for discretionary schemes	4.44%

SECTION 5 – NON-EXECUTIVE DIRECTORS

Board Chairman

John Napier retired from the Board on 31 December 2012. During 2012, he received an annual fee of £400,000, which had remained unchanged since 2010, and an annual accommodation allowance of £33,000. Upon retirement, Mr Napier was paid £100,000 in lieu of his three months' contractual notice period, plus a taxable lump sum of £16,500 in full and final settlement of the contractual obligation on RSA to pay for his rented accommodation.

Martin Scicluna was appointed as Chairman on 1 January 2013 for an initial fixed term of three years, although this can be extended by agreement from the Board or terminated by the giving of at least three months' notice by either party. Under the terms of his appointment letter, Mr Scicluna receives an annual fee of £400,000 and does not qualify for any other benefits or incentives. His fee will not be reviewed until January 2016.

Non-Executive Directors

Under the Company's Articles, the remuneration paid to Non-Executive Directors is determined by the Board, within limits set by shareholders. Non-Executive Directors are not entitled to participate in RSA's incentive arrangements, nor do they receive any benefits. The fees were last adjusted in 2010 and were benchmarked during 2012. The current Non-Executive Directors' fees are set out in the table below.

Fee structure	(£)
Base fee	60,000
Additional fee for chairing committees:	
– Group Audit Committee	20,000
– Group Remuneration Committee	12,500
– Group Investment Committee	12,500
– Board Risk Committee	12,500
Additional fee for Senior Independent Director	20,000
Additional fee for sitting on one or more Committees in a capacity other than Chairman	5,000

Non-Executive Directors do not have service agreements but are issued with an appointment letter. All Non-Executive Directors are subject to a three-year period of appointment, which may be terminated by either party giving not less than one month's notice to the other. The table below shows when the Non-Executive Directors' appointments became effective and when their terms will expire.

Non-Executive Director	Date of initial appointment	Expiry date of current term
Alastair Barbour	10 October 2011	10 October 2014
Noel Harwerth	30 March 2004	27 May 2013
Edward Lea	10 July 2003	27 May 2013
Malcolm Le May	30 March 2004	27 May 2013
John Maxwell	10 July 2003	27 May 2013
Hugh Mitchell	26 September 2012	26 September 2015
Jos Streppel	3 October 2011	3 October 2014
Johanna Waterous	20 May 2008	20 May 2014

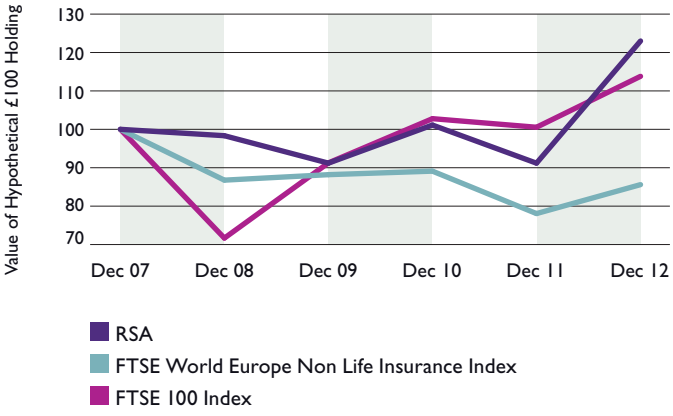
SECTION 6 – ADDITIONAL DISCLOSURE

Historical TSR performance

The graph below is included in the report of the Committee as a requirement of Schedule 8 to The Large and Medium-sized Companies and Group (Accounts and Reports) Regulations 2008.

The graph shows the TSR of the Group with reference to the FTSE World Europe Non Life Insurance Index and the FTSE 100 Index. The FTSE World Europe Non Life Insurance Index comprises a range of European insurance businesses which are considered to be key competitors to RSA. The FTSE 100 Index comprises the 100 most highly capitalised companies of the UK market. TSR performance relative to the indices is shown over the five years from 31 December 2007 to 31 December 2012. 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. Data was provided by Datastream.

Historical TSR performance of the value of a hypothetical £100 holding over five years (based on spot values)



SECTION 7 – AUDITED INFORMATION

Deloitte LLP has audited the following items, as stipulated by law:

- The table of Directors' emoluments and associated footnotes on page 67 and the disclosure of the items comprising benefits in kind
- The table of Directors' defined contribution pensions on page 68 and associated footnotes
- The table of disclosure of Directors' share options and share awards on pages 69 to 71 and associated footnotes.

In constitution and operation the Committee complies fully with the UK Corporate Governance Code as described in the Directors' and Corporate Governance Report on pages 40 to 54. The information required by paragraph 1, schedule 5 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 is shown in note 4 of the Financial Statements.

Directors' emoluments

Remuneration for the year ended 31 December 2012 was as follows:

	Base salary and fees £000	Allowances and benefits £000	Bonuses[2] £000	Other payments £000	Total[1] 2012 £000	Total 2011 £000
Executive Directors						
Adrian Brown[3]	475	149	247	–	**871**	607
George Culmer[4]	206	56	–	19	**281**	703
Richard Houghton[5]	267	45	255	–	**567**	–
Simon Lee[6]	800	234	481	–	**1,515**	1,149
Non-Executive Directors						
Alastair Barbour[7]	80	–	–	–	**80**	15
Noel Harwerth	78	–	–	–	**78**	78
Edward Lea	85	–	–	–	**85**	85
Malcolm Le May	78	–	–	–	**78**	78
John Maxwell	74	–	–	–	**74**	78
Hugh Mitchell[8]	19	–	–	–	**19**	–
John Napier[9]	400	17	–	117	**534**	417
Jos Streppel	65	–	–	–	**65**	16
Johanna Waterous	65	–	–	–	**65**	65

Notes:

1. The total figure includes all allowances chargeable to UK Income Tax.
2. 2012 cash bonuses were calculated in accordance with the plan described on page 56 of this Report and will be paid in March 2013.
3. Adrian Brown's allowances include 17.5% of basic salary as a retirement allowance, paid monthly with effect from February 2012 when Adrian Brown opted out of the defined contribution scheme. In addition, he received medical benefits worth £861 and additional taxable travel benefits worth £60k .
4. George Culmer resigned as a Director with effect from 14 May 2012. Accordingly the table above shows his salary, allowances and benefits for the period 1 January 2012 to 14 May 2012. In addition, he received payment in lieu of holiday not taken. His allowances included medical, car and travel benefits of £10k. He received a pension allowance of 22% of basic salary.
5. Richard Houghton was appointed as a Director on 12 June 2012. Accordingly the table above shows his salary, allowances and benefits for the period from 12 June 2012 to 31 December 2012. His allowances include 13.18% of basic salary as a retirement allowance, paid monthly with effect from his appointment. In addition, he received car and medical benefits worth £10k.
6. Simon Lee's allowances include 25% of basic salary as a retirement allowance, paid monthly. During 2012, the amount paid to him was £200k. He also received travel, car benefits and medical and accidental death cover benefits worth £34k.
7. Alastair Barbour chaired the Group Audit Committee with effect from 1 April 2012. There was a period of overlap with Edward Lea during which time a handover was undertaken resulting in both Directors receiving the additional Chairman's fee.
8. Hugh Mitchell was appointed as a Director on 26 September 2012 and as Chairman of the Group Remuneration Committee on 27 September 2012. Accordingly, the table above shows the fees paid for the period 26 September 2012 until 31 December 2012.
9. John Napier retired as a Director and Chairman on 31 December 2012. He received an annual fee of £400k per annum and was entitled to receive an accommodation allowance of £33k gross per annum. Additionally, he claimed business travel expenses of £1k in the year. John Napier was paid £116,500 in lieu of his three-month notice period and the balance of six months' accommodation allowance for the outstanding commitment of the lease.

Pension benefits

Non-Executive Directors are not entitled to any pension benefits. No Executive Directors were members of the Group defined benefit scheme in the year. The Company contributions paid in respect of Executive Directors who are members of Group defined contribution schemes, were as follows:

	Company contributions paid in 2012 £	Company contributions paid in 2011 £
Adrian Brown[1]	**4,354**	23,141
George Culmer[2]	**16,495**	44,520

Notes:

1. The contributions disclosed in the table above relate to the period to 31 January 2012 at which date Adrian Brown opted out of the defined contribution scheme.
2. The contributions for George Culmer for 2012 relate to the period from 1 January 2012 to 14 May 2012 when he left the Company.

Shareholdings

The interests of Directors in ordinary shares of 27.5p each of the Company were as follows:

Director	Shares held at 1 January 2012	Shares held at 31 December 2012
Executive Directors[1,2]		
Adrian Brown	505,149	624,407
Richard Houghton[3]	–	–
Simon Lee	1,016,664	1,359,300
Non-Executive Directors[2]		
Alastair Barbour	20,000	20,609
Noel Harwerth	10,000	10,000
Edward Lea	703,521	764,917
Malcolm Le May	20,107	21,862
John Maxwell	522,977	536,832
Hugh Mitchell[3]	–	20,000
John Napier[4]	600,821	653,256
Jos Streppel	–	–
Johanna Waterous	36,761	36,761

Notes:

1. The Executive Directors each had a beneficial interest as at 31 December 2012 in Voluntarily Invested Deferred Shares of 27.5p each held under the LTIP and in the Partnership, Dividend and Matching Shares under Sharebuild which are not included in the above table. These are disclosed on pages 70 and 71.
2. As at 19 February 2013, the interests in ordinary shares of the current Non-Executive Directors and Richard Houghton had not changed since 31 December 2012. Changes in the interests of Simon Lee and Adrian Brown are disclosed in the notes to the Sharebuild table on page 71. The above table does not reflect any subsequent changes in shareholdings of those Directors who have left the Company.
3. Richard Houghton and Hugh Mitchell were appointed to the Board on 12 June 2012 and 26 September 2012 respectively. Accordingly, the table above shows shares held by them on the date of their respective appointments and not 1 January 2012.
4. John Napier retired as a Director and Chairman of the Company on 31 December 2012. The above schedule reflects his shareholding as at 31 December 2012.

Options

1999 ESOS

The 1999 ESOS is an executive share option scheme under which options were granted with an exercise price equal to the fair value of the shares at the date of grant. Any outstanding options expire ten years from the date of grant. No grants have been made under the 1999 ESOS since 2006. The 1999 ESOS expired in 2009 although a number of options remain outstanding in accordance with the rules of the scheme. The relevant performance conditions were achieved in respect of all options granted between those dates.

Outstanding options – ESOS and Sharesave

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 by shareholders at the AGM and at the Company's registered office during standard business hours.

Unexpired options held during 2012 in respect of the ordinary shares of the Company as a result of executive and Sharesave share option schemes are shown below. All options were granted for nil consideration.

Director and Scheme	Number of options at 1 January 2012	Options granted during the year	Options exercised during the year	Market price (pence) on date of Exercise[1]	Options lapsed during the year	Number of options at 31 December 2012	Exercise price (pence)	Dates exercisable from	Dates exercisable to
Adrian Brown									
1999 ESOS	38,423	–	–	–	38,423	–	234.2	11.03.05	10.03.12
Sharesave	5,096	–	–	–	–	5,096	117.0	01.12.13	31.05.14
Sharesave	6,091	–	–	–	–	6,091	97.0	01.12.14	31.05.15
Sharesave	4,078	–	–	–	–	4,078	100.0	01.12.15	31.05.16
Simon Lee									
1999 ESOS	206,049	–	–	–	–	206,049	114.1	04.06.06	03.06.13
1999 ESOS	125,000	–	–	–	–	125,000	92.4	16.10.06	15.10.13
1999 ESOS	161,392	–	–	–	–	161,392	79.0	14.06.07	13.06.14
1999 ESOS	167,763	–	–	–	–	167,763	76.0	18.11.07	17.11.14
1999 ESOS	525,937	–	–	–	–	525,937	80.0	08.04.08	07.04.15
1999 ESOS	169,355	–	–	–	–	169,355	93.0	18.08.08	17.08.15
Sharesave	2,297	–	–	–	2,297	–	117.0	01.12.11	31.05.12
Sharesave	3,555	–	3,555	119.3	–	–	97.0	01.12.12	31.05.13
Sharesave	3,060	–	–	–	–	3,060	100.0	01.12.13	31.05.14
Sharesave	2,652	–	–	–	–	2,652	95.0	01.12.14	31.05.15
Sharesave	–	3,800	–	–	–	3,800	90.0	01.02.16	31.07.16

Notes

1. The aggregate gain made by Directors during the year on the exercise of share options amounted to £792.77.
2. The official closing middle market price at its highest during the year was 127.9p per share and at its lowest was 97.65p per share. On the last dealing day of the year it was 125.7p per share.

Long-Term Incentive Plan

	Share awards held at 1 January 2012	Share awards granted during the year	Share awards vested during the year[6,7]	Share awards lapsed during the year	Share awards held at 31 December 2012
Adrian Brown					
Deferred Shares[1,2,5]	357,286	101,669	58,383	–	400,572
Matching Shares[3,5]	1,094,108	325,288	68,039	115,174	1,236,183
Performance Shares[4,5]	1,235,636	1,140,291	101,728	230,392	2,043,807
Richard Houghton					
Performance Shares[1,4,5]	–	712,025	–	–	712,025
Simon Lee					
Deferred Shares[1,2,5]	612,560	112,135	151,451	–	573,244
Matching Shares[3,5]	1,881,603	381,548	176,501	298,771	1,787,879
Performance Shares[4,5]	1,306,709	1,152,294	123,527	279,762	2,055,714

Notes:

1. The market price of ordinary shares on 11 May and 15 June 2012, the dates on which LTIP interests were granted during the year, were 103.7p and 102.3p respectively.
2. Deferred Shares are inclusive of Voluntarily Invested Deferred Shares and Compulsory Deferred Shares. Voluntarily Invested Deferred Shares are purchased by Capita Trustees Limited 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 any associated Matching Shares lapse if this occurs.
3. The performance conditions relating to the Matching Shares granted in the year are as noted on page 61 of this Report and are noted in prior years' reports relating to grants made in 2010 and 2011.
4. Performance conditions relating to awards of Performance Shares are the same as those relating to Compulsory Deferred Matching Shares for the relevant year of grant, and are noted on page 61 of this Report in relation to grants made in 2012.
5. The date by which qualifying conditions for LTIP awards must be met is as follows: 2010 awards by 31 December 2012, 2011 awards by 31 December 2013 and 2012 awards by 31 December 2014.
6. In respect of the awards made to Adrian Brown and Simon Lee, the market price on the date of grant of awards (6 April 2009) was 121.2p, the market price on the date of vesting of awards (6 April 2012) was 104.3p. For awards made in 2009, the ROE performance condition was partially met at a result of 11.5% and the relative TSR performance condition was not met.
7. The aggregate value of share awards vested for Directors during the year under the LTIP amounted to £619,739.44. Voluntarily Invested Deferred Shares which are shown in the table above are not included in this value.
8. No other current Directors of the Company held long-term incentive scheme interests during 2012.

Sharebuild

The Directors' interests in Sharebuild Shares were as follows:

	Sharebuild Shares held at 1 January 2012	Partnership Shares acquired during the year	Matching[2] Shares awarded during the year	Dividend Shares acquired during the year	Sharebuild Shares held at 31 December 2012
Adrian Brown[1]	5,334	1,362	1,362	581	8,639
Simon Lee[1]	5,334	1,362	1,362	581	8,639

Notes

1. The interests of Adrian Brown and Simon Lee each increased by 198 ordinary shares on 7 January 2013 and a further 192 ordinary shares on 7 February 2013 following the purchase of Partnership Shares and the awards of Matching Shares on those dates.
2. Under the terms of the Company's all employee Sharebuild Plan (an HMRC approved Share Incentive Plan), the Matching Shares awarded between December 2009 and February 2010 have vested. Any Matching Shares which have vested under the rules have remained in the Trust and are included in the above table.

Hugh Mitchell

Chairman of the Group Remuneration Committee, on behalf of the Board

19 February 2013



Italian Earthquakes

The Emilia Romagna region in the north of Italy was struck by two earthquakes in May 2012, both with a magnitude of 6. These were the strongest recorded earthquakes in the region in over 500 years. A number of historical and cultural buildings were damaged and the region is also the heartland of Italy's manufacturing sector. Our response was focused on our customers and intermediaries, and within 24 hours, we had appointed loss adjusters to some of the largest and most important property claims, and set up a dedicated claims handling team.



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DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the Annual Report and Accounts in accordance with applicable laws and regulations. Company law requires the Directors to prepare such financial statements for each financial year. Under that law the Directors are required to prepare group financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and Article 4 of the IAS Regulation and have also chosen to prepare the Parent Company financial statements under IFRS as adopted by the European Union. Under company law the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, International Accounting Standard 1 requires that Directors:

- Properly select and apply accounting policies
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information
- Provide additional disclosures when compliance with the specific requirements in IFRS are insufficient to enable the users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance and
- Make an assessment of the Company's ability to continue as a going concern.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement

We confirm to the best of our knowledge:

- The financial statements on pages 76 to 145, prepared in accordance with International Financial Reporting Standards as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group
- The business review on pages 8 to 33, which is incorporated into the Directors' report, includes a fair review of the development and performance of the business and the position of the Group and
- The risk review section on pages 26 to 29, which is incorporated into the Directors' report, includes a description of the principal risks and uncertainties faced by the Group.

Signed by order of the Board

Simon Lee
Group Chief Executive
19 February 2013

Richard Houghton
Group Chief Financial Officer
19 February 2013

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF RSA INSURANCE GROUP PLC

We have audited the consolidated financial statements of RSA Insurance Group plc for the year ended 31 December 2012 which comprise the consolidated Income Statement, the consolidated Statement of Comprehensive Income, the consolidated Statement of Changes in Equity, the consolidated Statement of Financial Position, the consolidated Statement of Cashflows and the related notes 1 to 34. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the consolidated financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the consolidated financial statements:

- give a true and fair view of the state of the group's affairs as at 31 December 2012 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the group financial statements are prepared is consistent with the consolidated financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the directors' statement, contained within the Directors' Report, in relation to going concern; and
- the part of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review;
- certain elements of the report to shareholders by the Board on directors' remuneration.

Other matter

We have reported separately on the parent company financial statements of RSA Insurance Group plc for the year ended 31 December 2012 and on the information in the Directors' Remuneration Report that is described as having been audited.

David Barnes (Senior statutory auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, UK
19 February 2013

CONSOLIDATED INCOME STATEMENT

for the year ended 31 December 2012

	Notes	2012 £m	2011 £m
Income			
Gross written premiums		**9,397**	9,131
Less: reinsurance premiums		**(1,044)**	(993)
Net written premiums	1	**8,353**	8,138
Change in the gross provision for unearned premiums		**(188)**	(273)
Less: change in provision for unearned premiums, reinsurers' share		**2**	(9)
Change in provision for unearned premiums		**(186)**	(282)
Net earned premiums		**8,167**	7,856
Net investment return	2	**534**	745
Other operating income	4	**141**	134
Total income		**8,842**	8,735
Expenses			
Gross claims incurred		**(5,829)**	(5,595)
Less: claims recoveries from reinsurers		**448**	382
Net claims and benefits	3	**(5,381)**	(5,213)
Underwriting and policy acquisition costs		**(2,543)**	(2,399)
Unwind of discount		**(84)**	(94)
Other operating expenses	4	**(234)**	(291)
Total expenses		**(8,242)**	(7,997)
Finance costs	4	**(115)**	(117)
Acquisitions and disposals	30	**–**	1
Net share of loss after tax of associates	11	**(6)**	(9)
Profit before tax	1	**479**	613
Income tax expense	5	**(128)**	(186)
Profit for the year		**351**	427
Attributable to:			
Equity holders of the Parent Company		**344**	426
Non controlling interests		**7**	1
		351	427
Earnings per share on profit attributable to the ordinary shareholders of the Parent Company			
Basic	6	**9.5p**	11.9p
Diluted	6	**9.4p**	11.8p
Ordinary dividends paid and proposed for the year			
Interim dividend paid (per share)	7	**3.41p**	3.34p
Final dividend proposed (per share)	7	**3.90p**	5.82p

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

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2012

	Notes	2012 £m	2011 £m
Profit for the year		**351**	427
Exchange (losses)/gains net of tax	17	**(70)**	(70)
Fair value gains/(losses) net of tax	17	**116**	26
Pension fund actuarial (losses)/gains net of tax	17	**(161)**	(63)
Other comprehensive (expense)/income for the year		**(115)**	(107)
Total comprehensive income/(expense) for the year		**236**	**320**
Attributable to:			
Equity holders of the Parent Company		**232**	318
Non controlling interests		**4**	2
		236	320

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2012

	Ordinary share capital £m	Ordinary share premium £m	Own shares £m	Preference shares £m	Revaluation reserves £m	Capital redemption reserve £m	Translation reserve £m	Retained earnings £m	Share-holders' equity £m	Non controlling interests £m	Total equity £m
Balance at 1 January 2011	962	1,124	(2)	125	433	8	299	817	3,766	129	3,895
Total comprehensive income/(expense) (note 17)	–	–	–	–	21	–	(56)	353	318	2	320
Dividends – paid (note 7)	–	–	–	–	–	–	–	(325)	(325)	(18)	(343)
Issued by scrip (note 18)	5	17	–	–	–	–	–	–	22	–	22
Issued for cash (note 18)	1	3	–	–	–	–	–	–	4	–	4
Own shares utilised	–	–	1	–	–	–	–	2	3	–	3
Changes in shareholders' interests in subsidiaries	–	–	–	–	1	–	–	3	4	1	5
Depreciation transfer	–	–	–	–	(1)	–	–	1	–	–	–
Share based payments	3	–	–	–	–	–	–	6	9	–	9
Balance at 1 January 2012	971	1,144	(1)	125	454	8	243	857	3,801	114	3,915
Total comprehensive income/(expense) (note 17)	**–**	**–**	**–**	**–**	**113**	**–**	**(61)**	**180**	**232**	**4**	**236**
Dividends – paid (note 7)	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(336)**	**(336)**	**(3)**	**(339)**
Issued by scrip (note 18)	**12**	**38**	**–**	**–**	**–**	**–**	**–**	**–**	**50**	**–**	**50**
Issued for cash (note 18)	**3**	**5**	**–**	**–**	**–**	**–**	**–**	**–**	**8**	**4**	**12**
Changes in shareholders' interests in subsidiaries	**–**	**–**	**–**	**–**	**(1)**	**–**	**–**	**(10)**	**(11)**	**10**	**(1)**
Depreciation transfer	**–**	**–**	**–**	**–**	**(12)**	**–**	**–**	**12**	**–**	**–**	**–**
Share based payments	**3**	**–**	**–**	**–**	**–**	**–**	**–**	**3**	**6**	**–**	**6**
Balance at 31 December 2012	**989**	**1,187**	**(1)**	**125**	**554**	**8**	**182**	**706**	**3,750**	**129**	**3,879**

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

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

as at 31 December 2012

	Notes	2012 £m	2011 £m
Assets			
Goodwill and other intangible assets	8	**1,489**	1,359
Property and equipment	9	**272**	275
Investment property	10	**340**	362
Investments in associates	11	**40**	29
Financial assets	12	**12,660**	12,838
Total investments		**13,040**	13,229
Reinsurers' share of insurance contract liabilities	13	**1,949**	2,073
Insurance and reinsurance debtors	14	**3,592**	3,328
Current tax assets	23	**76**	33
Deferred tax assets	23	**285**	249
Other debtors and other assets	15	**753**	777
		1,114	1,059
Cash and cash equivalents	16	**1,329**	1,258
		22,785	22,581
Assets held for sale	34	**–**	17
Total assets		**22,785**	22,598
Equity and liabilities			
Equity			
Shareholders' equity		**3,750**	3,801
Non controlling interests		**129**	114
Total equity		**3,879**	3,915
Liabilities			
Loan capital	19	**1,311**	1,313
Insurance contract liabilities	20	**14,854**	14,766
Insurance and reinsurance liabilities	21	**558**	602
Borrowings	22	**296**	298
Current tax liabilities	23	**58**	104
Deferred tax liabilities	23	**139**	102
Provisions	24	**487**	389
Other liabilities	25	**1,203**	1,109
Provisions and other liabilities		**1,887**	1,704
Total liabilities		**18,906**	18,683
Total equity and liabilities		**22,785**	22,598

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

The financial statements were approved on 19 February 2013 by the Board of Directors and are signed on its behalf by:

Richard Houghton
Group Chief Financial Officer

CONSOLIDATED STATEMENT OF CASHFLOWS

for the year ended 31 December 2012

	Notes	2012 £m	2011 £m
Cashflows from operations	31	**165**	104
Tax paid		**(201)**	(227)
Investment income		**526**	597
Interest paid		**(115)**	(116)
Dividends received from associates		**1**	1
Pension deficit funding		**(73)**	(56)
Net cashflows from operating activities		**303**	303
Proceeds from sales or maturities of:			
Financial assets		**4,533**	4,432
Investment property		**–**	11
Property and equipment		**22**	14
Investments in subsidiaries (net of cash disposed of)		**–**	6
Purchase of:			
Financial assets		**(4,198)**	(3,983)
Investment property		**(2)**	(3)
Property and equipment		**(35)**	(37)
Intangible assets		**(146)**	(159)
Investments in subsidiaries (net of cash acquired)	30	**(97)**	(299)
Investments in associates		**(9)**	–
Net cashflows from investing activities		**68**	(18)
Proceeds from issue of share capital		**12**	4
Sale of shares to non controlling interests		**6**	–
Dividends paid to ordinary shareholders		**(277)**	(294)
Dividends paid to preference shareholders		**(9)**	(9)
Dividends paid to non controlling interests		**(2)**	(18)
Net movement in other borrowings		**(1)**	1
Net cashflows from financing activities		**(271)**	(316)
Net increase/(decrease) in cash and cash equivalents		**100**	(31)
Cash and cash equivalents at beginning of the year		**1,258**	1,314
Effect of exchange rate changes on cash and cash equivalents		**(29)**	(25)
Cash and cash equivalents at end of the year	16	**1,329**	1,258

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

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).

There are no new IFRS or interpretations of IFRS that have become effective during 2012 and that have a significant impact on the Group accounting policies. There are no other significant changes to Group accounting policies during 2012.

Except where otherwise stated, all figures included in the consolidated financial statements are presented in millions of Pounds Sterling, being the currency in the primary economic environment of the Company, shown as '£m', rounded to the nearest million.

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 provide 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 designates financial assets that are held as investments on the basis on which the investment return is managed and the performance is evaluated internally. Where the investment return is managed on the basis of the periodic cashflows arising from the investment, a financial asset is designated as an available for sale financial asset with unrealised gains recognised in the statement of comprehensive income. Where the investment return is managed on the basis of the total return on the investment (including unrealised investment gains), the financial asset is designated as at fair value through the income statement
- 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 statement of comprehensive income during 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 their 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.

For business combinations completed on or after 1 January 2010 the cost of acquisition includes the fair value of deferred and contingent consideration at the acquisition date and subsequent changes in the carrying value of the consideration are recognised in the income statement. For business combinations completed prior to 31 December 2009, the cost also includes costs directly attributable to the acquisition and the value of contingent consideration on settlement.

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 non controlling 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.

Changes in the ownership interests of a subsidiary between shareholders of the Group and shareholders holding a non controlling interest are accounted for as transactions between equity holders of the Group. Any difference between the fair value of the consideration given by the transferee and the carrying value of the ownership interest transferred is recognised directly in equity.

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 is recognised in the statement of comprehensive income. 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 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 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).

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

- Assets and liabilities for each statement of financial position presented are translated at closing exchange rates at the end of the period
- 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.

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, liabilities and contingent liabilities acquired, is initially capitalised in the statement of financial position 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. For business combinations completed prior to 31 December 2009, the cost also includes costs directly attributable to the acquisition and the value of contingent consideration on settlement. Goodwill is allocated to cash generating units for the purpose of impairment testing. 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 in the income statement.

The increased carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss does not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years. An impairment loss recognised for goodwill is not reversed in a subsequent period.

When calculating the goodwill arising on an acquisition, provisions for losses and loss adjustment expenses are discounted to present value. Immediately following the acquisition, the provisions for losses and loss adjustment expenses are valued at full nominal value. This increase in liabilities is matched by the recognition of an intangible asset arising from acquired provisions for losses and loss adjustment expenses, 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 within the liability adequacy test of insurance contract liabilities where the balances of intangible assets associated with insurance contracts are deducted from the carrying amount of the insurance contract liabilities. The run off period is normally between five and 11 years.

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.

Other intangible assets comprise renewal rights, customer lists, brands and other acquired identifiable non monetary assets without physical form.

Computer software and other intangible assets are carried at cost less accumulated amortisation. Amortisation on computer software and other intangible assets 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 12 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.

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 reserves 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 asset's 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. Valuations are carried out on an annual basis or more frequently. For interim periods internal valuations are made by reference to current market conditions. Unrealised gains and unrealised losses or changes thereof are recognised in net investment return.

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 when the Group has substantially transferred 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 investments in equity and debt securities in accordance with its investment strategy on the basis on which the investment return is managed and the performance is evaluated internally. Where the investment return is managed on the basis of the periodic cashflows arising from the investment, a financial asset is designated as an available for sale financial asset. Where the investment return is managed on the basis of the total return on the investment (including unrealised investment gains), the financial asset is designated as at fair value through the income statement. Other investments comprising loans, reinsurance deposits and other deposits are classified as loans and receivables.

Financial assets arising from non investment activities are not classified on initial recognition as available for sale assets and are therefore categorised as loans and receivables.

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 for equity investments 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.

For other loans and receivables, where there is evidence that the contracted cashflows will not be received in full, an impairment charge is recognised in the income statement to reduce the carrying value of the financial asset to its recoverable amount.

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 classified as available for sale, the cumulative gain or loss previously recognised in equity is recognised in the income statement.

Derivative financial instruments

Derivatives are recognised in the statement of financial position 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, consistent 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 a foreign exchange derivative is designated as a 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
- For cash, loans and receivables, 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 different, fair value 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.

For disclosure purposes, fair value measurements are classified as Level 1, 2 or 3 based on the degree to which fair value is observable:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

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 end of the reporting period. Premiums written exclude taxes and duties levied on premiums and directly related expenses, e.g. commissions. Premiums are earned as revenue over the period of the contract and are calculated principally on a daily pro rata basis.

Insurance contract liabilities
The provision for unearned premium represents the portion of the premiums written relating to periods of insurance coverage subsequent to the end of the reporting period after the deduction of related acquisition costs.

Acquisition costs comprise the direct and indirect costs of obtaining and processing new insurance business. These costs are recognised as deferred acquisition costs and are deducted from the provision for unearned premiums. Deferred acquisition costs are amortised on the same basis as the related premiums are earned.

The provisions for losses and loss adjustment expenses, whether reported or not, comprise the estimated cost of claims incurred but not settled at the end of the reporting period. 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 losses and loss adjustment expenses relating to long-term permanent disability claims in the UK, Canada and Scandinavia are also determined using recognised actuarial methods.

The provisions for losses and loss adjustment expenses, and related reinsurance recoveries, are discounted where there is a particularly long period from incident to claims settlement or when nominal interest rates are high 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 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 losses and loss adjustment expenses being discounted, during the period necessary for the payment of such claims.

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 losses and loss adjustment expenses are re-estimated.

At the end of each reporting period an assessment is made of whether the provisions for unearned premiums are adequate. A separate provision is made, based on information available at the end of the reporting period, 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 end of the reporting period. 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 contract liabilities) is recognised to reflect the amount estimated to be recoverable under the reinsurance contracts in respect of the provisions for losses and loss adjustment expenses reported under insurance contract liabilities. The amount recoverable from reinsurers is initially valued on the same basis as the underlying provisions for losses and loss adjustment expenses. 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 reinsurance contract and the event has a reliably measurable impact on the expected amount that will be recovered from the reinsurer.

The reinsurers' share 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.

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

Loan capital
Loan capital comprises subordinated bonds which are initially measured at the consideration received less transaction costs. Subsequently, loan capital 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 end of the reporting period and are expected to apply when the related deferred tax asset is realised or the related 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

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 income statement 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 cost 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 value 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 the end of each reporting period 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 obligations 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 returns on scheme assets are determined for each asset class, at the beginning of the period, as the expected investment returns on scheme assets over the entire life of the related obligations. All returns are net of investment expenses.

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 in the statement of comprehensive income.

The value recognised in the statement of financial position for each individual post retirement scheme is calculated as follows:

- The present value of defined benefit obligation of the scheme at the end of the reporting period
- Minus any past service cost not yet recognised
- Minus the fair value at the end of the reporting period of the scheme assets out of which the obligations are to be settled directly.

For those individual schemes in deficit, the resulting net liabilities are recognised in the statement of financial position in provisions. For those individual schemes in surplus, an asset is recognised in the statement of financial position in other debtors and other assets to the extent that the Group can realise an economic benefit, in the form of a refund or a reduction in future contributions, at some point during the life of the scheme or when the scheme liabilities are settled.

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 end of the reporting period are discounted to present value.

Share based payments
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 is based upon the fair value of the awards at the end of the reporting period.

Vesting conditions, which comprise service conditions and performance 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 is recognised as an expense on a systematic basis over the period during which the employment services are provided. Where an award of options is cancelled by an employee, the full value of the award (less any value previously recognised) is recognised at the cancellation date.

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 Annual General Meeting.

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.

Operating segments
Operating segments are identified on the basis of the regional structure of the Group. Internal reports about these segments are regularly reviewed by the Board of Directors (determined to be the chief operating decision maker) to assess their performance and to allocate capital and resources.

Assets and liabilities held for sale and discontinued operations
Assets are classified as held for sale if their carrying amount is to be recovered principally through a sale transaction, that are highly probable to be completed 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 statement of financial position. Assets and liabilities of a disposal group are not netted. In the period where a non current asset or disposal group is recognised for the first time, the statement of financial position 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 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 statement of financial position is not presented using current and non current classifications. However, the following balances are generally classified as current: cash and cash equivalents 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 or in the risk management section.

Recently issued accounting pronouncements

Pronouncements issued by the International Accounting Standards Board (IASB) and adopted by the EU but which are not yet mandatory for adoption and have yet to be adopted in the Group financial statements are described below:

New and revised IFRSs that will be applied by the Group in its 2013 financial statements

The Group will apply a revised version of IAS 19 'Employee Benefits' (issued by the IASB in June 2011). The revisions include the following changes to the Group's existing accounting policies:

- Expected returns on plan assets will no longer be recognised in profit or loss. Expected returns are replaced by recording interest income in the income statement, which is calculated using the discount rate used to measure the pension obligation
- Unvested past service costs are no longer deferred and recognised over the future vesting period. Instead all past service costs will be recognised at the earlier of when the amendment/ curtailment occurs or when the entity recognises related restructuring or termination costs.

The impact of the revised standard on the results reported at 31 December 2012 is provided in note 26.

The Group will also apply Amendment to IAS 1 'Presentation of Financial Statements – Presentation of Items of Other Comprehensive Income' (issued by the IASB in June 2011). The presentation of items already disclosed in the consolidated statement of comprehensive income will be rearranged in accordance with the revised standard. The application of this revised IFRS will have no impact on either the total financial results of the Group or the financial position of the Group.

The comparative information will be restated when applying the above changes.

The Group will also adopt IFRS 13 'Fair Value Measurement' at 1 January 2013 (issued by the IASB in May 2011). The standard sets out a framework for measuring fair value and the associated disclosures, whenever fair value is used under IFRSs. The adoption of IFRS 13 will have no impact on either the total financial results or the financial position of the Group.

There are a number of other changes to IFRSs that become mandatory in 2013 but which have no significant impact on the financial statements of the Group.

Other new and revised IFRSs that are not mandatory for adoption in 2013

There are a number of new IFRSs and revised IFRSs that have been issued and which are mandatory after 2013. These include new IFRSs dealing with consolidated financial statements, joint arrangements and disclosures of interests in other entities. It is expected that none of these changes will have a significant impact on the financial statements of the Group.

Other new IFRSs that are not yet adopted by the EU

The IASB has issued a new IFRS and a number of changes to existing IFRSs that have not yet been adopted by the EU. The most significant of these ongoing developments for the Group is the project to replace IAS 39 'Financial Instruments: Recognition and Measurement'. The new IFRS on financial instruments is expected to be mandatory for the 2015 financial statements.

ESTIMATION TECHNIQUES, RISKS, 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 contract liabilities of the Company.

The insurance contract liabilities of an insurance company include the provision for unearned premiums and unexpired risks and the provision for losses and loss adjustment expenses. 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 end of the reporting period. Outstanding claims represent the Company's estimate of the cost of settlement of claims that have occurred by the end of the reporting period 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 end of the reporting period 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 potential longer-term significance of large events, the levels of unpaid claims, legislative changes, judicial decisions and economic, political and regulatory 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 provisions for losses and loss adjustment expenses 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 losses and loss adjustment expenses and unexpired periods of risk.

It should be emphasised that the estimation techniques for the determination of insurance contract 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.

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 from time to time, including inflation, interest rate, investment return and mortality. IAS 19 compares, at a given date, the current market value of a pension 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 will also be impacted by changes in 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 judgments that broaden policy coverage beyond the intent of the original insurance, legislative changes and claims handling procedures.

The establishment of insurance contract 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 provisions for losses and loss adjustment expenses 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 geographic and insurance risk diversity within the Group's portfolio of issued insurance policies mean it is 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 contract 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 judgements and assumptions that are more likely than others to have a material impact on the future development of the insurance contract 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 provisions for losses and loss adjustment expenses 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 up to 40 years). This makes estimating the ultimate number of claims the Group will receive particularly difficult
- Issues of allocation of responsibility among potentially responsible parties and insurers
- Emerging court decisions and the possibility of retrospective legislative changes 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 the Group's London market business, developments in the tactics of US plaintiff lawyers and court decisions and awards.

Potential change in discount rate for lump sum damages awards

Legislative changes may affect the Group's liability in respect of unsettled claims in the use of predetermined factors used by courts to calculate compensation claims. For example, in the UK, standard formulae are used as an actuarial measure by the courts to assess lump sum damages awards for future losses (typically loss of earnings arising from personal injuries and fatal accidents). The calibration of these standard formulae can be updated by the UK Government and the Lord Chancellor may review the methodology to be applied in determining the discount rate to calculate the appropriate settlements, or the discount rate itself, in due course. A reduction in the prescribed discount rate would increase the value of future claims settlements.

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 Group 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 these processes and any 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 the Group 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 being willing and able to perform their obligations in accordance with the terms and conditions of the contracts.

Litigation, disputes and investigations

The Group, in common with the insurance industry in general, is subject to litigation, mediation and arbitration, and regulatory, governmental and other sectoral inquiries and investigations in the normal course of its business. In addition, the Group is exposed to the risk of litigation in connection with its former ownership of the US operation. The directors do not believe that any current mediation, arbitration, regulatory, governmental or sectoral inquiries and investigations 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 or financial penalties resulting from any current mediation, arbitration, regulatory, governmental or sectoral inquiries and investigations 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 and to potential reinsurance capacity constraints. In selecting the reinsurers with whom the Group conducts business its strategy is to seek reinsurers with the best combination of financial strength, price and capacity. The Group Corporate Centre publishes internally a list of authorised reinsurers who pass the Group's selection process and which its 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 which the directors believe may not be able to pay amounts due to the Group in full.

Investment risk

The Group is exposed to market risk and credit risk on its invested assets. Market risk includes the risk of potential losses from adverse movements in market rates and prices including interest rates, equity prices, property prices and foreign exchange rates. The Group's exposure to market risks is controlled by the setting of investment limits in line with the Group's risk appetite. From time to time the Group also makes use of derivative financial instruments to reduce exposure to adverse fluctuations in foreign exchange rates and equity markets. The Group has strict controls over the use of derivative instruments.

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. Limits are set at both a portfolio and counterparty level based on likelihood of default to manage the Group's overall credit profile and specific concentrations within risk appetite. The Group's insurance investment portfolios are concentrated in listed securities with very low levels of exposure to assets without quoted market prices. The Group uses model based analysis to verify asset values when market values are not readily available.

The current economic crisis adds further uncertainty and volatility to underlying levels of market and credit risk in the Eurozone. The Group has, however, very limited direct exposure via its investment portfolio to the Eurozone and to the peripheral Eurozone countries in particular. As with all other invested assets, limits are set in line with the Group's risk appetite. The Group continues to monitor the situation closely and takes action to manage its exposure as required.

Rating environment

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+' (negative outlook) from S&P and 'A2' (stable outlook) from Moody's. A worsening in the ratings could have an adverse impact on the ability of the Group to write certain types of general insurance business.

In assessing credit risk in relation to reinsurance and investments, the Group takes into account a variety of factors, including credit rating. If any such rating changes, or is otherwise reassessed, this has potential implications for the related exposures.

Foreign exchange risk

The Group publishes consolidated financial statements in Pounds Sterling. Therefore, fluctuations in exchange rates used to translate other currencies, particularly other European currencies and the Canadian Dollar, into Pounds Sterling will impact the reported consolidated financial position, results of operations and cashflows from period to period. These fluctuations in exchange rates will also impact the Pound Sterling value of, and the return on, the Group's investments.

Income and expenses for each income statement item are translated at average exchange rates. Assets and liabilities, as reported in the statement of financial position, are translated at closing exchange rates at the end of the reporting period.

Regulatory environment

The legal, regulatory and accounting environment is subject to significant change in many of the jurisdictions in which the Group operates, including developments in response to changes in the economic and political environment and the recent financial crisis. The Group continues to monitor the developments and react accordingly.

The new solvency framework for insurers being developed by the EU, referred to as 'Solvency II', is intended in the medium term to achieve greater harmonisation of approach across EU member states to assessing capital resources and requirements. There remains continued uncertainty as delays in agreeing the rules have caused the planned implementation date of 2014 to be delayed. The Group is actively participating in shaping the outcome through its involvement with European and UK regulators and industry bodies, whilst appropriately progressing its implementation plans and the Directors are confident that the Group will continue to meet all future regulatory capital requirements.

RISK MANAGEMENT

As an insurance company, the Group is fundamentally concerned with the management of risks. This note summarises the key risks to the Group and the steps taken to manage them.

As set out in the corporate governance report, the Group's Board of Directors (the 'Board') defines the risk appetite of the organisation.

The Group employs a comprehensive Risk Management System to identify, measure, manage, monitor and report the risks arising as a result of operating the business. The Risk Management System includes a comprehensive suite of risk policies, procedures, measurement, reporting and monitoring techniques and a series of stress tests and scenario analyses to ensure that the Group's risk exposures are managed appropriately.

The Group is exposed to financial risk through its financial assets, financial liabilities (borrowings), reinsurance assets and insurance contract 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 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 contracts. A key principle behind this process is to hold assets of sufficient credit quality and currency that provide a broad match against the liabilities arising from insurance contracts.

The components of insurance, reinsurance, operational, credit, market and liquidity risk management 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 risks the Group is committing to the payment of claims and therefore these risks must be understood and controlled. Disciplined underwriting, encompassing risk assessment, risk management, pricing and exposure control is critical to the Group's success.

Underwriting and claims risks

The Group manages these risks through its underwriting strategy, adequate reinsurance arrangements and proactive claims handling. The underwriting strategy aims to ensure that the underwritten risks are well diversified in terms of type and amount of risk, industry and geography.

Pricing for the Group's products is generally based upon historical claims frequencies and claims severity averages, adjusted for inflation and modelled catastrophes 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.

Underwriting limits are in place to enforce appropriate risk selection criteria. For example, the Group generally 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 imposes a minimum amount for which employers can be liable for claims for compensation from employees injured at work. These liabilities are usually insured under an employer's liability (or similar) insurance policy. All policies issued by the Group comply with minimum statutory requirements.

All of the Group's underwriters have specific licences 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 reviews.

The Group has developed enhanced methods of recording exposures and concentrations of risk. This means there is greater control of exposures in high risk areas and enables a prompt response to claims from policyholders should there be a catastrophic event such as an earthquake.

Reinsurance arrangements in place include proportional, excess of loss, stop loss and catastrophe coverage. The effect of such reinsurance arrangements is that the Group should not suffer total net insurance losses beyond the Group's risk appetite in any one year.

Reserves – an overview

The Group establishes 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 unallocated loss adjustment expenses (ULAE). Loss reserve estimates are based on known facts and on interpretation of circumstances including the Group's 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. The Group's 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 Group Chief Executive, Group Chief Financial Officer, Group Underwriting and Claims Director, Group Chief Actuary and Group Chief Risk Officer. A similar committee has been established in each of the Group's major operating segments. The Group Reserving Committee monitors the decisions and judgements 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 consolidated financial statements ('Management Best Estimate'). In making its judgement, 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 Management Best Estimate. In making its judgement of the Management Best Estimate of reserves to include in the consolidated financial statements, the Group Reserving Committee adopts the following approach:

- 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 reflected in calculating these indications. At the end of 2012 these risks and developments include: 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 of 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 other 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 judgement, the Committee considers this information as a whole.

Emerging and legal risks

These are risks that have been identified as potentially affecting the Group but are not able to be quantified. Existing or potential future risk exposures are identified and investigated in a structured way, using internal and external resources, and actions to mitigate, contai n or remove these risks are taken.

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. However, 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 financial results by either extending coverage beyond its underwriting intent or by increasing the number and size of claims.

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 reserves may prove insufficient to cover actual losses, LAE 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 reserves and incur a charge to earnings. Such insufficiencies could have a material adverse effect on the Group's future consolidated financial position, financial results and cashflows.

Reinsurance risk

The Group is exposed to both multiple insured losses and losses arising out of a single occurrence, for example a natural peril event such as a hurricane, flood or earthquake.

The ability of the business units 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 groupwide catastrophe exposures and reinsurance adequacy. A reinsurance programme is considered to be 'adequate' only if it covers possible events that could happen in at least 199 out of 200 years. This is referred to as the '1 in 200 year expected maximum loss'.

The Group uses financial analysis models to assess the risk and reward effects of different reinsurance structures and prices. A strategic review was undertaken during 2012, the result of which is to improve the financial performance of the Group through rebalancing retention levels whilst continuing to protect capital and manage volatility.

All of the Group's operations are required to purchase reinsurance within agreed local reinsurance appetite parameters. The Group Corporate Centre authorises the operations' proposed treaty purchases to check that they at least meet the Group's appetite, for example the '1 in 200 year' standard for catastrophe risk. 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. In addition, local facultative arrangements may be purchased where deemed appropriate.

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 insurance risk ceded.

Operational risk

Operational risk is the risk of direct or indirect losses resulting from human factors, external events and inadequate or failed internal processes and systems. Operational risks are inherent in the Group's operations and are typical of any large enterprise. Major sources of operational risk can include operational process reliability, information security, outsourcing of operations, dependence on key suppliers, implementation of strategic and operational change, integration of acquisitions, fraud, human error, customer service quality, inadequacy of business continuity arrangements, recruitment, training and retention of staff, and social and environmental impacts.

The Group manages operational risk using a range of techniques and tools to identify, monitor and mitigate its operational risk in accordance with Group's risk appetite. These tools include Risk and Control Self Assessments, Key Risk Indicators (e.g. fraud and service indicators), Scenario Analyses and Loss Reporting. In addition the Group has developed a number of contingency plans including Incident Management and Business Continuity Plans. Quantitative analysis of operational risk exposures material to the Group is used to inform decisions on the overall amount of capital held and the adequacy of contingency arrangements.

Credit risk

Credit risk is the risk of loss of value of the financial assets due to counterparties failing to meet all or part of their obligations. The Board Risk Committee (BRC) is responsible for ensuring that the Board approved Group credit risk appetite is not exceeded. This is done through the setting and imposition of Group policies, procedures and limits. In defining its appetite for credit risk the Group looks at exposures at both an aggregate and business unit level distinguishing between credit risks incurred as a result of offsetting insurance risks or operating in the insurance market (e.g. reinsurance credit risks and risks to receiving premiums due from policyholders and intermediaries) and credit risks incurred for the purposes of generating a return (e.g. invested assets credit risk).

Limits are set at both a portfolio and counterparty level based on likelihood of default, derived from the rating of the counterparty, to ensure that the Group's overall credit profile and specific concentrations are managed and controlled within risk appetite. Financial assets are graded according to company standards. AAA is the highest possible rating. Investment grade financial assets are classified within the range of AAA to BBB ratings. For invested assets, restrictions are placed on each of the Group's investment managers as to the level of exposure to various rating categories including unrated securities.

The following table provides information regarding the aggregated credit risk exposure for financial assets of the Group as at 31 December 2012.

	Credit rating relating to financial assets that are neither past due nor impaired						Total of financial assets that are neither past due nor impaired
	AAA £m	AA £m	A £m	BBB £m	<BBB £m	Not rated £m	£m
Debt securities	**5,985**	**2,079**	**2,585**	**835**	**81**	**159**	**11,724**
Loans and receivables	**18**	**–**	**21**	**3**	**3**	**41**	**86**
Reinsurers' share of insurance contract liabilities	**35**	**533**	**1,040**	**218**	**50**	**55**	**1,931**
Insurance and reinsurance debtors[1]	**121**	**23**	**695**	**136**	**104**	**2,336**	**3,415**
Derivative assets	**–**	**12**	**31**	**–**	**–**	**3**	**46**
Other debtors	**–**	**–**	**–**	**–**	**–**	**323**	**323**
Cash and cash equivalents	**276**	**452**	**412**	**97**	**33**	**59**	**1,329**

Notes:
1. The insurance and reinsurance debtors classified as not rated comprise personal policyholders and small corporate customers that do not have individual credit ratings. The overall credit risk to the Group is deemed to be low as the cover could be cancelled if payment were not received on time.

As at 31 December 2011

	Credit rating relating to financial assets that are neither past due nor impaired						Total of financial assets that are neither past due nor impaired
	AAA £m	AA £m	A £m	BBB £m	<BBB £m	Not rated £m	£m
Debt securities	6,639	2,070	2,231	524	53	150	11,667
Loans and receivables	3	5	18	2	–	76	104
Reinsurers' share of insurance contract liabilities	50	466	1,171	179	79	116	2,061
Insurance and reinsurance debtors	53	21	63	52	2	2,984	3,175
Derivative assets	–	–	57	–	–	2	59
Other debtors	–	–	–	–	–	300	300
Cash and cash equivalents	339	316	320	89	62	132	1,258

With the exception of AAA rated government debt securities, the largest aggregate credit exposure does not exceed **3%** of the Group's total financial assets. Holdings of government bonds in Greece, Italy, Ireland, Spain and Portugal are **£121m** at 31 December 2012 and comprises around **1%** of the total bond portfolio (2011: around 1%). In addition to this the Group holds **£227m** of senior and subordinated bank debt and **£122m** of other corporate holdings in these countries.

The Group is exposed to credit and concentrations of risk with individual reinsurers, due to the nature of the reinsurance market and the restricted range of reinsurers that have acceptable credit ratings. The reinsurance strategy is to purchase reinsurance in the most effective manner from reinsurers who meet its security standards. Reinsurance counterparties are subject to a rigorous internal assessment process on an ongoing basis to ensure that their creditworthiness continues to be satisfactory and the potential impact from reinsurer default is measured regularly and managed accordingly. The Group Reinsurance Credit Committee oversees the management of these risks. Group standards are set such that reinsurers that have a financial strength rating of less than 'A-' with Standard & Poor's, or a comparable rating, are removed from the Group's authorised list of approved reinsurers unless the Group's internal review discovers exceptional circumstances in favour of the reinsurer. Collateral is taken to mitigate exposures, where appropriate, to acceptable levels or the size or credit quality of the exposure. At 31 December 2012 the Group held collateral against **£89m** (2011: £115m) of reinsurers' share of insurance contract liabilities.

The Group regularly monitors its aggregate exposures by reinsurer group against predetermined reinsurer group limits, in accordance with the methodology agreed by the BRC. The Group's largest reinsurance exposures to active reinsurance groups are Swiss Re, Munich Re, and HDI-Gerling. At 31 December 2012 the reinsurance asset recoverable from these groups does not exceed **3%** of the Group's total financial

assets. Stress tests are performed by reinsurer counterparty and the limits are set such that in a catastrophic event, the exposure to a single reinsurer is estimated not to exceed **3%** of the Group's total financial assets. Certain of the Group's subsidiaries are members of government mandated pools in various parts of the world. As of 31 December 2012 the largest pool (by premium volume) is Pool Re operated by the UK Government to provide terrorism cover.

There are no material financial assets that would have been past due or impaired had the terms not been renegotiated.

The following table provides information regarding the carrying value of financial assets that have been impaired and the ageing of financial assets that are past due but not impaired as at 31 December 2012.

		Financial assets that are past due but not impaired						
	Neither past due nor impaired £m	Up to three months £m	Three to six months £m	Six months to one year £m	Greater than one year £m	Financial assets that have been impaired £m	Carrying value in the statement of financial position £m	Impairment losses charged to the income statement £m
Debt securities	**11,724**	**–**	**–**	**–**	**–**	**–**	**11,724**	**–**
Loans and receivables	**86**	**–**	**–**	**–**	**–**	**11**	**97**	**(7)**
Reinsurers' share of insurance contract liabilities	**1,931**	**–**	**–**	**–**	**–**	**18**	**1,949**	**1**
Insurance and reinsurance debtors	**3,415**	**107**	**35**	**11**	**24**	**–**	**3,592**	**(1)**
Derivative assets	**46**	**–**	**–**	**–**	**–**	**–**	**46**	**–**
Other debtors	**323**	**5**	**18**	**3**	**8**	**–**	**357**	**–**
Cash and cash equivalents	**1,329**	**–**	**–**	**–**	**–**	**–**	**1,329**	**–**

As at 31 December 2011

		Financial assets that are past due but not impaired						
	Neither past due nor impaired £m	Up to three months £m	Three to six months £m	Six months to one year £m	Greater than one year £m	Financial assets that have been impaired £m	Carrying value in the statement of financial position £m	Impairment losses charged to the income statement £m
Debt securities	11,667	–	–	4	–	3	11,674	(6)
Loans and receivables	104	–	–	–	–	–	104	–
Reinsurers' share of insurance contract liabilities	2,061	–	–	–	–	12	2,073	–
Insurance and reinsurance debtors	3,175	97	25	11	13	7	3,328	(4)
Derivative assets	59	–	–	–	–	–	59	–
Other debtors	300	13	19	6	3	–	341	–
Cash and cash equivalents	1,258	–	–	–	–	–	1,258	–

Local operations are responsible for assessing and monitoring the creditworthiness of their counterparties (e.g. brokers and policyholders). Local credit committees are responsible for ensuring these exposures are within the risk appetite of the local operations. Exposure monitoring and reporting is embedded throughout the organisation with aggregate credit positions reported and monitored at Group level.

The Group's investments comprise a broad range of financial investments issued principally in the UK, Canada and Scandinavia.

At 31 December 2012, the Group had pledged **£895m** (2011: £901m) of financial assets as collateral for liabilities or contingent liabilities and had accepted **£827m** (2011: £936m) in collateral. The nature of the assets pledged as collateral comprises government securities of **£831m** (2011: £855m), cash and cash equivalents of **£32m** (2011: £13m) and debt securities of **£32m** (2011: £33m). The terms and conditions of the collateral pledged are market standard in relation to letter of credit facilities.

The Group is permitted to sell or repledge collateral held in the event of default by the owner, the fair value of which has been noted above at **£827m**. The terms and conditions of the collateral held are market standard. The assets held as collateral are readily convertible into cash.

At 31 December 2012, the Group had entered into short-term sale and repurchase agreements for UK government securities. The Group continues to recognise the debt securities in the statement of financial position as the Group remains exposed to the risks and rewards of ownership. The carrying value of these debt securities recognised in the statement of financial position is **£295m** (2011: £297m) and the carrying value of the associated liabilities is **£295m** (2011: £297m).

Market risk

The Group is exposed to the risk of potential losses from adverse movements in market prices including those of interest rates, equities, property, exchange rates and derivatives. The Group's exposure to these risks is governed by the market risk policy.

Exposures are controlled by the setting of investment limits and managing asset-liability matching 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 investment 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 on page 99.

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 on page 99.

The Group sets appropriate risk limits to ensure that no significant concentrations to individual companies arise. The Group takes a long-term view in selecting shares 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 manage equity exposure and to protect the portfolio from losses outside of its risk appetite.

Property price risk

The Group's portfolio of properties is subject to property price risk arising from changes in the market value of properties. Further information on the valuation approach is included in Significant Accounting Policies. Thus if the value of property falls so will the fair value of the portfolio as set out in the sensitivity analysis on page 99.

A number of the Group's property holdings are Group occupied and therefore are reported within property and equipment. The Group's investment in investment property is recorded as such and these investments are held as part of an efficient portfolio management strategy.

Currency risk

The Group operates in 32 countries. Accordingly, its net assets are subject to foreign exchange rate movements. The Group's primary foreign currency exposures are to the Danish Krone, Euro, Canadian Dollar and the Swedish Krona. If the value of Sterling strengthens then the value of non Sterling net assets will decline when translated into Sterling and consolidated.

The Group incurs exposure to currency risk in two ways:

- Operational currency risk – by underwriting liabilities in currencies other than the currency of the primary environment in which the business units operate (non functional currencies)
- Structural currency risk – by investing in overseas subsidiaries and operating an international insurance group.

Operational currency risk is managed within the Group's individual operations by broadly matching assets and liabilities by currency.

Structural currency risk is managed at a Group level through currency forward and foreign exchange option contracts within the limits that have been set. In managing structural currency risk, the needs of the Group's subsidiaries to maintain net assets in local currencies to satisfy local regulatory solvency and internal risk based capital requirements are taken into account. These assets should prove adequate to support local insurance activities irrespective of exchange rate movements. Consequently, this may affect the value of the consolidated shareholders' equity expressed in Sterling.

At 31 December 2012, the Group's total shareholders' equity analysed by currency is:

	Pounds Sterling £m	Danish Krone/Euro £m	Canadian Dollar £m	Swedish Krona £m	Other £m	Total £m
Shareholders' equity at 31 December 2012	**1,057**	**629**	**572**	**558**	**934**	**3,750**
Shareholders' equity at 31 December 2011	876	681	745	568	931	3,801

Shareholders' equity is stated after taking account of the effect of currency forward contracts and foreign exchange options. On this basis, a 10% change in Pounds Sterling against Danish Krone/Euro, Canadian Dollar or Swedish Krona would have the following impact on shareholders' equity:

	10% strengthening in Pounds Sterling against Danish Krone/Euro £m	10% weakening in Pounds Sterling against Danish Krone/Euro £m	10% strengthening in Pounds Sterling against Canadian Dollar £m	10% weakening in Pounds Sterling against Canadian Dollar £m	10% strengthening in Pounds Sterling against Swedish Krona £m	10% weakening in Pounds Sterling against Swedish Krona £m
Movement in shareholders' equity at 31 December 2012	**(57)**	**70**	**(52)**	**64**	**(51)**	**62**
Movement in shareholders' equity at 31 December 2011	(62)	75	(68)	83	(52)	63

The analysis aggregates the Danish Krone exposure and the Euro exposure as the Danish Krone continues to be pegged closely to the Euro. The Group considers the aggregate exposures when reviewing its hedging strategy.

Apart from the impact on derivative financial instruments covered below, the changes arise from retranslation of foreign subsidiaries' net asset positions from their functional currencies into Pounds Sterling, with movements being taken through the translation reserve. These movements in exchange rates therefore have no impact on profit.

Derivatives

The Group may use derivative financial instruments for the purpose of reducing its exposure to adverse fluctuations in interest rates, foreign exchange rates, equity prices and long-term inflation. The Group does not use derivatives to leverage its exposure to markets and does not hold or issue derivative financial instruments for speculative purposes. Forward contracts and foreign exchange options are used to reduce the risk of adverse currency movements on certain forecast future cash transactions and for structural hedging. The policy on use of derivatives is approved by the BRC.

	Remaining life			Fair value		Notional principal amounts	
	Less than one year £m	One to five years £m	More than five years £m	2012 £m	2011 £m	2012 £m	2011 £m
Cross currency							
Asset	**14**	**1**	–	**15**	15	**974**	900
Liability	**6**	–	–	**6**	14	**830**	760
Inflation							
Asset	–	–	**21**	**21**	10	**see below**	see below
Liability	–	–	**24**	**24**	13	**see below**	see below
Equity index							
Asset	**10**	–	–	**10**	34	**see below**	see below
Liability	**12**	–	–	**12**	27	**see below**	see below

At 31 December 2012 there are derivative contracts in place to protect the value of the UK, Canadian, European, and US equity portfolios of the Group. These provide limited protection against declines in market levels whilst also capping participation in any appreciation of the market. In total, this strategy covers an underlying equity value up to approximately **£348m** (2011: £477m). If UK, Canadian, European and US equity markets decreased by 15%, the impact of these derivatives as at 31 December 2012, would be to decrease the impact of the decline by **£26m** (2011: £30m).

During 2011 the Group entered into a series of swap contracts which collectively provide limited cover against a sharp increase in long-term inflation. In total the swap contracts provide inflation cover over a nominal value of **£180m** (2011: £180m) and are split over different contract terms.

At 31 December 2012 the Group holds currency forward contracts and foreign exchange options that are designated as hedging instruments to reduce structural foreign exchange risk. The derivatives are included in the table above. Further information on designated hedges can be found in note 28.

Sensitivity analysis

The Group uses a number of sensitivity or stress test-based risk management tools to understand the impact of the above risks on earnings and capital in both normal and stressed conditions. These stress tests combine deterministic shocks, analysis of historical scenarios and stochastic modelling using the internal capital model to inform the Group's decision making and planning process and also for identification and management of risks within the business units.

The following table provides an indication of some of the single factor changes adopted within the Group.

Changes in the income statement and equity:

	Increase/(decrease) in income statement		Decrease in other comprehensive income	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Interest rate markets:[2]				
Impact on fixed interest securities of increase in interest rates of 100bps[3]	**–**	–	**(446)**	(393)
Decrease of equity markets:[4]				
Direct impact on equities of a 15% fall in equity markets	**(25)**	(28)	**(84)**	(116)
Mitigating impact arising from derivatives held	**26**	30	**–**	–
Property markets:[4]				
Decrease of property markets of 15%	**(51)**	(54)	**(23)**	(22)

Notes:

1. This analysis assumes that there is no correlation between equity price, interest rate and property market 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, but reflects management's view of key sensitivities.
2. The sensitivity of the fixed interest securities 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. The effect of movement in interest rates is reflected as a one time rise of 100bps on 1 January 2013 and 1 January 2012.
3. The impact on the fair value of the loan capital is a decrease of **£55m** (2011: £75m).
4. 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 2013 and 1 January 2012 which results in a 15% decline in the value of the Group's assets in these investment categories.
5. This analysis has not considered the impact of the above market changes on the valuation of the Group's insurance contract liabilities or retirement benefit obligations.
6. This analysis is presented gross of the corresponding tax credits/(charges).

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 liquidity risk and is committed to meeting all liabilities as they fall due. The investment risk limits set by the BRC ensure that a large part of the Group's portfolio is kept in highly liquid marketable securities sufficient to meet its liabilities as they fall due based on actuarial assessment and allowing for contingencies. 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.

Maturity periods or contractual repricing

The following table summarises the contractual repricing or maturity dates (whichever is earlier) for financial liabilities that are subject to fixed and variable interest rates. Insurance contract liabilities are also presented and are analysed by remaining duration.

As at 31 December 2012

	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	Five to ten years £m	Greater than ten years £m	Total £m	Carrying value in the statement of financial position £m
Subordinated guaranteed US$ bonds	–	–	–	–	–	–	15	15	14
Subordinated guaranteed perpetual bonds	–	–	–	–	375	–	–	375	334
Subordinated guaranteed perpetual notes	–	450	–	–	–	–	–	450	470
Subordinated guaranteed dated notes	–	–	–	–	–	500	–	500	493
Provision for unearned premium	3,481	263	79	7	5	17	–	3,852	3,852
Provisions for losses and loss adjustment expenses	4,065	1,849	1,199	826	600	1,464	2,334	12,337	11,002
Direct insurance creditors	283	6	–	–	–	–	–	289	289
Reinsurance creditors	253	9	2	4	–	–	–	268	269
Borrowings	295	–	–	–	–	1	–	296	296
Deposits received from reinsurers	33	–	–	–	–	–	–	33	33
Derivative liabilities	42	–	–	–	–	–	–	42	42
Total	8,452	2,577	1,280	837	980	1,982	2,349	18,457	17,094
Interest on loan capital	112	109	73	73	62	71	9	509	

As at 31 December 2011

	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	Five to ten years £m	Greater than ten years £m	Total £m	Carrying value in the statement of financial position £m
Subordinated guaranteed US$ bonds	–	–	–	–	–	–	15	15	14
Subordinated guaranteed perpetual bonds	–	–	–	–	–	375	–	375	326
Subordinated guaranteed perpetual notes	–	–	450	–	–	–	–	450	480
Subordinated guaranteed dated notes	–	–	–	–	–	500	–	500	493
Provision for unearned premium	3,327	228	79	14	9	12	–	3,669	3,669
Provisions for losses and loss adjustment expenses	3,563	1,842	1,182	873	639	1,588	2,663	12,350	11,097
Direct insurance creditors	283	2	–	–	–	–	–	285	285
Reinsurance creditors	307	8	2	–	–	–	–	317	317
Borrowings	298	–	–	–	–	–	–	298	298
Deposits received from reinsurers	33	–	–	–	–	–	–	33	33
Derivative liabilities	54	–	–	–	–	–	–	54	54
Total	7,865	2,080	1,713	887	648	2,475	2,678	18,346	17,066
Interest on loan capital	112	112	112	73	73	132	11	625	

The duration analysis above is presented on an undiscounted basis. The carrying values in the statement of financial position are discounted where appropriate in accordance with Group accounting policy.

The capital and interest payable on the bonds and notes has been included until the dates on which the Group has the option to call the instruments and the interest rates are reset. For further information on the terms of the bonds and notes see note 19 to the financial statements.

Undiscounted interest payments are calculated based on underlying fixed interest (as detailed in note 19). Year end exchange rates have been used for interest projections on loans in foreign currencies.

Capital management

The maintenance of a strong capital position is critical to the Group's ability to conduct business.

The Group maintains sufficient capital, which comprises shareholders' equity and subordinated loan capital, to meet its plan and objectives. This represents sufficient surpluses for both regulatory and economic capital, as well as sufficient capital to support the Group's aim of maintaining single 'A' ratings.

To provide protection against material events or shocks, the Group would normally expect to hold appropriate levels of capital to maintain sufficient economic and regulatory surpluses.

The maintenance of a capital position in excess of regulatory requirements is an absolute requirement for all of the Group's regulated entities. There is no tolerance for breaching capital requirements for any regulated entity.

The Group's regulated entities hold appropriate levels of capital to satisfy applicable local regulations. In certain instances this could restrict the subsidiaries' ability to transfer funds to the UK parent where retained earnings form part of the local required regulatory capital. Additionally, regulation in certain countries in which the Group's subsidiaries operate may also impose other limitations such as foreign exchange control restrictions.

Economic capital

Economic capital is the Group's preferred measure of capital sufficiency. It is the Group's own assessment of the amount of capital it needs to hold to meet its obligations given the Group's risk appetite. Assets and liabilities are valued on an economic basis providing the most realistic representation of the Group's financial position.

The economic capital analysis compares the economic value of the Group's assets with the total resources required in a range of adverse scenarios, calibrated to a defined risk tolerance consistent with the Group's 'A' rating which is in line with target. The economic capital surplus is the amount by which the economic assets exceed the total resources required. The total resources required is the amount of assets the Group needs today to meet its liabilities under the defined risk tolerance. The Group defines the economic capital required as the difference between the total resource requirement and the accounting value of liabilities. At 31 December 2012, the Group's surplus economic capital calibrated to Standard & Poor's long-term A rated bond default curve was approximately **£0.7bn** (2011: £0.8bn). When calibrated to a risk tolerance of insolvency of 1 in 200 per annum the ECA surplus was **£1.2m** (31 December 2011: £1.2bn).

The position was adversely impacted in the year by falling yields and increased acquisitions offset by an improvement in expected future retained profits.

The economic capital model is used to support, inform and improve the Group's decision making across the Group. It is used to determine the Group's optimum capital structure, its investment strategy, its reinsurance programme and to determine the pricing and target returns for each portfolio. The economic capital model is also used for the Group's Individual Capital Assessment (ICA). The only adjustment made is to use the FSA's required calibration.

Regulatory solvency position

The Group remains fully compliant with both the FSA's risk based ICA methodology and Solvency I, which is used to calculate the Insurance Groups Directive (IGD) requirement.

For the Group's senior regulated insurance company, Royal & SunAlliance Insurance plc, the capital position continues to be reported under Solvency I.

As at 31 December 2012 the Group has an IGD surplus of approximately **£1.2bn** (2011: £1.3bn). Whilst the IGD surplus remains strong it has experienced a small decrease in the year with retained earnings being offset by increases in both capital requirements resulting from higher business volumes and increased goodwill and intangible assets. The coverage ratio stood at **1.9** times at 31 December 2012 (2011: 2.0 times).

The Group received its latest Individual Capital Guidance (based on its ICA submission) from the FSA in late 2011 and 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 its assessment of the risks to which it is exposed. 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.

NOTES TO THE FINANCIAL STATEMENTS

1. OPERATING SEGMENTS

From 1 January 2012, the Group is organised into four operating segments, Scandinavia, Canada, UK & Western Europe, and Emerging Markets with each operating segment managed by a Chief Executive Officer (CEO) who is directly accountable to the Group Chief Executive and the Board of Directors. Each of the CEOs is also a member of the Group Executive Committee. Scandinavia, Canada and UK & Western Europe represent the major geographical areas in which the Group operates through established businesses in mature markets. The UK is the Group's country of domicile and one of its principal markets. Western Europe includes the operations in Ireland and Italy. Emerging Markets comprises the Group's operations in Latin America, Asia and Central and Eastern Europe and the Middle East. All operations are engaged in providing personal and commercial general insurance services. Central functions include the Group's internal reinsurance function and Group Corporate Centre.

Prior to this date, the businesses in Scandinavia, Canada, Ireland and Italy had been reported together as the International region. Additionally, the investment result now comprises investment income and the unwind of discount. The comparative information has been restated.

The Group uses the following key measures to assess the performance of its operating segments:

- Net written premiums
- Underwriting result
- Combined operating ratio (COR).

Net written premiums is the key measure of revenue used in internal reporting. Underwriting result and COR are the key internal measures of profitability of the operating segments. The COR reflects the ratio of claims costs and expenses (including commission) to premiums, expressed as a percentage.

As described in the Risk Management section of the notes to the financial statements sufficient net assets are maintained by each of the Group's subsidiaries to satisfy local regulatory and internal risk based capital requirements. In addition the Group monitors the Group's total capital position at all times. Assets and liabilities are reviewed by the chief operating decision maker at the Group level, and as such are not presented at the operating segment level.

All of these items are measured in accordance with the Group's accounting policies. Certain items included within the Group's investment result are allocated to the operating segments based on economic capital requirements.

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

Management basis

The management basis reflects the way management monitor the business. Operating result on a management basis comprises the underwriting result, the investment result and other activities.

Major components of underwriting result are net earned premiums, other operating income, net claims incurred, acquisition costs and other underwriting costs.

Other activities comprise administration expenses, ongoing investment in the Group's operations in Central and Eastern Europe and other expenses of **£89m** (2011: £99m), which includes the Group share in the loss after tax of its associates of **£6m** (2011: £9m). In addition there are investment expenses and charges of **£33m** (2011: £34m).

1. OPERATING SEGMENTS CONTINUED

Segment revenue and results

Year ended 31 December 2012

	Scandinavia £m	Canada £m	UK & Western Europe £m	Emerging Markets £m	Central Functions £m	Total Group £m
Net written premiums	1,791	1,614	3,689	1,237	22	8,353
Underwriting result	237	98	12	33	(5)	375
Investment result	94	61	233	45	(2)	431
Insurance result	331	159	245	78	(7)	806
Other activities	(9)	(7)	(1)	(32)	(73)	(122)
Operating result (management basis)	322	152	244	46	(80)	684
Realised gains/(losses)						79
Unrealised (losses)/gains, impairments and foreign exchange						(51)
Interest costs						(115)
Amortisation and impairment of intangible assets						(42)
Solvency II costs						(32)
Reorganisation costs						(24)
Acquisitions and disposals						(20)
Profit before tax (per income statement)						479
Combined operating ratio (%)	86.6	93.7	99.5	96.9	–	95.4
Other segment items included in the income statement:						
Investment income	133	63	262	49	8	515
Investment expense and charges	(8)	(4)	(1)	(11)	(9)	(33)
Depreciation, amortisation and impairment	(29)	(36)	(81)	(22)	(4)	(172)

Year ended 31 December 2011 (restated)

	Scandinavia £m	Canada £m	UK & Western Europe £m	Emerging Markets £m	Central Functions £m	Total Group £m
Net written premiums	1,824	1,483	3,701	1,103	27	8,138
Underwriting result	264	116	1	3	(9)	375
Investment result	123	71	245	51	(5)	485
Insurance result	387	187	246	54	(14)	860
Other activities	(8)	(5)	5	(42)	(83)	(133)
Operating result (management basis)	379	182	251	12	(97)	727
Realised gains/(losses)						201
Unrealised (losses)/gains, impairments and foreign exchange						(44)
Interest costs						(117)
Amortisation and impairment of intangible assets						(114)
Solvency II costs						(30)
Acquisitions and disposals						(10)
Profit before tax (per income statement)						613
Combined operating ratio (%)	85.4	91.6	99.6	98.7	–	94.9
Other segment items included in the income statement:						
Investment income	166	72	276	52	13	579
Investment expense and charges	(8)	(5)	(1)	(11)	(9)	(34)
Depreciation, amortisation and impairment	(19)	(33)	(115)	(48)	(2)	(217)

No other material non cash expenses are reported internally by segment.

Net written premiums from major geographical regions

	Net written premiums		Non current assets	
	2012 £m	2011 £m	**2012 £m**	2011 £m
Scandinavia	**1,791**	1,824	**432**	420
Canada	**1,614**	1,483	**453**	391
UK	**3,141**	3,087	**444**	440
Western Europe	**548**	614	**135**	133
Emerging Markets	**1,237**	1,103	**354**	291
Central Functions	**22**	27	**323**	350
	8,353	8,138	**2,141**	2,025

Net written premiums are allocated to the countries in which the business is underwritten or managed.

Non current assets comprise goodwill and intangible assets, property and equipment, investment property and investments in associates.

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	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Investment property	**28**	37	**–**	2	**(24)**	(6)	**–**	–	**4**	33
Equity securities:										
Available for sale	**57**	58	**70**	155	**–**	–	**(12)**	(18)	**115**	195
At fair value through the income statement	**–**	5	**–**	(1)	**6**	2	**–**	–	**6**	6
Debt securities:										
Available for sale	**403**	446	**19**	17	**–**	–	**–**	(6)	**422**	457
At fair value through the income statement	**–**	–	**–**	–	**(15)**	(17)	**–**	–	**(15)**	(17)
Other investments:										
Loans secured by mortgages	**1**	1	**–**	(1)	**–**	–	**–**	–	**1**	–
Other loans	**2**	4	**–**	–	**–**	–	**(7)**	–	**(5)**	4
Other	**4**	20	**2**	1	**(4)**	–	**–**	–	**2**	21
Deposits, cash and cash equivalents	**15**	15	**(4)**	–	**(3)**	–	**–**	–	**8**	15
Derivatives	**5**	(7)	**(8)**	28	**(1)**	10	**–**	–	**(4)**	31
Net investment return	**515**	579	**79**	201	**(41)**	(11)	**(19)**	(24)	**534**	745

The net investment return on derivatives represents the investment return on financial assets that the Group is required to classify as held for trading investments. The derivatives are used to provide an economic hedge for fair value changes of assets held within the investment portfolio.

2. NET INVESTMENT RETURN CONTINUED

During 2012 or 2011 there was no significant accrued interest income on impaired financial assets.

Direct operating expenses (including repairs and maintenance) arising from investment properties were not material in 2012 or 2011.

Unrealised capital gains and losses recognised directly in equity for available for sale assets are as follows:

	Net unrealised gains/(losses)		Net realised (gains)/losses transferred to income statement		Impairments transferred to income statement		Net movement recognised in equity	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Equity securities	**55**	(70)	**(70)**	(155)	**12**	18	**(3)**	(207)
Debt securities	**155**	245	**(19)**	(17)	**–**	6	**136**	234
Other	**(7)**	–	**–**	–	**7**	–	**–**	–
Total	**203**	175	**(89)**	(172)	**19**	24	**133**	27

3. NET CLAIMS AND BENEFITS

	2012 £m	2011 £m
Gross claims paid	**6,010**	6,448
Gross changes in provisions for losses and loss adjustment expenses	**(181)**	(853)
Reinsurance recoveries on losses and loss adjustment expenses paid	**(555)**	(1,099)
Reinsurers' share of change in insurance contract liabilities for claims	**107**	717
Net claims and benefits	**5,381**	5,213

4. PROFIT BEFORE TAX

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

Other operating income

	2012 £m	2011 £m
Engineering inspection fees	**39**	38
Other income	**102**	96
Other operating income	**141**	134

Engineering inspection fees are ancillary to the provision of engineering insurance cover.

Other operating expenses

	2012 £m	2011 £m
Administration and other expenses	**92**	93
Investment expenses and charges	**33**	34
Amortisation and impairment of intangible assets	**42**	114
Solvency II costs	**32**	30
Reorganisation costs	**24**	–
Acquisitions	**20**	11
Foreign exchange (gains)/losses	**(9)**	9
Other operating expenses	**234**	291

Reorganisation costs relate to the closure of the Czech Republic operation and the restructuring of Group Corporate Centre.

Other lease payments

The operating lease payments recognised as an expense during the year are **£71m** (2011: £70m). The Group has no significant lease agreements that include contingent rent.

Finance costs

	2012 £m	2011 £m
Interest expense on loan capital	**110**	109
Other loan interest	**5**	8
Finance costs	**115**	117

Auditor's remuneration

	2012 £m	2011 £m
Fees payable to the Company's auditor and its associates for the audit of the Company's annual accounts	**0.9**	0.9
Fees payable to the Company's auditor and its associates for other services:		
The audit of the Company's subsidiaries	**4.5**	4.6
Audit related assurance services	**0.4**	0.5
Taxation advisory services	**0.2**	0.2
Corporate finance services	**0.2**	0.7
Other services	**9.5**	2.7
Auditor's remuneration	**15.7**	9.6

Other services include fees payable to the Company's auditor in respect of consultancy services relating to business transformation processes and regulatory development projects.

Directors' emoluments

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

	2012 £000	2011 £000
Emoluments of Executive Directors	**3,233**	5,230
Fees and other payments to Non-Executive Directors	**1,077**	832
	4,310	6,062

Details of Directors' remuneration and pension benefits and details of Directors' interests in the Parent Company are shown in the remuneration report.

Employee information

Staff costs for all employees comprise:

	2012 £m	2011 £m
Wages and salaries	**932**	904
Social security costs	**127**	124
Pension costs	**72**	78
Share based payments to Directors and employees	**6**	9
	1,137	1,115

4. PROFIT BEFORE TAX CONTINUED

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

	2012 Number	2011 Number
Scandinavia	**3,687**	3,696
Canada	**4,073**	3,694
UK & Western Europe	**9,846**	9,874
Emerging Markets	**6,218**	5,976
	23,824	23,240

UK & Western Europe includes staff employed in Group Corporate Centre.

5. INCOME TAX EXPENSE

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

	2012 £m	2011 £m
Current tax	**139**	155
Deferred tax	**(11)**	31
Taxation attributable to the Group	**128**	186

UK corporation tax is calculated at **24.5%** (2011: 26.5%) of the estimated assessable profit for the year. Since the Group operates around the world, it is subject to income taxes in many different jurisdictions. Taxation for jurisdictions other than the UK is calculated at the rates prevailing in those jurisdictions. Of the above taxation attributable to the Group **£8m** (2011: £(8)m) relates to UK corporation tax and **£120m** (2011: £194m) to overseas taxation.

	2012 £m	2011 £m
Profit before tax	**479**	613
Tax at the UK rate of **24.5%** (2011: 26.5%)	**117**	163
Tax effect of:		
Income/gains not taxable	**(17)**	(24)
Expenses not deductible for tax purposes	**17**	45
Tax losses not recognised	**4**	12
Release of tax provided in respect of prior periods	**(21)**	(36)
Different tax rates of subsidiaries operating in other jurisdictions	**–**	(1)
Effect of change in tax rates	**7**	10
Other	**21**	17
Income tax expense	**128**	186

6. EARNINGS PER SHARE ATTRIBUTABLE TO THE ORDINARY SHAREHOLDERS OF THE PARENT COMPANY

The earnings per ordinary share are calculated by reference to the profit attributable to the ordinary shareholders and the weighted average of shares in issue during the year.

Basic

Basic earnings per share are calculated by dividing the profit attributable to the ordinary shareholders of the Parent Company by the weighted average number of ordinary shares in issue during the period, excluding ordinary shares purchased by various share trusts and held as own shares.

	2012 £m	2011 £m
Profit attributable to the shareholders of the Parent Company	**344**	426
Less: cumulative preference dividends	**(9)**	(9)
Profit for the calculation of earnings per share	**335**	417
Weighted average number of ordinary shares in issue (thousands)	**3,534,577**	3,511,180
Basic earnings per share (p)	**9.5**	11.9

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 share options and contingently issuable shares as categories of dilutive potential ordinary shares.

The calculation is performed for the dilutive potential ordinary shares to determine the number of shares that could have been issued 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 dilutive potential ordinary shares. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the dilutive potential ordinary shares.

	2012 £m	2011 £m
Profit for the calculation of earnings per share	**335**	417
Weighted average number of ordinary shares in issue (thousands)	**3,534,577**	3,511,180
Adjustments for share options and contingently issuable shares (thousands)	**41,954**	29,824
Weighted average number of ordinary shares for diluted earnings per share (thousands)	**3,576,531**	3,541,004
Diluted earnings per share (p)	**9.4**	11.8

7. DIVIDENDS

	2012 p	2011 p	2012 £m	2011 £m
Ordinary dividend:				
Final paid in respect of prior year	**5.82**	5.70	**206**	198
Interim paid in respect of current year	**3.41**	3.34	**121**	118
			327	316
Preference dividend			**9**	9
			336	325

At the Annual General Meeting (AGM) on 15 May 2013, a final dividend in respect of the year ended 31 December 2012 of **3.90p** per share amounting to a total dividend of **£140m** 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 2013.

The Group subsidiaries may be subject to restrictions on the amount of dividends they can pay to shareholders as a result of local regulatory requirements. However, based on the information currently available, the Group does not believe that such restrictions materially impact the ability to meet obligations or pay dividends.

The trustees of the Royal & SunAlliance ESOP Trust and the Royal & SunAlliance ESOP Trust No 2 waived their entitlement to dividends (except for a nominal amount) which reduced the total dividend paid by less than **£1m** (2011: less than £1m).

8. GOODWILL AND OTHER INTANGIBLE ASSETS

	Goodwill £m	Intangible assets arising from acquired claims provisions £m	Software development £m	Other £m	Total £m
Cost					
At 1 January 2012	734	122	894	321	2,071
Additions and transfers	67	5	140	63	275
Disposals and transfers	–	–	(75)	(1)	(76)
Exchange adjustment	(9)	(4)	(2)	(9)	(24)
At 31 December 2012	792	123	957	374	2,246
Accumulated amortisation					
At 1 January 2012	–	117	394	128	639
Amortisation charge	–	2	82	32	116
Amortisation on disposals	–	–	(75)	(1)	(76)
Exchange adjustment	–	(4)	–	(4)	(8)
At 31 December 2012	–	115	401	155	671
Accumulated impairment					
At 1 January 2012	71	–	2	–	73
Impairment charge	–	–	12	–	12
Exchange adjustment	1	–	–	–	1
At 31 December 2012	72	–	14	–	86
Net carrying amount at 31 December 2012	720	8	542	219	1,489

Other intangible assets include customer lists, renewal rights and acquired brands.

	Goodwill £m	Intangible assets arising from acquired claims provisions £m	Software development £m	Other £m	Total £m
Cost					
At 1 January 2011	650	120	749	243	1,762
Additions and transfers	112	5	156	86	359
Disposals and transfers	–	–	(3)	(2)	(5)
Exchange adjustment	(28)	(3)	(8)	(6)	(45)
At 31 December 2011	734	122	894	321	2,071
Accumulated amortisation					
At 1 January 2011	–	117	332	104	553
Amortisation charge	–	3	67	29	99
Amortisation on disposals	–	–	(3)	(2)	(5)
Exchange adjustment	–	(3)	(2)	(3)	(8)
At 31 December 2011	–	117	394	128	639
Accumulated impairment					
At 1 January 2011	–	–	–	–	–
Impairment charge	71	–	2	–	73
At 31 December 2011	71	–	2	–	73
Net carrying amount at 31 December 2011	663	5	498	193	1,359

Amortisation expense of **£82m** (2011: £67m) has been charged to underwriting and policy acquisition costs with the remainder recognised in other operating expenses.

Additions of software development comprise **£12m** (2011: £9m) of external software and **£128m** (2011: £147m) of internally developed software.

Software impairment charges of **£12m** (2011: £2m) have been charged to underwriting and policy acquisition costs during the year, which includes a charge of £10m arising from the integration of operational systems in Scandinavia.

Impairment tests for goodwill

Goodwill is allocated to the Group's cash generating units (CGUs) which operate in the following segments:

	2012 £m	2011 £m
Scandinavia	**163**	176
Canada	**230**	208
UK & Western Europe	**92**	93
Emerging Markets	**235**	186

No goodwill impairment charges have been recognised within other operating expenses during 2012 (2011: £71m).

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 to ten year period. Cashflows beyond this 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 and taxes using historical trends, general geographical market conditions, industry trends and forecasts and other available information. These assumptions are subject to review by management. The cashflow forecasts are adjusted by appropriate discount rates. Discount rates used in 2012 are within a range of **6%** to **24%** (2011: 8% to 21%), are post tax and reflect specific risks relating to the relevant segments at the date of evaluation. The weighted average growth rates used in 2012 are within a range of **2%** to **13%** (2011: 3% to 13%).

9. PROPERTY AND EQUIPMENT

	Group occupied property – land and buildings £m	Other £m	Total £m
Cost/valuation			
At 1 January 2012	**149**	**381**	**530**
Additions	**1**	**35**	**36**
Acquisition of subsidiaries	**5**	**5**	**10**
Disposals	**(2)**	**(71)**	**(73)**
Exchange adjustment	**–**	**(6)**	**(6)**
At 31 December 2012	**153**	**344**	**497**
Accumulated depreciation			
At 1 January 2012	**–**	**255**	**255**
Depreciation charge	**–**	**35**	**35**
Depreciation on disposals	**–**	**(61)**	**(61)**
Exchange adjustment	**–**	**(4)**	**(4)**
At 31 December 2012	**–**	**225**	**225**
Net carrying amount at 31 December 2012	**153**	**119**	**272**

	Group occupied property – land and buildings £m	Other £m	Total £m
Cost/valuation			
At 1 January 2011	164	398	562
Additions	–	37	37
Acquisition of subsidiaries	–	1	1
Disposals	(1)	(48)	(49)
Revaluation adjustment	5	–	5
Exchange adjustment	(3)	(6)	(9)
Transfer to assets held for sale	(16)	(1)	(17)
At 31 December 2011	149	381	530
Accumulated depreciation			
At 1 January 2011	–	268	268
Depreciation charge	1	33	34
Depreciation on disposals	–	(41)	(41)
Revaluation adjustment	(1)	–	(1)
Exchange adjustment	–	(4)	(4)
Transfer to assets held for sale	–	(1)	(1)
At 31 December 2011	–	255	255

	Group occupied property – land and buildings £m	Other £m	Total £m
Accumulated impairment			
At 1 January 2011	–	7	7
Impairment on disposals	–	(7)	(7)
At 31 December 2011	–	–	–
Net carrying amount at 31 December 2011	149	126	275

The Group occupied property was revalued on 31 December 2012 by independent valuers.

Depreciation expenses of **£35m** (2011: £34m) have been charged to underwriting costs 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 2012 is **£140m** (2011: £136m).

The movement in the Group occupied property reserve is shown below:

	2012 £m	2011 £m
Group occupied property reserve at 1 January	**31**	33
Fair value gains	**3**	–
Transfers	**(12)**	(1)
Exchange adjustment	**–**	(1)
Group occupied property reserve at 31 December	**22**	31

10. INVESTMENT PROPERTY

Investment property consists of **£340m** (2011: £362m) freehold and long leasehold buildings.

The movement in the carrying value of investment property is detailed below:

	2012 £m	2011 £m
Investment property at 1 January	**362**	374
Additions from subsequent expenditure	**2**	3
Sales and purchases	**1**	(8)
Fair value (losses)/gains	**(24)**	(6)
Exchange adjustment	**(1)**	(1)
Investment property at 31 December	**340**	362

Investment properties are included in the Group's investment portfolio to provide investment returns over the longer term in accordance with the Group's investment strategy. Investment properties are managed by external managers.

The lease agreements are normally drawn up in line with local practice and the Group has no significant exposure to leases that include contingent rents.

11. INVESTMENTS IN ASSOCIATES

The Group has the following investments in associates:

	Country	Ordinary shareholding
Caunce O'Hara & Company Limited	United Kingdom	30.0%
Jones Brown Inc	Canada	30.0%
Royal Sundaram Alliance Insurance Company Limited	India	26.0%
Shaw Sabey & Associates Limited	Canada	25.0%
Syn Mun Kong Public Limited Company	Thailand	20.0%

Syn Mun Kong Public Limited Company is listed on the Stock Exchange of Thailand. The fair value of the Group's holding at 31 December 2012 is **£28m** (2011: £18m).

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

	2012 £m	2011 £m
Total assets	**493**	425
Total liabilities	**398**	358
Total revenue	**359**	342
Goodwill on acquisition	**17**	13
Profit/(loss) for the year after tax	**8**	(11)

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 note to avoid providing particulars of excessive length but none materially affects the results or assets of the Group.

12. FINANCIAL ASSETS AND FINANCIAL LIABILITIES

	2012 £m	2011 £m
Equity securities	**839**	1,060
Debt securities	**11,724**	11,674
Financial assets measured at fair value	**12,563**	12,734
Loans and receivables	**97**	104
Total financial assets	**12,660**	12,838

Fair value measurements recognised in the statement of financial position

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable, as explained more fully in Significant Accounting Policies:

	Fair value hierarchy 2012			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Available for sale financial assets:				
Equity securities	762	8	35	805
Debt securities	11,522	154	10	11,686
Financial assets at fair value through the income statement:				
Equity securities	1	–	33	34
Debt securities	–	–	38	38
	12,285	162	116	12,563
Derivative assets:				
At fair value through the income statement	–	32	–	32
Designated as hedging instruments	–	14	–	14
Total	12,285	208	116	12,609
Derivative liabilities:				
At fair value through the income statement	–	36	–	36
Designated as hedging instruments	–	6	–	6
Total	–	42	–	42

	Fair value hierarchy 2011			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Available for sale financial assets:				
Equity securities	1,010	–	28	1,038
Debt securities	11,461	148	10	11,619
Financial assets at fair value through the income statement:				
Equity securities	1	–	21	22
Debt securities	–	–	55	55
	12,472	148	114	12,734
Derivative assets:				
At fair value through the income statement	–	45	–	45
Designated as hedging instruments	–	14	–	14
Total	12,472	207	114	12,793
Derivative liabilities:				
At fair value through the income statement	–	42	–	42
Designated as hedging instruments	–	12	–	12
Total	–	54	–	54

None of the Group's insurance contract liabilities are measured at fair value. There were no transfers between Level 1, Level 2 and Level 3 during 2012 or 2011.

12. FINANCIAL ASSETS AND FINANCIAL LIABILITIES CONTINUED

A reconciliation of Level 3 fair value measurements of financial assets is shown in the table below. There are no Level 3 financial liabilities.

	Available for sale investments		Investments at fair value through the income statement		
	Equity securities £m	Debt securities £m	Equity securities £m	Debt securities £m	Total £m
Level 3 financial assets at 1 January 2011	28	23	13	71	135
Total gains/(losses) recognised in:					
Income statement	–	–	3	(17)	(14)
Other comprehensive income	1	–	–	–	1
Purchases	–	1	5	1	7
Disposals	(1)	(14)	–	–	(15)
Level 3 financial assets at 1 January 2012	28	10	21	55	114
Total gains/(losses) recognised in:					
Income statement	**–**	**–**	**6**	**(15)**	**(9)**
Other comprehensive income	**1**	**–**	**–**	**–**	**1**
Purchases	**6**	**–**	**5**	**–**	**11**
Exchange adjustment	**–**	**–**	**1**	**(2)**	**(1)**
Level 3 financial assets at 31 December 2012	**35**	**10**	**33**	**38**	**116**

Of the total gains/(losses) for the period recognised in the income statement (shown in the reconciliation above), losses of **£9m** (2011: £14m) relate to assets held at the end of the reporting period.

Of the total gains/(losses) for the period recognised in other comprehensive income (shown in the reconciliation above), **£1m** (2011: £1m) relate to assets held at the end of the reporting period and is reported in movements in the revaluation reserves in the statement of changes in equity.

13. REINSURERS' SHARE OF INSURANCE CONTRACT LIABILITIES

	2012 £m	2011 £m
Reinsurers' share of provision for unearned premiums	**299**	302
Reinsurers' share of provisions for losses and loss adjustment expenses	**1,650**	1,771
Total reinsurers' share of insurance contract liabilities	**1,949**	2,073
To be settled within 12 months	**948**	954
To be settled after 12 months	**1,001**	1,119

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

	2012 £m	2011 £m
Reinsurers' share of provision for unearned premiums at 1 January	**302**	299
Premiums ceded to reinsurers	**1,044**	993
Reinsurers' share of premiums earned	**(1,042)**	(1,002)
Changes in reinsurance asset	**2**	(9)
Reinsurers' share of portfolio transfers and acquisitions/(disposals) of subsidiaries	**6**	27
Exchange adjustment	**(11)**	(15)
Reinsurers' share of provision for unearned premiums at 31 December	**299**	302

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

	2012 £m	2011 £m
Reinsurers' share of provisions for losses and loss adjustment expenses at 1 January	**1,771**	2,353
Reinsurers' share of total claims incurred	**448**	382
Total reinsurance recoveries received	**(555)**	(1,099)
Reinsurers' share of portfolio transfers and acquisitions/(disposals) of subsidiaries	**22**	125
Exchange adjustment	**(42)**	4
Other movements	**6**	6
Reinsurers' share of provisions for losses and loss adjustment expenses at 31 December	**1,650**	1,771

14. INSURANCE AND REINSURANCE DEBTORS

	2012 £m	2011 £m
Insurance debtors comprise:		
Due from policyholders	**1,654**	1,435
Due from intermediaries	**1,747**	1,678
Total insurance debtors	**3,401**	3,113
Reinsurance debtors	**191**	215
Total insurance and reinsurance debtors	**3,592**	3,328

15. OTHER DEBTORS AND OTHER ASSETS

	2012 £m	2011 £m
Derivatives designated as hedging instruments	**14**	14
Derivatives used for economic hedging purposes	**32**	45
Other debtors	**357**	341
Pension scheme surplus	**55**	46
Accrued interest and rent	**166**	178
Prepayments	**129**	153
Total other debtors and other assets	**753**	777
To be settled within 12 months	**619**	640
To be settled after 12 months	**134**	137

16. CASH AND CASH EQUIVALENTS

The interest bearing financial assets included in cash and cash equivalents had an effective interest rate of **1.17%** (2011: 1.14%) and had an average maturity of **34 days** (2011: 33 days).

17. TOTAL COMPREHENSIVE INCOME

Year ended 31 December 2012

	Revaluation reserves £m	Translation reserve £m	Retained earnings £m	Shareholders' equity £m	Non controlling interests £m	Total equity £m
Profit for the year	–	–	**344**	**344**	**7**	**351**
Exchange (losses)/gains net of tax	**(5)**	**(61)**	–	**(66)**	**(4)**	**(70)**
Fair value gains/(losses) net of tax	**118**	–	**(3)**	**115**	**1**	**116**
Pension fund actuarial (losses)/gains net of tax	–	–	**(161)**	**(161)**	–	**(161)**
Other comprehensive income/(expense) for the year	**113**	**(61)**	**(164)**	**(112)**	**(3)**	**(115)**
Total comprehensive income/(expense) for the year	**113**	**(61)**	**180**	**232**	**4**	**236**

Year ended 31 December 2011

	Revaluation reserves £m	Translation reserve £m	Retained earnings £m	Shareholders' equity £m	Non controlling interests £m	Total equity £m
Profit for the year	–	–	426	426	1	427
Exchange (losses)/gains net of tax	(5)	(56)	(10)	(71)	1	(70)
Fair value gains/(losses) net of tax	26	–	–	26	–	26
Pension fund actuarial (losses)/gains net of tax	–	–	(63)	(63)	–	(63)
Other comprehensive income/(expense) for the year	21	(56)	(73)	(108)	1	(107)
Total comprehensive income/(expense) for the year	21	(56)	353	318	2	320

18. SHARE CAPITAL

The issued share capital of the Parent Company is fully paid and consists of two classes; ordinary shares with a nominal value of 27.5p each and preference shares with a nominal value of £1 each. The issued share capital at 31 December 2012 is:

	2012 £m	2011 £m
Issued and fully paid		
3,595,951,315 ordinary shares of 27.5p each (2011: 3,531,021,230 ordinary shares of 27.5p each)	**989**	971
125,000,000 preference shares of £1 each (2011: 125,000,000 preference shares of £1 each)	**125**	125
	1,114	1,096

During 2012, the Company issued a total of **64,930,085** new ordinary shares ranking pari passu with ordinary shares in issue (2011: 35,070,353 new ordinary shares), on the exercise of employee share options and in respect of employee share awards and under the scrip dividend scheme. The number of ordinary shares issued, their nominal value and the associated share premiums are as follows:

	Number of shares	Nominal value £m	Share premium £m
At 1 January 2011	3,495,950,877	962	1,124
Issued in respect of employee share options and employee share awards	18,409,921	4	3
Issued in lieu of dividends	16,660,432	5	17
At 1 January 2012	3,531,021,230	971	1,144
Issued in respect of employee share options and employee share awards	**19,335,754**	**6**	**5**
Issued in lieu of dividends	**45,594,331**	**12**	**38**
At 31 December 2012	**3,595,951,315**	**989**	**1,187**

Rights attaching to the shares

The preference shares are not redeemable but the holders of the preference shares have preferential rights over the holders of ordinary shares in respect of dividends and of the return of capital in the event of the winding up of the Parent Company.

Holders of preference shares are entitled to a cumulative preferential dividend of 7.375% per annum, payable in half yearly instalments out of the profits available for distribution and resolved by the Board, to be distributed in priority to any payment of dividend to other shareholders (other than any dividend not exceeding 0.1p per share). Preference shareholders have no further right to participate in the profits of the Parent Company.

Full information on the rights attaching to shares is in the Parent Company's Articles of Association which are available on the Company's website.

Employee share schemes

6,153,749 ordinary shares (2011: 5,514,248 ordinary shares) are held by various employee share trusts which may subsequently be transferred to employees (including Executive Directors) to satisfy options exercised under the Group employee share option plans and share awards vesting to Group employees under the long-term incentive plans and under the Sharebuild plan. These shares are presented as own shares.

At 31 December 2012, the total number of options over ordinary shares outstanding under the Group employee share option plans is **51,342,336** (2011: 58,299,174) and the total number of potential shares outstanding under the long-term incentive plan and under the Sharebuild plan is **71,975,051** ordinary shares (2011: 66,653,576 ordinary shares). Further information on the employee share schemes is provided in note 27 and in the Directors' Remuneration Report within the corporate governance section.

19. LOAN CAPITAL

	2012 £m	2011 £m
Subordinated guaranteed US$ bonds	**14**	14
Subordinated guaranteed dated notes	**493**	493
Total dated loan capital	**507**	507
Subordinated guaranteed perpetual bonds	**334**	326
Subordinated guaranteed perpetual notes	**470**	480
Total loan capital	**1,311**	1,313

The subordinated guaranteed US$ bonds ('Yankee Bonds') have a nominal value of $24m and a redemption date of 15 October 2029. The rate of interest payable on the Yankee Bonds is 8.95%.

The subordinated guaranteed dated notes were issued on 20 May 2009 at a fixed rate of 9.375%. The nominal £500m bonds have a redemption date of 20 May 2039. The Parent Company has the option to repay the notes on specific dates from 20 May 2019. If the notes are not repaid on that date, the rate of interest would be reset at a rate of 8.475% plus the appropriate benchmark gilt yield for a further five year period.

The subordinated guaranteed perpetual bonds have a nominal value of £375m 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 interest rate payable would be LIBOR plus 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.

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.

There have been no defaults on any of the bonds or notes during the year. The Group has the option to defer interest payments on the bonds and notes but to date has not exercised this right.

The aggregate fair value of total loan capital at 31 December 2012 is **£1,510m** (2011: £1,325m).

20. INSURANCE CONTRACT LIABILITIES

	2012 £m	2011 £m
Provision for unearned premiums	**3,852**	3,669
Provisions for losses and loss adjustment expenses	**11,002**	11,097
Total insurance contract liabilities	**14,854**	14,766

The provision for unearned premiums is shown net of deferred acquisition costs of **£938m** (2011: £845m). The movement in deferred acquisition costs during 2012 is attributed to **£1,187m** (2011: £1,119m) acquisition costs deferred during the year, **£1,114m** (2011: £1,060m) amortisation charged during the year, **£13m** exchange losses (2011: £13m exchange losses), and **£33m** (2011: £16m) due to acquisition of subsidiaries.

The reinsurers' share of deferred acquisition costs is shown within accruals and deferred income.

Provision for unearned premiums, gross of acquisition costs

	2012 £m	2011 £m
Provision for unearned premiums at 1 January	**4,514**	4,229
Premiums written	**9,397**	9,131
Less: premiums earned	**(9,209)**	(8,858)
Changes in provision for unearned premiums	**188**	273
Gross portfolio transfers and acquisitions	**153**	85
Exchange adjustment	**(65)**	(73)
Provision for unearned premiums (gross of acquisition costs) at 31 December	**4,790**	4,514

Provisions for losses and loss adjustment expenses

The following changes have occurred in the provisions for losses and loss adjustment expenses during the year:

	2012 £m	2011 £m
Provisions for losses and loss adjustment expenses at 1 January	**11,097**	11,694
Claims losses and expenses incurred	**5,829**	5,595
Total claims payments made in the year, net of salvage and other recoveries	**(6,010)**	(6,448)
Gross portfolio transfers, acquisitions and disposals	**160**	274
Exchange adjustment	**(159)**	(108)
Other movements	**85**	90
Provisions for losses and loss adjustment expenses at 31 December	**11,002**	11,097

Assumptions

The total value of provisions for losses and loss adjustment expenses less related reinsurance recoveries before discounting is **£9,943m** (2011: £9,939m).

Claims on certain classes of business (excluding annuities) have been discounted as follows:

		Discount rate		Average number of years to settlement from reporting date	
	Category	2012 %	2011 %	2012 Years	2011 Years
UK	Asbestos and environmental	**5.00**	5.00	**12**	13
Scandinavia	Disability	**3.70**	3.70	**7**	8
Canada	Asbestos, environmental and casualty	**3.50**	3.50	**7**	7

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

Claims development tables

The tables below present changes in the historical provisions for losses and loss adjustment expenses that were established in 2002 and the provisions for losses and loss adjustment expenses arising in each subsequent accident year. The tables are presented at current year average exchange rates on an undiscounted basis and have been adjusted for operations that have been disposed of.

Consolidated claims development table gross of reinsurance

	2002 and prior £m	2003 £m	2004 £m	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	**2012 £m**	Total £m
Estimate of cumulative claims												
At end of accident year	10,456	3,375	2,849	2,982	2,661	3,031	2,929	2,804	3,792	3,425	**3,437**	
One year later	10,329	3,197	2,592	2,897	2,687	3,022	2,946	2,879	3,781	3,479		
Two years later	10,705	3,078	2,404	2,777	2,587	3,011	2,920	2,842	3,722			
Three years later	11,028	2,961	2,291	2,652	2,507	2,937	2,880	2,803				
Four years later	11,449	2,885	2,212	2,576	2,451	2,888	2,872					
Five years later	11,336	2,819	2,163	2,507	2,452	2,870						
Six years later	11,086	2,803	2,129	2,486	2,403							
Seven years later	11,047	2,735	2,083	2,461								
Eight years later	11,021	2,729	2,059									
Nine years later	10,889	2,717										
Ten years later	10,823											
Claims paid												
One year later	2,906	1,241	957	1,265	1,090	1,383	1,470	1,395	2,165	1,603		
Two years later	1,711	370	315	364	402	454	456	482	540			
Three years later	1,120	255	206	211	213	297	276	291				
Four years later	746	184	167	161	194	191	204					
Five years later	528	122	101	119	135	153						
Six years later	452	86	90	93	88							
Seven years later	374	66	32	45								
Eight years later	354	35	32									
Nine years later	230	18										
Ten years later	180											
Cumulative claims paid	8,601	2,377	1,900	2,258	2,122	2,478	2,406	2,168	2,705	1,603		
2012 redundancy/(deficiency)	66	12	24	25	49	18	8	39	59	(54)		246
Reconciliation to the statement of financial position												
Current year provision before discounting	2,222	340	159	203	281	392	466	635	1,017	1,876	**3,437**	11,028
Exchange adjustment to closing rates												(76)
Discounting												(667)
Annuities												717
Present value recognised in the statement of financial position												**11,002**

20. INSURANCE CONTRACT LIABILITIES CONTINUED

Consolidated claims development table net of reinsurance

	2002 and prior £m	2003 £m	2004 £m	2005 £m	2006 £m	2007 £m	2008 £m	2009 £m	2010 £m	2011 £m	**2012 £m**	Total £m
Estimate of cumulative claims												
At end of accident year	8,057	2,443	2,280	2,445	2,471	2,569	2,627	2,518	2,666	2,936	**3,078**	
One year later	8,095	2,476	2,147	2,323	2,453	2,567	2,629	2,557	2,691	2,929		
Two years later	8,447	2,389	1,957	2,233	2,356	2,540	2,621	2,528	2,670			
Three years later	8,468	2,279	1,872	2,159	2,271	2,477	2,592	2,503				
Four years later	8,889	2,219	1,805	2,076	2,219	2,433	2,576					
Five years later	8,809	2,159	1,756	2,013	2,197	2,417						
Six years later	8,701	2,136	1,721	1,988	2,167							
Seven years later	8,617	2,077	1,677	1,963								
Eight years later	8,545	2,065	1,659									
Nine years later	8,416	2,048										
Ten years later	8,347											
Claims paid												
One year later	2,291	892	720	952	992	1,148	1,307	1,276	1,404	1,375		
Two years later	1,395	298	259	292	350	366	389	402	442			
Three years later	829	212	183	169	190	267	253	258				
Four years later	580	110	141	142	174	165	192					
Five years later	359	92	89	103	118	139						
Six years later	363	64	72	80	88							
Seven years later	287	51	26	45								
Eight years later	223	26	28									
Nine years later	161	16										
Ten years later	156											
Cumulative claims paid	6,644	1,761	1,518	1,783	1,912	2,085	2,141	1,936	1,846	1,375		
2012 redundancy/(deficiency)	69	17	18	25	30	16	16	25	21	7		244
Reconciliation to the statement of financial position												
Current year provision before discounting	1,703	287	141	180	255	332	435	567	824	1,554	**3,078**	9,356
Exchange adjustment to closing rates												(52)
Discounting												(591)
Annuities												639
Present value recognised in the statement of financial position												**9,352**

The top triangle of the tables presents the estimated provisions for ultimate incurred losses and loss adjustment expenses for each accident year as at the end of each reporting period.

The lower (paid) triangle of the tables presents the amounts paid against those provisions in each subsequent accounting period.

The estimated provisions 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 rates of exchange change.

21. INSURANCE AND REINSURANCE LIABILITIES

	2012 £m	2011 £m
Direct insurance creditors	**289**	285
Reinsurance creditors	**269**	317
Total insurance and reinsurance liabilities	**558**	602

22. BORROWINGS

The Group's borrowings of **£296m** (2011: £298m) primarily relate to loans from credit institutions under a repurchase agreement. Further information is contained in the risk management section.

At 31 December 2012 total unsecured loans from credit institutions under committed credit facilities of **£500m** (2011: £455m) are available to the Group. There are no amounts outstanding at 31 December 2012 (2011: £nil). The facility expires in 2017.

At 31 December 2012 the Group has in place a **US$1bn** (2011: US$1bn) Euro commercial paper programme. There are no amounts outstanding at 31 December 2012 (2011: £nil).

The Articles of Association of the Group defines a cap on borrowing limits. This cap is not being amended at the 2013 AGM. At 31 December 2012 the cap on borrowing limits is **£4,484m** (2011: £4,708m) of which **£1,636m** (2011: £1,638m) had been utilised.

23. CURRENT AND DEFERRED TAX

Current tax

	Asset		Liability	
	2012 £m	2011 £m	2012 £m	2011 £m
To be settled within 12 months	**58**	10	**14**	50
To be settled after 12 months	**18**	23	**44**	54
	76	33	**58**	104

Deferred tax

	2012 £m	2011 £m
Deferred tax assets	**285**	249
Deferred tax liabilities	**(139)**	(102)
Net deferred tax position at 31 December	**146**	147

23. CURRENT AND DEFERRED TAX CONTINUED

The following are the major deferred tax assets and liabilities recognised by the Group and their movements during the year:

	Reclassification of debt £m	Retirement benefit obligations £m	Net insurance contract liabilities £m	Revaluation of investments £m	Other temporary differences £m	Total £m
Deferred tax at 1 January 2011	11	61	19	(12)	83	162
(Charge)/credit to the income statement for the year	–	(22)	(54)	(5)	60	(21)
Credit/(charge) to other comprehensive income for the year	–	12	–	18	(1)	29
Charge to equity for the year	(2)	–	–	–	(2)	(4)
Net credit arising on acquisition/disposal of subsidiaries and other transfers	–	–	8	–	(15)	(7)
Exchange adjustment	–	–	1	–	(1)	–
Effect of change in tax rates						
Income statement	–	–	–	(1)	(9)	(10)
Other comprehensive income/equity	(1)	(2)	–	1	–	(2)
Deferred tax at 1 January 2012	8	49	(26)	1	115	147
(Charge)/credit to the income statement for the year	**–**	**(28)**	**(10)**	**13**	**42**	**17**
Credit/(charge) to other comprehensive income for the year	**–**	**50**	**–**	**(45)**	**(2)**	**3**
Charge to equity for the year	**(2)**	**–**	**–**	**–**	**–**	**(2)**
Net credit arising on acquisition/disposal of subsidiaries and other transfers	**–**	**–**	**1**	**–**	**(10)**	**(9)**
Exchange adjustment	**–**	**(1)**	**1**	**(3)**	**1**	**(2)**
Effect of change in tax rates						
Income statement	**–**	**(1)**	**7**	**(1)**	**(11)**	**(6)**
Other comprehensive income/equity	**–**	**(2)**	**–**	**1**	**(1)**	**(2)**
Deferred tax at 31 December 2012	**6**	**67**	**(27)**	**(34)**	**134**	**146**

The current tax and deferred income tax (charged)/credited to each component of other comprehensive income is as follows:

	Current tax		Deferred tax		Total	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Exchange gains and losses	**1**	(3)	**(3)**	1	(2)	(2)
Available for sale financial assets	**23**	(18)	**(44)**	19	(21)	1
Group occupied property	**–**	–	**–**	(2)	–	(2)
Fair value gains and losses	**23**	(18)	**(44)**	17	(21)	(1)
Pension fund actuarial gains and losses	**–**	–	**48**	10	48	10
Total (charged)/credited to other comprehensive income	**24**	(21)	**1**	28	25	7

The aggregate current and deferred tax relating to items that are (charged)/credited directly to equity is **£(2)m** (2011: £(3)m).

At the end of the reporting period, the Group has unused tax losses of **£2,130m** (2011: £2,128m) and unused tax credits of **£15m** (2011: £15m) available for offset against future profits. A deferred tax asset of **£141m** (2011: £148m) has been recognised in respect of losses and unused tax credits. In addition, the Group recognised **£89m** (2011: £80m) in respect of other deferred tax reliefs. These are included within other temporary differences at 31 December 2012. No deferred tax asset has been recognised in respect of **£1,568m** (2011: £1,572m) tax losses and unused tax credits of **£11m** (2011: £11m) due to the unpredictability of future profit streams. Tax losses include **£176m** (2011: £194m) which will expire between 2013 and 2032, of which **£68m** (2011: £87m) have been recognised for deferred tax. Other tax losses and unused credits may be carried forward indefinitely.

The Group does not recognise deferred tax on the unremitted earnings of overseas subsidiaries, as the Group is able to control the remittance of earnings to the UK and there is no intention to remit any such earnings to the UK in the foreseeable future if the remittance would trigger a material incremental tax liability. The temporary difference in respect of the retained earnings of overseas subsidiaries and associates is **£893m** (2011: £965m).

Deferred tax assets of **£241m** (2011: £199m), which are in excess of profits arising from the reversal of existing taxable temporary differences and that relate to tax jurisdictions in which the Group has suffered a loss in either the current or preceding period, have been recognised on the basis that future taxable profits will be available against which these can be utilised. The evidence for the future taxable profits is a forecast consistent with the three year operational plans prepared by the relevant businesses, which are subject to internal review and challenge. Where relevant, the forecast includes extrapolations of the operational plans using assumptions consistent with those used in the plans.

24. PROVISIONS

	2012 £m	2011 £m
Pensions and post retirement obligations	**329**	235
Reorganisation provisions	**6**	–
Other provisions	**152**	154
Total provisions at 31 December	**487**	389

Of the above, **£396m** is due to be settled outside of 12 months (2011: £324m).

Reorganisation provisions recognised in 2012 relate mainly to Emerging Markets.

Other provisions includes **£28m** (2011: £29m) 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 include Motor Insurance Bureau levy provisions of **£18m** (2011: £21m) and deferred consideration of **£9m** (2011: £17m) in respect of acquisitions.

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 2012	–	**154**
Exchange adjustment	–	**(3)**
Credited	**24**	**47**
Utilised	**(18)**	**(36)**
Released	–	**(11)**
Acquisition of subsidiary undertaking	–	**1**
Provisions at 31 December 2012	**6**	**152**

25. OTHER LIABILITIES

	2012 £m	2011 £m
Deposits received from reinsurers	**33**	33
Derivatives designated as hedging instruments	**6**	12
Other derivatives used for economic hedging purposes	**36**	42
Other creditors	**615**	577
Accruals and deferred income	**513**	445
Total other liabilities	**1,203**	1,109
To be settled within 12 months	**922**	877
To be settled after 12 months	**281**	232

In 2003 a subsidiary of the Group wrote an Adverse Development Cover (ADC) contract with its former US subsidiary. The liabilities arising under the ADC contract comprise an insurance component and a deposit component. The liability arising under the insurance component represents the timing risk on the settlement of those liabilities. The financial liability arising under the deposit component is offset by the value of funds held in a trust fund whose trust deed only permits the trust fund assets to be used to settle amounts due under the ADC. The value of the funds held in trust at 31 December 2011 was £0.1bn and the value of the liability of the deposit component was £0.1bn. The deposit component of the liability was fully paid during 2012.

26. RETIREMENT BENEFIT OBLIGATIONS

The Group operates defined contribution pension schemes, funded and unfunded defined benefit pension schemes, and has other post retirement obligations.

Defined contribution pension schemes

Costs of **£68m** (2011: £65m) 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 scheme, it is included in these accounts as a defined contribution scheme. Contributions of **£13m** (2011: £14m) were paid to this scheme during 2012 and are included in the costs shown above. The latest information regarding the funding of this scheme is taken from the interim report for the first half of 2012, when the scheme funding rate was **104%** (2011: 115%).

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.

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 are based on salaries in that year and are revalued up to retirement.

In addition to these changes, the 2002 Scheme (which was the scheme to which new UK employees had been admitted following 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 accrue future benefits on a defined contribution basis under the stakeholder scheme.

During 2009 the Group entered into arrangements that insured 55% of the retirement obligations relating to pensions in payment in the two main UK schemes. The arrangements comprise assets and interest rate swaps combined with an insurance contract that provide for the full payment of the pensions in return for the actual investment return on a segregated portfolio of assets held by the pension funds at the inception of the arrangement. The pension schemes continue to benefit from the assets held in the portfolio and retain the obligation to meet the insured pension obligations. The assets and pension obligations are therefore not derecognised in the financial statements and an asset (representing the recovery of the insured pension obligations) and a liability (to pay the investment return on the portfolio of assets to the insurer) are recognised.

During 2010 changes were made to the benefit structure of three UK schemes. Changes affected future accrual from 1 March 2010 onwards. Accrual rates were reduced; the retirement age was increased; revaluation was subject to a cap of 2.5%; a cap was applied to the salary used for the defined benefit schemes and the schemes contracted back in to the State scheme. Employees were entitled to join the Stakeholder Pension scheme for earnings above the cap.

For the two main UK defined benefit schemes, the level of contributions in 2012 were **£94m** (2011: £73m) of which **£70m** (2011: £51m) were additional contributions in line with the plan to reduce their funding deficits. Expected contributions to the two schemes for the year ending 31 December 2013 are approximately £44m including £30m of additional contributions to reduce the deficit. Further additional contributions may become due once the results of the March 2012 funding valuations are known (results expected in 2013).

The Group also provides post retirement healthcare benefits to certain current and retired Canadian employees. The benefits are not prefunded. 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 (deficit)/surplus during the year:

	2012 £m	2011 £m
(Deficit)/surplus at 1 January	**(189)**	(203)
Total pension expense	**(4)**	(13)
Employer contribution	**128**	100
Actuarial (losses)/gains	**(209)**	(73)
Exchange adjustment	**(3)**	1
Acquisition of subsidiary	**3**	(1)
Pension and post retirement (deficit)/surplus	**(274)**	(189)
Deferred tax in respect of net pension and post retirement deficit	**67**	49
Net pension and post retirement (deficit)/surplus at 31 December	**(207)**	(140)

The amounts recognised in the income statement are as follows:

	2012			2011
	UK £m	Other £m	Total £m	Total £m
Current service cost	**18**	**11**	**29**	28
Interest cost	**266**	**23**	**289**	295
Expected return on scheme assets	**(288)**	**(21)**	**(309)**	(311)
Past service cost/(benefit)	**1**	**–**	**1**	1
Gains on curtailments/settlements	**–**	**(6)**	**(6)**	–
Total (included in staff costs)	**(3)**	**7**	**4**	13

26. RETIREMENT BENEFIT OBLIGATIONS CONTINUED

The actuarial gains/(losses) recognised in equity are as follows:

	2012			2011
	UK £m	Other £m	Total £m	Total £m
Actual return on scheme assets	**515**	**30**	**545**	690
Less: expected return on scheme assets	**(288)**	**(21)**	**(309)**	(311)
Actual return on assets in excess of expected	**227**	**9**	**236**	379
Experience (losses)/gains on liabilities	**(28)**	**4**	**(24)**	(66)
Change in actuarial assumptions	**(358)**	**(63)**	**(421)**	(386)
Actuarial (losses)/gains	**(159)**	**(50)**	**(209)**	(73)

The accumulated actuarial losses since 1 January 2004 are **£811m** (2011: £602m).

Excluding the pension liabilities covered by the insurance arrangement the assets and liabilities committed to the arrangement, the value of scheme assets and the residual scheme obligations are as follows:

	2012			2011
	UK £m	Other £m	Total £m	Total £m
Present value of obligations not covered by insurance arrangement	**4,437**	**511**	**4,948**	4,492
Equities	**1,470**	**189**	**1,659**	1,493
Bonds	**2,246**	**186**	**2,432**	1,995
Cash	**145**	**–**	**145**	318
Property	**122**	**–**	**122**	110
Derivatives	**279**	**–**	**279**	352
Other	**30**	**7**	**37**	35
Total assets in the schemes (excluding those used to fund insurance arrangement)	**4,292**	**382**	**4,674**	4,303
Total deficit	**(145)**	**(129)**	**(274)**	(189)

Including the pension liabilities covered by the insurance arrangement and the assets and liabilities committed to the arrangement, the value of scheme assets and the residual scheme obligations are as follows:

	2012			2011
	UK £m	Other £m	Total £m	Total £m
Present value of funded obligations	5,972	384	6,356	5,880
Present value of unfunded obligations	9	127	136	122
Present value of obligations	5,981	511	6,492	6,002
Equities	1,470	189	1,659	1,493
Bonds	4,704	186	4,890	4,588
Cash	145	–	145	320
Property	122	–	122	110
Derivatives	279	–	279	352
Other	30	7	37	35
Present value of funded obligations fully covered by insurance arrangement	1,544	–	1,544	1,510
Value of obligations under insurance arrangement	(1,969)	–	(1,969)	(2,157)
Value of asset and longevity swaps under insurance arrangement	(489)	–	(489)	(438)
Total assets in the schemes	5,836	382	6,218	5,813
Total deficit	(145)	(129)	(274)	(189)
Defined benefit pension schemes	(145)	(70)	(215)	(135)
Other post retirement benefits	–	(59)	(59)	(54)
Schemes in surplus (note 15)	40	15	55	46
Schemes in deficit (note 24)	(185)	(144)	(329)	(235)

The UK pension funds have swap arrangements in place to ensure that the assets backing the liabilities under the insurance arrangement exactly fund the amounts payable. Additionally these funds have purchased inflation swaps and interest rate swaps to reduce investment risk within the funds.

The following is a reconciliation of the Group's retirement benefit obligations:

	2012 £m	2011 £m
Retirement benefit obligation at 1 January	6,002	5,467
Current service costs	29	28
Past service costs	1	1
Interest costs	289	295
Contributions by scheme participants	1	1
Actuarial loss/(gain) on obligations	445	452
(Gain)/loss on curtailments	(12)	–
Benefits paid	(258)	(254)
Acquisition of subsidiary	7	18
Exchange rate adjustment	(12)	(6)
Retirement benefit obligations at 31 December	6,492	6,002

26. RETIREMENT BENEFIT OBLIGATIONS CONTINUED

The following is a reconciliation of the Group's pension schemes' assets:

	2012 £m	2011 £m
Pension schemes' assets at 1 January	**5,813**	5,264
Return on schemes' assets	**545**	690
Contributions by the employer	**128**	100
Contributions by scheme participants	**1**	1
Benefits paid	**(258)**	(254)
Loss on settlement	**(6)**	–
Acquisition of subsidiary	**4**	17
Exchange rate adjustment	**(9)**	(5)
Pension schemes' assets at 31 December	**6,218**	5,813

Additional information for the current annual period and previous four annual periods:

	2012 £m	2011 £m	2010 £m	2009 £m	2008 £m
At 31 December					
Present value of defined benefit obligations	**6,492**	6,002	5,467	5,178	4,536
Fair value of plan assets	**6,218**	5,813	5,264	4,810	5,042
(Deficit)/surplus	**(274)**	(189)	(203)	(368)	506
Experience adjustments on plan liabilities	**(24)**	(66)	(44)	116	(101)
Experience adjustments on plan assets	**236**	379	257	(389)	(413)

Assumptions

The principal actuarial assumptions used were as follows:

	UK		Other	
	2012 %	2011 %	2012 %	2011 %
Assumptions used in calculation of retirement benefit obligations:				
Discount rate	**4.3**	4.9	**4.2**	5.1
Annual rate of general inflation	**2.5**	2.8	**2.2**	2.2
Annual rate of increase in salaries	**2.6**	3.6	**4.0**	4.2
Annual rate of increase in pensions	**2.5**	2.7	**2.2**	2.2
Assumptions used in calculation of income statement credit/(charge) in the year:				
Discount rate	**4.9**	5.5	**5.1**	5.8
Expected return on:				
Equities	**8.0**	8.0	**7.8**	7.8
Bonds	**4.3**	5.3	**4.5**	4.3
Other	**4.9**	5.4	**2.2**	2.4

Expected return on schemes' assets

The weighted average expected return on schemes' assets across the Group for 2012 was **5.5%** (2011: 6.1%). The expected return on schemes' assets are determined for each asset class by considering both market conditions at the beginning of the reporting period and any expectations for longer term changes in current returns. All returns are net of investment expenses.

Mortality rate

The mortality assumptions are set following investigations of the main schemes' recent experience by the schemes' actuaries for the funding valuations. At the funding valuation in March 2009, the mortality assumptions adopted for the main UK schemes used the SAPS Light Normal base table with percentage adjustments to reflect the schemes' recent experience compared with that expected under these tables. The next funding valuation has an effective date of March 2012, with results expected in 2013.

Reductions in future mortality rates are allowed for by using 80% (males) and 60% (females) of the long cohort improvements. The weighted average assumptions imply that a current pensioner aged 60 has an expected future lifetime of **27.6** (2011: 27.5) years (males) and **28.2** (2011: 28.1) years (females) and a future pensioner aged 60 in 15 years' time has a future expected lifetime from age 60 of **28.3** (2011: 28.3) years (males) and **28.7** (2011: 28.7) years (females).

Commutation

Each of the UK defined benefit pension schemes has changed its rules to allow for increased commutation following 'A day' in April 2006. In 2011 and 2012, the Group followed the 2009 funding valuation assumptions, and an allowance was made for future commutation using the current commutation factors.

Sensitivity analysis

The discount rate, the assumed inflation rate and the mortality assumptions all have a significant effect on the IAS 19 accounting valuation. A 0.1% increase in the discount rate would reduce the defined benefit obligations in the UK not covered by the insurance arrangement by **£63m** (2011: £55m). A 0.1% increase in the inflation rate assumption would increase the defined benefit obligations in the UK not covered by the insurance arrangement by **£47m** (2011: £51m). An increase of one year in life expectancy would increase the defined benefit obligations in the UK not covered by the insurance arrangement by approximately **£97m** (2011: £84m). The Group has no material exposure to the effect of changes in medical costs.

Impact of adoption of the revised IAS 19 in the 2013 financial statements

The Group will adopt the revised version of IAS 19 'Employment Benefits' at 1 January 2013. The changes to IAS 19 are described in the Significant Accounting Policies.

In 2012, the impact of the changes to IAS 19 for the main UK schemes is to increase the charge recognised in the income statement by **£28m** (£22m net of taxes). There is a corresponding reduction in the actuarial losses recognised in other comprehensive income. There is no impact on the net asset value of the Group.

27. SHARE BASED COMPENSATION

The Group has four types of share based payment plans which are settled in the form of ordinary shares: the Long-Term Incentive Plan (LTIP), the Sharesave Plan (SAYE), the Sharebuild Plan and the Executive Share Option Scheme (ESOS). Dilution levels for all schemes are held strictly within Association of British Insurers limits. Further information on the LTIP scheme is included below and information on the other share schemes can be found in the remuneration report.

The total employment cost recorded in the income statement for all plans is **£6m** in 2012 (2011: £9m).

Analysis of share scheme costs (per income statement):

	2012 £m	2011 £m
LTIP	**1**	4
SAYE	**3**	4
Sharebuild	**2**	1
Total	**6**	9

The value of the awards granted during 2012 is **£14m** (2011: £25m) of which **£2m** (2011: £6m) is charged in the income statement. The balance of the value of the awards will be charged to the income statement during the remaining vesting periods.

27. SHARE BASED COMPENSATION CONTINUED

Analysis of new awards costs:

	2012		2011	
	Charge for year £m	**Total value £m**	Charge for year £m	Total value £m
LTIP	**2**	**10**	5	21
SAYE	**–**	**2**	–	2
Sharebuild	**–**	**2**	1	2
Total	**2**	**14**	6	25

Long-Term Incentive Plan

The Long-Term Incentive Plan (LTIP) for Executive Directors and other selected executives was adopted following approval obtained at the 2006 AGM. Awards have been made each year since 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 gross bonus (limited to 33% of that bonus) into an award over shares referred to for the purpose of the plan as Compulsory Deferred Shares. Voluntary Deferred Shares are held in trust for three years. Compulsory Deferred Shares awards 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') up to a maximum of 2:1 and these are normally forfeited on an employee leaving the Group.

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. Performance Shares and Restricted Shares are normally forfeited on an employee leaving the Group.

Further information on the LTIP can be found in the remuneration report within the corporate governance section. Further disclosures in respect of the SAYE and Sharebuild schemes have not been made on the grounds that the schemes are immaterial to the Group.

28. HEDGE ACCOUNTING

The Group designates certain forward foreign exchange contracts and foreign exchange options as hedging instruments against the net investment in designated subsidiaries to reduce the foreign exchange risk exposure.

For forward foreign exchange contracts, on designation, the interest element is separated from the forward exchange rate and is excluded from the hedge relationship. Effectiveness of the hedge is then measured using the spot rate, which is also the exchange rate used when measuring the net investment in the designated subsidiaries.

For foreign exchange options the hedge designation is to hedge the value of the foreign operations at the strike price at the exercise date of the option.

The fair value of the hedging instruments at 31 December 2012 are a liability of **£6m** (2011: £12m) and an asset of **£14m** (2011: £14m). The hedge ineffectiveness recognised in the income statement during 2012 is **£nil** (2011: £nil).

Further information on derivatives, including those designated as hedging instruments, can be found in the risk management section.

29. SUBSIDIARIES

Country of incorporation		Principal activity
United Kingdom	Royal Insurance Holdings plc	Holding company
	Royal & Sun Alliance Insurance plc	General insurance
	British Aviation Insurance Company Limited (57.1%)	General insurance
	The Globe Insurance Company Limited[4]	Holding company
	The Marine Insurance Company Limited	General insurance
	Royal International Insurance Holdings Limited[5]	Holding company
	Royal & Sun Alliance Reinsurance Limited	General insurance
	Sun Insurance Office Limited[6]	General insurance
Argentina	Royal & Sun Alliance Seguros (Argentina) SA	General insurance
	El Comercio Compañía de Seguros a Prima Fija SA (96.7%)	General insurance
	Aseguradora de Créditos y Garantías SA (99.9%)	General insurance
Bahrain	Royal & Sun Alliance Insurance (Middle East) Limited E.C. (50.0%)	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
	Canadian Northern Shield Insurance Company	General insurance
	L'Union Canadienne Compagnie D'Assurances	General insurance
Chile	RSA Seguros Chile SA (99.5%)	General insurance
China	Sun Alliance Insurance (China) Limited	General insurance
Colombia	Royal & Sun Alliance Seguros (Colombia) SA (86.7%)	General insurance
Denmark	Codan A/S	Holding company
	Codan Forsikring A/S	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	RSA Overseas (Netherlands) BV	Holding company
	RSA Overseas Holdings BV	Holding company
	Intouch Insurance Group BV	Holding company
Netherlands Antilles	Royal & Sun Alliance Insurance (Antilles) NV (51.0%)	General insurance
Poland	Link4 Towarzystwo Ubezpieczeń SA	General insurance
Republic of Ireland	RSA Insurance Ireland Limited	General insurance
Sweden	Trygg-Hansa Försäkrings AB	General insurance
Uruguay	Royal & Sun Alliance Seguros (Uruguay) SA	General insurance

Notes:

1. This note only lists principal subsidiaries in the Group to avoid providing particulars of excessive length. None of the subsidiaries omitted from this note materially affects the results or assets of the Group.
2. A full list of Group subsidiaries is attached to the Company's latest Annual Return, available from Companies House.
3. Except where indicated all of the subsidiaries listed are wholly owned within the Group. In all cases the proportion of voting power held equals the proportion of ownership interest.
4. The general insurance business of The Globe Insurance Company Limited was legally transferred to Royal & Sun Alliance Insurance plc and The Marine Insurance Company Limited on 1 January 2012.
5. The general insurance business of Royal International Insurance Holdings Limited was legally transferred to Royal & Sun Alliance Insurance plc and The Marine Insurance Company Limited on 1 January 2012. Following this transfer, the principal activity of Royal International Insurance Holdings Limited is as a holding company.
6. On 1 January 2012, general insurance business from The Sea Insurance Company Limited and National Vulcan Engineering Insurance Group Limited legally transferred to Sun Insurance Office Limited.

30. BUSINESS COMBINATIONS

Acquisition of subsidiaries

On 31 July 2012, the Group acquired 96.7% of the share capital of El Comercio Compañía de Seguros a Prima Fija SA and 99.9% of the share capital of Aseguradora de Créditos y Garantías SA, two sister companies in Argentina. The fair values of identifiable assets acquired comprise investments of £2m, intangible assets (excluding goodwill) of £11m, other assets of £68m and cash and cash equivalents of £70m. The fair values of liabilities assumed comprise insurance contract liabilities of £108m and other liabilities of £35m. The total cash consideration paid was £47m and goodwill of £39m arose on this acquisition.

On 1 October 2012, the Group acquired 100% of the share capital of L'Union Canadienne, Compagnie D'Assurances. The fair values of identifiable assets acquired comprise investments of £151m, intangible assets (excluding goodwill) of £32m, other assets of £78m and cash and cash equivalents of £4m. The fair values of liabilities assumed comprise insurance contract liabilities of £160m and other liabilities of £22m. The total cash consideration paid was £96m and goodwill of £13m arose on this acquisition.

During the year a number of small acquisitions were completed in Canada. These acquisitions principally comprised of insurance intermediaries and increase the Group's insurance activity in each of the countries. The total cash consideration paid was £28m and goodwill of £15m arose on these acquisitions.

Fair values of identifiable assets acquired and liabilities assumed for all business combinations in the year:

	£m
Investments	153
Intangible assets (excluding goodwill)	63
Other assets	152
Cash and cash equivalents	74
Insurance contract liabilities	(269)
Other liabilities	(69)
Net assets	104
Cash consideration	171
Total consideration paid	171
Goodwill on acquisitions	67

The above values are provisional pending the final agreement of completion accounts which will determine the consideration payable.

The fair value of the financial assets acquired, included within other assets, includes premiums and insurance debtors of £146m, with no reduction of their nominal value to take account of balances that are expected to be uncollectable.

During 2012 there were no significant changes in the recognised amounts of contingent consideration, and no changes in the range of outcomes, in respect of business combinations completed in earlier years.

Acquisition related costs for acquisitions concluded during the period (included in other operating expenses in the income statement for the year ended 31 December 2012) amounted to £2m.

As a result of the above acquisitions the Group recognised £2m of non controlling interests. The non controlling interests are measured as the proportionate share of the identifiable acquired net assets.

If the acquisitions had occurred on 1 January 2012, the contribution to the Group's net written premiums and fee income for the year would have been £264m and the contribution to the Group's profit after tax for the year would have been £5m. The total net written premiums and fee income of the acquired businesses since the acquisition dates included in the Group's net written premiums for the year is £85m. The total profit after tax of the acquired businesses since the acquisition dates included in the Group's profit for the year is £1m.

The goodwill recognised on the acquisition of L'Union Canadienne, Compagnie D'Assurances arises primarily from the premium paid to significantly expand the Group's presence in the Quebec region and to enhance the Group's Canadian proposition in both Personal and

Commercial lines. Goodwill arising on the acquisitions in Argentina and Canada is further derived from the value of the workforces acquired and the significant synergies from reinsurance, capital and expense savings on integration into the Group.

Of the total goodwill recognised, £7m is expected to be deductible for income tax purposes.

Disposal of subsidiaries

No subsidiaries were disposed of during the year. There was a £1m profit on disposal of subsidiaries in 2011.

31. CASHFLOWS FROM OPERATIONS

	2012 £m	2011 £m
Net profit for the year before tax	**479**	613
Adjustments for:		
Depreciation	**35**	34
Amortisation and impairment of intangible assets	**128**	172
Fair value losses/(gains) (including losses/(gains) on disposal) on property and equipment	**1**	(1)
Fair value gains (including gains on disposal) on financial assets	**(70)**	(194)
Fair value losses on investment property	**24**	4
Impairment charge on available for sale financial assets	**19**	24
Share of loss from associates	**6**	9
Gain on disposal of subsidiaries	**–**	(1)
Foreign exchange	**(27)**	37
Amortisation of available for sale investments	**44**	39
Other non cash movements	**(108)**	(136)
Changes in operating assets/liabilities:		
Movement in insurance contract liabilities:		
Unearned premiums	**138**	216
Losses and loss adjustment expenses	**8**	(52)
Movement in working capital	**(112)**	(201)
Reclassification of interest received	**(400)**	(459)
Cash generated from operations	**165**	104

32. RELATED PARTY TRANSACTIONS

The ultimate Parent Company of the Group is RSA Insurance Group plc which is incorporated in England and Wales.

The following transactions were carried out with related parties:

Key management compensation

	2012 £m	2011 £m
Salaries and other short-term employee benefits	**6**	7
Bonus awards	**3**	3
Pension benefits	**1**	1
Share based awards	**(1)**	2
Total	**9**	13

Key management personnel comprise members of the Group Executive Committee, Executive Directors, and Non-Executive Directors.

32. RELATED PARTY TRANSACTIONS CONTINUED

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 available at discounted rates to all employees including Executive Directors.

As at 31 December 2012, there are interest free loans totalling **£5,000** (2011: £10,000) outstanding to members of the key management team under standard terms of the Group's UK Car Ownership Scheme, which is open to all UK managers within a qualifying salary band.

33. COMMITMENTS

Capital commitments

The Group's significant capital commitments in respect of property and equipment and intangible assets are detailed in the table below:

	2012 £m	2011 £m
Property and equipment	**4**	**19**
Intangible assets	**52**	**95**
Total	**56**	**114**

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	
	2012 £m	2011 £m	2012 £m	2011 £m
One year or less	**59**	63	**2**	1
Between one and five years	**161**	184	**3**	2
After five years	**107**	116	**–**	–
	327	363	**5**	3
Recoveries under sub tenancies	**(14)**	(22)	**–**	–
Total	**313**	341	**5**	3

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	
	2012 £m	2011 £m
One year or less	**26**	26
Between one and five years	**83**	86
After five years	**83**	98
Total	**192**	210

34. ASSETS HELD FOR SALE

There are no assets held for sale at the end of 2012 (2011: £17m). Profit on disposal of assets held for sale of **£2m** (2011: less than £1m) in aggregate is recognised within other operating income.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF RSA INSURANCE GROUP PLC

We have audited the Parent Company financial statements of RSA Insurance Group plc for the year ended 31 December 2012 which comprise the Parent Company Statement of Comprehensive Income, the Parent Company Statement of Changes in Equity, the Parent Company Statement of Financial Position, the Parent Company Statement of Cashflows and the related notes 1 to 11. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the Parent Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Parent Company and the Parent Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the Parent Company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Parent Company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Parent Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the Parent Company financial statements:

- give a true and fair view of the state of the Parent Company's affairs as at 31 December 2012;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the Parent Company financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matters

We have reported separately on the consolidated financial statements of RSA Insurance Group plc for the year ended 31 December 2012.

David Barnes (Senior statutory auditor) for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, UK

19 February 2013

PARENT COMPANY STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2012

	2012 £m	2011 £m
(Loss)/profit for the year net of tax	**(81)**	387
Fair value gains/(losses) net of tax	**1,413**	(797)
Total comprehensive income/(expense) for the year	**1,332**	(410)

The loss for the year net of tax includes a tax credit of **£10m** (2011: £10m). There is no tax relating to fair value gains.

PARENT COMPANY STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2012

	Ordinary share capital £m	Ordinary share premium £m	Preference shares £m	Revaluation reserves £m	Capital redemption reserve £m	Retained earnings £m	Total equity £m
Balance at 1 January 2011	962	1,124	125	1,659	8	864	4,742
Fair value losses net of tax	–	–	–	(797)	–	–	(797)
Profit for the year net of tax	–	–	–	–	–	387	387
Total comprehensive (expense)/income for the year	–	–	–	(797)	–	387	(410)
Dividends – paid (note 7)	–	–	–	–	–	(325)	(325)
Issued by scrip	5	17	–	–	–	–	22
Issued for cash (note 4)	1	3	–	–	–	–	4
Share based payments	3	–	–	–	–	5	8
Balance at 1 January 2012	971	1,144	125	862	8	931	4,041
Fair value gains net of tax	**–**	**–**	**–**	**1,413**	**–**	**–**	**1,413**
Loss for the year net of tax	**–**	**–**	**–**	**–**	**–**	**(81)**	**(81)**
Total comprehensive income/(expense) for the year	**–**	**–**	**–**	**1,413**	**–**	**(81)**	**1,332**
Dividends – paid (note 7)	**–**	**–**	**–**	**–**	**–**	**(336)**	**(336)**
Issued by scrip	**12**	**38**	**–**	**–**	**–**	**–**	**50**
Issued for cash (note 4)	**3**	**5**	**–**	**–**	**–**	**–**	**8**
Share based payments	**3**	**–**	**–**	**–**	**–**	**2**	**5**
Balance at 31 December 2012	**989**	**1,187**	**125**	**2,275**	**8**	**516**	**5,100**

The movement in equity for the year net of tax includes a net tax charge of **£1m** (2011: £1m).

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

PARENT COMPANY STATEMENT OF FINANCIAL POSITION

as at 31 December 2012

	Notes	2012 £m	2011 £m
Assets			
Fixtures and fittings		**4**	6
Intangible assets		**3**	2
Investments	2	**6,479**	5,066
Amounts owed by subsidiaries	9	**1,381**	1,662
Current tax assets	6	**8**	12
Deferred tax assets	6	**22**	22
Other debtors and other assets	3	**8**	4
		1,419	1,700
Cash and cash equivalents		**3**	8
Total assets		**7,908**	6,782
Equity and liabilities			
Equity			
Share capital	4	**1,114**	1,096
Reserves		**3,470**	2,014
Retained earnings		**516**	931
Total equity and reserves		**5,100**	4,041
Liabilities			
Amounts owed to subsidiaries	9	**1,406**	1,338
Loan capital	5	**1,311**	1,313
Current tax liabilities	6	**2**	4
Accruals and other liabilities		**89**	86
Total liabilities		**2,808**	2,741
Total equity, reserves and liabilities		**7,908**	6,782

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

The separate financial statements were approved on 19 February 2013 by the Board of Directors and are signed on its behalf by:

Richard Houghton
Group Chief Financial Officer

PARENT COMPANY STATEMENT OF CASHFLOWS

for the year ended 31 December 2012

	Notes	2012 £m	2011 £m
Net cashflows from operating activities	8	**(94)**	(98)
Purchase of fixtures and fittings		**–**	(1)
Purchase of intangible assets		**(2)**	(2)
Net movement in amounts owed by subsidiaries		**369**	405
Net cashflows from investing activities		**367**	402
Proceeds from issue of share capital		**8**	4
Dividends paid		**(286)**	(303)
Net cashflows from financing activities		**(278)**	(299)
Net (decrease)/increase in cash and cash equivalents		**(5)**	5
Cash and cash equivalents at beginning of the year		**8**	3
Cash and cash equivalents at end of the year		**3**	8

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

NOTES TO THE SEPARATE FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

RSA Insurance Group plc, incorporated in England and Wales, is the ultimate Parent Company ('the Company') of the RSA group of companies. 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 ('Sterling'), shown as £m, rounded to the nearest million.

In accordance with section 408 of the Companies Act 2006, 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 RSA Insurance Group plc 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 comprehensive income. 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

	2012 £m	2011 £m
Investments at 1 January – at valuation	**5,066**	4,713
Additions during the year	**–**	1,158
Disposals during the year	**–**	(8)
Fair value adjustments	**1,413**	(797)
Investments at 31 December – at valuation	**6,479**	5,066

The balance at 31 December comprises:

	2012 £m	2011 £m
Investment in subsidiaries	**5,475**	4,202
Loans to subsidiaries	**1,004**	864
	6,479	5,066

2. INVESTMENTS CONTINUED

The investments in subsidiaries are recognised in the statement of financial position at fair value measured in accordance with the Company's accounting policies. The Company's investments are classified as Level 2 financial assets. 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 end of the reporting period, 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 arm's 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 in the statement of financial position, at the fair values ascribed to them. The market value of the Company's ordinary shares at 31 December 2012 was **125.7p**. A movement of 1% in the share price would have an impact of **£45m** on the fair value.

Full details of the principal subsidiaries of the Company are set out in note 29 to the consolidated financial statements.

3. OTHER DEBTORS AND OTHER ASSETS – TO BE SETTLED WITHIN 12 MONTHS

	2012 £m	2011 £m
Prepayments and accrued income	**1**	1
Other debtors	**7**	3
Total other debtors and other assets	**8**	4

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

	Asset		Liability	
	2012 £m	2011 £m	**2012 £m**	2011 £m
To be settled within 12 months	**8**	12	**–**	–
To be settled after 12 months	**–**	–	**2**	4
	8	12	**2**	4

The current tax relating to items that are credited to equity is **£2m** (2011: £2m).

Deferred tax assets

Deferred tax for the current year is based on a rate of **23.0%** (2011: 25.0%). The following are the major deferred tax assets recognised by the Company and movements during the year:

	Other temporary differences £m	Reclassification of bonds £m	Accelerated capital allowances £m	Total £m
Deferred tax assets at 1 January 2011	12	11	2	25
Credit to the income statement for the year	–	–	1	1
Charge to equity for the year	–	(2)	–	(2)
Effect of change in tax rates – income statement	(1)	–	–	(1)
Effect of change in tax rates – other comprehensive income/equity	–	(1)	–	(1)
Deferred tax assets at 1 January 2012	11	8	3	22
Credit to the income statement for the year	**2**	**–**	**1**	**3**
Charge to equity for the year	**–**	**(2)**	**–**	**(2)**
Effect of change in tax rates – income statement	**(1)**	**–**	**–**	**(1)**
Deferred tax assets at 31 December 2012	**12**	**6**	**4**	**22**

Within other temporary differences, there is **£10m** (2011: £9m) in respect of deferred tax reliefs.

Deferred tax assets of **£22m** (2011: £22m), which are in excess of profits arising from the reversal of existing taxable temporary differences and that relate to tax jurisdictions in which the Company has suffered a loss in either the current or preceding period, have been recognised on the basis that future taxable profits will be available against which these can be utilised. The evidence for the future taxable profits is a forecast consistent with the three year operational plans prepared by the relevant businesses, which are subject to internal review and challenge. Where relevant, the forecast includes extrapolations of the operational plans using assumptions consistent with those used in the plans.

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

	2012 £m	2011 £m
Net (loss)/profit for the year before tax	**(91)**	378
Dividends received	**–**	(450)
Changes in operating assets/liabilities	**(3)**	(26)
Net cashflows from operating activities	**(94)**	(98)

9. RELATED PARTY TRANSACTIONS

RSA Insurance Group plc (incorporated in England and Wales) is the ultimate Parent Company of the RSA Group of companies.

The following transactions were carried out with related parties:

Provision of services and benefits

RSA 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%** (2011: 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.

	2012 £m	2011 £m
Salaries and other short-term employee benefits	**6**	7
Bonus awards	**3**	3
Pension benefits	**1**	1
Share based awards	**(1)**	2
Total	**9**	13

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.

As at 31 December 2012, there are interest free loans totalling **£5,000** (2011: £10,000) outstanding to members of the key management team under the standard terms of the Group's UK Car Ownership Scheme, which is open to all UK managers within a qualifying salary band.

Other transactions

Year end balances with related parties are set out below:

	2012 £m	2011 £m
Receivable from related parties:		
Receivable from subsidiaries, interest bearing loans	**567**	842
Receivable from subsidiaries, non interest bearing loans	**814**	820
Total receivable from related parties	**1,381**	1,662
Payable to related parties:		
Payable to subsidiaries, interest bearing loans	**976**	888
Payable to subsidiaries, non interest bearing loans	**430**	450
Total payable to related parties	**1,406**	1,338

Interest is charged on interest bearing loans, which are repayable on 24 hours' written notice. This is comprised of **£706m** (2011: £618m) at three months LIBOR plus 0.6% and **£270m** (2011: £270m) at three months LIBOR plus 2.0%.

Loans to subsidiaries of **£1,004m** (2011: £864m) as disclosed within note 2 have been made. Of this, **£319m** (2011: £294m), **£81m** (2011: £78m) and **£604m** (2011: £492m) are subordinated loans on which interest is charged at 8.5%, 6.701% and 9.375% respectively.

Royal & Sun Alliance Insurance plc (RSAI), a subsidiary of the Company, has provided guarantees to the Company's creditors for amounts arising from its loan capital agreements (as set out in note 19 to the consolidated financial statements) and for amounts arising from its committed credit facilities (as set out in note 22 to the consolidated financial statements). The guarantees relating to the loan capital agreements are subordinated to all other creditors of RSAI.

10. SHARE BASED COMPENSATION

Details of share based compensation plans are provided in note 27 to the consolidated financial statements.

11. RISK MANAGEMENT

The risks faced by the Company are derived from its investment in subsidiaries and are therefore the same as those of the RSA Group of companies. Details of the key risks to the Group and the steps taken to manage them are disclosed in the Risk Management section of the consolidated financial statements.



Brazil Marine

In Brazil we have a leading Marine business. We are the market leader in Inland Transit & Cargo and second in the overall Marine market. We are also a leader in the automotive segment with a specialised Marine automotive offering. Our key clients include some of the world's largest multinational automotive manufacturers and technology companies. In 2012 our Brazil Marine premiums grew 5% and represent 9% of our total business in Latin America.

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SHAREHOLDER INFORMATION

Registered Office and Group Corporate Centre
9th Floor, One Plantation Place, 30 Fenchurch Street, London EC3M 3BD. Telephone: +44(0) 20 7111 7000. Registered in England and Wales No. 2339826.

Group website
The Company's corporate website provides shareholders with a broad range of information about the Company's heritage, social and environmental responsibilities and investor information such as the Group's financial statements, current and historic share prices, AGM materials, events, governance information and answers to frequently asked questions in respect of shareholder matters. Visit the investor website at **www.rsagroup.com** for further information.

Registrar
The Company's share register is maintained by Equiniti Limited. Any administrative enquiries relating to shareholdings, such as dividend payment instructions or a change of address, should be notified to Equiniti at the following address:

Equiniti Limited
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA
Telephone: 0871 384 2048

When contacting Equiniti, please quote your shareholder reference number which can be found on your share certificate or dividend tax voucher. Calls cost 8p per minute plus network extras. Telephone lines are open from 8.30am to 5.30pm Monday to Friday. Overseas callers should use +44(0) 121 415 7064. Shareholders with a text phone facility should use +44(0) 871 384 2255 or alternatively use the Text Relay service by dialling 18001 0121 415 7064 directly from the text phone.

Annual General Meeting
Holders of RSA ordinary shares are invited to attend the Company's Annual General Meeting (AGM), which will be held at 200 Aldersgate, St Paul's, London EC1A 4HD at 11.00am on 15 May 2013.

Managing your shareholding
Information on how to manage your shareholding can be found at **https://help.shareview.co.uk**. If you do not find the information you require, you can send your enquiry via secure email from these pages. You will be asked to complete a form providing your name, address and shareholder reference number. If you require an email response, you will need to provide your email address.

Electronic communications
Receiving the Company's communications electronically allows the Company to communicate with its shareholders in a more environmentally friendly, cost effective and timely manner.

You can elect to receive email notifications of shareholder communications by registering at **www.shareview.co.uk** where you can also set up a bank mandate to receive dividends directly to your bank account and submit proxy votes for shareholder meetings. Shareholders may elect to receive a printed copy of the Annual Report and Accounts at any time by contacting Equiniti.

Dividends
Shareholders are encouraged to have their dividends paid directly into their bank account. It is a more secure and faster way to receive the dividend payment with cleared funds available to shareholders on the dividend payment date. Shareholders who have their dividends paid directly into their bank receive a consolidated tax voucher in March, showing payments received in the respective tax year. Alternatively, individual tax vouchers are available upon request. To take advantage of this convenient method of payment visit **www.shareview.co.uk** or contact Equiniti. Details of 2013 dividend dates can be found in the Financial Calendar on page 150.

Scrip Dividend Scheme
The Company offer a Scrip Dividend Scheme to shareholders giving them the opportunity to use their final and interim dividend payments to increase their holding in the Company without incurring dealing costs or stamp duty. Shareholders wishing to receive a scrip dividend instead of a cash dividend should contact Equiniti for details or visit the shareholder services area of the Company's website. Details of the 2013 scrip election dates can be found in the Financial Calendar on page 150.

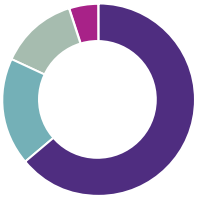
Amalgamation of accounts
Shareholders who receive duplicate sets of Company mailings owing to multiple accounts in their name should contact Equiniti to request that their accounts be amalgamated.

Low cost share dealing facilities
Shareholders may purchase or sell their RSA ordinary shares through their stockbroker, a high street bank or one of the providers detailed below:

Equiniti offer a telephone and internet dealing service. Commission is currently 1.5% with a minimum charge of £45 for telephone dealing and currently 1.5% with a minimum charge of £40 for internet dealing. For telephone sales call +44(0) 845 6037 037 between 8.30am and 4.30pm, Monday to Friday. For internet sales log on to **www.shareview.co.uk/dealing**. Please quote your shareholder reference number.

Stocktrade also offer a telephone dealing service. Commission is currently 0.5% on amounts up to £10,000 and 0.2% on the excess thereafter, all of which are subject to a minimum charge of £17.50. A postal dealing service is also available upon request. For telephone sales call +44(0) 131 240 0414 between 8.00am and 4.30pm, Monday to Friday. Please quote reference: Low Cost 331. Alternatively visit their website, **www.stocktrade.co.uk**.

Distribution of shares by geography (%)



UK	64
USA and Canada	18
Europe	13
Asia and others	5

Analysis of investors (%)



Unit trusts/Mutual funds	52
Private/Retail	14
Pension funds	13
Other	14
Insurance	7

Please note that rates quoted are as at February 2013 and may be subject to change. Please contact either provider for further guidance on their full terms and conditions.

Share register fraud: protecting your investment

It is required by law that our shareholder register is available for public inspection. We are unable to control the use of information obtained by persons inspecting the register. Shareholders are advised to be wary of any unsolicited advice, offers to buy shares at a discount, or offers of free reports about the Company. Details of any share dealing facilities that the Company endorses will be included in Company mailings or on our website. If you receive any unsolicited advice, make sure you get the correct name of the person and organisation and check that they are appropriately authorised by the FSA by visiting **www.fsa.gov.uk/fsaregister**. More information on protecting your investment can be found at **www.fsa.gov.uk/consumerinformation/stay_safe.**

Tips on protecting your shares

- Keep any documentation that contains your shareholder reference number in a safe place and destroy any documentation you no longer require by shredding it
- Inform Equiniti promptly when you change your address
- Be aware of dividend payment dates and contact Equiniti if you do not receive your dividend cheque, or better still, make arrangements to have the dividend paid directly into your bank account
- Consider holding your shares electronically in a CREST account via a nominee.

Share ownership

The issued share capital of the Company consists of two classes; ordinary shares with a nominal value of 27.5p each and preference shares with a nominal value of £1 each. Further details of the Company's share capital is detailed in Note 18.

The Company is listed on the London Stock Exchange under the code RSA. The average total daily trading volume during 2012 was approximately 12m ordinary shares. The closing market price of an ordinary share on 3 January 2012 was 107.8p and the closing market price on 31 December 2012 was 125.7p. The highest daily closing price of an ordinary share was 127.9p on 24 December 2012 and the lowest daily closing price was 97.65p on 1 June 2012.

Shareholdings by size (as at 31 December 2012)

No. of shares	Shareholders	%	Shares	%
1 – 24,999	42,782	95.73	123,308,466	3.43
25,000 – 99,999	1,034	2.31	45,709,026	1.27
100,000 – 499,999	402	0.90	93,571,770	2.60
500,000 – 999,999	133	0.30	95,295,312	2.65
1,000,000 – 1,999,999	106	0.24	152,531,068	4.24
2,000,000 and above	231	0.52	3,085,535,673	85.81
Total	**44,688**	**100**	**3,595,951,315**	**100**

ShareGift

Shareholders with a small number of shares, the value of which makes it uneconomic to sell them, may wish to consider donating them to charity through ShareGift, a registered charity administered by The Orr Mackintosh Foundation, registered charity number 1052686. The relevant share transfer form can be obtained from Equiniti. Further details can be obtained from **www.sharegift.org** or by calling +44(0) 20 7930 3737.

FINANCIAL CALENDAR

27 February 2013
Ex dividend date for the first preference share dividend for 2013.

1 March 2013
Record date for the first preference dividend for 2013.

2 April 2013
Payment date for the first preference dividend for 2013.

3 April 2013
Ex dividend date for the ordinary final dividend for 2012.

5 April 2013
Record date for the ordinary final dividend for 2012.

10 April 2013
Announcement of the scrip dividend price for the ordinary final dividend for 2012.

2 May 2013
Q1 2013 interim management statement.

3 May 2013
Deadline for the receipt of scrip dividend mandates by Equiniti in relation to the ordinary final dividend for 2012.

15 May 2013
Annual General Meeting.

24 May 2013
Payment date for the ordinary final dividend for 2012 (subject to shareholder approval at the AGM).

1 August 2013*
Announcement of the half year results for the six months ended 30 June 2013, the ordinary interim dividend for 2013 and the second preference dividend for 2013.

7 August 2013*
Ex dividend date for the second preference dividend for 2013.

9 August 2013*
Record date for the second preference dividend for 2013.

25 September 2013*
Ex dividend date for the ordinary interim dividend for 2013.

27 September 2013*
Record date for the ordinary interim dividend for 2013.

1 October 2013*
Payment date for the second preference dividend for 2013.

2 October 2013*
Announcement of the scrip dividend price for the ordinary interim dividend for 2013.

25 October 2013*
Deadline for the receipt of scrip dividend mandates by Equiniti in relation to the ordinary interim dividend for 2013.

7 November 2013*
Q3 2013 interim management statement.

22 November 2013*
Payment of the ordinary interim dividend for 2013.

* Provisional date

JARGON BUSTER

Below is a simple explanation of some of the key technical terms used within this report.

Term	Definition
Affinity	• Selling insurance through a partner's distribution network, usually to a group of similar customers, e.g. store card holders, alumni groups, unions and utility company customers.
Bancassurance	• Selling insurance through a bank's distribution network.
Capacity	• Largest amount of insurance available from a company • Can also refer to the largest amount of insurance or reinsurance available in the marketplace.
Capital	• The money invested in the Group. This includes the money invested by shareholders and profits retained within the Group.
Claims Frequency	• Average number of claims per policy over the year.
Claims Handling Expenses	• The administrative cost of processing a claim (salary costs, costs of running claims centres, etc. and allocated shares of the costs of head office units). Not the cost of the claim itself.
Claims Ratio (Loss Ratio)	• Percentage of Net Earned Premiums which is paid out in claims and Claims Handling Expenses.
Claims Reserve (Provision for Losses and Loss Adjustment Expenses)	• Reserve established by the Group to reflect the estimated cost of claims payments and related expenses that we estimate we will ultimately be required to pay.
Claims Severity	• Average cost of claims incurred over the period.
Combined Operating Ratio (COR)	• The sum of the Claims Ratio and Expense Ratio • Measures how much we pay out in claims and expenses for each unit of net premium received • A COR of less than 100% indicates that we are writing profitable business • Calculated as: $\frac{\text{Net Incurred Claims}}{\text{Net Earned Premiums}}\% + \frac{\text{Expenses (including commissions)}}{\text{Net Written Premiums}}\%$
Commission	• An amount paid to an intermediary such as a broker for generating business.
Commission Ratio	• Ratio of net commission costs to Net Written Premiums.
Current Year Result	• The underwriting profit or loss earned from business for which protection has been provided in the current financial period.
Earned Premium	• The portion of an insurance premium for which we have already provided protection.
Economic Capital	• The Group's assessment of the capital we must hold to have a high confidence of meeting our obligations given our risk appetite.
Expense Ratio	• Percentage of Net Written Premiums which is paid out in operating expenses e.g. salaries, premises costs, etc. The ratio does not include claims related expenses but can include or exclude commissions.
Exposure	• A measurement of risk we are exposed to through the premiums we have written. For example, in motor insurance one vehicle insured for one year is one unit of exposure.
Financial Services Authority (FSA)	• The regulatory authority for the UK financial services industry (or its successor(s) for the UK insurance industry).
Gross Written Premium (GWP)	• Total premium written or processed in the period, irrespective of whether it has been paid.
IBNR (Incurred but Not Reported)	• A reserve for accidents or incidents that have occurred but which have not yet been reported to us.
IGD Capital Requirement	• Insurance Groups Directive capital is the capital the Group is required to hold based on standard calculations defined by the FSA under the EU Solvency I directive.
Insurance Result	• This is a measure of how well we have done, including both our underwriting result and investment performance.
Net Asset Value (NAV)	• The value of the Group calculated by subtracting our total liabilities including loan capital from our total assets. This represents the funds that would be available to ordinary shareholders if the Group were wound up.

JARGON BUSTER CONTINUED

Net Earned Premium (NEP)	• The portion of Net Written Premiums for which we have already provided protection. This is included as income in the period.
Net Incurred Claims (NIC)	• The total claims cost incurred in the period less any share to be paid by reinsurers. It includes both claims payments and movements in claims reserves in the period.
Net Written Premium (NWP)	• Net Written Premium is premium written or processed in the period, irrespective of whether it has been paid, less the amount paid out in reinsurance premiums.
Operating Profit	• The profit generated by the ordinary activities of the Group including both insurance and investment activity.
Portfolio Management	• Management of a group of similar risks, these are usually grouped by geography and line of business.
Prior Year Result	• Profit or loss generated by settling claims incurred in a previous year at a better or worse level than the previous estimated cost.
Property and Casualty (P&C) (Non Life Insurance or General Insurance)	• Property insurance covers loss or damage through fire, theft, floods, storms and other specified risks. Casualty insurance primarily covers losses arising from accidents that cause injury to other people or damage to the property of others.
Rate	• The price of a unit of insurance based on a standard risk for one year. Actual premium charged to the customer may differ from the rate due to individual risk characteristics and marketing discounts.
Reinsurance	• The practice whereby we transfer part or all of the risk we have accepted to another insurer (the reinsurer).
Run-off	• A situation where an insurer is no longer underwriting new business but continues to meet its liabilities under existing contracts.
Solvency II	• New capital adequacy regime for the European insurance industry. Establishes a revised set of EU wide capital requirements and risk management standards.
Scrip Dividend	• Where shareholders choose to receive the dividend in the form of additional shares rather than cash. The Group issues new shares to meet the scrip demand.
Total Shareholder Return	• A measure of performance based on the overall value to shareholders of their investment in the Group over a period of time. Includes the movement in the share price and dividends paid, expressed as a percentage of the share price at the beginning of the period.
Underlying Return on Average Equity	• A measure of the profits the Group earns, adjusted for profit/loss on disposal of subsidiaries, reorganisation and integration costs and acquisition costs, relative to average funds attributable to ordinary shareholders.
Underwriting Result	• This is a measure of how well the Group has done excluding its investment performance and is calculated as: NEP – Claims (including Claims Handling Expenses) – Expenses (including commissions).
Unearned Premium	• The portion of a premium that relates to future periods, for which protection has not yet been provided, irrespective of whether the premium has been paid or not.
Yield	• Rate of return on an investment in percentage terms • The dividend payable on a share expressed as a percentage of the market price.

Important disclaimer

This document contains 'forward-looking statements' with respect to certain of the Group's plans and its current goals and expectations relating to its future financial condition, performance, results, strategic initiatives and objectives. Generally, words such as "may", "could", "will", "expect", "intend", "estimate", "anticipate", "aim", "outlook", "believe", "plan", "seek", "continue" or similar expressions, identify forward-looking statements. These forward-looking statements are not guarantees of future performance. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances which are beyond the Group's control, including amongst other things, UK domestic and global economic business conditions, market-related risks such as fluctuations in interest rates and exchange rates, the policies and actions of regulatory authorities (including changes related to capital and solvency requirements), the impact of competition, inflation, deflation, the timing impact and other uncertainties of future acquisitions or combinations within relevant industries, as well as the impact of tax and other legislation or regulations in the jurisdictions in which the Group and its affiliates operate. As a result, the Group's actual future financial condition, performance and results may differ materially from the plans, goals and expectations set forth in the Group's forward-looking statements. The Group undertakes no obligation to update any forward-looking statements, save in respect of any requirement under applicable law or regulation. Neither the content of RSA's website nor the content of any other website accessible from hyperlinks on RSA's website is incorporated into, or forms part of, this document.

www.rsagroup.com

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