# Aviva plc
Annual report and accounts 2003

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**Life profits reporting** In reporting the Aviva plc headline operating profit, life profits have been included using the achieved profit basis. This is used throughout the Aviva group and by many in the investment community to assess performance. The modified statutory basis, which is used in our accounts, is also identified in the headline figures. We have focused on the achieved profit basis, as we believe life achieved operating profit is a more realistic measure of the performance of life businesses than the modified statutory basis. Life modified statutory operating profit before tax amounted to £1,138 million. The basis used for reporting achieved profit is consistent with the guidance circulated by the Association of British Insurers.

Aviva is the world's **seventh-largest** insurance group† and the biggest in the UK. It is one of the **leading providers** of life and pensions products to Europe and has substantial businesses elsewhere around the world. Its **main activities** are long-term savings, fund management and general insurance. It has premium income and investment sales from continuing operations of **£30 billion****, and around **£240 billion** of assets under management. The group has **56,000** employees serving **30 million** customers worldwide.

### Operational highlights

Strong performance in both long-term savings and general insurance businesses

Robust life results: good sales growth in continental Europe; signs of confidence returning to UK market; margins up to 26.1%

Significant growth from bancassurance: sales up 27%; now accounts for 25% of new life and pensions sales; average margins 39.7%

Excellent and sustainable general insurance results with new group combined operating ratio target of 100% for next three years

Strong capital position and well-prepared for new UK realistic solvency reporting regime

### Highlights of the year

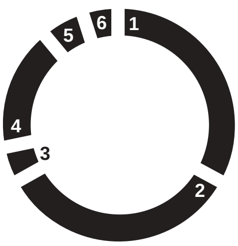
**£1,907m**
operating profit before tax*

**£14.4bn**
worldwide long-term savings new business sales**

**24.15p**
full year dividend

**£11.2bn**
shareholders' funds***

### Geographical breakdown of worldwide business mix‡




| **Long-term savings#** | |
|---|---|
| 1 UK | 33% |
| 2 Continental Europe | 34% |
| 3 Rest of world | 5% |

| **General insurance** | |
|---|---|
| 4 UK | 17% |
| 5 Continental Europe | 6% |
| 6 Rest of world | 5% |

*From continuing operations, including life achieved operating profit, before amortisation of goodwill and exceptional items.
**From continuing operations, including share of associates' premiums.
***On an achieved profit basis.
‡With reference to net premium income from continuing operations.
#Including health premium income.
†Based on gross worldwide premiums.
All growth rates in this document are quoted at constant rates of exchange.

# Chairman's statement

**Aviva has come through a third year of adverse economic conditions. Some of our competitors have suffered severely. Others have undertaken massive capital raisings. At Aviva we reduced dividends early to a sustainable level. We further increased our capital strength by issuing subordinated debt in 2001 and 2003 to raise altogether £2.8 billion.**

Through strict cost control and stringent capital allocation we have run and developed our business with undisturbed continuity and maintained a Standard & Poor's AA range of ratings for the group.

Our two main operational aims – to be the insurance industry's low-cost producer and provider of choice – are being reached gradually. We benchmark our performance continually to measure our progress.

In the UK, our long-term savings business is showing resilience in a slow market. We are making steady progress in France, with strong performances in Spain and Italy. Our recent bancassurance agreement with ABN AMRO in the Netherlands is off to a promising start. In the United States we are growing profitably. Our start-up operations in India and China are growing well, above plan.

Our UK general insurance operation is turning in excellent results and good free cashflow. Worldwide, our general insurance business is improving steadily, and Canada is promising after a setback earlier in the year.

Our fund management results are more robust than in the previous year.

We continue to look for promising strategic opportunities, and will expand our business where we see the chance to be a market leader and grow the business profitably.

We propose a final dividend for 2003 of 15.15 pence net per share, which brings the total for the year to 24.15 pence, an increase of 5%. This will be payable on 17 May 2004 to shareholders on the register on 26 March 2004. Our policy remains that of growing the dividend by about 5% a year.

"Through strict cost control and stringent capital allocation we have run and developed our business with undisturbed continuity"

Aviva is a firm supporter of sensible corporate governance disciplines, and we already follow what has become regarded as best boardroom practice. From the 2004 financial year we shall be required to report the board's compliance with the revised Combined Code on Corporate Governance. The Code incorporates recommendations from the Higgs review of the role of non-executive directors, which generated considerable debate in the City throughout 2003, and the Smith report on audit committees. We are ahead of the game reporting this year as if the Code had been in effect for 2003.

Two non-executive directors, Carole Piwnica and Anna Catalano, joined our board during the year, and are already making significant contributions.

One long-time executive director, Tony Wyand, retired in November 2003. Likewise, Philip Twyman will retire in March this year. I would like to thank both of them for their exceptional contributions. They will be missed for their eminent qualities and their international experience. Sir Michael Partridge, a non-executive director and member of the audit committee, retired in May 2003, and I thank him for his invaluable contribution.

**Pehr G Gyllenhammar**
Chairman

**Group strategy**

**1** To grow our long-term savings business aggressively and profitably.

**2** To build a world-class fund management business.

**3** To take a focused approach to general insurance, with disciplined underwriting and efficient claims handling.

**4** To build top-five positions in key markets.

**5** To withdraw from lines of business or markets which do not offer the potential for market-leading positions or superior returns.

# "I believe that Aviva has emerged from tough times in good shape"

"I am pleased with the progress we are making towards the creation of a single market for financial services"

Mike Biggs decided to leave the group at 31 December. He did an excellent job, and I thank him for what he accomplished. Philip Twyman took on additional responsibility for the group finance director role from 1 January on a transitional basis. I am pleased that Andrew Moss will be joining us from Lloyd's of London as group finance director later in the year.

As chairman of the European Financial Services Round Table, I am pleased with the progress we are making towards the creation of a single market for financial services, although much patience is required. We have proposed significant simplification to supervision and regulation, steps toward a single capital market, and are preparing proposals for more effective and community-wide consumer protection.

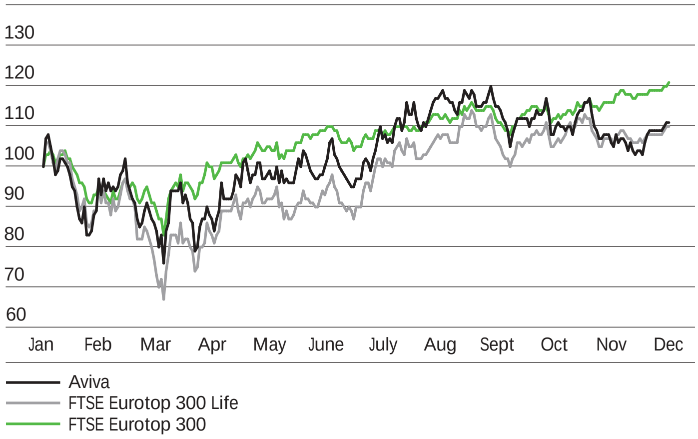
In the area of corporate social responsibility, Aviva has high ambitions and is making good progress. I feel that all business operations in our group now understand our mission and are eager to do their best.

Our staff have been under pressure through several years of adversity. I know that our management recognise that ambitious efforts are needed to motivate and encourage our dedicated employees. Management has done well under demanding circumstances and will continue to address these issues.

I believe that Aviva has emerged from tough times in good shape. We are strongly positioned as a leading European-based financial services group. That should benefit you as our shareholders.

**Pehr G Gyllenhammar**
Chairman

**Aviva relative to FTSE Eurotop 300 Life and FTSE Eurotop 300**



## Business overview

## Long-term savings

### Our credentials

Our strategy is to grow this business aggressively and profitably by building strong positions in our chosen markets. Aviva is one of the leading life and pensions providers to Europe. We are the largest company in the UK long-term savings and Spanish life markets. We are among the top five in the Netherlands, Ireland, Poland, Turkey and Singapore, among the top 10 in France, Italy, Belgium, Romania and Australia, and have significant operations in the United States and Germany. We have also established businesses with great long-term potential in India and China.

### Performance

Operating profit before tax from continuing operations, including life achieved profit

**£1,555m**

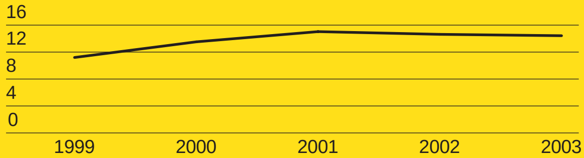
Geographical analysis of net premium and investment sales from continuing operations


| | |
|---|---|
| 1 UK | £9,212m |
| 2 Continental Europe | £9,882m |
| 3 Rest of world | £1,007m |
| Total | £20,101m |

Including health premiums of £1,066 million.

Five-year trend for performance

**Worldwide long-term savings new business sales**
£billion




### Developments in 2003

- Strengthened our market position in many countries, becoming the largest life insurer in Spain after considerable growth in just a few years.
- Life and pension new business sales were £13.3 billion, including a 3% increase in continental European sales to £6.6 billion, mostly driven through bancassurance.
- Bancassurance joint venture with ABN AMRO in the Netherlands became operational, contributing £227 million to total sales.
- Joint ventures in India and China both made good progress in their first full year of operation, in markets with huge long-term growth potential.
- Substantial improvement in customer service in the UK reflected in a three-star rating at the Financial Services Awards and other industry accolades.

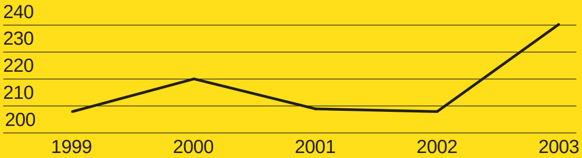
## Fund management

We continue to develop our presence as a leading international fund manager, with worldwide assets under management of around £240 billion. We are the second-largest UK-based fund manager, among the top five in Ireland and the Netherlands, and a top-five master trust in Australia through Navigator. We also have a significant business in France. This in-house expertise aims to generate superior investment performance for shareholders, policyholders and institutional clients, and supports our long-term savings businesses by investing funds on their behalf.

# £10m


| | |
|---|---|
| 1 UK | £680m |
| 2 Continental Europe | £363m |
| 3 Rest of world | £98m |
| Total | £1,141m |

**Worldwide assets under management**
£billion




- Greater efficiencies achieved within Morley Fund Management through increased centralisation of our international equity fund management expertise.
- Ground-breaking investment administration service being set up by Morley with JPMorgan Investor Services.
- Excellent investment performance in France again earned a large number of awards from the financial press.
- Healthy fund performances, strong demand and third-party distribution arrangements contributed to increased assets under management of £34 billion in the Netherlands.
- Navigator added new funds to enhance the range of investment choices available to financial advisors and their clients in Australia.

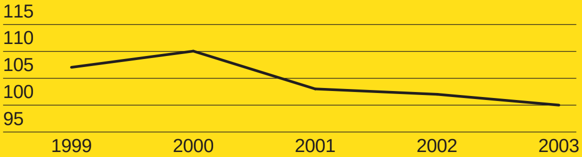
## General insurance

Rigorous cost control, disciplined underwriting and excellent customer service are at the core of our general insurance business. We aim to deliver high-quality earnings from market-leading positions in personal insurance and selected commercial lines. Our sustained profitability gives us a solid platform to provide high-quality service, strengthen relationships with our customers and broaden our range of propositions. Aviva is the leading general insurer in the UK and Ireland, the second-largest in Canada, and among the top five in the Netherlands and Singapore. We also have a significant business in France and an extensive insurance network in Asia.

# £911m


| | |
|---|---|
| 1 UK | £5,135m |
| 2 Continental Europe | £1,915m |
| 3 Rest of world | £1,474m |
| Total | £8,524m |

**Combined operating ratio from continuing operations**
%




- Third consecutive year of improvements as we achieved a combined operating ratio from continuing operations of 100%.
- Continued investment in the development of innovative, tailored propositions such as digital flood mapping, Pay As You Drive™ and Norwich Union Rescue vehicle breakdown service.
- Shared service initiatives helped keep costs down and improved claims handling and standards of customer service across the group.
- Aviva Canada launched its first corporate partnership with supermarket chain Loblaws, under the highly regarded President's Choice brand.
- Call and claims processing centre in India became operational, delivering cost and service benefits to our UK business and other operations.

"We took a number of tough but clear-sighted decisions to protect and grow our business during 2003"

# Group Chief Executive's review

**Overview**
The Aviva group delivered a strong performance against a challenging commercial backdrop in 2003. We committed ourselves to applying our strategy clearly and consistently in the face of slow worldwide economic growth, stock market volatility and increasing pace of regulatory change.

In particular, we achieved the operational targets we set ourselves at the start of the year. We improved productivity, to keep our costs in line with revenues. We continued to apply rigorous financial management to maximise returns from our valuable capital resources. We generated cashflow from our general insurance business and from our focus on capital management disciplines and costs. We committed ourselves to improving customer service by sharing best practice groupwide.

Most importantly, our combination of strong and diversified long-term savings operations and cash-generative general insurance business delivered consistent and reliable financial results.

**Richard Harvey**
Group Chief Executive

**Group results**
Our pre-tax operating profit* of £1,907 million *(2002: £1,720 million)* and an improved return on capital employed† of 12.7% *(2002: 9.7%)* reflects the continued strength of both our long-term savings and general insurance businesses.

"We achieved the operational targets we set ourselves at the start of the year"

Given the uncertain financial climate, we were pleased that our worldwide long-term savings new business sales** were £14.4 billion *(2002: £14.6 billion)*. Sales in continental Europe improved by 5% to £6.9 billion (*2002: £6.0 billion*). We continue to benefit from our bancassurance distribution agreements as they develop across Europe and South East Asia, with worldwide total sales of £3.5 billion *(2002: £3.0 billion)*. We are seeing signs that investment market conditions are improving and customer confidence is recovering in equity markets. Life achieved operating profit was £1,555 million *(2002: £1,524 million)*.

We made an excellent operating profit† of £911 million *(2002: £881 million)* from our general insurance business, which reaped the benefits from strict underwriting and pricing disciplines for the third consecutive year, in addition to favourable weather conditions. We achieved a combined operating ratio (COR)† of 100%.

This operational performance, combined with improvements in global investment markets and a strengthened euro, saw shareholders' funds# increase to £11.2 billion *(2002: £9.7 billion)*. Net asset value per share was up 12% to 502 pence *(2002: 433 pence per share)*.

On a modified statutory basis, group operating profit before tax*** was £1,490 million (*2002: £1,218 million*). On an after tax basis, this operating profit covers the proposed full year ordinary dividend of £545 million 1.82 times, in line with our dividend policy. The group delivered an overall profit before tax of £1,390 million *(2002: £282 million loss)*.

**Cost management**
We continue to improve our operational efficiency by reducing costs and capitalising on economies of scale. We endeavour to align costs to revenues across our businesses. We have continued to apply rigorous financial targets for new developments and internal projects.

The net pre-tax benefit to the profit and loss account for the year was £65 million, which is in line with our indication at the half year.

**Senior management responsibilities**
A realignment of responsibilities among the executive directors took effect from July 2003 to support our strategy and structure more effectively.

*From continuing operations, including life achieved operating profit before amortisation of goodwill and exceptional items.

†From continuing operations.

**From continuing operations, including share of associates' premiums.

***From continuing operations, before amortisation of goodwill, amortisation of acquired additional value of in-force long-term business and exceptional items.

#On an achieved profit basis.

**12.7%**

**An improved return on capital employed† of 12.7% *(2002: 9.7%)* reflects the continued strength of our business.**

In addition to my duties as group chief executive, I became non-executive chairman of Norwich Union Life in the UK, with Gary Withers continuing as chief executive. Our continental European and international long-term savings businesses now report to Philip Scott. Patrick Snowball, chief executive of Norwich Union Insurance in the UK, also took on responsibility for our general insurance businesses in Canada, Ireland and Asia.

Philip Scott will become non-executive chairman of Morley Investment Holdings, in addition to his existing responsibilities, after Philip Twyman's retirement on 31 March 2004. We look forward to welcoming Andrew Moss as group finance director, following the departure of Mike Biggs.

**Association of British Insurers**

As a leading insurance and investment provider, Aviva plays an active role in advising and consulting on government policy and regulatory reforms as they affect our industry in countries around the world.

I was delighted to be appointed chairman of the Association of British Insurers in July 2003. During my time in office I intend to ensure that the ABI continues to provide effective and influential leadership for the insurance industry in the UK.

We have a big task to explain the full value of the industry's contribution to the social and economic health of the country. We need to communicate more effectively with governments, regulators and consumers on issues that concern all of us. There is also more we can do to build trust with our customers through greater openness and better service.

**Outlook**

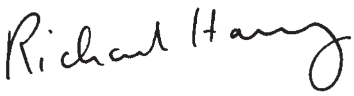
Investment markets are showing signs of recovery and there is evidence that investors are regaining confidence. The group's longer-term prospects remain excellent.

Having invested around £2 billion in strategic long-term businesses and savings partnerships since 2000, we are beginning to gain rewards in terms of sales volumes, profitability and market share. Many of our bancassurance partnerships worldwide are still at a relatively early stage of development and we expect further growth as these relationships mature. Furthermore, as one of the leading providers of life and pension products to Europe, Aviva's potential to grow remains strong, particularly given Europe's ageing populations and widespread pension reform. We are well placed to capitalise on this growing demand for private provision as the European Union expands.

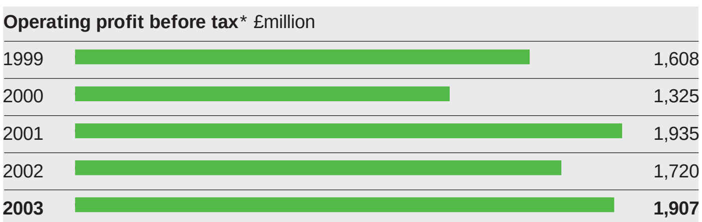
Our powerful presence in our chosen markets is aided by the Aviva brand, which has been successfully launched in more than 20 countries worldwide. Our long-term savings business is focused on profitable growth, supported by well-managed general insurance operations where our investment in improved efficiency, claims handling and distribution is generating consistent and sustainable earnings.

Our employees continue to adapt, as we face more challenging competition and market forces. I thank them for their willingness and capability to embrace change in the pursuit of our cost effectiveness and customer service ambitions.

We took a number of tough but clear-sighted decisions to protect and grow our business during 2003. We will continue with clarity of purpose and action to develop our distribution channels, improve standards of customer service, increase efficiency and maintain capital disciplines. We remain financially strong and we believe we are the best-positioned life company in Europe to benefit as consumer confidence returns.



**Richard Harvey**
Group Chief Executive



# £1,555m

**Life achieved operating profit before tax.**

# +8%

**Worldwide sales through bancassurance were up 8% at £3.5 billion.**

# Long-term savings

Aviva is strongly positioned as one of the largest life and pensions providers to Europe, with competitive businesses elsewhere around the world. Our **clear-sighted** strategy is to achieve profitable growth by providing our customers with a choice of high-quality, value-for-money products through a variety of distribution channels.

# Long-term savings

### Business strategy

We continue to make excellent progress and in many countries have strengthened our market position, despite 2003 being a difficult year for long-term savings markets. Aviva's long-term savings business including health insurance accounts for 72% of our total premiums. Our strategy is to grow this business aggressively and profitably.

We continue to see significant opportunities to develop our business. We have major positions in many markets where governments are encouraging individuals to save more for their retirement. We have established operations and are building our market position where we see good medium to longer-term growth opportunities in the large, relatively undeveloped markets of Eastern Europe and Asia. Our size, efficiency and international brand enable us to provide a choice of life insurance, pensions, savings and investment products through a variety of distribution channels to suit the needs of our customers.

**"There are excellent opportunities to develop our strong positions in Europe and emerging markets through our multi-distribution capability"**
Philip Scott, group executive director, Aviva life international

### Market position

Aviva is one of the leading life and pensions providers to Europe. We are the largest company in the UK long-term savings market and the Spanish life market. We are also among the top five in the Netherlands, Ireland, Poland, Turkey and Singapore, among the top 10 in France, Italy, Belgium, Romania, Australia and India, and have significant operations in the United States and Germany.

In 2003 Norwich Union regained its leadership position in the UK, with a market share of over 12% in the third quarter and nearly seven million customers. Aviva also became the largest life insurer in the Spanish market during 2003, having grown considerably over the past few years through our success with our bancassurance partners. Hibernian improved its position to become Ireland's number three life and pensions company, with a market share of 11%. We also established the foundation for our important long-term operations in India and China.

### Distribution

We have developed a strong multi-distribution capability well suited to the preferences of customers in local markets.

Independent advisers continue to introduce the majority of our business, providing about 48% of worldwide sales. Bancassurance has become an increasingly important source, generating 25% of new business for the group. Direct sales represent 23% of the total, and partnerships with non-banking organisations provide the remaining 4% of our business.

Our strategy is to align our distribution model to the channels that dominate local market distribution. In more developed markets, such as the UK, the Netherlands and France, we have a multi-distribution model which enables us to meet customer demand for a wider choice of products sold in a variety of ways, including advice through independent advisers. The markets of Spain and Italy are dominated by the bancassurance channel, through which over two-thirds of new business is written. In the developing markets of Central and Eastern Europe and China, our primary method of distribution is through a direct sales force. Our distribution mix continues to evolve as these markets develop.


Delta Lloyd customers in the Netherlands can access a full range of information, products and services via the internet, in addition to a choice of other methods, including the telephone, intermediaries and bancassurance.

### Multi-distribution capability

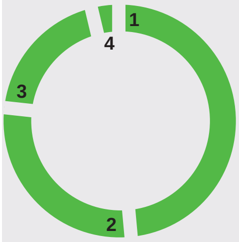
In the UK, independent financial advisers (IFAs) remain our main distribution channel, producing about 74% of sales, and we continue to develop relationships with the largest IFA firms. In addition, we have developed a strong multi-distribution business through our bancassurance agreement with The Royal Bank of Scotland Group, together with other partnerships, including Tesco Personal Finance and 20 building societies. This capability positions us well as we look towards depolarisation of the IFA market, when more advisers will have greater freedom to sell products from a wider choice of providers.

Imaginative and prominent marketing has helped Aviva become a familiar name in India. We operate in more that 90 locations, selling innovative products through strong bancassurance partnerships and a well-trained direct sales force.

# No1 in UK

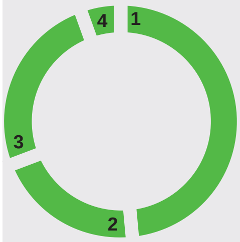
**We reclaimed our leadership position with a market share of over 12% in the third quarter.**

**2003 – Worldwide new business sales by distribution channels**




| | |
|---|---|
| 1 Independent advisers | £6,996m |
| 2 Bancassurance | £3,507m |
| 3 Direct | £3,355m |
| 4 Partnerships with non-banking organisations | £575m |
| Total | £14,433m |

**2002 – Worldwide new business sales by distribution channels**




| | |
|---|---|
| 1 Independent advisers | £7,092m |
| 2 Bancassurance | £3,030m |
| 3 Direct | £3,725m |
| 4 Partnerships with non-banking organisations | £799m |
| Total | £14,646m |

Similarly, Aviva France sells through a mixture of distribution channels, including tied agents, brokers, a salaried sales force, direct operations, a partnership with AFER, the largest savings association in the country with 580,000 members, and our general insurance business, Aviva Assurances. When it launches in October 2004, our bancassurance partnership with Crédit du Nord will greatly strengthen our distribution mix. The equally owned joint venture at the heart of the partnership will enjoy access to the bank's 1.3 million customers for the sale of long-term savings products.

Delta Lloyd has enhanced its multi-distribution capability in the Netherlands through a bancassurance joint venture with ABN AMRO, selling life and general insurance products to over five million potential customers through a network of 570 branches. The arrangement complements existing channels through independent intermediaries (using our Delta Lloyd operating brand) and direct (through our OHRA brand). We also signed an agreement in February 2003 with MKB Nederland, the Dutch organisation for small and medium-sized businesses, to advise on pension schemes, which gives us a foothold in one of our main target markets.

**"Pension reforms should create further opportunities. In addition, we expect continued growth from our efficient bancassurance business."**
Cesare Brugola, chief executive officer, Aviva Italy

In Ireland, Hibernian products are predominantly distributed by brokers and we aim to increase our market share by targeting this sector. Our main sales channel in Australia is independent advisers, with our Navigator online platform broadening our distribution capability. In the United States we have a network of 6,000 agents and brokers, and have distribution agreements with several leading banks.

In addition to these more developed businesses, we are also improving our multi-distribution capability in emerging markets.

The majority of sales through our joint venture in India with Dabur Group come from bancassurance partnerships with ABN AMRO, American Express, Lakshmi Vilas Bank and Canara Bank. We also employ a direct sales force network of 1,800 specialist financial planning advisers, and have launched an insurance broking business in partnership with Bajaj Capital, India's premier financial planning and investment advisory company.

In China, where we have a joint venture with COFCO, we have applied for licences to sell life and pensions products through banks and direct sales in Beijing and Chengdu. Our existing operation in Guangzhou employs a sales force of around 2,000 people.

## Bancassurance

Bancassurance is an important source of new business, having grown significantly over the past three years. In some countries, such as the UK and Netherlands, it forms part of our multi-distribution mix; in others, particularly Italy and Spain, it is the dominant sales channel.

Our partners in Italy – UniCredito Italiano, Banca Popolare di Lodi, Banca delle Marche and Banche Popolari Unite, (formerly Banca Popolare Commercio e Industria) – provide 86% of our business in a market where bancassurance accounts for 76% of total sales. Aviva is one of the most efficient providers in the Italian bancassurance market, measured by expenses as a proportion of premiums.

In Spain, bancassurance contributes over 96% of our new business sales. Our partnerships already provide access to nine million customers across the country, and we see continued growth potential from our agreements with Bancaja, Unicaja, Caixa Galicia, Caja España and Caja de Granada.

We continue to develop our bancassurance partnerships with DBS in Singapore and Hong Kong. We are also a leader in the growing independent adviser sector, building upon our experience in the UK.

# Long-term savings
continued

Direct sales
Business generated through direct sales forces, by phone and over the internet provides a valuable stream of income in many of the countries in which we operate.

We continue to develop specialist direct sales forces as our main distribution method in Central and Eastern Europe, while looking for viable opportunities to diversify distribution throughout the region.

The customer service team at Aseval, our "factory" company in Spain, produces and administers products for our bancassurance operations, leading to low running costs.

**"We made substantial progress on improving customer service through greater productivity in 2003."**
Gary Withers, chief executive, Norwich Union Life

**Customer service**
We believe that customer service is one of the key areas where we can distinguish our long-term savings offering. We recognise that recently in the UK we have not always done as well in this area as we need to. However we are committed to raising our standards, and our service improved during the year. We are developing solutions tailored to individual customer preferences, making better use of technology to improve our service through banking channels, and are driving best practice across our business by sharing expertise groupwide.

The substantial improvement in our performance in the UK is reflected in Norwich Union's achievement of a three-star rating at the Financial Services Awards in November 2003, compared with a one-star rating the previous year. We were also voted best life product provider in the Life & Pensions Money Facts Awards in March, and earned gold awards for the second consecutive year in the protection, investment and pension provider categories of the *Financial Adviser* IFA & Provider Awards in May. Norwich Union Healthcare was awarded the accolade of best healthcare provider in the UK for the third successive year at the *Money Marketing* Awards 2003.

We achieved similar successes in other businesses. In Ireland, for example, Hibernian earned the most improved company accolade in the Irish Brokers Association Service Excellence Awards. Our customer service was also recognised in Spain and Italy, where we are among the most efficient and lowest-cost providers.

We also took further steps towards ensuring our service is efficient and streamlined. For example, in the Netherlands, Delta Lloyd introduced online pensions administration for its business customers via an internet facility called Pension World, which allows employers to view and make amendments to their own information.

**Performance**
Worldwide long-term savings new business sales* were stable at £14.4 billion *(2002: £14.6 billion)*. This was a good overall performance by the group in difficult but improving market conditions. Life and pension new business sales* were £13.3 billion *(2002: £13.6 billion)*, including a 3% increase in continental European sales to £6.6 billion, mostly driven through bancassurance. Continental Europe new business now accounts for almost half of our total life and pension sales and over half of life achieved operating profit.

Pre-tax life achieved operating profit was £1,555 million *(2002: £1,524 million)*, driven by higher new business margins and higher operational profits from existing business, offset by the impact of anticipated lower levels of investment return on the lower asset values at the beginning of the year. The contribution to profits from new business sales amounted to £621 million *(2002: £578 million)*.

Our French life business launched a successful series of limited-offer products, such as Puissance 2, during 2003.

*From continuing operations, including share of associates' premiums.

# £6.6bn

**UK life new business sales, including investment products.**

## UK

Norwich Union, our largest long-term savings business, produces 45% of our total sales. New business sales including investment products were £6.6 billion *(2002: £7.4 billion)*, having stabilised during 2003. This followed a reduction in market volumes from mid-2002 arising from the effect on customer confidence of prolonged equity market falls. We took early action to lead price increases in a number of product areas as we focused on improving margins.

Investment conditions have improved and consumer confidence is building. We expect a steady recovery in the UK long-term savings market through 2004. We see the market consolidating towards the larger players such as ourselves who have the scale, brand and financial strength to develop new products, improve distribution and provide reassurance to customers as the Government seeks to reform pension provision and stimulate levels of personal saving. We are well placed to benefit from a market upturn.

Norwich Union continues to play a leading role in the debate over pensions reform and product simplification. We await the results of the Government's decision on price capping of Sandler savings products. Product pricing must be based on a realistic charging structure to be economically viable. In the appropriate circumstances, we intend to be a major player in this market.

Total sales through our joint venture with The Royal Bank of Scotland Group were £843 million *(2002: £880 million)*, reduced with-profit bond sales being offset by encouraging sales of collective investments introduced in February 2003. Further development of our products, increased sales force capacity and technology improvements will underpin the growth of this business and enhance cost-efficiencies in 2004.

Pension sales were lower at £2.6 billion *(2002: £2.7 billion)*, reflecting reduced individual pension sales. This was offset by good growth in our target sector of larger group and corporate schemes, with sales up 20% to £829 million. Annuities continued to perform well in a competitive market.

Bond and savings sales were lower at £1.9 billion *(2002: £2.8 billion)*, reflecting the poor investment climate in which market demand for with-profit bonds fell by 77% during 2003. Unit-linked bonds sales increased significantly benefiting from the relaunch of our product range during the second half of 2003, and we expect continued growth in 2004.

Our equity release business, which enables customers to free up capital from their homes, continued its strong growth with sales up 39% to £501 million *(2002: £361 million)*, fuelled by an ageing population, low investment returns and house price inflation. Norwich Union is the UK's largest equity release provider, with a market share of 43%.

UK life achieved operating profit was £659 million *(2002: £699 million)*, reflecting reduced investment returns on lower asset values at the beginning of the year of £104 million, offset by the non-recurrence of a £123 million net charge for strengthening annuity reserves in 2002.

We reduced our cost base, adjusted our product mix and realigned product commissions for IFAs. Operational efficiency measures announced in 2003 included a number of job reductions in the UK. Following a series of feasibility studies in 2003, our intention is to create about 700 call centre and administrative jobs in India during 2004.

We maintained our financial strength in the UK. We led the market in lowering with-profit bonus rates to protect the long-term interests of policyholders and ensure the continued financial stability of our funds.

**"We have made good progress on our distribution partnership with Crédit du Nord which will significantly reinforce our distribution strengths and contribute to our business development from the fourth quarter of 2004."**
Bruno Rostain, chief executive, Aviva France

| **Worldwide new business sales*** £billion | |
|---|---|
| 1999 | 11.2 |
| 2000 | 13.5 |
| 2001 | 15.0 |
| 2002 | 14.6 |
| **2003** | **14.4** |

| **Life achieved operating profit** £million | |
|---|---|
| 1999 | 1,455 |
| 2000 | 1,533 |
| 2001 | 1,665 |
| 2002 | 1,524 |
| **2003** | **1,555** |

# Long-term savings
continued

"We are a strong, dynamic player in the Dutch insurance industry, particularly now that we have a third distribution channel through ABN AMRO Insurance"
Niek Hoek, chairman, Delta Lloyd

"We have created an excellent formula. We have ambitious plans for business development to ensure Aviva remains a permanent fixture as market leader"
Gerardo Arostegui, chief executive, Aviva Spain

## France
Aviva France, our second-largest long-term savings business with some 1.6 million customers, reported total sales of £2.0 billion *(2002: £1.9 billion)*. This reflected underlying growth of 4% after excluding the protection business we sold to Médéric.

Sales of single premium euro products through the AFER savings association increased to £1,157 million *(2002: £983 million)*. In October we signed an agreement reaffirming our role as the insurer of AFER, and are optimistic about the future prospects for this important sales channel.

Sales of unit-linked and other savings products were £779 million *(2002: £699 million)*, despite an overall contraction of 15% in the unit-linked market. A successful series of limited-offer products, featuring a one-year guaranteed return followed by a choice of long-term investment options at the end of the period, were launched during the year, with the last of these sales being made during November 2003.

The Government's proposed reform of pension legislation is the first step in opening up the French pension market. We intend to launch a new pensions product later in 2004 and expect gradual take-up as consumers adapt to longer-term saving commitments.

In difficult market conditions we continued our drive to contain operating expenses while delivering growth in revenues, resulting in an operating profit of £220 million *(2002: £228 million)*.

## Ireland
Hibernian reported total sales of £250 million *(2002: £343 million)*, which reflected continuing difficult market conditions and non-recurring sales in 2002 of the Government's special savings incentive account. Operating profit was £65 million *(2002: £75 million)*.

Irish investors had little appetite for equity-related savings products as a result of poor economic growth and stock market performance. Strong sales of group pensions were offset by lower demand for individual pension products. In line with market experience, sales of the Irish Government's personal retirement savings account from April 2003 were slow.


**Norwich Union Life aims to provide a "one-stop" telephone service for its customers and business partners. Paul Taylor (pictured) is a member of the helpdesk team in Sheffield.**

## Italy
Continued growth through our bancassurance network and one-off direct sales of £187 million *(2002: £126 million)* resulted in total new business sales in Italy up 16% to £1,453 million *(2002: £1,133 million)*. Operating profit was £70 million *(2002: £52 million)*.

Bancassurance sales accounted for £1,245 million *(2002: £964 million)*, or 86% of new business. Pension reforms should create further opportunities for the private sector.

## Spain
New business sales in Spain increased to £1,464 million *(2002: £1,309 million)*, including one-off sales of £149 million *(2002: £177 million)*. This reflected the continued success of our bancassurance partnerships, with sales of £1,407 million *(2002: £1,252 million)* accounting for over 96% of the total.

Our performance also benefited from the previously low level of life and pensions business sold in the market. With low interest rates holding back sales of lower-margin traditional savings products, our emphasis moved to higher-margin protection products in response to growth in the mortgage market. Operating profit was £158 million *(2002: £83 million)*.

Our approach in both Spain and Italy is to have a "factory" company producing and administering products for our bancassurance operations, which leads to scaleable cost advantages. The low running costs we have achieved in both countries underpin the attractive margins from our bancassurance business.

*Including share of associates' premiums.

# £815m

**Continental Europe accounts for over half of the group's life achieved operating profit.**

**"We are delighted by the strong performance of our new operations in South East Asia. Our controlled growth strategy is working well"**
Charles Anderson, managing director, Aviva Asia Financial Services

## Netherlands, Belgium, Luxembourg and Germany

Delta Lloyd achieved a 15% increase in total sales to £1,356 million *(2002: £1,069 million)*. This performance was boosted by a contribution of £227 million from our new bancassurance partnership in the Netherlands with ABN AMRO, which under the terms of the agreement includes sales from 1 January 2003.

Intermediary and direct sales were stable, reflecting tough conditions in the Dutch life market. Significantly higher sales in Belgium saw us enter the top 10 in the life market. Sales in Germany were £163 million *(2002: £154 million)*, reflecting difficult economic conditions which meant we were one of the first companies to reduce our profit share ratio to guarantee long-term profitability.

The continued integration of ABN AMRO insurance business into our distribution model has resulted in additional opportunities to reduce our cost base through the planned use of a shared back office for all our operations. Operating profit was £199 million *(2002: £203 million)*.

## Other European and international operations

Total new business sales from our other European operations amounted to £239 million *(2002: £225 million)*, reflecting continued testing economic conditions in Central and Eastern Europe.

Our operation in Turkey continues to progress positively, and we launched a personal pensions business in the fourth quarter. In Lithuania, where we have achieved a market share of almost 30% for new life policies within two years of starting the business, early sales of pensions were also very encouraging. Owing to the prevailing economic conditions in Poland, sales of individual life products remained challenging, although our new mutual fund business performed strongly, resulting in total sales of £174 million *(2002: £92 million)*.

Life and pensions sales in our International businesses were £853 million *(2002: £952 million)*. As fixed annuity sales slowed in the second half of the year, our business in the United States reported sales of £538 million *(2002: £587 million)*. In Australia, life and pension sales were £230 million *(2002: £239 million)*. Sales of unit trusts were £98 million *(2002: £267 million)* from our Australian business.

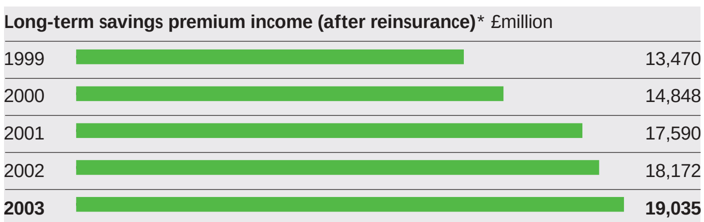
Sales in Singapore and Hong Kong through our bancassurance partnership with DBS were £63 million *(2002: £121 million)* as we focused on higher-margin regular premium savings business.

Our joint venture life operations in India and China both made good progress in their first full year of operation. In India we began selling pension products and introduced a new, affordable life insurance product for people on lower incomes in rural areas. Total sales from our joint venture were £9 million. Our new joint venture in China produced total sales of £3 million.

## Outlook

We are building a successful, cost-effective long-term savings business that we believe will continue to prosper in an uncertain financial climate. There are excellent opportunities to develop our strong market positions in the UK, other European and emerging markets. We will continue to achieve profitable growth by providing a range of high-quality, value-for-money products and services through a choice of distribution channels, supported by high standards of customer service.

Our marketing and propositions team in Singapore see significant growth opportunities in the long-term savings market, where we continue to develop our bancassurance partnership with DBS and are a leader in the growing independent adviser sector.



# Fund management

Aviva's in-house fund management expertise is crucial to our business. Our **aim** is to generate superior investment performance on behalf of our shareholders, policyholders and institutional clients.

**£1,141m**
Total retail investment sales.

**£5.3bn**
New funded external mandates secured by Morley Fund Management.

**Worldwide assets under management** £billion

| Year | £billion |
|---|---|
| 1999 | 208* |
| 2000 | 220 |
| 2001 | 209 |
| 2002 | 208 |
| **2003** | **240** |

*Has not been restated for the effect of Financial Reporting Standard 19 'Deferred Tax'.

# Fund management

**Business strategy**
Aviva's in-house fund management business aims to generate superior investment performance for shareholders, policyholders and institutional clients. Our operations in the UK, France and the Netherlands support our long-term savings businesses by investing funds on their behalf. We are developing our presence as a leading international fund manager through application of our investment and research expertise.

**Market position**
Following continued volatility in the first half of 2003, global equity markets demonstrated greater stability during the second half of the year, with share prices becoming less volatile and growing signs of investor confidence as most markets finished the year higher than they started for the first time since 1999. Prospects for 2004 remain cautiously optimistic.

We are the second-largest UK-based fund manager, among the top five in Ireland through Hibernian, the Netherlands, and a top-five master trust in Australia through Navigator. We also have a significant fund management business in France.

**"As markets recover, our focus will be on the core investment classes where we have superior expertise"**
Philip Twyman, group executive director, Aviva fund management

**Performance**
Total retail investment sales rose 6% to £1,141 million *(2002: £1,028 million)*, with increases in the UK, Netherlands and Poland.

Worldwide assets under management increased to £240 billion *(2002: £208 billion)*, reflecting the benefit of new business flows and improved investment markets. Operating profit rose to £10 million *(2002: £5 million)*, reflecting the partial recovery across global equity markets during 2003.

Morley Fund Management
Morley Fund Management is a leading UK-based institutional fund manager, with staff in London, Dublin, Boston, Melbourne, Singapore, Tokyo and Warsaw, and a presence in Milan and Madrid.

Morley primarily provides fund management expertise for Aviva companies and leverages this capacity through its own distribution channels in the UK and Europe. During 2003 we achieved greater efficiencies within the business through increased centralisation of our international equity fund management expertise. This included the integration of Portfolio Partners in Australia, and the move to London of our Asian equity fund management operations from Singapore and the international equity fund management operation from Dublin.

We are developing our leading position in the UK fixed income market, and our European equities team continues to deliver strong performance. We invested more than £13 billion in UK property, and have developed a number of market-leading partnership arrangements that offer investors access to specialist property sectors.

**Once again, Aviva Gestion d'Actifs received leading industry awards for investment performance in France, including Corbeille de *Mieux Vivre Votre Argent* and the Victoire des Sicav from *La Tribune*/Standard & Poors.**

Morley also has one of the world's largest and most experienced teams of socially responsible investment fund managers and researchers. In addition, we recognise our responsibility as a major shareholder in the UK stock market and continue our commitment to take an active interest in the companies in which we invest, to protect the rights of shareholders.

Morley's achievements have been recognised in the investment market, and we received a number of awards and nominations during the year. For example, Standard & Poor's placed us first in two sectors over five years for the Norwich European Equity Fund, and we won the title of best property fund manager at the Pensions Management Provider Awards.

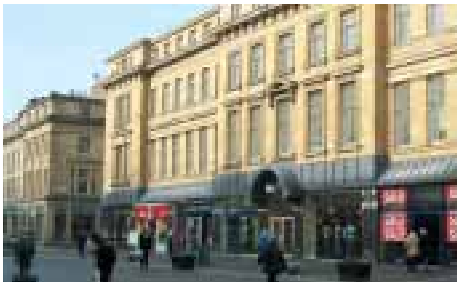
New products launched in 2003 included a European property fund and a high-income property unit trust, both reflecting the demand for property-related investment vehicles, and two hedge funds.

We are setting up a ground-breaking investment administration service with JPMorgan Investor Services (JPM IS). The new service will combine Morley's operational experience and administration platform with JPMorgan's administration infrastructure to form a new business service provided by JPM IS. This agreement allows us to focus on our core capabilities – the manufacture and distribution of investment products to our target European markets – while JPM IS will concentrate on administration.

Morley secured £3.9 billion of new funded external mandates *(2002: £3.7 billion)* from its combined institutional and retail UK-based businesses. In addition, it secured £0.7 billion of new funded external mandates for its property partnership vehicles, £0.5 billion from overseas operations and £0.2 billion in respect of pooled pension business.

Morley's operating profit of £3 million *(2002: £4 million)* for its combined institutional and retail UK-based businesses was a good result in uncertain markets and reflects active management of the underlying cost base. Within the group results are profits of £6 million relating to other Morley businesses including our pooled pension business and overseas operations. Assets under management for the global operations rose to £121 billion.

**"Our new, pioneering investment administration service with JPMorgan Investor Services will allow us to focus on our core capabilities – the manufacture and distribution of investment products to our target European markets"**
Keith Jones, chief executive,
Morley Fund Management



**This prestigious high street retail property, 139-153 Grainger Street, Newcastle, was purchased by the Morley Pooled Pensions Fund in September 2003.**

# +56%

**Sales of investment fund products in the Netherlands were up 56% at £204 million *(2002: £119 million)*.**

## Other UK
In addition to mutual fund sales under the Morley brand, we sell retail Isas, unit trusts, open-ended investment companies (Oeics) and structured products under the Norwich Union and Royal Bank of Scotland Group (RBSG) brands.

Sales through Norwich Union were £577 million *(2002: £556 million)*. The operating loss of £3 million *(2002: loss of £16 million)* benefited from changes to commission charges.

Our new collective investment joint venture with RBSG produced sales of £103 million. Operating loss was £6 million *(2002: nil)*, predominantly arising from £7 million of development costs.

## France
Aviva Gestion d'Actifs has an enviable reputation for strong investment performance, with over 70% of our funds in the top quartile for returns over three years.

Our excellent investment performance was once again widely recognised in the financial press. Awards won in 2003 included best asset manager over five years from monthly financial magazine *Mieux Vivre Votre Argent*, and best performance over three years among asset managers with a large range of funds from *La Tribune*/Standard & Poor's. For the second successive year, we received the gold Lauriers award from *Investir Magazine* for our unit trust performance over five years.

We have £36 billion of assets under management, most of which are invested on behalf of our own operations, and recorded an operating profit of £13 million *(2002: £11 million)*.

## Netherlands and Belgium
Delta Lloyd is among the leading fund managers in the Netherlands. Continued strong demand for investment products, healthy fund performances and third-party distribution arrangements contributed to increased assets under management of £34 billion *(2002: £27 billion)*. Total investment sales increased 56% to £204 million *(2002: £119 million)*.

## Navigator
Navigator is a top-five master trust and one of Australia's largest investment portfolio administration services, with £3.5 billion of funds under administration. New sales in 2003 of £617 million *(2002: £797 million)* reflected investor sentiment in equity markets, although sales showed some improvement in the second half of the year. Sales from our Navigator business in Singapore were £8 million *(2002: nil)*. In November, Navigator added a number of new funds to enhance the range of investment choices available to financial advisers and their clients.

## Outlook
We will build on the good progress made in 2003 by continuing to improve our investment performance and increasing our sales revenue as markets slowly recover. Our focus will be on those core investment classes where we have superior expertise and which satisfy the needs of our customers and partners.

# General insurance

We take a **focused** approach to general insurance, with disciplined underwriting, efficient claims handling and rigorous control of costs. These strengths enable us to deliver good-quality earnings and give us a solid platform to provide high-quality service, increase access to our customers and broaden our range of propositions.

**1.6m**

**In 2003 we helped 1.6 million UK customers get their lives back to normal following an incident.**

**100%**

**An excellent combined operating ratio from continuing operations, improved for the third consecutive year.**

# General insurance

## Business strategy
Rigorous cost control, disciplined underwriting and excellent customer service are at the core of our general insurance business. We aim to deliver high-quality earnings from our market-leading positions in personal insurance and selected commercial lines.

Our sustained profitability gives us a solid platform from which to deliver high-quality service, strengthen our relationships with our customers and broaden our range of propositions. Our range of distribution channels and balanced portfolio of products and services enable us to react flexibly to changing market conditions and to meet customer needs. By investing for the future, we ensure that we can deliver innovative solutions to our customers and sustain our excellent performance.

## Market position
Aviva is the leading general insurer in the UK, where Norwich Union has a 14% market share, and in Ireland, where Hibernian has a 22% share of the market.

We are the second-largest insurer in Canada, with a 9% market share, and are among the top five in the Netherlands and Singapore. We have a significant business in France, serving 1.2 million customers. We also have an extensive insurance network in Asia, where we operate across seven countries in addition to Singapore.

Our philosophy demands that we achieve market-leading positions and superior returns. As a result, we closed or disposed of small-scale operations in Portugal, Greece, Malta, Switzerland and Belgium during 2003.

## Multi-distribution capability
Part of our strength lies in our balanced distribution approach, enabling customers to conduct business with us through a choice of methods to suit their needs.

In the UK we have strong positions across the broker, corporate partner and retail direct channels. Among developments in 2003 was our new three-year partnership with ASDA to provide personal motor, home and travel insurance products to the supermarket chain's 11 million customers. We have also announced the closure of our national broker subsidiary, Hill House Hammond (HHH), by the end of 2004, and the sale of its commercial business. Personal lines customers will be invited to transfer to Norwich Union Direct. We remain committed to the broker channel, which accounts for 59% of our sales, but this move will allow us to respond to the increasing preference of our personal lines customers to deal with us directly.

In France we operate through Aviva Assurances, which sells through a network of 910 tied agencies, and Eurofil, the second-largest direct insurance business in the French market. Our partnership with Crédit du Nord, through which we have been selling car and household insurance since September 2002, has proved a growing source of business for Eurofil.

**"We have demonstrated our ability to deliver consistent earnings in a rapidly changing market"**
Patrick Snowball, group executive director, Aviva general insurance

Wildfires in British Columbia, Canada, resulted in thousands of people being evacuated from their homes in August. Aviva claims staff were mobilised to offer on-the-spot help. Marketing representative Scott Preston described the scene – including helicopters, air tankers and hundreds of firefighters – as "mind-numbing and surreal".

**£911m**

**Excellent general insurance operating profit from continuing operations *(2002: £881 million).***

We also have an integrated approach in the Netherlands, with intermediary business sold through Delta Lloyd and direct business through OHRA augmented by sales through our new bancassurance relationship with ABN AMRO. To support intermediaries and direct customers, Delta Lloyd specialists from general insurance work in a new shared service centre. In addition, intermediaries have access to administrative processes via our Meeting Point website, which saw the number of connections tripled and the number of online sales doubled.

While the Irish market remains dominated by traditional brokers, Hibernian is expanding its direct capability and recorded a 20% increase in direct policies in force since the prior year.

Aviva Canada, which sells a broad range of traditional products through a network of independent brokers, launched its first corporate partner relationship with Loblaws, Canada's largest supermarket chain, under the highly regarded President's Choice brand.

In Asia we augmented our traditional broker distribution network with a bancassurance partnership to market our products to HSBC customers in Malaysia.

| **General insurance net written premiums from continuing operations** £million | |
|---|---|
| 1999 | 7,699 |
| 2000 | 8,356 |
| 2001 | 7,850 |
| 2002 | 7,805 |
| **2003** | **8,524** |

**"The premium discount we have introduced for drivers with penalty points-free licences is part of our effort to change and improve behaviour on our roads"**
Bryan Jenkins, chief executive, Hibernian

Our "Quote Me Happy" advertising campaign in the UK underlined our ability to provide competitively priced products, reflecting our values of integrity and progressiveness.

## Customer offering

Customer satisfaction is key to our strategy. We continue to deliver high-quality service, fair prices and innovative solutions.

Our success is evident from the result of independent benchmarking in the UK, which places us in industry-leading positions in most areas of service delivery. In 2003 we helped 1.6 million UK customers get their lives back to normal following an incident. Norwich Union Insurance was named UK general insurer of the year at the *Insurance Times* Awards in December, and collected the service provider of the year and insurance provider of the year titles at the *Insurance Age* Awards in November.

Key to our strategy is increasing the range of services that we offer beyond insurance, and providing solutions that are increasingly tailored to individual customer requirements. We continue to invest in the development of innovative solutions such as digital flood mapping and Pay As You Drive™, both of which will enable us to understand underwriting risks better and tailor prices more closely to individual circumstances. Pay As You Drive™ is currently in its trial phase, with this new approach to motor insurance being piloted with a limited number of customers prior to wider marketing. In conjunction with Norwich Union Insurance, Hibernian plans to pilot Pay As You Drive™ technology in Ireland in 2004.

Our ability to provide customers with the solutions they need is further demonstrated in the UK by the rapid growth of Norwich Union Rescue, our vehicle breakdown service, and the successful launch of Physiofast, our add-on to motor policies offering fast-track physical recovery treatment. Our size enables us to pass on many benefits arising from economies of scale directly to our customers. For example, we offer car purchasing and leasing through yournucar.com and the opportunity to buy electrical goods via norwichunion.com

In France, Aviva Assurances continued to build on its competitive advantages of quality of service and proximity to the customer. We continue to make good use of internet technology, with broadband connections having been set up at each agency and a dedicated portal made available to give agents swift and easy online access.

Our standards of customer service were put to the test in Canada when we responded to the fires in British Columbia in August. We were the first insurer to have staff on the scene, and introduced temporary mobile claims offices to provide an on-the-spot service. Our Canadian staff also made great efforts to maintain normal service following a massive power cut earlier in the same month.

# General insurance
continued

## Performance
Market conditions continued to be competitive during 2003. Our focused approach to disciplined underwriting, pricing, efficient claims handling and rigorous cost control has enabled us to benefit from our size and strength in our chosen markets. We delivered a first-class operational performance for the third consecutive year as a favourable rating environment persisted in commercial lines while personal lines continued to be competitive.

Our success was reflected in an excellent combined operating ratio (COR)* of 100% *(2002: 102%)*, underpinned by strong performances in the UK and Ireland. COR, which broadly expresses the total of claims costs, commission and expenses as a percentage of premiums, is one of our key performance measures. An excellent operating profit* of £911 million *(2002: £881 million)* was helped by better-than-expected weather conditions, offset by anticipated lower longer-term investment returns. Worldwide net premiums written* were £8.5 billion *(2002: £7.8 billion)*.


Our ability to provide customers with solutions beyond insurance is demonstrated by the rapid growth of Norwich Union Rescue, our UK vehicle breakdown service.

We continue to improve efficiency and invest in product development initiatives to maintain our market-leading positions and sustain our operational performance in the future.

Our call and claims processing centre in India became operational during the year. This will deliver cost and service benefits to our UK business, while the expertise gained is being shared across the group. For example, Aviva Canada aims to use the Indian claims processing centre to support expected growth from its new corporate partnership with Loblaws. We expect to create about 1,800 jobs in India in 2004 to service our general insurance operations.

We have made announcements regarding job reductions in the UK during the year, some of which arose from an internal operational efficiency review. As a result of the closure of HHH, a further 1,600 jobs will be lost in 2004, though some 400 staff will be redeployed in our UK operations. In addition, we will create over 450 new jobs in the UK to help handle the personal business transferred from HHH.

### UK
Norwich Union Insurance in the UK produces 60% of Aviva's general insurance business sales. Our market-leading position is based upon a proven business model designed to achieve consistent and sustainable performance. Our results are underpinned by a commitment to deliver customer satisfaction, combined with profitable growth, in an increasingly competitive market.

Our strategy has delivered an excellent COR of 99% *(2002: 101%)* and we are confident that we can deliver a target COR of 100% over each of the next three years. Our operating profit of £676 million *(2002: £611 million)* was achieved from net premiums written of £5.1 billion *(2002: £4.7 billion)*.

**97%**

**Hibernian, our market-leading general insurance operation in Ireland, reported a COR of 97% *(2002: 100%)*.**

The personal lines market remains competitive, with net premiums written of £2,987 million *(2002: £2,811 million)*. However, we continue to increase our rates, and our focused approach to pricing and cost control means that our business remains profitable. Commercial lines performance was excellent, with net premiums written of £2,148 million *(2002: £1,929 million)*. We have led the commercial market in achieving sustained rating increases and volume growth in our target markets. We are committed to achieving profitable growth in both personal and commercial lines.

### France
Aviva France achieved an operating profit of £35 million *(2002: £47 million)*, despite the floods in December and lower longer-term investment returns. Net premiums written were up at £515 million *(2002: £478 million)*.

We also achieved a COR of 102%, reflecting our focus on personal and small commercial business, where we have a strong presence in the motor, household and health markets.

The increased use of approved repair networks has helped us to keep costs down while ensuring a high standard of service and a quicker claims handling process for our customers. Our shared telephone-based claims platform, used not only by Eurofil but also by some Aviva Assurances agents, handled motor cases for the first time in 2003, in addition to household claims.

*From continuing operations.

## Ireland

Net premiums written of £611 million *(2002: £377 million)* and an excellent operating profit of £91 million *(2002: £44 million)* reflected the impact of significant rating increases, markedly lower motor claims and better-than-expected weather-related claims for Hibernian, which provides cover for motor, household and small commercial business.

Against a backdrop of the Irish Government's commitment to reduce insurance costs, in November we introduced a 10% premium discount for motorists with no penalty points on their driving licences. We also offer reduced premiums to those who complete our Ignition driver training programme. In addition we are using technology to help contain costs. Hibernian's e-Claims project has implemented automated claims processing for all our business in Ireland.

## Netherlands

In the Netherlands, Delta Lloyd achieved an operating profit of £35 million *(2002: £13 million)* on net premiums written of £563 million *(2002: £412 million)*. Our COR was 101% *(2002: 105%)*.

We introduced several health insurance schemes to help employers reduce staff absences. Sales of a new car insurance product with an innovative pricing structure were successful. A new buildings and contents product was also launched, with distinctive features including competitive premiums, simplified terms and a guarantee against under-insurance. We met our targets for improvements to margins and operational cost-effectiveness, which provides us with a sound base for future profitability.

**General insurance operating profit before tax from continuing operations**
£million

| | |
|---|---|
| 1999 | 444 |
| 2000 | 330 |
| 2001 | 876 |
| 2002 | 881 |
| **2003** | **911** |

## Canada

In Canada, the group's second-largest general insurance operation, our COR was 108% *(2002: 102%)* and operating profit was £12 million *(2002: £80 million)* after strengthening prior year reserves by £70 million in Pilot, one of our subsidiaries. We have increased our rates to align them more closely with our claims experience.

Concern over motor insurance costs is a major issue in Canada and has resulted in a challenging regulatory environment, with several provinces introducing rate reductions or freezes. In response, we have lobbied local government to impose limits on court awards for bodily injury claims, so that we can continue to operate profitably in these markets.

Our Canadian claims operation uses total incident management systems devised by Norwich Union in the UK to streamline processes, reduce costs by using preferred supplier networks, and improve customer service.

## Outlook

We have demonstrated our ability to deliver consistent earnings in a rapidly changing market. We have consistently kept our performance promises, including significant savings following the group merger in 2000 and a COR maintained at under 102%. Our new group combined operating ratio target is 100% for each of the next three years.

Through our clear strategy we are creating opportunities to broaden our earnings stream, both in our core insurance offering and through wider propositions. Our scale and trusted brand can be used, wherever we operate, to deliver sustained competitive advantage and long-term growth.

**"There is no question our new agreement with Loblaws represents an excellent growth opportunity for Aviva. This is just the beginning"**
Igal Mayer, president and chief executive officer, Aviva Canada


Our Ignition driver training programme in Ireland, which offers reduced premiums to inexperienced drivers, won an international road safety award in 2003.

# Corporate social responsibility

**Aviva continues to develop its corporate social responsibility (CSR) programme with vigour. These activities now cover some 98% of staff worldwide and reflect our responsibilities as an insurer, employer, investor and consumer.**

CSR focuses on managing performance in respect of the environment, community, employees, health and safety, human rights, standards of business conduct, suppliers and customers.

**Environment**
Our environment programme continues to build on the foundations laid in 1998. We measure, monitor and seek to improve performance in all the areas where we have a significant impact on the environment.

For example, 86% of the electricity we use in the UK comes from renewable sources. Our businesses in the UK, France, Ireland, Canada and the Netherlands include environmental performance questions in their supplier tendering process.

**Community investment**
We are committed to supporting community activities and charitable causes worldwide. In 2003 we donated some £4.6 million to various initiatives, according to Business in the Community's PerCent standard, which in addition to cash recognises gifts in kind, employee time and management costs.

Besides making financial donations, Aviva encourages staff volunteering to support charities. In 2003, Aviva Australia and Morley Fund Management launched staff volunteering schemes allowing employees to take paid leave to participate in company-sponsored volunteering programmes. Commercial Union Polska has also set up a staff community volunteering scheme, which the company supports by matching volunteers with organisations and providing training. Payroll giving and matched funding provide other opportunities for staff to support charitable causes.

In the UK, Norwich Union continues to invest in UK Athletics' grassroots development programmes, which enable children of all ages to experience athletics and help tackle the growing problem of obesity among the young. Further, Norwich Union has entered a five-year partnership with NCH, the children's charity, which also offers volunteering opportunities to staff.

**"Our CSR programme continues to become more firmly embedded in our business and to deliver clear benefits"**
Anthony Sampson, director of corporate social responsibility

**£4.6m**
**In 2003 we donated some £4.6 million to various community initiatives.**

**1st**
**Innovest placed Aviva first for CSR performance among the world's leading insurers for the second consecutive year.**

**Employees**
We believe that our employees are a source of competitive advantage, and we encourage and support them in the workplace and in their personal careers. Our group development programmes continue to encourage and develop talented staff for future roles, and help to bring the company together by building mutual understanding and international networks.

We are also keenly aware of our responsibilities as an equal opportunity employer. Our commitment was recognised in October 2003 when Aviva was ranked eighth for reporting on disability in the workplace in the Employers' Forum on Disability global inclusion benchmark.

Change is continually with us in the modern business environment. The way in which we manage all our business change initiatives is guided by the Gyllenhammar framework on managing change. We manage structural change through detailed planning, the early involvement of those affected and, where job losses are unavoidable, by looking for alternative employment opportunities to minimise the personal and social impact.

In connection with the movement of some operational activities to India, we have taken great care to look after the career interests of the UK staff involved. We have taken account of opportunities for local redeployment or relocation across our UK businesses, and have offered support for re-skilling and life-long learning. In India, we have also been rigorous in our selection of partners with reputations as good corporate citizens. We work only with those who have transparent policies on recruitment, progression and procurement, and who have a demonstrable track record in gender equality and a total absence of religious discrimination.

**Managing customer relations**
Our businesses are committed to providing our customers with a service hallmarked by integrity, quality and care. In Ireland, Hibernian's pioneering products such as Ignition (for inexperienced drivers) and RiskASyst (for commercial customers) are both examples of how our businesses innovate to meet customer needs. In the UK, Norwich Union Insurance's ground-breaking digital flood mapping helps to link premiums more accurately to individual risk.

**External assessment**
Aviva's CSR programme continues to be ranked favourably by specialist research agencies and investment houses.

For the second consecutive year, Innovest has placed Aviva first for CSR performance among the world's leading insurers. We are still the only UK insurer included in both the Dow Jones Sustainability World and STOXX indices. Aviva is also a member of the FTSE4Good index series.

**Our partnership with children's charity NCH in the UK provides opportunities for staff teambuilding while making a difference to the community, including this garden makeover at King's Lynn, Norfolk.**

**Working with others**
Aviva is keen to work with others to develop further understanding of CSR. We continue to chair the Forge group of banks and insurers in the UK, which is developing guidance on practices and behaviours that enhance public trust and the development of key CSR performance indicators for the financial services sector.

We have also been instrumental in setting up a UK forum for UN Global Compact signatories, of which Aviva is one, to develop understanding and practice in embedding the nine principles of the Compact covering human rights, labour and the environment.

**Further details**
A copy of the printed summary CSR report is available from the group company secretary. The full annual CSR report is available on the group website at www.aviva.com/csr

**"We are delighted to be working with one of the UK's leading children's charities, NCH, to help us support, educate and build confidence in the UK's most vulnerable young people"**
David Czerwinski, head of sponsorship, community and event management

**Aviva is included in the DJSI World and STOXX indices and is also a member of the FTSE4Good index series.**

**Key financial objectives**

| | Target | 2003 | 2002* | 2001* |
|---|---|---|---|---|
| Return on Capital Employed (ROCE)1 | 10% + inflation | **12.7%** | 9.7% | 11.1% |
| COR2 | 102% | **100%** | 102% | 103% |
| Proposed ordinary dividend per share | increase by around 5% pa | **24.15p** | 23p | 38p |
| Dividend cover3 | 1.5-2.0x | **1.82x** | 1.51x | 1.07x |

*From continuing operations excluding the results of our Australia and New Zealand general insurance operations which were disposed of in December 2002.

1. Calculated using after-tax returns and opening equity capital, based on operating profit, including life achieved profit, before amortisation of goodwill and exceptional items.

2. Combined Operating Ratio (COR) expresses the extent to which expenses and claims cover insurance premiums. It is the sum of expenses, including commissions, expressed as a percentage of net written premiums, and claims as a percentage of net earned premiums.

3. Measured on operating earnings after tax, on a modified statutory solvency basis, expressed as a multiple of the ordinary dividend for the year.

**Operating profit (figure 1)**

| | Achieved basis | | MSSB basis | |
|---|---|---|---|---|
| | 2003 | 2002 | 2003 | 2002 |
| Year ended 31 December | £m | £m | £m | £m |
| **Pre-tax operating profit, before amortisation of goodwill and exceptional items** | | | | |
| – Life achieved profit | **1,555** | 1,524 | **–** | – |
| – Life modified statutory solvency profit | **–** | – | **1,138** | 1,022 |
| Health | **61** | 61 | **61** | 61 |
| Fund management | **10** | 5 | **10** | 5 |
| General insurance | **911** | 881 | **911** | 881 |
| Non-insurance operations* | **(64)** | (99) | **(64)** | (99) |
| Corporate costs | **(160)** | (218) | **(160)** | (218) |
| Unallocated interest charges | **(406)** | (434) | **(406)** | (434) |
| **Continuing operations** | **1,907** | 1,720 | **1,490** | 1,218 |
| Taxation on operating profit, minorities and preference dividends | **(709)** | (631) | **(499)** | (434) |
| **Operating profit**** | | | | |
| **– including life achieved operating profit** | **1,198** | 1,089 | **–** | – |
| **– including modified statutory solvency profit** | **–** | – | **991** | 784 |
| **Operating earnings per share***** | | | | |
| **– achieved profit basis** | **53.2p** | 48.3p | **–** | – |
| **– modified statutory solvency basis** | **–** | – | **44.0p** | 34.8p |
| **Proposed ordinary dividend per share** | **24.15p** | 23.0p | **24.15p** | 23.0p |

*The wealth management result has been included within non-insurance result in all periods.

**Operating profit before amortisation of goodwill and exceptional items after tax, attributable to equity shareholders in respect of continuing operations. The modified statutory solvency operating earnings is also stated before the amortisation of acquired additional value of in-force long-term business.

***From continuing operations.

# Financial review

## Introduction

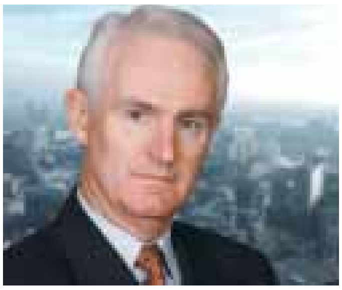
Business news in 2003 was dominated by concerns about the reliability of company accounts, controls and risk management systems, and corporate governance. In my comments below I will show that Aviva operates under strong corporate governance principles which are supported by strict management disciplines. I will also highlight our more important financial measures of performance.

## Developments in the year

Our major focus in the year has been on reducing costs and improving operational efficiency. The benefit to the profit and loss account for the year from cost savings was £65 million.

In addition we enhanced our capital position through our highly successful £1.6 billion subordinated debt issue in September. This issue was significantly oversubscribed due to high demand from investors.

**Philip Twyman**
Group Executive Director



The UK insurance industry is entering a period of unprecedented change, with further developments in regulatory, solvency capital and corporate governance requirements. This is in addition to the requirement to report under International Financial Reporting Standards ("IFRS") for financial years starting 1 January 2005 onwards.

We welcome many of these changes as we believe they will enhance corporate accountability, improve transparency and increase the prospects for stable financial markets, albeit at a significant cost. Aviva is well-advanced in its preparations for these new requirements, with strong corporate governance principles already being integral parts of the group's operating model.

In anticipation of these changes we have invested £60 million into our global finance transformation programme during the year. The group will continue to make a significant investment in this programme over the next two years to 2005 to improve the quality and effectiveness of our global finance systems and processes.

## Performance management

Key financial objectives

The group strategy is underpinned by the following key financial objectives:

- Prudent and reliable financial management systems;
- Delivering an after-tax operating profit, including life achieved profit, equivalent to a 10% net real return on opening equity capital;
- Maintaining a dividend cover between 1.5 and 2.0 times based on statutory after tax operating profits; and
- Achieving a combined operating ratio (COR), on general insurance business, of 102% across the underwriting cycle.

## Basis of preparation

The accounts have been prepared on the modified statutory basis, with supplementary information using the achieved profit basis. The main difference between the two methods is that the achieved profit basis measures the economic profit on insurance contracts at the point of sale, whereas the modified statutory basis measures profits that can be distributed to shareholders.

The modified statutory solvency basis of reporting is required by statute. The statutory operating profit excludes amortisation of goodwill, amortisation of acquired additional value of in-force long-term business and exceptional items.

In November 2003, the Association of British Insurers ("ABI") issued a revised version of its Statement of Recommended Practice ("SORP") on accounting for insurance business. This takes effect for accounting periods beginning on or after 1 January 2004. The directors have chosen to adopt the SORP early, from 1 January 2003. Its main effect is to exclude internally-generated additional value of in-force long-term business ("AVIF") from the modified statutory basis balance sheet.

The group continues to report supplementary information using profits measured on an achieved profit basis as the directors believe this more closely reflects the performance of a long-term savings business than that measured on a modified statutory basis. Accordingly, these financial accounts include supplementary information on achieved profit reporting on pages 102 to 110 and the group's incentive schemes and internal management reporting are aligned to that basis.

The directors and many of our investors continue to believe that shareholders' funds incorporating internally-generated AVIF present a more realistic view of assets. We have therefore included an achieved profit basis summarised consolidated balance sheet within the supplementary information section of these accounts. This combines the modified statutory basis net assets with the internally-generated AVIF.

All growth rates in the financial review are quoted at constant rates of exchange.

**Accounting policies**
Other than the change in balance sheet reporting arising from adopting the ABI SORP early, there have been no significant changes in accounting policies required for the preparation of the 2003 accounts.

### Life achieved operating profit
(see figure 1)
The group's operating profit before tax from continuing operations, including life achieved profit, was up 6% to £1,907 million *(2002: £1,720 million)*.

This profit corresponds to an improvement in the normalised post-tax return from continuing operations on opening equity capital to 12.7% *(2002: 9.7%)*. This continues the steady increase in total return on equity capital achieved over the last four years.

**Profit/(loss) attributable to equity shareholders (figure 2)**

| | Achieved basis | | MSSB basis | |
|---|---|---|---|---|
| | 2003 | 2002 | 2003 | 2002 |
| Year ended 31 December | £m | £m | £m | £m |
| **Profit/(loss) for the financial year attributable to equity shareholders** | | | | |
| Pre-tax operating profit*, including life achieved operating profit | **1,907** | 1,720 | **–** | – |
| Pre-tax operating profit*, including modified statutory life operating profit | **–** | – | **1,490** | 1,218 |
| Discontinued operations – Australia and New Zealand general insurance | **–** | 78 | **–** | 78 |
| | **1,907** | 1,798 | **1,490** | 1,296 |
| Amortisation of goodwill | **(103)** | (135) | **(103)** | (135) |
| Amortisation of acquired additional value of in-force long-term business | **–** | – | **(135)** | (139) |
| **Operating profit before tax** | **1,804** | 1,663 | **1,252** | 1,022 |
| Short-term fluctuation in investment return | **–** | – | **212** | (1,243) |
| Variation from longer-term investment return | **766** | (3,504) | **–** | – |
| Effect of economic assumption changes | **11** | (561) | **–** | – |
| Change in the equalisation provision | **(49)** | (57) | **(49)** | (57) |
| Net loss on the disposal of subsidiary undertakings | **(6)** | (4) | **(6)** | (4) |
| Exceptional costs for termination of operations | **(19)** | – | **(19)** | – |
| **Profit/(loss) on ordinary activities before tax** | **2,507** | (2,463) | **1,390** | (282) |
| Tax | **(753)** | 451 | **(367)** | (206) |
| **Profit/(loss) on ordinary activities after tax** | **1,754** | (2,012) | **1,023** | (488) |
| Minority interests and preference dividends | **(129)** | (50) | **(91)** | (63) |
| **Profit/(loss) for the financial year attributable to equity shareholders** | **1,625** | (2,062) | **932** | (551) |
| Ordinary dividends | **(545)** | (519) | **(545)** | (519) |
| **Retained profit/(loss)** | **1,080** | (2,581) | **387** | (1,070) |
| **Earnings per share attributable to equity shareholders** | | | | |
| **– achieved profit basis** | **72.2p** | (91.5)p | **–** | – |
| **– modified statutory solvency basis** | **–** | – | **41.4p** | (24.4)p |

*Pre-tax operating profit before amortisation of goodwill and exceptional items, in respect of continuing operations. The modified statutory solvency operating earnings is also stated before the amortisation of acquired additional value of in-force long-term business.

Our operating profit has increased as a result of a very strong performance from our life and general insurance operations notwithstanding the lower contribution to operating profit from investment returns. Investment returns in 2003 were lower than 2002 by £188 million in respect of our life, general insurance and health businesses, as a result of lower asset values at the start of the year.

### Modified statutory operating profit
(see figure 1)
On a modified statutory basis operating profit before tax from continuing operations showed a 17% improvement to £1,490 million *(2002: £1,218 million)*.

The improvement in modified statutory operating profit benefited from higher life profits driven primarily by strong results from our European businesses, particularly France, Spain and Poland and the excellent general insurance underwriting performance.

### Profit and loss account – achieved profit basis (see figure 2)
The strong operational performance and positive long-term investment return variances of £766 million *(2002: negative variance of £3,504 million)* and the impact of economic assumption changes of £11 million *(2002: loss of £561 million)* resulted in a profit on ordinary activities before tax of £2,507 million *(2002: £2,463 million loss)*. This reflected the impact of the partial recovery across global equity markets on the group's life embedded value.

The tax for the year included a charge of £561 million *(2002: £531 million)* in respect of the operating profit from continuing operations. The effective rate of tax on life achieved operating profit was lower at 29.4% *(2002: 30.9%)*.

Profit for the year attributable to equity shareholders improved significantly to £1,625 million *(2002: £2,062 million loss)*. Earnings per share attributable to equity shareholders reflected this improvement and was higher at 72.2 pence *(2002: loss per share 91.5 pence)*.

The retained profit for the year after ordinary dividends was £1,080 million *(2002: £2,581 million loss)*.

### Profit and loss account – modified statutory basis (see figure 2)
The group reported a profit on ordinary activities before tax on a modified statutory basis of £1,390 million *(2002: £282 million loss)*. The improvement arose primarily as a result of the surplus of £83 million *(2002: £1,184 million shortfall)* in the actual investment return compared to the group's longer-term assumptions. This arises from the

# Financial review
continued

unrealised gains on equities held by the group's non-life operations and reflects the partial recovery in global equity markets.

The effective rate of tax on operating profit from continuing operations was lower at 27.0% *(2002: 30.4%)*. This decrease reflects an increased proportion of profits arising from our overseas businesses which bear a lower tax charge than that levied in the UK. The charge for the year was £403 million *(2002: £370 million)*.

The result for the year attributable to equity shareholders on a modified statutory basis improved significantly to a profit of £932 million *(2002: £551 million loss)*. This resulted in improved earnings per share of 41.4 pence *(2002: 24.4 pence loss per share)*.

Retained profit post-ordinary dividend on a modified statutory basis improved significantly during the year to £387 million *(2002: £1,070 million retained loss)*.

## Ordinary dividends
The directors establish the appropriate level for dividends with reference to the longer-term trend in business performance, keeping in mind the need to retain earnings to fund future growth. Total ordinary dividends for 2003 were £545 million *(2002: £519 million)* representing an increase of 5% to 24.15 pence net per share *(2002: 23 pence net per share)*.

## Dividend cover
The proposed full year ordinary dividend of £545 million is covered by the post-tax statutory basis operating profit 1.82 times *(2002: 1.51 times)*.

## Cost savings (see figure 3)
One of our key objectives for 2003 has been to focus on reducing costs and to improve our operational efficiency. In 2003 we have announced and taken actions to reduce our cost base through a series of initiatives. We have increased hurdle rates on new developments and internal projects.

The following table summarises the benefit to the profit and loss account for 2003 and 2004 relative to the 2002 expense base.

| | Annualised savings £m | Earned savings £m | One-off costs £m | Benefit to the profit and loss account £m |
|---|---|---|---|---|
| Relative to 2002: | | | | |
| 2003 expenses | 250 | 165 | (100) | 65 |
| 2004 expenses | 250 | 225 | (140) | 85 |

In 2003 we announced a series of job reductions across our UK life and general insurance operations and a total of 3,700 new jobs in India to service the Group's UK life and general insurance businesses and our general insurance operations in Canada. In 2003, total upfront costs incurred on these initiatives were £66 million with an equivalent amount in 2004.

Our expense saving initiatives are expected to deliver total estimated annualised savings of £250 million. The net pre-tax benefit to the profit and loss account in 2003 was £65 million after bearing one-off costs of £66 million representing the costs associated with achieving these savings and the incremental cost of our global financial transformation programme of £34 million.

The net pre-tax benefit to the profit and loss account is shown in figure 3 for each business unit.

In 2004 the net pre-tax benefit to the profit and loss account is estimated to be £85 million. This represents the realisation of a substantial part of the £250 million annualised savings achieved, offset by the remainder of the upfront costs and the increased cost in 2004 of our global financial transformation programme.

The realisation of the actions announced in 2003 will deliver estimated annualised gross savings of £250 million in 2005.

**Net pre-tax profit and loss benefit by business unit (figure 3)**

| | Earned savings £m | One-off costs £m | Benefit to the profit and loss account £m |
|---|---|---|---|
| UK Life | **33** | **(8)** | **25** |
| UK General insurance | **98** | **(58)** | **40** |
| Other businesses | **18** | **–** | **18** |
| Corporate costs | **16** | **(34)** | **(18)** |
| | **165** | **(100)** | **65** |

**Long-term savings: new business contribution[1] (figure 4)**

| Year ended 31 December | 2003 £m | 2002 £m |
|---|---|---|
| UK | **241** | 290 |
| France | **70** | 69 |
| Ireland | **23** | 29 |
| Italy | **45** | 38 |
| Netherlands (including Belgium and Luxembourg) | **62** | 21 |
| Poland | **3** | 10 |
| Spain | **134** | 87 |
| Other Europe | **(3)** | (5) |
| International | **46** | 39 |
| Total | **621** | 578 |

1. Excludes retail investment sales and is stated before the effect of solvency margin.

**Long-term savings new business margin[1,2] (figure 5)**

| Year ended 31 December | 2003 % | 2002 % |
|---|---|---|
| UK | **22.6** | 23.6 |
| France | **29.0** | 30.9 |
| Ireland | **28.5** | 28.2 |
| Italy | **23.2** | 24.9 |
| Netherlands (including Belgium and Luxembourg) | **27.7** | 13.3 |
| Poland | **8.5** | 20.8 |
| Spain | **54.4** | 45.9 |
| Other Europe | **(3.0)** | (5.4) |
| International | **24.6** | 22.2 |
| Total | **26.1** | 24.4 |

1. The ratio of long-term savings new business contribution to sales measured on an annual premium equivalent basis.
2. Excludes retail investment sales and is stated before the effects of solvency margin.

**Long-term savings: life achieved operating profit (figure 6)**

| Year ended 31 December | 2003 £m | 2002 £m |
|---|---|---|
| New business contribution | **472** | 452 |
| Profit from existing business | | |
| Expected return | **757** | 849 |
| Experience variances | **(12)** | (110) |
| Operating assumption changes* | **38** | 9 |
| Expected return on shareholders' net worth | **300** | 324 |
| Life achieved operating profit | **1,555** | 1,524 |

*In 2003, operating assumption changes included the impact of reducing risk margins in Poland, the US and Australia in line with the directors' views of the risks associated with this in-force portfolio. The impact of this change was £27 million. In 2002, operating assumptions included the impact of reducing risk margins in the US. The impact of this change was £13 million.

**General insurance: combined operating ratio* (figure 7)**

| Year ended 31 December | 2003 % | 2002 % |
|---|---|---|
| UK | **99** | 101 |
| France | **102** | 102 |
| Ireland | **97** | 100 |
| Netherlands (including Belgium and Luxembourg) | **101** | 105 |
| Other Europe | **103** | 102 |
| Canada | **108** | 102 |
| Other international | **103** | 101 |
| Continuing operations | **100** | 102 |

*Combined Operating Ratio (COR) expresses the extent to which expenses and claims cover insurance premiums. It is the sum of expenses, including commissions, as a percentage of net written premiums, and claims as a percentage of net earned premiums.

**General insurance: operating profit (figure 8)**

| Year ended 31 December | 2003 £m | 2002 £m |
|---|---|---|
| UK | **676** | 611 |
| France | **35** | 47 |
| Ireland | **91** | 44 |
| Netherlands (including Belgium and Luxembourg) | **35** | 13 |
| Other Europe | **32** | 49 |
| Canada | **12** | 80 |
| Other international | **30** | 37 |
| Continuing operations | **911** | 881 |

## Long-term savings

On an annual premium equivalent ("APE") basis (the sum of new regular premiums and one tenth of new single premiums) total new business sales were £2,506 million *(2002: £2,488 million)*. This reflects a fall in sales of primarily with-profit bonds in the UK and Ireland. This has been offset by continuing strong sales through our bancassurance operations, particularly in Spain and Italy, and in the Netherlands with our new agreement with ABN AMRO. Bancassurance sales accounted for 23% of life and pension sales on an APE basis in 2003.

We have two main measures for performance in sales – volumes (as measured by APE) and contribution (being the total economic value added based on sales volumes).

New business contribution amounted to £621 million (see figure 4) for the year with strong growth in Spain and the Netherlands offsetting a fall in the UK which is largely attributed to lower volumes. Lower new business contribution in both France and Ireland reflected the changes in business mix.

In the UK, we have continued to focus on strict pricing disciplines particularly for annuities and pensions. The beneficial impact on margins (see figure 5) of pricing and cost control initiatives were offset by the impact of changes in economic assumptions resulting in a lower UK new business margin. Strengthened new business margins in Spain reflected our focus on sales of higher margin protection products in the second half of 2003. Margins in the Netherlands benefited from our new joint venture with ABN AMRO.

Life achieved operating profit was £1,555 million (see figure 6) reflecting a combination of economic factors. The 2003 expected returns from existing business and on shareholders' net worth were lower than 2002 by £116 million due to the application of lower start of year economic assumptions to a lower opening embedded value. Improvements in new business contribution and profits from in-force business more than offset this.

The net charge of £123 million for the change in UK annuitant mortality assumptions made in 2002 did not recur in 2003. Excluding this charge, the profit from experience variances and operating assumption changes was largely unchanged year on year.

## Long-term savings: modified statutory operating profit

On a modified statutory basis, the profit from long-term business operations before tax was £1,138 million *(2002: £1,022 million)*. The increase is largely attributed to an improvement in the results from our European business, principally France, Poland and Spain benefiting from the recovery in economic market conditions and the outcome of normal year end reserving reviews. Offsetting this was a fall in the UK result driven by lower annual and final bonus rates to our with-profit policyholders.

## General Insurance

Worldwide general insurance net premium income, from continuing operations, increased to £8,524 million *(2002: £7,805 million)* reflecting strong rating actions particularly in our commercial lines.

Although market conditions have remained favourable, the achievement of 100% *(2002: 102%)* COR (see figure 7) at a group level is an excellent result. The results include the benefit of favourable weather-related claims in the year and although this was partially offset by a small increase in UK subsidence costs, we saw a net benefit of £40 million.

The COR in Canada was impacted by £70 million charged in the first half of 2003 relating to the prior year adjustment to claims case reserves in our Canadian subsidiary, Pilot. Excluding this item, the Canada COR was 101%.

We are targeting a group COR of 100% for each of the next three years.

The operating profit from continuing operations (see figure 8) comprised an improved underwriting loss of £54 million *(2002: loss of £145 million)* and a lower normalised investment return of £965 million *(2002: £1,026 million)*. The normalised investment return declined by £61 million in 2003 as a result of the lower start of year asset values which were depressed by falling markets in 2002 partially offset by the impact of appreciation of the euro during 2003 and additional returns on assets acquired in the year. The improved underwriting result reflects our continuing disciplined approach to risk and strong rating action, with particularly strong performance in the UK and Ireland.

# Financial review
continued

There is naturally a degree of uncertainty around the ultimate settlement costs of claims. Claims reserves are calculated within a range of possible outcomes. Our actuarial analysis suggests that our claims reserves across the Group are now extremely strong, which in the UK enables us to raise the net retention on our UK catastrophe reinsurance program by at least £50 million.

**Corporate costs (figure 9)**

| Year ended 31 December | 2003 £m | 2002 £m |
|---|---|---|
| Global finance transformation programme | **(60)** | (26) |
| Central costs and share save schemes | **(176)** | (192) |
| | **(236)** | (218) |
| Allocation of staff profit share and other incentive plans to business unit operating results | **76** | – |
| | **(160)** | (218) |

**Sensitivity analysis (figure 10)**

| Component of shareholders' funds | 31 December 2003 £bn | Equities down 10% £bn | Interest rates up 1% £bn |
|---|---|---|---|
| Long-term savings[1] | **12.4** | 11.9 | 12.5 |
| General insurance and other | **8.1** | 7.9 | 7.8 |
| Borrowings[2] | **(8.4)** | (8.4) | (8.4) |
| Shareholders' funds | **12.1** | 11.4 | 11.9 |

1. Assumes achieved profit assumptions adjusted to reflect revised bond yields.
2. Comprising internal, external and subordinated debt.
3. These sensitivities assume a full tax charge/credit on market value appreciation/falls.

**Capital employed by segment (figure 11)**

| At 31 December | 2003 £m | 2002 £m |
|---|---|---|
| Long-term savings | **12,373** | 10,379 |
| General insurance and health | **4,481** | 3,917 |
| Other business | **725** | 554 |
| Corporate | **2,934** | 2,475 |
| Total continuing operations | **20,513** | 17,325 |
| Discontinued operations | | |
| – Australia and New Zealand | **–** | – |
| Total capital employed | **20,513** | 17,325 |

The group expense ratio from continuing operations remained stable at 11.3% *(2002: 11.3%)*. This improvement has been achieved after absorbing an additional allocation of £43 million relating to group profit share and other incentive plan costs which were previously included within corporate costs.

**Fund management**
Fees for fund management operations are linked to the group's assets under management which increased at 31 December 2003 to £240 billion *(2002: £208 billion)* driven by a partial recovery of global equity markets and new business flows. The benefit of increased fee levels, cost reductions and improved operational efficiency across the group's major operations were offset by set-up costs arising from our new agreement with the Royal Bank of Scotland Group (RBSG) to sell collective investments.

Fund management: operating profit
Our UK fund management business comprises Morley Fund Management, a retail and institutional business, a retail investment operation operating as Norwich Union and our new collective investments business with RBSG. The combined UK operations reported a loss of £6 million *(2002: loss of £12 million)*. Morley's combined UK operations reported a profit of £3 million *(2002: £4 million)*, while our UK retail business reported a loss of £3 million *(2002: loss of £16 million)*. The loss of £7 million reported by our collective investments business with RBSG reflected set-up costs.

Within the group results are profits of £6 million relating to other Morley businesses including our pooled pensions business and overseas operations.

**Non-insurance**
The non-insurance result was a loss of £64 million *(2002: loss of £99 million)* due to the non-recurring costs in our wealth management operations and a better result from banking operations in the Netherlands. The loss in the period includes an allocation of £30 million in respect of group profit share and other incentive plan costs, which were previously included within corporate costs.

**Corporate costs** (see figure 9)
Corporate costs were lower in the year at £160 million *(2002: £218 million)* due to costs arising from bonus plans and staff share schemes being allocated to business operations with effect from 1 January 2003.

Costs from the global finance transformation programme were £60 million in the year *(2002: £26 million)*. The main activity of the programme will be in 2004, with costs expected to be up to £100 million, tailing off thereafter.

**Prudential regulation**
One of the most significant changes in the regulatory environment will be the introduction of the Financial Services Authority's ("FSA") Prudential Sourcebook (PSB) which defines the approach for risk-based regulation. The group is a leading participant in the industry's dialogue with the FSA to ensure these reforms meet the requirements of the industry.

Key to the new regime will be the introduction of Enhanced Capital Requirements (ECR). This is likely to increase the levels of capital required to support our UK general insurance businesses and consequently the capital requirement of the Aviva group. Given Aviva's strong capital position it is well placed to respond to these requirements.

Further proposals outline new requirements regarding realistic solvency for UK life insurers. These proposals are further advanced than those for general insurance and we are confident that NU Life's realistic solvency position is robust under the proposed rules.

**International Financial Reporting Standards (IFRS)**
The European Union requires all European listed groups to prepare their consolidated financial statements using standards issued by the International Accounting Standards Board ("IASB") with effect from 1 January 2005.

The Aviva group's consolidated accounts for 2005 will therefore be prepared under IFRS, rather than UK GAAP. Comparative figures will be required for 2004, together with reconciliations of income and shareholders' equity to the previously-reported UK GAAP figures.

Based on current proposals, the principal effects of reporting under IFRS are an increase in the use of fair value accounting for both assets and liabilities, and additional disclosures in the accounts. However, the most significant aspect of IFRS for the European insurance sector is the treatment of insurance contracts, for which an accounting standard is yet to be developed.

The need to meet the EU deadline has led to a two phase development with Phase 1, due to be issued in March 2004, providing interim guidance until a comprehensive basis of accounting for insurance contracts is delivered in Phase 2. The IASB's interim proposals for 2005 require some contracts with the legal form of insurance to be reclassified as investment products with changes in their valuation, whereas those still classified as insurance contracts remain valued under local GAAP until the IASB has completed its project. Given the current state of developments and associated uncertainty in the industry, we are not yet in a position to evaluate fully the impact of IFRS on our group.

Our preparations for reporting under IFRS are well-advanced in all our businesses and represent a major part of our global finance transformation programme. The group is actively engaged, both internally and externally, in understanding and influencing the IASB developments. Our objective is to see the development of a conceptually robust and economically meaningful basis of accounting for insurance which has been properly field-tested. We continue to believe that the achieved profit basis, modified to more fully reflect the fair value of guarantees and options, is the most meaningful method of accounting for longer-term insurance contracts.

**Capital management**

Shareholders' funds on an achieved basis have increased to £11,165 million *(2002: £9,668 million)* largely reflecting the strong operational performance and the benefit of the euro appreciation. This corresponds to a net asset value per ordinary share of 502 pence *(2002: 433 pence per share)* after adding back the equalisation provision of £364 million *(2002: £314 million)*.

Shareholders' funds are sensitive to movements in global investment markets. We have sound processes in place to actively manage these risks. The need for these processes is illustrated by the sensitivity to a 10% fall in global equity markets or a 1% rise in global interest rates (see figure 10).

**Capital employed** (see figure 11)

The group maintains an efficient capital structure from a combination of equity shareholders' funds, preference capital, subordinated debt and borrowings, consistent with the group's risk profile and the regulatory and market requirements of its business. The group presents its capital disclosures on an achieved profit basis as this is the basis on which we measure our performance against key performance indicators.

The group's capital has been allocated such that the capital employed by trading operations is some £5.6 billion *(2002: £5.7 billion)* greater than the capital provided by its shareholders and its subordinated debtholders. The group is therefore able to earn enhanced returns on its equity capital.

**Deployment of equity shareholders' funds (figure 12)**

| | Equities £m | Fixed income securities £m | Other investments £m | Other net assets £m | Full year 2003 Total £m | Full year 2002 Total £m |
|---|---|---|---|---|---|---|
| Assets | | | | | | |
| Long-term savings | **604** | **3,843** | **924** | **1,552** | **6,923** | 5,726 |
| General insurance, health, corporate and other business | **2,967** | **3,286** | **867** | **(85)** | **7,035** | 5,906 |
| | **3,571** | **7,129** | **1,791** | **1,467** | **13,958** | 11,632 |
| Goodwill | | | | | **1,323** | 1,271 |
| Additional value of in-force long-term business | | | | | **5,232** | 4,422 |
| Assets backing total capital employed in continuing operations | | | | | **20,513** | 17,325 |
| External debt | | | | | **(1,749)** | (2,053) |
| Internal debt | | | | | **(3,841)** | (3,671) |
| Subordinated debt | | | | | **(2,814)** | (1,190) |
| | | | | | **12,109** | 10,411 |
| Minority interests | | | | | **(944)** | (743) |
| Preference capital | | | | | **(200)** | (200) |
| Equity shareholders' funds | | | | | **10,965** | 9,468 |

At 31 December 2003, total capital employed in our long-term savings operations was higher, predominantly reflecting an increase in the future value of in-force business. The total capital employed in our general insurance businesses increased due to the impact of stronger equity markets on the asset base and the beneficial impact of foreign exchange rate movements.

Assets available to shareholders to finance future growth of the group are held within the group's UK general insurance legal entities. For the purposes of analysing the capital employed by segment, these assets are classified as corporate. In September 2003, Aviva plc issued £1.6 billion of subordinated debt which provides cost-effective funding and is treated as equity for regulatory purposes. Of the £1.6 billion of subordinated debt proceeds, some £400 million was used to repay senior debt with the remaining £1.2 billion classified within corporate.

The group also has a number of internal debt arrangements in place. These have allowed the assets supporting technical liabilities to be invested into the pool of central capital for use across the group. They have also enabled the shareholders to deploy cash from some parts of the business to others in order to fund growth. Although intra-group loans in nature, they are counted as part of the capital base for the purpose of capital management. All internal loans have been negotiated on a basis that satisfies arm's length criteria and all interest payments have been made when due. Internal debt increased in 2003 as a result of the formalisation of intra group arrangements, offset by the use of corporate assets to satisfy the final instalment of the Berkshire Hathaway premium of £0.5 billion in early January.

At the end of 2003, the group's total external borrowings amounted to £4.6 billion *(2002: £3.2 billion)* including subordinated debt (see figure 12). A significant proportion of these borrowings are on a fixed rate basis with maturity terms between one and 33 years. The balance comprises commercial paper and floating rate bank borrowings.

The ratio of the group's external debt to shareholders' funds was 12% *(2002: 18%)*. Interest cover, measuring the extent to which external interest costs are covered by achieved operating profit, was 19 times *(2002: 14 times)*.

Our exposure to equities has increased from £3.1 billion at 31 December 2002 to £3.6 billion, which represents 17% of our total capital employed (see figure 12).

# **Financial review** continued

Our capital position has improved as a result of strong operational performance and improving equity markets. The ratings of the group's main operating subsidiaries are AA/AA- ("very strong") with a stable outlook from Standard & Poor's and Aa2 ("excellent") from Moody's. These ratings were reaffirmed in September 2003, although the rating agencies have indicated that the insurance sector remains under review.

**Return on capital employed**
(see figure 13)
The group achieved an excellent return on capital of 12.7% *(2002: 9.7%)*, against its target of 10% net real return. This reflects strong operating results, following cost reductions and improved operational efficiency.

Financial strength of the group and its principal insurance operations
Markets are increasingly looking for quality and financial strength, so the resilience of the regulatory capital position of the group and its principal insurance operations is of great importance.

At this time there is no single measure of capital strength and resilience so we report on the mandatory measures as well as our own risk-based measures.

*EU Group's Directive*
Aviva group had an estimated excess regulatory capital, as measured on the new EU Group's Directive, of some £2.4 billion at 31 December 2003 *(2002: £0.7 billion)* including the benefit of £1.6 billion of subordinated debt issued in 2003. This measure represents the excess of the aggregate value of regulatory capital employed in our business over the aggregate minimum solvency requirements imposed by local regulators excluding the surplus held in the group's UK and Irish life funds.

*General insurance – regulatory basis*
Our principal UK general insurance regulated subsidiaries are CGU International Insurance plc (CGUII) and Norwich Union Insurance (NUI). CGUII is the parent company of the majority of the group's overseas life and general insurance subsidiaries.

The combined businesses of the CGUII group and NUI have strong solvency positions. On an aggregate basis the estimated excess solvency margin (representing the regulatory value of excess available assets over the required minimum margin) was £3.9 billion at the end of 2003 *(2002: £2.2 billion)* after covering the required minimum margin of £3.3 billion *(2002: £3.2 billion)*. The increase in the excess solvency margin is largely attributable to the benefit of £1.2 billion of subordinated-debt proceeds injected in the form of equity capital.

*General insurance – realistic basis*
Capital requirements for the Group's worldwide general insurance businesses are assessed using risk based capital techniques and results were published for the first time in 2002. Calculations have been reviewed to reflect recent trends including increasing strength of the general insurance business balance sheets and improving stability and continuing reductions achieved in the combined operating ratios, producing a revised risk based capital requirement of 34% of net written premiums *(2002: 36%)*.

At 31 December 2003 the risk-based capital requirement of our worldwide general insurance businesses was £3.3 billion *(2002: £3.1 billion)*. The combined general insurance businesses of CGUII and NUI hold total regulated available assets of £7.2 billion. After deducting the risk-based capital for the general insurance businesses of CGUII and NUI of £3.3 billion and adding back the claims equalisation reserve of £0.4 billion, the remaining available capital of £4.3 billion is sufficient to cover the minimum margins of the overseas life businesses by approximately 2.2 times *(2002: 1.7 times)*.

*UK Life Operations*
*With-profit funds – statutory basis*
The statutory approach for CGNU Life (CGNU) and Commercial Union Life Assurance Company (CULAC) has been modified to include Tiner waivers. We did not seek a waiver for Norwich Union Life and Pensions (NUL&P). An implicit item remains in NUL&P, supported by the non-profit business.

The free asset ratio (FAR) is the measure of the excess of assets over liabilities, expressed as a proportion of liabilities.

*With-profit funds - realistic basis*
We measure our realistic strength by the value of the orphan estate. The estate provides a level of capital that is available to absorb any unexpected short-term impact from adverse experience. It provides a level of investment freedom to improve policyholder returns and enables the operation of the with-profit business and associated features of guarantees and smoothing.

Results below have been calculated in line with the key principles of CP 195, for CGNU, CULAC and for the realistic orphan estate of NUL&P. This makes appropriate allowance for all realistic liabilities of the with-profits fund, including provision for future bonus, the fair value of guarantees, options and provisions on a market consistent basis and the cost of shareholder transfers and tax associated with future bonus. The estimated value of these is £4.9 billion.

The FAR for the three main companies at 31 December 2003 based on the statutory basis are set out below together with a comparison of with-profit free assets on statutory and realistic bases.

| | Statutory FAR % | With-profit free assets (net of RMM) £bn | Realistic orphan estate £bn |
|---|---|---|---|
| CGNU Life | 16.0 | 0.9 | 1.3 |
| CULAC | 13.6 | 1.1 | 1.6 |
| NUL&P | 17.7 | 1.8 | 1.4 |
| Aggregate | 16.2 | 3.8 | 4.3 |

*Non-profit funds – statutory basis*
The FAR for NUL&P includes implicit items for non-profit business only. The realistic orphan estate is quoted before any Risk Capital Margin (RCM). The FSA is currently consulting on proposals for an appropriate RCM for with-profit business. Based on current guidelines the RCM is more than 2.5 times covered by the orphan estate in aggregate.

We manage the strength of our non-profit fund through a variety of different means. In addition, during 2004 we continue to use, where appropriate, financial reinsurance and securitisation. In addition, we are progressing our review to merge the legacy non-profit life funds to improve operational efficiency and consolidate solvency margin requirements. We continue our review of the potential reattribution of the orphan estate in the interests of both policyholders and shareholders alike.

**Return on capital employed (figure 13)**

| At 31 December | Normalised after-tax return £m | Opening equity capital restated £m | 2003 Return on capital[1] % | 2002 Return on capital[1] % |
|---|---|---|---|---|
| Long-term savings | **1,082** | **10,379** | **10.4** | 9.4 |
| General insurance and health | **641** | **3,917** | **16.4** | 12.5 |
| Other business | **(44)** | **554** | **(7.9)** | (20.7) |
| Corporate | **(38)** | **2,475** | **(1.5)** | (2.1) |
| | **1,641** | **17,325** | **9.5** | 7.9 |
| Borrowings | **(295)** | **(6,914)** | **4.3** | 4.4 |
| | **1,346** | **10,411** | **12.9** | 9.9 |
| Minority interests | **(131)** | **(743)** | **17.6** | 12.7 |
| Preference capital | **(17)** | **(200)** | **8.5** | 8.5 |
| Total continuing operations | **1,198** | **9,468** | **12.7** | 9.7 |
| Discontinued operations | | | | |
| – Australia and New Zealand | **–** | **–** | **–** | 20.2 |
| Equity shareholders' funds | **1,198** | **9,468** | **12.7** | 10.1 |

1. The return on capital is calculated as the after tax return on opening equity capital, based on operating profit, including life achieved profit, before amortisation of goodwill and exceptional items.

## Management of financial and non-financial risks

The group recognises the importance of effective risk management systems and has an established group governance framework. The group analyses risk exposures between financial risks (these being market, liquidity, credit and insurance risk), and non-financial risks (these being operational, group and strategic risk). Each of these risks areas are overseen by a specialist risk committee and/or the Group Risk Committee. The results of the Group Risk Committee, which reviews all financial and non-financial risks reported at a group level are reported to the Group Executive Committee, The Group Audit Committee and the Board.

### Financial risks

Details of the group's processes for managing financial risks are provided below.

### Market risk

*Asset and liability management*

Close attention is paid to asset and liability management which is particularly important for our life businesses, given the long-term nature of the liabilities involved. General insurance funds are primarily invested in fixed income securities to match broadly the duration of our insurance liabilities. The balance of the portfolio is invested largely in equities.

*Derivatives*

Derivative instruments are used within guidelines outlined in the Group Derivative Policy for efficient portfolio management, hedging debt and the outcome of corporate transactions or to structure specific retail savings products. In addition, the group's Dutch bank trades in derivatives as part of its normal banking activities. This trading is controlled through the allocation of limits which are very low in the context of both Delta Lloyd and the group. Derivatives trading, except for these uses, is prohibited.

*Exchange fluctuation*

Approximately half of the group's premium income arises in currencies other than sterling. Similarly on an achieved profit basis, the group's net assets are denominated in a variety of currencies, of which the largest are sterling (43%) and the euro (43%).

In managing our foreign currency exposures the group does not hedge revenues as these are substantially retained locally to support the growth of our business and to meet local regulatory and market requirements.

The group's net assets and, to a more limited extent its solvency, are exposed to movements in exchange rates. The group's FX policy is to manage these exposures by aligning the deployment of capital by currency, with the group's capital requirement by currency. Limits are set to control the extent to which the deployment of capital is not aligned fully with the group's capital requirement, for each major currency. Currency borrowings and derivatives are used to ensure that exposures are managed within the limits that have been set.

### Liquidity risk

The group has a strong liquidity position and through the application of a group liquidity management policy seeks to ensure that it has sufficient financial resources available to meet its obligations as they fall due.

### Credit risk

The group manages credit risk at business unit (BU) level within a framework of approved investment mandates. Aggregate group-wide credit exposures are progressively being monitored centrally so that material exposures can be identified and managed appropriately. The financial strength of reinsurance counterparties is also assessed centrally on an ongoing basis and monitored against approved limits.

### Insurance risk

Insurance risk is fundamental to our business and as such is controlled at an individual BU level, through practices such as underwriting guidelines and authorities, pricing guides, reserving and claims processes.

Reinsurance is actively used to limit insurance risk and capital requirements in the inherently volatile general insurance business and in particular is a key tool in managing our catastrophe exposure. The group maintains a reinsurance retention of £250 million for a single catastrophic event covering more than one country in Europe. This cover protects the net retentions of our individual business units which have their own reinsurance programmes in place.

### Non-financial risks

Operational, group and strategic risk

Further details are given in the Audit Committee report on page 44. There is also an established process for the central monitoring of the group capital and solvency positions which reflects both current and expected future regulatory capital requirements. Details are contained on pages 33 to 35.

### Conclusion

Overall, Aviva has sound financial management policies and systems managed by committed and professional people. Three years of very difficult markets have tested them to the full. This report illustrates how well we have passed these tests and shows why we need to continue to invest in our systems and professional people.

**Philip Twyman**
Group Executive Director

# Board of directors

**1. Pehr Gyllenhammar** (68)
**Chairman**
Appointed to the board in 1997, becoming chairman in 1998. Currently vice-chairman, Europe at Rothschild *(banking)*, chairman of Reuters Founders Share Company Limited *(media)* and of Swedish Ships Mortgage Bank *(banking)* and a non-executive director of Lagardère SCA *(media and technology)*. Former executive chairman of AB Volvo *(automotive)* and former senior adviser to Lazard Freres & Co. LLC *(banking)*. *Chairman of the chairman's and nomination committees*.

**2. Richard Harvey FIA** (53)
**Group Chief Executive**
Appointed group chief executive in April 2001. Joined Norwich Union in 1992, holding senior positions in New Zealand and the United Kingdom before joining the Norwich Union board in 1995 and becoming group chief executive of Norwich Union in 1998. Chairman of the Association of British Insurers. *Member of the nomination committee*.

**3. George Paul DL** (64)
**Deputy Chairman and senior independent non-executive director**
Appointed to the board in May 2000 as deputy chairman. Joined the Norwich Union board as a non-executive director in 1990, becoming chairman in 1994. Currently a non-executive chairman of Agricola Group Limited *(agricultural)* and of JP Morgan Fleming Overseas Investment Trust plc *(asset management)* and a non-executive director of Notcutts Limited *(horticulture)*. A former chairman and chief executive officer of Harrisons & Crosfield plc *(manufacturing)*. *Chairman of the remuneration committee and member of the audit and chairman's committees*.

**4. Anna Catalano** (44)
**Independent non-executive director**
Appointed to the board in May 2003. Former group vice-president of marketing, BP plc *(oil)*. *Member of the remuneration committee*.

**5. Guillermo de la Dehesa** (62)
**Independent non-executive director**
Appointed to the board in May 2000. Joined the board of Norwich Union as a non-executive director in 1999. Currently non-executive chairman of Aviva's operations in Spain, non-executive vice-chairman of Goldman Sachs Europe *(banking)* and a director of Campofrio *(consumer)*, Unión Eléctrica Fenosa *(utility)*, Bank Santander Central Hispano *(banking)* and Telepizza *(consumer)*. Former chief executive and director of Banco Pastor *(banking)*. A former deputy governor of the International Monetary Fund and the World Bank and a former deputy general manager of the Bank of Spain and former Secretary of State of Finance in Spain. *Member of the audit and nomination committees*.

**6. Wim Dik** (65)
**Independent non-executive director**
Appointed to the board in 1999, having served as a chairman of Nuts Ohra, a Dutch insurer acquired by the group in 1999. Currently chairman of NV Casema *(telecommunications)*, a member of the Supervisory Board of ABN AMRO Bank *(banking)* and an advisory member of the boards of Unilever *(consumer)* and a non-executive director of LogicaCMG plc *(computer services)*. A former chairman of Nederlandse Unilever Bedrijven BV *(consumer)* and former chairman and chief executive officer of KPN Royal Dutch Telecom *(telecommunications)*. A former member of the advisory board of TNT Post Group *(mail services)* and former director of Vos Logistics *(transport)*. Former Minister for Foreign Trade in the Netherlands. *Member of the remuneration committee*.

**7. Carole Piwnica LLM** (46)
**Independent non-executive director**
Appointed to the board in May 2003. Currently non-executive vice-chairman, governmental affairs, Tate & Lyle plc *(agriculture/industrial)* and non-executive director of SA Spadel NV *(mineral water)*. A former chairman of Amylum Group *(agriculture/industrial)*. A member of the New York and Paris bars, practicing law in Europe and the United States specialising in mergers and acquisitions, and EU regulatory matters. *Member of the audit committee*.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**8. Philip Scott** FIA (50)
**Executive director**
Appointed to the board in May 2000. Joined Norwich Union in 1973, held a number of senior positions and was appointed to the board of Norwich Union in 1993. Former chief executive and executive chairman of Norwich Union Life (Aviva's life assurance and long-term savings business in the United Kingdom). Currently responsible for the group's continental European and international life assurance and long-term savings business.

**9. Patrick Snowball** (53)
**Executive director**
Appointed to the board in March 2001 as chief executive of Norwich Union Insurance (Aviva's general insurance operation in the United Kingdom). Previously a director of Norwich Union, appointed in October 1999, having joined that company in 1989. Currently responsible for the group's worldwide general insurance operations and the provision of shared services across the United Kingdom.

**10. Derek Stevens** (65)
**Independent non-executive director**
Appointed to the board in 1995. Currently non-executive chairman of The Airline Group Limited *(transport)*, chairman of British Airways Pension Investment Management Limited, non-executive director of NATS Holdings Limited *(transport)*, a member of the financial sector committee of the Accounting Standards Board, chairman of The Royal Academy of Arts Pension Scheme Board, a member of the Council of the Institute of Education at the University of London, a member of the Fundraising Advisory Board of VSO *(charity)* and chairman of The Travel Foundation *(charity)*. A former director and chief financial officer of British Airways Plc *(transport)*, a former finance director of TSB Group plc *(banking)* and a former chairman of the Trustees of British Airways Pension Schemes.
*Chairman of the audit committee, member of the chairman's committee and chairman of Aviva Staff Pension Trustee Limited*.

**11. Philip Twyman** FIA, FIAA (59)
**Executive director**
Appointed to the board in June 1998. Joined the board of General Accident in 1996 as executive director responsible for finance, life and investment operations. Currently the director responsible for Aviva's finance and fund management operations. Mr Twyman will retire in March 2004.

**12. Elizabeth Vallance** (58)
**Independent non-executive director**
Appointed to the board in May 2000. Joined the board of Norwich Union as a non-executive director in 1995. Currently Fellow of Queen Mary College University of London, chairman of the Council of the Institute of Education University of London, chairman of the Advisory Committee on Clinical Excellence, non-executive director of Charter Pan European Trust plc *(asset management)*, a former non-executive director of HMV Group Limited *(music retail)* and former chairman of the NHS Advisory Committee on Distinction Awards.
*Member of the remuneration, nomination and chairman's committees*.

**13. André Villeneuve** (59)
**Independent non-executive director**
Appointed to the board in 1996. Non-executive chairman of Euronext Liffe *(financial services)*, a non-executive director of United Technologies Corporation *(aerospace)* and a director of the Institut Francais de Relations Internationales. A former executive chairman of Instinet Corporation *(securities broker)*, a former executive director of Reuters plc *(media)* and a former chairman of Promethee.
*Member of the remuneration and nomination committees*.

**Richard Whitaker** LLB, FCII
**Group Company Secretary**


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# Directors' report

The directors submit their report and accounts for Aviva plc, together with the consolidated accounts of the Aviva Group of companies, for the year ended 31 December 2003.

### Annual General Meeting
A separate document accompanying the Annual report and accounts contains the notice convening the Annual General Meeting and a description of the business to be conducted thereat. The Annual General Meeting of the Company will be held on 27 April 2004 at The Barbican Centre, Silk Street, London EC2Y 8DS at 11.00am.

### Principal activities
Aviva plc is the holding company of the Aviva Group of companies, which transacts life assurance (other than industrial life) and long-term savings business, fund management and all classes of general insurance through its subsidiaries, associates and branches in the United Kingdom, continental Europe and Ireland, North America, Asia, Australia and other countries throughout the world.

Details of material acquisitions and disposals made by the Group during the year are contained on pages 78 to 79.

### Review of operations, current position and future prospects
Details of the Group's operations for the accounting period, its current position and future prospects are contained in the Chairman's statement, Group Chief Executive's review, business reviews and financial reviews set out on pages 2 to 35.

### Going concern
After making enquiries, the directors have a reasonable expectation that the Company and the Group as a whole have adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

### Results
The Group results for the year are shown in the Consolidated profit and loss account on pages 59 to 61.

### Dividend
The directors are recommending a final dividend of 15.15 pence *(2002: 14.25 pence)* per share which, together with the interim dividend of 9.00 pence *(2002: 8.75 pence)* per share, produces a total dividend for the year of 24.15 pence *(2002: 23.00 pence)* per share. The total cost of dividends for 2003, including preference dividends, will amount to £562 million *(2002: £536 million)*, leaving £387 million to be transferred to reserves *(2002: £1,070 million transferred from reserves)*.

The final dividend for 2003 will be paid on 17 May 2004 to all holders of ordinary shares on the Register of Members at the close of business on 26 March 2004. The Company's Dividend Reinvestment Plan will be available to shareholders in respect of the payment of the final dividend. In addition, a local currency payment service will be available to shareholders residing in certain participating countries outside the United Kingdom. Further details of these arrangements can be found within the shareholder information on page 112.

### Share capital
Details of the share capital and shares under option as at 31 December 2003, and shares issued during the year which ended on that date, are given in note 31 on pages 86 to 87.

### Authority to purchase own shares
At the Annual General Meeting held on 7 May 2003, members renewed the Company's authority to make market purchases of up to 225 million ordinary shares, up to 100 million 8¾% preference shares and up to 100 million 8⅜% preference shares. This authority was not used during the year and at the forthcoming Annual General Meeting shareholders will be asked to renew these authorities for another year. Details are contained in the Notice of Meeting.

### Directors
The names of the present members of the Board and their biographical notes appear on pages 36 to 37.

Sir Michael Partridge retired at the Annual General Meeting on 7 May 2003 and Tony Wyand retired from the Board on 31 July 2003 and from service on 30 November 2003 upon reaching his normal retirement age. Mike Biggs resigned as a director on 31 December 2003.

Philip Twyman will reach his normal retirement age in March 2004 and will retire as a director of the Company and from service on 31 March 2004.

On 8 May 2003, Anna Catalano and Carole Piwnica were appointed to the Board as independent non-executive directors. As these directors joined the Board after the date of the last Annual General Meeting they will, in accordance with the Company's articles of association, retire at the forthcoming Annual General Meeting and, being eligible, offer themselves for election by shareholders.

The directors retiring by rotation in accordance with the articles of association at the Annual General Meeting and, being eligible, offering themselves for reappointment are George Paul, Philip Scott, Patrick Snowball and Elizabeth Vallance. Philip Scott and Patrick Snowball each have a service contract with a Group company, details of which can be found on page 50.

Other than service contracts between executive directors and a Group company, no director had a material interest at any time during the year in any contract of significance with the Company or any of its subsidiary undertakings.

### Directors' interests
Details of directors' interests in the shares of the Company are set out in the Remuneration report on page 54.

### Substantial shareholdings
As at 24 February 2004, the Company's register of substantial shareholdings maintained in accordance with the provisions of Section 211 of the Companies Act 1985 showed that the holdings exceeding the 3% disclosure threshold were those of Barclays Plc which held 91,056,515 ordinary shares, representing an interest of 4.03%, Legal & General Group Plc which held 83,729,729 ordinary shares, representing an interest of 3.70% and Fidelity Investments which held 74,856,224 ordinary shares, representing an interest of 3.32% of the issued ordinary share capital of the Company.

### Corporate governance
The Company's statement on corporate governance is set out on pages 41 to 43.

### Group employees
The Group is committed to continuing communication and dialogue with employees. It believes there is a strong link between informed, motivated staff and operational effectiveness. News from business units and the Group is provided using a variety of media. For example, employees across the Group can listen to regular Aviva Radio newscasts on major developments. Arena, the Group-wide intranet, provides a daily source of information on strategic and operational issues. Local intranets provide a route for staff publicly to raise issues of interest and concern. These approaches all contribute to a better quality of dialogue. However, the fundamental communication and feedback tool remains face-to-face briefings. Staff report regularly in surveys that this is how they prefer to hear key messages.

In addition, employees are encouraged to say how they view the Company and their employment through confidential staff opinion surveys. Results are fed back to staff and action plans are put in place to address concerns. Through their participation, staff help to shape future employment developments. Regular discussions also take place with the staff representative bodies, where appropriate.

# **Directors' report**
continued

The Company encourages and promotes employee development. Support includes the building of relevant competencies, encouraging staff to gain appropriate professional qualifications and assistance with wider personal development. The Group is developing its electronic based training applications and increasing numbers of staff have access to a very wide range of development materials and are taking increasing ownership of their own learning.

The Group's operations in the United Kingdom have established employee career and recognition frameworks, which draw together Aviva values, competencies, and performance management systems. These are linked to appropriate rewards and benefits. At the 2001 Annual General Meeting, shareholders approved the establishment of an All Employee Share Ownership Plan as a way for employees to participate further in the Group's fortunes through share ownership. The Group operates two elements of the plan in the United Kingdom. The partnership element allows eligible employees to purchase Aviva shares at the prevailing market price from their pre-tax income. The second element enables staff to receive free shares, at the Board's discretion, based on the performance of the Company's operations in the United Kingdom. The Group also operates a savings related share option scheme, which provides employees with an opportunity to save over a fixed period and acquire share options at a discount.

## **Corporate Social Responsibility (CSR)**

Aviva defines CSR as embracing corporate performance in environmental management, community, employees, human rights, health and safety, suppliers, customers and standards of business conduct.

Respecting the guidelines issued by the Association of British Insurers, the governance of Aviva's CSR programme is subject to both a regular schedule and continual review. High level progress is reviewed internally throughout the year by a CSR Steering Group which includes senior executives from the Group's principal businesses. The Board examines progress and plans annually. The Group's businesses undertake a self assessment of their performance annually which is subject to an external assurance review every year.

Regular dialogue is maintained with a number of external agencies to help ensure that the CSR programme remains focused and in line with emerging best practices. Representatives from these agencies join members of senior management annually to undertake a review of the Group's performance.

More CSR information can be found on pages 26 and 27. Aviva also prepares a separate CSR report each year which includes full details of the Group's CSR programme and the progress achieved during the year. A copy of the printed summary of the CSR report is available from the Group Company Secretary and the full report may be viewed on www.aviva.com/csr

### Employee practice

Aviva Group companies are committed to providing equal opportunities to all employees, irrespective of their sex, sexual orientation, marital status, creed, colour, race, ethnic origin or disability. The commitment extends to recruitment and selection, training, career development, flexible working arrangements, promotion and performance appraisal. In the event of members of staff becoming disabled, every effort is made to ensure that their employment with the Group continues and to provide specialised training where this is appropriate.

### Health and Safety

The health and safety of staff is a priority and is reviewed at regular intervals. Each business unit has an appointed health and safety representative, whose role is to bring to the attention of senior management any areas of concern that should be addressed within the health and safety programme.

Information on health and safety matters is communicated to staff through the normal communication channels. Under the Group's Health and Safety Policy, the Group Chief Executive is accountable for health and safety.

### Standards of Business Conduct

The Group operates a Standards of Business Conduct Policy which provides guidance for every employee, Group-wide, to act with integrity in all business relationships.

### Charitable donations

Aviva has continued to support community initiatives and charitable causes worldwide and the total Group commitment during the year was £4.6 million *(2002: £5.9 million)*.

In 2003, the Group's community investment in the United Kingdom, as measured using the Business in the Community's benchmarking template, totalled £3.2 million *(2002: £4.9 million)* of which £1.3 million *(2002: £2.3 million)* was direct donations to charitable organisations. The Company's policy regarding charitable giving in the United Kingdom is to support local charities and community organisations particularly in the areas of the country in which the Group has major operations. In addition, it provides a significant level of support to a small number of national charities. During 2003, these included Cruse Bereavement Care, The Princess Royal Trust for Carers, Breakthrough Breast Cancer, The Lymphoma Association and Multiple Sclerosis.

### Political donations

No political donations were made in the United Kingdom or elsewhere during the year *(2002: £nil)*. It is the Company's policy not to make donations to political organisations or for political causes, and it has no intention of changing this policy.

At the 2003 Annual General Meeting, shareholders passed a resolution authorising the Board to make expenditure, up to an aggregate limit of £100,000, on activities which fall under the Political Parties, Elections and Referendums Act (PPER). This piece of legislation introduced a very broad definition of EU political expenditure in the European Union, such that some of the activities undertaken throughout the Group's businesses in the EU could now fall within that definition.

There is a requirement for companies to seek shareholders' approval for expenditure falling under the PPER and therefore, at the forthcoming Annual General Meeting, shareholders will be asked to renew the authority to permit political expenditure, as defined by the PPER, up to £100,000 per annum. The Board does not believe that the Group has made any EU political expenditure in the past year. However, in view of the broad definitions contained in the PPER, it is seeking to renew the authority so as to avoid any inadvertent breaches of the legislation. Further clarification on this issue can be found in the Notice of Meeting for the Annual General Meeting which accompanies this report.

### Creditor payment policy and practice

It is the Group's policy to pay creditors when they fall due for payment. Terms of payment are agreed with suppliers when negotiating each transaction and the policy is to abide by those terms, provided that the suppliers also comply with all relevant terms and conditions.

The Company has no trade creditors. In respect of Group activities in the United Kingdom, the amounts due to trade creditors at 31 December 2003 represented approximately 29 days of average daily purchases through the year *(2002: 29 days)*.

## **Auditor**

In accordance with Section 385 of the Companies Act 1985, a resolution is to be proposed at the Annual General Meeting for the reappointment of Ernst & Young LLP as auditor of the Company.

By order of the Board.

**Richard Whitaker**
Group Company Secretary

24 February 2004

# Corporate governance



**Application of the Combined Code**
The directors' report on the Company's compliance with the applicable provisions of the Combined Code during 2003 is set out below.

The Financial Services Authority requires listed companies to disclose, in relation to Section 1 of the Combined Code produced by the Committee on Corporate Governance in June 1998 (the Combined Code), how they have applied its principles and whether they have complied with its provisions throughout the accounting year. In July 2003, the Financial Reporting Council issued a revised Combined Code taking into account reviews concerning the role and effectiveness of non-executive directors (the Higgs Report) and audit committees (the Smith Report). This revised Combined Code takes effect in respect of reporting years beginning on or after 1 November 2003 and accordingly, does not apply to the year under review. The directors have however reviewed the Company's corporate governance arrangements in the light of the revised Combined Code and have included in this report details of the extent to which the Company would have complied with the revised Combined Code had it been in force for the 2003 financial year.

**The Board of Directors**
The Board has eight scheduled meetings each year and meets more frequently as required. It currently comprises the Chairman, eight independent non-executive directors and four executive directors. Each non-executive director serves for a fixed term of three years, which may be renewed by mutual agreement and, subject to the Board being satisfied as to the director's performance and independence, there is no specified limit regarding the number of terms a director may serve. The Company's articles of association require that following appointment by the Board, directors submit themselves for election by shareholders at the next Annual General Meeting. The articles also provide that one-third of directors shall retire by rotation each year, but are eligible to submit themselves for re-election by the shareholders, and that directors shall not serve longer than the third Annual General Meeting following their election without being re-elected by shareholders. Details of the directors retiring by rotation and seeking re-election at the forthcoming Annual General Meeting are set out below and in the Notice of Meeting. In accordance with the revised Combined Code any non-executive directors who serve on the Board of the Company for nine years or more will in future submit themselves for re-election annually.

The Board has appointed George Paul, the Deputy Chairman, to be the Company's senior independent non-executive director.

During 2003 the Board met on eight occasions and all directors attended every meeting. Wim Dik was unable to attend the Annual General Meeting. The directors bring to the Board a wide range of experiences and skills and participate fully in decisions on the key issues facing the Group.

In respect of the composition of the Board it is necessary to retain directors possessing a sound understanding of both the Group and the financial services industry whilst at the same time maintaining a programme to refresh the Board through the acquisition of new skills and experience. In addition to the strengths of skill, diversity and an international perspective, the Board also seeks to comply with the requirements of the revised Combined Code as they relate to the independence of directors.

Against the above background Aviva announced in May 2003 the appointment of two new independent non-executive directors. Anna Catalano has a background in marketing and brand development and is a Mandarin speaker with experience of managing operations in China, a country where the Group has a new and expanding life assurance business. Carole Piwnica is a non-executive director of Tate & Lyle plc and a member of the New York and Paris bars and practices law in the United States and Europe specialising in mergers and acquisitions, and EU regulatory matters. These new directors bring additional diversity to the Board in terms of skill, international perspective and age. In accordance with the Company's articles of association Anna Catalano and Carole Piwnica will stand for election by shareholders at the Annual General Meeting.

George Paul and Elizabeth Vallance fall due for retirement in accordance with the Company's articles of association at the forthcoming Annual General Meeting and submit themselves for re-election. Both directors joined the Company's Board when CGU merged with Norwich Union in 2000 and, therefore have, in legal terms, served as directors of the Company for three years although, when their service as directors of Norwich Union is included, they have been connected with the Group for 13 and nine years respectively. The Board has therefore considered the independence of these directors with particular care. Both directors contribute significantly through their individual skills, their considerable knowledge of both the Company and the insurance industry and they currently provide continuity and an overall balance to the Board. In particular, they both continue to demonstrate a strong independence of management in the manner in which they discharge their responsibilities as directors. Accordingly, the Board has decided that, in the absence of any other relevant factors, George Paul and Elizabeth Vallance are independent non-executive directors. However, being mindful of the programme to refresh the skills and experiences of the directors, it is the Board's intention that subject to being re-elected by shareholders at the Annual General Meeting, George Paul and Elizabeth Vallance will retire from service by 31 December 2005.

Philip Scott and Patrick Snowball, being respectively the executive directors responsible for the Group's continental European and international life assurance and long-term savings business, and the Group's worldwide general insurance operations, will also retire at the Annual General Meeting and offer themselves for re-election.

To ensure that the non-executive directors are able to exercise an independence of judgement, the Nomination Committee undertakes an annual review of directors' interests in which all potential or perceived conflicts and issues relevant to their independence and commitment are considered. Based on the December 2003 review, the Board has agreed that all of the current non-executive directors are independent of management and free from any relationship or circumstances that could affect, or appear to affect, the exercise of their independent judgement. The Board is also satisfied that the non-executive directors are able to devote sufficient time to their duties to the Company.

The principal commitments of the directors are summarised in the biographical details on pages 36 and 37. Pehr Gyllenhammar resigned as a senior adviser to Lazard Freres in July 2003 and was appointed Vice Chairman, Europe at Rothschild in September 2003. This change has had no effect on his time commitment to the Company.

# Corporate governance
continued

**Board process**
The duties of the Board and its committees are set out clearly in formal terms of reference. This document is reviewed annually by the Board and was updated during the year to reflect the requirements of the revised Combined Code. The terms of reference address a wide range of corporate governance issues including those items which are specifically reserved for decision by the Board. These include the approval of the Group's strategy, business plans, acquisitions and disposals outside delegated limits, significant financial decisions and the approval of key business policies including the remuneration policy. Matters which are not specifically reserved to shareholders by applicable legislation or regulation or by the Company's articles of association, or to the Board and its committees under the Board's terms of reference, are delegated to the Group Chief Executive.

The Board's terms of reference describe the procedure whereby directors may, in the furtherance of their duties, seek independent professional advice at the Company's expense if considered appropriate. No director obtained any such independent professional advice during 2003. The document also sets out the separate roles and responsibilities of the Chairman and the Group Chief Executive.

Directors are fully briefed in advance of Board and committee meetings on all matters to be discussed and, at Board meetings, directors receive regular reports on the Group's financial position, key areas of the Group's business operations and other material issues.

The Group Company Secretary is responsible for advising the Board, through the Chairman, on governance matters and ensuring that Board procedures are followed. All directors have access to his advice and services.

The Board has established a number of standing committees, including Remuneration, Audit, Nomination, and Chairman's committees. Each committee operates within defined terms of reference and the minutes of their meetings are circulated to the Board. Details of the work of the respective committees, including their membership and duties, are set out in the reports of the committees on pages 44 to 54.

The Company has an established formal performance review process to assess how well the Board, its committees and directors are performing. The process is conducted over a two year period. Directors complete, in confidence, a detailed questionnaire in which they assess Board and committees' processes and their effectiveness and suggest areas where such may be improved. The completed questionnaires are returned to the Group Company Secretary who prepares a report for the Chairman and feedback for the Board. The following year interviews take place between each individual director and the Chairman in which a range of issues, including their own and other directors' performance are discussed. The conclusions of the process are fed back to the Board. As part of this process the Chairman leaves the Board meeting whilst the directors, under the chairmanship of the senior independent non-executive director, discuss the performance of the Chairman. The next review is due to be undertaken in Spring 2004 when the Board will also consider its current practice in line with the Combined Code.

During the year, the directors met without the Chairman being present to consider his performance and the Chairman and non-executive directors met in the absence of the executive directors.

The Board believes strongly in the development of all its employees, including its directors, and it is a requirement of directors' appointments that they commit to continue their development. The form which this development takes varies depending upon each director and the quality/relevance of the training available, but directors have attended a range of courses, seminars, workshops and lectures on issues relevant to the Group's business and/or their roles and responsibilities. During the year three directors attended courses designed specifically for non-executive directors of major companies. Following attendance on a course, directors report briefly to the Board on its content and relevance. The 2004 work plan for the Board includes two specific training topics. The Board undertook two site visits during the year in order to gain a closer understanding of the businesses visited. The two non-executive directors who joined the Board during the year have completed a detailed induction programme which was conducted over a seven-month period comprising 14 sessions including visits to the Group's main operating businesses and meetings with the external auditor and one of the Company's corporate brokers.

**Relations with shareholders**
The Company places considerable importance on communication with shareholders and engages with them on a wide range of issues. As and when considered appropriate, the Company seeks the views of major investors, particularly on remuneration issues, both directly and through consultation with the Association of British Insurers. The Company's Investor Relations Department is dedicated to facilitating communication with institutional investors. The Group has an ongoing programme of dialogue and meetings between the executive directors and its major institutional shareholders, where a wide range of relevant issues including strategy, performance, management and governance are discussed within the constraints of the information already known to the market. During the year, the Chairman met with a number of major shareholders. For 2004, arrangements have been made, in accordance with the best practice recommendations set out in the revised Combined Code, for the senior independent non-executive director to attend meetings with shareholders in order to gain a fuller understanding of shareholders' issues and to make the other members of the Board aware of these.

The Company's Annual General Meeting provides a valuable opportunity to communicate with private investors. At the meeting, the Company complies with the Combined Code as it relates to voting, including votes withheld, the separation of resolutions and the attendance of committee chairmen. The Notice of the Annual General Meeting is sent out to shareholders at least 20 business days before the meeting, to ensure that they have sufficient time in which to consider the items of business. Details of the voting by shareholders at general meetings are made available on request and are placed on the Company's website. Whenever possible all directors attend the Annual General Meeting and shareholders are invited to ask questions during the meeting and have an opportunity to meet with the directors after the conclusion of the formal part of the meeting.

The Company's Annual report and accounts and Annual review, together with the Company's interim reports, trading statements and other public announcements are designed to present a balanced and understandable view of the Group's activities and prospects. The Chairman's statement, Group Chief Executive's review and business and financial reviews on pages 2 to 35 provide an assessment of the Group's affairs and will be supported by a presentation to be made at the Annual General Meeting.

**Institutional investor**
Morley Fund Management Limited, the Group's asset management company believes that good governance leads to better performance and practices. Therefore, as a major investor, the Group monitors the governance of the companies in which it invests. To this end Morley holds regular meetings with the senior management of companies where it will raise all relevant matters which may affect the future performance of those companies.

Morley operates a Corporate Governance and Voting Policy in respect of the voting rights it holds in United Kingdom companies and always votes its shares in line with that policy unless clients instruct otherwise. The policy also extends to cover social, environmental and ethical issues. Details of how Morley's voting discretion has been used on any particular issue are available to clients upon request. In addition, Morley engages with the management of the companies in which it invests on contentious matters, and its policy is applied flexibly after careful consideration of all relevant information.

**Directors' responsibilities**
Directors are required to ensure that accounts are prepared for each accounting period which comply with the relevant provisions of the Companies Act 1985, and which give a true and fair view of the state of affairs of the Company and the Group as at the end of the accounting period and of the profit or loss for the period. Suitable accounting policies have to be used and applied consistently in preparing accounts, using reasonable and prudent judgements and estimates on the going concern basis unless it is inappropriate to presume that the Company and the Group will continue in business. Applicable accounting and financial reporting standards also have to be followed, with any material departures being disclosed and explained.

The directors are responsible for maintaining proper accounting records which are intended to disclose with reasonable accuracy at any time the financial position of the Company and the Group. They are also ultimately responsible for the systems of internal control maintained by the Group for safeguarding the assets of the Company and the Group and for the prevention and detection of fraud and other irregularities. Further details of the systems of internal controls maintained by the Group are more fully described in the report of the Audit Committee on page 44.

**Compliance with the Combined Code**
The Company has complied fully throughout the accounting period with the provisions set down in Section 1 of the Combined Code. The auditor's report on page 55 covers its review of the Company's compliance with the relevant provisions of the Combined Code as applicable to the Company during the year under review.

Had the revised Combined Code been in force for the 2003 financial year the Company would have complied with its provisions save for the fact that Board performance reviews are conducted over a two year cycle rather than annually as recommended by the revised Combined Code and there was no formal process in place during the year for the senior independent director to meet with major shareholders and communicate their views to the Board. From 2004 the Audit Committee will, in line with the revised Combined Code put in place annual reviews covering the effectiveness of both the internal and external audit functions and the implementation of the policy concerning the use of the external auditor.

# Audit Committee report

This report provides details of the role of the Audit Committee and the work it has undertaken during the year.

The purpose of the Committee is to assist the Board in discharging its responsibilities for the integrity of the Company's financial announcements, the assessment of the effectiveness of the systems of risk management, internal control and regulatory compliance and to oversee the objectivity and effectiveness of the internal and external auditors. A copy of the Committee's terms of reference is available from the Group Company Secretary and can be viewed on the Company's website.

## The Audit Committee

The Audit Committee comprises the following independent non-executive directors, appointed by the Board:

Derek Stevens (Chairman)
Guillermo de la Dehesa
George Paul
Carole Piwnica*

*Appointed to the Committee in September 2003.

The Committee met on four occasions during the year and all members attended each meeting.

Sir Michael Partridge served as a member of the Committee until his retirement at the close of the Company's Annual General Meeting in May 2003.

Derek Stevens is a Chartered Accountant and served as the Chief Financial Officer of British Airways Plc for 13 years until his retirement from service in 2001. In addition to his other non-executive appointments, he is also a member of the "Financial Sector and Other Special Industries Committee of the Accounting Standards Board". Accordingly the Board is satisfied that Mr Stevens has recent and relevant financial experience.

The Group Finance Director, Group Business Risk Director (Head of Internal Audit), Group Company Secretary and external auditor normally attend, by invitation, all meetings of the Committee. Other senior members of management are also invited to attend meetings in order to present reports to the Committee as necessary. In undertaking its duties, the Committee has access to the services of the Group Business Risk Director and the Group Company Secretary and their resources, as well as access to external professional advice.

The Committee undertakes its duties in line with an agreed annual work plan. It reviews, with members of management and the internal and external auditors, the Company's formal financial announcements including the Annual report and accounts to shareholders and associated documentation, with a particular emphasis on their fair representation and the reasonableness of the judgemental factors and appropriateness of significant accounting policies used in their preparation. Twice each year, the Committee receives reports from the Group's reporting actuary regarding the adequacy of the Group's life assurance and general insurance reserves. At each meeting, the Committee receives a report from the Group Business Risk Director covering internal audit, risk management, fraud, anti money laundering and corporate governance matters to help it assess the effectiveness of the risk management and control frameworks. These reports include material notifications arising under the Group policy on "whistleblowing". The Committee also reviews annually the operational plan for the Group's internal audit function. The Group Compliance Director reports to the Committee regularly on the Group's compliance with rules and regulations and any regulatory developments and compliance issues which have arisen.

With effect from 2004, the Committee will, in line with the recommendations contained in the revised Combined Code, undertake an annual review covering the effectiveness of both the internal audit function and the external audit process.

Each of the Group's major business units have formally constituted audit committees which provide an oversight role for their business. All such committees include some members who are independent of the relevant business. The Group Business Risk Director reviews the business unit audit committee papers and minutes on behalf of the Group Audit Committee and all significant matters are brought to the Committee's attention.

The Committee receives regular reports from the external auditor as well as reports of significant issues raised at the audit committees of the Group's principal businesses. The Committee also meets regularly with both the internal and external auditors in the absence of management. In order that the Board is kept fully appraised of the Committee's work, its chairman reports at the next following meeting of the Board and the Board receives a copy of the minutes of each meeting of the Committee.

## External auditor

Ernst & Young LLP was appointed as auditor of the Company in 2001 following a competitive bid process between the firms which had acted as auditors of CGU and Norwich Union prior to their merger in 2000. Ernst & Young had been the auditor of Norwich Union plc. During 2002, the audit signing partner changed as part of a rotation process. Ernst & Young LLP audit the whole of the Group other than Delta Lloyd, the Group's subsidiary in the Netherlands, which is audited by PricewaterhouseCoopers LLP (PwC). To fulfil its Group reporting responsibilities Ernst & Young LLP reviews the work of PwC in accordance with standard auditing practices.

The Company has established a policy, approved by the Board, aimed at safeguarding and supporting the independence of the auditor by avoiding conflicts of interests. The policy sets out the approach to be taken by the Group when using the services of the auditor and distinguishes between those matters where the Company requires an independent view, such as audit and assurance work, from other consultancy work. In addition to statutory audits, audit and assurance work includes statutory returns, actuarial assurance, regulatory advice which requires auditor reporting, due diligence associated with acquisitions and disposals, fraud investigations and control and audit reviews. The auditor cannot be used for any other purpose, although, the policy recognises that there may be a small number of areas where, for pragmatic or historical reasons, it may be in the Company's interests to use the external auditors for this work. Such appointments are subject to a transparent approval process. Over a number of years Ernst & Young LLP has provided support to the Company in respect of advice concerning senior executive remuneration. Management has now appointed KMPG LLP to provide this service in respect of a major remuneration review to be undertaken during the current year. From 2004 the Committee will, in line with the best practice recommendations contained in the revised Combined Code, review annually the implementation of the policy concerning the use of the external auditor.

The total fees paid to Ernst & Young LLP in 2003 were £13.3 million of which £3.6 million related to non-audit work. Further details are provided in note 13 to the Report and Accounts on page 74.

The Committee reviews, annually, a formal letter provided by the external auditor confirming its independence and objectivity within the context of regulatory requirements and professional standards.

### Internal controls

The Board has the ultimate responsibility for the systems of internal control maintained by the Group and for reviewing the effectiveness of those control systems. The systems of internal control are intended to provide reasonable assurance, but not an absolute guarantee, against material financial misstatement or loss, and include the safeguarding of assets, the maintenance of proper accounting records, the reliability of financial information, compliance with appropriate legislation, regulation and best practice, and the identification and containment of business risks.

During the year, the Committee, acting on behalf of the Board, has reviewed the effectiveness of the framework for the Group's systems of internal control and has received regular reports on the status of major finance systems development projects. In the Board's view, the information received was sufficient to enable it to review the effectiveness of the Group's systems of internal control in accordance with the Guidance on Internal Control (the Turnbull Guidance). The principal features of the control framework are as follows:

*Control environment*

The Group has an established governance framework. The key features of the control environment within the framework include: the terms of reference for the Board and each of its committees; a clear organisational structure, with documented delegation of authority from the Board to executive management; a Group policy framework, which sets out risk management and control standards for the Group's operations worldwide; and defined procedures for the approval of major transactions and capital allocation. The Group is also preparing for future changes to the regulatory regime impacting on governance. In particular, the Group has an established plan in place to implement the Prudential Sourcebook, which is the Financial Services Authority's new risk-based framework for integrating and embedding risk and capital management.

*Risk identification, assessment and management*

The Group has an established system of business risk management, which is integrated into the Group's business planning and performance monitoring processes. The Group's risk management and control framework is designed to support the identification, assessment, monitoring and control of risks that are significant to the achievement of the Group's business objectives. There is an established risk management network across the Group, with dedicated risk management teams within Head Office and within each of the businesses in the United Kingdom. The overseas businesses also have risk management functions, a number of which are combined with either compliance or internal audit. These teams use a consistent methodology, and are responsible for assessing and reporting the potential impact and probability of the most significant risks identified across the Group and the adequacy of the mitigating action programmes. These impact assessments are based on financial, reputational and operational criteria and take into account social, ethical and environmental risks as well as business risks.

Businesses report residual risk profiles, based on local materiality levels on a regular basis. A consolidated Group risk report, is reviewed regularly by the Group Business Risk Committee, under the chairmanship of the Group Finance Director. Each quarter, material items in the Group risk report are reported to the Group Executive Committee, the Audit Committee and the Board, who consider whether residual risks are within risk appetite and the adequacy of the risk mitigating actions. Local business unit boards, audit committees and management also consider local risk reports in a similar way. These regular reports are supported by escalation procedures for new or deteriorating risks that are classified at the highest impact levels.

In addition, all business unit heads and Group functional heads provide to the Group a formal certificate every six months confirming compliance with the Group's risk management framework and the terms of their delegated authority. They are also required to specify any risks or control issues not already reported through the regular risk management processes.

*Control procedures and monitoring systems*

The Group has a well-developed system of planning and monitoring, which incorporates Board approval of a rolling three year Group Plan. Performance against the Plan is subsequently monitored and reported to the Board each time it meets. This report also includes reports on risk, audit, compliance, solvency and liquidity. Performance is also reported formally through the publication of Group results, and accounting policies are applied consistently throughout the Group. Operational management report frequently to the executive directors and the Board receives regular representations from management responsible for each principal business operation.

This report was reviewed and approved by the Board on 24 February 2004.

**Derek Stevens**
Chairman, Audit Committee

# Nomination Committee report

This report provides details of the role of the Nomination Committee and the work it has undertaken during the year.

The Committee comprises the following directors, appointed by the Board:

Pehr Gyllenhammar (Chairman)
Guillermo de la Dehesa
Richard Harvey
Elizabeth Vallance
André Villeneuve*

*Appointed a member of the Committee in September 2003.

In 2003 the Committee met on six occasions and all the members recorded a full attendance other than Guillermo de la Dehesa and Richard Harvey who were absent from three, and one, meeting respectively.

The terms of reference of the Committee require it to deal with the constitution of the Board, evaluating the balance of skills and experience of the directors and anticipating the skills and knowledge requirements for the future. The Committee identifies, assesses and nominates to the Board the appointments of new directors as and when required. A copy of the Committee's terms of reference is available from the Group Company Secretary and can be viewed on the Company's website.

The Committee also keeps under review and advises the Board on matters relating to the independence of each non-executive director and directors' other interests with a view to monitoring any conflicts or perceived/potential conflicts of interests including directors' time commitments. The matters of independence and conflicts of interest are reviewed formally each year and, based on this and the Board's performance review, the Committee makes recommendations to the Board regarding the renewal of individual director's appointments. No member of the Committee takes part in any discussions concerning their own circumstances. In assessing a director's conflicts of interests, the Committee attempts to identify relationships between Group companies and those companies in which the relevant director has an interest. The Group is one of the United Kingdom's largest institutional investors and holds shares in most of the country's major companies. The Committee does not believe that this situation compromises the independence of those non-executive directors who serve on the boards of companies in which the Group invests.

During the year, the Board undertook to widen its base of skills and experience by appointing two new independent non-executive directors. In addition to the acquisition of specific skills, the Board was seeking to diversify its composition in terms of international experience and age. With the assistance of search consultants, the Committee prepared a shortlist of suitable candidates for consideration. Following meetings with the candidates, the Committee made a recommendation to the Board that two new non-executive directors, Anna Catalano and Carole Piwnica, join the Board with effect from 8 May 2003. These recommendations were unanimously approved by the Board.

The Committee is keeping the constitution of the Board under review and continues to work with executive search consultants in this regard.

This report was reviewed and approved by the Board on 24 February 2004.

**Pehr G Gyllenhammar**
Chairman

# Chairman's Committee report

This report provides details of the role of the Chairman's Committee and the work it has undertaken during the year.

The Committee comprises the following directors, appointed by the Board:

Pehr Gyllenhammar (Chairman)
George Paul
Derek Stevens
Elizabeth Vallance

The main duties of this Committee are to review the performance of the Group Chief Executive and the succession planning for the executive director group of management. The Committee has two scheduled meetings each year and makes recommendations to the Board as appropriate.

On two occasions during the year, the Committee reviewed the Group Chief Executive's performance against the written objectives considered by the Remuneration Committee and approved by the Board.

This report was reviewed and approved by the Board on 24 February 2004.

**Pehr G Gyllenhammar**
Chairman

# Directors' remuneration report



This report sets out the remuneration policy for the Company's directors and senior executives, outlines the various elements of their remuneration and sets out the amounts of remuneration paid to the directors in 2003. Shareholders will be invited to approve this report at the Annual General Meeting to be held on 27 April 2004.

**The Remuneration Committee**
The Remuneration Committee comprises the following independent non-executive directors, appointed by the Board:

George Paul (Chairman)
Anna Catalano*
Wim Dik
Elizabeth Vallance
André Villeneuve

*Appointed to the Committee in September 2003.

The Committee met on four occasions during the year and all members recorded a full attendance other than Wim Dik who was absent from one meeting.

The Group Chief Executive is normally invited to attend the meetings of the Committee, except when his own remuneration is being discussed, as is the Group Human Resources Director.

The Committee considers all aspects of remuneration paid to the Group's senior executives, and makes recommendations to the Board on the remuneration policy, strategy and framework for this group of employees. The remuneration policy is reviewed by the Committee on a regular basis to ensure that it remains appropriate within the market and for the achievement of its objectives. Within the scope of the policy, which is approved by the Board, the Committee determines the level of remuneration paid to each of the executive directors and the Chairman. The Committee also exercises discretion on behalf of the Board in relation to the operation of the Group's various share schemes and incentive plans. A copy of the Committee's terms of reference is available from the Group Company Secretary and can be viewed on the Company's website.

Mike Pemberton, the Group Human Resources Director, has provided material assistance to the Committee during the year advising on market trends, practices and appropriate levels of remuneration. He has been supported by Ernst & Young LLP who has advised on remuneration benefits generally, including salary levels, bonus and incentive arrangements. Deloitte & Touche has advised on the calculation of total shareholder return for the purposes of the long-term incentive plans. In addition, the Committee has taken into account the views of Pehr Gyllenhammar, Chairman, and Richard Harvey, Group Chief Executive, on performance assessments. Ernst & Young LLP is the Company's auditor and has provided audit and assurance services to the Group as disclosed in the report of the Audit Committee on page 44 and note 13 on page 74. KPMG LLP has now been appointed by Management, in place of Ernst & Young LLP, to assist it with a thorough review of senior executive remuneration to be undertaken during the current year. Deloitte & Touche provide no other material services to the Group.

It is the Committee's current practice to commission every three years its own independent review of the remuneration policy and the packages paid, to ensure that the policy reflects good practice and that the packages remain competitive and in line with the market. New Bridge Street Consultants, who provide no other services to the Group, were appointed by the Committee to undertake such a review during 2002. In light of a wider review of the Company's executive remuneration to take place in 2004, the Committee will seek a further independent review.

**Remuneration policy**

Executive directors
The Company's remuneration policy seeks to provide remuneration packages appropriate for each particular market in which the Company operates, which attract and retain high calibre employees and encourage and reward superior performance in a manner which is consistent with the interests of shareholders. The policy is aimed at ensuring senior executives are rewarded fairly for their individual and collective contributions to the Company's performance.

Against this broad policy, the Committee has set the content of the senior executives' total remuneration package by reference to a variety of factors, including market practices for companies of similar size, type and standing. It also considers the current economic and prevailing operating conditions within both the Group and the financial services industry generally. The Committee considers the level of earnings of the Group's employees and the skills and management capabilities which the Group must secure in order to attain its strategic objectives.

The Board's philosophy is that the senior executives' own interests should be aligned with those of the Company's shareholders. It therefore believes that, whilst paying a competitive basic salary a substantial proportion of the targeted total remuneration package should be closely linked to the performance of the business and delivered in the form of shares. The policy seeks to provide an appropriate balance between the delivery of the annual business plan and the long-term profitable growth of the Company. The Board believes that the executive directors should build and maintain a personal stake in the equity of the Company and to this end, each director is required to defer 50%, and is encouraged through share matching to defer 100%, of their annual bonus into shares and is further required to retain these for three years. The share interests of the directors are set out on page 54.

In their 2002 review, New Bridge Street Consultants confirmed that overall the Company's remuneration policy and levels of remuneration were broadly in line with market practice for companies of similar size. Two areas in relation to the long-term incentive plans, where the Company's approach differed from that preferred by institutional investors, were noted and these are commented upon below.

The Committee continues to review and develop the remuneration policy in order to reflect market conditions and changes in best practice. No material changes have been made to the remuneration policy or packages during the year and none are planned in 2004. However, from 1 April 2004 those members of the defined benefit section of the Aviva Staff Pension Scheme, including the executive directors, who currently do not make a contribution will be required to contribute 2.5% pa of their gross pensionable salary, increasing to 5% pa from 1 April 2005. As mentioned above, a review of the senior executives' remuneration practice will be undertaken in 2004, with any proposed changes taking effect from 1 April 2005. The review will include a response to the Government's proposals on pension reform and the effect of those changes on the pension arrangements for the Group's United Kingdom based senior executives.

Non-executive directors
The Company's articles of association provide that the total aggregate fees paid to directors shall be determined by the Board within the limits set by shareholders. The current limit is £1 million pa as approved at the 2002 Annual General Meeting. Executive directors receive no fees for serving as directors.

The fees paid to the non-executive directors are set by the Board after considering a recommendation from the executive directors.

It is the Company's policy to set the fees paid to its non-executive directors at the median level for international companies of similar size and complexity. Non-executive directors receive a basic annual fee in respect of their Board and Board committee duties, with a further fee being paid to those directors (other than the Chairman and Deputy Chairman) who have the additional responsibility of chairing meetings of Board committees. These fees are reviewed, but not necessarily increased, annually and are set by the Board to attract individuals with the broad range of skills and experience appropriate for a major international company.

# Directors' remuneration report
continued

In determining the level of fees, the Board considers a recommendation of the executive directors who take into account the duties and responsibilities of the non-executive directors, the time commitment required in preparing for and attending meetings, and the amounts paid by competitors and similar-sized companies. Other than the Chairman who receives a car allowance, non-executive directors receive no benefits in addition to their fees nor do they participate in any incentive or performance plans.

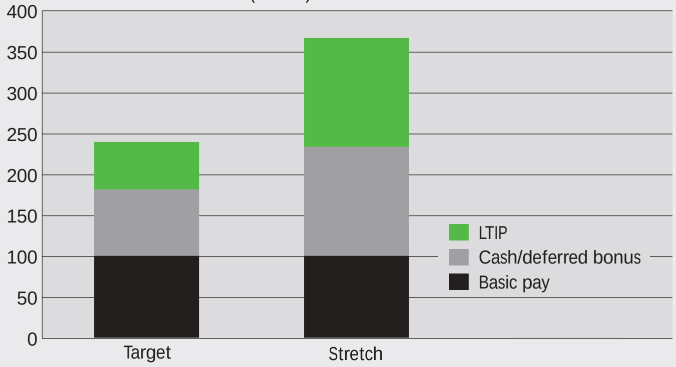
The basic fee payable to each non-executive director was increased from £38,000 pa to £42,000 pa from July 2003 and that payable to the chairman of the Audit Committee from £15,000 pa to £25,000 pa. The fee paid to the Chairman was increased from £275,000 pa to £300,000 pa from July 2003 and no increase was made to the Deputy Chairman's fee of £160,000 which includes acting as chairman of the Remuneration Committee and as the senior independent non-executive director.

**Remuneration package**
The remuneration package for the Company's senior executives comprises the following elements:

- a basic salary;
- an annual bonus plan – to encourage executives to meet annual targets relating to business and personal performance;
- a deferred bonus plan – linked to the annual bonus plan to encourage executives to take all of their bonus in the form of shares and retain them for a period of three years;
- a long-term incentive plan – to align executives' longer term interests with those of shareholders;
- a defined benefit pension entitlement and other benefits.

The balance of these elements is such that, for directors achieving "Target" performance, basic salary represents approximately 40% of the potential total remuneration package, with the annual bonus/deferred bonus plan representing 35% and the long-term incentive plan 25%. At "Stretch" performance, basic pay represents approximately 28% of the potential total remuneration package, with the annual bonus/deferred bonus plan representing 36% and the long-term incentive plan also representing about 36%. "Stretch" performance would represent the achievement of business results significantly better than the business plan target.

**The relative value of the elements of executive directors' remuneration*** (£'000)




*For the purposes of this diagram, the following assumptions have been made:

At "Target" performance – the annual bonus is 35% of basic pay and the executive director chooses to defer the whole of his bonus, which is matched. The Return on Capital Employed (ROCE) performance condition on the long-term incentive plan is met in full and the Company's Total Shareholder Return (TSR) position is median, resulting in the vesting of 50% of the shares awarded. The share price growth during the three-year performance/deferral period averages 5% per year.

At "Stretch" performance – the annual bonus is the maximum 50% of basic pay and the executive director chooses to defer the whole of his bonus, which is matched. The ROCE performance condition on the long-term incentive plan is met in full and the Company's TSR position is upper decile, resulting in the vesting of 100% of the shares awarded. The share price growth during the three-year performance/deferral period averages 10% per year.

Basic salaries
In determining the level of basic salaries, the Committee gathers data from a number of independent sources concerning the level of salaries paid to senior executives performing comparable functions within the largest 50 listed companies in the United Kingdom, with an additional focus on leading United Kingdom and European financial services companies. Salaries are reviewed annually.

When reviewing basic salaries the Committee takes into account both market data and each senior executive's performance. The Company's policy is to set basic salaries for competent performance at the median level. Salaries are targeted towards the upper quartile for those executives who display sustained superior performance.

Cash bonuses
Senior executives participate in a discretionary annual cash bonus plan that provides for the payment of cash bonuses. For executive directors the bonus for "Target" performance is 35% of basic salary and for achieving "Stretch" performance a payment of up to 50% can be made. Of the potential payment, 70% is dependent upon financial targets and the remaining 30% is based upon the director's attainment of personal objectives.

For the executive directors, shared Group-wide financial objectives are based on financial measures relevant to the business, including new business contribution, combined operating ratio and operating profit. For the Group Chief Executive and the Group Finance Director, Group-wide targets are the relevant performance measures for annual bonus purposes. For the other executive directors, Group-wide targets represent about 40% of their overall financial target with the remainder represented by targets pertaining to the businesses for which they have responsibility.

A fundamental part of the annual bonus plan is the requirement that a stated proportion of any cash bonus awarded under the plan be taken in the form of shares through the Deferred Bonus Plan. Executive directors are required to defer 50%, and may elect to defer up to 100%, of their cash bonus. In respect of bonuses deferred, participants are granted an award of shares of equal value to the amount of cash bonus deferred and this is matched on a "one for one" basis with a further award of shares. The shares granted under the plan are held in trust and vest automatically after three years. Upon vesting the particpants are entitled to receive additional shares representing the dividends paid on the shares during the deferral period.

If a participant leaves service during the deferral period for reasons of ill-health, retirement or redundancy, the matching shares are released in full at the end of the deferral period. In all other cases, the matching shares normally lapse.

The Committee has considered carefully the suggestion of certain institutional investors that the vesting of the matching awards should be subject to the attainment of performance conditions. The award of matching shares can only be made in relation to bonuses actually earned, (ie the performance conditions attaching to the annual bonus plan must have been met). The plan makes it compulsory for participants to defer 50% of their bonus into shares and encourages participants to invest the whole of their bonus into shares, thereby strengthening further the alignment of their interests with those of shareholders. The Committee believes that the imposition of additional performance conditions would be detrimental to achieving this. As a result of benchmarking the Company's remuneration package, the Committee is aware that the maximum amount which a participant can earn under the Company's annual cash bonus plan, and hence defer (being 50% of basic salary), is at the bottom decile of the market range. Taking the above into account, the Committee believes that the absence of performance conditions is reasonable. However, the Company's incentive plans fall for renewal by shareholders at the 2005 Annual General Meeting and therefore during 2004 the plan will be fully reviewed when all relevant matters, including the above issue and emerging best practice, will be taken into account.

Long-term incentives
The Aviva Long Term Incentive Plan is a discretionary share plan. It is the Committee's policy to make an annual award of shares to executive directors with a value equal to 100% of their basic salary as at 31 December of the previous year.

All awards are made subject to the achievement of stretching performance conditions which contain two elements. The first element compares the Total Shareholder Return (TSR) produced by the Company over the performance period with the TSR of companies in a chosen comparator group (70% of award). The second element of the performance condition measures the Return on Capital Employed (ROCE) within the Company against a target return (30% of award). The Committee believes that this combination is the most appropriate way of incentivising executives since it takes into account both the returns to shareholders and the Company's underlying performance.

Achievement of median TSR performance within the comparator group triggers the vesting of 20% of the shares, which rises to 70% if the Company's performance is in the upper decile of the comparator group. Recognising the Company's position as one of the largest providers of life and pension products in Europe, the comparator group for the TSR part of the plan comprises 19 European financial services companies, namely – Abbey, AEGON, Allianz, AXA, Barclays, CNP Assurances, Ergo, Fortis, HBOS, HSBC, ING, Legal & General, Lloyds TSB, Prudential, Royal Bank of Scotland, Royal & Sun Alliance, Skandia, Swiss Life and Zurich.

The other 30% of the award vests if the Company achieves a given return in excess of inflation on the ROCE over the three-year performance period. Awards under this performance condition will begin to vest if the cumulative ROCE over the performance period is 24% in excess of the rate of inflation, with the full 30% vesting if the ROCE is 30%, or higher.

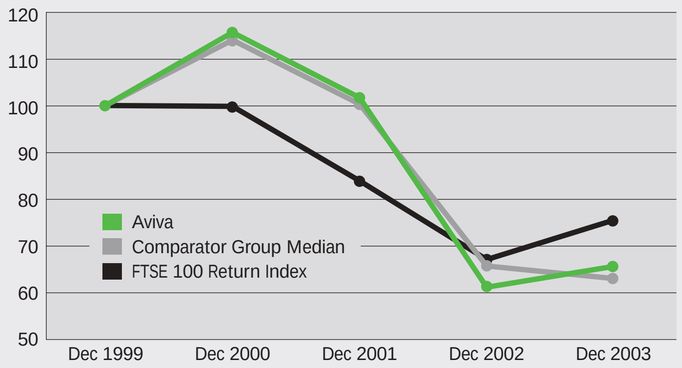
If the performance targets have not been met at all at the end of the three year performance period they will be retested at the end of five years, the ROCE performance condition being adjusted accordingly (i.e. the cumulative ROCE would need to be at least 40% in excess of the rate of inflation over the extended performance period for any awards under that part of the plan to vest).

The Committee is conscious that certain institutions are not in favour of performance conditions being retested. From a benchmarking exercise the Committee is aware that the Company's performance conditions ie upper decile TSR and ROCE exceeding 30% real return over the performance period, are very demanding compared with such plans generally. The Committee believes that it is important to strike a balance between setting challenging performance conditions and retaining the motivational incentive which is the fundamental purpose of the plan. The Committee is also conscious of the cyclical nature of its general insurance operations and believes that one retest allows performance to be measured over a larger part of the cycle. After careful consideration it believes that this is best achieved by retaining the demanding conditions but allowing one retest at the end of five years. No retesting takes place if any part of the performance condition has been met at the end of the three-year performance period. The Company's incentive plans fall for renewal by shareholders at the 2005 Annual General Meeting and therefore during 2004 the plan will be fully reviewed when all relevant matters, including the above issue and emerging best practice, will be taken into account.

Whether or not the performance conditions have been met is determined by the Committee. The rules of the plan require the Committee to request an independent consultant to determine the relevant TSR positions. In respect of the ROCE calculation, the Committee requests that the Group's auditor expresses a formal opinion on the basis of the calculation used.

The following graph compares the TSR performance of the Company with the TSR of the FTSE 100 index. The period covered is the four years since the beginning of 2000, the year in which CGU and Norwich Union merged to form Aviva. The graph also includes the median TSR of the companies in the comparator group which is included as it is the group with which performance is measured for the purposes of the Long Term Incentive Plan.

**Four year total shareholder return comparison**




## Pension arrangements

The remuneration package for senior executives in the United Kingdom includes company contributions into the Group's staff pension scheme. All executive directors are members of the defined benefit section of the Aviva Staff Pension Scheme.

Under the Scheme, executive directors have a normal retirement age of 60 and accrue pensions at a rate of one-thirtieth of their final pensionable salary for each year of service since they became a senior executive, subject to a maximum pension of two-thirds of their final pensionable salary. No pension benefits are accrued on bonuses or other benefits. The Scheme provides a lump sum death-in-service benefit of four times the member's basic salary at the date of death and a spouse's pension equal to two-thirds of a member's actual or prospective pension. Post-retirement, pensions are reviewed annually and increases are guaranteed at a rate equivalent to the annual increase in the Retail Prices Index up to a maximum of 10% pa.

During the year, the majority of members of the defined benefit section of the Scheme, including executive directors, have been members on a non-contributory basis. From 1 April 2004, all members, including executive directors, who do not currently contribute will be required to pay 2.5% pa of their total gross pensionable salary, increasing to 5% pa from 1 April 2005.

The benefits paid from the Scheme are subject to Inland Revenue limits. There is in place an unfunded pension top-up arrangement to ensure that senior executives receive the benefits promised by the Scheme notwithstanding an Inland Revenue limit relating to their level of earnings, which, in some cases, caps the amount of pension that can be paid from a tax-approved scheme. Where this limit applies, additional benefits are provided from the unfunded arrangement. Richard Harvey and Philip Twyman are affected by this limit and therefore will, at retirement, receive some of their pension benefits from the unfunded arrangement.

## Other benefits

In addition to the benefits described above, senior executives are entitled to the benefit of a company car allowance and private medical insurance.

The Company operates a number of Inland Revenue approved all-employee share plans in the United Kingdom. Senior executives are entitled to participate in these plans on the same basis as other eligible employees. These include the Free Share element of the Aviva All-Employee Share Ownership Plan (AESOP). Under this plan, eligible employees can receive up to a maximum of £3,000 pa in the form of shares from the profits of the Company, free of tax, subject to a retention period. The Partnership element of the AESOP allows participants to invest up to £125 per month out of their gross salary in the Company's shares.

The Aviva Savings Related Share Option Scheme allows eligible employees to acquire options over the Company's shares at a discount of up to 20% to their market value at the date of grant. In order to exercise the options, participants must have saved the consideration through either a three, five or seven year approved savings contract, subject to a maximum savings limit of £250 per month.

# Directors' remuneration report
continued

## Service contracts

Service contracts agreed with each executive director incorporate their terms and conditions of employment. Executive directors have rolling service contracts which came into effect from 1 June 2000 and which can be terminated by the Company giving 12 months' notice and by the director giving six months' notice.

In respect of the early termination of a service contract, the Company would, depending upon the circumstances, either seek to make a payment in respect of damages less an amount for appropriate mitigation, or would invoke a provision in the service contract allowing it to terminate the contract by making a payment of one year's basic salary in lieu of notice.

Under the Company's discretionary redundancy arrangements, which apply to United Kingdom based employees, an executive director may, depending on his length of service, receive an ex gratia payment of up to one year's basic salary should he leave employment on the grounds of redundancy. No special arrangements would apply should there be a change in the control of the Company.

During the year, the Committee reviewed the terms of the service contracts and except in a few areas, the current contracts comply with much of what has come to be regarded as best practice. In respect of appointments made following the review, the contracts include provisions to allow the Company to phase any termination payments over a 12 month period and include a specific requirement for employees to mitigate their losses. It is the Company's policy to notify to the market the terms offered to executive directors upon appointment.

The non-executive directors, including the Chairman, have letters of appointment which set out their duties and responsibilities. Such appointments are for three years and, subject to performance, may be renewed by mutual consent. The Company may terminate these appointments at any time upon giving one month's written notice without the payment of compensation.

Directors' service contracts and letters of appointment are available for inspection at the Company's registered office during normal hours of business.

## Directors' remuneration in 2003

This section of the report on pages 50 to 54 (which has been subject to audit) sets out the remuneration paid to the directors during the year to 31 December 2003.

The remuneration payable, in respect of 2003 to directors who held office for any part of the financial year, including amounts paid to them as directors of subsidiary undertakings, was as follows:

| | Basic salary | | Bonuses[1] | | Benefits[2] | | Incentive plans[3] | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2003 £000 | 2002 £000 | 2003 £000 | 2002 £000 | 2003 £000 | 2002 £000 | 2003 £000 | 2002 £000 | 2003 £000 | 2002 £000 |
| **Chairman** | | | | | | | | | | |
| Pehr Gyllenhammar[4] | **288** | 275 | **–** | – | **21** | 22 | **–** | – | **309** | 297 |
| **Executive directors** | | | | | | | | | | |
| Mike Biggs[5] | **459** | 437 | **191** | 163 | **84** | 147 | **–** | 257 | **734** | 1,004 |
| Richard Harvey | **718** | 691 | **312** | 258 | **67** | 70 | **–** | 402 | **1,097** | 1,421 |
| Philip Scott | **459** | 437 | **183** | 163 | **43** | 136 | **–** | 262 | **685** | 998 |
| Patrick Snowball | **420** | 376 | **212** | 145 | **21** | 17 | **–** | 207 | **653** | 745 |
| Philip Twyman | **466** | 451 | **192** | 178 | **53** | 16 | **–** | 143 | **711** | 788 |
| Tony Wyand*[7] | **285** | 476 | **124** | 181 | **13** | 21 | **–** | 195 | **422** | 873 |
| **Non-executive directors**[4] | | | | | | | | | | |
| Anna Catalano** | **27** | – | **–** | – | **–** | – | **–** | – | **27** | – |
| Guillermo de la Dehesa | **64** | 68 | **–** | – | **–** | – | **–** | – | **64** | 68 |
| Wim Dik | **40** | 38 | **–** | – | **–** | – | **–** | – | **40** | 38 |
| Sir Michael Partridge* | **13** | 38 | **–** | – | **–** | – | **–** | – | **13** | 38 |
| George Paul | **160** | 160 | **–** | – | **–** | – | **–** | – | **160** | 160 |
| Carole Piwnica** | **27** | – | **–** | – | **–** | – | **–** | – | **27** | – |
| Derek Stevens | **70** | 63 | **–** | – | **–** | – | **–** | – | **70** | 63 |
| Elizabeth Vallance | **40** | 38 | **–** | – | **–** | – | **–** | – | **40** | 38 |
| André Villeneuve | **40** | 38 | **–** | – | **–** | – | **–** | – | **40** | 38 |
| Total emoluments of directors[6] | **3,576** | 3,586 | **1,214** | 1,088 | **302** | 429 | **–** | 1,466 | **5,092** | 6,569 |

*To the date of ceasing to be a director: Sir Michael Partridge – 7 May 2003; Tony Wyand – 31 July 2003.

**From the date of appointment: Anna Catalano and Carole Piwnica – 8 May 2003.

Notes

(1) "Bonuses" include amounts earned under the Annual Bonus Plan (including amounts deferred under the Aviva Deferred Bonus Plan) in respect of performance in 2003, and the value of shares granted under the free share part of the Aviva All-Employee Share Ownership Plan in respect of 2003 performance.

(2) "Benefits". All the executive directors received the benefit of private medical insurance and, along with the Chairman, a car allowance. The disclosure also includes, in respect of Mike Biggs, Richard Harvey and Philip Twyman, charges relating to the cost of insuring their pension entitlements which cannot be provided from the pension scheme as a result of the "earnings cap", and in the case of Mike Biggs, the cost of providing accommodation in London and the payments for holiday entitlements not taken by his date of leaving.

(3) "Incentive Plans". In 2002, awards were made to participants in the CGNU Integration Incentive Plan and the Norwich Union Restricted Share Plan. Full details were disclosed in the Remuneration report for that year. These were one off awards and the plans are now closed.

(4) Non-executive directors. The benefits disclosed for Pehr Gyllenhammar refer to a car allowance. The fee for George Paul reflects his duties as Deputy Chairman, which includes chairing the Remuneration Committee and acting as the senior independent non-executive director. The fee for Derek Stevens includes an additional amount for serving as the Chairman of the Board's Audit Committee and of the trustee of the Aviva Staff Pension Scheme. The fee for Guillermo de la Dehesa includes an amount for serving as the non-executive Chairman of the Group's operations in Spain. No non-executive director accrued retirement benefits during the year.

(5) No compensation for loss of office was made to any director, or former director, during the year and no compensation for such will be paid to Mr Biggs who resigned with effect from 31 December 2003.

(6) For the purposes of the disclosure required by Schedule 6 of the Companies Act 1985 the total aggregate emoluments of the directors in respect of 2003 was £5.1 million *(2002: £6.6 million)*.

(7) Mr Wyand was the only executive director to serve on the board of an external company in a personal capacity during the year. He was a director of Grosvenor Estate Limited and during the year to his retirement from the Board on 31 July 2003 he received fees totalling £17,500.

## Pension benefits

During the year, each of the executive directors accumulated pension benefits under the defined benefits section of the Aviva Staff Pension Scheme, the Group's pension scheme for its United Kingdom employees.

| | Age at 31 December 2003 | Pension accumulated 2003 £000 | Increase in pension 2003 £000 | Increase in pension 2003 (net of inflation) £000 | Transfer value of previous column at 31 December 2003 £000 | Transfer value of pension 2003 £000 | Transfer value of pension 2002 £000 | Increase of transfer value 2003 £000 |
|---|---|---|---|---|---|---|---|---|
| Mike Biggs | **51** | **150** | **27** | **23** | **246** | **1,579** | 1,150 | **429** |
| Richard Harvey | **53** | **452** | **49** | **38** | **469** | **5,613** | 4,536 | **1,077** |
| Philip Scott | **49** | **272** | **31** | **25** | **237** | **2,624** | 2,109 | **515** |
| Patrick Snowball | **53** | **158** | **32** | **29** | **359** | **1,979** | 1,431 | **548** |
| Philip Twyman | **59** | **115** | **21** | **18** | **365** | **2,306** | 1,803 | **503** |
| Tony Wyand | **60** | **323** | **5** | **1** | **11** | **6,504** | 6,311 | **193** |

Disclosed for each director is the "Pension accumulated 2003", being the amount of pension to which the directors would have been entitled had they left service at 31 December 2003. The "Increase in pension" columns relate to the difference between the accumulated pensions at the end of 2003 on both gross and net of inflation basis. Also disclosed is the transfer value of the accumulated pensions at 31 December 2002 and 2003. The "Increase of transfer value 2003" is the difference between these values. The transfer values disclosed represent an obligation on the pension fund (where funded) or the Company (where unfunded) – they are not sums paid or due to the director.

## Payments to former directors

Mr Wyand retired from the Board on 31 July 2003 and served as an employee until 30 November 2003 when he retired at his normal retirement age. Between retiring from the Board and leaving service his remuneration including salary, bonuses and benefits was £241,711. Mr Wyand has agreed to serve as a consultant following his retirement and to join the boards of the Group's operations in Spain, Italy and France. The terms of the consultancy arrangement are that the Company will pay a per diem rate for approximately 40 days per year, subject to a maximum payment of £120,000 pa. This agreement took effect from 1 January 2004.

No former directors received any increase in retirement benefits in excess of the amount to which they were entitled on the later of the date when the benefits first became payable or 31 March 1997.

# Directors' remuneration report
continued

## Incentive plans

Details of the directors who held executive office for any part of the financial year, and hold or held options to subscribe for ordinary shares of the Company or hold or held awards over shares in the Company, pursuant to the Company's share-based incentive plans, are set out below.

### Share options

| | At 1 January 2003 Number | Options granted during year Number | Options exercised during year Number | Options lapsing during year Number | At 31 December 2003 Number | Exercise price p | Exercise period |
|---|---|---|---|---|---|---|---|
| **Richard Harvey** | | | | | | | |
| – Savings related options | | | | | | | |
| 2002 | 4,426 | – | – | – | **4,426** | 401.0 | Dec 2009 – May 2010 |
| **Philip Scott** | | | | | | | |
| – Savings related options | | | | | | | |
| 2002 | 4,096 | – | – | – | **4,096** | 401.0 | Dec 2007 – May 2008 |
| **Patrick Snowball** | | | | | | | |
| – Savings related options | | | | | | | |
| 2003 | – | 2,272 | – | – | **2,272** | 406.0 | Dec 2006 – May 2007 |
| **Philip Twyman** | | | | | | | |
| – Savings related options | | | | | | | |
| 2002 | 2,356 | – | – | – | **2,356** | 401.0 | Dec 2005 – May 2006 |
| – Executive options | | | | | | | |
| 1996 | 39,714 | – | – | – | **39,714** | 553.9 | Aug 1999 – Aug 2006 |
| 1997 | 36,637 | – | – | – | **36,637** | 766.4 | Aug 2000 – Aug 2007 |
| 1998 | 36,107 | – | – | – | **36,107** | 853.0 | Dec 2001 – Dec 2008 |
| 1999 | 36,866 | – | – | – | **36,866** | 919.0 | Aug 2002 – Aug 2009 |
| 2000 | 41,666 | – | – | 37,083 | **4,583** | 960.0 | Sep 2003 – Sep 2010 |
| – Bonus Plan options | | | | | | | |
| 1999 | 3,824 | – | – | – | **3,824** | 966.5 | July 2002 – July 2009 |
| 2000 | 4,259 | – | – | – | **4,259** | 875.0 | Mar 2003 – Mar 2010 |
| **Tony Wyand*** | | | | | | | |
| – Savings related options | | | | | | | |
| 1998 | 2,162 | – | – | – | **2,162** | 797.6 | Nov 2003 – April 2004 |
| – Executive options | | | | | | | |
| 1994 | 37,099 | – | – | – | **37,099** | 575.3 | Mar 1997 – Mar 2004 |
| 1994 | 12,701 | – | – | – | **12,701** | 547.2 | Nov 1997 – Nov 2004 |
| 1995 | 5,651 | – | – | – | **5,651** | 614.8 | Aug 1998 – Aug 2005 |
| 1996 | 50,129 | – | – | – | **50,129** | 581.2 | Mar 1999 – Mar 2006 |
| 1998 | 43,376 | – | – | – | **43,376** | 853.0 | Dec 2001 – Dec 2008 |
| 1999 | 42,720 | – | – | – | **42,720** | 919.0 | Aug 2002 – Aug 2009 |
| 2000 | 45,000 | – | – | – | **45,000** | 960.0 | Sep 2003 – Sep 2010 |
| – Bonus Plan options | | | | | | | |
| 1999 | 4,593 | – | – | – | **4,593** | 966.5 | July 2002 – July 2009 |

*As at the date of ceasing to be a director – 31 July 2003.

### Current plans

*"Savings related options"* are options granted under the Inland Revenue-approved Save As You Earn (SAYE) share option schemes. Options are normally exercisable during the six month period following either the third, fifth or seventh anniversary of the relevant savings contract.

### Closed plans

*"Executive options"* are those granted to former CGU directors under the CGNU Executive Share Option Scheme, or predecessor schemes. Options, granted on various dates from 1994 to 2000, are normally exercisable between the third and tenth anniversaries of their date of grant. No options have been granted to executive directors under these schemes since 2000.

Options granted after 1997 are only exercisable if certain performance conditions have been met. The exercise of options is subject to the attainment of performance conditions over a three-year performance period. The three-year performance condition relating to the options granted in 2000 fell due for testing during the year. For any options to vest under the Total Shareholder Return (TSR) condition, the Company's TSR, when compared with the TSR of a comparator group of European financial services companies (see page 49), would need to at least match median performance. At median performance, 20% of the options become exercisable and at upper decile performance 70% would become exercisable. Between median and upper quartile the number of options vesting is determined on a straight-line basis. For any options to vest under the ROCE condition, the Company's ROCE would have to exceed 24% in excess of RPI over the three-year performance period when 10% of the awards would vest, rising to 30% if the ROCE exceeded 30% over the same period. At the end of the performance period relating to the options granted in 2000, the Company was ranked 12th out of the 20 companies in the comparator group and the ROCE, net of inflation, was 24.3%. Accordingly, none of the options vested under the TSR condition but 11% of the options vested under the ROCE condition. The options are exercisable at 960 pence per share. Under the rules of the Scheme options which have not vested lapse.

*"Bonus Plan options"* are the options granted in 1999 and 2000 under the CGU Deferred Bonus Plan. Participants who deferred their annual cash bonus and instead received an award of shares also received a matching award over an equivalent number of options. These options, which are not subject to performance conditions, are normally exercisable between the third and tenth anniversary of their grant.

The mid-market price of an ordinary share in the Company on 31 December 2003 was 490 pence, and the mid-market prices during the year ranged from 335 pence to 591 pence. No director exercised any options during the year and therefore no gains on such were made.

Share awards
Details of the performance conditions relating to these awards are set out in the notes below:

| | At 1 January 2003 Number | Awards granted during year Number | Awards vesting during year Number | Awards lapsing during year Number | At 31 December 2003 Number | Market price at date awards granted p | Market price at date awards vested p | Vesting date |
|---|---|---|---|---|---|---|---|---|
| **Mike Biggs** | | | | | | | | |
| Aviva Long Term Incentive Plan* | | | | | | | | |
| – 2000 | 34,453 | – | – | – | **34,453** | 960.0 | – | March 2005 |
| – 2001 | 43,229 | – | – | – | **43,229** | 949.5 | – | March 2004 |
| – 2002 | 54,177 | – | – | – | **54,177** | 739.0 | – | March 2005 |
| – 2003 | – | 111,250 | – | – | **111,250** | 379.5 | – | March 2006 |
| Aviva Deferred Bonus Plan* | | | | | | | | |
| – 2001 | 29,492 | – | – | – | **29,492** | 949.5 | – | May 2004 |
| – 2002 | 46,592 | – | – | – | **46,592** | 739.0 | – | March 2005 |
| – 2003 | – | 80,100 | – | – | **80,100** | 379.5 | – | March 2006 |
| **Richard Harvey** | | | | | | | | |
| Aviva Long Term Incentive Plan | | | | | | | | |
| – 2000 | 107,988 | – | – | – | **107,988** | 960.0 | – | March 2005 |
| – 2001 | 69,270 | – | – | – | **69,270** | 949.5 | – | March 2004 |
| – 2002 | 86,814 | – | – | – | **86,814** | 739.0 | – | March 2005 |
| – 2003 | – | 175,000 | – | – | **175,000** | 379.5 | – | March 2006 |
| Aviva Deferred Bonus Plan | | | | | | | | |
| – 2001 | 50,530 | – | – | – | **50,530** | 949.5 | – | May 2004 |
| – 2002 | 72,924 | – | – | – | **72,924** | 739.0 | – | March 2005 |
| – 2003 | – | 127,750 | – | – | **127,750** | 379.5 | – | March 2006 |
| **Philip Scott** | | | | | | | | |
| Aviva Long Term Incentive Plan | | | | | | | | |
| – 2000 | 34,453 | – | – | – | **34,453** | 960.0 | – | March 2005 |
| – 2001 | 38,541 | – | – | – | **38,541** | 949.5 | – | March 2004 |
| – 2002 | 54,177 | – | – | – | **54,177** | 739.0 | – | March 2005 |
| – 2003 | – | 111,250 | – | – | **111,250** | 379.5 | – | March 2006 |
| Aviva Deferred Bonus Plan | | | | | | | | |
| – 2001 | 35,458 | – | – | – | **35,458** | 949.5 | – | May 2004 |
| – 2002 | 44,424 | – | – | – | **44,424** | 739.0 | – | March 2005 |
| – 2003 | – | 80,100 | – | – | **80,100** | 379.5 | – | March 2006 |
| **Patrick Snowball** | | | | | | | | |
| Aviva Long Term Incentive Plan | | | | | | | | |
| – 2000 | 24,682 | – | – | – | **24,682** | 960.0 | – | March 2005 |
| – 2001 | 36,458 | – | – | – | **36,458** | 949.5 | – | March 2004 |
| – 2002 | 45,691 | – | – | – | **45,691** | 739.0 | – | March 2005 |
| – 2003 | – | 96,250 | – | – | **96,250** | 379.5 | – | March 2006 |
| Aviva Deferred Bonus Plan | | | | | | | | |
| – 2001 | 16,888 | – | – | – | **16,888** | 949.5 | – | May 2004 |
| – 2002 | 36,552 | – | – | – | **36,552** | 739.0 | – | March 2005 |
| – 2003 | – | 35,612 | – | – | **35,612** | 379.5 | – | March 2006 |
| **Philip Twyman** | | | | | | | | |
| CGU Deferred Bonus Plan | | | | | | | | |
| – 2000 | 4,259 | – | 4,259 | – | **–** | 875.0 | 352.0 | March 2003 |
| Aviva Long Term Incentive Plan | | | | | | | | |
| – 2001 | 41,666 | – | – | – | **41,666** | 949.5 | – | March 2004 |
| – 2002 | 57,441 | – | – | – | **57,441** | 739.0 | – | March 2005 |
| – 2003 | – | 113,750 | – | – | **113,750** | 379.5 | – | March 2006 |
| Aviva Deferred Bonus Plan | | | | | | | | |
| – 2001 | 21,666 | – | – | – | **21,666** | 949.5 | – | May 2004 |
| – 2002 | 34,464 | – | – | – | **34,464** | 739.0 | – | March 2005 |
| – 2003 | – | 87,586 | – | – | **87,586** | 379.5 | – | March 2006 |
| **Tony Wyand**** | | | | | | | | |
| Aviva Long Term Incentive Plan | | | | | | | | |
| – 2001 | 45,000 | – | – | – | **45,000** | 949.5 | – | March 2004 |
| – 2002 | 60,704 | – | – | – | **60,704** | 739.0 | – | March 2005 |
| – 2003 | – | 120,000 | – | – | **120,000** | 379.5 | – | March 2006 |
| Aviva Deferred Bonus Plan | | | | | | | | |
| – 2001 | 20,700 | – | – | – | **20,700** | 949.5 | – | May 2004 |
| – 2002 | 52,206 | – | – | – | **52,206** | 739.0 | – | March 2005 |
| – 2003 | – | 44,400 | – | – | **44,400** | 379.5 | – | March 2006 |

*Awards granted to Mike Biggs under the Long Term Incentive Plan lapsed on 1 January 2004 following his resignation taking effect on 31 December 2003. Based on the performance of Mr Biggs during his notice period, the Committee exercised its discretion to allow him to retain the benefits of his matched awards which will vest at the end of their deferral period.

**As at the date of ceasing to be a director – 31 July 2003.

# Directors' remuneration report
continued

*The Aviva Long Term Incentive Plan* was approved by shareholders at the 2001 Annual General Meeting. Awards under the plan are made on an annual basis and the 2003 award was made in March. Awards are subject to the attainment of performance conditions over a three-year performance period as described on pages 48 and 49. The three-year performance condition relating to the awards granted in 2000 fell due for testing during the year. For any awards to vest under the TSR condition the Company's TSR, when compared with the TSR of a comparator group of European financial services companies (see page 49), would need to at least match median performance when 20% of the awards become exercisable. At upper decile performance 70% of the options would become exercisable. Between median and upper quartile the number of awards vesting is determined on a straight-line basis. For any awards to vest under the ROCE condition, the Company's ROCE would have to exceed 24% in excess of RPI over the three-year performance period when 10% of the awards would vest, rising to 30% if the ROCE exceeded 30% over the same period. At the end of the performance period relating to the awards granted in 2000, the Company was ranked 12th out of the 20 companies in the comparator group and the ROCE was 21.4%. Accordingly none of the awards vested. Under the rules of the Plan, there will be one further test of the performance condition in 2005 measured over five years.

*The Aviva Deferred Bonus Plan* was approved by shareholders at the 2001 Annual General Meeting. The awards disclosed include those made in lieu of some or all of the cash bonus earned under the Company's Annual Bonus Plan in 2003 and deferred, and also the matching awards granted on a "one for one" basis. The awards are not subject to performance conditions and vest on the third anniversary of their grant.

**Directors' interests in Aviva shares**

The interests held by each person who was a director at the end of the financial year in the ordinary shares of 25 pence each in the Company is shown below. The table also summarises the interests in shares held through the Company's various share and incentive schemes. Details of the options, deferred bonus awards and long-term incentive awards are shown on pages 52 and 53.

| | Shares[1] | | Deferred Bonus Plan Awards[2] | | Long Term Incentive Awards[3] | | Options[4] | |
|---|---|---|---|---|---|---|---|---|
| | 1 January 2003 | 31 December 2003 | 1 January 2003 | 31 December 2003 | 1 January 2003 | 31 December 2003 | 1 January 2003 | 31 December 2003 |
| Mike Biggs | 43,550 | **44,404** | 76,084** | **156,184** | 131,859 | **243,109**** | – | **–** |
| Anna Catalano* | – | **–** | – | **–** | – | **–** | – | **–** |
| Guillermo de la Dehesa | 144 | **144** | – | **–** | – | **–** | – | **–** |
| Wim Dik | 200 | **200** | – | **–** | – | **–** | – | **–** |
| Pehr Gyllenhammar | 25,760 | **27,056** | – | **–** | – | **–** | – | **–** |
| Richard Harvey | 21,829 | **23,151** | 123,454 | **251,204** | 264,072 | **439,072** | 4,426 | **4,426** |
| George Paul | 30,593 | **30,693** | – | **–** | – | **–** | – | **–** |
| Carole Piwnica* | – | **–** | – | **–** | – | **–** | – | **–** |
| Philip Scott | 68,571 | **73,274** | 79,882 | **159,982** | 127,171 | **238,421** | 4,096 | **4,096** |
| Patrick Snowball | 3,447 | **4,719** | 53,440 | **89,052** | 106,831 | **203,081** | – | **2,272** |
| Derek Stevens | 2,005 | **2,005** | – | **–** | – | **–** | – | **–** |
| Philip Twyman | 24,286 | **28,818** | 60,389 | **143,716** | 99,107 | **212,857** | 201,429 | **164,346** |
| Elizabeth Vallance | 830 | **830** | – | **–** | – | **–** | – | **–** |
| André Villeneuve | 640 | **640** | – | **–** | – | **–** | – | **–** |

*At appointment – 8 May 2003.

**Awards held by Mike Biggs under the Long Term Incentive Plan lapsed on 1 January 2004 following his resignation taking effect on 31 December 2003. Based on the performance of Mr Biggs during his notice period, the Committee exercised its discretion to allow him to retain the benefits of his matched awards which will vest at the end of their deferral period.

Notes

(1) "Shares" are the directors' interests in the ordinary shares of the Company. All the interests disclosed are beneficial interests. The table includes shares purchased by directors under the partnership element of the Company's All Employee Share Ownership Plan (AESOP) and shares granted under the free share element of the AESOP and the employee profit sharing scheme.

(2) "Deferred Bonus Plan Awards" relates to an entitlement to shares arising through the Aviva Deferred Bonus Plan. Half of the number of the shares disclosed relate to the deferral of some or all of the directors' annual cash bonuses and therefore represent a director's investment in the Company. The remaining half are shares granted on a "one for one" matching basis and, normally, will only be received if the director remains in employment until the vesting date. Upon vesting the participants are entitled to receive additional shares representing the dividends paid during the deferral period.

(3) "Long Term Incentive Awards" are awards granted under the Aviva Long Term Incentive Plan which vest subject to the attainment of performance conditions.

(4) "Options" are options over shares granted under the CGNU Executive Share Option Scheme, CGU Deferred Bonus Plan or Save As You Earn share scheme. The exercise of some of these options is subject to the attainment of performance conditions.

The following changes to directors' interests during the period 1 January 2004 to 24 February 2004, which relate to shares acquired through dividend reinvestment, have been reported to the Company:

| | Number of shares |
|---|---|
| Richard Harvey | 62 |
| George Paul | 34 |
| Philip Scott | 45 |
| Patrick Snowball | 45 |

This report was reviewed and approved by the Board on 24 February 2004.

**George Paul**
Chairman, Remuneration Committee

# Independent auditors' report to the members of Aviva plc



We have audited the Group's accounts for the year ended 31 December 2003 which comprise the Accounting policies, the Consolidated profit and loss account, Reconciliation of Group operating profit to profit on ordinary activities before taxation, Consolidated statement of total recognised gains and losses, Reconciliation of movements in consolidated shareholders' funds, Consolidated Group balance sheet, Consolidated cash flow statement and Company balance sheet, and the related notes 1 to 50. These accounts have been prepared on the basis of the accounting policies set out therein. We have also audited the information in the Directors' remuneration report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. 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 auditors' 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 auditors**

The directors' responsibilities for preparing the Annual report, the Directors' remuneration report and the accounts in accordance with applicable United Kingdom law and accounting standards are set out in the Statement of directors' responsibilities on page 43.

Our responsibility is to audit the accounts and the part of the Directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements, United Kingdom Auditing Standards and the Listing Rules of the Financial Services Authority.

We report to you our opinion as to whether the accounts give a true and fair view and whether the accounts and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' report is not consistent with the accounts, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions with the Group is not disclosed.

We review whether the Corporate governance statement reflects the Company's compliance with the seven provisions of the Combined Code issued in June 1998 that are specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual report and consider whether it is consistent with the audited accounts. This other information comprises the Highlights of the year, Chairman's statement, Business overview, Group Chief Executive's review, Operating review, Corporate social responsibility, Financial review, Directors' report, Corporate governance statement, Audit committee report, Nomination committee report, Chairman's committee report and the unaudited part of the Directors' remuneration report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts. Our responsibilities do not extend to any other information.

**Basis of audit opinion**

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts and the part of the Directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

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

**Equalisation provision**

Our evaluation of the presentation of information in the accounts has had regard to the statutory requirement for insurance companies to maintain an equalisation provision. The nature of the equalisation provision, the amount set aside at 31 December 2003 and the effect of the movement in the provision during the year on the general business technical result and profit on ordinary activities before tax, are disclosed in accounting policy T and note 40 to the accounts.

**Opinion**

In our opinion, the accounts give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2003 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

**Ernst & Young LLP**
Registered Auditor

London

24 February 2004

# Accounting policies

**A – Basis of accounts**
The consolidated accounts have been prepared in accordance with Section 255A of, and the special provisions relating to insurance companies of Schedule 9A to, the Companies Act 1985 and with the Statement of Recommended Practice issued by the Association of British Insurers (the "ABI SORP") issued in November 2003. The practices recommended by the ABI SORP are applicable for accounting periods ending after 1 January 2004, but the Group has chosen to adopt such practices early. The accounting policies adopted reflect United Kingdom financial reporting standards and statements of standard accounting practice applicable at 31 December 2003, as considered appropriate for an insurance company. The balance sheet of the Company has been prepared in accordance with Section 226 of, and Schedule 4 to, the Companies Act 1985.

The profit and loss account for the year reflects all income, expenditure, and investment gains and losses, except certain items which are taken directly to reserves after tax. The items taken directly to reserves include exchange gains and losses on the net investment in foreign enterprises (except for certain items dealt with in the fund for future appropriations).

The general business technical result is determined on an annual basis.

**B – Premiums**
General business premiums written reflect business incepted during the year. General business unearned premiums are those proportions of the premiums written in a year that relate to the periods of risk after the balance sheet date. Unearned premiums are computed principally on either the daily or monthly pro rata basis. Long-term business premiums are accounted for when receivable, except for investment-linked premiums which are accounted for when liabilities are recognised.

**C – Claims**
General business claims incurred include all losses occurring during the year, whether reported or not, related handling costs, a reduction for the value of salvage and other recoveries, and any adjustments to claims outstanding from previous years.

General business outstanding claims provisions are based on the estimated ultimate cost of all claims incurred but not settled at the balance sheet date, whether reported or not, together with related claims handling costs and a reduction for the expected value of salvage and other recoveries. Significant delays are experienced in the notification and settlement of certain general insurance claims, particularly in respect of liability business, including environmental and pollution exposures, the ultimate cost of which cannot be known with certainty at the balance sheet date. Provisions for certain claims are discounted using rates having regard to the returns generated by the assets supporting the liabilities. Any estimate represents a point within a range of possible outcomes. Further details of estimating techniques are given in note 39a.

Long-term business claims reflect the cost of all claims arising during the year, including claims handling costs, as well as policyholder bonuses paid in anticipation of a bonus declaration.

**D – Deferred acquisition costs**
Deferred acquisition costs represent a proportion of commission and other acquisition costs that relate to policies that are in force at the year end. General business deferred acquisition costs are amortised over the period in which the related premiums are earned. Long-term business deferred acquisition costs are amortised over a period no longer than that in which they are expected to be recoverable out of margins in revenues from the related policies.

**E – Unexpired risks**
Provision is made for any overall excess of expected claims and deferred acquisition costs over unearned premiums, after taking account of the investment return expected to arise on assets relating to the relevant general business provisions.

**F – Investment income and unrealised investment gains or losses**
Investment income consists of interest, dividends and rents receivable for the year, together with realised investment gains and losses. Interest includes the interest rate differential on forward foreign exchange contracts. Realised investment gains and losses represent the difference between the net sale proceeds and the cost of acquisition. Unrealised investment gains and losses represent the difference between the carrying value at the year end and the carrying value at the previous year end or purchase value during the year.

Long-term business investment income and unrealised gains and losses are included in the long-term business technical account and, where applicable, a transfer is made to the non-technical account to ensure that the return remaining in the long-term technical account attributable to shareholders reflects the longer-term investment return.

Non-long-term business investment income and unrealised gains and losses are taken to the non-technical account. The longer-term return on the investments owned by general business operations is then transferred from the non-technical account to the general business technical account. Profits and losses arising on investment transactions with the long-term funds are included in realised investment gains.

**G – Long-term business result and fund valuations**
Transfers from the long-term business technical account to the non-technical account in respect of shareholders' profits are determined as a result of annual actuarial valuations, which are based on local practice, subject to transfers to or from the fund for future appropriations.

**H – Pension costs**
The Group operates defined benefit pension schemes in a number of countries around the world, with contributions made on a going concern basis, as recommended by actuaries. There are also several money purchase pension plans. The pension costs, which are included in expenses, are calculated using actuarial valuation methods which give a substantially even charge over the expected service lives of employees. The costs of other material post-retirement benefits, also included in expenses, are charged as they accrue.

In November 2000, the Accounting Standards Board issued Financial Reporting Standard ("FRS") 17 "Retirement Benefits", the accounting provisions of which are not required to be adopted by the Group until 2005. However, the FRS requires certain disclosures to be made in the notes to the accounts, as shown in note 45e.

**I – Tax**
The shareholder tax charge in the non-technical account is based on the taxable profits for the year, after any adjustments in respect of prior years. Tax, including tax relief for losses if applicable, is allocated over profits on ordinary activities and amounts charged or credited to reserves as appropriate. In the long-term business technical account, the charge is based on the method of assessing tax for long-term funds applicable in the relevant country of operation.

The balance on the long-term business technical account is computed net of the total tax attributable to that business. In order to present the profit on long-term business operations on a pre-tax basis, this net figure is grossed up at the long-term effective rate of tax borne by shareholders in respect of the underlying business. This shareholder tax add-back is included in the tax charge on the profit on ordinary activities in the non-technical account.

Provision is made for deferred tax liabilities, or credit taken for deferred tax assets, using the liability method, on all material timing differences, including revaluation gains and losses on investments recognised in the profit and loss account. Deferred tax is calculated at the rates at which it is expected that the tax will arise and discounted to take into account the likely timing of payments and pattern of expected realisation of investments. The discount rates used are the post-tax yields to maturity that could be obtained at the balance sheet date on government bonds with maturity dates and in currencies similar to those of the deferred tax assets or liabilities.

No provision is made for tax that might arise if profits retained by overseas subsidiary and associated undertakings were remitted to the United Kingdom, unless a binding agreement exists for the relevant undertaking to distribute those earnings in future.

### J – Goodwill

Goodwill arising on the acquisition of subsidiary undertakings is carried on the balance sheet as a separate intangible asset. Goodwill arising on the acquisition of associated undertakings is included within their carrying value. All goodwill is amortised on a straight-line basis over its useful economic life, and its carrying value is reviewed regularly for indications of impairment. On subsequent disposal of the underlying investment, any goodwill not yet amortised will be taken to the profit and loss account when calculating the profit or loss on disposal.

Goodwill arising before 1 January 1998 was eliminated against reserves and has not been reinstated. Goodwill previously written off to reserves will be taken back through the profit and loss account when calculating the profit or loss on any disposal of the underlying investment.

### K – Investments

Investments are stated at their current values at the end of the year, with the exception of certain non-linked long-term business debt securities and fixed income securities which are shown at amortised cost, as this basis more closely corresponds with the valuation of the relevant long-term liabilities. Current values, for this purpose, are: stock exchange mid-market values for listed securities; average trading prices for unlisted securities where a market exists; and directors' valuations for other unlisted securities, and for mortgages and loans.

All properties are valued annually by qualified external valuers or members of staff, at market value. No depreciation is provided on properties held for own use since such depreciation is immaterial. No depreciation is provided on investment properties as the directors consider that, as these properties are held for investment, to depreciate them would not give a true and fair view of the Group's financial position or results for the financial year.

### L – Derivative instruments

The Group uses derivative instruments, including forward foreign exchange contracts, interest rate swaps, futures and options for hedging purposes. Derivative instruments are accounted for as follows:

- forward foreign exchange contracts. The interest rate differential is included in investment income, while the effect of the currency movements on these contracts is treated as an exchange difference;
- cross-currency swaps related to the Group's borrowings. These are translated at the year end rates and included as part of borrowings;
- interest rate swaps. The interest payable and receivable is included within investment expenses or investment income as appropriate;
- futures contracts and purchased options. These are included at market value and shown under the category of investments to which the contracts relate. No adjustment is made to the classification of existing investments to reflect the effect of the future settlement of these transactions.

### M – Consolidation of subsidiary undertakings

The results of all material subsidiary undertakings are consolidated using audited accounts prepared to 31 December, either from 1 January or the effective date of acquisition. In the Company balance sheet, subsidiary undertakings are stated at current value which, for this purpose, is embedded value for life operations and net asset value for other entities.

### N – Participating interests, associated undertakings and joint ventures

Participating interests are investments in which the Group has a long-term equity holding of over 20% and not more than 50%. Where the interests are beneficial and significant influence is exercised, such interests are classified as associated undertakings. The Group has also invested in a number of joint ventures, where its share of the underlying assets and liabilities may be greater than 50% but where the terms of the relevant agreements make it clear that control is not exercised. The appropriate proportion of the profit or loss on ordinary activities before tax of joint ventures and associated undertakings is shown separately in the non-technical account, except where these investments are held by the long-term businesses, in which case the profit is included within investment income in the long-term technical account. The appropriate proportion of the shareholders' funds of joint ventures and associated undertakings is included in the consolidated balance sheet, with gross equity method disclosures for the former as required by FRS9 "Associates and joint ventures".

### O – Acquired additional value of in-force long-term business

The additional value of in-force long-term business arising on acquisitions is recognised in the Group's balance sheet and is amortised through the profit and loss account over the useful lifetime of the related contracts in the portfolio on a systematic basis. The rate of amortisation is chosen by considering the profile of the additional value of in-force business acquired and the expected depletion in its value. The value of acquired additional in-force long-term business is reviewed annually for any impairment in value and any reductions are charged to the long-term business technical account.

The full embedded value of the long-term business and further details of the methodology and assumptions are included as supplementary information on pages 102 to 110.

# Accounting policies
continued

**P – Long-term business provision and technical provision for linked liabilities**
The long-term business provision is calculated separately for each life operation, based on local actuarial principles consistent with those applied in the United Kingdom. Each calculation represents a point within a range of possible outcomes, and the assumptions used in the calculations depend on the circumstances prevailing in each life operation. Further details of the methodology and the principal assumptions used are given in note 38.

Within the long-term business provision, explicit allowance is made for vested bonuses, including those added following the most recent fund valuation. The allowance for future bonuses depends on the methodology and is explained in note 38. The provisions held for linked business and unitised with-profits business are the unit liabilities together with certain non-unit provisions.

**Q – Tangible assets**
Computer equipment, motor vehicles and other tangible assets are capitalised at cost and depreciation is charged to the profit and loss account, within expenses on a straight-line basis, over their estimated useful lives of between three and five years. Assets acquired under finance leases are capitalised and charged to the profit and loss account over the shorter of the term of the leases or their estimated useful lives, subject to a maximum of five years. All tangible assets are tested for impairment where events or changes in circumstances indicate that the carrying amount may not be recoverable. Impairment losses are included within the cumulative depreciation amounts disclosed.

**R – Subordinated debt and debenture loans**
Subordinated debt and borrowings issued at a discount are included in the balance sheets at their proceeds, net of other expenses, together with amortised discount to the balance sheet date. The discount, amortised on a compound basis, and expenses are charged to loan interest in the profit and loss account over the term of the relevant instrument.

**S – Fund for future appropriations**
The fund for future appropriations is used in conjunction with long-term business where the nature of the policy benefits is such that the division between shareholder reserves and policyholder liabilities is uncertain. Amounts whose allocation either to policyholders or shareholders has not been determined by the end of the financial year are held in the fund for future appropriations. Transfers between the fund for future appropriations and the long-term business technical account represent changes in the unallocated amounts between balance sheet dates.

**T – Equalisation provision**
Provision is made in the Group accounts for the equalisation provisions established, where required, in the accounts of individual insurance companies in the United Kingdom and in a limited number of countries overseas. The provision is required by law even though no actual liability exists at the balance sheet date.

**U – Exchange rates**
The results of foreign enterprises are translated into sterling at average exchange rates while their assets and liabilities are translated at year end rates. The resulting exchange differences arising within long-term businesses are included within the long-term business technical account and form part of the transfer to the fund for future appropriations, while those arising within other businesses are taken directly to reserves.

Transactions denominated in foreign currencies are translated at the exchange rate at the date of transaction. Foreign currency assets and liabilities held at the year end are translated at year end rates of exchange. The resulting exchange gains or losses are included in the profit and loss account.

**V – Share-based compensation**
The Group offers share award and option plans over the Company's ordinary shares for certain employees, including a Save As You Earn plan ("SAYE plan"), details of which are given in the Directors' remuneration report on pages 47 to 54. Compensation costs for non-SAYE plans are based as a minimum on the market price of the shares at the time of grant, less any amounts paid or payable by employees in respect of the awards. These costs are charged to the profit and loss account over the periods during which the share awards or options are earned. Shares purchased by the employee share trusts to fund these awards are held in the balance sheet at cost and shown as a deduction from shareholders' funds.

Until June 2003, for the SAYE plan, shares were issued to a qualifying share ownership trust, with the excess of the market price subscribed at the date of transfer by the trust over the nominal value being recorded in the Company's share premium account. The difference between the market price at the date of transfer to the trust and exercise price payable by employees was charged to the Company's profit and loss account or, in the consolidated Group accounts, directly to the profit and loss account reserve. After June 2003, shares are allotted directly to the employee to satisfy the obligations arising. In accordance with Urgent Issues Task Force Abstract 17 revised 2003 "Employee Share Schemes", the Company has taken advantage of the exemptions contained therein in respect of such schemes and no charge is made to the profit and loss account for the discount to market value at which the options are granted.

# Consolidated profit and loss account
## Technical account – long-term business
## For the year ended 31 December 2003

| 2003 €m | | 2003 £m | 2002 £m |
|---|---|---|---|
| **28,077** | Gross premiums written – continuing operations (6a) | **19,373** | 18,330 |
| **(863)** | Outward reinsurance premiums | **(595)** | (457) |
| **27,214** | **Written and earned premiums, net of reinsurance** (B & 6a) | **18,778** | 17,873 |
| **10,817** | **Investment income** (F & 7a) | **7,464** | 4,815 |
| **10,245** | **Unrealised gains on investments** (F & 7a) | **7,069** | – |
| | Claims paid | | |
| **(19,136)** | Gross amount | **(13,204)** | (12,531) |
| **759** | Reinsurers' share | **524** | 437 |
| **(18,377)** | | **(12,680)** | (12,094) |
| | Change in the provision for claims | | |
| **(66)** | Gross amount | **(46)** | 227 |
| **(3)** | Reinsurers' share | **(2)** | 8 |
| **(69)** | | **(48)** | 235 |
| **(18,446)** | **Claims incurred, net of reinsurance** (C) | **(12,728)** | (11,859) |
| | Change in long-term business provision (P) | | |
| **(5,229)** | Gross amount | **(3,608)** | (3,685) |
| **528** | Reinsurers' share | **364** | 1,517 |
| **(4,701)** | | **(3,244)** | (2,168) |
| **(12,850)** | Change in technical provision for linked business, net of reinsurance (P) | **(8,866)** | 190 |
| **(17,551)** | **Changes in other technical provisions, net of reinsurance** | **(12,110)** | (1,978) |
| **(3,012)** | Net operating expenses (9) | **(2,078)** | (2,061) |
| **(397)** | Investment expenses and charges (7a) | **(274)** | (270) |
| **–** | Unrealised losses on investments (F & 7a) | **–** | (8,833) |
| **(107)** | Other technical charges (24) | **(74)** | (100) |
| **(774)** | Tax attributable to long-term business (I & 14b) | **(534)** | 163 |
| **(187)** | Allocated investment return transferred (to)/from the non-technical account (F & 7b) | **(129)** | 59 |
| **(6,770)** | Transfers (to)/from the fund for future appropriations (S) | **(4,672)** | 2,801 |
| **(11,247)** | **Other income/(charges)** | **(7,761)** | (8,241) |
| **1,032** | **Balance on the long-term business technical account – continuing operations** (G) | **712** | 610 |
| **1,032** | **Balance on the long-term business technical account** | **712** | 610 |
| **403** | Tax credit attributable to balance on the long-term business technical account (I & 14a) | **278** | 260 |
| **1,435** | **Profit from long-term business operations before tax** | **990** | 870 |

The table below provides a reconciliation between the analysis used in the narrative sections of this Report and the profit from long-term business operations above.

| 2003 €m | | 2003 £m | 2002 £m |
|---|---|---|---|
| **1,650** | Long-term business operating profit before amortisation of acquired additional value of in-force long-term business and amortisation of goodwill on associated undertakings (4a) | **1,138** | 1,022 |
| **(196)** | Amortisation of acquired additional value of in-force long-term business (included within other technical charges and investment income) | **(135)** | (139) |
| **(19)** | Amortisation of goodwill on associated undertakings (included within investment income) (7a & 21c) | **(13)** | (13) |
| **1,435** | **Profit from long-term business operations before tax** | **990** | 870 |

The accounting policies (identified alphabetically) on pages 56 to 58 and notes (identified numerically) on pages 68 to 100 are an integral part of these accounts.
The auditors' report is on page 55.

# Consolidated profit and loss account
## Technical account – general business
## For the year ended 31 December 2003

| 2003 €m | | 2003 £m | 2002 £m |
|---|---|---|---|
| 15,065 | Gross premiums written – continuing operations (6a) | 10,395 | 9,796 |
| – | – discontinued operations (6a) | – | 783 |
| 15,065 | **Gross premiums written** (6b) | 10,395 | 10,579 |
| (1,166) | Outward reinsurance premiums | (805) | (1,154) |
| 13,899 | Net premiums written – continuing operations (6a) | 9,590 | 8,733 |
| – | – discontinued operations (6a) | – | 692 |
| 13,899 | **Net premiums written** (B) | 9,590 | 9,425 |
| | Change in the provision for unearned premiums | | |
| (217) | Gross amount | (150) | (407) |
| (257) | Reinsurers' share | (177) | 171 |
| (474) | | (327) | (236) |
| 13,425 | **Earned premiums, net of reinsurance** | 9,263 | 9,189 |
| 1,506 | **Allocated investment return transferred from the non-technical account** (F & 7b) | 1,039 | 1,182 |
| | Claims paid | | |
| (9,474) | Gross amount | (6,537) | (7,226) |
| 848 | Reinsurers' share | 585 | 736 |
| (8,626) | | (5,952) | (6,490) |
| | Change in the provision for claims | | |
| (1,169) | Gross amount | (806) | 333 |
| 248 | Reinsurers' share | 171 | (499) |
| (921) | | (635) | (166) |
| (9,547) | **Claims incurred, net of reinsurance** (C) | (6,587) | (6,656) |
| 1 | Changes in other technical provisions, net of reinsurance | 1 | (2) |
| (3,977) | Net operating expenses (9) | (2,744) | (2,693) |
| (3,976) | **Other charges** | (2,743) | (2,695) |
| (71) | Change in the equalisation provision (T & 40) | (49) | (57) |
| 1,337 | **Balance on the general business technical account** | 923 | 963 |

The table below provides a reconciliation between the analysis used in the narrative sections of this Report and the balance on the general business technical account above.

| | Underwriting result | | Allocation of longer-term investment return | | Total | |
|---|---|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| **Operating profit** | | | | | | |
| General insurance – continuing operations (4a) | (54) | (145) | 965 | 1,026 | 911 | 881 |
| Health business – continuing operations (4a) | (13) | (24) | 74 | 85 | 61 | 61 |
| | (67) | (169) | 1,039 | 1,111 | 972 | 942 |
| General insurance – discontinued operations (2 & 4a) | – | 7 | – | 71 | – | 78 |
| Profit before exceptional items | (67) | (162) | 1,039 | 1,182 | 972 | 1,020 |
| Change in the equalisation provision (40) | | | | | (49) | (57) |
| **Balance on the general business technical account** | | | | | 923 | 963 |

The accounting policies (identified alphabetically) on pages 56 to 58 and notes (identified numerically) on pages 68 to 100 are an integral part of these accounts.
The auditors' report is on page 55.

# Consolidated profit and loss account
## Non-technical account
## For the year ended 31 December 2003

| 2003 €m | | 2003 £m | 2002 £m |
|---|---|---|---|
| **1,032** | Balance on long-term business technical account | **712** | 610 |
| **403** | Tax credit attributable to balance on the long-term business technical account (I & 14a) | **278** | 260 |
| **1,435** | **Profit from long-term business operations before tax** | **990** | 870 |
| **1,337** | **Balance on general business technical account** | **923** | 963 |
| | Investment income (F & 7a) | | |
| **–** | Share of result of associated undertakings, net of goodwill amortisation | **–** | 16 |
| **1,464** | Other | **1,010** | 1,066 |
| **1,464** | | **1,010** | 1,082 |
| **207** | Unrealised gains on investments (F & 7a) | **143** | – |
| | Allocated investment return transferred from/(to) the long-term | | |
| **187** | business technical account (F & 7b) | **129** | (59) |
| **(632)** | Investment expenses and charges (7a) | **(437)** | (485) |
| **–** | Unrealised losses on investments (7a) | **–** | (1,017) |
| | Allocated investment return transferred to the general business | | |
| **(1,506)** | technical account (F & 7b) | **(1,039)** | (1,182) |
| | Other income/(charges), including value adjustments | | |
| **23** | Profit from fund management (4a) | **16** | 5 |
| **(105)** | Loss from other operations (3b) | **(72)** | (115) |
| | Other charges: | | |
| **(232)** | – corporate costs (10) | **(160)** | (218) |
| **(127)** | – amortisation of goodwill (18) | **(88)** | (122) |
| **(9)** | Net loss on the disposal of subsidiary undertakings (17c) | **(6)** | (4) |
| **(28)** | Exceptional costs for termination of operations (17d) | **(19)** | – |
| **(478)** | | **(329)** | (454) |
| **2,014** | **Profit/(loss) on ordinary activities before tax** | **1,390** | (282) |
| **(531)** | Tax on profit/(loss) on ordinary activities (I & 14a) | **(367)** | (206) |
| **1,483** | **Profit/(loss) on ordinary activities after tax** (A) | **1,023** | (488) |
| **(78)** | Minorities – equity | **(53)** | (25) |
| **(30)** | – non-equity | **(21)** | (21) |
| **(108)** | | **(74)** | (46) |
| **1,375** | **Profit/(loss) for the financial year** | **949** | (534) |
| **(24)** | Preference dividends | **(17)** | (17) |
| **1,351** | **Profit/(loss) for the financial year attributable to equity shareholders** | **932** | (551) |
| **(790)** | Ordinary dividends (15) | **(545)** | (519) |
| **561** | **Retained profit/(loss) transferred to/(from) reserves** (34) | **387** | (1,070) |

| | | | |
|---|---|---|---|
| | **Earnings per share attributable to equity shareholders** | | |
| | Operating profit before amortisation of goodwill, amortisation of acquired additional value of in-force long-term business and exceptional items, after tax, in respect of: | | |
| **63.8c** | – continuing operations (16a) | **44.0p** | 34.8p |
| **63.8c** | – continuing and discontinued operations (16a) | **44.0p** | 38.0p |
| **60.0c** | Profit/(loss) attributable to equity shareholders (16a) | **41.4p** | (24.4)p |
| **59.9c** | Profit/(loss) attributable to equity shareholders – diluted (16b) | **41.3p** | (24.4)p |

The accounting policies (identified alphabetically) on pages 56 to 58 and notes (identified numerically) on pages 68 to 100 are an integral part of these accounts.
The auditors' report is on page 55.

# Reconciliation of Group operating profit to profit on ordinary activities before tax

For the year ended 31 December 2003

| 2003 €m | | 2003 £m | 2002 £m |
|---|---|---|---|
| | **Operating profit before tax based on longer-term investment return before amortisation of goodwill, amortisation of acquired additional value of in-force long-term business and exceptional items:** | | |
| | Continuing operations | | |
| **1,650** | Modified statutory life profit (4a) | **1,138** | 1,022 |
| **88** | Health business (4a) | **61** | 61 |
| **14** | Fund management (4a) | **10** | 5 |
| **1,320** | General insurance (4a) | **911** | 881 |
| **(93)** | Non-insurance operations (3b) | **(64)** | (99) |
| **(232)** | Corporate costs (10) | **(160)** | (218) |
| **(588)** | Unallocated interest charges (7a) | **(406)** | (434) |
| **2,159** | Total continuing operations | **1,490** | 1,218 |
| | Discontinued operations (4a) | | |
| **–** | – Australia and New Zealand general insurance operations | **–** | 78 |
| **2,159** | | **1,490** | 1,296 |
| | Amortisation of goodwill | | |
| **(19)** | – long-term business associates (7a & 21) | **(13)** | (13) |
| **(127)** | – non-long-term business subsidiary undertakings (18) | **(88)** | (122) |
| **(3)** | – non-long-term business associates (7a & 21) | **(2)** | – |
| **(149)** | | **(103)** | (135) |
| | Amortisation of acquired additional value of in-force business | | |
| **(145)** | – long-term business subsidiary undertakings | **(100)** | (139) |
| **(51)** | – long-term business associates | **(35)** | – |
| **(196)** | | **(135)** | (139) |
| **1,814** | **Operating profit before tax based on longer-term investment return after amortisation of goodwill and amortisation of acquired additional value of in-force long-term business** (4b) | **1,252** | 1,022 |
| | Short-term fluctuation in investment return | | |
| **187** | – long-term business (7b) | **129** | (59) |
| **121** | – non-long-term business (7b) | **83** | (1,184) |
| **308** | | **212** | (1,243) |
| **(71)** | Change in the equalisation provision (40) | **(49)** | (57) |
| **(9)** | Net loss on the disposal of subsidiary undertakings (17c) | **(6)** | (4) |
| **(28)** | Exceptional costs for termination of operations (17d) | **(19)** | – |
| **2,014** | **Profit/(loss) on ordinary activities before tax** | **1,390** | (282) |

The accounting policies (identified alphabetically) on pages 56 to 58 and notes (identified numerically) on pages 68 to 100 are an integral part of these accounts.
The auditors' report is on page 55.

# Consolidated statement of total recognised gains and losses
For the year ended 31 December 2003

| 2003 €m | | 2003 £m | Restated 2002 £m |
|---|---|---|---|
| **1,375** | Profit/(loss) for the financial year | **949** | (534) |
| **(179)** | Foreign exchange gains (U & 34) | **329** | 104 |
| **1,196** | **Total recognised gains and losses arising in the year** | **1,278** | (430) |
| **(5,895)** | Prior year adjustment (3a) | **(3,832)** | |
| **(4,699)** | **Total recognised gains and losses since last annual report** | **(2,554)** | |

# Reconciliation of movements in consolidated shareholders' funds
For the year ended 31 December 2003

| 2003 €m | | 2003 £m | Restated 2002 £m |
|---|---|---|---|
| | Shareholders' funds at 1 January | | |
| | As previously reported | | 11,752 |
| | Prior year adjustments (3a & 3b) | | (5,278) |
| **8,978** | As restated | **5,836** | 6,474 |
| **1,196** | Total recognised gains and losses arising in the year | **1,278** | (430) |
| **(814)** | Dividends | **(562)** | (536) |
| **3** | Increase in share capital (31c) | **2** | 11 |
| **–** | Movement in shares held by employee trusts (33) | **–** | 9 |
| **–** | Goodwill written back and other movements (J & 34) | **–** | 308 |
| **9,363** | **Shareholders' funds at 31 December** | **6,554** | 5,836 |

The accounting policies (identified alphabetically) on pages 56 to 58 and notes (identified numerically) on pages 68 to 100 are an integral part of these accounts.
The auditors' report is on page 55.

# Consolidated Group balance sheet
## At 31 December 2003

| 2003 €m | Assets | 2003 £m | Restated 2002 £m |
|---|---|---|---|
| | **Goodwill** (J & 18) | | |
| 1,636 | Positive goodwill | 1,145 | 1,079 |
| (57) | Negative goodwill | (40) | (39) |
| 1,579 | | 1,105 | 1,040 |
| | **Investments** (K) | | |
| 13,009 | Land and buildings (19) | 9,106 | 9,416 |
| | Investments in joint ventures (N & 20) | | |
| 2,023 | Share of gross assets | 1,416 | 1,242 |
| (1,751) | Share of gross liabilities, including loans from Group undertakings | (1,226) | (1,126) |
| 272 | | 190 | 116 |
| 969 | Loans to joint ventures | 679 | 665 |
| 1,241 | | 869 | 781 |
| 1,490 | Investments in associated undertakings and other participating interests (N & 21a) | 1,043 | 1,050 |
| 188,821 | Other financial investments (22a) | 132,175 | 116,156 |
| (4,490) | Less: Non-recourse funding (22a) | (3,143) | (2,099) |
| 184,331 | | 129,032 | 114,057 |
| 697 | Acquired additional value of in-force long-term business (O & 24) | 488 | 505 |
| 161 | Deposits with ceding undertakings | 113 | 81 |
| 200,929 | | 140,651 | 125,890 |
| 58,093 | **Assets held to cover linked liabilities** (25) | 40,665 | 29,538 |
| | **Reinsurers' share of technical provisions** | | |
| 484 | Provision for unearned premiums (B) | 339 | 517 |
| 4,795 | Long-term business provision (P) | 3,356 | 2,906 |
| 3,727 | Claims outstanding (C) | 2,609 | 2,394 |
| 827 | Technical provision for linked liabilities (P & 25) | 579 | 337 |
| 9,833 | | 6,883 | 6,154 |
| | **Debtors** | | |
| 4,896 | Debtors arising out of direct insurance operations (26) | 3,427 | 3,199 |
| 1,151 | Debtors arising out of reinsurance operations | 806 | 814 |
| 3 | Loan to associated undertaking | 2 | 25 |
| 9,156 | Other debtors (27) | 6,409 | 5,929 |
| 15,206 | | 10,644 | 9,967 |
| | **Other assets** | | |
| 457 | Tangible assets (Q & 28) | 320 | 295 |
| 4,284 | Cash at bank and in hand | 2,999 | 3,190 |
| 4,741 | | 3,319 | 3,485 |
| | **Prepayments and accrued income** | | |
| 2,326 | Accrued interest and rent | 1,628 | 1,465 |
| 4,060 | Deferred acquisition costs (D & 29) | 2,842 | 2,684 |
| 1,347 | Other prepayments and accrued income | 943 | 782 |
| 7,733 | | 5,413 | 4,931 |
| 298,114 | **Total assets** | 208,680 | 181,005 |

The accounting policies (identified alphabetically) on pages 56 to 58 and notes (identified numerically) on pages 68 to 100 are an integral part of these accounts.
The auditors' report is on page 55.

| 2003 €m | Liabilities | 2003 £m | Restated 2002 £m |
|---|---|---|---|
| | **Capital and reserves** | | |
| **805** | Ordinary share capital (31) | **564** | 564 |
| **286** | Preference share capital (32a) | **200** | 200 |
| **1,091** | Called up share capital | **764** | 764 |
| **1,566** | Share premium account (31c) | **1,096** | 1,094 |
| **(1)** | Shares held by employee trusts (33) | **(1)** | (1) |
| **3,947** | Merger reserve (34) | **2,763** | 2,853 |
| **2,760** | Profit and loss account (A & 34) | **1,932** | 1,126 |
| | **Shareholders' funds:** | | |
| **9,077** | Equity | **6,354** | 5,636 |
| **286** | Non-equity | **200** | 200 |
| **9,363** | | **6,554** | 5,836 |
| **790** | Minority interests – equity | **553** | 400 |
| **369** | – non-equity (42j) | **258** | 258 |
| **1,159** | | **811** | 658 |
| **10,522** | **Total capital and reserves** | **7,365** | 6,494 |
| **4,020** | Subordinated debt (R & 36) | **2,814** | 1,190 |
| **14,542** | **Total capital, reserves and subordinated debt** | **10,179** | 7,684 |
| | **Other liabilities** | | |
| **12,061** | **Fund for future appropriations** (S) | **8,443** | 3,745 |
| | **Technical provisions** | | |
| **6,666** | Provision for unearned premiums (B) | **4,666** | 4,440 |
| **165,684** | Long-term business provision (P & 38) | **115,979** | 108,636 |
| **18,547** | Claims outstanding (C & 39) | **12,983** | 11,861 |
| **520** | Equalisation provision (T & 40) | **364** | 314 |
| **97** | Other technical provisions | **68** | 53 |
| **191,514** | | **134,060** | 125,304 |
| **58,920** | **Technical provision for linked liabilities** (P & 25) | **41,244** | 29,875 |
| **1,243** | **Provisions for other risks and charges** (41) | **870** | 826 |
| **1,229** | **Deposits received from reinsurers** | **860** | 897 |
| | **Creditors** | | |
| **2,439** | Creditors arising out of direct insurance operations | **1,707** | 1,460 |
| **747** | Creditors arising out of reinsurance operations | **523** | 1,003 |
| | Long-term business borrowings | | |
| **211** | Amounts due to credit institutions (42c) | **148** | 85 |
| | Non-long-term business borrowings | | |
| **680** | Debenture loans (R & 42b) | **476** | 431 |
| **217** | Amounts due to credit institutions (42c) | **152** | 180 |
| **1,617** | Commercial paper (42d) | **1,132** | 1,453 |
| **11,030** | Other creditors including tax and social security (43) | **7,721** | 6,978 |
| **20** | Loans from associated undertakings | **14** | 27 |
| **16,961** | | **11,873** | 11,617 |
| **1,644** | **Accruals and deferred income** (44) | **1,151** | 1,057 |
| **283,572** | **Total other liabilities** | **198,501** | 173,321 |
| **298,114** | **Total liabilities** | **208,680** | 181,005 |

Approved by the Board on 24 February 2004

**Philip Twyman**
Group Executive Director

The accounting policies (identified alphabetically) on pages 56 to 58 and notes (identified numerically) on pages 68 to 100 are an integral part of these accounts.
The auditors' report is on page 55.

# Consolidated cash flow statement
## For the year ended 31 December 2003

| | 2003 £m | 2002 £m |
|---|---|---|
| **Operating activities** | | |
| Net cash inflow from operating activities, excluding exceptional items (47a)* | **1,203** | 1,001 |
| Exceptional items* | **(522)** | (523) |
| | **681** | 478 |
| **Dividends from joint ventures and associates** | | |
| Dividends from associates (21b) | **5** | 4 |
| **Returns on investments and servicing of finance** | | |
| Interest paid on borrowings | **(120)** | (136) |
| Interest paid on subordinated debt | **(75)** | (73) |
| Preference dividends paid | **(17)** | (21) |
| Dividends paid to minorities | **(44)** | (35) |
| Net cash outflow from servicing of finance | **(256)** | (265) |
| **Tax** | | |
| Corporation tax (paid)/received | **(174)** | 175 |
| **Capital expenditure** | | |
| Purchases of tangible fixed assets | **(104)** | (138) |
| Sales of tangible fixed assets | **3** | 36 |
| Net purchases of tangible fixed assets | **(101)** | (102) |
| **Acquisitions and disposals** | | |
| Net disposals of subsidiary and associated undertakings** (47b) | **600** | 241 |
| **Equity dividends** | | |
| Equity dividends paid | **(523)** | (732) |
| **Financing activities** | | |
| Issue of share capital (47c) | **2** | 11 |
| Proceeds from issue of subordinated debt (36 & 47c) | **1,567** | – |
| Net drawdown/(repayment) of debt (47c) | **80** | (68) |
| Net cash inflow/(outflow) from financing activities | **1,649** | (57) |
| **Net cash flows** | **1,881** | (258) |
| **Cash flows were invested as follows:** | | |
| **(Decrease)/increase in cash holdings** (47d) | **(164)** | 719 |
| **Net portfolio investment** | | |
| Purchases of investments | **24,807** | 9,815 |
| Sales of investments | **(22,545)** | (10,562) |
| Net purchases/(sales) of investments (47f) | **2,262** | (747) |
| **Non-trading cash outflow to long-term business operations** | **(217)** | (230) |
| **Net investment of cash flows** | **1,881** | (258) |

The cash flows presented in this statement relate to non-long-term business transactions only. Long-term business profits are included as net cash inflow from operating activities only to the extent that they have been remitted to shareholders by way of dividends from life operations.

*Included within the exceptional items are payments to the Berkshire Hathaway Group for reinsurance purchased in December 2000, to secure protection against any adverse impact of the run-off of London Market claims reserves. The final instalment was paid on 2 January 2003.

**The 2003 figure includes £651 million of consideration received on 2 January 2003 in relation to the disposal of the Australia and New Zealand general insurance businesses.

The accounting policies (identified alphabetically) on pages 56 to 58 and notes (identified numerically) on pages 68 to 100 are an integral part of these accounts.
The auditors' report is on page 55.

# Company balance sheet
## At 31 December 2003

| | 2003 £m | Restated 2002 £m |
|---|---|---|
| **Fixed assets** | | |
| Shares in subsidiary undertakings (M & 17e) | **14,046** | 10,614 |
| Investment in joint venture (N and 20c) | **22** | 20 |
| | **14,068** | 10,634 |
| **Current assets** | | |
| Amounts owed by subsidiary undertakings | **3,734** | 4,111 |
| Other assets | **100** | 146 |
| | **3,834** | 4,257 |
| **Creditors: Amounts falling due within one year** | | |
| Amounts owed to subsidiary undertakings | **(1,949)** | (1,745) |
| Loans (42e) | **(1,172)** | (1,433) |
| Proposed ordinary dividend (15) | **(342)** | (322) |
| Other creditors | **(63)** | (61) |
| **Net current assets** | **308** | 696 |
| **Total assets less current liabilities** | **14,376** | 11,330 |
| **Creditors: Amounts falling due after more than one year** | | |
| Loans (42e) | **(397)** | (472) |
| Subordinated debt (R & 36) | **(2,814)** | (1,190) |
| **Net assets** | **11,165** | 9,668 |
| Represented by: | | |
| **Capital and reserves** | | |
| Ordinary share capital (31) | **564** | 564 |
| Preference share capital (32a) | **200** | 200 |
| Called up share capital | **764** | 764 |
| Share premium account (31c) | **1,096** | 1,094 |
| Revaluation reserve (35) | **2,074** | 114 |
| Merger reserve (35) | **227** | 227 |
| Profit and loss account: (35) | | |
| Distributable | **1,269** | 1,734 |
| Non-distributable | **5,735** | 5,735 |
| | **7,004** | 7,469 |
| **Shareholders' funds** | **11,165** | 9,668 |
| Analysed between: | | |
| Equity | **10,965** | 9,468 |
| Non-equity | **200** | 200 |
| | **11,165** | 9,668 |

Approved by the Board on 24 February 2004

**Philip Twyman**
Group Executive Director

The accounting policies (identified alphabetically) on pages 56 to 58 and notes (identified numerically) on pages 68 to 100 are an integral part of these accounts.
The auditors' report is on page 55.

# Notes to the accounts

### 1 – Exchange rates

The euro rates employed in this report are an average rate of €1 = £0.69 *(2002: €1 = £0.63)* and a closing rate of €1 = £0.70 *(2002: €1 = £0.65)*.

### 2 – Discontinued operations

"Discontinued operations" disclosures in 2002 relate to the disposal of the general insurance businesses in Australia and New Zealand. The results of all other operations are described as "Continuing operations". The Group's consolidated profit and loss account incorporates the following financial information in respect of the Australia and New Zealand general insurance businesses:

Abridged statement of operating and investment gains

| | 2003 £m | 2002 £m |
|---|---|---|
| Net premiums written | – | 692 |
| Change in the provision for unearned premiums | – | (38) |
| Earned premiums, net of reinsurance | – | 654 |
| Allocated investment return transferred from the non-technical account | – | 71 |
| Claims incurred, net of reinsurance | – | (452) |
| Other charges | – | (195) |
| **Balance on the general business technical account** | | |
| Underwriting result | – | 7 |
| Longer-term investment return | – | 71 |
| **Operating profit** | – | 78 |
| Amortisation of goodwill | – | (2) |
| Short-term fluctuation in investment returns and other items | – | (40) |
| Profit on ordinary activities before tax | – | 36 |
| Tax on profit on ordinary activities | – | (6) |
| **Profit for the financial year** | – | 30 |

### 3 – Changes in accounting policy

(a) Additional value of internally-generated in-force business

In November 2003, the Association of British Insurers issued a revised version of its Statement of Recommended Practice on accounting for insurance business ("ABI SORP"). One of the amendments is that insurance companies are no longer allowed to recognise the internally-generated additional value of in-force business ("AVIF") on their balance sheets, either as an asset or as part of shareholders' funds. The Group has therefore changed its accounting policy in this area.

The effects of implementing this change are that equity shareholders' funds at 31 December 2003 have been reduced by £4,611 million *(2002: reduced by £3,832 million; 2001: reduced by £5,268 million)* and minority interests have been reduced by £133 million *(2002: reduced by £85 million; 2001: reduced by £81 million)*.

(b) Presentation changes

*(i)* In December 2003, the Urgent Issues Task Force issued UITF Abstract 38 which requires shares held by employee share trusts to be deducted from capital in arriving at shareholders' funds rather than being held as assets.

The effects of implementing this change are that equity shareholders' funds at 31 December 2003 have been reduced by £1 million *(2002: reduced by £1 million; 2001: reduced by £10 million)*.

*(ii)* The Group's wealth management result was previously shown separately but is now shown as part of the result from non-insurance operations. The result reclassified in 2003 is nil *(2002: loss of £30 million)*.

### 4 – Geographical segmental information

The Group's reportable business segments are long-term business, health business, fund management and general insurance business. The main geographical segments are the United Kingdom, Europe (excluding the United Kingdom) and International.

(a) Operating profit by business

*(i) Operating profit in respect of long-term business before amortisation of acquired additional value of in-force long-term business and amortisation of goodwill on associates*

| | Operating profit | |
|---|---|---|
| | 2003 £m | 2002 £m |
| **United Kingdom** | **594** | 626 |
| **Europe (excluding UK)** | | |
| France | **179** | 142 |
| Ireland | **41** | 36 |
| Italy | **30** | 24 |
| Netherlands (including Belgium and Luxembourg) | **107** | 111 |
| Poland | **103** | 66 |
| Spain | **50** | 27 |
| Other Europe | **(4)** | (19) |
| **International** | **38** | 9 |
| | **1,138** | 1,022 |

**4 – Geographical segmental information** continued

*(ii) Operating profit in respect of health business*

| | Underwriting result | | Operating profit | |
|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| **United Kingdom** | **9** | 5 | **13** | 9 |
| **Europe (excluding UK)** | | | | |
| France | **(2)** | (2) | **9** | 10 |
| Netherlands | **(20)** | (27) | **39** | 42 |
| | **(13)** | (24) | **61** | 61 |

*(iii) Operating profit in respect of fund management*

| | Operating profit | |
|---|---|---|
| | 2003 £m | 2002 £m |
| **United Kingdom** | **(6)** | (12) |
| **Europe (excluding UK)** | | |
| France | **13** | 11 |
| Netherlands | **–** | 4 |
| Other Europe | **3** | 2 |
| **International** | | |
| Australia and New Zealand | **(1)** | (1) |
| Other International | **1** | 1 |
| | **10** | 5 |
| Add: share of associate loss (UK) | **6** | – |
| Operating profit in respect of fund management, excluding associates | **16** | 5 |

*(iv) Operating profit in respect of general insurance business excluding health business, before exceptional items*

| | Underwriting result | | Operating profit | |
|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| **United Kingdom** | **50** | (52) | **676** | 611 |
| **Europe (excluding UK)** | | | | |
| France | **(9)** | (14) | **35** | 47 |
| Ireland | **26** | (15) | **91** | 44 |
| Netherlands | **(5)** | (21) | **35** | 13 |
| Other Europe | **(6)** | (10) | **32** | 49 |
| **International** | | | | |
| Canada | **(98)** | (28) | **12** | 80 |
| Other International | **(12)** | (5) | **30** | 37 |
| Continuing operations | **(54)** | (145) | **911** | 881 |
| Discontinued operations (note 2) | **–** | 7 | **–** | 78 |
| | **(54)** | (138) | **911** | 959 |

(b) Operating profit before tax

| | 2003 £m | 2002 £m |
|---|---|---|
| United Kingdom | **1,133** | 1,072 |
| Europe (excluding UK) | **621** | 415 |
| International | **64** | 109 |
| Continuing operations | **1,818** | 1,596 |
| Discontinued operations (note 2) | **–** | 78 |
| Corporate costs (note 10) | **(160)** | (218) |
| Unallocated interest charges (note 7a) | **(406)** | (434) |
| Operating profit | **1,252** | 1,022 |

# Notes to the accounts
continued

### 4 – Geographical segmental information continued

(c) Net assets by business and geographical segment

| | Long-term business | | General insurance and health business | | Total | |
|---|---|---|---|---|---|---|
| | 2003 £m | Restated 2002 £m | 2003 £m | 2002 £m | 2003 £m | Restated 2002 £m |
| United Kingdom | **2,988** | 2,650 | **2,448** | 2,052 | **5,436** | 4,702 |
| Europe (excluding UK) | **3,605** | 2,923 | **1,109** | 1,055 | **4,714** | 3,978 |
| International | **548** | 384 | **924** | 810 | **1,472** | 1,194 |
| | **7,141** | 5,957 | **4,481** | 3,917 | **11,622** | 9,874 |
| Other business | | | | | **725** | 554 |
| Acquired additional value of in-force long-term business (note 24) | | | | | **488** | 505 |
| Corporate and other holding company assets | | | | | **2,934** | 2,475 |
| | | | | | **15,769** | 13,408 |
| External borrowings (note 42) | | | | | **(1,749)** | (2,053) |
| Internal borrowings | | | | | **(3,841)** | (3,671) |
| Subordinated debt (note 36) | | | | | **(2,814)** | (1,190) |
| Total | | | | | **7,365** | 6,494 |

(d) Net assets by principal currency

| | 2003 £m | Restated 2002 £m |
|---|---|---|
| Sterling | **2,473** | 508 |
| Euro | **3,535** | 4,265 |
| Canadian dollar | **534** | 532 |
| United States dollar | **231** | 240 |
| Other | **592** | 949 |
| Total | **7,365** | 6,494 |

Net assets are stated after taking account of the effect of currency swaps and forward foreign exchange contracts.

### 5 – New long-term savings business premiums

An analysis of new life and savings business premiums written is provided below.

| | New single premiums | | New regular premiums | | Total | |
|---|---|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| **Life and pensions:** | | | | | | |
| **United Kingdom** – Group companies | **5,184** | 6,066 | **511** | 591 | **5,695** | 6,657 |
| – associates* | **152** | 171 | **23** | 16 | **175** | 187 |
| | **5,336** | 6,237 | **534** | 607 | **5,870** | 6,844 |
| **Europe (excluding UK)** | | | | | | |
| France | **1,950** | 1,814 | **46** | 42 | **1,996** | 1,856 |
| Ireland | **188** | 267 | **62** | 76 | **250** | 343 |
| Italy | **1,399** | 1,089 | **54** | 44 | **1,453** | 1,133 |
| Netherlands (including Belgium and Luxembourg) | **850** | 709 | **139** | 87 | **989** | 796 |
| Poland – life | **24** | 22 | **17** | 24 | **41** | 46 |
| – pensions | **8** | 9 | **15** | 21 | **23** | 30 |
| Spain | **1,353** | 1,244 | **111** | 65 | **1,464** | 1,309 |
| Other Europe | **280** | 240 | **73** | 69 | **353** | 309 |
| **International**** | **740** | 863 | **113** | 89 | **853** | 952 |
| **Total life and pensions (including share of associates)** | **12,128** | 12,494 | **1,164** | 1,124 | **13,292** | 13,618 |
| **Investment sales:** | | | | | | |
| **United Kingdom** | **664** | 543 | **16** | 13 | **680** | 556 |
| **Europe (excluding UK)** | | | | | | |
| Netherlands | **204** | 119 | **–** | – | **204** | 119 |
| Poland | **109** | 16 | **1** | – | **110** | 16 |
| Other Europe | **49** | 70 | **–** | – | **49** | 70 |
| **International** | **98** | 267 | **–** | – | **98** | 267 |
| **Total investment sales** | **1,124** | 1,015 | **17** | 13 | **1,141** | 1,028 |
| **Total long-term savings (including share of associates)** | **13,252** | 13,509 | **1,181** | 1,137 | **14,433** | 14,646 |

*The figures for associates comprise the Group's 49.99% share of our associate RBS Life Investments Limited.

**The 2003 figures for International include the Group's 26% share of our associate company in India (Aviva Life Insurance Pvt. Limited) and the Group's 50% share of our joint venture in China (Aviva COFCO Life Insurance Company Limited).

**5 – New long-term savings business premiums** continued

Single premiums are those relating to products issued by the Group, which provide for the payment of one premium only. Regular premiums are those where there is a contractual obligation to pay on an ongoing basis.

In addition to the amounts included above, Navigator, our Australian funds administration business, recorded sales of £625 million in 2003 *(2002: £797 million)* including sales through Navigator Asia in Singapore.

**6 – Premiums written and sales of investment products**

(a) *(i) Total premiums written and investment sales*

| | Premiums before reinsurance | | Premiums after reinsurance | |
|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Long-term business premiums (note 6a(ii)) | **19,648** | 18,645 | **19,035** | 18,172 |
| Sales of investment products (note 5) | **1,141** | 1,028 | **1,141** | 1,028 |
| Health business premiums (note 6a(iii)) | **1,069** | 931 | **1,066** | 928 |
| General insurance business premiums (note 6a(iv)) | **9,326** | 8,865 | **8,524** | 7,805 |
| | **10,395** | 9,796 | **9,590** | 8,733 |
| Total premiums written and investment sales – continuing operations | **31,184** | 29,469 | **29,766** | 27,933 |
| General insurance business premiums – discontinued operations | **–** | 783 | **–** | 692 |
| Total premiums written and investment sales | **31,184** | 30,252 | **29,766** | 28,625 |

*(ii) Long-term business premium income by geographical origin – continuing operations*

| | Premiums before reinsurance | | Premiums after reinsurance | |
|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| **United Kingdom*** | **9,346** | 9,379 | **8,942** | 9,099 |
| **Europe (excluding UK)** | | | | |
| France | **2,331** | 2,131 | **2,300** | 2,081 |
| Ireland | **464** | 486 | **442** | 469 |
| Italy | **1,681** | 1,402 | **1,662** | 1,382 |
| Netherlands (including Belgium and Luxembourg) | **1,758** | 1,311 | **1,722** | 1,300 |
| Poland | **705** | 732 | **703** | 730 |
| Spain | **1,658** | 1,502 | **1,641** | 1,489 |
| Other Europe | **674** | 605 | **616** | 548 |
| **International** | **1,031** | 1,097 | **1,007** | 1,074 |
| Total long-term business premiums, including share of associates and joint ventures | **19,648** | 18,645 | **19,035** | 18,172 |
| Less: share of premiums from associates and joint ventures** | **(275)** | (315) | **(257)** | (299) |
| Total Group long-term business premiums | **19,373** | 18,330 | **18,778** | 17,873 |

*Included within the 2003 premium income before and after reinsurance are transfers of institutional business into Morley Pooled Pensions of £1,247 million *(2002: £34 million)* which, since they are institutional in nature, are excluded from new business sales in note 5.

**The figures for associates and joint ventures comprise the Group's 49.99% share of our associate in the United Kingdom (RBS Life Investments Limited), our 26% associate in India (Aviva Life Insurance Company India Pty Limited) and our 50% joint venture in China (Aviva COFCO Life Insurance Company Limited).

*(iii) Health business premium income by geographical origin – continuing operations*

| | Premiums before reinsurance | | Premiums after reinsurance | |
|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| **United Kingdom** | **270** | 264 | **270** | 264 |
| **Europe (excluding UK)** | | | | |
| France | **134** | 107 | **134** | 107 |
| Netherlands | **665** | 560 | **662** | 557 |
| Total health business premiums | **1,069** | 931 | **1,066** | 928 |

*(iv) General insurance business premium income (excluding health business premiums) by geographical origin – continuing operations*

| | Premiums before reinsurance | | Premiums after reinsurance | |
|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| **United Kingdom** | **5,721** | 5,461 | **5,135** | 4,740 |
| **Europe (excluding UK)** | | | | |
| France | **558** | 544 | **515** | 478 |
| Ireland | **650** | 594 | **611** | 377 |
| Netherlands | **605** | 444 | **563** | 412 |
| Other Europe | **284** | 489 | **226** | 408 |
| **International** | | | | |
| Canada | **1,307** | 1,082 | **1,208** | 1,009 |
| Other International | **201** | 251 | **266** | 381 |
| Total general insurance business premiums (excluding health business) | **9,326** | 8,865 | **8,524** | 7,805 |

*(v)* Premium income by destination does not differ materially from premium income by geographical origin, as most risks are located in the countries where the policies were written.

# Notes to the accounts
continued

**6 – Premiums written and sales of investment products** continued

(b) The analysis of general insurance business premiums written before reinsurance is:

| | 2003 £m | 2002 £m |
|---|---|---|
| Property | **3,142** | 2,870 |
| Motor | **3,943** | 3,710 |
| Liability | **771** | 635 |
| Creditor | **811** | 688 |
| Other | **659** | 962 |
| General business premiums excluding health business – continuing operations (note 6a(iv)) | **9,326** | 8,865 |
| Discontinued operations | **–** | 783 |
| General business premiums excluding health business | **9,326** | 9,648 |
| Health business (note 6a(iii)) | **1,069** | 931 |
| Total general business premiums written before reinsurance | **10,395** | 10,579 |

**7 – Analysis of investment return**

(a) The total investment return before tax comprises:

| | Long-term business | | Non-long-term business | |
|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Share of result of joint ventures | **36** | 29 | **–** | – |
| Share of result of associated undertakings | **29** | 27 | **2** | 16 |
| Amortisation of goodwill on associated undertakings (note 21c) | **(13)** | (13) | **(2)** | – |
| Amortisation of acquired additional value of in-force long-term business (note 21b) | **(24)** | – | **–** | – |
| | **(8)** | 14 | **–** | 16 |
| Income from land and buildings | **656** | 599 | **35** | 41 |
| Income from other investments | **6,915** | 5,618 | **931** | 918 |
| Realised investment (losses)/gains | **(135)** | (1,445) | **44** | 107 |
| | **7,436** | 4,772 | **1,010** | 1,066 |
| Investment income | **7,464** | 4,815 | **1,010** | 1,082 |
| Expenses and charges, including allocated interest charges | **(274)** | (270) | **(31)** | (51) |
| Unallocated interest charges: | | | | |
| External – subordinated debt | **–** | – | **(101)** | (73) |
| – other borrowings | **–** | – | **(109)** | (133) |
| Intra-group | **–** | – | **(196)** | (228) |
| | **–** | – | **(406)** | (434) |
| | **(274)** | (270) | **(437)** | (485) |
| Investment return before unrealised gains/(losses) | **7,190** | 4,545 | **573** | 597 |
| Unrealised investment gains/(losses) | **7,069** | (8,833) | **143** | (1,017) |
| Total investment return before tax | **14,259** | (4,288) | **716** | (420) |

(b) Longer-term investment return

*(i)* The longer-term investment return, net of expenses, allocated to the general business technical account and transferred from the long-term business technical account was £1,039 million *(2002: £1,182 million)* and £129 million *(2002: £59 million transferred to)*, respectively.

*(ii)* The longer-term investment return and short-term fluctuation are as follows:

| | Shareholders' interest in long-term business | | Non-long-term business | |
|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Total investment return before tax | **214** | 28 | **716** | (420) |
| Less: share of result of associated undertakings, net of goodwill amortisation | **–** | – | **–** | (16) |
| Add: unallocated interest charges | **–** | – | **406** | 434 |
| | **214** | 28 | **1,122** | (2) |
| Longer-term investment return | **85** | 87 | **1,039** | 1,182 |
| Short-term fluctuation in investment return | **129** | (59) | **83** | (1,184) |
| | **214** | 28 | **1,122** | (2) |

*(iii)* The longer-term investment return is calculated separately for each principal general insurance business unit and certain long-term business operations. In respect of equities and properties, the return is calculated by multiplying the opening market value of the investments, adjusted for sales and purchases during the year, by the longer-term rate of investment return. The longer-term rate of investment return is determined using consistent assumptions between operations, having regard to local economic and market forecasts of investment return. The allocated longer-term return for other investments is the actual income receivable for the year.

**7 – Analysis of investment return** continued

*(iv)* The principal assumptions underlying the calculation of the longer-term investment return are:

| | Longer-term rates of return Equities | | Longer-term rates of return Properties | |
|---|---|---|---|---|
| | 2003 % | 2002 % | 2003 % | 2002 % |
| United Kingdom | **8.1%** | 8.1% | **6.6%** | 6.6% |
| France | **7.5%** | 7.5% | **6.5%** | 6.5% |
| Ireland | **8.7%** | 8.7% | **6.7%** | 6.7% |
| Netherlands | **8.4%** | 8.4% | **6.5%** | 6.5% |
| Canada | **9.3%** | 9.3% | **7.3%** | 7.3% |

(c) The actual return on investments, before deducting investment management expenses and charges, is compared below with the aggregate longer-term return over a five year period.

| | 1999-2003 £m | 1998-2002 £m |
|---|---|---|
| Actual return attributable to shareholders: | | |
| Long-term business* | **625** | 581 |
| Non-long-term business | **5,431** | 6,692 |
| | **6,056** | 7,273 |
| Longer-term return credited to operating results: | | |
| Long-term business* | **562** | 626 |
| Non-long-term business | **7,005** | 7,587 |
| | **7,567** | 8,213 |
| Shortfall of actual returns over longer-term returns | **(1,511)** | (940) |

*Figures represent non-with-profits business only, where a longer-term rate of return is used.

(d) The table below shows the sensitivity of Group operating profit before tax to changes in the longer-term rates of return:

| | | | By | |
|---|---|---|---|---|
| Movement in investment return for | By | Change in | 2003 £m | 2002 £m |
| Equities | 1% higher/lower | Group operating profit before tax | **33** | 40 |
| Properties | 1% higher/lower | Group operating profit before tax | **11** | 13 |

**8 – Long-term business bonuses**

The following amounts have been included in the long-term business technical account in respect of policyholder bonuses:

| | 2003 £m | 2002 £m |
|---|---|---|
| Bonuses allocated in anticipation of a bonus declaration, included in claims paid | **332** | 508 |
| Reversionary and similar policyholder bonuses, included in the movement in the long-term business provision | **2,372** | 2,346 |
| | **2,704** | 2,854 |

**9 – Net operating expenses**

Net operating expenses in the technical accounts comprise:

| | Long-term business | | General business | | Total | |
|---|---|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Acquisition costs | **1,453** | 1,494 | **2,404** | 2,379 | **3,857** | 3,873 |
| Changes in deferred acquisition costs | **(79)** | (144) | **(70)** | (30) | **(149)** | (174) |
| Administrative expenses | **739** | 737 | **509** | 483 | **1,248** | 1,220 |
| | **2,113** | 2,087 | **2,843** | 2,832 | **4,956** | 4,919 |
| Reinsurance commissions receivable | **(35)** | (26) | **(99)** | (139) | **(134)** | (165) |
| | **2,078** | 2,061 | **2,744** | 2,693 | **4,822** | 4,754 |

# Notes to the accounts
continued

## 10 – Corporate costs

| | 2003 £m | 2002 £m |
|---|---|---|
| Central costs and sharesave schemes | **176** | 192 |
| Global finance transformation programme | **60** | 26 |
| | **236** | 218 |
| Allocation of staff profit share and other incentive plans to business unit operating results | **(76)** | – |
| | **160** | 218 |

## 11 – Employee information

The average number of persons employed by the Group during the year was:

| | 2003 Number | 2002 Number |
|---|---|---|
| United Kingdom | **37,185** | 38,662 |
| Europe (excluding UK) | **17,801** | 18,555 |
| International | **5,754** | 9,709 |
| | **60,740** | 66,926 |

The analysis of total staff costs was:

| | 2003 £m | 2002 £m |
|---|---|---|
| Wages and salaries | **1,447** | 1,473 |
| Social security costs | **213** | 198 |
| Pension costs (note 45d) | **116** | 117 |
| | **1,776** | 1,788 |

## 12 – Directors

Information concerning individual directors' emoluments, interests and transactions is given on pages 50 to 54.

## 13 – Auditors' remuneration

The total remuneration payable by the Group, excluding VAT and any overseas equivalent thereof, to its principal auditor, Ernst &Young LLP, in respect of the audit of these accounts is shown below, together with fees payable in respect of other work.

| | 2003 £m | 2002 £m |
|---|---|---|
| Audit services | | |
| Statutory audit | **6.4** | 4.0 |
| Audit-related regulatory and supplementary reporting | **3.3** | 3.3 |
| | **9.7** | 7.3 |
| Further assurance services | **2.7** | 5.7 |
| Other services | **0.9** | 0.9 |
| | **13.3** | 13.9 |

In addition to the above amounts payable to principal auditors, fees for audit services of £2.2 million *(2002: £1.5 million)* were payable to other firms. The total fees payable for audit services were therefore £11.9 million *(2002: £8.8 million)*.

Further assurance services included advice on accounting matters, reporting on internal controls and corporate governance matters, and due diligence work.

The auditor's remuneration in respect of the parent company was £12,000 *(2002: £11,000)*.

## 14 – Tax

### (a) Tax on profit/(loss) on ordinary activities

Tax (charged)/credited in the non-technical account comprises:

| | 2003 £m | 2002 £m |
|---|---|---|
| **Current tax** | | |
| UK corporation tax | **(73)** | (15) |
| Overseas tax | **(20)** | (89) |
| Prior year adjustments | | |
| United Kingdom | **17** | (4) |
| Overseas | **3** | 6 |
| | **20** | 2 |
| Tax attributable to balance on long-term business technical account | **(278)** | (260) |
| Total current tax charged (note 14c) | **(351)** | (362) |
| **Deferred tax** | | |
| Origination and reversal of timing differences | **(19)** | 177 |
| Changes in tax rates or law | **(11)** | 5 |
| Increase/(decrease) in discount | **14** | (26) |
| Total deferred tax (charged)/credited (note 14e(ii)) | **(16)** | 156 |
| **Total tax charged in the non-technical account** | **(367)** | (206) |
| The total tax (charged)/credited in the non-technical account relates to the following: | | |
| Parent company and subsidiary undertakings | **(371)** | (197) |
| Associated undertakings | **4** | (9) |
| **Total tax charged in the non-technical account** | **(367)** | (206) |

### (b) Long-term business

Tax (charged)/credited in the long-term business technical account comprises:

| | 2003 £m | 2002 £m |
|---|---|---|
| **Current tax** | | |
| UK corporation tax | **(212)** | (382) |
| Overseas tax | **(105)** | (77) |
| Prior year adjustments | | |
| United Kingdom | **(52)** | (7) |
| Overseas | **6** | 4 |
| | **(46)** | (3) |
| Total current tax charged | **(363)** | (462) |
| **Deferred tax** | | |
| Origination and reversal of timing differences | **(129)** | 676 |
| Decrease in discount | **(35)** | (51) |
| Prior year adjustments | **(7)** | – |
| Total deferred tax (charged)/credited (note 14e(ii)) | **(171)** | 625 |
| **Total tax (charged)/credited in the long-term business technical account** | **(534)** | 163 |
| The total tax (charged)/credited in the long-term business technical account relates to the following: | | |
| Parent company and subsidiary undertakings | **(525)** | 171 |
| Associated undertakings | **(9)** | (8) |
| **Total tax (charged)/credited in the long-term business technical account** | **(534)** | 163 |

# Notes to the accounts
continued

**14 – Tax** continued

(c) Factors affecting current tax charge for the year
The tax assessed in the non-technical account is lower *(2002: higher)* than the standard UK corporation tax rate, because of the following factors:

| | Non-long-term business | |
|---|---|---|
| | 2003 £m | 2002 £m |
| Profit/(loss) on ordinary activities before tax | **1,390** | (282) |
| Current tax (charge)/credit at standard UK corporation tax rate of 30% *(2002: 30%)* | **(417)** | 85 |
| Adjustment to tax charge in respect of prior years | **20** | 2 |
| Non-assessable dividends | **5** | 9 |
| Non-taxable loss on the sale of subsidiaries and associates | **(10)** | (58) |
| Non-taxable amortisation of goodwill | **(5)** | (21) |
| Other disallowable expenses | **(33)** | (20) |
| Non-utilisation of current year tax losses | **(10)** | – |
| Different local basis of tax on overseas profits | **53** | (51) |
| Deferred tax credit arising from movement in unrealised gains and losses | **20** | (154) |
| Other deferred tax movements | **10** | (23) |
| Deferred tax assets not recognised | **38** | (96) |
| Other items | **(22)** | (35) |
| Current tax charge for the year (note 14a) | **(351)** | (362) |

(d) Factors that may affect future tax charges
The deferred tax assets, which have not been recognised due to the uncertainty of their recoverability in the foreseeable future, comprise:

| | Long-term business | | Non-long-term business | | Total | |
|---|---|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Unrealised losses on investments | **–** | – | **–** | 29 | **–** | 29 |
| Provisions and other timing differences | **10** | 165 | **79** | 90 | **89** | 255 |
| Losses | **50** | 50 | **267** | 17 | **317** | 67 |
| | **60** | 215 | **346** | 136 | **406** | 351 |

The deferred tax assets above are principally in respect of corporate entities and which would be recoverable in the event that these entities generate taxable profits in the future.

In addition, the Group has capital losses which may be available to offset future capital gains.

(e) Balance sheet
*(i)* The discounted net (provision)/asset for deferred tax, comprises:

| | Long-term business | | Non-long-term business | | Total | |
|---|---|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Unrealised gains on investments | **(443)** | (214) | **(199)** | (48) | **(642)** | (262) |
| Deferred acquisition costs | **(217)** | (203) | **1** | – | **(216)** | (203) |
| Provisions and other timing differences | **262** | (62) | **(52)** | (37) | **210** | (99) |
| Losses | **5** | 3 | **173** | 146 | **178** | 149 |
| Undiscounted net (provision)/asset for deferred tax | **(393)** | (476) | **(77)** | 61 | **(470)** | (415) |
| Discount | **59** | 94 | **92** | 78 | **151** | 172 |
| Discounted net (provision)/asset for deferred tax | **(334)** | (382) | **15** | 139 | **(319)** | (243) |

*(ii)* Movements in the deferred tax balances are analysed as follows:

| | Long-term business | | Non-long-term business | | Total | |
|---|---|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Net (provision)/asset at 1 January | **(382)** | (1,029) | **139** | (34) | **(243)** | (1,063) |
| Amounts (charged)/credited to the profit and loss account (note 14a and 14b) | **(171)** | 625 | **(16)** | 156 | **(187)** | 781 |
| Other items | **219** | 22 | **(108)** | 17 | **111** | 39 |
| Net (provision)/asset at 31 December | **(334)** | (382) | **15** | 139 | **(319)** | (243) |

**14 – Tax** continued

*(iii)* The net (provision)/asset for deferred tax is disclosed in the accounts as follows:

| | Long-term business 2003 £m | Long-term business 2002 £m | Non-long-term business 2003 £m | Non-long-term business 2002 £m | Total 2003 £m | Total 2002 £m |
|---|---|---|---|---|---|---|
| Amount included in provisions for other risks and charges (note 41) | **(438)** | (407) | **(96)** | (58) | **(534)** | (465) |
| Amount included in other debtors (note 27) | **104** | 25 | **111** | 197 | **215** | 222 |
| Net (provision)/asset at 31 December | **(334)** | (382) | **15** | 139 | **(319)** | (243) |

*(iv)* Deferred tax assets arise in certain overseas subsidiaries in respect of tax timing differences. The subsidiaries are expected to generate sufficient future taxable profits to use the assets created.

**15 – Ordinary dividends**

Ordinary dividends in the profit and loss account comprise:

| | 2003 £m | 2002 £m |
|---|---|---|
| Interim – 9.0 pence *(2002: 8.75 pence)* paid on 17 November 2003 | **203** | 197 |
| Final – 15.15 pence *(2002: 14.25 pence)* payable on 17 May 2004 | **342** | 322 |
| | **545** | 519 |

Irish shareholders who are due to be paid a dividend denominated in euros will receive a payment at the exchange rate prevailing on 24 February 2004.

**16 – Earnings per share**

(a) Basic earnings per share

| | 2003 Before tax £m | 2003 Net of tax, minorities and preference dividends £m | 2003 Per share p | 2002 Before tax £m | 2002 Net of tax, minorities and preference dividends £m | 2002 Per share p |
|---|---|---|---|---|---|---|
| Operating profit | | | | | | |
| – continuing operations | **1,490** | **991** | **44.0** | 1,218 | 784 | 34.8 |
| – discontinued operations | **–** | **–** | **–** | 78 | 72 | 3.2 |
| | **1,490** | **991** | **44.0** | 1,296 | 856 | 38.0 |
| Adjusted for the following items: | | | | | | |
| – Amortisation of goodwill (note 18 & 21b) | **(103)** | **(103)** | **(4.6)** | (135) | (135) | (6.0) |
| – Amortisation of acquired additional value of in-force long-term business | **(135)** | **(98)** | **(4.4)** | (139) | (100) | (4.4) |
| – Exceptional costs for termination of operations (note 17d) | **(19)** | **(16)** | **(0.7)** | – | – | – |
| – Short-term fluctuation in investment return | **212** | **198** | **8.9** | (1,243) | (1,071) | (47.5) |
| – Change in the equalisation provision (note 40) | **(49)** | **(34)** | **(1.5)** | (57) | (40) | (1.8) |
| – Net loss on the disposal of subsidiary undertakings (note 17c) | **(6)** | **(6)** | **(0.3)** | (4) | (61) | (2.7) |
| **Profit/(loss) attributable to equity shareholders** | **1,390** | **932** | **41.4** | (282) | (551) | (24.4) |

Earnings per share has been calculated based on the operating profit before amortisation of goodwill, amortisation of acquired additional value of in-force long-term business and exceptional items, after tax attributable to equity shareholders for continuing operations and for total operations, as well as on the profit attributable to equity shareholders. The directors believe the former two earnings per share figures provide a better indication of operating performance.

The calculation of basic earnings per share uses a weighted average of 2,251 million *(2002: 2,254 million)* ordinary shares in issue, after deducting shares owned by the employee share trusts as required by FRS14 “Earnings per share”. The actual number of shares in issue at 31 December 2003 was 2,257 million *(2002: 2,257 million)*.

# Notes to the accounts
continued

## 16 – Earnings per share continued

(b) Diluted earnings per share

| | 2003 | | | 2002 | | |
|---|---|---|---|---|---|---|
| | Total £m | Weighted average number of shares m | Per share p | Total £m | Weighted average number of shares m | Per share p |
| Profit/(loss) attributable to equity shareholders | **932** | **2,251** | **41.4** | (551) | 2,254 | (24.4) |
| Dilutive effect of share awards and options | **–** | **8** | **(0.1)** | – | 4 | – |
| Diluted earnings per share | **932** | **2,259** | **41.3** | (551) | 2,258 | (24.4) |

## 17 – Subsidiary undertakings

(a) Acquisitions
During the year ended 31 December 2003, the Group acquired the following company:

| | Country of incorporation | Percentage acquired | Month of acquisition |
|---|---|---|---|
| Delta Lloyd ABN AMRO Verzekeringen Holdings BV | Netherlands | 51.0% | May |

On 8 May 2003, the Group's Dutch subsidiary, Delta Lloyd Group ("Delta Lloyd"), entered into a bancassurance agreement with ABN AMRO Bank NV ("ABN AMRO") for life and general insurance. As part of this agreement, the Group purchased 51% of the issued share capital of Delta Lloyd ABN AMRO Verzekeringen Holdings BV ("DL ABN AMRO"), the company established by ABN AMRO on 30 December 2002, into which the insurance businesses were transferred. Total cash consideration was £178 million, including transaction costs, with a further maximum amount payable over the next five years of £16 million if DL ABN AMRO meets certain performance criteria. The Group's share of DL ABN AMRO's embedded value and net assets was £62 million, giving rise to goodwill of £132 million after taking into account the estimated value of the deferred consideration. Under the terms of the agreement the results of DL ABN AMRO have been consolidated in the Group accounts with effect from 1 January 2003.

(b) Goodwill on acquisitions
The identifiable assets and liabilities acquired of DL ABN AMRO, the only material acquisition in 2003 giving rise to goodwill, were as set out below:

| | | Fair value adjustments | | |
|---|---|---|---|---|
| | Book value £m | Accounting policy alignments £m | Other significant adjustments £m | Fair value £m |
| **Assets** | | | | |
| Total investments | **2,645** | **–** | **–** | **2,645** |
| Additional value of in-force long-term business | **–** | **–** | **36** | **36** |
| Other assets | **256** | **(15)** | **–** | **241** |
| Total assets | **2,901** | **(15)** | **36** | **2,922** |
| **Liabilities** | | | | |
| Technical provisions including linked liabilities | **2,332** | **–** | **–** | **2,332** |
| Other creditors and provisions | **473** | **(5)** | **–** | **468** |
| Total liabilities | **2,805** | **(5)** | **–** | **2,800** |
| Total shareholders' funds | **96** | **(10)** | **36** | **122** |
| Less: Minority interests | | | | **(60)** |
| Shareholders' funds acquired | | | | **62** |
| Goodwill arising on acquisition | | | | **132** |
| Total consideration | | | | **194** |
| The total consideration comprised: | | | | |
| Cash (including contingent cash amounts) | | | | **194** |

In addition to the goodwill arising on the acquisition of DL ABN AMRO, the Group also made a number of smaller acquisitions giving rise to an additional goodwill amount of £8 million.

**17 – Subsidiary undertakings** continued

(c) Disposals
The net loss on the disposal of subsidiary undertakings comprises:

| | 2003 £m | 2002 £m |
|---|---|---|
| General insurance businesses: | | |
| UK | – | (20) |
| France | – | 6 |
| Australia and New Zealand | – | (66) |
| Spain | – | 94 |
| Other businesses: | | |
| France | – | 1 |
| Other small operations | **(6)** | (19) |
| | **(6)** | (4) |

No disposals were sufficiently material to warrant separate disclosure.

(d) Exceptional costs for termination of operations
During 2003, the Group incurred costs on the closure of its general insurance operations in Belgium. These exceptional costs relate to termination activities, including redundancy costs and closure provisions.

(e) The Company's subsidiary undertakings
Movements in the Company's shares in subsidiary undertakings are set out below:

| | 2003 £m | Restated 2002 £m |
|---|---|---|
| Current value: | | |
| At 1 January | **10,614** | 13,579 |
| Additions | **1,472** | – |
| Movement in current value (note 35) | **1,960** | (2,965) |
| At 31 December | **14,046** | 10,614 |

Shares in subsidiary undertakings are valued at current value, which for this purpose is embedded value for life operations or net asset value for other entities, computed in accordance with the Company's accounting policies. The resulting gain over book value of £2,074 million *(2002: £114 million)* has been credited to the Company's revaluation reserve (note 35). The directors are satisfied that the aggregate value of all such investments is not less than the aggregate amount at which they are stated in the balance sheet.

(f) Principal subsidiary undertakings at 31 December 2003 are listed on page 111.

One of the Group's subsidiaries, Delta Lloyd NV, is subject to the provisions of Dutch corporate law and particularly the Dutch "structure company" regime. Under this regime, Delta Lloyd's Supervisory Board has to have regard to the interests of a wide variety of stakeholders including shareholders. Under the structure regime, the Supervisory Board appoints its own successors. The relationship between the Board and its shareholder is close and positive, strengthening the position of Delta Lloyd Group as a major division of the Aviva Group. The Supervisory Board includes two Aviva Group representatives and is responsible for advising and supervising Delta Lloyd's Executive Board.

**18 – Goodwill**

The carrying value of goodwill on subsidiary undertakings relates to investments held by the non-long-term business operations and comprises the following:

| | Positive goodwill £m | Negative goodwill £m | Total 2003 £m | Total 2002 £m |
|---|---|---|---|---|
| Cost: | | | | |
| At 1 January | **1,390** | **(48)** | **1,342** | 1,340 |
| Additions (note 17a) | **140** | **–** | **140** | 76 |
| Disposals | **(9)** | **–** | **(9)** | (67) |
| Foreign exchange rate movements | **32** | **(5)** | **27** | (7) |
| At 31 December | **1,553** | **(53)** | **1,500** | 1,342 |
| Amortisation: | | | | |
| At 1 January | **311** | **(9)** | **302** | 199 |
| Charge in the year | **91** | **(3)** | **88** | 122 |
| Disposals | **(9)** | **–** | **(9)** | (19) |
| Foreign exchange rate movements | **15** | **(1)** | **14** | – |
| At 31 December | **408** | **(13)** | **395** | 302 |
| Carrying value at 31 December | **1,145** | **(40)** | **1,105** | 1,040 |

Positive and negative goodwill is being amortised on a straight-line basis over its useful economic life. Useful economic lives have been determined in respect of each acquisition to match the period over which the value of the underlying businesses will exceed the value of their identifiable net assets. No useful economic lives are in excess of 20 years. As explained in accounting policy J on page 57, goodwill arising in 1997 and prior years was charged directly to reserves.

# Notes to the accounts
continued

## 19 – Land and buildings

The carrying value of land and buildings comprises:

| | Long-term business | | Non-long-term business | | Total | |
|---|---|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Freeholds | **6,918** | 7,027 | **597** | 599 | **7,515** | 7,626 |
| Long leaseholds – over 50 years | **1,535** | 1,692 | **20** | 12 | **1,555** | 1,704 |
| Short leaseholds – under 50 years | **16** | 29 | **20** | 57 | **36** | 86 |
| | **8,469** | 8,748 | **637** | 668 | **9,106** | 9,416 |

The cost of land and buildings at 31 December 2003 was £7,452 million *(2002: £7,741 million)*. The carrying value of land and buildings occupied by the Group for its own activities was £405 million *(2002: £355 million)*.

The valuation of properties has been undertaken by qualified external valuers or by local qualified staff of the Group in overseas operations. All properties are valued at market value.

## 20 – Investments in joint ventures

(a) As part of their investment strategy, the UK long-term business policyholder funds have invested in a number of property limited partnerships ("PLPs") through a mix of capital and loans. The PLPs are managed by general partners ("GPs"), in which the UK long-term business shareholder companies hold equity stakes and which themselves hold nominal stakes in the PLPs.

Most of the PLPs have raised external debt, secured on their respective property portfolios. The lenders are only entitled to obtain payment, of both interest and principal, to the extent that there are sufficient resources in the respective PLPs. The lenders have no recourse whatsoever to the policyholder or shareholders' funds of any company in the Aviva Group.

Accounting for the PLPs as subsidiary undertakings, joint ventures or other financial investments depends on the shareholdings in the GPs and the terms in each partnership agreement. Where the Group exerts control over a PLP, it has been treated as a subsidiary and its results, assets and liabilities have been consolidated. Where the partnership is managed by a contractual agreement such that no one party exerts control, notwithstanding that the Group's partnership share in the PLP (including its indirect stake via the relevant GP) may be greater than 50%, such PLPs have been accounted for as joint ventures. Here, the Group's share of the respective PLPs' gross assets and gross liabilities are shown on the face of the consolidated balance sheet, in accordance with the requirements of FRS9 "Associates and joint ventures". Where the Group holds minority stakes in PLPs, with no disproportionate influence, the relevant investments are included in other financial investments at their market value.

(b) Movements in the Group's investments in joint ventures comprise:

| | 2003 £m | 2002 £m |
|---|---|---|
| Share of result for the year after tax | **36** | 29 |
| Unrealised investment gains after tax | **52** | 72 |
| Dividends received | **(33)** | (27) |
| Additions | **33** | 707 |
| Movements in investments in joint ventures | **88** | 781 |
| Balance at 1 January | **781** | – |
| Balance at 31 December | **869** | 781 |

(c) The principal joint ventures included above are as follows:
*(i) Property management undertakings*

| Company | GP proportion held | PLP proportion held |
|---|---|---|
| Ashtenne Industrial Partnership | 66.7% | 40.2% |
| Bishopsbridge Limited Partnership | 50.0% | 50.0% |
| The Junction Limited Partnership | 50.0% | 50.7% |
| The Mall Limited Partnership | 50.0% | 34.7% |
| Quercus Property Partnership Limited | 50.0% | 76.7% |

All the above undertakings perform property ownership and management activities, and are incorporated and operate in Great Britain. All these investments are held by subsidiary undertakings.

*(ii) Other*
The Group also has a 50% holding in AVIVA-COFCO Life Insurance Company Limited, a life assurance company incorporated and operating in China. These shares are held by the Company, with a cost of £22 million *(2002: £20 million)* and share of net assets of £18 million *(2002: £20 million)*.

### 21 – Investments in associated undertakings and other participating interests

(a) Investments in participating interests included in the consolidated balance sheet comprise:

| | Long-term business | | Non-long-term business | | Total | |
|---|---|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Investments in associated undertakings (note 21b) | **725** | 727 | **249** | 240 | **974** | 967 |
| Other participating interests | **39** | 36 | **30** | 47 | **69** | 83 |
| | **764** | 763 | **279** | 287 | **1,043** | 1,050 |

The cost of the above investments was £950 million and £72 million respectively *(2002: £915 million and £44 million respectively)*.

None of the other participating interests are listed on a recognised investment exchange.

(b) Associated undertakings

*(i)* Movements in the Group's investments in associated undertakings comprise:

| | Long-term business £m | Non-long-term business £m | Total 2003 £m |
|---|---|---|---|
| Share of result for the year after tax | **20** | **6** | **26** |
| Foreign exchange rate movements | **9** | **12** | **21** |
| Realised investment losses after tax | **–** | **(6)** | **(6)** |
| Unrealised investment gains after tax | **–** | **3** | **3** |
| Dividends received | **–** | **(5)** | **(5)** |
| Net assets acquired | **6** | **11** | **17** |
| Goodwill acquired (note 21c) | **–** | **37** | **37** |
| Amortisation of goodwill (note 7a) | **(13)** | **(2)** | **(15)** |
| Amortisation of acquired additional value of in-force long-term business (note 7a) | **(24)** | **–** | **(24)** |
| Disposals | **–** | **(47)** | **(47)** |
| Movements in investments in associated undertakings | **(2)** | **9** | **7** |
| Balance at 1 January | | | |
| Goodwill (note 21c) | **231** | **–** | **231** |
| Share of net assets | **496** | **240** | **736** |
| | **727** | **240** | **967** |
| Balance at 31 December | | | |
| Goodwill (note 21c) | **218** | **35** | **253** |
| Share of net assets | **507** | **214** | **721** |
| | **725** | **249** | **974** |

The amortisation charges for the year in respect of both goodwill and acquired additional value of in-force long-term business ("AVIF") appear under the heading "Investment income" in the long-term business technical account on page 59. The amortisation charge for AVIF is grossed up for attributable tax in the reconciliations on pages 59 and 62.

On 28 January 2003 and 12 March 2003 respectively, the Group disposed of its holdings in Norwich Winterthur Holdings Limited and Global Aerospace Underwriting Managers Limited.

*(ii)* The principal associated undertakings included above are:

| Company | Type of business | Class of share | Proportion held | Country of incorporation and operation |
|---|---|---|---|---|
| Aviva Life Insurance Company India Pvt. Limited | Insurance | Ordinary Rs1 shares | 26.0% | India |
| ProCapital S.A. | Online brokerage | Ordinary €1 shares | 43.5% | France |
| RBSG Collective Investments Limited | Investment | Ordinary £1 shares | 49.99% | Great Britain |
| RBS Life Investments Limited | Insurance | Ordinary £1 shares | 49.99% | Great Britain |
| Société Foncière Lyonnaise | Property | Ordinary €2 shares | 31.4% | France |
| The British Aviation Insurance Company Limited | Insurance | Ordinary £1 shares | 38.1% | Great Britain |

All investments in associated undertakings are held by subsidiary undertakings and are included in the accounts using year ended 31 December 2003 figures. Société Foncière Lyonnaise ("SFL") is listed on Euronext Paris, on the "Première Marché", and its total value, based on mid-market prices at 31 December 2003, is £867 million *(2002: £682 million)*. All other associated undertakings are not listed. The Group's shareholding in SFL would reduce to 26.31% if all convertible bonds previously issued by SFL are converted to ordinary shares.

# Notes to the accounts
continued

## 21 – Investments in associated undertakings and other participating interests continued

(c) The carrying value of goodwill on associated undertakings comprises the following:

| | Long-term business | | Non-long-term business | | Total | |
|---|---|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Cost: | | | | | | |
| At 1 January | **257** | 257 | **–** | – | **257** | 257 |
| Additions | **–** | – | **37** | – | **37** | – |
| At 31 December | **257** | 257 | **37** | – | **294** | 257 |
| Amortisation: | | | | | | |
| At 1 January | **26** | 13 | **–** | – | **26** | 13 |
| Charge in the year (note 7a) | **13** | 13 | **2** | – | **15** | 13 |
| At 31 December | **39** | 26 | **2** | – | **41** | 26 |
| Carrying value at 31 December | **218** | 231 | **35** | – | **253** | 231 |

Goodwill is being amortised on a straight-line basis over its useful economic life of 20 years, which has been determined to match the period over which the value of the underlying businesses will exceed the value of their identifiable net assets.

Through two separate transactions in January and September 2003, the Group acquired 49.99% of the ordinary share capital of RBSG Collective Investments Limited (“RBSGCI”), the immediate holding company of RBS Collective Investment Funds Limited (“RBSCIF”), for a total cash consideration of £47 million, representing net assets acquired of £10 million and goodwill of £37 million. The investment is in the form of a £0.5 million 49.99% equity participation in RBSGCI and a £46.5 million interest-free loan to RBS Collective Investments Holding Limited, the company holding the remaining 50.01% of the ordinary shares in RBSGCI. The loan would become repayable if RBSGCI disposed of its investment in RBSCIF and is guaranteed by The Royal Bank of Scotland plc.

(d) In France, the Group has invested in a number of specialised investment companies. These invest mainly in equities, bonds and properties, and distribute most of their income. The Group’s interests in these companies are included in these accounts within other financial investments or land and buildings as appropriate.

## 22 – Other financial investments

(a) The tables below show the carrying value and cost of these financial investments as at the dates indicated. All investments are held at current value unless otherwise indicated.

| | Carrying value | | | Cost | | |
|---|---|---|---|---|---|---|
| | Long-term business £m | Non-long-term business £m | Total 2003 £m | Long-term business £m | Non-long-term business £m | Total 2003 £m |
| Shares and other variable yield securities and units in unit trusts | **27,346** | **2,967** | **30,313** | **24,816** | **2,839** | **27,655** |
| Debt securities and other fixed income securities: | | | | | | |
| At current value | **36,950** | **10,098** | **47,048** | **35,668** | **10,071** | **45,739** |
| At amortised cost | **34,709** | **–** | **34,709** | **33,806** | **–** | **33,806** |
| Participation in investment pools | **7** | **–** | **7** | **7** | **–** | **7** |
| Loans secured by mortgages: | | | | | | |
| Own mortgages | **9,485** | **1,396** | **10,881** | **9,058** | **1,412** | **10,470** |
| Securitised mortgages (note 23) | **2,237** | **912** | **3,149** | **2,237** | **912** | **3,149** |
| Less: Non-recourse funding (note 23) | **(2,237)** | **(906)** | **(3,143)** | **(2,237)** | **(906)** | **(3,143)** |
| | **–** | **6** | **6** | **–** | **6** | **6** |
| Other loans: | | | | | | |
| Loans secured on policies | **1,065** | **–** | **1,065** | **1,065** | **–** | **1,065** |
| Other loans | **285** | **46** | **331** | **284** | **43** | **327** |
| Deposits with credit institutions | **2,436** | **394** | **2,830** | **2,436** | **394** | **2,830** |
| Other investments | **1,777** | **65** | **1,842** | **1,682** | **50** | **1,732** |
| **Total other financial investments** | **114,060** | **14,972** | **129,032** | **108,822** | **14,815** | **123,637** |

**22 – Other financial investments** continued

| | Carrying value | | | Cost | | |
|---|---|---|---|---|---|---|
| | Long-term business £m | Non-long-term business £m | Total 2002 £m | Long-term business £m | Non-long-term business £m | Total 2002 £m |
| Shares and other variable yield securities and units in unit trusts | 22,197 | 2,603 | 24,800 | 23,409 | 2,749 | 26,158 |
| Debt securities and other fixed income securities: | | | | | | |
| At current value | 23,084 | 7,737 | 30,821 | 21,871 | 7,562 | 29,433 |
| At amortised cost | 42,721 | – | 42,721 | 42,201 | – | 42,201 |
| Participation in investment pools | 68 | – | 68 | 68 | – | 68 |
| Loans secured by mortgages: | | | | | | |
| Own mortgages | 9,320 | 1,121 | 10,441 | 8,606 | 1,124 | 9,730 |
| Securitised mortgages (note 23) | 1,621 | 483 | 2,104 | 1,621 | 483 | 2,104 |
| Less: Non-recourse funding (note 23) | (1,621) | (478) | (2,099) | (1,621) | (478) | (2,099) |
| | – | 5 | 5 | – | 5 | 5 |
| Other loans: | | | | | | |
| Loans secured on policies | 997 | – | 997 | 996 | – | 996 |
| Other loans | 337 | 23 | 360 | 383 | 9 | 392 |
| Deposits with credit institutions | 2,207 | 532 | 2,739 | 2,207 | 532 | 2,739 |
| Other investments | 1,053 | 52 | 1,105 | 1,070 | 52 | 1,122 |
| **Total other financial investments** | 101,984 | 12,073 | 114,057 | 100,811 | 12,033 | 112,844 |

(b) Listed investments included in the carrying value above are:

| | 2003 £m | 2002 £m |
|---|---|---|
| Shares and other variable yield securities and units in unit trusts | **25,623** | 21,521 |
| Debt securities and other fixed income securities | **76,318** | 66,595 |

(c) The long-term debt securities and other fixed income securities, which are shown at amortised cost, are analysed below:

| | 2003 £m | 2002 £m |
|---|---|---|
| Cost | **33,806** | 42,201 |
| Cumulative amortisation | **903** | 520 |
| Amortised cost | **34,709** | 42,721 |
| Market value | **36,486** | 44,818 |

The redemption value of investments held at the year end was £997 million more *(2002: £74 million less)* than the amortised cost.

(d) In addition to the investments in participating interests detailed in note 21a, the Group holds investments exceeding 20% of a class of the equity capital in a number of other companies in the United Kingdom and elsewhere. These investments do not represent a material part of the assets or investment income of the Group. These include the Group's shareholding in Delta Lloyd Investment Fund NV where 13.0% *(2002: 8.3%)* is held directly and a further 20.8% *(2002: 25.1%)* is held in segregated policyholder funds. As this company invests mainly in equities and all dividends received are passed on to the shareholders, the Group's interest has been shown in other financial investments in these accounts.

(e) Included within other financial investments are shareholdings held on a long-term basis in the issued share capital of Société Générale, a banking company incorporated in France, Münchener Rückversicherungs-Gesellschaft, a reinsurance company incorporated in Germany, The Royal Bank of Scotland Group, a banking company incorporated in Scotland and UniCredito Italiano, a banking company incorporated in Italy. The market values of these holdings at 31 December 2003 were £233 million, £403 million, £854 million and £536 million, respectively *(2002: £595 million, £372 million, £956 million and £188 million, respectively)* and represented 1.1%, 2.6%, 1.8% and 2.8% *(2002: 3.8%, 2.8%, 2.2% and 1.2%)* of the respective issued share capitals of these companies. Of these holdings, the long-term business operations owned £231 million *(2002: £355 million)* of the Société Générale shares, £232 million *(2002: £211 million)* of the Münchener Rückversicherungs-Gesellschaft shares, £808 million *(2002: £911 million)* of The Royal Bank of Scotland Group shares and £279 million *(2002: £104 million)* of the UniCredito Italiano shares.

(f) At 31 December 2003, the Group held equity index futures, forwards and options to buy a notional total of £2,528 million *(2002: £1,480 million)* and to sell a notional total of £2,397 million *(2002: £1,832 million)* for long-term business operations. These contracts have a net positive fair value of £337 million *(2002: £331 million)*. No adjustment has been made to the classification of existing investments to reflect the effect of the future settlement of these transactions.

In 1998 and 2003, the Group purchased several swap options from European banks, to cover its possible future exposure to interest rates related to guaranteed annuities sold by subsidiaries in the United Kingdom. At 31 December 2003, the exposure hedged by these options was £3,147 million *(2002: £2,550 million)* and the contracts had a fair market value of £190 million *(2002: £167 million)*. These options have varying expiry dates up to 2028.

(g) The Group has entered into stocklending arrangements in the United Kingdom and overseas during the year in accordance with established market conventions. In the United Kingdom, investments are lent to locally-domiciled counterparties and governed by agreements written under English law. Other investments are specifically deposited under local laws in various countries overseas as security to holders of policies issued there.

Included within other financial investments are £164 million *(2002: £295 million)* of debt securities and other fixed income securities which have been sold under stock repurchase arrangements. The obligations arising under these arrangements are included in other creditors (see note 43).

# Notes to the accounts
continued

**23 – Securitised mortgages and related assets**

Other financial investments include loans secured by mortgages, subject to non-recourse finance arrangements, in a UK long-term business subsidiary and in a Dutch subsidiary. Details of the relevant transactions are as follows:

(a) In a United Kingdom long-term business subsidiary, Norwich Union Equity Release Limited ("NUER"), the beneficial interest in three portfolios of equity release mortgages has been transferred to three special purpose securitisation companies, Equity Release Funding (No. 1) plc ("ERF1"), Equity Release Funding (No. 2) plc ("ERF2") and Equity Release Funding (No.3) plc ("ERF3") (together "the ERF companies"), in return for initial consideration and, at later dates, deferred consideration. The deferred consideration represents receipts accrued within the ERF companies after meeting all their obligations to the noteholders, loan providers and other third parties in the priority of payments. No gain or loss was recognised on the transfer to ERF1 and ERF3, and a gain of £5.2 million was recognised on the transfer to ERF2. The purchases of the mortgages were funded by the issue of fixed rate, floating rate and index linked notes by the ERF companies.

The ultimate effective holding company of each of the ERF companies is Equity Release Funding Holdings Limited, whose shares are held on trust. NUER does not own, directly or indirectly, any of the share capital of the ERF companies or their parent company. NUER has no right to repurchase the benefit of any of the securitised mortgage loans, other than in certain circumstances where NUER is in breach of warranty or loans are substituted in order to effect a further advance.

NUER has indemnified the ERF companies for any losses they may suffer should its customers set off any shortfall in their annuities purchased from another Aviva Group company against amounts they owe to the ERF companies, and any shortfall due to negative equity not insured elsewhere. NUER's liability under these indemnities, estimated as £6 million *(2002: £5 million),* is included in other creditors in the consolidated balance sheet, whilst the linked liabilities figure has been reduced by the same amount to show the Group's net interest in these securitisations.

NUER has purchased £12.5 million of subordinated fixed rate notes in ERF1, which are repayable in 2031 and has granted a £14 million floating rate subordinated loan to ERF3. These are included in debt securities and other fixed income securities within other financial investments in the consolidated balance sheet.

NUER receives payments from the ERF companies in respect of fees for loan administration and cash handling purposes. Income of £3 million *(2002: £2 million)* has been included in investment income, relating to the securitisation of the mortgage portfolios.

(b) In a Dutch subsidiary, Delta Lloyd Levensverzekering NV ("DLL"), the principal benefits of four portfolios of mortgage loans have been transferred to four special purpose securitisation companies, Arena 2000-1 BV, Arena 2001-1 BV, Arena 2002-1 BV and Arena 2003-1 BV, ("the Arena companies"), which were funded primarily through the issue of fixed rate notes. No gains or losses were recognised on these transfers.

All the shares in the Arena companies are held by independent trustees, respectively Stichting Security Trustee Arena 2000-1 BV, Stichting Security Trustee Arena 2001-1 BV, Stichting Security Trustee Arena 2002-1 BV and Stichting Security Trustee Arena 2003-1 BV. DLL does not own, directly or indirectly, any of the share capital of the Arena companies or their parent companies. DLL has no right, nor any obligation, to repurchase the benefit of any of the securitised mortgage loans, other than in certain circumstances where DLL is in breach of warranty.

At 31 December 2003, DLL held £23 million of fixed rate notes in the Arena companies, which are repayable at various dates between 2053 and 2062. These are included in debt securities and other fixed income securities within other financial investments in the consolidated balance sheet at their market value of £24 million *(2002: £5 million)*.

DLL received interest of £2 million in 2003 *(2002: £2 million)* on the loan notes it holds in the Arena companies. It also receives payments under the terms of interest rate swaps written between DLL and these companies to hedge their respective exposures to movements in interest rates arising from these transactions. In each case, the effect of the swaps is that the Arena companies convert all or part of the interest flows receivable from customers in respect of the securitised mortgage loans into fixed interest flows which are designed substantially to match the interest payable to the noteholders. DLL has written further interest rate swaps with a bank to hedge its own interest rate risk under these contracts. Included in investment income is £25 million *(2002: £7 million)* relating to these swaps.

(c) In all of the above transactions, the Company and its subsidiaries are not obliged to support any losses that may be suffered by the noteholders and do not intend to provide such support. Additionally, the notes were issued on the basis that noteholders are only entitled to obtain payment, of both principal and interest, to the extent that the available resources of the respective special purpose securitisation companies, including funds due from customers in respect of the securitised loans, are sufficient and that noteholders have no recourse whatsoever to other companies in the Aviva Group.

Total mortgage assets and non-recourse funding in the above quasi-subsidiaries at 31 December 2003 were £3,149 million *(2002: £2,104 million)* and £3,143 million *(2002: £2,099 million)* respectively. As permitted by FRS5 "Reporting the substance of transactions", these balances are accounted for in the consolidated Group balance sheet using a linked presentation. Interest receivable and payable on the above items in 2003 totalled £195 million *(2002: £121 million)* and £166 million *(2002: £106 million)* respectively. Apart from the administration fees payable to other Group undertakings, described above, there are no other material profit and loss items in these companies.

The majority of the securitisations relate to long-term business. Cash inflows from non-recourse funding on non-long-term business were £478 million in 2003 *(2002: £219 million)*.

### 24 – Acquired additional value of in-force long-term business

Movements in the acquired additional value of in-force long-term business comprise:

| | 2003 £m |
|---|---|
| Balance at 1 January | **505** |
| Foreign exchange rate movements | **21** |
| Additional in-force long-term business acquired in subsidiaries | **36** |
| Amortisation charge for the year | **(74)** |
| Movements arising in the year | **(17)** |
| Balance at 31 December | **488** |

The amortisation charge for the year appears under the heading "Other technical charges" in the long-term business technical account on page 59. This is grossed up for attributable tax in the reconciliations on pages 59 and 62.

### 25 – Assets held to cover linked liabilities

(a) A reconciliation of assets to linked liabilities is as follows:

| | 2003 £m | 2002 £m |
|---|---|---|
| Assets held to cover linked liabilities | **40,665** | 29,538 |
| Reinsurers' share of technical provision | **579** | 337 |
| Technical provision for linked liabilities | **41,244** | 29,875 |

(b) The cost of assets held to cover linked liabilities is £37,150 million *(2002: £28,047 million)*.

### 26 – Debtors arising out of direct insurance operations

| | 2003 £m | 2002 £m |
|---|---|---|
| Amounts owed by policyholders | **1,990** | 1,748 |
| Amounts owed by intermediaries | **1,437** | 1,451 |
| Debtors arising out of direct insurance operations | **3,427** | 3,199 |

### 27 – Other debtors

| | 2003 £m | 2002 £m |
|---|---|---|
| Banking assets (note 30a) | **4,106** | 3,514 |
| Deferred tax asset (note 14e(iii)) | **215** | 222 |
| Other | **2,088** | 2,193 |
| Other debtors | **6,409** | 5,929 |

### 28 – Tangible assets

| | Motor vehicles £m | Computer equipment £m | Other £m | Total £m |
|---|---|---|---|---|
| Cost: | | | | |
| At 1 January | **37** | **411** | **352** | **800** |
| Additions | **8** | **77** | **55** | **140** |
| Disposals | **(15)** | **(53)** | **(21)** | **(89)** |
| Foreign exchange rate movements | **–** | **11** | **13** | **24** |
| At 31 December 2003 | **30** | **446** | **399** | **875** |
| Depreciation: | | | | |
| At 1 January | **20** | **297** | **188** | **505** |
| Charge for the year | **6** | **59** | **31** | **96** |
| On disposals | **(12)** | **(40)** | **(8)** | **(60)** |
| Foreign exchange rate movements | **–** | **7** | **7** | **14** |
| At 31 December 2003 | **14** | **323** | **218** | **555** |
| **Net book value at 31 December 2003** | **16** | **123** | **181** | **320** |
| Net book value at 31 December 2002 | 17 | 114 | 164 | 295 |

# Notes to the accounts
continued

## 29 – Deferred acquisition costs

The asset in the consolidated balance sheet comprises:

| | 2003 £m | 2002 £m |
|---|---|---|
| Costs in respect of long-term business | **1,862** | 1,750 |
| Costs in respect of general business | **980** | 934 |
| | **2,842** | 2,684 |

## 30 – Banking activities

(a) Banking assets (see note 27), excluding intra-group balances, comprise:

| | 2003 £m | 2002 £m |
|---|---|---|
| Investments | **1,141** | 977 |
| Loans and advances to banks | **136** | 543 |
| Loans and advances to customers | **2,563** | 1,722 |
| | **3,840** | 3,242 |
| Short-term deposits and cash | **42** | – |
| Other assets | **224** | 272 |
| | **4,106** | 3,514 |

(b) Banking liabilities (see note 43), excluding intra-group balances, comprise:

| | 2003 £m | 2002 £m |
|---|---|---|
| Deposits by banks | **130** | 72 |
| Bank customer accounts | **2,790** | 2,720 |
| Other liabilities | **965** | 457 |
| | **3,885** | 3,249 |

## 31 – Ordinary share capital

(a) The authorised share capital of the Company at 31 December 2003 was:

| | 2003 £m | 2002 £m |
|---|---|---|
| 3,000,000,000 *(2002: 3,000,000,000)* ordinary shares of 25 pence each | **750** | 750 |

The allotted, called up and fully paid share capital of the Company at 31 December 2003 was:

| | 2003 £m | 2002 £m |
|---|---|---|
| 2,257,282,501 *(2002: 2,256,737,144)* ordinary shares of 25 pence each | **564** | 564 |

(b) At 31 December 2003, options to subscribe for ordinary shares of 25 pence each in the Company were outstanding as follows:

| Aviva Savings Related Share Option Scheme | Option price p | Number of shares | Normally exercisable | Option price p | Number of shares | Normally exercisable |
|---|---|---|---|---|---|---|
| | 478.26 | 28,066 | 2003 | 895.20 | 988,760 | 2003, 2005 or 2007 |
| | 580.27 | 64,156 | 2004 | 664.00 | 1,555,023 | 2004, 2006 or 2008 |
| | 797.60 | 469,919 | 2003 or 2005 | 401.00 | 13,345,108 | 2005, 2007 or 2009 |
| | 750.00 | 365,820 | 2004 or 2006 | 406.00 | 4,715,338 | 2006, 2008 or 2010 |

| Norwich Union Savings Related Share Option Scheme | Option price p | Number of shares | Normally exercisable |
|---|---|---|---|
| | 752.00 | 204,348 | 2004 |

| Hibernian Savings Related Share Option Scheme (in Euros) | Option price c | Number of shares | Normally exercisable | Option price c | Number of shares | Normally exercisable |
|---|---|---|---|---|---|---|
| | 1,150.12 | 79,883 | 2004 | 662.85 | 326,775 | 2005 or 2007 |
| | 1,653.37 | 124,423 | 2003 or 2005 | 785.00 | 5,187 | 2006 or 2008 |
| | 1,087.56 | 45,237 | 2004 or 2006 | 586.00 | 450,716 | 2006 or 2008 |

| General Accident Savings Related Share Option Scheme | Option price p | Number of shares | Normally exercisable | Option price p | Number of shares | Normally exercisable |
|---|---|---|---|---|---|---|
| | 421.73 | 369 | 2003 | 555.55 | 108,646 | 2004 |

## 31 – Ordinary share capital continued

| Aviva Executive Share Option Scheme | Option price p | Number of shares | Normally exercisable | Option price p | Number of shares | Normally exercisable |
|---|---|---|---|---|---|---|
| | 547.17 | 39,251 | 1997 to 2004 | 1,119.00 | 59,372 | 2001 to 2008 |
| | 575.29 | 130,625 | 1997 to 2004 | 853.00 | 571,667 | 2001 to 2008 |
| | 542.17 | 18,222 | 1998 to 2005 | 965.00 | 32,295 | 2002 to 2009 |
| | 614.83 | 6,587 | 1998 to 2005 | 870.83 | 119,624 | 2002 to 2009 |
| | 581.17 | 179,262 | 1999 to 2006 | 919.00 | 988,779 | 2002 to 2009 |
| | 601.17 | 23,423 | 1999 to 2006 | 947.67 | 3,165 | 2002 to 2009 |
| | 689.17 | 13,690 | 1999 to 2006 | 952.00 | 28,362 | 2002 to 2009 |
| | 677.50 | 18,015 | 2000 to 2007 | 822.00 | 82,410 | 2003 to 2010 |
| | 680.00 | 60,877 | 2000 to 2007 | 972.33 | 23,245 | 2003 to 2010 |
| | 725.50 | 2,345 | 2000 to 2007 | 960.00 | 133,836 | 2003 to 2010 |
| | 763.50 | 3,929 | 2000 to 2007 | 1,035.00 | 2,025,484 | 2004 to 2011 |
| | 773.50 | 41,231 | 2000 to 2007 | 499.00 | 14,272 | 2005 to 2012 |
| | 857.00 | 32,352 | 2000 to 2007 | 516.00 | 3,903,162 | 2005 to 2012 |
| | 1,073.31 | 16,002 | 2001 to 2008 | 512.00 | 4,392,700 | 2006 to 2013 |

| General Accident Executive Share Option Scheme | Option price p | Number of shares | Normally exercisable | Option price p | Number of shares | Normally exercisable |
|---|---|---|---|---|---|---|
| | 463.09 | 62,210 | 1997 to 2004 | 553.93 | 238,806 | 1999 to 2006 |
| | 506.08 | 93,583 | 1998 to 2005 | 766.42 | 181,336 | 2000 to 2007 |

| Aviva Executive Share Option Scheme (Delta Lloyd) | Option price p | Number of shares | Normally exercisable | Option price p | Number of shares | Normally exercisable |
|---|---|---|---|---|---|---|
| | 965.00 | 364,198 | 1999 to 2004 | 950.00 | 714,679 | 2001 to 2006 |
| | 952.00 | 19,388 | 1999 to 2004 | 739.00 | 947,096 | 2002 to 2007 |
| | 822.00 | 587,186 | 2000 to 2005 | 380.00 | 2,678,317 | 2003 to 2008 |

| CGU plc Deferred Bonus Plan | Option price p | Number of shares | Normally exercisable | Option price p | Number of shares | Normally exercisable |
|---|---|---|---|---|---|---|
| | 899.50 | 35,706 | 2002 to 2009 | 875.00 | 43,300 | 2003 to 2010 |
| | 966.50 | 10,403 | 2002 to 2009 | | | |

At 31 December 2003, awards over a total of 6,998,765 ordinary shares were outstanding under the Aviva Long Term Incentive Plan. Subject to satisfying performance criteria, these awards will vest in 2003, 2004, 2005 and 2006. Further details of this plan can be found on pages 48 and 49. The awards will be satisfied by means of shares purchased by employee share trusts set up for the purpose of satisfying awards under various executive incentive plans and funded by the Company. Details are given in note 33. In respect of grants made from March 2003 onwards, awards will be satisfied by means of a new issue of shares. As at 31 December 2003, the trusts held 7,598,384 shares with an aggregate nominal value of £1.9 million and their market value at the year end was £37.2 million. The trustees have waived their right to dividends on the shares held in trust.

As at 31 December 2003, awards over a total of 6,659,928 ordinary shares, and options over a total of 406,429 ordinary shares, were outstanding under the Aviva Deferred Bonus Plan. These awards will vest in 2004, 2005 and 2006. Shares will be purchased into an employee share trust to satisfy the vesting awards and will also be satisfied by the new issue of shares.

(c) During 2003, a total of 545,357 ordinary shares of 25 pence each were allotted and issued by the Company as follows:

| | Number of shares | Share capital £m | Share premium £m |
|---|---|---|---|
| At 1 January | **2,256,737,144** | **564** | **1,094** |
| Shares issued under the Group's Employee and Executive Share Option Schemes | **545,357** | **–** | **2** |
| At 31 December | **2,257,282,501** | **564** | **1,096** |

Ordinary shares in issue in the Company rank pari passu. All the ordinary shares in issue carry the same right to receive all dividends and other distributions declared, made or paid by the Company.

# Notes to the accounts
continued

## 32 – Preference share capital

(a) The preference share capital of the Company at 31 December 2003 was:

| | 2003 £m | 2002 £m |
|---|---|---|
| Authorised | | |
| 200,000,000 cumulative irredeemable preference shares of £1 each | **200** | 200 |
| | **200** | 200 |
| Issued and paid up | | |
| 100,000,000 8⅜% cumulative irredeemable preference shares of £1 each | **100** | 100 |
| 100,000,000 8¾% cumulative irredeemable preference shares of £1 each | **100** | 100 |
| | **200** | 200 |

The fair value of these shares at 31 December 2003 was £224 million *(2002: £213 million)*.

(b) The preference shares are non-voting except where their dividends are in arrears, on a winding up or where their rights are being altered. On a winding up, they carry a preferential right to return of capital ahead of the ordinary shares.

## 33 – Shares held by employee trusts

Movements in the cost of shares held by employee trusts comprise:

| | 2003 | | 2002 | |
|---|---|---|---|---|
| | Number | £m | Number | £m |
| Cost debited to shareholders' funds | | | | |
| At 1 January | **2,008,459** | **19** | 3,125,687 | 18 |
| Additions | **5,736,206** | **23** | 114,875 | 1 |
| Distributed in year | **(146,281)** | **(1)** | (1,232,103) | – |
| At 31 December | **7,598,384** | **41** | 2,008,459 | 19 |
| Credit to shareholders' funds in respect of the above | | | | |
| At 1 January | | **18** | | 8 |
| Movement for the year | | **22** | | 10 |
| Balance at 31 December | | **40** | | 18 |
| Net deduction from shareholders' funds | | **1** | | 1 |

These shares are owned by employee share trusts in the Company and a subsidiary undertaking to satisfy awards under the Group's Long Term Incentive Plan, Executive Share Option Plans and Deferred Bonus Plans. The shares are purchased in the market and carried at cost. Further details of the shares held can be found in note 31b. Further details of the features of the plans can be found in the Directors' remuneration report on pages 48 and 49.

## 34 – Group reserves

| | Revaluation reserve £m | Merger reserve £m | Profit and loss account £m | Total £m |
|---|---|---|---|---|
| At 1 January 2003 as previously reported | 3,832 | 2,853 | 1,126 | 7,811 |
| Prior year adjustment (note 3a) | (3,832) | – | – | (3,832) |
| Restated opening balances | **–** | **2,853** | **1,126** | **3,979** |
| Transfer from non-technical account | **–** | **–** | **387** | **387** |
| Foreign exchange rate movements | **–** | **–** | **329** | **329** |
| Other movements | **–** | **(90)** | **90** | **–** |
| **At 31 December 2003** | **–** | **2,763** | **1,932** | **4,695** |

As explained in accounting policy J on page 57, goodwill arising on acquisitions since 1 January 1998 is carried on the balance sheet and amortised over its useful economic life. The cumulative amounts of positive and negative goodwill charged or credited to the consolidated profit and loss account, attributable to subsidiary undertakings acquired from 1 January 1968 to 31 December 1997 and not subsequently sold, are £957 million and £15 million respectively. Similar information relating to subsidiary undertakings acquired before 1968 is not readily available.

The cumulative amount in the profit and loss account reserve relating to net unrealised gains is £161 million *(2002: £136 million)*.

### 35 – Company reserves

Movements in the Company's reserves comprise:

| | Revaluation reserve £m | Merger reserve £m | Profit and loss account £m | Total £m |
|---|---|---|---|---|
| At 1 January 2003 as previously reported | 115 | 227 | 7,469 | 7,811 |
| Prior year adjustment (note 3b(i)) | (1) | – | – | (1) |
| **Restated opening balances** | **114** | **227** | **7,469** | **7,810** |
| Profit for the year attributable to equity shareholders, including dividends received or receivable from subsidiary undertakings | **–** | **–** | **97** | **97** |
| Dividends | **–** | **–** | **(562)** | **(562)** |
| Retained loss for the year | **–** | **–** | **(465)** | **(465)** |
| Unrealised gains (note 17e) | **1,960** | **–** | **–** | **1,960** |
| **At 31 December 2003** | **2,074** | **227** | **7,004** | **9,305** |

The cumulative amount in the profit and loss account includes non-distributable gains of £5,735 million *(2002: £5,735 million)*.

As permitted by Section 230 of the Companies Act 1985, the profit and loss account of the Company has not been included in these accounts.

### 36 – Subordinated debt

| | Group and Company | |
|---|---|---|
| | 2003 £m | 2002 £m |
| 6.125% £700 million subordinated notes 2036 | **679** | 679 |
| 5.750% €800 million subordinated notes 2021 | **553** | 511 |
| 5.250% €650 million subordinated notes 2023 | **450** | – |
| 5.700% €500 million undated subordinated notes | **347** | – |
| 6.125% £800 million undated subordinated notes | **785** | – |
| | **2,814** | 1,190 |

A description of each of the above subordinated notes is set out in the table below:

| Notional amount | Issue date | Redemption date | Callable at par at option of the Company from | In the event the Company does not call the notes, the coupon will reset at each applicable reset date to |
|---|---|---|---|---|
| £700 million | 14 Nov 2001 | 14 Nov 2036 | 16 Nov 2026 | 5 year Benchmark Gilt + 2.85% |
| €800 million | 14 Nov 2001 | 14 Nov 2021 | 14 Nov 2011 | 3 month Euribor + 2.12% |
| €650 million | 29 Sep 2003 | 2 Oct 2023 | 2 Oct 2013 | 3 month Euribor + 2.08% |
| €500 million | 29 Sep 2003 | Undated | 29 Sep 2015 | 3 month Euribor + 2.35% |
| £800 million | 29 Sep 2003 | Undated | 29 Sep 2022 | 5 year Benchmark Gilt + 2.40% |

The subordinated notes rank below the senior obligations of the Company and ahead of the preference shares and ordinary share capital issued by the Company. The dated subordinated notes rank ahead of the undated subordinated notes. The fair value of these notes at 31 December 2003 was £3,003 million *(2002: £1,167 million)*.

### 37 – Long-term business

(a) The Group underwrites long-term business in a number of countries as follows:

*(i)* In the United Kingdom mainly in

– "with-profit" funds of CGNU Life, Commercial Union Life, Norwich Union Life & Pensions and the Provident Mutual fund, where the with-profits policyholders are entitled to at least 90% of the distributed profits, the shareholders receiving the balance;

– "non-profit" funds of Norwich Union Annuity, Norwich Union Life & Pensions and Norwich Union Linked Life, where shareholders are entitled to 100% of the distributed profits. Shareholder profits on unitised with-profit business written by Norwich Union Life & Pensions and on stakeholder unitised with-profit business are derived from management fees and policy charges, and emerge in the non-profit funds.

*(ii)* In France, where the majority of policyholders' benefits are determined by investment performance, subject to certain guarantees, and shareholders' profits are derived largely from management fees. In addition, a substantial number of policies participate in investment returns, with the balance being attributable to shareholders.

*(iii)* In the Netherlands, where the balance of profits, after providing appropriate returns for policyholders, accrues for the benefit of the shareholders. The bases for determining returns for policyholders are complex, but are consistent with methods and criteria followed generally in the Netherlands. In addition, a substantial number of policies provide benefits which are determined by investment performance, subject to certain guarantees, and shareholders' profits are derived largely from management fees.

*(iv)* In other overseas operations, using methods similar to those described above.

(b) The directors have been advised by the Group's reporting actuary that the assets of each of the long-term operations were at least sufficient to meet their respective liabilities at 31 December 2003.

# Notes to the accounts
continued

## 38 – Long-term business provision

### (a) Methodology
There are two main methods of actuarial valuation of liabilities arising under long-term insurance contracts – the net premium method and the gross premium method – both of which involve the discounting of projected premiums and claims.

Under the net premium method, the premium taken into account in calculating the provision is determined actuarially, based on the valuation assumptions regarding discount rates, mortality and disability. The difference between this premium and the actual premium payable provides a margin for expenses. This method does not allow for voluntary early termination of the contract by the policyholder, and so no assumption is required for persistency. Explicit provision is made for vested bonuses (including those vesting following the most recent fund valuation), but no such provision is made for future regular or terminal bonuses. However, this method makes implicit allowance for future regular or terminal bonuses already earned, by margins in the valuation discount rate used.

The gross premium method uses the amount of contractual premiums payable and includes explicit assumptions for interest and discount rates, mortality and morbidity, persistency and future expenses. These assumptions can vary by contract type and reflect current and expected future experience. Explicit provision is made for vested bonuses and explicit allowance is also made for future regular bonuses, but not terminal bonuses.

### (b) Group practice
The long-term business provision is calculated separately for each of the Group's life operations. The provisions for overseas subsidiaries have generally been included on the basis of local regulatory requirements, mainly using the net premium method, modified where necessary to reflect the requirements of the Companies Act.

Material judgement is required in calculating the provisions and is exercised particularly through the choice of assumptions where there is discretion over these. In turn, the assumptions used depend on the circumstances prevailing in each of the life operations. Provisions are most sensitive to assumptions regarding discount rates and mortality/morbidity rates.

Bonuses paid during the year are reflected in claims paid, whilst those allocated as part of the bonus declaration are included in the movements in the long-term business provision, as detailed in note 8.

The principal assumptions in the United Kingdom, France and the Netherlands are:

*(i) United Kingdom*

The net premium method is used for most contracts except term assurances in the Norwich Union Life & Pensions and Norwich Union Linked Life funds, business in the "with-profit" funds of CGNU Life and Commercial Union Life, and non-profit deferred annuity and with-profit business in the Provident Mutual Fund.

For term assurances in the Norwich Union Life & Pensions and Norwich Union Linked Life funds, business in the "with-profit" funds of CGNU Life and Commercial Union Life, and non-profit deferred annuity and with-profit business in the Provident Mutual Fund, the provisions are valued using the gross premium method. All contracts are assumed to continue for the contractual term and, for consistency with the discount rates, no future regular bonuses are assumed to be added to with-profit business.

For unitised with-profit business, the provisions are valued initially by determining the lower of the current non-guaranteed surrender value and the bid value of units. This result is then compared with a prospective valuation and the higher result is taken. The prospective valuation projects future benefits on the assumption that future premiums cease and regular bonuses are decreased to the guaranteed rate or nil, at a rate consistent with policyholder reasonable expectations. Allowance for persistency is based on actual experience and takes into account the likelihood of a significantly greater lapse experience on those occasions on which the life company guarantees not to apply a Market Value Reduction charge.

For unit-linked business, the provisions are valued initially by adding a prospective non-unit reserve to the bid value of units. The prospective non-unit reserve is calculated by projecting the future non-unit cashflows on the assumption that future premiums cease. Where appropriate, allowance for persistency is based on actual experience.

The provisions held in respect of guaranteed annuity options are a prudent assessment of the additional liability incurred under the option on a basis and method consistent with that used to value basic policy liabilities, and includes a prudent assessment of the proportion of policyholders who will choose to exercise the option.

Valuation discount rate assumptions are set with regard to yields on the supporting assets and the general level of long-term interest rates as measured by gilt yields. An explicit allowance for risk is included by restricting the yields for equities and properties with reference to a margin over long-term interest rates or by making an explicit deduction from the yields on corporate bonds, mortgages and deposits, based on historical default experience of each asset class. A further margin for risk is then deducted for all asset classes.

The changes in the valuation discount rates since 2002 reflect the changes in the yields on the supporting assets.

| | Valuation discount rates | |
|---|---|---|
| | 2003 | 2002 |
| Assurances | | |
| Life conventional with-profit | **3.3% to 3.8%** | 3.2% to 3.5% |
| Life conventional non-profit | **3.3% to 4.0%** | 3.2% to 4.0% |
| Life unitised with-profit | **3.7% to 4.0%** | 3.6% to 3.8% |
| Pensions conventional with-profit | **4.2% to 4.8%** | 4.0% to 4.5% |
| Pensions conventional non-profit | **4.2% to 5.8%** | 4.0% to 5.3% |
| Pensions unitised with-profit | **4.3% to 4.8%** | 4.5% to 5.0% |
| Deferred annuities | | |
| With-profit – in deferment | **4.2% to 4.8%** | 4.0% to 5.0% |
| Non-profit – in deferment | **4.2% to 5.8%** | 5.0% to 5.3% |
| In payment | **4.2% to 4.7%** | 4.0% to 5.0% |
| Annuities in payment | | |
| Conventional annuity | **5.0% to 5.5%** | 4.8% to 5.3% |
| With-profit annuity | **1.5%** | 0.5% to 0.8% |

**38 – Long-term business provision** continued

Mortality assumptions are set with regard to recent company experience and general industry trends. Since 2002, there have been some changes to the adjustments to the base tables for annuities in payment in order to reflect more closely the actual experience of this business.

| | Mortality tables used |
|---|---|
| | 2003 and 2002 |
| Assurances | |
| With-profit | AM92/AF92 or A67/70 adjusted |
| Non-profit | AM80/AF80 or AM92/AF92 or TM92/TF92 adjusted for smoker status |
| Pure endowments and deferred annuities before vesting | Nil or AM80/AF80 or AM92/AF92 adjusted |
| General annuity business after vesting | IM80/IF80 or IM92/IF92 adjusted plus allowance for future mortality improvement* |
| Pensions business after vesting | PMA80/PFA80 or PMA92/PFA92 adjusted plus allowance for future mortality improvement* |
| Annuities in payment | |
| General annuity business | IMA80/IFA80 adjusted plus allowance for future mortality improvement* |
| Pensions business | PMA80/PFA80 adjusted plus allowance for future mortality improvement* |

*Allowance for future mortality improvements reflect the "medium cohort" projection from the CMIB working paper published in December 2002, adjusted for females and for a higher rate of improvement at very old ages.

*(ii) France*
The majority of provisions arise from a single premium savings product and are based on the accumulated fund value, adjusted to maintain consistency with the value of the assets backing the policyholder liabilities. The net premium method is used for prospective valuations, in accordance with local regulation, where the valuation assumptions depend on the date of issue of the contract. The valuation discount rate also depends on the original duration of the contract and mortality rates are based on industry tables. There have been no changes in the assumptions since 2002.

| | Valuation discount rate | Mortality tables used |
|---|---|---|
| | 2003 and 2002 | 2003 and 2002 |
| Life assurances | 2.5% to 4.5% | PM60-64, TD73-77, TD 88/90 |
| Annuities | 2.5% to 4.5% | TPRV (prospective table) |

*(iii) Netherlands*
Provisions are generally calculated using the net premium valuation method, in accordance with local regulation, where the valuation assumptions generally depend on the date of issue of the contract, with additional provisions where experience indicates this is required. There have been no changes in the assumptions since 2002.

| | Valuation discount rate | Mortality tables used |
|---|---|---|
| | 2003 and 2002 | 2003 and 2002 |
| Life assurances | 3.0% or 4.0% | GBM 61-65, 76-80, 80-85 GBM/V 85-90, 90-95 |
| Annuities in deferment and in payment | 3.0% or 4.0% | GBM/V 76-80, 80-85, 85-90, 90-95, Coll 1993 and DIL 98 plus further allowance for future mortality improvement |

*(iv)* In all countries, local generally accepted interest rates and published standard mortality tables are used for different categories of business as appropriate. The tables are based on relevant experience and show mortality rates, by age, for specific groupings of people.

**39 – Provisions for outstanding claims**

(a) The ultimate cost of general business outstanding claims is estimated by using a range of standard actuarial claims projection techniques, such as the Chain Ladder and Bornhuetter-Ferguson methods. Such methods extrapolate the development of paid and incurred claims, average costs per claim and ultimate claim numbers for each accident year, based upon the observed development of earlier years and expected loss ratios. The main assumption underlying these techniques is that past claims development experience can be used to project ultimate claims costs. Judgement is used to assess the extent to which past trends may not apply in future, for example to reflect public attitudes to claiming, economic conditions or varying levels of claims inflation. The approach adopted takes into account, inter alia, the nature and materiality of the business and the type of data available. Large claims are usually separately assessed, either by being measured at case estimate face value or separately projected in order to reflect their future development. Case estimates are generally set by skilled claims technicians applying their experience and knowledge to the circumstances of individual claims. Additional qualitative input, such as allowance for one-off occurrences or changes in legislation, policy conditions or portfolio mix, is also used in arriving at the estimated ultimate cost of claims, in order that it represents the most likely outcome, from a range of possible outcomes, taking account of all the uncertainties involved.

Provisions are calculated allowing for reinsurance recoveries and a separate asset is recorded for the reinsurers' share, having regard to collectability.

# Notes to the accounts
continued

### 39 – Provisions for outstanding claims continued

(b) Claims on certain classes of business are discounted as follows:

| | Class | Rate 2003 | Rate 2002 | Mean term of liabilities 2003 | Mean term of liabilities 2002 |
|---|---|---|---|---|---|
| Netherlands | Permanent health and injury | **3.25%** | 3.5% | **11 years** | 12 years |

Net of reinsurers' share, the outstanding claims provisions before discounting were £10,430 million *(2002: £9,508 million)*. The period of time which will elapse before the liabilities are settled has been estimated by modelling the settlement patterns of the underlying claims and related reinsurance recoveries.

### 40 – Equalisation provision

An equalisation provision has been established in the Group accounts as explained in accounting policy T on page 58. This had the effect of reducing Group and Company shareholders' funds by £364 million at the year end *(2002: £314 million)*. The change in the equalisation provision during the year comprised a reduction of £49 million *(2002: £57 million)* in the balance on the general business technical account and the profit on ordinary activities before tax. In 2002, the reduction of £57 million included a partial offset of £15 million representing the equalisation provision of a subsidiary company sold during that year.

### 41 – Provisions for other risks and charges

Movements in provisions for other risks and charges were:

| | Pensions and similar obligations £m | Deferred tax (note 14e(iii)) £m | Other £m | Total £m |
|---|---|---|---|---|
| At 1 January 2003 | **67** | **465** | **294** | **826** |
| Foreign exchange rate movements on opening provisions | **4** | **(5)** | **11** | **10** |
| Movement during the year: | | | | |
| Additional provisions made in the year | | | **42** | |
| Amounts utilised | | | **(79)** | |
| Amounts released unutilised | | | **(10)** | |
| Total movement | **7** | **74** | **(47)** | **34** |
| At 31 December 2003 | **78** | **534** | **258** | **870** |

"Other" provisions comprise many small provisions throughout the Group for obligations such as the costs of compensation, litigation, staff entitlements and reorganisation.

### 42 – Borrowings

(a) The analysis by business segment is:

| | Debenture loans 2003 £m | Debenture loans 2002 £m | Amounts owed to credit institutions 2003 £m | Amounts owed to credit institutions 2002 £m | Commercial paper 2003 £m | Commercial paper 2002 £m | Total 2003 £m | Total 2002 £m |
|---|---|---|---|---|---|---|---|---|
| Long-term business | **–** | – | **148** | 85 | **–** | – | **148** | 85 |
| General business | **–** | – | **11** | 11 | **–** | – | **11** | 11 |
| Other | **476** | 431 | **141** | 169 | **1,132** | 1,453 | **1,749** | 2,053 |
| Non-long-term business | **476** | 431 | **152** | 180 | **1,132** | 1,453 | **1,760** | 2,064 |
| | **476** | 431 | **300** | 265 | **1,132** | 1,453 | **1,908** | 2,149 |

"Other" comprises borrowings by holding companies within the Group that are not allocated to operating companies. The amounts shown above are net of related derivative contracts.

(b) Debenture loans

| | Other 2003 £m | Other 2002 £m |
|---|---|---|
| 9.5% guaranteed bonds 2016 | **170** | 157 |
| 11.9% C$24 million mortgage 2005 | **5** | 6 |
| 8.625% guaranteed bonds 2005 | **168** | 155 |
| 2.5% subordinated perpetual loan notes | **133** | 113 |
| | **476** | 431 |
| Repayable as follows: | | |
| One year or less | **1** | – |
| Between one and two years | **172** | – |
| Between two and five years | **–** | 161 |
| After five years | **303** | 270 |
| | **476** | 431 |
| The interest charge for the year on the above loans was: | **42** | 41 |

**42 – Borrowings** continued

The 9.5% and the 8.625% guaranteed bonds were issued at a discount of £1.1 million and £0.2 million respectively. These amounts, together with the issue expenses, are being amortised over the full term of the bonds. Although these bonds were issued in sterling, the loans have been converted into euro liabilities through the use of financial instruments in a subsidiary undertaking.

The 2.5% subordinated perpetual loan notes were issued by a Dutch subsidiary undertaking to finance the acquisition of NUTS OHRA Beheer BV in 1999. These loan notes have a face value of €489.9 million and their fair value is estimated at €176.7 million *(2002: €172.4 million)* which is based on the future cash flows in perpetuity discounted back at a market rate of interest. The rate of interest paid on the notes will be gradually increased over the next six years to a maximum of 2.76%. The loan notes are convertible into ordinary shares in Delta Lloyd NV, should there be a public offering of those shares.

(c) Amounts due to credit institutions

| | Long-term business | | General business | | Other | |
|---|---|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Bank loans | **148** | 85 | **11** | 11 | **141** | 169 |
| | **148** | 85 | **11** | 11 | **141** | 169 |
| Repayable as follows: | | | | | | |
| One year or less | **16** | – | **11** | 11 | **111** | 93 |
| Between one and two years | **6** | – | **–** | – | **2** | 75 |
| Between two and five years | **–** | – | **–** | – | **5** | 1 |
| After five years | **126** | 85 | **–** | – | **23** | – |
| | **148** | 85 | **11** | 11 | **141** | 169 |
| The interest charge for the year on the above was: | **3** | 2 | **1** | 1 | **5** | 13 |

As explained in note 20a, the UK long-term business policyholder funds have invested in a number of property limited partnerships ("PLPs"). The PLPs have raised external debt, secured on their respective property portfolios, and the lenders are only entitled to obtain payment of both interest and principal to the extent there are sufficient resources in the respective PLPs. The lenders have no recourse whatsoever to the policyholder or shareholders' funds of any companies in the Aviva Group. The figures in the long-term business columns above relate to those PLPs which have been consolidated as subsidiaries.

(d) Commercial paper

| | Other | |
|---|---|---|
| | 2003 £m | 2002 £m |
| Average rate 4% *(2002: 4%)* | **1,132** | 1,453 |
| The interest charge for the year on the above borrowings was: | **47** | 67 |

All commercial paper is repayable within one year and is issued in a number of different currencies, primarily sterling, euros and US dollars. Part of this has been converted into a sterling liability through the use of financial instruments in the Company and a subsidiary undertaking.

(e) The Company's loans comprise:

| | 2003 £m | 2002 £m |
|---|---|---|
| 9.5% guaranteed bonds 2016 | **198** | 198 |
| 8.625% guaranteed bonds 2005 | **199** | 199 |
| Bank loans | **75** | 75 |
| Commercial paper | **1,097** | 1,433 |
| | **1,569** | 1,905 |
| Repayable as follows: | | |
| One year or less | **1,172** | 1,433 |
| Between one and two years | **199** | 75 |
| Between two and five years | **–** | 199 |
| After five years | **198** | 198 |
| | **397** | 472 |
| | **1,569** | 1,905 |

(f) Loans exclude intra-group borrowings, certain of which are guaranteed by third parties.

# Notes to the accounts
continued

**42 – Borrowings** continued

(g) After taking into account the various interest rate and currency swaps entered into by the Group, the currency and interest rate exposure of the non-long-term business borrowings of the Group was:

| | Floating rate borrowings | | Fixed rate borrowings | | Total | |
|---|---|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Sterling | **390** | 922 | **338** | 323 | **728** | 1,245 |
| Euro | **543** | 106 | **143** | 113 | **686** | 219 |
| United States dollar | **334** | 582 | **–** | – | **334** | 582 |
| Canadian dollar | **3** | 8 | **5** | 6 | **8** | 14 |
| Other | **3** | 3 | **1** | 1 | **4** | 4 |
| Total non-long-term business borrowings | **1,273** | 1,621 | **487** | 443 | **1,760** | 2,064 |

The floating rate borrowings comprise commercial paper and bank borrowings bearing interest based on local inter-bank offer rates, which are fixed in advance for the period of the borrowings. Excluding the subordinated perpetual loan notes, the fixed rate borrowings have a weighted average interest rate of 7.93% *(2002: 7.94%)* for a weighted average term of seven years *(2002: eight years)*.

(h) The Group has the following undrawn committed central borrowing facilities available to it, of which £1,100 million *(2002: £1,000 million)* is used to support the commercial paper programme:

| | 2003 £m | 2002 £m |
|---|---|---|
| Expiring within one year | **1,605** | 880 |
| Expiring beyond one year | **1,357** | 2,060 |
| | **2,962** | 2,940 |

(i) The difference between the carrying value and the fair value of the non-long-term business fixed rate borrowings and the related swaps is as follows:

| | Carrying value 2003 £m | Fair value 2003 £m | Carrying value 2002 £m | Fair value 2002 £m |
|---|---|---|---|---|
| Non-long-term business fixed rate borrowings | **549** | **614** | 529 | 624 |
| Currency swaps | **(59)** | **(91)** | (86) | (133) |
| | **490** | **523** | 443 | 491 |

(j) The General Accident preference shares, included in minority interests at their par value of £250 million together with an £8 million accrual for dividends, are listed on the London Stock Exchange. Their fair value at 31 December 2003 was £292 million *(2002: £267 million),* based on their quoted market price.

### 43 – Other creditors including tax and social security

| | 2003 £m | 2002 £m |
|---|---|---|
| Banking liabilities (note 30b) | **3,885** | 3,249 |
| Proposed final ordinary dividend (note 15) | **342** | 322 |
| United Kingdom and overseas tax | **742** | 868 |
| Bank overdrafts | **214** | 348 |
| Other | **2,538** | 2,191 |
| Other creditors including tax and social security | **7,721** | 6,978 |

Bank overdrafts arise substantially from unpresented cheques and amount to £77 million *(2002: £61 million)* in long-term business operations and £137 million *(2002: £287 million)* in general business and other operations. The "other" totals include the obligation to repay £164 million *(2002: £295 million)* received under stock repurchase arrangements entered into in the United Kingdom and the Netherlands.

### 44 – Accruals and deferred income

| | 2003 £m | 2002 £m |
|---|---|---|
| Deferred reinsurance commissions | **48** | 90 |
| Other accruals and deferred income | **1,103** | 967 |
| Accruals and deferred income | **1,151** | 1,057 |

**45 – Pension and other post-retirement benefit costs**

(a) The Group operates a large number of pension schemes around the world, whose members receive benefits on either a defined benefit basis or a defined contribution basis. The only material defined benefit schemes are in the United Kingdom, the Netherlands, Canada and Ireland and, of these, the United Kingdom scheme is by far the largest. The assets of the main United Kingdom, Irish and Canadian schemes are held in separate trustee-administered funds and, in the Netherlands, the main scheme is held in a separate foundation which invests in the life funds of the Group. An actuarial report has been submitted for each of the defined benefit schemes within the last three years, using appropriate methods for the respective countries on local funding bases. The substantial falls in stock markets worldwide over the last few years have affected the funding position of the schemes. In the United Kingdom scheme, the employing companies have agreed to pay additional contributions.

(b) The Group has continued to account for pensions in accordance with SSAP24 and the disclosures given in section (c) below are those required by that accounting standard. FRS17 "Retirement Benefits" was issued in November 2000 and differs from SSAP24 in a number of ways. These are principally in the choice of assumptions, and that the difference between the market value of assets and liabilities is immediately recognised in the balance sheet under FRS17, whereas changes in assets and liabilities are recognised on a smoothed basis under SSAP24.

The accounting provisions of FRS17 were not expected to be mandatory for the Group until the year ending 31 December 2003 but, in the transitional period, certain disclosures were required in the notes to the accounts. In November 2002, the Accounting Standards Board issued an amendment to FRS17 which extended the transitional period through to, in the Group's case, the year ending 31 December 2005. The transitional disclosures, to the extent not given in section (c), are set out in section (e) below.

(c) In the United Kingdom, the Group operates one main pension scheme, the Aviva Staff Pension Scheme. New entrants join the defined contribution section of the scheme, as the defined benefit section is generally closed to most new employees.

The scheme was valued as at an effective date of 1 April 2002, on a market value basis using the Projected Unit Method. The main financial assumptions used were a pension increase rate of 2.5%, a salary increase rate of 4.25% and an interest rate of 6.4%. The scheme had an asset value of £4,639 million, projected accrued liabilities of £4,010 million and a funding level of 116%. The employer cost of future service benefits in respect of defined benefit members for 2003 was 21.2% of pensionable salaries which, after allowing for interest on the prepayment held in the balance sheet and the additional surplus since, led to a net pension cost for the period to 31 December 2003 of 8.6% of pensionable salaries. The pension cost was then increased to allow for the amounts credited to members' accounts under the defined contribution section of the scheme.

The employing companies' contributions to the defined benefit section of the scheme throughout 2003 were 25% of employees' pensionable salaries and, for members of the defined contribution section, were 8% of pensionable salaries together with further contributions up to 4% where members contribute and the cost of the death-in-service benefits. The employers' contribution rate for 2004 for members of the defined benefit section have been maintained at 25% of pensionable salaries together with an additional payment of £50 million, while the contribution rates for members of the defined contribution section are the same as for 2003.

In the Netherlands, Canada and Ireland, regular actuarial valuations of the main schemes are made in accordance with local funding and/or accounting standards. Total pension costs for the schemes in these countries have been taken as equal to the locally determined accounting costs or contributions paid to the plans as, at a Group level, these are not considered to be materially different from charges calculated under a detailed application of SSAP24.

The Group also operates a variety of smaller pension arrangements in these and other countries, where costs have also been based on those calculated locally.

(d) The pension costs of the Group's defined benefit and defined contribution schemes were:

| | 2003 £m | 2002 £m |
|---|---|---|
| UK defined benefit schemes | **39** | 50 |
| UK defined contribution schemes | **34** | 27 |
| Overseas defined benefit schemes | **33** | 34 |
| Overseas defined contribution schemes | **10** | 6 |
| | **116** | 117 |

There were no significant contributions outstanding or prepaid as at either 31 December 2003 or 2002.

(e) FRS17 defined benefit plan disclosures

*(i)* The valuation used for FRS17 disclosures has been based on the most recent actuarial valuations, updated to take account of the requirements of FRS17 in order to assess the liabilities of the major schemes at 31 December 2003. The updating was made by actuaries in each country, with overall co-ordination by external consultants, Watson Wyatt. Other than the actuary of the Aviva Staff Pension Scheme, the actuaries making the calculation were independent of the Group. Scheme assets are stated at their market values at 31 December 2003. The details for the main defined benefit schemes are shown below. Where schemes provide both defined benefit and defined contribution pensions, the assets and liabilities shown exclude those relating to defined contribution pensions.

| | UK | | Netherlands | | Canada | | Ireland | |
|---|---|---|---|---|---|---|---|---|
| | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 | 2003 | 2002 |
| Date of most recent actuarial valuation | **1.4.03** | 1.4.02 | **31.12.02** | 31.12.01 | **31.12.02** | 31.12.01 | **Various** | Various |
| The main financial assumptions used to calculate scheme liabilities under FRS17 are: | | | | | | | | |
| Inflation rate | **2.6%** | 2.2% | **2.5%** | 2.5% | **2.5%** | 2.5% | **2.5%** | 2.5% |
| General salary increases | **4.4%** | 4.0% | **3.5%** | 3.5% | **3.0%** | 3.0% | **4.25%** | 4.25% |
| Pension increases | **2.6%** | 2.2% | **2.5%** | 2.5% | **1.25%** | 1.25% | **2.25%** | 2.25% |
| Deferred pension increases | **2.6%** | 2.2% | **2.5%** | 2.5% | **0%** | 0% | **2.25%** | 2.25% |
| Discount rate | **5.6%** | 5.75% | **5.25%** | 5.5% | **5.5%** | 5.75% | **5.3%** | 5.55% |

# Notes to the accounts
continued

**45 – Pension and other post-retirement benefit costs** continued

*(ii)* The expected rates of return on the schemes' assets are:

| | UK | | Netherlands | | Canada | | Ireland | |
|---|---|---|---|---|---|---|---|---|
| | 2004 % | 2003 % | 2004 % | 2003 % | 2004 % | 2003 % | 2004 % | 2003 % |
| Equities | **8.1%** | 8.25% | **8.25%** | 8.5% | **8.25%** | 8.5% | **8.25%** | 8.5% |
| Bonds | **5.0%** | 4.9% | **4.7%** | 4.7% | **5.25%** | 5.4% | **4.7%** | 4.8% |
| Property | **6.3%** | 6.0% | **n/a** | n/a | **n/a** | n/a | **6.2%** | 6.3% |

*(iii)* The pension expense for these schemes on an FRS17 basis comprises:

| | Total | |
|---|---|---|
| | 2003 £m | 2002 £m |
| Current service cost | **149** | 137 |
| Past service cost | **1** | 1 |
| Loss on curtailments | **7** | – |
| Charge to net operating expenses | **157** | 138 |
| Expected return on pension scheme assets | **(348)** | (402) |
| Interest charge on pension scheme liabilities | **322** | 319 |
| Credit to investment income | **(26)** | (83) |
| **Total charge that would be made to profit on ordinary activities before tax in respect of these schemes under FRS17** | **131** | 55 |
| Expected return on pension scheme assets less actual return | **(479)** | 1,139 |
| Experience losses/(gains) arising on scheme liabilities | **106** | (131) |
| Changes in assumptions underlying the present value of the scheme liabilities | **587** | 41 |
| Loss on acquisitions and scheme transfer | **5** | – |
| Increase in recoverable surplus | **–** | (17) |
| **Actuarial loss that would be recognised in the statement of total recognised gains and losses under FRS17** | **219** | 1,032 |

*(iv)* The following disclosures of experience gains and losses will be built up over time to give a five year history:

| | 2003 | | 2002 | |
|---|---|---|---|---|
| | £m | % | £m | % |
| Difference between the expected and actual return on scheme assets | | | | |
| Amount | **(479)** | | 1,139 | |
| Percentage of the scheme assets at the end of the year | | **8.4%** | | 23.4% |
| Experience losses/(gains) on scheme liabilities | | | | |
| Amount | **106** | | (131) | |
| Percentage of the present value of scheme liabilities | | **1.6%** | | 2.4% |
| Total amount that would be recognised in the statement of total recognised gains and losses under FRS 17 | | | | |
| Amount of loss | **219** | | 1,032 | |
| Percentage of the present value of scheme liabilities | | **3.3%** | | 18.7% |

*(v)* The assets and liabilities of the schemes, attributable to defined benefit members, at 31 December 2003 were:

| | UK | | Netherlands | | Canada | | Ireland | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m | 2003 £m | 2002 £m | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Equities | **3,107** | 2,678 | **192** | 141 | **84** | 72 | **222** | 187 | **3,605** | 3,078 |
| Bonds | **1,001** | 880 | **369** | 338 | **79** | 68 | **86** | 68 | **1,535** | 1,354 |
| Property | **314** | 309 | **–** | – | **–** | – | **26** | 26 | **340** | 335 |
| Other | **129** | 83 | **88** | 7 | **–** | – | **(1)** | 1 | **216** | 91 |
| Total market value of assets | **4,551** | 3,950 | **649** | 486 | **163** | 140 | **333** | 282 | **5,696** | 4,858 |
| Present value of scheme liabilities | **(5,264)** | (4,538) | **(749)** | (533) | **(180)** | (156) | **(341)** | (285) | **(6,534)** | (5,512) |
| Deficit in the schemes | **(713)** | (588) | **(100)** | (47) | **(17)** | (16) | **(8)** | (3) | **(838)** | (654) |
| Related deferred tax asset | **214** | 176 | **34** | 16 | **6** | 6 | **1** | – | **255** | 198 |
| Net pension liability | **(499)** | (412) | **(66)** | (31) | **(11)** | (10) | **(7)** | (3) | **(583)** | (456) |

**45 – Pension and other post-retirement benefit costs** continued

*(vi)* Movements in the pension schemes' surplus/deficit on a FRS17 basis comprise:

| | Total 2003 £m | Total 2002 £m |
|---|---|---|
| (Deficit)/surplus in the schemes at 1 January | **(654)** | 334 |
| Contributions paid into the schemes | **172** | 113 |
| Charge to net operating expenses | **(157)** | (138) |
| Credit to investment income | **26** | 83 |
| Actuarial loss, excluding increase in recoverable surplus | **(219)** | (1,049) |
| Foreign exchange rate movements | **(6)** | 3 |
| Deficit in the schemes at 31 December | **(838)** | (654) |

The change in the net pension deficit calculated under FRS17 is mainly attributable to changes in assumptions underlying the present value of the schemes' liabilities, partially offset by an increase in the market value of their assets. In the United Kingdom, the value of the liabilities has increased due to lower corporate bond yields, which are used to set the valuation discount rate, and a higher assumed inflation rate. The increase in asset values is primarily due to a strong improvement in equity values since the previous year end.

*(vii)* The effect on the Group's net assets and retained profits at 31 December 2003 of substituting the FRS17 figures for the corresponding SSAP24 balance sheet entries would be as follows:

| | Net assets | | Profit and loss account reserve | |
|---|---|---|---|---|
| | 2003 £m | Restated 2002 £m | 2003 £m | 2002 £m |
| Totals included in the Group accounts | **7,365** | 6,494 | **1,932** | 1,126 |
| Less: pension asset on SSAP24 basis | **(251)** | (175) | **(251)** | (175) |
| Totals excluding pension asset | **7,114** | 6,319 | **1,681** | 951 |
| Less: pension liability on FRS17 basis | **(583)** | (456) | **(583)** | (456) |
| Totals including pension liability on FRS17 basis | **6,531** | 5,863 | **1,098** | 495 |

**46 – Assets under management**

The total Group assets under management are:

| | 2003 £m | Restated 2002 £m |
|---|---|---|
| Total assets included in the balance sheet | **208,680** | 181,005 |
| Additional value of internally-generated in-force long-term business | **4,744** | 3,917 |
| Third party funds under management | | |
| Securitised mortgages (gross of non-recourse funding) | **3,143** | 2,099 |
| Unit trusts, Oeics, Peps and Isas | **4,460** | 3,636 |
| Segregated funds | **19,355** | 16,955 |
| Total assets under management | **240,382** | 207,612 |

**47 – Cash flow statement**

The cash flow statement reflects long-term business activities only to the extent that cash is transferred between long-term and non-long-term operations. In the following analyses, long-term business assets and liabilities shown in the consolidated balance sheet have therefore been excluded.

(a) The reconciliation of profit/(loss) on ordinary activities to net cash inflow from operating activities is:

| | 2003 £m | 2002 £m |
|---|---|---|
| Profit/(loss) on ordinary activities before tax, excluding the results of joint ventures and associated undertakings | **1,385** | (283) |
| Add back: Exceptional costs for termination of operations | **19** | – |
| Profit/(loss) on ordinary activities before tax, excluding exceptional items | **1,404** | (283) |
| Adjustments for financing expense and items not involving movements of cash: | | |
| Depreciation of tangible fixed assets | **75** | 82 |
| Amortisation of goodwill | **103** | 135 |
| Amortisation of acquired additional value of in-force long-term business | **135** | 139 |
| Increase in general business underwriting liabilities and provisions | **1,011** | 461 |
| Realised and unrealised (gains)/losses on investments | **(166)** | 894 |
| Net loss on the disposal of subsidiary undertakings | **6** | 4 |
| Decrease in deferred acquisition costs | **(71)** | (30) |
| Movement in banking assets and liabilities | **143** | 40 |
| Movement in other assets/liabilities | **(648)** | (293) |
| Profits not yet transferred from long-term business funds | **(1,030)** | (412) |
| Loan interest expense | **241** | 264 |
| | **(201)** | 1,284 |
| Net cash inflow from operating activities, excluding exceptional items | **1,203** | 1,001 |

# Notes to the accounts
continued

**47 – Cash flow statement** continued

(b) Analysis of cash flows in respect of the acquisition and disposal of subsidiary and associated undertakings is:

| | 2003 £m | 2002 £m |
|---|---|---|
| Cash consideration for subsidiary and associated undertakings acquired | **(218)** | (55) |
| Cash proceeds from disposal of subsidiary and associated undertakings | **698** | 381 |
| Net cash balances acquired/(divested) with subsidiary undertakings | **120** | (85) |
| | **600** | 241 |

(c) Changes in financing during the year were:

| | Share capital | | Borrowings | |
|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| Issue of ordinary share capital (note 31c) | **2** | 11 | **–** | – |
| New borrowings drawn down, net of expenses | **–** | – | **3,349** | 1,466 |
| Repayment of borrowings | **–** | – | **(1,702)** | (1,534) |
| Net cash inflow/(outflow) | **2** | 11 | **1,647** | (68) |
| Foreign exchange rate movements | **–** | – | **64** | 60 |
| Borrowings acquired/loans repaid for non-cash consideration | **–** | – | **35** | (299) |
| Amortisation of discounts and other non-cash items | **–** | – | **2** | 1 |
| Changes in financing | **2** | 11 | **1,748** | (306) |
| Balance at 1 January | | | | |
| Share capital | **3,854** | 3,843 | | |
| External borrowings | | | **3,254** | 3,819 |
| Non-recourse funding | | | **478** | 219 |
| | **3,854** | 3,843 | **3,732** | 4,038 |
| Balance at 31 December | | | | |
| Share capital | **3,856** | 3,854 | | |
| External borrowings (note 42 and note 36) | | | **4,574** | 3,254 |
| Non-recourse funding (note 22) | | | **906** | 478 |
| | **3,856** | 3,854 | **5,480** | 3,732 |
| Share capital is represented by: | | | | |
| Ordinary share capital (note 31a) | **564** | 564 | | |
| Preference share capital (note 32a) | **200** | 200 | | |
| Share premium account (note 31c) | **1,096** | 1,094 | | |
| Merger reserve in respect of share capital | **1,996** | 1,996 | | |
| | **3,856** | 3,854 | | |

(d) Changes in cash during the year were:

| | 2003 £m | 2002 £m |
|---|---|---|
| (Decrease)/increase in cash holdings | **(164)** | 719 |
| Foreign exchange rate movements | **29** | 16 |
| Changes in cash | **(135)** | 735 |
| Balance at 1 January | **1,273** | 538 |
| Balance at 31 December | **1,138** | 1,273 |

(e) Non-long-term business cash included in the consolidated balance sheet comprised:

| | 2003 £m | 2002 £m | Changes in year £m |
|---|---|---|---|
| Cash at bank and in hand: | | | |
| General business and other activities | **1,233** | 1,560 | (327) |
| Banking | **42** | – | 42 |
| | **1,275** | 1,560 | (285) |
| Bank overdrafts: | | | |
| General business and other activities (note 43) | **(137)** | (287) | 150 |
| Net non-long-term business cash included in the consolidated balance sheet | **1,138** | 1,273 | (135) |

**47 – Cash flow statement** continued

(f) Movements in opening and closing non-long-term portfolio investments were:

| | 2003 £m | 2002 £m |
|---|---|---|
| Net purchases/(sales) of investments | **2,262** | (747) |
| Net investments acquired/(divested) with subsidiary undertakings | **289** | (1,826) |
| Changes in market values and foreign exchange rate movements | **915** | (668) |
| Investments sold for non-cash consideration | **–** | (267) |
| Changes in non recourse funding | **(428)** | (259) |
| Net movement in opening and closing non-long-term portfolio investments | **3,038** | (3,767) |
| Balance at 1 January | | |
| Total non-long-term portfolio investments | **14,261** | 17,769 |
| Non-recourse funding | **(478)** | (219) |
| | **13,783** | 17,550 |
| Balance at 31 December | | |
| Total non-long-term portfolio investments | **17,727** | 14,261 |
| Non-recourse funding | **(906)** | (478) |
| | **16,821** | 13,783 |

(g) Non-long-term portfolio investments included in the consolidated balance sheet comprised:

| | 2003 £m | 2002 £m | Changes in year £m |
|---|---|---|---|
| Land and buildings (note 19) | **637** | 668 | (31) |
| Other participating interests (note 21a) | **30** | 47 | (17) |
| Other financial investments (note 22a) | **14,972** | 12,073 | 2,899 |
| Deposits with ceding undertakings | **41** | 18 | 23 |
| Banking (note 30a) | **1,141** | 977 | 164 |
| | **16,821** | 13,783 | 3,038 |

**48 – Contingent liabilities and other risk factors**

(a) Uncertainty over claims provisions
Note 38 gives details of the assumptions used in determining the long-term business provision which are designed to allow for prudence and the appropriate emergence of surpluses to pay future bonuses. Note 39 gives details of the estimation techniques used in determining the general business outstanding claims provision. Both are estimated to give a result within the normal range of outcomes. To the extent that the ultimate cost falls outside this range, for example where experience is worse than that assumed for long-term business, or assumptions over general business claims inflation may alter in the future, there is uncertainty in respect of this liability.

(b) Asbestos, pollution and social environmental hazards
In the course of conducting insurance business, various companies within the Aviva Group receive general insurance liability claims, and become involved in actual or threatened litigation arising therefrom, including claims in respect of pollution and other environmental hazards. Amongst these are claims in respect of asbestos production and handling in various jurisdictions, including the United Kingdom, Australia, Canada and South Africa. Given the significant delays that are experienced in the notification of these claims, the potential number of incidents which they cover and the uncertainties associated with establishing liability and the availability of reinsurance, the ultimate cost cannot be determined with certainty. However, the Group's exposure to such liabilities is not significant and, on the basis of current information and having regard to the level of provisions made for general insurance claims, the directors consider that any costs arising are not likely to have a material impact on the financial position of the Group.

(c) Guarantees on long-term savings products
As a normal part of their operating activities, various Group companies have given guarantees, including interest rate guarantees, in respect of certain long-term insurance and fund management products. In the United Kingdom, in common with other pension and life policy providers, the Group wrote individual and group pension policies in the 1970s and 1980s with a guaranteed annuity rate option ("GAO"). Since 1993, such policies have become more valuable to policyholders, and more costly for insurers, as current annuity rates have fallen in line with interest rates. Reserving policies for the cost of GAOs varied until a ruling by the House of Lords in the Equitable Life case in 2000 which effectively required full reserving by all companies. Prior to the ruling, consistent with the Group's ordinary reserving practice in respect of such obligations, full reserves for GAOs had already been established. No adjustment was made, or was necessary, to the Group's reserving practice as a result of the ruling. The directors continue to believe that the existing provisions are sufficient.

(d) Pensions mis-selling
The Pensions Review of past sales of personal pension policies which involved transfers, opt outs and non-joiners from occupational schemes, as required by the Financial Services Authority ("FSA"), has largely been completed. A provision of some £65 million *(2002: £68 million)* remains to meet the outstanding costs of the few remaining cases, the anticipated cost of any guarantees provided, and potential levies payable to the Financial Services Compensation Scheme ("FSCS"). The provision reflects the significant increases in levies expected over the next two to three years, as advised by the FSCS. It continues to be the directors' view that there will be no material effect either on the Group's ability to meet the expectations of policyholders or on shareholders.

# **Notes to the accounts**
continued

**48 – Contingent liabilities and other risk factors** continued

(e) Endowment reviews
In December 1999, the FSA announced the findings of its review of mortgage endowments and expressed concern as to whether, given decreases in expected future investment returns, such policies could be expected to cover full repayment of mortgages. A key conclusion was that, on average, holders of mortgage endowments had enjoyed returns such that they had fared at least as well as they would have done without an endowment. Nevertheless, following the FSA review, all of the Group's UK mortgage endowment policyholders received policy-specific letters advising them whether their investment was on track to cover their mortgage.

In May 2002, in accordance with FSA requirements, the Group commenced sending out the second phase of endowment policy update letters, which provide policyholders with information about the performance of their policies and advice as to whether these show a projected shortfall at maturity. The Group will continue to send these updates annually to all mortgage endowment holders, in accordance with FSA requirements. The Group has made provisions totalling £80 million *(2002: £50 million)* to meet potential mis-selling costs and the associated expenses of investigating complaints. It continues to be the directors' view that there will be no material effect either on the Group's liability to meet the expectations of policyholders or on shareholders.

(f) Split capital investment trusts
The Group's fund management subsidiary, Morley Fund Management Limited, acts as fund manager for a number of split capital investment trusts. In May 2002, the FSA launched extensive and industry-wide investigations into allegations of collusion by fund managers, mis-selling by intermediaries, and the production and distribution of misleading marketing material. In July 2003, the FSA announced that it had broadened the coverage of the collusion investigations to cover a larger number of firms and individuals. As part of these investigations, Morley Fund Management Limited has been asked to supply information to the FSA. These investigations are ongoing and are likely to continue for some time. The FSA is expected to publish its findings in due course.

(g) Other
The Company and several of its subsidiaries have guaranteed the overdrafts and borrowings of certain subsidiary and associated undertakings. In the opinion of the directors, no material loss will arise in respect of these guarantees and indemnities.

In addition, in line with standard business practice, various Group companies have given guarantees, indemnities and warranties in connection with disposals in recent years of subsidiary and associated undertakings to parties outside the Aviva Group. In the opinion of the directors, no material loss will arise in respect of these guarantees, indemnities and warranties.

**49 – Capital commitments**

In carrying on the business of investment, the Group has entered into future commitments, including property development, after 31 December 2003. These amounts are not reflected in the consolidated Group balance sheet on pages 64 and 65. The Group has in hand a number of property developments which, under contracts already signed, will require expenditure of £181 million *(2002: £344 million)* for long-term business operations.

# Five year review

| | 2003 £m | Restated 2002 £m | Restated 2001 £m | Restated 2000(d) £m | Restated 1999(d) £m |
|---|---|---|---|---|---|
| **Premium income after reinsurance and investment sales** | | | | | |
| Life assurance, investment sales, including share of associates | **20,176** | 19,200 | 19,065 | 17,349 | 15,048 |
| General insurance | **8,524** | 7,805 | 7,850 | 8,356 | 7,699 |
| Health | **1,066** | 928 | 841 | 687 | 402 |
| **Total continuing operations** | **29,766** | 27,933 | 27,756 | 26,392 | 23,149 |
| **Consolidated profit and loss account** | | | | | |
| Life assurance (achieved profit basis) | **1,555** | 1,524 | 1,665 | 1,533 | 1,455 |
| Health | **61** | 61 | 70 | 68 | 24 |
| Fund management and non-insurance operations (d) | **(54)** | (94) | (63) | (60) | 87 |
| General insurance | **911** | 881 | 876 | 330 | 444 |
| Corporate costs and unallocated interest charges | **(566)** | (652) | (613) | (546) | (402) |
| Operating profit including life achieved profit – Continuing operations | **1,907** | 1,720 | 1,935 | 1,325 | 1,608 |
| Deduct life achieved profit | **(1,555)** | (1,524) | (1,665) | (1,569) | (1,496) |
| Add modified statutory life profit | **1,138** | 1,022 | 1,194 | 1,190 | 1,172 |
| Operating profit on continuing operations before tax, amortisation of goodwill, amortisation of acquired additional value of in-force long-term business and exceptional items | **1,490** | 1,218 | 1,464 | 946 | 1,284 |
| Discontinued operations | **–** | 78 | 48 | (472) | 216 |
| Amortisation of goodwill and acquired value of in-force long-term business | **(238)** | (274) | (151) | (121) | (56) |
| Financial Services Compensation Scheme levy | **–** | – | (31) | – | – |
| Integration costs | **–** | – | (59) | (425) | (163) |
| Operating profit/(loss) before tax | **1,252** | 1,022 | 1,271 | (72) | 1,281 |
| Short-term fluctuation in investment return | **212** | (1,243) | (988) | 258 | 250 |
| Change in the equalisation provision | **(49)** | (57) | (56) | (27) | (55) |
| Net profit/(loss) on the disposal of subsidiary undertakings | **(6)** | (4) | 287 | (1,058) | (8) |
| Exceptional costs for termination of operations | **(19)** | – | – | – | – |
| Loss on withdrawal from London Market operations | **–** | – | – | (448) | – |
| Merger transaction costs | **–** | – | – | (59) | – |
| Profit/(loss) on ordinary activities before tax | **1,390** | (282) | 514 | (1,406) | 1,468 |
| Tax | **(367)** | (206) | (198) | (255) | (382) |
| Minority interests | **(74)** | (46) | (57) | (52) | (66) |
| Dividends | **(562)** | (536) | (874) | (872) | (790) |
| Retained profit/(loss) transferred to/(from) reserves | **387** | (1,070) | (615) | (2,585) | 230 |
| **Consolidated shareholders' funds** | | | | | |
| Equity shareholders' funds (e) | **6,354** | 5,636 | 6,274 | 7,078 | 9,555 |
| Non-equity shareholders' funds | **200** | 200 | 200 | 200 | 200 |
| Shareholder funds per statutory accounts | **6,554** | 5,836 | 6,474 | 7,278 | 9,755 |
| Additional value of internally-generated in-force long-term business | **4,611** | 3,832 | 5,268 | 5,999 | 5,914 |
| Shareholders' funds on an achieved profit basis | **11,165** | 9,668 | 11,742 | 13,277 | 15,669 |
| **Pence per ordinary share** | | | | | |
| Net asset value per statutory accounts (a) (e) | **297p** | 264p | 290p | 324p | 436p |
| Net asset value on an achieved profit basis (a) | **502p** | 433p | 524p | 591p | 699p |
| Market price (London) (a) | **490p** | 443p | 845p | 1082p | 998p |
| Earnings per share attributable to equity shareholders (b): MSSB operating profit before amortisation of goodwill, amortisation of acquired additional value of in-force long-term business and exceptional items, after tax, attributable to equity shareholders in respect of continuing operations | **44.0p** | 34.8p | 40.8p | 24.6p | 38.5p |
| Ordinary dividend (c) | **24.15p** | 23.0p | 38.0p | 38.0p | 34.3p |

Notes

(a) The net asset value and market price (London) are as at 31 December. The market price for 1999 is for CGU plc. The net asset value is calculated based on equity shareholders' funds, adding back the equalisation provision.

(b) Basic earnings per ordinary share are shown only. No figures have been provided for diluted earnings per share.

(c) Figures for 1999 are based on the weighted average dividends per share of CGU plc and Norwich Union plc.

(d) The profit and loss account figures for 1999 and 2000 and the balance sheet figures for 1999 have not been restated for the effects of implementing FRS19 "Deferred Tax". The wealth management result has been included within fund management and non-insurance operations in all years.

(e) Equity shareholders' funds for all years have been restated for the effects of the changes in accounting policy as detailed in note 3.

# Alternative method of reporting long-term business

**Summarised consolidated profit and loss account – achieved profit basis**
For the year ended 31 December 2003

| 2003 €m | | 2003 £m | 2002 £m |
|---|---|---|---|
| | **Operating profit** | | |
| **2,255** | Life achieved operating profit | **1,555** | 1,524 |
| **88** | Health | **61** | 61 |
| **14** | Fund management | **10** | 5 |
| **1,320** | General insurance | **911** | 881 |
| **(93)** | Non-insurance operations* | **(64)** | (99) |
| **(232)** | Corporate costs | **(160)** | (218) |
| **(588)** | Unallocated interest charges | **(406)** | (434) |
| **2,764** | **Operating profit – continuing operations before tax, amortisation of goodwill and exceptional items** | **1,907** | 1,720 |
| | Discontinued operations | | |
| **–** | Australia and New Zealand general insurance operations | **–** | 78 |
| **2,764** | **Operating profit – before tax, amortisation of goodwill and exceptional items** | **1,907** | 1,798 |
| **(149)** | Amortisation of goodwill | **(103)** | (135) |
| **2,615** | **Operating profit before tax** | **1,804** | 1,663 |
| **1,110** | Variation from longer-term investment return | **766** | (3,504) |
| **16** | Effect of economic assumption changes | **11** | (561) |
| **(71)** | Change in the equalisation provision | **(49)** | (57) |
| **(9)** | Net loss on the disposal of subsidiary undertakings | **(6)** | (4) |
| **(28)** | Exceptional costs for termination of operations | **(19)** | – |
| **3,633** | **Profit/(loss) on ordinary activities before tax** | **2,507** | (2,463) |
| **(813)** | Tax on operating profit – continuing operations before amortisation of goodwill and exceptional items | **(561)** | (531) |
| **(278)** | Tax on profit/(loss) on other ordinary activities | **(192)** | 982 |
| **2,542** | **Profit/(loss) on ordinary activities after tax** | **1,754** | (2,012) |
| **(162)** | Minority interests | **(112)** | (33) |
| **2,380** | **Profit/(loss) for the financial year** | **1,642** | (2,045) |
| **(24)** | Preference dividends | **(17)** | (17) |
| **2,356** | **Profit/(loss) for the financial year attributable to equity shareholders** | **1,625** | (2,062) |
| **(790)** | Ordinary dividends | **(545)** | (519) |
| **1,566** | **Retained profit/(loss) for the financial year** | **1,080** | (2,581) |

*The wealth management result has been included within non-insurance in all periods.

| | | | |
|---|---|---|---|
| | **Earnings per share** | | |
| | Operating profit on an achieved profit basis before amortisation of goodwill and exceptional items, after tax, attributable to equity shareholders in respect of: | | |
| **77.1c** | – continuing operations | **53.2p** | 48.3p |
| **77.1c** | – continuing and discontinued operations | **53.2p** | 51.5p |
| **104.6c** | Profit/(loss) attributable to equity shareholders | **72.2p** | (91.5)p |
| **104.2c** | Profit/(loss) attributable to equity shareholders – diluted** | **71.9p** | (91.5)p |

**As required by FRS14 "Earnings per share", the impact of the dilutive effect on 2002 comparatives is not recognised as it would result in a smaller loss.

**Consolidated statement of total recognised gains and losses – achieved profit basis**
For the year ended 31 December 2003

| 2003 €m | | 2003 £m | 2002 £m |
|---|---|---|---|
| **2,380** | Profit/(loss) for the financial year* | **1,642** | (2,045) |
| **(492)** | Foreign exchange gains | **415** | 179 |
| **1,888** | **Total recognised gains/(losses) arising in the year** | **2,057** | (1,866) |

*Stated before the effect of foreign exchange movements, which are reported within the foreign exchange gains line.

**Reconciliation of movements in consolidated shareholders' funds – achieved profit basis**
For the year ended 31 December 2003

| 2003 €m | | 2003 £m | Restated** 2002 £m |
|---|---|---|---|
| | **Shareholders' funds at the beginning of the year, as originally reported** | | 11,752 |
| | Prior year adjustment | | (10) |
| **14,874** | **Shareholders' funds at the beginning of the year, as restated** | **9,668** | 11,742 |
| **1,888** | Total recognised gains/(losses) arising in the year | **2,057** | (1,866) |
| **(815)** | Dividends | **(562)** | (536) |
| **3** | Other movements | **2** | 328 |
| **15,950** | **Shareholders' funds at the end of the year** | **11,165** | 9,668 |

**Restated for the effect of a change in accounting policy in respect of the treatment of shares held by employee trusts as a deduction from shareholders' capital.

# Alternative method of reporting long-term business
continued

## Summarised consolidated balance sheet – achieved profit basis
As at 31 December 2003

| | Long-term business 2003 £m | General business and other 2003 £m | Group 2003 £m | Long-term business 2002 £m | Restated* General business and other 2002 £m | Restated* Group 2002 £m |
|---|---|---|---|---|---|---|
| **Total assets before acquired additional value of in-force long-term business** | **177,906** | **30,286** | **208,192** | 152,887 | 27,613 | 180,500 |
| Acquired additional value of in-force long-term business | **488** | **–** | **488** | 505 | – | 505 |
| **Total assets included in the modified statutory balance sheet** | **178,394** | **30,286** | **208,680** | 153,392 | 27,613 | 181,005 |
| Liabilities of the long-term business | **(170,765)** | **–** | **(170,765)** | (146,930) | – | (146,930) |
| Liabilities of the general insurance business | **–** | **(27,736)** | **(27,736)** | – | (26,391) | (26,391) |
| **Net assets on a modified statutory basis** | **7,629** | **2,550** | **10,179** | 6,462 | 1,222 | 7,684 |
| Additional value of internally-generated in-force long-term business (1) | **4,744** | **–** | **4,744** | 3,917 | – | 3,917 |
| **Net assets on an achieved profits basis** (2) | **12,373** | **2,550** | **14,923** | 10,379 | 1,222 | 11,601 |
| Shareholders' capital, share premium, shares held by employee trusts and merger reserve | | | **4,622** | | | 4,710 |
| Modified statutory basis retained profit | | | **1,932** | | | 1,126 |
| Additional achieved profit basis retained profit (1) | | | **4,611** | | | 3,832 |
| **Shareholders' funds on an achieved profit basis** | | | **11,165** | | | 9,668 |
| Minority interests | | | **944** | | | 743 |
| | | | **12,109** | | | 10,411 |
| Subordinated debt | | | **2,814** | | | 1,190 |
| **Achieved profit basis total capital, reserves and subordinated debt** | | | **14,923** | | | 11,601 |

*Restated for the effect of a change in accounting policy in respect of the treatment of shares held by employee trusts as a deduction from shareholders' capital.

Approved by the Board on 24 February 2004

**Philip Twyman**
Group Executive Director

Notes

(1) The analysis between the Group's and the minority interest share of the additional value of internally-generated in-force long-term business is as follows:

| | 2003 £m | 2002 £m | Movement in the year £m |
|---|---|---|---|
| Group's share included in shareholders' funds | **4,611** | 3,832 | 779 |
| Minority interest share | **133** | 85 | 48 |
| | **4,744** | 3,917 | 827 |

(2) Analysis of net assets on an achieved profit basis is made up as follows:

| | 2003 £m | 2002 £m |
|---|---|---|
| Long-term business net assets on an achieved profit basis | **12,373** | 10,379 |
| Comprises: | | |
| Embedded value of life operations | **12,155** | 10,148 |
| RBSG goodwill | **218** | 231 |

**Basis of preparation – achieved profit basis**

The achieved profit statement includes the results of the Group's life operations reported under the achieved profit basis combined with the modified statutory basis results of the Group's non-life operations set out on pages 56 to 100. In the directors' opinion, the achieved profit basis provides a more accurate reflection of the performance of the Group's life operations year on year than results under the modified statutory basis. The achieved profit methodology used is in accordance with the guidance on "Supplementary reporting for long-term insurance business (the achieved profit method)" circulated by the Association of British Insurers in December 2001. Further details on the methodology and assumptions are set out on pages 107 to 109.

The results of the Group's life operations under the modified statutory basis, which is the basis used in the annual statutory accounts, can be found on pages 56 to 100.

The contribution from the Group's share of the alliance with The Royal Bank of Scotland Group (RBSG) is incorporated within the achieved operating profit. Goodwill amortised in the year in respect of the Group's holding in the associated company, RBS Life Investments Limited, is included within the "Amortisation of goodwill" line in the Summarised consolidated profit and loss account.

The results for 2003 and 2002 have been audited by the auditors Ernst & Young LLP. Their audit report in respect of 2003 is on page 110.

**Components of total life achieved profit**

Total life achieved profit, including the Group's share from the alliance with RBSG, comprises the following components, the first three of which in aggregate are referred to as life achieved operating profit:

- new business contribution written during the period including value added between the point of sale and end of the period;
- the profit from existing business equal to:
  - the expected return on the value of the in-force business at the beginning of the period,
  - experience variances caused by the differences between the actual experience during the period and expected experience based on the operating assumptions used to calculate the start of year value,
  - the impact of changes in operating assumptions including risk margins;
- the expected investment return on the shareholders' net worth, based upon assumptions applying at the start of the year;
- investment return variances caused by differences between the actual return in the period and the expected experience based on economic assumptions used to calculate the start of year value; and
- the impact of changes in economic assumptions in the period.

| | 2003 £m | 2002 £m |
|---|---|---|
| New business contribution (after the effect of solvency margin) | **472** | 452 |
| Profit from existing business – expected return | **757** | 849 |
| – experience variances | **(12)** | (110) |
| – operating assumption changes* | **38** | 9 |
| Expected return on shareholders' net worth | **300** | 324 |
| **Life achieved operating profit before tax** | **1,555** | 1,524 |
| Investment return variances | **683** | (2,320) |
| Effect of economic assumption changes | **11** | (561) |
| Total life achieved profit/(loss) before tax | **2,249** | (1,357) |
| Tax on operating profit/(loss) | **(473)** | (460) |
| Tax on other ordinary activities | **(191)** | 857 |
| **Total life achieved profit/(loss) after tax** | **1,585** | (960) |

*In 2003, operating assumption changes included the impact of reducing the risk margins in Poland, the US and Australia in line with the directors' views of the risks associated with this in-force portfolio. The impact of this change was £24 million. In 2002, operating assumptions included the impact of reducing risk margins in the US. The impact of this change was £13 million.

# Alternative method of reporting long-term business
continued

## New business contribution

The following table sets out the contribution from new business written by the long-term business operations. The contribution generated by new business written during the period is the present value of the projected stream of after-tax distributable profit from that business. Contribution before tax is calculated by grossing up the contribution after-tax at the full corporation tax rate for UK business and at appropriate rates of tax for other countries.

| | Annual premium equivalent* | | | New business contribution | |
|---|---|---|---|---|---|
| | 2003 £m | 2002 £m | Local currency growth % | 2003 £m | 2002 £m |
| **United Kingdom** | **1,068** | 1,231 | (13%) | **241** | 290 |
| **Europe (excluding UK)** | | | | | |
| France | **241** | 223 | (2%) | **70** | 69 |
| Ireland | **81** | 103 | (29%) | **23** | 29 |
| Italy | **194** | 153 | 15% | **45** | 38 |
| Netherlands (including Belgium and Luxembourg) | **224** | 158 | 29% | **62** | 21 |
| Poland | **35** | 48 | (23%) | **3** | 10 |
| Spain | **246** | 189 | 18% | **134** | 87 |
| Other | **101** | 93 | 2% | **(3)** | (5) |
| **International** | **187** | 175 | 9% | **46** | 39 |
| **Total annualised premiums** | **2,377** | 2,373 | (3%) | | |
| **Total new business contribution before effect of solvency margin**** | | | | **621** | 578 |
| Effect of solvency margin | | | | **(149)** | (126) |
| **Total new business contribution including effect of solvency margin** | | | | **472** | 452 |

*Annual premium equivalent represents regular premiums plus 10% of single premiums.

**New business contribution before the effect of solvency margin includes minority interests in 2003 of £106 million *(2002: £69 million)*. This comprises minority interests in France of £4 million *(2002: £4 million)*, Italy £25 million *(2002: £19 million)*, Netherlands £8 million *(2002: nil)*, Poland £1 million *(2002: £1 million)* and Spain £68 million *(2002: £45 million)*.

New business contributions have been calculated using the same economic assumptions as those used to determine the embedded values as at the beginning of each year and operating assumptions used to determine the embedded values as at the end of the period. The effect of solvency margin represents the impact of holding the minimum European Union (EU) solvency margin (or equivalent for non-EU operations) and discounting to present value the projected future releases from the solvency margin to shareholders.

## Analysis of life achieved operating profit

Life achieved operating profit is calculated on an after-tax basis and then grossed up at the full rate of corporation tax for UK business and at appropriate rates of tax for other countries.

| | 2003 £m | 2002 £m |
|---|---|---|
| **United Kingdom** | **659** | 699 |
| **Europe (excluding UK)** | | |
| France | **220** | 228 |
| Ireland | **65** | 75 |
| Italy | **70** | 52 |
| Netherlands (including Belgium and Luxembourg) | **189** | 200 |
| Poland | **104** | 111 |
| Spain | **158** | 83 |
| Other | **9** | (2) |
| **International** | **81** | 78 |
| **Total life achieved operating profit before tax*** | **1,555** | 1,524 |

*Life achieved operating profit includes minority interests in 2003 of £154 million *(2002: £90 million)*. This comprises minority interests in France of £6 million *(2002: £7 million)*, Italy £37 million *(2002: £26 million)*, Netherlands £14 million *(2002: nil)*, Poland £20 million *(2002: £18 million),* Spain £76 million *(2002: £39 million)* and Other Europe £1 million *(2002: nil)*.

## Embedded value of life business

| | 2003 £m | 2002 £m |
|---|---|---|
| **Embedded value at the beginning of the year** | **10,148** | 11,063 |
| Total life achieved profit/(loss) after tax | **1,585** | (960) |
| Exchange rate movements | **342** | 220 |
| Embedded value of businesses acquired* | **64** | 13 |
| Amounts injected into life operations | **221** | 419 |
| Amounts released from life operations | **(205)** | (607) |
| **Embedded value at the end of the year**** | **12,155** | 10,148 |

*Embedded value of businesses acquired in 2003 represents the embedded value of Delta Lloyd ABN AMRO Verzekeringen Holding BV, the insurance company acquired as part of the bancassurance agreement entered into with ABN AMRO NV in the Netherlands of £64 million. Embedded value from businesses acquired in 2002 represents the life subsidiary of DBS Hong Kong of £13 million.

**Embedded value at the end of the year includes minority interests in 2003 of £559 million *(2002: £410 million)*. This comprises minority interests in France of £46 million *(2002: £42 million)*, Italy £230 million *(2002: £180 million)*, Netherlands £43 million *(2002: nil)*, Poland £63 million *(2002: £51 million)*, Spain £174 million *(2002: £134 million)* and Other Europe £3 million *(2002: £3 million)*.

### Segmental analysis of embedded value of life business

| | Net worth at 31 December* | | Value of in-force at 31 December** | | Embedded value at 31 December | |
|---|---|---|---|---|---|---|
| | 2003 £m | 2002 £m | 2003 £m | 2002 £m | 2003 £m | 2002 £m |
| **United Kingdom** | **2,141** | 1,845 | **3,532** | 3,167 | **5,673** | 5,012 |
| **Europe (excluding UK)** | | | | | | |
| France | **1,012** | 833 | **437** | 388 | **1,449** | 1,221 |
| Ireland | **270** | 218 | **284** | 254 | **554** | 472 |
| Italy | **348** | 250 | **94** | 99 | **442** | 349 |
| Netherlands (including Belgium and Luxembourg) | **1,267** | 859 | **1,131** | 947 | **2,398** | 1,806 |
| Poland | **148** | 129 | **248** | 223 | **396** | 352 |
| Spain | **187** | 149 | **268** | 201 | **455** | 350 |
| Other | **140** | 128 | **60** | 48 | **200** | 176 |
| **International** | **468** | 294 | **120** | 116 | **588** | 410 |
| | **5,981** | 4,705 | **6,174** | 5,443 | **12,155** | 10,148 |

*The shareholders' net worth comprises the market value of the shareholders' funds and the shareholders' interest in the surplus held in the non-profit component of the long-term business funds determined on a statutory solvency basis and adjusted to add back any non-admissible assets.

**The value of in-force includes the effect of holding shareholders' capital to support the minimum statutory solvency margin requirements and allowing for projected future releases. This impact reduces the value of in-force by £870 million *(2002: £750 million)*. The minimum statutory solvency margin requirements supported by shareholders' capital of £3,100 million *(2002: £2,600 million)* is included within the net worth.

### Minority interest in life achieved profit

| | 2003 | | | 2002 |
|---|---|---|---|---|
| | Shareholders' interest £m | Minority interest £m | Group £m | Group £m |
| New business contribution before effect of solvency margin | **515** | **106** | **621** | 578 |
| Effect of solvency margin | **(126)** | **(23)** | **(149)** | (126) |
| **New business contribution including effect of solvency margin** | **389** | **83** | **472** | 452 |
| **Life achieved operating profit before tax** | **1,401** | **154** | **1,555** | 1,524 |
| Total life achieved profit/(loss) before tax | **2,129** | **120** | **2,249** | (1,357) |
| Attributed tax | **(624)** | **(40)** | **(664)** | 397 |
| **Total life achieved profit/(loss) after tax** | **1,505** | **80** | **1,585** | (960) |
| **Closing life embedded value** | **11,596** | **559** | **12,155** | 10,148 |

### Methodology

#### (a) Life achieved profit

The achieved profit method of financial reporting is designed to recognise profit as it is earned over the life of an insurance policy. The total profit recognised over the lifetime of a policy is the same as under the modified statutory basis of reporting, but the timing of recognition is different.

Distributable profits from long-term businesses arise when they are released to shareholders following actuarial valuations. These are carried out in accordance with statutory requirements designed to ensure and demonstrate solvency in long-term business funds.

Future distributable profits will depend on experience in a number of areas such as investment return, discontinuance rates, mortality and administration costs. Using realistic assumptions of future experience, we can project releases to shareholders arising in future years from the business in-force and associated minimum statutory solvency margin.

The life achieved profit reflects current performance by measuring the movement, from the beginning to the end of the year, in the present value of projected releases to shareholders from the business in-force and associated minimum statutory margin, together with the movement in the net assets of the long-term operations, adjusted for any amounts released from or invested in life operations.

The present value of the projected releases to shareholders is calculated by discounting back to the current time using a risk discount rate. The risk discount rate is a combination of a discount rate to reflect the time value of money and a risk margin to make prudent allowance for the risk that experience in future years may differ from the assumptions referred to above.

Achieved profit reporting takes account of the cost of maintaining local provisions. In addition, a significant allowance for the expected cost of guarantees is implicitly allowed for in the risk margin inherent in the risk discount rate consistent with the principles of the achieved profit guidance.

The calculations are carried out on an after-tax basis and the profits are then grossed up for tax at the full rate of corporation tax for the United Kingdom and at an appropriate rate for each of the other countries.

#### (b) Embedded value

The shareholders' interest in the long-term business operations is represented by the embedded value. The embedded value is the total of the net assets of the long-term operations and the present value at risk discount rates (which incorporate a risk margin) of the projected releases to shareholders arising from the business in-force, less a deduction for the effect of holding the minimum statutory solvency margin. This effect of solvency margin is the difference between the nominal value of the solvency margin and the present value at risk discount rates of the projected release of the solvency margin and investment earnings on the assets deemed to back the solvency margin.

For with-profit funds in the United Kingdom and Ireland, for the purpose of recognising the value of the estate, it is assumed that terminal bonuses are increased to exhaust all of the free assets over the future lifetime of the in-force with-profit policies.

# Alternative method of reporting long-term business
continued

### Principal economic assumptions

Economic assumptions are derived actively, based on market yields on risk-free fixed interest assets at each period end. Margins are applied on a consistent basis to risk free yields to obtain investment return assumptions for ordinary shares and property, and risk discount rates. The change in assumptions in 2003 reflects the movements in actual risk-free yields in each territory. Risk margins remain unchanged in all of our key businesses, except Poland, the US and Australia.

The principal economic assumptions used are as follows:

| | United Kingdom | | | France | | |
|---|---|---|---|---|---|---|
| | 2003 | 2002 | 2001 | 2003 | 2002 | 2001 |
| Risk discount rate | **7.5%** | 7.3% | 7.7% | **8.1%** | 8.1% | 8.6% |
| Pre-tax investment returns: | | | | | | |
| Base government fixed interest | **4.8%** | 4.5% | 5.0% | **4.3%** | 4.3% | 5.1% |
| Ordinary shares | **7.3%** | 7.0% | 7.5% | **6.3%** | 6.3% | 7.1% |
| Property | **6.3%** | 6.0% | 6.5% | **5.8%** | 5.8% | 6.6% |
| Future expense inflation | **4.1%** | 3.6% | 3.7% | **2.5%** | 2.5% | 2.5% |
| Tax rate | **30.0%** | 30.0% | 30.0% | **35.4%** | 35.4% | 36.4% |

| | Ireland | | | Italy | | |
|---|---|---|---|---|---|---|
| | 2003 | 2002 | 2001 | 2003 | 2002 | 2001 |
| Risk discount rate | **8.6%** | 8.7% | 9.3% | **7.4%** | 7.3% | 7.6% |
| Pre-tax investment returns: | | | | | | |
| Base government fixed interest | **4.5%** | 4.6% | 5.3% | **4.4%** | 4.4% | 5.3% |
| Ordinary shares | **7.5%** | 7.6% | 8.3% | **7.4%** | 7.4% | 8.3% |
| Property | **6.0%** | 6.1% | 6.8% | **5.9%** | 5.9% | 6.8% |
| Future expense inflation | **4.0%** | 4.0% | 4.0% | **3.3%** | 3.3% | 3.3% |
| Tax rate | **12.5%** | 12.5% | 16.0% | **38.3%** | 39.8% | 41.0% |

| | Netherlands | | | Poland* | | |
|---|---|---|---|---|---|---|
| | 2003 | 2002 | 2001 | 2003 | 2002 | 2001 |
| Risk discount rate | **7.4%** | 7.4% | 8.0% | **13.5%** | 15.4% | 18.5% |
| Pre-tax investment returns: | | | | | | |
| Base government fixed interest | **4.2%** | 4.2% | 5.1% | **6.0%** | 8.0% | 12.5% |
| Ordinary shares | **7.2%** | 7.2% | 8.1% | **6.0%** | 8.0% | 12.5% |
| Property | **5.7%** | 5.7% | 6.6% | **n/a** | n/a | n/a |
| Future expense inflation | **2.5%** | 2.5% | 2.5% | **3.4%** | 5.4% | 9.2% |
| Tax rate | **25.0%** | 25.0% | 25.0% | **19.0%** | 27.0% | 28.0% |

| | Spain | | |
|---|---|---|---|
| | 2003 | 2002 | 2001 |
| Risk discount rate | **7.7%** | 7.7% | 8.3% |
| Pre-tax investment returns: | | | |
| Base government fixed interest | **4.6%** | 4.6% | 5.3% |
| Ordinary shares | **7.6%** | 7.6% | 8.3% |
| Property | **6.1%** | 6.1% | 6.8% |
| Future expense inflation | **3.0%** | 3.0% | 3.2% |
| Tax rate | **35.0%** | 35.0% | 35.0% |

*The economic assumptions shown above are those in the calculations for the life business. The economic assumptions for the pension business are identical with the exception of the risk discount rate which is 12.7% *(2002: 13.8%; 2001: 16.9%)*.

### Other assumptions

- Current tax legislation and rates have been assumed to continue unaltered, except where changes in future tax rates have been announced.
- Assumed future mortality, morbidity and lapse rates have been derived from an analysis of Aviva's recent operating experience.
- The management expenses of Aviva attributable to long-term business operations have been split between expenses relating to the acquisition of new business and to the maintenance of business in-force. Certain expenses of an exceptional nature have been identified separately and the discounted value of projected exceptional costs has been deducted from the value of in-force business. A realistic estimate of future fund management expenses that will be charged to long-term businesses by Group companies not included in the long-term business covered by the achieved profits method has been included within the value of in-force business.
- It has been assumed that there will be no changes to the methods and bases used to calculate the statutory technical provisions and current surrender values.
- The value of in-force business allows for future premiums under recurring single premium business where collection of future single premiums is expected and where the receipt of further single premiums is not regarded as new business at the point of receipt. It does not allow for future premiums under non-contractual increments, or for future Department of Work and Pensions (DWP) rebate premiums, and the value arising therefrom is included in the value of new business when the premiums are received.
- The value of the in-force business has been determined after allowing for the effect of holding solvency margins equal to the minimum EU solvency requirement (or equivalent for non-EU operations). Solvency margins relating to with-profit business are assumed to be covered by the surplus within the with-profit funds and no effect has been attributed to shareholders.
- Bonus rates on with-profit business have been set at levels consistent with the economic assumptions and Aviva's medium-term bonus plans. The distribution of profit between policyholders and shareholders within the with-profit funds assumes that the shareholder interest in conventional with-profit business in the United Kingdom and Ireland continues at the current rate of one-ninth of the cost of bonus.

### Alternative assumptions

#### Economic assumptions

The table below shows the sensitivity to a one percentage point increase in the assumed investment returns for equity and property investments, and in the discount rate for the Group's 2003 new business contribution and embedded value.

| | New business contribution | | Embedded value | |
|---|---|---|---|---|
| | Equity/property returns £m | Discount rate £m | Equity/property returns £m | Discount rate £m |
| **United Kingdom** | 16 | (40) | 150 | (275) |
| **Europe (excluding UK)** | | | | |
| France | 3 | (7) | 50 | (80) |
| Ireland | 2 | (3) | 10 | (15) |
| Italy | – | (3) | 20 | (10) |
| Netherlands (including Belgium and Luxembourg) | 14 | (15) | 225 | (130) |
| Poland | 1 | (1) | 10 | (15) |
| Spain | 1 | (9) | 5 | (20) |
| Other | – | (1) | 5 | (5) |
| **International** | – | (8) | – | (20) |
| | 37 | (87) | 475 | (570) |

The impact of an increase of one percentage point in the assumed investment returns for equity and property investments is calculated with all other assumptions remaining unchanged.

The impact of an increase of one percentage point in the discount rate is calculated with all other assumptions remaining unchanged.

#### Non-economic assumptions

Sensitivity calculations have been performed to identify the non-economic assumptions to which new business contribution and the value of in-force business within embedded value are particularly sensitive. The calculations have been based on similar percentage movements in each assumption from the base assumption used to calculate the published new business contribution and value of in-force business. Based on this, both the Group's new business contribution and value of in-force are most sensitive to changes in future maintenance expenses.

# Alternative method of reporting long-term business
continued

## Independent auditors' report to the directors of Aviva plc on the alternative method of reporting long-term business profits

We have audited the supplementary information on pages 102 to 109 in respect of the year ended 31 December 2003, which comprises an achieved profit basis Summarised profit and loss account, Consolidated statement of total recognised gains and losses, Reconciliation of movements in consolidated shareholders' funds, Summarised consolidated balance sheet and the related notes and analyses. The supplementary information has been prepared in accordance with the achieved profit basis, using the methodology and assumptions set out on pages 107 to 109. The supplementary information should be read in conjunction with the accounts prepared on the modified statutory solvency basis, which are on pages 56 to 100.

This report is made solely to the Company's directors, as a body. Our audit work has been undertaken so that we might state to the Company's directors those matters we are required to state to them in an auditors' 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 directors as a body, for our audit work in respect of this report, for this report, or for the opinions we have formed.

### Respective responsibilities of directors and auditors

The directors are responsible for preparing the Annual report, including, as described on page 43, the accounts prepared on the modified statutory solvency basis. Our responsibilities in relation to the Annual report, including those accounts, are set out on page 55. The directors are also responsible for preparing the supplementary information on the above achieved profits basis.

Our responsibilities, as independent auditors, in relation to the supplementary information are established in the United Kingdom by the Auditing Practices Board and our profession's ethical guidance. We report to you our opinion as to whether the supplementary information has been properly prepared in accordance with the achieved profit basis. We also report to you if we have not received all the information and explanations we require for our audit of the supplementary information.

We also read the other information in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the supplementary information. The other information comprises the Highlights of the year, the Chairman's statement, Business overview, Group Chief Executive's review, Operating review, Corporate social responsibility, Financial review, Director's report, Corporate governance statement, Audit Committee report, Nomination Committee report, Chairman's Committee report and the unaudited part of the Director's remuneration report.

### Basis of audit opinion

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

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

### Opinion

In our opinion, the supplementary information for the year ended 31 December 2003 has been properly prepared in accordance with the achieved profit basis, using the methodology and assumptions set out on pages 107 to 109.

**Ernst & Young LLP**

Registered Auditor

London

24 February 2004

# Aviva Group of companies



**Parent Company**
Aviva plc

**Subsidiaries**
The principal subsidiaries of the Company are listed below by country of incorporation. All are wholly-owned, directly or indirectly, and transact insurance or reinsurance business, fund management or services in connection therewith, unless otherwise stated.

**United Kingdom**
CGNU Life Assurance Limited
CGU Bonus Limited
CGU Insurance plc
CGU International Insurance plc
CGU Underwriting Limited
Commercial Union Life Assurance Company Limited
General Accident plc
London & Edinburgh Insurance Group Limited
Morley Fund Management International Limited
Morley Fund Management Limited
Morley Investment Services Limited
Morley Pooled Pensions Limited
Morley Properties Limited
Northern Assurance Company Limited, The
Norwich Union Annuity Limited
Norwich Union Equity Release Limited
Norwich Union Healthcare Limited
Norwich Union Insurance Limited
Norwich Union Investment Funds Limited
Norwich Union Life & Pensions Limited
Norwich Union Linked Life Assurance Limited
Norwich Union Personal Finance Limited
your-move.co.uk Limited

**Australia**
Aviva Australia Holdings Limited and its principal subsidiaries:
Norwich Union Life Australia Limited
Navigator Australia Limited
Portfolio Partners Limited

**Belgium**
Bank Nagelmackers 1747 NV *(Banking)* (99.6%)
Delta Lloyd Life NV

**Bermuda**
Curepool Limited

**Canada**
Aviva Canada Inc and its principal operating subsidiary:
Aviva Insurance Company of Canada

**Czech Republic**
Aviva zivotni pojist'ovna a.s.

**France**
Aviva Participations SA and its principal subsidiaries:
Aviva Assurances SA
Aviva Courtage SA
Aviva Direct SA
Aviva France SA
Aviva Gestion d'Actifs
Aviva Vie SA
Eurofil SA
Société d'Epargne Viagére SA (75.0%)
Union Financière de France Banque *(Banking)* (76.3%)

**Germany**
Delta Lloyd Deutschland AG and its principal subsidiary:
Berlinische Lebensversicherung AG (99.5%)

**Hungary**
Aviva Eletbiztosito Rt.

**Ireland**
Hibernian Group plc and its principal subsidiaries:
Hibernian General Insurance Limited
Hibernian Investment Managers Limited
Hibernian Life & Pensions Limited

**Italy**
Aviva Italia Holding SpA and its principal subsidiaries:
Aviva Vita SpA (25.5%)
Commercial Union Assicurazioni SpA (50.0%)
Commercial Union Insurance SpA
Commercial Union Life SpA (50.0%)
Commercial Union Previdenza SpA (50.0%)
Commercial Union Vita SpA (51.0%)
Eurovita Assicurazioni SpA (41.0%)
Commercial Union Italia SpA

**Luxembourg**
Commercial Union International Life SA

**Malaysia**
Aviva Insurance Berhad (51.0%)

**Netherlands**
Delta Lloyd NV and its principal subsidiaries:
Delta Lloyd ABN AMRO Verzekeringen Holding BV (51.0%)
Delta Lloyd Asset Management NV
Delta Lloyd Bankengroep NV *(Banking)*
Delta Lloyd Levensverzekering NV
Delta Lloyd Schadeverzekering NV
Delta Lloyd Zorgverzekering NV
OHRA Schadeverzekeringen NV
OHRA Levensverzekeringen NV

**Poland**
Commercial Union Polska Towarzystwo Ubezpieczen Ogolnych SA (90.0%)
Commercial Union Polska Towarzystwo Ubezpieczen na Zycie SA (90.0%)
Commercial Union Powszechne Towarzystwo Emerytalne BPH CU WBK SA (75.0%)

**Portugal**
Eurovida BNC – CGU Companhia de Seguros de Vida S.A. (50.0%)

**Singapore**
Aviva Limited

**Spain**
Aseguradora Valenciana, SA de Seguros y Reaseguros (50.0%)
Aviva Vida y Pensiones, SA de Seguros y Reaseguros
Bia Galicia de Seguros y Reaseguros (50.0%)
Caja Espana Vida, Compania de Seguros y Reaseguros (50.0%)
General Vida Sociedad de Agencia de Seguros (25.0%)
Unicorp Vida, Compania de Seguros y Reaseguros SA (50.0%)

**Thailand**
Aviva Insurance (Thai) Co. Limited (68.4%)

**Turkey**
Commercial Union Hayat ve Emeklilik
Commercial Union Sigorta AS (98.6%)

**United States**
Aviva USA Corporation and its principal operating subsidiary:
Aviva Life Insurance Company

**Associates and joint ventures**
In addition to the principal subsidiaries listed above, the Group has ongoing interests in the following operations that are classified as associates or joint ventures. Further details of those operations that were most significant in 2003 are set out in notes 20 and 21 on pages 80 to 82.

**United Kingdom**
RBS Life Investments Limited (49.99%)
RBSG Collective Investments Limited (49.99%)
The Group also has interests in several UK property limited partnerships. Further details are provided in note 20 on page 80.

**China**
AVIVA – COFCO Life Insurance Company Limited (50.0%)

**France**
ProCapital SA (43.5%)
Société Foncière Lyonnaise (31.4%)

**India**
Aviva Life Insurance Company India Pvt. Limited (26.0%)

# Shareholder information

**Dividend Reinvestment Plan**

Aviva's Dividend Reinvestment Plan (the "Plan") enables cash dividends to be reinvested in the Company's shares at reduced dealing costs. Shareholders who have not already joined the Plan and wish to do so should contact the Company's registrar at the address opposite to obtain full details and a mandate form. Shareholders who have previously elected to join the Plan need take no further action. At the Annual General Meeting the Board will be seeking authority to offer shareholders the choice of receiving scrip dividends as an alternative to cash dividends. If this proposal is approved by shareholders and is introduced, it would replace the Company's current dividend reinvestment plan and accordingly the Company would write to all shareholders setting out full details of the scrip dividend scheme and its implications.

**Dividend payments direct to your bank account**

If you wish, you can have your dividend payments credited directly into your bank or building society account on the dividend payment date. For overseas shareholders the Company has introduced Transcontinental Account Payment Service ("TAPS") which allows shareholders in many countries to have dividends credited direct to bank accounts in local currencies. To obtain further details and a mandate form please contact the Company's registrar at the address opposite.

**Consolidated tax vouchers**

For those shareholders who currently receive dividends paid directly into their bank/building society account, it is now the Company's intention to issue one tax voucher each year instead of two. This we hope will prove to be more convenient for shareholders and will also result in cost and environmental savings. The new practice does not alter the dividend payments or when they are paid and will come into operation in the 2004/05 tax year. You will not receive a tax voucher for the May and November 2004 dividends, you will instead receive a consolidated tax voucher relating to these payments in 2005. The voucher will be issued prior to any tax return from the Inland Revenue. Any shareholders who do not wish to receive this service and wish to continue to receive tax vouchers with each dividend may elect to do so by contacting the Company's registrar at the address opposite. Please note that we are unable to offer the service to institutional shareholders or those participating in the Dividend Reinvestment Plan.

**Shareview**

Shareview is the internet based service that allows you to view your shareholding online and, if you wish, to receive shareholder communications (e.g. Notice of Meeting, Report and Accounts, etc.) via e-mail rather than by post.

To register please go to www.shareview.co.uk where you will also find more details of the service, practical help and extensive information on other share registration matters.

**Share price**

You can access the current share price of Aviva shares at www.aviva.com or alternatively you can call 0906 843 2197*.

**Share dealing facilities**

The Company has arranged the following services that can be used to buy or sell Aviva Shares. Alternatively if you hold a share certificate you can also use any bank, building society or stockbroker offering share dealing facilities. If you are in any doubt about buying or selling your shares you should seek professional financial advice.

Share dealing facilities for UK shareholders/share account members:

Shareview Dealing is a telephone and internet service arranged through Lloyds TSB Registrars and provides a simple and convenient way of selling Aviva plc shares. For telephone sales call 0870 850 0852 between 8.30am and 4.30pm, Monday to Friday and for internet sales log on to www.shareview.co.uk/dealing

To buy or sell your shares over the telephone, you can contact Barclays Stockbrokers on 0870 549 3002 (if you hold a share certificate) or 0870 549 3001 (if you hold a share account statement). Barclays Stockbrokers Limited is a member of the London Stock Exchange and is authorised and regulated by the Financial Services Authority.

NatWest Stockbrokers provide a Share Dealing Service at certain branches for Aviva Share Account holders only. For more information contact NatWest Stockbrokers on 0845 122 0689.

Share dealing facilities for overseas shareholders:

To sell your shares over the telephone, you can contact Barclays Stockbrokers on 00 44 141 352 3959. They will be able to sell your shares and send you a sterling cheque for the proceeds. Barclays Stockbrokers Limited is a member of the London Stock Exchange and is authorised and regulated by the Financial Services Authority.

**Amalgamating your shares**

If you were mailed more than one copy of this Annual report, it may be because Aviva has more than one record of shareholdings in your name. To ensure that you do not receive duplicate mailings in future, you can have all your shares amalgamated into one account by contacting Lloyds TSB Registrars at the address opposite.

**ShareGift**

The Orr Mackintosh Foundation operates a, purely voluntary, charity share donation scheme for shareholders who wish to dispose of small numbers of shares whose value makes it uneconomical to sell them. Details of the scheme are available from ShareGift at www.sharegift.org or telephone 020 7337 0501, or can be obtained from the Company's registrar.

**Shareholders with disabilities**

Alternative versions of this publication (including braille, large print and audio-tape) are available on request from the Company's registrar.

*Calls are currently charged at 60 pence per minute at all times. The average time to access the share price is approximately one minute.

## Shareholder profile

The categories of ordinary shareholders and the ranges and size of shareholding as at 31 December 2003 are set out below:

| Analysis of shareholders | No. of shareholders | % | No. of shares | % |
|---|---|---|---|---|
| Individuals | 849,765 | 97.10 | 306,227,641 | 13.57 |
| Banks and nominee companies | 19,440 | 2.22 | 1,792,006,710 | 79.39 |
| Pension fund managers and insurance companies | 122 | 0.01 | 14,514,272 | 0.64 |
| Other corporate bodies | 5,853 | 0.67 | 144,533,878 | 6.40 |
| **Total** | 875,180 | 100.00 | 2,257,282,501 | 100.00 |

| Range of shareholdings | No. of shareholders | % | No. of shares | % |
|---|---|---|---|---|
| 1 – 1,000 | 820,348 | 93.73 | 212,548,895 | 9.42 |
| 1,001 – 5,000 | 49,169 | 5.62 | 90,014,648 | 3.99 |
| 5,001 – 10,000 | 2,710 | 0.31 | 18,648,208 | 0.82 |
| 10,001 – 250,000 | 2,290 | 0.26 | 113,292,874 | 5.02 |
| 250,001 – 500,000 | 232 | 0.03 | 83,663,387 | 3.71 |
| 500,001 and above | 431 | 0.05 | 1,739,114,489 | 77.04 |
| **Total** | 875,180 | 100.00 | 2,257,282,501 | 100.00 |

## Group financial calendar for 2004

| | |
|---|---|
| Ex-dividend date (ordinary shares) | 24 March |
| Record date (ordinary shares) | 26 March |
| First dividend payment for 8⅜% cumulative irredeemable preference shares | 1 April |
| Dividend Reinvestment Plan election date | 23 April |
| Annual General Meeting | 27 April |
| Announcement of first quarter long-term savings new business figures | 5 May |
| Dividend payment date (ordinary shares) | 17 May |
| First dividend payment for 8¾% cumulative irredeemable preference shares | 1 July |
| Announcement of unaudited six months' interim results | 4 August |
| Second dividend payment for 8⅜% cumulative irredeemable preference shares | 30 September |
| Announcement of third quarter long-term savings new business figures | 2 November |
| Second dividend payment for 8¾% cumulative irredeemable preference shares | 31 December |

## Useful contact details

Detailed below are various addresses that may prove useful in the event that you have a query in respect of your shareholding.

Please quote Aviva plc, as well as the name and address in which your shares are held, in all correspondence.

| | | | |
|---|---|---|---|
| General shareholding, administration queries and Aviva share account queries | Lloyds TSB Registrars | The Causeway<br>Worthing<br>West Sussex BN99 6DA | 0870 600 3952 |
| Corporate and single company Peps | Barclays Stockbrokers Limited | Tay House<br>300 Bath Street<br>Glasgow G2 4LH | 0870 514 3263 |
| Individual Savings Accounts ("Isas") | Lloyds TSB Registrars (Isa Manager) | The Causeway<br>Worthing<br>West Sussex BN99 6DA | 0870 242 4244 |

## Internet sites

Aviva owns various internet sites, most of which interlink with each other.

| | |
|---|---|
| Aviva Group | www.aviva.com |
| UK long-term savings and general insurance | www.norwichunion.com |
| Fund management | www.morleyfm.com |
| Aviva worldwide internet sites | www.aviva.com/customers/global.cfm |

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**Aviva plc**
St Helen's, 1 Undershaft
London EC3P 3DQ
Telephone +44 (0)20 7283 2000
www.aviva.com
Registered in England
Number 2468686